



**Testimony of Mandy Smithberger, Director of the Center for Defense Information
Project On Government Oversight
Before the House Committee on Oversight and Reform
On “Price Gouging in Military Contracts:
New Inspector General Report Exposes Excess Profit Obtained by TransDigm Group”
January 19, 2022**

Founded in 1981, The Project On Government Oversight (POGO) is a nonpartisan independent watchdog that investigates and exposes waste, corruption, abuse of power, and when the government fails to serve the public or silences those who report wrongdoing. We champion reforms to achieve a more effective, ethical, and accountable federal government that safeguards constitutional principles.

We made our mark in the 1980s by looking into Pentagon waste, fraud, and abuse, spotlighting overspending on \$640 toilet seats, \$7,600 coffee makers, and \$436 hammers. Back then contractors were forced to correct their prices and provide mandatory refunds.¹ Four decades later, things have mostly changed for the worse. Now this type of contract pricing is perfectly legal.

In the most recent example, the Department of Defense inspector general (DOD IG) found that taxpayers are paying too much for spare parts, in this case \$20.8 million in excess profits.² While contracting officers might have been able to challenge the proposed prices that led to this excess, current law tied their hands. At the time of the TransDigm deals reviewed by the DOD IG, companies were required to provide certified cost or pricing data only when a transaction exceeded the Truth in Negotiations Act’s then-threshold of \$750,000.³ For the period between January 2017 and June 2019, the inspector general found that TransDigm’s deals fell under that threshold more than 95% of the time, making it nearly impossible for agency officials to ensure the prices the company offered were fair and reasonable.⁴

¹ Truth in Negotiations Act, Pub. Law 87-653 (1962).

² Department of Defense Inspector General, *Audit of the Business Model for TransDigm Group Inc. and Its Impact on Department of Defense Spare Parts Pricing*, DODIG-2022-043 (December 13, 2021), ii, <https://media.defense.gov/2021/Dec/27/2002914678/-1/-1/1/DODIG-2022-043%20508.PDF>.

³ The Truth in Negotiations Act is now called the Truthful Cost or Pricing Data Act but is still better known by its historical name and acronym. 10 U.S.C. § 2306a; 41 U.S.C. 3501 *et seq.*

⁴ Department of Defense Inspector General, *Audit of the Business Model for TransDigm Group* [see note 2].

But even at a lower Truth in Negotiations Act threshold, TransDigm could have simply claimed the parts were “commercial items,” and regardless of the price agreed upon, the government would have no recourse for defective pricing or overpricing.⁵

As the DOD IG report shows, while contracting officers *can* request uncertified cost or price data for some transactions, this doesn’t provide much of a safeguard. Companies can provide almost any data they want. And the report found that TransDigm often simply refused government requests for that data, because nothing in its contract required such disclosures.⁶ The worst part is that no one broke any laws; all of this is legal.

The findings of the DOD IG report on TransDigm are all too familiar. Past DOD IG reports have found similar overcharges to the government, including payments of:

- \$2,286 for a landing gear that should have cost \$10;⁷
- \$71 for a pin that should have cost less than a nickel;⁸ and
- \$8,124 for a bevel gear that should have cost \$445.⁹

And as this committee knows well, this isn’t even the first time that the DOD IG or this committee have raised concerns about TransDigm’s business and pricing practices. In 2006, the DOD IG found that the Defense Logistics Agency (DLA) paid the company \$5.3 million more than was fair and reasonable.¹⁰

A 2019 DOD IG report estimated TransDigm received \$16.1 million in excess profits from the Defense Logistics Agency and the Army between 2015 and 2017.¹¹

Responding to this most recent IG report’s calculation of \$20.8 million more in excess profits, TransDigm has challenged the findings with three primary concerns, largely centered around the validity of the calculated profits.¹² The most serious concern they raise is that auditors did not include real costs, including taxes. In their report, DOD IG addressed this issue directly, noting

⁵ John Krieger, “Selling Movie Theater Popcorn: A Treatise on ‘Excess Profit,’” *Contract Management*, June 2020, 42.

