

UNCLASSIFIED

STATEMENT BY

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BEFORE THE HOUSE

COMMITTEE ON OVERSIGHT AND REFORM

ON

PRICING OF CONTRACTS FOR MILITARY SPARE PARTS

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THE HOUSE COMMITTEE ON OVERSIGHT AND REFORM

Chairwoman Maloney, Ranking Member Comer, and distinguished Members of the Committee on Oversight and Reform, thank you for the opportunity to testify today to address policies and practices impacting the Department of Defense's (DoD) ability to contract and determine reasonable prices for military spare parts and other items, particularly where the Government is the only buyer of an item and the offeror is the sole source provider. I very much appreciate the work of the Department of Defense Inspector General (DoDIG) in identifying policy gaps that inhibit DoD contracting officers from obtaining information they need to establish fair and reasonable prices for items they procure for the Warfighter. I also appreciate the DoDIG recommending DoD pursue alternative strategies for negotiating with sole source companies. The Department embraces and will implement each of the formal recommendations included in the DoDIG's report dated December 13, 2021, "Audit of the Business Model for TransDigm Group Inc. and Its Impact on Department of Defense Spare Parts Pricing." Finally, I thank this Committee for requesting the DoDIG audit and for following up on your May 2019 hearing on this matter.

I am John Tenaglia, the Principal Director, Defense Pricing and Contracting, in the Office of the Under Secretary of Defense for Acquisition and Sustainment. I began my civil service career with the Department in 2008 after retiring from active duty as an officer in our United States Air Force. As the Principal Director, Defense Pricing and Contracting, I am privileged to serve as the functional leader of DoD's contracting and pricing community. My staff and I enable DoD Components, through their pricing and contracting professionals, to effectively and affordably acquire goods and services to meet the needs of the Warfighter. We enable mission-critical activity by developing and providing Federal and DoD-wide contracting regulations, policies, strategies, and eBusiness capabilities.

In order to deliver the capabilities our uniformed military members need to defend the nation, the Department contracts with the Defense Industrial Base (DIB). DoD contracting officials engage directly with DIB contractors and in doing so seek to award and administer contracts at prices that are fair and reasonable to U.S. taxpayers, the DoD, and to the contractor that is delivering the product or service. Ideally, our contract pricing is based on competitive market pressures that dictate boundaries of what is fair and reasonable. However, due to a number of factors, the practical reality is DoD's sustainment of fielded weapon systems operates in an environment where we don't always enjoy the benefit of competitive market forces. One of those factors is consolidation in the defense industry. The Department assesses proposed mergers and acquisitions in accordance with DoD Directive 5000.62 and makes a recommendation to the cognizant antitrust agency for a given transaction, either the Department of Justice or the Federal Trade Commission. The Department is currently engaged with the White House Competition Council, in furtherance of Executive Order 14036, *Promoting Competition in the American Economy*, to identify areas where lack of competition is a concern and ultimately implement recommendations in areas such as intellectual property management and product support analysis, which will improve our ability to function in a competitive environment.

In 1962, the Congress enacted the Truth in Negotiations Act (TINA) (P.L. 87-653) aimed at providing a degree of level footing for contracting officers negotiating with sole source contractors by requiring, in certain circumstances, submission of cost and pricing data and certification that the data is current, accurate, and complete. The DoDIG's recent audit report chronicles the legislative history, including the FY2018 National Defense Authorization Act (NDAA) increase of the threshold for this requirement from \$750,000 to \$2,000,000. As codified in Chapter 35 of Title 41 United States Code (Truthful Cost or Pricing Data), "the term 'cost or pricing data' means all facts that, as of the date of

agreement on the price of a contract ... a prudent buyer or seller would reasonably expect to affect price negotiations significantly.” The Federal Acquisition Regulation (FAR) and the Defense FAR Supplement (DFARS), managed by my office, implement Title 41 and the corresponding Chapter 137 of Title 10. Where certified cost and pricing data is not required, due to the transaction being below the dollar threshold or other exceptions such as the “commercial item” exception, contracting officers employ other price analysis techniques to determine contract prices as fair and reasonable.

As noted in their report, the DoDIG was able to obtain uncertified cost data from TransDigm for 152 of the 153 contracts in their sample; yet TransDigm declined to provide this same data to our contracting officers in the course of negotiations. The DoDIG’s audit report concluded, “without the necessary legislative changes, the DoD will continue to be unable to perform adequate price reasonableness determinations because contractors are not compelled to provide uncertified cost data . . . and other price analysis methods are not always effective in identifying excessive prices.” The report went on to say, and I agree, “the DoD will continue to pay higher prices if the DoD is not enabled to use cost analysis to determine price reasonableness for sole-source spare parts using market-based pricing on contracts valued under the TINA threshold.”

