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BEFORE THE SUBCOMMITTEE ON GOVERNMENT MANAGEMENT, ORGANIZATION AND PROCUREMENT

COMMITTEE ON OVERSIGHT AND GOVERNMENT REFORM

U.S. HOUSE OF REPRESENTATIVES

"THE STATE OF FEDERAL CONTRACTING: OPPORTUNITIES AND CHALLENGES FOR STRENGTHENING GOVERNMENT PROCUREMENT AND ACQUISITION POLICIES"

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I. INTRODUCTION

Chairwoman Watson, Ranking Member Bilbray, members of the subcommittee, thank you for the invitation to participate in today's hearing. My name is Kara Sacilotto. I am a partner with the law firm Wiley Rein, LLP, and practice in the firm's government contracts practice group. I also have the privilege of teaching government contracts as an Adjunct Professor at George Mason University School of Law. My testimony today is not provided on behalf of any institution, organization or entity and represents solely my own personal views as a practitioner in the area of government contracting.

While the focus of today's hearing is strengthening the federal procurement system, my belief is that the federal procurement system is fundamentally sound. Statutes, such as the Competition in Contracting Act, Truth in Negotiations Act, Procurement Integrity Act, and Contract Disputes Act, as well as regulations issued by the Civilian Agency Acquisition Council and Defense Acquisition Regulations Council (collectively "the Councils") and embodied in the Federal Acquisition Regulation ("FAR") that are the foundation for our procurement system are comprehensive, promote competition, provide a robust body of guidance, regulation, and oversight that, on the whole, serve the Government and the procurement community well.

A. Recent Reform Initiatives

Nevertheless, the past two years have seen a near-unprecedented growth in legislative and regulatory initiatives aimed at "reforming" federal procurement law. In late 2007 and 2008, the following legislative reforms were enacted:

- The Acquisition Improvement and Accountability Act of 2007, Title VIII to the FY08 National Defense Authorization Act.[1] This Act provided a host of reforms aimed at increased competition, transparency, and oversight. Notable provisions include:

[1] Pub. L. No. 110-181.

- Enhanced competition requirements for task and delivery order contracts over $5 million, restrictions on sole-source task and delivery orders over $100 million, and public disclosure of justification and approval documents for non-competitive contracts;[2]

- Revised requirements for Department of Defense ("DoD") procurements of commercial items and services and restrictions on its use of time-and-material contracts for commercial services;[3]

- Reporting to Congress by agency Inspectors General and the Defense Contract Audit Agency ("DCAA") of completed contract audits and significant audit findings;[4]

- Expanded protection of DoD contractor employee "whistleblowers;"[5]

- Requirements for certain former DoD officials seeking employment with defense contractors;[6]

- Reports by the Government Accountability Office ("GAO") to Congress regarding the internal ethics and compliance programs of major defense contractors;[7]

- Limits on the use of lead systems integrators for DoD programs;[8] and

- Additional oversight mechanisms and restrictions relating to contracts being performed in Iraq and Afghanistan and regulation of contracts for private security functions.[9]

- The Openness Promotes Effectiveness in our National ("OPEN") Government Act of 2007,[10] which amended the Freedom of Information Act to enhance transparency and expedite public requests for information.

- Mandatory reporting obligations relating to suspected violations of federal criminal law or overpayments on certain contracts and subcontracts as part of the Close the Contractor Fraud Loophole Act.[11]

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[2] *Id.*, §§ 843, 844.

[3] *Id.* § 805, 815, and 821.

[4] *Id.*, § 845.

[5] *Id.* § 846.

[6] *Id.* § 847.

[7] *Id.* § 848.

[8] *Id.* § 802.

[9] *Id.* §§ 841-42, 862-63.

[10] Pub. L. No. 110-175.

- Reform efforts related to cost-reimbursement contracts, performance of "inherently governmental functions" by contractors, and personal and organizational conflicts of interest as part of the FY09 National Defense Authorization Act ("FY09 NDAA").[12]

Thus far in 2009, Congress has passed and the President has signed into law the "Fraud Enforcement and Recovery Act of 2009" to amend the False Claims Act[13] and the "Weapon Systems Acquisition Reform Act of 2009" ("WSARA") to provide additional oversight and accountability with respect to major weapon systems programs.[14]

In addition to these legislative initiatives, the Councils have issued several substantive regulations implementing many of these efforts. One of the most significant recent reform initiatives requires certain contractors to establish and maintain business ethics policies and internal control systems and imposes mandatory reporting obligations regarding suspected civil or criminal False Claims Act violations, violations of other criminal laws, and overcharging on government contracts.[15]

B. Costs of Regulatory Change

Like any regulatory system, the federal procurement system can be improved. Regulatory change, however, even in the name of reform or improvement, comes at a cost. Repeated regulatory changes generate inefficiencies for industry and Government acquisition professionals who must track and modify their policies and processes to incorporate new legal requirements. There is no instant implementation. Regulatory change also creates instability for both Government and contractors by disrupting established practices and expectations. Furthermore, as former DoD officials with procurement and program management

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[11] Pub. L. No. 110-252, §§ 6101-03.