⁶ Department of Defense Inspector General, *Audit of the Business Model for TransDigm Group*, 29 [see note 2].

⁷ Neil Gordon, “New Details Emerge in Boeing Spare Parts Overbilling,” Project On Government Oversight, June 21, 2013, <https://www.pogo.org/analysis/2013/06/new-details-emerge-in-boeing-spare-parts-overbilling/>.

⁸ Nick Schwellenbach, “Leaked Audit: Boeing Overcharged Army Up to 177,000 Percent on Helicopter Spare Parts,” Project On Government Oversight, June 28, 2011, <https://www.pogo.org/investigation/2011/06/leaked-audit-boeing-overcharged-army-up-to-177000-percent-on-helicopter-spare-parts/>.

⁹ Mandy Smithberger, “The Unredacted Truth About Spare Parts Overcharges,” Project On Government Oversight, February 23, 2015, <https://www.pogo.org/analysis/2015/02/unredacted-truth-about-spare-parts-overcharges/>.

¹⁰ Department of Defense Inspector General, *Acquisition: Spare Parts Procurements from TransDigm, Inc.*, D-2006-055 (February 23, 2006), Executive Summary, <https://media.defense.gov/2006/Feb/23/2001712361/-1/-1/1/06-055.pdf>.

¹¹ Department of Defense Inspector General, *Review of Parts Purchased From TransDigm Group*, DODIG-2019-060 (February 25, 2019), i-iii, <https://media.defense.gov/2019/Feb/27/2002093922/-1/-1/1/DODIG-2019-060.PDF>.

¹² TransDigm Group, Inc., “The DOD IG Report,” accessed January 18, 2022, <https://tdgdod.com/#dodigreport>.

that “The FAR identifies certain costs that are unallowable, including interest and taxes when cost analysis is performed.”¹³

The company also challenged the DOD IG’s use of 15% to determine a reasonable profit, particularly as applied to a fixed-price contract. Assessing this claim is ultimately a policy issue, but Congress should keep in mind that 15% is the highest fee allowable under various cost-plus-fixed-fee contracts and it falls within the industry average. Surprisingly, the company also declined to offer an alternative profit rate to determine reasonableness, saying that “TransDigm determines the cost of an item based on what the customer is willing to pay.”¹⁴

TransDigm isn’t the only company collecting excess profits at the expense of taxpayers and other defense programs. Reports from the DOD IG show the department paid excessive amounts for spare parts from Boeing, Lockheed Martin, and Raytheon — its top three contractors.¹⁵ Many in the defense industry hope to fend off meaningful statutory changes by claiming that TransDigm is unusual or an anomaly. Don’t be fooled. Years of DOD IG reports show that this form of overpricing is the rule, not the exception.

After the 2019 IG report, pressure from this committee led to TransDigm *voluntarily* refunding \$16.1 million to taxpayers. Renewed pressure may result in another voluntary refund following this latest report.¹⁶

But while refunds are an important step for accountability, Congress cannot continue to play whack-a-mole to address the systemic procurement problems that cost the Department of Defense and other government agencies billions every year. In the wake of the 2019 report, the head of defense pricing and contracting for the Department of Defense pleaded for legislative reforms to so-called commercial buying, including revising the legal definition of the word “commercial” and reviving a renegotiation board to compel companies to provide cost and pricing data for sole source items.¹⁷ Those recommendations remain relevant today.

Unfortunately, in the past, Congress has made it harder for the Department of Defense and other agencies to negotiate fair and reasonable prices for contracts, including spare parts for military equipment. In fact, the pricing practices that TransDigm and other contractors use have been

¹³ Department of Defense Inspector General, *Audit of the Business Model for TransDigm Group*, 43 [see note 2].

¹⁴ Department of Defense Inspector General, *Audit of the Business Model for TransDigm Group*, 44 [see note 2].

