AEROSPACE INDUSTRIES ASSOCIATION

October 27, 2005

Mr. Lou Kratz
Assistant Deputy Under Secretary of Defense for Logistic Plans and Programs
3500 Defense Pentagon RM 2C263
Washington, DC 20301-3015

Subject: Performance-based Logistics Corporate Contracting Recommendations

Dear Lou:

As a result of your request, the Aerospace Industries Association (AIA) Product Support Committee (PSC) is pleased to present the enclosed white paper: "Corporate Contracting: Accelerating the Implementation of Performance-Based Contracting." The joint Industry and Government team recognizes that focusing on two key recommendations can significantly accelerate Performance-Based Logistics (PBL) contracting process improvements:

Recommendation #1

Establish consistent and structured PBL contracts across all of DoD and the Services at the System, Sub-system and Major LRU levels

Recommendation #2

Maximize the use of FAR Part 12 contracting for PBLs

Implementing these recommendations in a phased approach will allow Office of the Secretary of Defense (OSD) and the Military Services to target the OSD PBL Maturity Model and address necessary policy decisions and updates to facilitate cross-service initiatives with Industry. As guidance and structure are understood and improved, contracting vehicles will emerge as the basis and evolution to PBL Corporate Contracting.

The benefits of this approach will enable DoD to focus on other necessary acquisition and sustainment reform while enabling Industry to formulate PBL solutions that jointly facilitate and streamline PBL contracting and deliver PBL outcomes.

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Attached is an extract of from the white paper that provides a summary discussion of the framework and contracting approach for Corporate Contracting for PBL and key issues that need to be addressed. In addition to the enclosed copy of the white paper, supporting documentation for the FAR Part 12 recommendation is enclosed. This document is titled "Commerciality of Performance Contracting.

The Corporate Contracting white report concludes several months of effort by a team of dedicated and knowledgeable Government and Industry personnel to whom we would like to express our sincere appreciation. There are several other issues have been identified and need to be included as part of the scope of Corporate Contracting such as small Business and Competition, which will be addressed in separate white papers. This report is only the beginning of the next phase: Implementation. We stand ready to do our part in this endeavor.

With my kindest regards,

Rusty Rentsch
Director Life Cycle Management

Attachments:

1. Executive Summary, Corporate Contracting White Paper
2. Corporate Contracting White Paper
3. Commerciality of Corporate Contracting Market Survey

Attachment 1

Corporate Contracting Accelerating the Implementation of Performance-Based Contracting (PBL)

Executive Summary

Recommendations:

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The benefits of this approach will enable DoD to focus on other necessary acquisition and sustainment reform while enabling Industry to formulate PBL solutions that jointly facilitate and streamline PBL contracting and deliver PBL outcomes.

The next section discusses further the Executive Summary Recommendations relative to framework and contracting approach.

Discussion:

In the fall of 2004 as a result of the "Time-to-Contract" Tiger Team recommendations, a team of experts from industry and Government were asked by the ADUSD(LPP) to investigate and make recommendations for accelerating the implementation of PBL through Corporate Contracts. In its simplest context, a Corporate Contract is the notion of a single vehicle for contracting for PBL between all the DoD Services and Agencies and a corporation (all sectors or segments or divisions, etc.). By establishing such a vehicle, the time to add additional PBL programs to the contract would be greatly reduced.

The goal of the Corporate Contracting for PBL team was to develop a strategy to enable DoD and the Services and Agencies to enter into a single contracting vehicle for all PBL contracts with a corporation for the purpose of the following:

- Reduce procurement administrative lead time for PBL contracts
- Obtain greater consistency of PBL contracts
- Embed DoD desired policy into PBL contracts
- Obtain added efficiencies in administration and execution of PBL contracts, both by government and industry
- Vehicle for sharing best practices from one contract to the next

The white paper presents the recommendations of the "PBL Corporate Contract Tiger Team." The issues associated with the implementation of PBL are complex and inter-related and contribute significantly to "Time-to-Contract." Therefore, the team also included in this white paper its recommendations with respect to these related issues. Please refer to the appropriate section in the white paper for the background and rationale for the recommendations. The following is a summary of the white paper.

Framework for Corporate Contracting for PBL

Policy guidance should be issued to promulgate the direction of implementation of Corporate Contracting for PBL. Supporting approaches are:

1. Near Term Approach: Expanding the utilization of existing PBL contracts across companies and the services. OSD should issue guidance that the desired approach for PBLs (especially on cross service initiatives) target at least Stage 3 of the OSD PBL Maturity Model. OSD should include encouragement in this policy for the services to utilize existing Corporate Contracts that are at Stage 3 or Stage 4 rather than start from scratch.
2. Longer Term Approach: In those instances where use of existing contracts is not feasible or an overall strategy and high level commitment is required, a framework is established based upon (1) an executive level Memorandum of Agreement (MOA), (2) a Basic Agreement captures those core terms and conditions to be incorporated into any PBL contracts awarded to that corporation by any Service or Agency, and (3) the individual PBL contracts that are subsequently awarded. Guidance and processes should be established for implementing the structured approach for PBL Corporate Contracting.

We recommend that there be a session(s) with senior executives from Government and industry to explain and gain acceptance in order to initiate and facilitate this process.

To support this new policy, we are asking DAU to establish or incorporate into an appropriate course education to aid program managers, logisticians, and contracting officers to adopt and implement these concepts and techniques.

We also encourage industry to join with DAU in providing personnel as trainers and as students, and to offer up examples of best practices they may be willing to share for the benefit of all.

We urge DOD and the Services to reconcile differing policies on the treatment of PBL – e.g., Supply vs. Services contract, use of Working Capital Funds, etc.

Commercial Item Determination (FAR Part 12 & 15)

The Commercial Item Determination Handbook should be updated to define Performance-Based Logistics as a commercial item. The test for a particular offering would be to show that it satisfies the requirements of the PBL definition and satisfies one or more of the performance requirements for contracting for PBL: (1) Operational Availability, (2) Operational Readiness, (3) Cost Per Unit of Usage, (4) Logistics Footprint and (5) Logistics Response Time. The DoD Maturity Framework could be used as a reference. [Note: A cost-type performance contract would necessarily have to be performed under FAR Part 15 requirements.]

Incorporating "Predetermination of Commerciality" within the BA (Basic Agreement) discussed in Section B above could be a valuable way to pull this often lengthy and sometimes contentious activity ahead of the discussions for individual PBLs. Predetermination of commerciality for a corporation's products and processes or services (based on existing catalogs, previous determinations, precedents, etc. would be a powerful tool for the acquirers and industry.

- Streamlines subsequent PBL initiatives
- Should satisfy commerciality and "fair and reasonable" once, instead of repeating the process over and over
- Changes to catalog prices, status, or services would be updated by exception or on a periodic basis (e.g., annually)

DAU should incorporate into an appropriate course education to aid program managers, logisticians, and contracting officers to adopt and implement these concepts and techniques. Have DAU become the repository of market survey information to facilitate the sharing of data as part of the Community of Practice (COP) forums. [A compilation of the market survey data developed in this study effort will be provided in a separate document.]

Price Reasonableness

Contracting officers need to be trained in the techniques of price-based best value contracting and to use "Other than Cost and Pricing Data" to make a price reasonableness determination. The concept of "Weighted Guidelines" and profit needs to be reevaluated in light of the new PBL environment that necessitates a different approach. DAU should incorporate into an appropriate course education to aid program

managers, logisticians, and contracting officers to adopt and implement these concepts and techniques.

Contractors need to provide appropriate "Other than Cost and Pricing Data" as a part of the price reasonableness process. Having buyers trained and comfortable with this data for determining reasonableness and Alpha contracting-type IPTs with sharing of data on both sides will facilitate movement to the new environment.

PBL - Supply or Service Contract?

In concert with DPAP and the DoD General Counsel, USD-AT&L is urged to provide guidance to the Services on the proper classification of PBL contracts. PBL is a method of buying an outcome that results in hardware; therefore, it is a supply contract and not a service contract.

Appropriations / Budget Categories (Color of Money)

Working Capital Funds should be viable candidate for funding PBL efforts. Currently some Services do so while others do not; although, it does not appear there are any DOD Financial Management regulations that would prohibit this. MID 917 should be implemented as DoD policy for all PBL programs.

PBL possibly meets the definition of a "Nonseverable deliverable"; therefore guidance for budgeting for PBL could recognize this provision in DFARS 204. DoD should evaluate the feasibility of applying this provision to PBL. Industry could participate in this evaluation by providing supporting rationale / examples of how the subdividing of a PBL contract (e.g., FIRST) would not be feasible and the negative impact of forcing subdivision would have on mission support and cost.

Implementation

OSD should be the single focal point for PBL Corporate Contracts. If OSD can implement the standardized guidelines/policies, the award of PBL contracts would be streamlined and it would allow for more intra-service contracting. The increased efficiencies will allow a lead-time reduction on PBLs on a go forward basis.