The DoDIG report acknowledged two legislative proposals developed by my office and submitted to the Congress in the FY2021 legislative cycle, and they included those proposals as appendix F and G of their audit report. Although these proposals were not acted upon, DoD is working through the review and coordination process to consider offering related legislative change proposals in the upcoming cycle. The Department seeks to improve the ability of contracting officers to negotiate fair and reasonable prices by having the supporting data they need to make those determinations; however, I must clarify, even where they have data such as details of uncertified cost

elements, our contracting officers will continue to face challenges where they lack negotiation leverage with sole source contractors who refuse to yield. Our contracting officers need authority that enables them to properly address situations where an offeror proposes what they call a “market price” for a product with no competitive market forces driving the offered price. In my opinion, the larger public policy question to be addressed is whether law should provide a check against the Government paying higher prices for contractors to cover their costs of purchasing companies in the supply chain, particularly where that business model precludes effective competition. Here, the DoDIG has highlighted the magnitude of those acquisition expenses. If unchecked, these expenses will continue to be embedded in the contract prices taxpayers pay for products the Warfighter must have to perform the mission. The price we pay matters because the more we pay, the less combat capability we can acquire for a ready force.

Since profit is the difference between the price of an item and the cost of an item, the DoDIG was able to approximate the amount of profit the contractor realized for sales of items in the sample. Under fixed priced contracts, contractors can increase profitability by reducing the costs associated with the item or by increasing the price of the item. In a competitive market, increasing the price of a product could result in less total revenue and less total profit as some customers may go elsewhere for a less expensive alternative. But for many of these products, as the customer, we don’t have that luxury.

Since your 2019 hearing on this subject, the Department has taken action to address issues associated with commercial item pricing. Here, the DoDIG’s sample included transactions valued below the TINA threshold, but I believe our contracting officers would have had to determine most of the parts to fall within the statutory and regulatory exception as commercial “of a type” items.

Senate Report 116-48, page 223, accompanying S. 1790, the NDAA for FY 2020 (Public Law 116-92), requested the Under Secretary of Defense for Acquisition and Sustainment submit to the congressional defense committees an annual report detailing instances where potential contractors have denied contracting officer requests for uncertified cost or pricing data to allow for the determination of fair and reasonable pricing of DoD acquisitions. In May of 2021, the Department submitted the first report responsive to this requirement and it detailed 83 known instances of such data denials. As noted in this report, we believe the problem is more prevalent than what is specifically identified. This month, we submitted the second report, which shows an increase in the number of data denials. My staff is continuing to refine our processes, in order to present the congressional defense committees a more complete picture for their consideration.

In June of 2020, responsive to section 836(i) of the NDAA for FY 2019 (Public Law 115-232), the Under Secretary of Defense for Acquisition and Sustainment (USD(A&S)) submitted to the congressional defense committees an implementation plan on “Revision of definition of commercial items for purposes of Federal acquisition statutes.” In that plan, we referenced your committee’s May 15, 2019, hearing related to excessive pricing practices, noting “it was evident that providing the Department with the statutory authority to obtain uncertified cost or pricing data to the extent necessary to determine price reasonableness is paramount in ensuring that such excessive pricing practices are curtailed.” Our plan summarized feedback from both the DoD Cadre of Pricing Experts and the Defense Contract Management Agency (DCMA) Commercial Item Group (CIG) regarding challenges in obtaining relevant, timely data in support of procurement of sole-source items asserted by offerors as “commercial.” Our internal survey of CIG officials who assist DoD components in this area of commercial item determinations and pricing confirmed our understanding that the magnitude

of this issue goes far beyond any one contractor. The feedback indicated 97 percent of the time, contractors provide either no pricing information, redacted sales invoices, or catalog pricing with extremely limited sales evidence. We used submission of this plan to highlight a core element of the legislative proposals we submitted for the FY 2021 cycle—to reinforce the requirement for companies to provide uncertified cost data when the contracting officer requests it.

In 2021, my staff and I continued to focus on concerns related to sole source items and contracting officers' ability to obtain the data necessary to determine a fair and reasonable price. In Peer Reviews of non-competitive actions, we encourage contracting officers to escalate to their leadership any instances where they were unable to obtain data or, in the case of sole source subcontracts, the prime contractor was unable to obtain data. We continued to engage DoD's Cadre of Pricing Experts and sponsored a Price Challenge Program in collaboration with the Navy Price Fighters. Through this program, we are able to target specific negotiation challenges, including the inability to obtain data. We were able to leverage the skills of the Navy Price Fighters, including the ability to conduct should-cost analysis, which enabled \$57M in savings. Recognizing the importance of the pricing skill set, we partnered with Defense Acquisition University to offer our "Striking the Balance" series of webinars, which included ten offerings and included topics such as "Subcontract Pricing." My staff and I continue to publish guidance, such as our DoD Sole Source Streamlining toolbox featuring 40 techniques for sole source negotiation, and share best practices and lessons learned with our workforce. Finally, we have transformed the way we train and certify our pricing and contracting professionals to provide learning at the point of need and in the form of "credentials" with our initial emphasis on rolling out pricing related training.

The Office of the Under Secretary of Defense for Acquisition and Sustainment is absolutely committed to delivering and sustaining preeminent capabilities for the Warfighter and our international partners. We must do so in a timely, cost-effective manner. Our contracting officers' ability to negotiate fair and reasonable prices for products and services with the defense industry translates directly to maximizing such capabilities. In part, their ability to do so is dependent on the information they can obtain and—unfortunately—under the current law, this ability is constrained. Thank you for the opportunity to testify, and I look forward to your questions.