¹⁵ Project On Government Oversight, “Department of Defense Inspector General Reports Questioning Spare Part Costs,” May 29, 2019, <https://www.documentcloud.org/documents/6152472-IG-Reports-Questioning-Spare-Part-Costs>; Scott Amey and Mandy Smithberger, Project On Government Oversight, In for a TransDigm, Out for Billions (May 29, 2019), <https://www.pogo.org/report/2019/05/in-for-a-transdigm-out-for-billions/>.

¹⁶ House Oversight and Reform Committee, “TransDigm To Refund \$16 Million to DOD as a Result of Committee Investigation,” Press Release, May 24, 2019, <https://oversight.house.gov/news/press-releases/transdigm-to-refund-161-million-to-dod-as-a-result-of-committee-investigation>.

¹⁷ The Renegotiation Board was created after World War II to recoup excess profits from defense contractors. During its last year of its operation, it recovered \$5.55 for every \$1 spent. “Senate Vote Means End of Renegotiation Board,” *New York Times*, April 3, 1979, <https://www.nytimes.com/1979/04/03/archives/senate-vote-means-end-of-renegotiation-board.html>; Department of Defense Inspector General, *Review of Parts Purchased From TransDigm Group*, 91-95 [see note 11].

legalized.¹⁸ However, we are hopeful that Congress may finally reverse those damaging policy choices. Subservience to contractor interests have not served the public interest, and we ask that you make the needed changes to undo the current industry-written laws that exploit taxpayers.¹⁹

There are three key reforms we hope Congress will undertake:

- Revise the definitions of “commercial items” and “commercial services.”
- Lower applicability thresholds for the Truth in Negotiations Act and ensure that contracting officers have access to certified cost or pricing data, especially for sole source contract awards.
- Implement tracking and accountability measures for companies that withhold data from contracting officials.

Revise the Definition of “Commercial Item”

When contracting for genuine commercial items, such as those available for public purchase, the government generally accepts the offered price. By presuming that market forces have ensured that a price is fair and reasonable, the government can avoid a difficult negotiation process. The problem is that the government’s definition of “commercial” — largely written by industry lobbyists — expands beyond items available to the public. It also applies to items that are similar (“of a type”) to those already on the market or are “offered” for sale.²⁰ Ironically, due to this loophole, the laws governing the purchase of commercial items and commercial services bar the government from requiring cost or pricing data *even in instances when the government is the predominant or only customer*. It’s an oxymoron: sole source commercial items.

In 2012, the Department of Defense proposed narrowing the definition of “commercial item” to mean goods or services that are **actually sold** to the general public in “like quantities.” This proposal is a significant improvement over the current definition, which relies on descriptive categories that are so broad as to be meaningless. For example, what characteristics must be shared for goods or services to be “of a type”? What actions constitute “offering” something for sale or lease? These definitions were designed to escape meaningful contract pricing, and to evade the very real protections offered by the Truth in Negotiations Act.²¹

While it is not the primary focus of the inspector general’s newest report, other watchdog reports have shown how this definition has been abused in the past. For example, Honeywell once tried

¹⁸ Project On Government Oversight, *Defense Waste & Fraud Camouflaged as Reinventing Government* (September 1999), <http://pogoarchives.org/m/ns/camo/report-19990901.pdf>.

¹⁹ For a comprehensive report on the issue see: Richard C. Loeb, *Caveat Emptor: Reversing the Anti-Competitive and Over-Pricing Policies that Plague Government Contracting*, American Economic Liberties Project (June 2020), https://www.economicliberties.us/wp-content/uploads/2020/06/Working-Paper-Series-on-Corporate-Power_4.pdf.

²⁰ Mandy Smithberger and Scott Amey, “Thornberry Buying Industry Commercial-Item Policies,” Project On Government Oversight, April 28, 2015, <https://www.pogo.org/analysis/2015/04/thornberry-buying-industry-commercial-item-policies/>.