We recommend that there be a session(s) with senior executives from Government and industry to explain and gain acceptance in order to initiate and facilitate this process.

To support implementation of these changes, DAU should establish or incorporate into an appropriate course education to aid program managers, logisticians, and contracting officers to adopt and implement these concepts and techniques.

Corporate Contracting: Accelerating the Implementation of Performance-Based Logistics (PBL)

A White Paper Prepared for ADUSD(LPP) by the Corporate Contracting for PBL Working Group

October 20, 2005

AEROSPACE INDUSTRIES ASSOCIATION

Forward

The 2001 Quadrennial Defense Review (QDR) endorsed Total Life Cycle System Management (TLCSM) and Performance-Based Logistics (PBL) as the Department of Defense (DoD) strategy to improve material readiness. This endorsement, and subsequent direction to implement via the Defense Planning Guidance (DPG) and Strategic Planning Guidance (SPG), was based on a few relatively simple observations:

- To focus on end-item readiness, the DoD needed to establish single point accountability across the life cycle – This was accomplished by recognizing the Program Manager as the Life Cycle Manager.
- Traditional weapon system support was functionally optimized within supply, maintenance, and transportation – DoD needed to turn to industry as partners to integrate those functions and deliver **outcomes** – readiness.
- Equipment reliability was degrading rapidly (and costs were rising) due to deferred modernization and aging equipment – DoD needed to implement business strategies that inherently incentivize reliability growth.
- Commercial industry demonstrated unprecedented gains in customer service and cost performance through logistics chain integration – DoD needed to draw upon that experience rapidly.

The QDR and SPG guidance were quickly followed by leading implementations across the Services. For these initial programs, the Services were afforded latitude in implementing practices, contract structure, and metrics.

In 2003, the Defense Business Board Supply Chain Task Force conducted an independent review of DoD progress and concluded the following:

- PBL was the right strategy – more rapid implementation was both warranted and needed.
- DoD should document and promulgate PBL best practices to drive to more consistent methods and metrics.
- Financial process adjustments were necessary and appropriate to foster greater PBL implementation.

Although much outstanding success has been demonstrated by programs utilizing PBL, the time to establish a PBL contract is long and the rate of PBL implementation has been less than desirable. In the fall of 2003 under the sponsorship of the ADUSD Logistics, Plans and Programs, a series of working groups (“PBL Tiger Teams”) consisting of experts from industry and Government were convened to make recommendations to facilitate the implementation of PBL. These teams addressed issues in the areas of Business Case Analysis, Appropriations and Budgeting (“Color of Money”), PBL Metrics, Training and Best Practices, Public-Private Partnerships (PPP), and Time-to-Contract.

Based on these findings, the Deputy Secretary of Defense directed the Under Secretary of Defense (Acquisition, Technology, and Logistics) (USD(AT&L) and the Under Secretary of Defense (Comptroller) (USD(C)) to accelerate implementation by:

- Promulgating consistent guidelines on buying performance
- Defining consistent PBL metrics
- Testing enabling financial accounting procedures via Management Initiative Directive 917 (MID-917).

Building upon Joint Chiefs review of Focused Logistics Functional Capabilities and unprecedented partnerships with the Services and industry (via the Aerospace Industries Association Product Support Committee), USD(AT&L) issued clear guidance on purchasing performance – outcomes – using multiyear contracts, consistent metrics, and appropriate incentive structures. This guidance is being implemented as new PBL contracts are awarded and existing contracts are renewed. Performance was defined by five specific metrics:

- Operational Availability
- Mission Reliability
- Cost-Per-Unit of Usage
- Logistics Response Time
- Logistics Footprint

In the fall of 2004 as a result of the "Time-to-Contract" Tiger Team recommendations, a team of experts from industry and Government was asked by the ADUSD(LPP) to investigate and make recommendations for accelerating the implementation of PBL through Corporate Contracts. In its simplest context, a Corporate Contract is the notion of a single vehicle for contracting for PBL between all the DoD Services and Agencies and a corporation (all sectors or segments or divisions, etc.). This idea builds upon precedents already developed by DLA and some of the Services to improve the efficiency of spares purchasing. By establishing such a vehicle, the time to add additional PBL programs to the contract would be greatly reduced.

This white paper presents the recommendations of the "PBL Corporate Contract Tiger Team." The issues associated with the implementation of PBL are complex and inter-related and contribute significantly to "Time-to-Contract." Therefore, the team also included in this white paper its recommendations with respect to these related issues.

Table of Contents

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The recommendations are presented below. Please refer to the appropriate section in this report for the background and rationale for the recommendations.

Section B: Framework for Corporate Contracting for PBL

Policy guidance should be issued to promulgate the direction of implementation of Corporate Contracting for PBL. Supporting approaches that are discussed in Section B are:

a. Expanding the utilization of existing PBL contracts across companies and the services. OSD should issue guidance that the desired approach for PBLs (especially on cross service initiatives) target at least Stage 3 of the OSD PBL Maturity Model. OSD should include encouragement in this policy for the services to utilize existing Corporate Contracts that are at Stage 3 or Stage 4 rather than start from scratch.
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Section A
Overview

In the fall of 2004 as a result of the "Time-to-Contract" Tiger Team recommendations, a team of experts from industry and Government was asked by the ADUSD(LPP) to investigate and make recommendations for accelerating the implementation of PBL through Corporate Contracts. In its simplest context, a Corporate Contract is the notion of a single vehicle for contracting for PBL between all the Department of Defense Services and Agencies and a corporation (all sectors or segments or divisions, etc.). Recognizing that such a goal is ambitious, if policy, tools, relationships, etc. could be implemented to facilitate establishing such a vehicle, the time to add additional PBL programs to a contract would be greatly reduced.

The concept of corporate contracting has been utilized by DLA and the Air Force and some companies (primarily for sole source spares with various incentives depending upon service / agency). A few PBL corporate contracts are in existence primarily between companies.

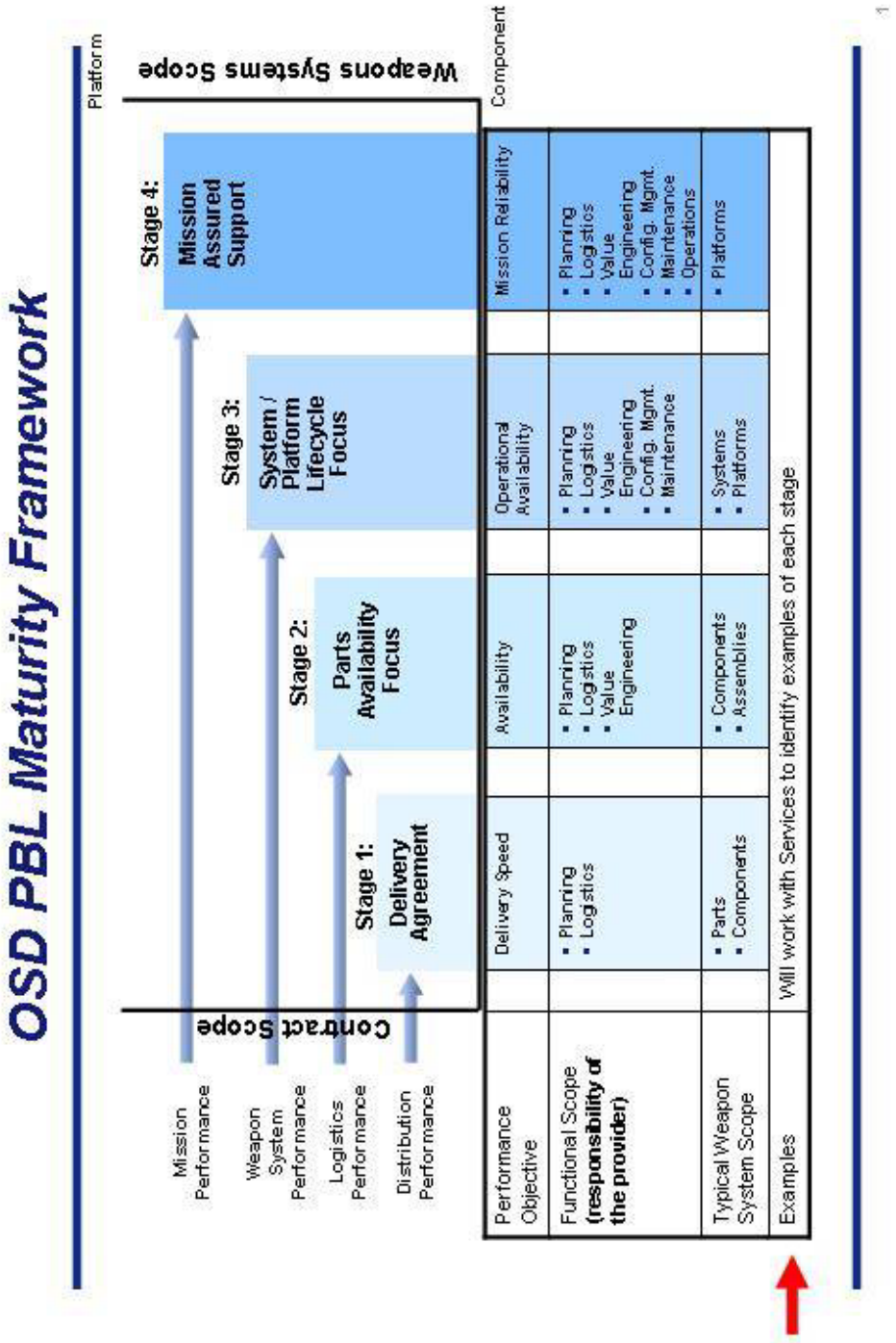
Some companies have found it difficult to enter into contracts that cut across business units & programs due to culture, internal competition, revenue sharing, incentive reward programs for management, and the difficulties of integrating multiple cage codes/cost centers having different overhead and G&A rates. Some companies are reluctant to enter into PBL contracts due to perceived risk. Some companies are organized such that they can more easily enter into Corporate Contracts. Examples are as follows:

- Marketing / contracting organizations that cut across business units / programs
- Separate business units that establish contracts and flow requirements to other business units
- Program offices that manage IDIQ, GSA Schedules, and BOAs for a small overhead allocation

Within DoD, the services have had differing policies, interpretations of guidance, procedures, funding processes (e.g., Working Capital Fund), etc. for the implementation of PBL that have made it difficult for them to collaborate. Also, there are different maturity levels of PBL implementation due to scope and sophistication of the contracts/projects at the time when they were created. This caused differences in the acquisition strategies across DoD as the services targeted PBLs at the piece part, LRU, system/subsystem or platform level. Targeting below the LRU level sub optimizes a PBL's effectiveness and in actuality is not a PBL at all. Buying piece parts may or may not guarantee piece part availability, but it does not guarantee end item availability and does not impact reliability improvements or obsolescence avoidance as the contractor is empowered only to make decisions on individual parts not the entire system. It also doesn't allow the contractor to impact maintenance plans, levels, depth of repair etc. where reliability and obsolescence can be greatly impacted.

Figure A-1 portrays the range of PBL programs in a maturity matrix.

Figure A-1
PBL Maturity Framework



The goal of the Corporate Contracting for PBL team was to develop a strategy to enable DoD and the Services and Agencies to enter into a single contracting vehicle for all PBL contracts with a corporation for the purpose of the following:

- Reduce procurement administrative lead time for PBL contracts
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There are enablers for achieving these objectives:

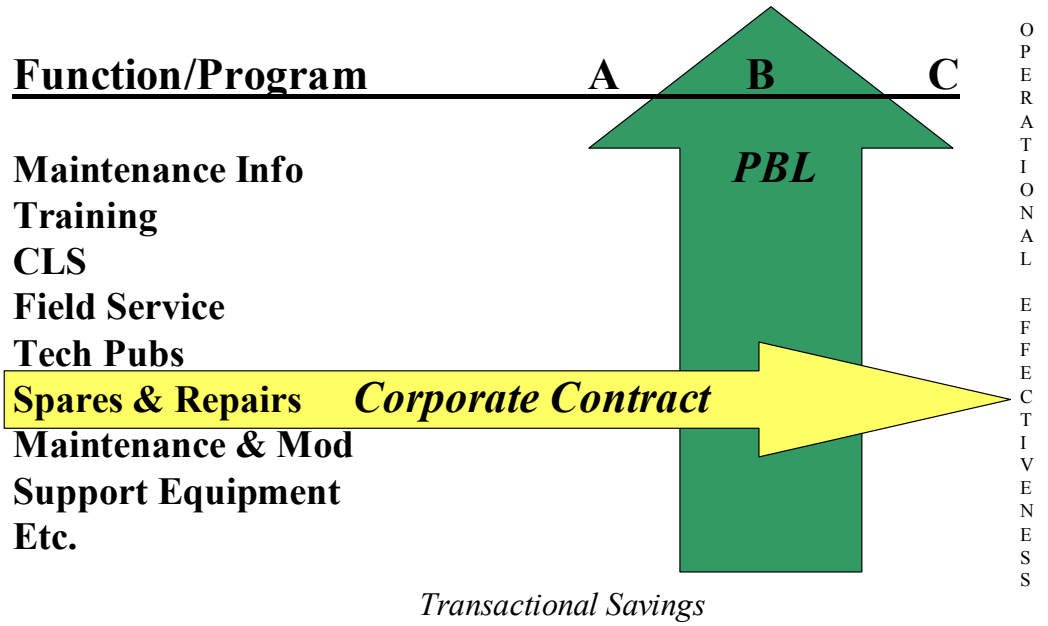
- Services and agencies have generally recognized the benefits of PBL and have committed to further implementation
- Some companies have come to recognize that logistics should be a business focus area on a level with programs
  - Corporate Contracts and PBL represent opportunities for growth and a competitive advantage
- Some Government services / agencies are implementing Supply Chain Management (SCM) that could facilitate PBL Corporate Contracting:
  - USAF - Purchasing and Supply Chain Management (PSCM)
  - DSCR - Strategic Supplier Alliances (SSAs), Senior Executive Partnership Round Table Conferences (SEPRT) and One-on-One executive meetings with key suppliers to review performance and establish strategic initiatives
  - AMCOM – Industry Days (similar to DSCR) and implementation of Life Cycle Management Center (LCMC) that integrates PEO and sustainment organizations
  - NAVICP has taken a strategic and corporate approach similar to SCM for implementing PBL and corporate contracting
- The Joint Aeronautical Logistics Commanders (JALC) group also has facilitated a Joint Service Corporate Contracting initiative with a cross-service perspective. One initiative they have underway is to have a lead Service enter into a contract with a company to purchase Contractor Engineering & Technical Services (CETS) – with the other Services utilizing this same contract for their purchases.

Section B
Framework for Corporate Contracting for PBL

Issue:

The Department of Defense encourages its contractor community and the DoD components acting jointly to help take the next step with PBL implementation. The goal is to reduce the "learning curve" and procurement administrative lead time to get the remaining weapons systems under PBL contracts. We believe there is now sufficient collective experience to institute the means for establishing alliances with contractors that span the systems they provide to the DoD under a single umbrella. This next step draws on the success that the Services and Agencies have had with initiatives like Strategic Supplier Alliances, Corporate Contracts, Award Term Contracts, Public-Private Partnering, and other supply chain management methods. These are demonstrated best practices. Figure B-1 contrasts how current corporate contracts have been aimed at improving transactional efficiency for ordering spares versus integration of logistics functions around a platform for operational effectiveness. We also want these arrangements to reflect the recommended procurement policies in the Memorandum issued by the Under Secretary of Defense for Acquisition, Technology and Logistics, dated 16 August 2004, entitled "Performance Based Logistics: Purchasing Using Performance Based Criteria" and the
PBL policies in DODI 5000.2.

Figure B-1
Contrasting Corporate Contracts Today with Performance Based Logistics



Background:

Utilizing Performance Based Logistics (PBL) for sustainment of weapons systems is the policy of the Department of Defense. Where PBL has been implemented, we have seen improved system availability at reduced overall costs – a better benefit to the warfighter. Excellent progress has been made in developing and implementing plans to establish PBL on major weapons systems, subsystems, and equipment. The Defense Acquisition University (DAU) has done an excellent job thus far in supporting the implementation of PBL by establishing a Logistics Community of Practice (LOGCOP) where lessons learned and best practices can be shared, by instituting training programs that are also open to industry, and even offering their services as facilitators to help initiate PBL planning efforts. However, much remains to be done. PBL has a steep "learning curve," requiring changes in culture, development of supporting business cases and PBL strategies, engagement of both organic and private sectors, and specialized contracting arrangements.

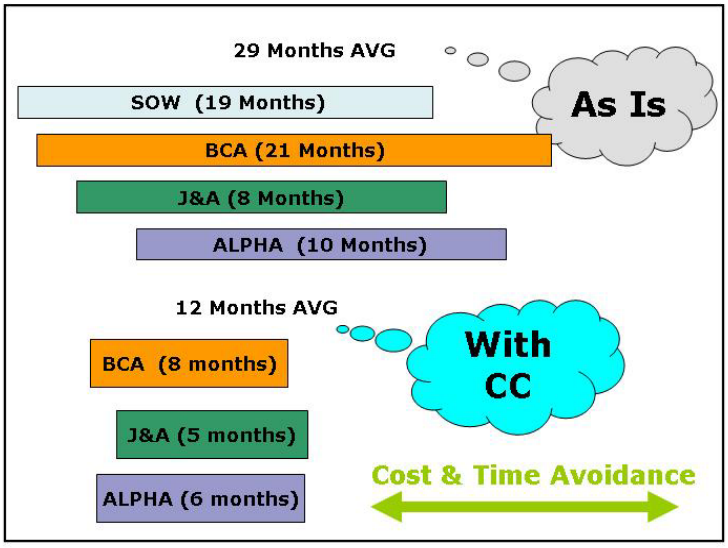
Discussion:

There are two complementary approaches to the implementation of PBL Corporate Contracts. One is a near term approach and the other is a longer term approach. These differences are due to the complexity of implementing corporate contracts across large complex organizations.

