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DOD Proposed Rule Would Eliminate Provisional Award Fee And Defer Substantial Award Fee Payments

By John W. Chierichella and W. Bruce Shirk

The Department of Defense recently proposed a rule that would revise guidance for award-fee evaluations to require:

- The incorporation of award-fee plans into all DOD award-fee contracts,
- The use of objective criteria to the maximum extent possible to measure contract performance including, where appropriate, use of formula-based incentives rather than or in addition to an award fee,
- The elimination of provisional award-fee payments, *i.e.*, payments made prior to evaluation of contractor performance, which have been allowed since 2003 in accordance with DFARS 216.405-2, and
- Reservation of at least 40% of the available award fee pool for payment after the final evaluation period.

75 Fed. Reg. 22728-29 (April 30, 2010).

As we will discuss below, the proposed rule – which will impose significant financial burdens on contractors – represents yet another attempt by the Government to punish contractors for the Government's inability to discipline itself. One can only hope – and it is likely a futile hope – that the Government will forward this proposed rule to the trash can of bad ideas.

Let's take each of the components of the proposed rule in turn.

No. 1 – the incorporation of award fee plans in award fee contracts.

Lest anyone think that we react, reflexively, as nattering nabobs of negativism with respect to all

proposed rules, this is one with which we agree. An award fee plan, fairly negotiated in advance of contract award, provides guidance and predictability to both parties. The contractor knows what the Government values most highly and where it should concentrate its resources for superior performance, and the Government incentivizes the contractor to deliver in that regard. Predictability is a highly valuable characteristic in transactions and award fee plans can provide it.

No. 2 – the increased use of formulaic incentives.

So much for positive thinking. The last time we looked – and for as long as we have been practicing law – award-fee contracts are designed for use when the scope of work does not allow for "...predetermined objective incentive targets applicable to cost, schedule, and technical performance...". FAR 16.401(e). So, if the contract lends itself to objectively verifiable measures of achievement, then the contract should not be structured as an award fee instrument. And if the Government reserves the award fee structure for cases in which there are no meaningful, objective, mathematically determinable measures of performance then this component of the rule really becomes unnecessary.

But that is not the way our acquisition system works anymore. You see, the Government does not trust itself to limit the use of the award fee structure to contracts of the type for which it was designed. And with good cause, because DOD has increasingly used award fee contracts for work other than high risk development efforts with undefined technical requirements. Of the $755 billion in DOD contract dollars obligated on actions over $25,000 between FYs 1999 and 2004 some 13% (or about $91 billion) were for CPAF contracts and more than half of the CPAF contracts were for non-research and development services and other purposes. GAO, *DOD Has Paid Billions in Award and Incentive Fees Regardless of Acquisition Outcomes*, GAO-06-66 (December 2005), at 11.

Now, when something does not work the way it is supposed to, you generally fix it. But the Government's first option in such cases is to externalize the problem and lay it off on contractors. Which brings us to the third component of the proposed rule.

No. 3 – the elimination of provisional award fee.

Government contracting is not an philanthropic undertaking. Not-for-profit corporations are not, and never have been, the backbone of our national defense. So, companies that make the kinds of enormous capital investments necessary to perform these CPAF contracts do it – how can we put this politely? – to make money. A key difference between a CPAF contract and a fixed or incentive fee contract is that, as to the latter, fee is earned and paid continuously throughout the contract. Routine billings include a component for fee. CPAF contracts are different. The award fee is determined and paid at the end of each evaluation period specified in the contract, "...*e.g.*, six months, nine months, twelve months, or at specific milestones". FAR 16.401(e)(2). A CPAF contractor thus can work for extended periods of time without seeing any appreciable fee. To remedy this inequity, DOD has, since 2003, authorized the payment of provisional award fee, which is "a payment made within an evaluation period prior to a final evaluation for that period." The provisional fee is then "trued up" against the fee determined at the end of the

period. DFARS 216.405-2(b).

Not anymore. If the proposed rule becomes final, provisional award fee payments will become a relic, and the only fee actually paid to contractors will be the fee earned for and paid at the end of each periodic award fee interval. Which takes us to the fourth element of the proposed rule.

No. 4 – deferral of at least 40% of the total award fee until contract completion.

Isn't it great to be able to write the rules? Contractors work, the Government obtains the ongoing real time benefits of performance, and contractors wait for their profits, which – by the way – will be unilaterally determined at the discretion of the fee determining Government official.

Now to be fair, DOD can attempt to justify this on the ground that, according to the GAO report referenced above, "DOD routinely ...[pays] its contractors nearly all of the available award fee, amounting to billions of dollars, regardless of … acquisition outcomes…." Of course, it may well be that those payments were properly earned under the terms of the underlying contracts – that fact is not discernable from the GAO Report. But, even if the award fees were generous, why does that justify the financial penalization of all award fee contractors? Once again, we find that the genesis of a rule penalizing contractors is the Government's own lack of discipline, in this case a lack of discipline in negotiating the terms of, implementing, and administering award fee contracts.

From DOD's perspective, the proposed rule would "appropriately incentivize the contractor throughout the entire period of contract performance." It also allows the military departments to play bookkeeping games by deferring fee expenditures until very late in the term of a CPAF contract, another salutary effect when budgetary issues are so obvious. From contractors' perspective, it is just another pound of flesh flayed by regulators who have little experience with profit and loss statements in the commercial world. One can only hope that DOD will, at a minimum, accede to contractor requests that the new rule be implemented only prospectively and that other agencies will not follow suit. Good luck.

There is not much contractors can do if the rule becomes final, but here are a few suggestions:

- Negotiate more frequent evaluation periods
- Negotiate a higher base fee
- Aggressively negotiate the details of an award fee plan, hold the Government accountable for punctilious compliance, and seek redress immediately for each and every variance by the customer from the plan's requirements. *See, e.g.*, *Boeing Co. v. U.S.*, 75 Fed. Cl. 34 (2007) (Government failure to utilize official designated as Award Fee Determination Official to determine award fee constituted a breach of contract).

While these suggestions will not completely negate the impact of the unbalanced nature of the rule, they will at least soften its blow.

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