²¹ Federal Acquisition Regulations System, 48 C.F.R. § 2.101, https://www.acquisition.gov/far/part-2#FAR_2_101.

to convince the department that a Chinook helicopter engine it manufactures is commercial — and worth 100 percent more than the department previously paid.²²

The impact of this definition has only become greater since Congress legislated a “preference” for commercial buying,²³ which continues to exclude more transactions from informed pricing and scrutiny.²⁴ The Air Force initially used a commercial item acquisition strategy for its new tanker program, and it tried to purchase C-130J and C-17 transport planes under that authority as well.²⁵

Lower Truth in Negotiations Act Thresholds

The Truthful Cost or Pricing Data statute (formerly known as the Truth in Negotiations Act) is meant to require contractors to submit certified current, accurate, and complete cost and pricing data to the government.²⁶ Yet contractors only have to submit that data if the contract price is above \$2 million and the goods or services are not labeled “commercial.”

Congress continues to raise the Truth in Negotiations Act applicability threshold, reducing the number of contracts for which the Department of Defense and other agencies can obtain cost and pricing data. Notably, a 2015 analysis by the Pentagon’s acquisition office analyzed proposals to increase the threshold and judged them “unlikely to provide cost savings.”²⁷ The cost risks, however, continue to be clear.

When the government buys goods or services for contract amounts that fall below the Truth in Negotiations Act threshold or when it designates items it purchases as commercial (even when acquired on a sole source basis), it is allowing companies to openly evade fair and reasonable pricing. Even when the government requests information other than certified cost or pricing data for these transactions, companies can legally refuse these requests, and contracting officers are then in the undesirable position of having to do their best to determine if prices are reasonable by using alternative methods like market research.²⁸

Congress must fix this system.

²² Department of Defense Inspector General, *Review of Parts Purchased From TransDigm Group*, 93 [see note 11].

²³ 10 U.S.C. § 2377; 41 U.S.C. § 3307.

²⁴ 10 U.S.C. § 2306a(b)(1)(b) (“Submission of certified cost or pricing data shall not be required under subsection (a) in the case of a contract, a subcontract, or modification of a contract or subcontract ... for the acquisition of a commercial item”); 10 U.S.C. §2306a(d).

²⁵ Department of Defense Inspector General, *Acquisition: Acquisition of the Boeing KC0767A Tanker Aircraft*, D-2004-064, (March 29, 2004), ii, <https://media.defense.gov/2004/Mar/29/2001712733/-1/-1/1/04-064.pdf>; Department Of Defense Authorization for Appropriations for Fiscal Year 2006, Hearings before the Senate Committee on Armed Services, 109th Cong. (March 16, 2005) (testimony of Danielle Brian, Executive Director, Project On Government Oversight), <https://www.pogo.org/testimony/2005/03/written-testimony-of-pogos-danielle-brian-on-dods-use-of-commercial-acquisition-and-other-transaction-authority-before-senate-armed-services-committee/>.

²⁶ 10 U.S.C. § 2306a; 41 U.S.C. 3501 *et seq.*

²⁷ D. Mark Husband and David J. Nicholls, Office of the Under Secretary of Defense, Acquisition, Technology, and Logistics, *Eliminating Requirements Imposed on Industry Where Costs Exceed Benefits* (September 29, 2015), 96, <https://www.acq.osd.mil/fo/docs/Eliminating-Requirements-Imposed-on-Industry-Study-Report-2015.pdf>.

²⁸ 10 U.S.C. §2306a(d).

The cost risks are clear. Congress should amend the contracting laws to require contractors to provide certified cost or pricing data to contracting officers before the award of any sole source contract of more than \$500,000.

Track Companies That Refuse to Provide Cost and Pricing Data and Hold Them Accountable

Last year, the Government Accountability Office (GAO) found that the Department of Defense continues to struggle to obtain the information it needs to make sure it isn't overpaying when it buys spare parts. The running around that government officials had to do to obtain information in place of certified cost data resulted in lengthy delays.