Near Term Approach:

One approach to establishing a corporate contract for PBL is to expand an existing contract. This methodology is a tier-step approach – create a Corporate Contract and add to it. A corporate contract for purposes of this discussion is a PBL contract that is structured for growth over a period of years. The benefits of establishing a corporate contract for performance based logistics using this approach have been demonstrated. It is a PBL contract that has an established Statement of Work as well as Terms and conditions. The contract can accommodate additional product lines and/or business units from the PBL provider along with requirements from other Government agencies or services. The benefits such as compression of time-to-contract and savings are presented conceptually in Figure B-2 below:

Figure B-2
PBL Contracting Timeline



A real world example of this approach is the activity by NAVICP and Honeywell to expand the scope of the existing contract shown in Figure B-3. Using the Honeywell APU PBL as an example, the initial corporate contract took four years to implement. An additional four Navy subsystems have been added with an average to contract award of under a year. US Customs service has been added to the Honeywell PBL contract and Air Force H-53 APU's are being added to the Hamilton Sundstrand PBL contract. These two cross agency/service efforts were completed within six months of initial discussion of the additional requirements. This clear benefit not only drives DoD savings sooner in terms of cost, reliability and availability but also frees up resources to craft and implement other PBLs. The time to add items to the existing contract was greatly reduced by using the existing contracting vehicle. This method is perhaps the fastest approach for establishing corporate contracts for PBL.

Figure B-3
Honeywell APU PBL Example

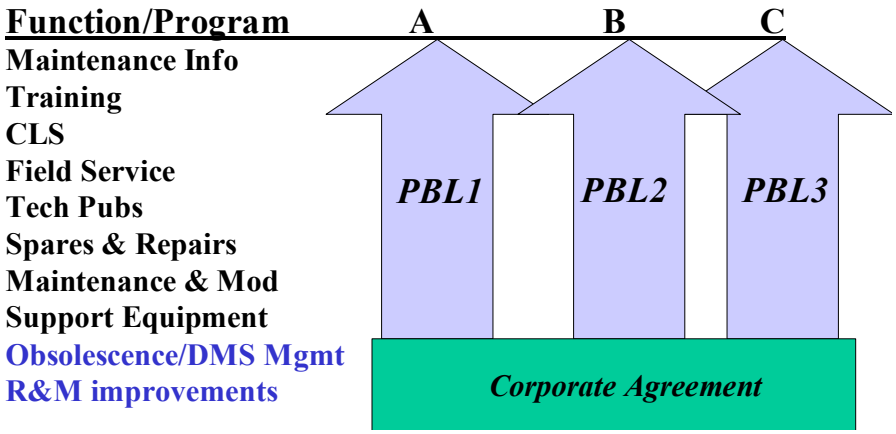
- Original APU contract 48 months
- Corporate Contract Adds
  - C-130 APUs 15 months
  - F404 Main Fuel Controls 14 months
  - Engine Driven Compressor 9 months
  - Environmental Control Systems 12 months

This clearly demonstrates the advantages of doing corporate PBL contracts. The economies of the savings are clearly measurable and calculable. The overarching savings across DoD would be huge.

Longer Term Approach:

The following presents an alternative approach to establishing Corporate Contracts in those instances where use of existing contracts is not feasible or an overall strategy and high level commitment is required. We see this new approach as laying a foundation for having many PBL contracts for systems, platforms, subsystems or equipment supported by the same corporation or company as shown in Figure B-4.

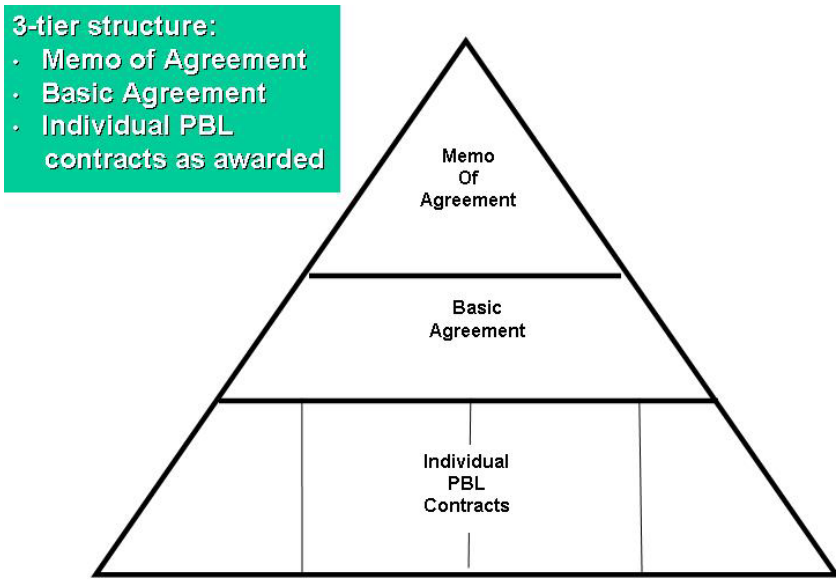
Figure B-4
Laying the Foundation for Corporate PBL Contracts



Discussion:

The construct for establishing a framework for establishing a corporate contract consists of three key elements as shown in Figure B-5.

Figure B-5
PBL Corporate Agreement Structure



1. Memorandum of Agreement - Corporations are encouraged to enter into a Memorandum of Agreement with their joint customers to support PBL approaches. The goal would be to have a single MOA with the commitment of all Services and Agencies that are customers for the products and services of that Corporation. This will require a corporate commitment to support this agreement from any division of their corporation, for any one or all products and services which may be candidates for PBL contracts. It likewise requires a commitment of the Services and Agencies to work together for the benefit of the joint warfighter. The Services should agree to provide the contractor with insight into maintenance and other logistics data they have available to help the contractor execute PBL efforts.

Sample MOA content is described in Attachment B-1 at the end of this Section. If a corporation has entered into such an agreement with any Service or Agency, the remaining Services and Agencies are encouraged to also sign this agreement should they wish to award PBL contracts to that corporation. This will be beneficial to the warfighter when pursuing an overall joint support strategy/solution.

> Note: These MOAs are envisioned to be similar in nature to those that the Defense Logistics Agency (DLA) has used successfully to support improved purchasing of spares [Strategic Supplier Alliance (SSA) Agreements and Strategic Sourcing Contracts (corporate contracts)]. Entering into an MOA does not guarantee award of any contracts or otherwise obligate the commitment of funds. Instead, it is intended to acknowledge the common goals shared between the parties to improve the sustainment of weapons systems for the benefit of the warfighter.

2. PBL Basic Agreement - One obligation of the MOA will be for the parties to enter into a Basic Agreement on terms and conditions for PBL contracts. The Basic Agreement (BA) is a contracting vehicle described in FAR 16.702. It does not guarantee award of any contracts or otherwise obligate the commitment of funds. It will include those core terms and conditions to be incorporated into any PBL contracts awarded to that corporation by any Service or Agency, on a sole source basis or after winning a competition.

The best starting point for a BA will be those terms and conditions for any already awarded PBL contracts between customers and the contractor. The BA should include sections for various contract types, including cost-plus and fixed-price contracts, and for commercial contracts if it is expected that some FAR Part 12 actions may be undertaken under this BA.

Parties are encouraged to add optional sections in the BA that provide guidance or templates for award fee or award term clauses, metrics and incentives, economic price adjustment clauses, common contract data requirements, etc. The real benefit in reducing procurement administrative lead-time is likely to arise more from these latter sections than the core terms and conditions.

Note: If a contractor, who has entered into a BA, wins a competition for a PBL contract, it is expected that the contract will be awarded under the terms and conditions of the BA, along with any special terms and conditions and unique contract requirements for that contract. Administration of the BA needs to be done jointly, although the Services are encouraged to select a Service agent to act on their behalf. Recommended content for a BA is presented in Attachment B-2 at the end of this Section.

The parties will review the BA at least annually, to incorporate any new required terms and conditions, as well as any applicable new PBL policies and lessons learned or best practices. Specific new FAR or DFAR clauses will be added as required.