[12] Pub. L. No. 110-417, §§ 321, 841, 864.

[13] Pub. L. No. 111-21.

[14] Pub. L. No. 111-23.

[15] 73 Fed. Reg. 67064 (Nov. 12, 2008); 72 Fed. Reg. 65873 (Nov. 23, 2007).

responsibilities recently testified before the House Armed Services Committee Panel on Acquisition Reform, the current acquisition system is already complex, and acquisition officials are straining under existing oversight and reporting obligations.[16] Additional oversight and reporting obligations add to an already complex body of requirements.

Therefore, before embarking on additional legislative and regulatory initiatives that might be a reaction to discrete allegations of misconduct or perceived mismanagement, policymakers should assess whether additional legislative or regulatory reform is necessary to address the issue of concern and worth the costs that it imposes for both Government and industry. I offer three thoughts regarding the challenges in our current procurement system.

II. CONSIDERATIONS

A. More Regulation v. Better Implementation

First, policymakers should ensure that existing legislative and regulatory tools do not already address the concern at hand. In other words, is the reform that is necessary more regulation or, instead, a tighter focus on execution of existing legal requirements? Having its origins in the Armed Services Procurement Regulation, the Federal Procurement Regulations, and the Defense Acquisition Regulations, the FAR was created in 1984 and today is the result of years of input from agencies, industry, and other interested procurement professionals and is the authoritative source for guidance and regulatory requirements for procurement officials and contractors. Because the FAR has developed over time with input from affected parties, it is comprehensive and already addresses many of the procurement issues that are the subject of recent reform initiatives. For example, President Obama's March 4, 2009 Memorandum on

[16] Written Statement of Gordon England, Former Deputy Secretary of Defense, before the House Armed Services Committee Panel on Acquisition Reform, at 4-5 (June 3, 2009); *see also* Written Statement of Ronald T. Kadish, LTG, USAF(ret), before the House Armed Services Committee Panel on Acquisition Reform (June 3, 2009) (discussing complexities of existing acquisition system).

Government Contracting and recent legislation have expressed concern with the use of cost-reimbursement contract types based, in part, on reports of cost growth on certain weapons systems programs.[17] The President's Memorandum states that the Government has a preference for fixed-price type contracts and that "[c]ost-reimbursement contracts shall be used only when circumstances do not allow the agency to define its requirements sufficiently to allow for a fixed-price contract."[18] FAR 16.301-2 today reiterates the same policy that "[c]ost-reimbursement contracts are suitable for use only when uncertainties involved in contract performance do not permit costs to be estimated with sufficient accuracy to use any type of fixed-price contract." In addition, existing regulations provide that cost-reimbursement type contracts should not be used unless (i) the contractor has adequate accounting systems in place to measure costs and (ii) the Government has the resources to supervise performance to ensure that "efficient methods and effective cost controls are used."[19] FAR Part 16 further provides guidance on when various types of cost-reimbursement contracts are (and are not) appropriate to use. In other words, FAR Part 16 already expresses a public policy in favor of fixed-price contracts, provides guidance on when such contracts should and should not be used, and requires the Government to exercise additional oversight when using cost-reimbursement contracts.

While some cost-reimbursement contracts have experienced cost growth,[20] the FAR recognizes that cost-reimbursement contracts still serve a valuable purpose in government

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[17] *E.g.*, "Defense Acquisitions: Assessments of Selected Weapons Programs," GAO Report No. 09-326SP (Mar. 2009).

[18] Memorandum for the Heads of Executive Departments and Agencies on Government Contracting, dated March 4, 2009 and published in the Federal Register at 74 Fed. Reg. 9755 (Mar. 9, 2009) (hereafter cited as "President's Memorandum on Government Contracting").

[19] FAR 16.301-3.