For example, efforts by the Defense Logistics Agency to assess a \$157.7 million engine parts contract resulted in it taking 459 days to issue the contract, and the final price was about 25% *less* than what the contractor initially proposed. This was likely offered as an attempt to see what price the government was willing to bear. The process shouldn't work this way. Contractors should be required to disclose their cost basis up front. It's outrageous to force the Department of Defense to take more than a year to wrangle enough information out of a contractor to ensure a reasonable contract price.²⁹ Previous efforts to negotiate better deals earned one senior Pentagon official the moniker of the "most hated man in the Pentagon."³⁰

These delays were likely intentional efforts by contractors to discourage officials from taking the extra steps needed to negotiate better prices. While the GAO found no company outright refused to provide cost or pricing data, seven of the ten contracts reviewed were set back at least in part by delays in contracting officials obtaining *it*.³¹

In the wake of the 2019 TransDigm scandal, the Department of Defense issued a memo requiring contracting officials to report instances when contractors refuse to provide cost or pricing information.³² The memo did not include asking those officials to track how efforts to obtain the information resulted in delays, a step the GAO recommended.

Government contracts are predicated on a basic principle: Taxpayer dollars should only be awarded to responsible contractors.³³ In addition to implementing the recommendations in the

²⁹ Govern Government Accountability Office, *Spare Parts Contracts: Collecting Additional Information Could Help DOD Address Delays in Obtaining Cost or Pricing Data*, GAO-21-388 (May 26, 2021), 13, <https://www.gao.gov/assets/gao-21-388.pdf>.

³⁰ Ellen Mitchell, "Meet the most hated man in the Pentagon," *Politico*, April 11, 2016, <https://www.politico.com/story/2016/04/defense-pentagon-spending-assad-221776>.

³¹ Government Accountability Office, *Spare Parts Contracts*, 12 [see note 29].

³² Memorandum from Kim Herrington, Acting Principal Director of Defense Pricing and Contracting for the Office of the Secretary of Defense, to Department of Defense Heads of Contracting Activities about "Implementation of Quarterly Reporting of Contractor Denials of Requests for Data Other than Certified Cost or Pricing Data to Evaluate Price Reasonableness for Department of Defense Contract Awards," April 25, 2019, <https://www.acq.osd.mil/dpap/policy/policyvault/USA001015-19-DPC.pdf>.

³³ "Purchases shall be made from, and contracts shall be awarded to, responsible prospective contractors only." Federal Acquisition Regulations System, 48 C.F.R. § 9.103(a), https://www.acquisition.gov/far/part-9#FAR_9_103.

Department of Defense memo and the GAO's report, Congress should require the Department of Defense to track which companies refuse or delay providing cost or pricing data by reporting that fact to the Federal Awardee Performance and Integrity Information System (FAPIIS) and the Contractor Performance Assessment Reporting System (CPARS).

Conclusion

The Department of Defense spent \$394 billion on contracts in fiscal year 2021.³⁴ As former Pentagon whistleblower and POGO founder Ernie Fitzgerald pointed out, most of us don't know what a bomber or fighter should cost, but we can see the boondoggle of "over-priced spare parts flying in close formation."³⁵

It's time for Congress to stop enabling contractor overpricing. Congress passed the laws that made all of this possible. So-called "acquisition reform" has been a bonanza for contractors and a disaster for taxpayers. It is now time to reverse the legalization of contractor overpricing. The problems identified by this watchdog report and other reports are only the tip of the iceberg, but the solutions are clear. They can only be fixed if Congress gets serious and takes action.

³⁴ USASpending.gov, <https://www.usaspending.gov/search/?hash=a46c2f8bcd84d973b40d5796d0860d31>.

³⁵ "Grassley Pays Tribute to Ernie Fitzgerald," February 6, 2019, <https://www.grassley.senate.gov/news/news-releases/grassley-pays-tribute-ernie-fitzgerald>.