3. PBL Contracts - PBL contracts are the third and final component of this approach. They will be no different than today, other than they will be awarded under the standard terms and conditions of the BA above. All subsequently awarded PBL contracts must be awarded under a BA, if it exists for the corporation, with any exceptions approved by the Component Acquisition Executive. The funding and administration of the PBL contract will continue to reside with the responsible, procuring Service or Agency.

Summary:

This is one more step in maturing the goal of provided Focused Logistics Support to the joint warfighter. It will increase the pace of PBL implementation, with attendant performance and Operating and Support (O&S) cost benefits.

Recommendations:

1. Policy guidance should be issued to promulgate the direction of implementation of Corporate Contracting for PBL.

    - OSD should issue guidance that the desired approach for PBLs (especially on cross service initiatives) target at least Stage 3 of the OSD PBL Maturity Model. OSD should include encouragement in this policy for the services to utilize existing Corporate Contracts that are at Stage 3 or Stage 4 rather than start from scratch.
    - Where use of existing contracts is not feasible or an overall strategy and high level commitment is required, that guidance and process be established for implementing the structured approach for PBL Corporate Contracting.

2. We recommend that there be a session(s) with senior executives from Government and industry to explain and gain acceptance in order to initiate and facilitate this process.

3. To support this new policy, we are asking DAU to establish or incorporate into an appropriate course education to aid program managers, logisticians, and contracting officers to adopt and implement these concepts and techniques.

4. We also encourage industry to join with DAU in providing personnel as trainers and as students, and to offer up examples of best practices they may be willing to share for the benefit of all.

5. We urge DOD and the Services to reconcile differing policies on the treatment of PBL – e.g., Supply vs. Services contract, use of Working Capital Funds, etc.

Attachment B-1
Sample Memorandum of Agreement Content

- Mirrors the SSA's DLA and others have implemented, and very similar to evolving USAF SSRM initiative
- Represents a joint commitment by the Services to partner and to provide the corporation access to their maintenance data and other relevant logistics data
- Captures "vision statement," high level goals (commander's intent), and signatures of leadership from Services/Agencies as well as the corporate leaders
- Creates top level support and executive oversight
- Becomes mechanism for continuous improvement and life cycle cost reduction, resolution of issues, and an enabler for communication
- Metrics for "time to contract"

Attachment B-2
Basic Agreement Outline

- Done as per FAR 16.702
  - Captures all mandatory FAR and DFAR terms and conditions as well as FAR Part 12 commercial terms and conditions, as applicable
  - Provides for both cost-plus and fixed-price efforts
  - Revisited at least annually, as per FAR 16.702, with updates for FAR/DFAR changes when required
- Also includes optional/recommended sections for:
  - Award fee/award term clauses
  - EPA clauses
  - Metrics and incentives
  - Common contract data requirements (CDRL/DID) such as reporting back to the Services to provide visibility across all efforts
- Signed by designated Service(s) & Corporate Contracting executive

Section C
Commercial Item Determination (FAR Part 12 & 15)

Issue:

Implementation of FAR Part 12 in PBL Contracting is not being executed uniformly in accordance with OSD policy.

OSD Position:

OSD's position on FAR Part 12 as the preferred contracting mechanism over Part 15 has been well-established and reaffirmed in the latest DODD 5000, chapter 5.3.1.10:

> *"Those purchasing Performance Based Logistics should follow the Federal Acquisition Regulation (FAR) and Defense Federal Acquisition Regulation Supplement (DFARS) guidance, as appropriate, for the acquisition of logistics services and support, and seek to utilize FAR Part 12- "Acquisition of Commercial Items" to acquire Performance Based Logistics as a commercial item. See USD(ATL) Memorandum, August 2004, "Performance Based Logistics: Purchasing Using Performance Based Criteria".* (See Attachment C-1)

The Study Team and Process:

The FAR 12 Study Team members were selected for their particular industry's experience with both commercial and military hardware and services or (for the DoD members) their experience with implementing FAR 12 in PBL contracts. Industry representatives from Parker Hannifin, BAE Systems, Boeing, Rolls Royce, Raytheon and Honeywell and Government representatives from NAVAIR, NAVICP and OSD participated.

Industry members polled their organizations for lessons learned and examples or comparisons of commercial to military contracting practices, particularly those that could lead to greater efficiency and lower total ownership cost for DoD. Additionally, all industry findings and relevant FAR Part 12 contracting experience was examined and analyzed by the collective government/industry team. Data was also collected and analyzed from the "pure" commercial (non-aerospace) marketplace. Market data findings from the survey can be found in a separate document that accompanies this white paper.

Background:

A key tenet of the acquisition reform initiatives undertaken by the DoD and Armed Services is the change in procedure and policy to utilize best commercial methods and practices. These methods and practices can lower costs and improve value received by the DoD, thus providing better sustainment of our aging military systems and controlling the overall cost of ownership.

The early literature carried definitions for support such as *Direct Vendor Delivery* and *Flexible Support* to categorize new ways of doing business. Many contracts in the 1990's were titled under these names to differentiate from traditional contracts. Given time and experience, the provision of commercial-type logistics support for military programs, including repair, overhaul, rotable pools, supply chain management, and others, has become institutionalized under the heading of *Performance- Based Logistics (PBL).*

OSD has identified five top-level goals for PBL:

- Operational Availability
- Operational Reliability
- Logistics Response Time
- Cost Per Unit of Usage
- Logistics Footprint

This document will consider all such commercial-type support for military use that address at least one of OSD's top five metrics as Performance Based Logistics.

By offering performance based logistics packages, contractors provide a support methodology that is a dramatic change from military business-as-usual. OSD's stated goal is to purchase an *end state of being* — availability of assets — rather than engage in a supply contract for fixed-price repair of a certain quantity of items. This brings a holistic approach to support — pay for value and incentivize performance throughout the supply chain.

From the buyer's perspective the overall objective of PBL and commercial contracting with FAR Part 12 terms should be to integrate best commercial practices and procedures into the military environment and reap the benefits of lower total ownership cost. A FAR 12 PBL program, with its commercial-type underpinnings, will provide improved availability, system reliability, and long-term assured logistics support to the user.

Discussion:

There is a world wide market for commercial aircraft Maintenance, Repair and Overhaul of about $35-40 billion annually. See following quote:

> "Wake-up call to a silent revolution?" by Manuel Magalhaes, EADS Programme Manager. "Two central concepts are emerging. First, adopting separate procurement approaches for large and smaller MRO programmes and for commodity and other low risk service provision. Second, MoDs want to adopt a through-life approach to programmes covering both aircraft acquisition and in-service support cost reductions. The global trend is fueled also in part by the need for MoDs cost reductions, lack of funding, political

> pressures to create more public private partnerships (PPP) between governmental and private companies as well as the increasing mobility of deployed forces all over the world. Outsourced maintenance ... seems to be changing from isolated Time & Material contracts to more integrated MRO services and solutions. In this respect the military client is becoming more inclined to follow the same path as many airlines have done and still do ... Assured Availability and Power by the Hour (PBTH)."

Commercial Support

To meet the test of "commerciality," the FAR 2.101 definition of a "commercial item" sets forth:

> "Commercial" means
>
> Any item, other than real property, that is of a type customarily used for non-governmental purposes and that has been sold, leased, or licensed to the general public, or, has been offered for sale, lease, or license to the general public.

For PBL programs, the CLIN (or "commercial item") is the program itself – delivery to demand with availability metrics – not a specific part number or group of part numbers. Justification of commerciality does not have to be made at the item level; it can be made at the repair process level or at the support concept level. So if a specific weapon system cannot be determined to be a commercial item, the commercial nature of the program supporting such a system can be determined to be the commercial item.

Cost Per Unit of Usage (CPUU):

A key aspect of PBL is the inclusion of a pricing arrangement to incentivize the contractor to reduce cost through increased reliability and at the same time continue to make a profit. One arrangement that has been in widespread use in the commercial aerospace sector is the Power-by-the-Hour (PBH) (® Rolls-Royce) or "*cost per flight hour*" (CPFH) concept. Many suppliers offer and provide CPFH programs to commercial airlines, thus selling to the general public. Under CPFH, an hourly rate is established by market price or price negotiation depending upon the mix of services provided. The typical supplier CPFH program includes repair/overhaul of repairables, along with replacement of failed components, in order to meet availability goals. Both the commercial CPFH as well as PBL programs require the contractor to implement material management processes, requirements forecasting, make/buy – subcontractor decisions, inventory management, and direct distribution to the demanding location. The contractor is paid in advance based upon the forecasted operational hours for the system. Actual hours are reconciled with projected hours and overages and shortfalls are either added to or credited from the next period's forecasted amounts. Since the contractor receives funding independent of failures he is incentivized to overhaul the asset the first time it fails so that it stays in operation as long as possible. Bottom line: under the PBH concept, the contactor touches a unit, the more money he makes. At

the same time, the operator is achieving a high level of dispatch and operational reliability at a known future cost.