[20] It is noteworthy that former DoD acquisition officials have taken issue with the Government Accountability Office's statistics on cost growth on major acquisition programs, arguing that the cost growth related to older Department of Defense programs. *See, e.g.*, Written Statement of Gordon England, Former Deputy Secretary of Defense, House Armed Services Committee Panel on Acquisition Reform, at 3 (June 3, 2009).

contracting. Procurements for state-of-the-art technologies are inherently risky, and development does not always follow a linear and predictable path. The recently-enacted WSARA reasonably focuses additional attention on managing technology risks for acquisitions of weapons systems, but the balance the FAR currently strikes between fixed-price and cost-reimbursement contracting should be retained.

This balance recognizes that fixed-price contracts involving highly complex system procurements or development effort may not result in cost-savings and, indeed, if history is any guide, could lead to delays and disputes. In the 1960s, concerns regarding cost growth on design and development programs and the difficulties of managing costs on such programs – concerns we hear repeated today – led to the development and use, endorsed by a predecessor of the FAR, of fixed-price contracts for design and development that included fixed-price options for production units.[21] The idea behind this type of procurement – called "total package procurement" – was that contractors would not agree to unrealistically low development cost estimates if both development and production were fixed-price. As scholars in the field note, however, "total package procurements" were highly unsuccessful, resulting in disputes and litigation, cost growth and staggering losses, and, as a result, were ultimately abandoned.[22]

Fixed-price development contracting had a resurgence in popularity in the 1980s, but in response to another wave of unsuccessful programs, Congress, in 1989, required DoD to issue regulations prohibiting the use of fixed-price contracts for development unless "(A) the level of program risk permits realistic pricing; and (B) the use of a fixed-price contract permits an

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[21] Ralph C. Nash, John Cibinic, "Total Package Procurement: A Forgotten No-No," No. 8 Nash & Cibinic Reports ¶ 41 (Aug. 2005).

[22] *Id.* (citing Robert Palsy, "Unconventional Methods of Procurement," Briefing Papers No. 69-4 (Aug. 1969)).

equitable and sensible allocation of program risk between the United States and the contractor."[23] For contracts over $10 million for development of major systems, DoD could not issue a firm fixed-price contract without written permission from the Under Secretary of Defense for Acquisition.[24]

Therefore, before rushing to revise the FAR to further discourage cost-reimbursement contracting, it may be appropriate to heed the lessons of the past and retain existing provisions that encourage the use of fixed-price contracting when the Government can adequately define its requirements and the cost risks are predictable and focus reform efforts on more disciplined adherence to these existing regulations and better Government management of cost-type contracts when they are deemed appropriate to use.

Much of this is also true with respect to sole-source contracting. The President's March 4 Memorandum states that the Government must "strive for an open and competitive process" but should also have the flexibility to use sole-source contracts (contracts awarded to a single entity deemed to be the only source for the procurement item) and other non-competitively awarded contracts in "exigent circumstances."[25] The Competition in Contracting Act, passed in 1984, already reflects this policy.[26] Likewise, the FAR also affirms that it is the policy of the Government to promote and provide for full and open competition in soliciting and awarding contracts, "with certain limited exceptions."[27] FAR Subpart 6.3 provides policies and procedures

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[23] Pub. L. No. 100-456, § 807.

[24] *Id.*

[25] President's Memorandum on Government Contracting.

[26] Pub. L. No. 98-369. The Competition in Contracting Act amended various statutes, including aspects of the Armed Services Procurement Act of 1947, 10 U.S.C. §§ 2304-2305, the Federal Property and Administrative Services Act of 1949, 41 U.S.C. §§ 253-253a, and the Office of Federal Procurement Policy Act, 41 U.S.C. § 401-424.

[27] FAR 6.101.

that must be followed in those "certain limited exceptions" when other than full and open competition is employed. Accordingly, just as with cost-reimbursement contracting, policymakers should assess whether a renewed focus on enforcement and application of existing regulations and restrictions will better address the current concerns than additional regulation or legislation.

B. Coordinated Filling Of The Regulatory Gaps

Second, where changes to the acquisition system are truly necessary, those changes should be coordinated. In 2008 and 2009, legislation requiring some form of review of organizational conflicts of interest ("OCIs") and personal conflicts of interest ("PCIs") was included in the FY09 NDAA and the WSARA. For example, the WSARA requires the Secretary of Defense to revise regulations dealing with OCIs to address conflicts that might arise from contracts using lead systems integrators, companies that have business units providing technical advice or assistance services on major weapons programs that also have business units competing for contracts on the program, and using contractors to perform technical evaluations on major defense acquisition programs.[28] The FY09 NDAA required rulemaking to address both PCIs and OCIs.

