



THE ASSISTANT SECRETARY OF THE NAVY

(RESEARCH, DEVELOPMENT AND ACQUISITION)

1 000 NAVY PENTAGON

WASHINGTON DC 20350-1000

JUN 08 2010

MEMORANDUM FOR DISTRIBUTION

SUBJECT: Aligning Department of the Navy Contracting Practices

The Department of the Navy's acquisition costs are rising faster than our top line—a trend that is having profound impact on the Department's ability to shape the future force. If we fail to arrest this trend, we risk removing capability from the hands of our Sailors and Marines. That is not acceptable. Accordingly, we need to change the way we do business to improve the affordability of our weapons systems, and the supplies and services that support those systems and the Sailors and Marines who use them.

Recognizing that contractor performance is key to this effort, this memorandum addresses contracting practices fundamental to incentivizing contractor performance: competition; limits on the use of cost reimbursement contracts; contract incentives; contract terms and conditions; and a preferred supplier program.

Competition. Competition is a powerful tool, and when effectively employed, drives cost improvement and increases innovation. Accordingly, we will maximize competition as appropriate, for the warfighter and the taxpayer. Further, our procurements need to be structured to sustain competition by avoiding contract approaches that, following initial competition, would eventually leave us in a sole-source environment. So it is important that we secure data rights and related technical data packages that enable us to compete.

We also need to ensure our prime contractors pursue competition throughout the vendor base for DoN contracts. Recent contract data suggest that prime contractors are increasing the amount of work they outsource, so it is important that we are confident that contractors will control cost through competition in their supply chains. When appropriate, contracting officers should use consent-to-subcontract and make/buy plan clauses to ensure that contractors are using competitive processes to manage their supply chains. Additionally, program managers and contracting officers should ensure that our acquisition strategies give the Navy the flexibility to break out components from our systems and procure them directly when it makes sense to do so.

Use of Cost Reimbursement Contracts. Cost reimbursement contracts provide only limited incentive for contractors to control cost. Consequently, the Federal Acquisition Regulation (FAR) prescribes the use of cost reimbursement contracts only "when uncertainties involved in contract performance do not permit costs to be estimated

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with sufficient accuracy to use any type of fixed price contract.” Contracting officers and program managers should not use cost reimbursement contracts unless the FAR criterion is met. Program managers and contracting officers should specifically tie program risks to the selection of contract types, and document the contract type/risk in acquisition strategies and plans. To the extent that program managers and contracting officers must use a cost reimbursement contract, they should structure fee arrangements in accordance with the principles of structuring contract incentives discussed below.

Contract Incentives. Performance measures for purposes of award and incentive fees should be clear, measurable, reasonably achievable by the contractor, and rationally related to the contract statement of work. In cases where program managers and contracting officers choose to incentivize factors in addition to cost, they should prepare a performance measurement plan that documents how contract performance will be measured in order to determine fee paid to the contractor, and how cost performance is linked to each incentivized factor.

Contracting officers and program managers should avoid constructing incentives that allow the contractor to prioritize the order in which contract incentives are pursued. Incentives should be linked in a way that allows DoN to reward the contractor for overall performance with respect to contract requirements, not just one aspect of the contract. Also, when multiple incentives are deemed appropriate, it is essential to ensure they reinforce each other and, in all cases, are integrated with cost performance on the contract.

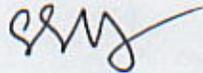
Contract incentives should be aligned with achieving contractor results, not merely execution of contractor processes. For example, contractors should not be rewarded for possessing excellent cost-control tools, when the contract results are not achieving cost targets. Incentives should be structured such that the contractor bears the risk of poor performance. Cost-plus-award-fee contracts should have a base fee of zero percent, and, where appropriate, contracting officers and program managers will consider the use of negative minimum fees in cost plus incentive fee contracts.

Compliance With Contract Requirements. The complexity of the supplies and services that we purchase requires us to hold the contractor accountable for supplying quality that remains well after product acceptance. When the Department acquires commercial items, program managers and contracting officers should take full advantage of warranties provided as part of the price of the item. For non-commercial items, program managers and contracting officers should comply with Part 46.7 of the FAR, “Warranties.” Program managers and contracting officers are to document the business case in the appropriate acquisition document that results in a decision whether or not to obtain a warranty.

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Preferred Suppliers. Cash flow, profit, and contract terms and conditions that reduce contractor cost and risk are powerful incentives that can be used to achieve superior contractor performance. The Department of the Navy and its contractors negotiate these key components of the business arrangement, contract by contract. As a result of this decentralized and individual approach to negotiating business arrangements, the DoN loses an important opportunity to align industry's operating goals with the Department's contract performance expectations. This opportunity, or leverage, is in addition to the normal terms and conditions of a contract. By separate policy, the Department is establishing a preferred supplier program. The preferred supplier program will establish a set of "most favored supplier" contract terms and conditions that will be available to corporate suppliers that have demonstrated exemplary performance in the areas of cost, schedule, performance, quality, and business relations at the corporate level. Once established, program managers and contracting officers can use the contract terms available to preferred suppliers to establish the best possible business arrangement for all parties concerned. The Contractor Performance Assessment Report System (CPARS) will be a partial, but important, determinant in assessing a contractor's preferred supplier status. So it is important that program managers ensure CPARS evaluations are consistent with actual contract performance and strictly adhere to CPARS guidelines.

If necessary, additional guidance on these contracting practices will be provided in changes to the Navy/Marine Corps Acquisition Regulation Supplement. My point of contact for these contracting practices is the Deputy Assistant Secretary for Acquisition and Logistics Management (DASN(A&LM)).



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