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VIA ELECTRONIC MAIL AND FIRST CLASS MAIL

Defense Acquisitions Regulations System
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On behalf of the Section of Public Contract Law of the American Bar Association (“the Section”), I am submitting comments on the above-referenced DFARS case. The Section of Public Contract Law consists of attorneys and associated professionals in private practice, industry and Government service. The Section’s governing Council and substantive committees have members representing these three segments, to ensure that all points of view are considered. By presenting their consensus view, the Section seeks to improve the process of public contracting for needed supplies, services and public works.

The Section is authorized to submit comments on acquisition regulations under special authority granted by the Association’s Board of Governors. The views expressed herein have not been approved by the House of Delegates or the

1 Jeri Kaylene Somers, a Council member of the Section of Public Contract Law, did not participate in the Section’s consideration of these comments and abstained from the voting to approve and send this letter.
Board of Governors of the American Bar Association and, therefore, should not be construed as representing the policy of the American Bar Association.²

**Introduction**

On April 26, 2007, the Department of Defense (“DoD”) published in the Federal Register an interim rule, 72 Fed. Reg. 20758, amending the Defense Acquisition Regulation Supplement (“DFARS”) with respect to pass-through charges on DoD contracts and subcontracts (“Interim Rule”). The Interim Rule implements Section 852 of the National Defense Authorization Act for Fiscal Year 2007 (Pub. L. No. 109-364), which requires the DoD to prescribe regulations to ensure that pass-through charges on contracts or subcontracts that are entered into for or on behalf of the DoD are not excessive in relation to the cost of work performed by the relevant contractor or subcontractor.

The Section agrees that pass-through charges should not be excessive. Furthermore, the Section commends the DoD for its recognition of the effect of market forces indicated by the exclusion of certain contracts and subcontracts from the requirements of this Interim Rule. Nevertheless, the Section notes that inconsistent policies exist at DoD with regard to subcontracting. Therefore, the Section recommends that DoD reconcile its policies to avoid confusion. In addition, the Section believes that express guidance should be provided to contracting officers so that they can effectively implement the goal of eliminating or reducing excessive pass-through charges. This guidance should recognize that one value a contractor or subcontractor provides is competency in identifying, forming, and managing contractual arrangements with best-in-class companies. In these arrangements, the prime contractor or higher tier subcontractor can bring considerable integration talents to the program. Without recognition of this value, the Interim Rule could result in arbitrary “make” decisions rather than reasoned “buy” decisions that provide best value, and the Interim Rule could be used merely as a tool to reprice contracts.

**Current Policies Conflict**

On July 12, 2004, Michael W. Wynne, then-Under Secretary of Defense, Acquisition, Technology and Logistics (acting), issued a memorandum for the secretaries of the military departments entitled *Selection of Contractors for Subsystems and Components* (“Wynne Memorandum” or “Memorandum”). The

² This letter is available in pdf format at http://www.abanet.org/contract/regscorr/home.html under the topic “Subcontracting and Teaming.”
The purpose of the Wynne Memorandum is to foster competition for major program subsystems and components. To achieve this purpose, the Memorandum mandates action by the Government during the acquisition planning process and by industry when assembling a team to deliver the required capabilities.

The Wynne Memorandum notes that defense acquisition benefits from the assembly of a strong team at both the prime and subcontractor levels. Furthermore, the Memorandum points out that because of defense consolidation, large defense contractors more often than not must choose between an affiliate and an unrelated company for major program subsystems or components. The potential for bias favoring the affiliate is a stated reason in the Wynne Memorandum for the Government to seek greater insight into the prime contractor’s team-selection process.

On October 27, 2004, the Section submitted comments to the DoD on the Wynne Memorandum. These comments stated that the Section understands and fully supports the Government’s efforts to foster robust competition at both the prime contract and subcontract levels.\(^3\) In fact, the first principle in the Principles of Competition in Public Procurements adopted by the American Bar Association urges that public acquisitions use full and open competition to the maximum extent practicable. The Section also strongly supports upholding the integrity of the acquisition process. With these principles in mind, the Section suggested that DoD recognize that the Wynne Memorandum does not distinguish between competitive and sole source situations, and suggested that a revision to the Memorandum or implementing guidance may be helpful to address the fact that, in competitive situations, the marketplace exerts an incentive to assemble the most competitive team possible, along with legal and regulatory restraints against anticompetitive behavior. As discussed in the Section comments, the marketplace tends to punish wrong decisions. The Section also noted that the Government has sought to avoid unnecessary involvement in team assembly decisions and has relied on the marketplace.