In 2008, GAO also issued a report urging DoD to develop Department-wide personal conflict of interest safeguards for contractors similar to those for federal employees, to be implemented through a required contract clause.[29] In response to GAO's findings, the Councils

[28] Pub. L. No. 111-23, § 207.

[29] "Additional Personal Conflict of Interest Safeguards Needed for Certain DOD Contractor Employees," GAO Report No. 08-169 (Mar. 2008).

issued two advance notices of proposed rulemaking to solicit public comment on whether changes to the FAR are required with respect to OCIs and PCIs.[30]

Thus, efforts to address concerns regarding the growth of and mitigation of potential PCIs and OCIs are currently underway. Regulatory enhancements here may be appropriate. The FAR currently does not contain a uniform body of regulations relating to PCIs. FAR Part 9.5 does address OCIs and identifies the types of activities that may lead to an OCI. In its favor, FAR Part 9.5 promotes flexibility and encourages contracting officers to identify and timely mitigate potential OCIs, but not to delay procurements unreasonably or impose burdensome requirements. This balance is good: the competitive field should not be unnecessarily limited by overly-restrictive OCI requirements; nevertheless, competitions also must be conducted fairly and on even footing. Because the FAR arguably does not provide sufficient guidance on effective options for mitigating (or neutralizing) OCIs, determinations of whether mitigation efforts are successful are often determined in the context of a protest of a contract award, with the unsuccessful offeror challenging (and the agency defending) its mitigation efforts in a litigation setting and the GAO essentially filling the regulatory "gap" through its decisions.

As efforts to address PCIs and OCIs proceed, these efforts should be coordinated so that conflicting and unnecessary obligations are avoided. Reform through agency-specific regulations may not be appropriate where a concern or regulatory "gap" appears to be Government-wide. It is important to remember the goal of the FAR. The FAR was intended as a uniform body of procurement regulation to replace the then-existing agency-specific procurement regulations. Procurement experts recognize that uniformity is also good for industry and Government:

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[30] FAR Case 2007-017, 73 Fed. Reg. 15961 (Mar. 26, 2008), and FAR Case 2007-018, 73 Fed. Reg. 15692 (Mar. 26, 2008).

> A uniform procurement system suggests that all government instrumentalities buy the same way, following the same laws, rules, and practices. Such a system is efficient because sellers do not need to learn new rules in order to do business with different agencies or departments. Further, it is much easier to train all of the government's buyers, and it permits buyers greater flexibility to work for various agencies or departments during their careers. In addition, if the government consistently uses standard provisions and clauses, the process operates more smoothly. Transactions become more routine. All parties to the transaction understand the rules to the game.[31]

Although agencies are permitted to supplement the FAR with agency-specific regulations, the FAR provides that supplemental regulations should be limited to those necessary for implementing the FAR and for satisfying specific agency needs.[32] When legislation affecting DoD requires DoD to modify its procurement practices, uniformity is threatened. Today, the DoD FAR Supplement ("DFARS") is nearly as thick as the FAR. While DoD admittedly has some mission-unique requirements, OCIs and PCIs are concerns that affect all agencies of Government. Thus, when ongoing efforts at regulatory reform are proceeding concurrently, at a minimum, the efforts should be coordinated to ensure that duplicative and conflicting regulatory requirements are not developed.

C. Allowing Prior Changes To Be Implemented

Finally, because regulatory churn increases costs, complexity, inefficiencies and instability, policymakers should take into account that the legislative and regulatory initiatives passed in 2008 and 2009 are relatively young and their efficacy has not been tested. Many of these reform efforts have only recently been incorporated into regulations, new solicitations, and contracts. Before expanding reform efforts, policy makers should consider allowing the current

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[31] Prof. Steven L. Schooner, "Desiderata: Objectives for a System of Government Contract Law," 11 Pub. Procurement L. Rev. 103, 109 (2002).

[32] FAR. 1.302.

legislative and regulatory efforts to take root and then assess whether their objectives have been met. By allowing new reform effort to be tested by Government and industry in practice, policy makers will have better information to evaluate what measures work (or do not work), where clarification may be warranted, and, if additional legislative or regulatory efforts are necessary, how to target them to aspects of the procurement system that still require improvement.

III. CONCLUSION

In summary, although the federal procurement system faces challenges and can be improved, there is also an existing framework of regulations that is flexible enough to respond to shifts in emphasis and policy. Where additional regulatory focus is required, requirements should be coordinated to preserve uniformity and promote clarity. Lastly, reform efforts need to take root before it is known whether they will bear fruit.

Chairwoman Watson and members of the Subcommittee, thank you again for this opportunity to share my thoughts.