Minor Modifications:

Further, FAR 2.101(c)(1) and (2) allows that minor modifications to the commercial item does not exempt that item from being considered commercial. Thus, the variation in specific terms and conditions of the individual program to suit the military requirements does not negate commerciality. Since CPFH programs are sold to the general public, PBL efforts qualify for contracting in accordance with FAR Part 12.

Commercial Services:

Excerpting in part from the *Commercial Item Handbook* (see Attachment C-2, Page 2):

> "In addition, the FAR definition of a "commercial item" also includes services. A service is considered a commercial item when it is provided in support of an item that meets the commercial item definition, or when the service itself is of a type offered and sold competitively in substantial quantities in the commercial market on the basis of established catalog or market prices for specific tasks performed under standard commercial terms and conditions. The latter, stand-alone definition does not preclude the inclusion of Government-unique requirements or terms and conditions, as long as there are sufficient "common characteristics" between the commercially available service and the service being acquired. Warehousing, garbage collection, and transportation of household goods are examples of services that are commercial. Other more sophisticated services (e.g., repair and overhaul work, research-related services, software design, testing, and engineering consultation) can also be commercial.
>
> "In order to meet the commercial item definition, the price for the stand-alone services must be "based on established catalog or market prices." The established market price for stand-alone services does not have to be published or written. Market research enables the Government to collect data from independent sources in order to substantiate the market price."

Aircraft component/system overhaul and logistics support are services of a type offered and sold competitively in substantial quantities in the commercial marketplace based on established catalog or market prices for specific tasks performed under standard commercial terms and conditions, for example:

- American Airlines, repair and supply of flight controls utilizing rotable pools.
- Trans States Airlines, repair and supply of flight controls utilizing rotable pools.
- Rolls Royce

- Turbofan engine maintenance is a competitive business, and Rolls-Royce offers flexible TCA (TotalCare Agreement) contracts, including a menu of other service activities to be performed by Rolls-Royce personnel. Rolls-Royce always seeks at least a firm 5-year term (and often a firm 10-year term) for their TCA's - *this position is consistent with our Defense Industry position that longer-term contracts are needed to induce the contractor to invest* with a contract timeline sufficient to realize an acceptable ROI (Return On Investment).

- Terms and conditions on Rolls-Royce TCA contracts are *similar to defense PBL contracts*, with unscheduled shop visit maintenance and condition-based shop visit maintenance always covered, and line maintenance parts replacement service available. Rolls-Royce has piloted taking on the responsibility for on-wing maintenance for engines with several operators and may move toward making this service a standard offering in the near future. Everything but FOD (foreign object damage), intentional misuse and abuse, and failure to follow the maintenance requirements in the Aircraft Maintenance Manuals with respect to the engines, is covered under Rolls-Royce's TCA coverage.

In the "pure" commercial (non-aerospace) marketplace, performance contracts are also commonplace. "Product-Services" have been in use by Commercial Industry for decades, are emerging as an "industry best practice" and the driver of a new business model that has the same goals as that of the PBL initiative. A few examples follow:

- Otis elevator has an OMMS (Otis Maintenance Management System) with REM (Remote Elevator Monitoring).
  - Elevator maintenance is a competitive business, and Otis offers flexible and extensible O&M (Operations & Maintenance) contracts, but a fact of interest to this study is that Otis always seeks at least a 5 year term for their O&M agreements - interesting to because *this position is consistent with the Defense Industry position that longer-term contracts are needed to induce the contractor to invest* with a contract timeline sufficient to realize an acceptable ROI (Return On Investment).

  - Terms and conditions on Otis O&M contracts are *similar to defense PBL contracts*, with unscheduled maintenance and their condition-based maintenance always covered, and general maintenance service (e.g., lubrication) available. Everything but intentional misuse and abuse is covered under Otis' O&M agreements.

  - Otis' pricing for their O&M contracts can be provided under FFP (Firm Fixed Price) conditions or under a "number of cycles" construct that is *completely analogous to one of OSD's Top 5 PBL metrics- a Cost Per Unit Of Usage arrangement*- although within DoD the usage more likely be "time on wing", "tread miles", "engine starts", etc.

- Twenty percent (20%) of all new capital goods are acquired by operating lease companies and they are aggressively contracting for product-services. Companies such as the following are paid for the use of the equipment that they provide not on the traditional basis of amortization, cost of capital and a profit rate, but on the basis of an output measure. Some examples are as follows:
    - Embrex - Poultry Egg Inoculation: number of eggs inoculated
    - HP - Large Format Printing: number of pages printed
    - FMC Tech - Juice Extraction: gallons of juice extracted
    - Hanover Compressor - Natural Gas Pipeline Compressors: cubic feet of gas transported

All contracts for the overhaul and logistics support described above are classified as firm-fixed price contract vehicles. The contractual price includes all required repair, overhaul, supply of parts or items, engineering services, technical services, or other services as appropriate to the need. It is important to differentiate that while logistics support may be billed either as a flat rate per month, or as rate per flight hour, they are not of the same type as *"services sold based on hourly rates"* as described in FAR 2.101.

"Services of a type":

Paragraph (6) of the FAR 2.101 definition of a commercial item describes a service that should be considered "commercial" as follows:

> *"(6) Services of a type offered and sold competitively in substantial quantities in the commercial marketplace based on established catalog or market prices for specific tasks to be performed under standard commercial terms and conditions…"*

The PBL support concept is comprised of the same features as CPFH programs in the private sector. Both efforts include repair/overhaul of repairables or replacement of assets at the contractor's option in order to meet availability goals. Both PBL and CPFH require the contractor to develop and implement material management processes such as inventory management, requirements forecasting to include repairable and consumable parts, procurement make-or-buy decisions and subcontractor selection, receiving and inventory management and the holding of inventory for distribution to field users as needed. On-site support for training and problem resolution is often also provided. Maintaining configuration control and data management for changes not impacting form, fit or function (Class II) is also common between the programs, thus enabling the contractor to make timely technology or reliability upgrades, including obsolescence, based upon the contractor's own affordability decisions.

Industry perspective of government benefits with contracting efficiencies of Commercial Contracting:

- The Boeing Company's KC-10 FAR 12 Contract
  - Streamlined proposal, funding and payment
  - Payment process by mutual agreement
  - Use of shared savings
- NAVICP / Honeywell Auxiliary Power Unit Total Logistics Support (TLS) contract
  - System support and availability, rather than specific part number or system, satisfies the commerciality definition
  - APU SOW activities are also performed by Honeywell in their Maintenance Service Agreements with the airlines; therefore it was concluded by the Navy that TLS is in fact a commercial item
- BAE Systems C-17 FAR 12 Contract
  - Digital Flight Controls Items "of a type", taken individually or as a group, customarily used for non-government use
  - Hardware containing same general characteristics used on commercial aircraft
  - Some items tailored for the C-17 have not been sold or offered for sale to the general public. Hardware "evolved from" items offered and sold to general public
  - C-17 benefits from streamlined contracting mechanisms and accelerated turnaround times of like-type civil hardware supported by BAE Systems
- BAE Systems T700 ECU *(Services of a type)*
  - Contract was initiated at the request of the USG Program Manager
  - Direct shipment of T700 ECU's (Electronic Control Unit) from User Command to BAE System's Ft. Wayne, IN. facility for Overhaul and Repair. Units are then returned to user upon completion
  - Pricing is based upon an agreed to pricing catalog. The incentive for BAE Systems is to beat the basic shop standards/rates to earn increased margins
  - User reduced their T700 ECU Inventory as BAE is repairing units in 21 Days or less versus the 60 to 90 day time to requisition a spare unit through the USG system
  - User is getting the same serial number unit back and receives a 1 year warranty with it. This was not available under previous government contracting as they never tracked a unit's performance history. Customers now know what their true MTBF is for each and every unit, and this assists maintenance scheduling and removal of Bad Actors (Rogue/Double Bouncer Units)

Value Stream Mapping of FAR 15 Military Repair and a physically identical commercial item:

BAE Systems manufactures and supports a number of items that are flown on both military and commercial aircraft. BAE Systems' Fort Wayne facility recently concluded a Lean Principles / Six Sigma event to compare military item support times to like-item commercial support times, and the Value Stream Mapping exercise concluded that the military items were taking from 28% to more than 600% longer than physically-identical commercial items, and that the wasted time ("*muda*" in "Lean" parlance) was almost entirely in FAR 15 Imposed Contract Queue Times. See Table C-1 below:

Table C-1
Comparison of Commercial to Military Throughput

		Commercial	Military	
Step		*Days In Process (Typical)*		Comments
0	*Arrival*	0	0	
1	*Receiving*	1	1 to 7	For military orders lot size can vary and require full assessment for contract assignment before release to next step.
2.1	*Order Review/Entry*	1	1	Parallel tasks - total process 1 day
2.2	*Creation of WIP Job*			
3	*Incoming Inspection*	2	2 to 5	For military orders lot size can vary which drives allocation to contract.
4	*Incoming Test*	1	1	
5	*Test Results/Warranty Review*	2	2	
6	*Repair and Modification*	5	5	
7	*Re-test/Engineering Evaluation*	1	1	
8	*Final Test*	3	3	
9	*Final Review/Inspection*	2	3	Notification for Gov't inspection required
10.1	*Pricing*	2	7 to 120	For commercial units catalogue pricing applies; Even with catalog pricing, military units require customer feedback, contract modification and CLIN adjustment
10.2	*Shipment Notification*			
11	*Invoice*	1	1	Shipment is not considered as part of turnaround time
	Total Turnaround Time	**21**	**27 to 130**	**Process capability for military orders is 27 days but is not typical based upon pricing constraints.**

Other benefits of FAR Part 12:

- Improved benefit of synergy between production and support
  - Government usually divides this responsibility and funding, and often loses the benefit of this synergy
- Customer may be able to leverage from existing worldwide support organization, such as warehouses, repair facilities, field reps, etc., vs. setting up unique infrastructure

- Maintain FAA certification and utilize that commercial infrastructure - e.g., certified repair facilities, mechanics, inspectors, etc. Also follow Service Alerts and other bulletins.
- Able to utilize global commercial aviation MRO marketplace
- Better utilization of entire supply chain, since it includes both commercial & military
- Achieve higher utilization rates (airline type levels of performance)

The spirit and intent of FAR Part 12 is to encourage the Government to evolve toward commercial practices and processes by allowing contractors the flexibility to implement these practices and processes in the execution of DoD contracts. If the improvements and savings that are to be achieved will be more likely to accrue if the contractor is allowed, under Government oversight, to implement the efficient practices already in place in the private sector. These efficiencies and cost savings will ultimately yield improved readiness, which is DoD's primary objective.

Recommendations:

1. Incorporating "Predetermination of Commerciality" within the BA (Basic Agreement) discussed in Section B above could be a valuable way to pull this often lengthy and sometimes contentious activity ahead of the discussions for individual PBLs. Predetermination of commerciality for a corporation's products and processes or services (based on existing catalogs, previous determinations (precedents), etc. would be a powerful tool for the acquirers and industry.

    - Streamlines subsequent PBL initiatives
    - Should satisfy commerciality and "fair and reasonable" once, instead of repeating the process over and over
    - Changes to catalog prices, status, or services would be updated by exception or on a periodic basis (e.g., annually)

2. Update the Commercial Item Determination Handbook to define Performance-Based Logistics as a commercial item. The test for a particular offering would be to show that it satisfies the requirements of the PBL definition and satisfies one or more of the performance requirements for contracting for PBL: (1) Operational Availability, (2) Operational Readiness, (3) Cost Per Unit of Usage, (4) Logistics Footprint and (5) Logistics Response Time. [Note: A cost-type performance contract would necessarily have to be performed under FAR Part 15 requirements.]

3. DAU should incorporate into an appropriate course education to aid program managers, logisticians, and contracting officers to adopt and implement these concepts and techniques.

4. Have DAU become the repository of market survey information to facilitate the sharing of data as part of the Community of Practice (COP) forums. [A compilation of the market survey data developed in this study effort will be provided in a separate document.]

Attachment C-1
USD(ATL) Memorandum, August 2004, "Performance Based Logistics: Purchasing Using Performance Based Criteria"

ACQUISITION, TECHNOLOGY AND LOGISTICS

THE UNDER SECRETARY OF DEFENSE

3010 DEFENSE PENTAGON
WASHINGTON, DC 20301-3010

AUG 16 2004

MEMORANDUM FOR SECRETARIES OF THE MILITARY DEPARTMENTS

SUBJECT: Performance Based Logistics: Purchasing Using Performance Based Criteria

The Deputy Secretary of Defense memorandum of February 4, 2004, "Implementation of the Defense Business Practice Implementation Board (DBB) Recommendation to the Senior Executive Council (SEC) on Continued Progress on Performance Based Logistics", directed that my office issue clear guidance on purchasing weapon system logistics support using performance-based criteria. That guidance follows.

DoD 5000.1, the Defense Acquisition System, requires program managers to develop and implement performance based logistics (PBL) strategies that optimize total system availability while minimizing cost and logistics footprint. PBL strategies may be applied at the system, subsystem, or major assembly level depending upon program unique circumstances and appropriate business case analysis. PBL arrangements will be constructed to truly purchase performance, as detailed in this memorandum.

Those purchasing PBL should follow Federal Acquisition Regulation (FAR) and Defense Federal Acquisition Regulation Supplement (DFARS) guidance, as appropriate, for the acquisition of logistics services and support and should seek to utilize FAR Part 12 – "Acquisition of Commercial Items" to acquire PBL as a commercial item. Additional information regarding PBL implementation is included in the DoD Interim Defense Acquisition Guidebook.

For PBL, "performance" is defined in terms of military objectives, using the following criteria:

(1) Operational Availability. The percent of time that a weapon system is available for a mission or ability to sustain operations tempo.

(2) Operational Reliability. The measure of a weapon system in meeting mission success objectives (percent of objectives met, by weapon system). Depending on the weapon system, a mission objective would be a sortie, tour, launch, destination reached, capability, etc.

(3) Cost Per Unit Usage. The total operating costs divided by the appropriate unit of measurement for a given weapon system. Depending on weapon system, the measurement unit could be flight hour, steaming hour, launch, mile driven, etc.

(4) Logistics Footprint. The government / contractor size or "presence" of logistics support required to deploy, sustain, and move a weapon system. Measurable elements include inventory / equipment, personnel, facilities, transportation assets, and real estate.

(5) Logistics Response Time. This is the period of time from logistics demand signal sent to satisfaction of that logistics demand. "Logistics Demand" refers to systems, components, or resources, including labor, required for weapon system logistics support.

PBL metrics should support these desired outcomes. Performance measures will be tailored by the Military Departments to reflect, specific Service definitions and the unique circumstances of the PBL arrangements.

The preferred PBL contracting approach is the use of long-term contracts with incentives tied to performance. Award term contracts should be used where possible to incentivize optimal industry support. Incentives should be tied to metrics tailored by the Military Departments to reflect their specific definitions and reporting processes. Award and incentive contracts shall include tailored cost reporting to enable appropriate contract management and to facilitate future cost estimating and price analysis. PBL contracts must include a definition of metrics and should be constructed to provide industry with a firm period of performance. Wherever possible, PBL contracts should be fixed price (e.g., fixed price per operating or system operating hour). Lack of data on systems performance or maintenance costs, or other pricing risk factors may necessitate cost type contracts for some early stage PBLs. Full access to DoD demand data will be incorporated into all PBL contracts. PBL contracts should be competitively sourced wherever possible and should make maximum use of small and disadvantaged sources. PBL contractors should be encouraged to use small and disadvantaged businesses as subcontractors, and may be incentivized to do so through PBL contractual incentives tied to small and disadvantaged business subcontracting goals.