The Section believes that the DoD should recognize that the Interim Rule may impact team assembly and formation decisions. In particular, the Memorandum’s emphasis on the desirability of teaming with independent companies conflicts with the Interim Rule’s emphasis on limiting the amount of work being subcontracted out. As the Wynne Memorandum indicates, a key DoD goal is to facilitate the most effective combination of complementary skills to

\(^3\) The Section’s comments on the Memorandum are available at http://www.abanet.org/contract/federal/regscmm/subk_003.pdf.
ensure that the prime contractor can provide best value and accomplish the task efficiently and effectively. If the amount of subcontracting is limited to an arbitrary share of the total work effort, this goal will be seriously jeopardized.

The Section further wishes to point out that the Federal Trade Commission ("FTC") and the Department of Justice ("DoJ") have noted that in order to compete in today’s marketplace, companies that are competitors might need to collaborate as teammates.\(^4\) The FTC and DoJ have also found that such teams may be pro-competitive. "Nevertheless, a perception that antitrust laws are skeptical about agreements among actual or potential competitors may deter the development of procompetitive collaborations."\(^5\)

In contrast to the emphasis in the Interim Rule on excessive pass-through charges on the amount of work subcontracted out, which could impact the use of subcontractors, the Memorandum provides a reason to look outward and add non-affiliated subcontractors. This is an inconsistency in policy and a mixed message on the subject of subcontracting. The Section recommends a reconciliation of these conflicting positions by noting (i) that the assembly of strong and capable teams remains the goal and that the Interim Rule does not seek to discourage the formation of strong teams and (ii) in order to avoid excessive pass-through charges, the DoD must be assured that the prime contractor or higher tier subcontractor is providing value commensurate with the pass-through charge.

**Guidance is Needed to Assist Contracting Officers**

As noted above, the Section believes that the objective of this Interim Rule is beneficial. To ensure that the Interim Rule is implemented in an effective manner, and not employed merely to reprice contracts, guidance is needed to assist contracting officers.

In Senate Report No. 109-254 for the National Defense Authorization Act for Fiscal Year 2007, the Senate Armed Services Committee recommended a provision that would require the Secretary of Defense to modify DoD regulations to prohibit excessive pass-through charges on contracts and subcontracts because a subcommittee "identified a potential problem with pass-through charges by contractors responsible for major defense acquisition programs."\(^6\) The


\(^5\) *Id.* at 1.

subcommittee “[was] particularly concerned by the possibility that the Department could be paying unnecessary pass-through charges to lead-system integrators on major weapon systems for which the integrator provides no value added, but that are acquired as a part of a system-of-systems.”7 DoD, however, is taking a procurement-wide approach; the Interim Rule does not focus on lead-system integrators. Unfortunately, the Interim Rule also does not address an important reality in today’s market: a strong prime contractor must actively search, administer, and integrate the work of many subcontractors in order to provide to the DoD the best solution and best value to fulfill the DoD’s needs. In such a situation, the prime contractor or higher-tier subcontractor should not be penalized for finding best-in-class support, and the DoD should avoid the implication that would drive contractors to decide to “make” rather than “buy” – the exact concern that gave rise to the Wynne Memorandum.

Another issue covered in Senate Report No. 109-254 is the press coverage of a Hurricane Katrina-related contracting problem, notably a situation where a company received a contract and passed work down to a subcontractor that then passed the work down further. In testimony before the Subcommittee on Readiness and Management Support of the Senate Armed Services Committee on April 5, 2006, the Comptroller General, when asked his view on pass-through charges, stated that “one of the things that we need more visibility over is: How many layers, how many players, how many margins are in here?”8

The Section notes that contingency contracting, whether in response to a natural disaster such as Hurricane Katrina or as a result of a contingency military operation, carries with it numerous contracting issues. These contracting issues, however, should not drive overall DoD policy with respect to subcontracting. The Interim Rule contains a fundamental and beneficial goal -- the avoidance of excessive pass-through charges -- but there is the potential for mischief in the Interim Rule’s procedure, which provides for price reductions and disallowances. This Interim Rule is no substitute for adequate contract planning and administration on the part of the Government. Without adequate guidance, this potential for mischief could become an issue.

**Conclusion**

The Section supports the goal of the Interim Rule on excessive pass-through charges, but is concerned with the conflict between the Interim Rule and the Wynne

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7 *Id.*

8 *Id.* at 364 (quoting Comptroller General testimony).
Memorandum. Recognizing the value in locating subcontractors that provide the Government with the best solution and the best value, the Section also believes that the DoD should create guidance to assist contracting officers in the implementation of the rule.

The Section appreciates the opportunity to provide these comments and is available to provide additional information or assistance as you may require.

Sincerely,

Michael A. Hordell
Chair, Section of Public Contract Law

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