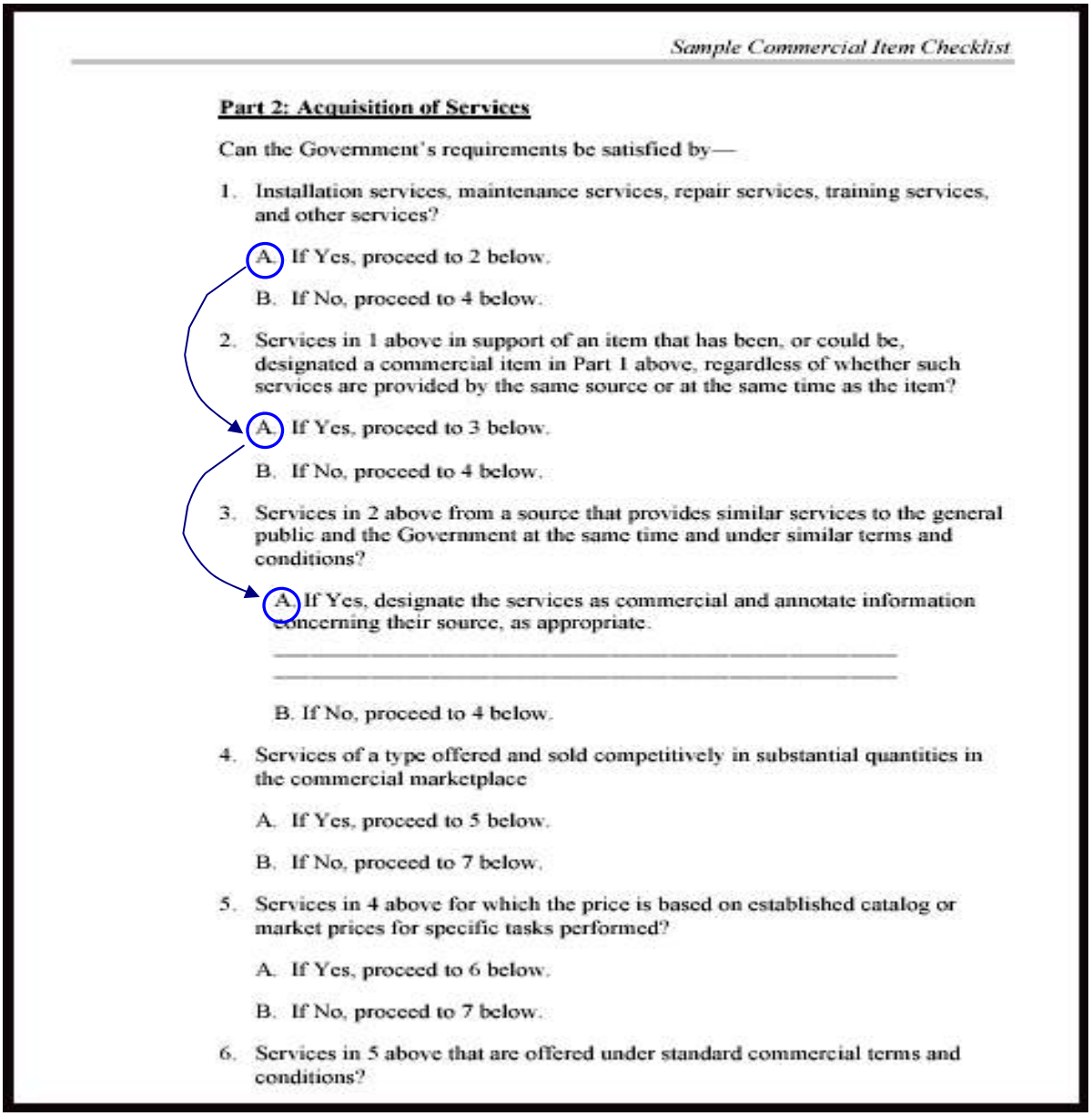
The Defense Acquisition University (DAU) website (www.dau.mil) provides courses in performance based service acquisition and PBL as well as PBL "lessons learned." Maximizing use of these DAU resources will increase our ability to support the warfighter.

This guidance is effective immediately and will be incorporated into the Defense Acquisition Guidebook.

Michael W. Wynne
Acting

Attachment C-2
Checklist for Commercial Services

(Extract from Commercial Item Determination Handbook)



Sample Commercial Item Checklist

Part 2: Acquisition of Services

Can the Government's requirements be satisfied by—

1. Installation services, maintenance services, repair services, training services, and other services?

   A. If Yes, proceed to 2 below.

   B. If No, proceed to 4 below.

2. Services in 1 above in support of an item that has been, or could be, designated a commercial item in Part 1 above, regardless of whether such services are provided by the same source or at the same time as the item?

   A. If Yes, proceed to 3 below.

   B. If No, proceed to 4 below.

3. Services in 2 above from a source that provides similar services to the general public and the Government at the same time and under similar terms and conditions?

   A. If Yes, designate the services as commercial and annotate information concerning their source, as appropriate.

   _____

   _____

   B. If No, proceed to 4 below.

4. Services of a type offered and sold competitively in substantial quantities in the commercial marketplace

   A. If Yes, proceed to 5 below.

   B. If No, proceed to 7 below.

5. Services in 4 above for which the price is based on established catalog or market prices for specific tasks performed?

   A. If Yes, proceed to 6 below.

   B. If No, proceed to 7 below.

6. Services in 5 above that are offered under standard commercial terms and conditions?

Attachment C-3
Commercial Item Definition Discussion

(Extract from Commercial Item Determination Handbook)

Appendix C
Commercial Item Definition Discussion

As a follow-up to the definition of "commercial item" set forth in Appendix B, the discussion below walks through this definition to discuss its subtleties.

Generally speaking, a commercial item is any item that is *of a type* that has been sold, leased, or licensed or even merely offered for sale, lease, or license to the general public. Several indicators of this are the existence of a commercial sales history, listings in catalogs or brochures, known established price, existence of multiple distributors, and availability or announcement to the general public.

The phrase "of a type" is not intended to allow the use of Federal Acquisition Regulation (FAR) Part 12 to acquire sole-source, military-unique items that are not closely related to items already in the marketplace. Rather, "of a type" broadens the commercial item definition so that qualifying items do not have to be identical to those in the commercial marketplace. The best-value offer in a competitive Part 12 solicitation can be for an item that has previously satisfied the Government's need but has not yet been sold, leased, licensed or offered for sale, lease, or license to the general public (e.g., a nondevelopmental item). In this scenario, the phrase "of a type" allows the best value offer to qualify for a Part 12 contract as long as the items offered are sufficiently like similar items that meet the Government's requirement and are sold, leased, licensed, or offered for sale, lease, or license to the general public. In such instances, "of a type" broadens the statutory commercial definition to allow Part 12 acquisition of a Government-unique item that can compete with commercial items that meet the Government's requirement. This avoids the undesirable result of preventing otherwise price-competitive preexisting suppliers of Government-unique items from responding to Part 12 solicitations.

Also included in the commercial item definition is any item that evolved from a commercial item as described above, through technical/performance advances—even if the item is not yet available in the commercial marketplace, as long as it will be available in time to satisfy the Government's requirements. Commercial items that evolve as a result of advances in technology or performance include product updates, model changes, and product improvements. For example, new versions of software fall into this category. Through this aspect of the "commercial item" definition, the Government can access new technology first.

A commercial item does not have to be "off-the-shelf" to be classified as commercial; items that require only modifications of a type customarily available in the commercial marketplace or minor Government-unique modifications still are considered commercial items. Thus, two types of modifications are available: (1) modifications of a type available in the commercial marketplace; and (2) minor modifications of a type not customarily available in the commercial marketplace, made to Federal Government requirements. For modifications of a type available in the commercial marketplace, the size or extent of the modifications is unimportant. For minor modifications, the item needs to retain a predominance of nongovernmental functions or

Section D
Price Reasonableness

Issue:

It is imperative that a PBL program be provided at a fair and reasonable price to the buyer. There is reluctance by contracting officers to utilize FAR Part 12 due to a bias for the traditional basis of negotiation using cost and pricing data under FAR Part 15. Also, the existence and past use of "Weighted Guidelines" contributes to the misperception of what is a reasonable profit for a PBL arrangement.

Discussion:

Fair and Reasonable Price:

PBL suppliers must realize their fiduciary responsibility to openly provide suitable and adequate data to substantiate the value offered. However, traditional negotiation based upon cost and pricing data cannot be employed when contracting under FAR Part 12. If PBL support meets the criteria of commerciality as set forth in FAR Part 12; therefore, certified cost and pricing data are not required. However, the contractor must provide adequate "information other than cost or pricing data" to allow determination of fair and reasonable price as well as value to be received. The price for a PBL program is typically developed using logistic and life-cycle cost models ─ not historical cost accounting data. Consequently, all data review and negotiation must be price-based upon the portfolio of service elements proposed. Elements not considered under traditional contracting include: risk being assumed by the seller, carrying costs for inventory required to meet program metrics, opportunity cost, and the assumption of responsibility for obsolescence management and technology refreshment. These are key to a successful program, but can only be estimated.

Three additional elements are interconnected to the fair and reasonable determination. First, a PBL program is for a complete support package, or *"end state of being"* ─ not any specific quantity or billable hours. Thus, individual cost elements cannot be estimated against buyer proposal data. Secondly, activities connected with the repair and supply of items are estimated by predictive modeling techniques, and may or may not become realized during the execution of the program. This again precludes cost data analysis for a specific quantity, since the contractor must provide a quantity whose sum is unknown until the end of the program. Third, if actual historical data is not available (as in a weapon system less than three years old,) predictive modeling is employed to estimate the activities required to provide a desired "state of being."

Market Data

In some cases, the contractor will have commercial products and programs that are comparable and adequate for substantiating pricing for a particular PBL. There may also be publicly accessible information of commercially available, sometimes

competitive, performance-based offerings that a market survey will reveal that can be used to validate price reasonableness.

Business Case Analysis

An additional tool to be employed in these price-and-value-based determinations, the business case analysis technique can bridge the gap from cost for work to be done to the price for value received. These analyses can help to delineate, quantitatively and qualitatively, the necessary linkage from the seller's offered value of the integrated capability to be provided to the buyer's expected spend for traditional individual elements of repair and spare packages and associated infrastructure costs, including working capital fund surcharges.

While the format and content of a BCA has not been specified in policy, several suggested models are available from commercial sources as well as Defense Acquisition University. Early in the process of developing a PBL offering, both buyer and seller should decide on elements that will be of significance and evaluated within a BCA. Also, it is typical for the seller to develop a BCA representing business-as-usual, and a BCA representing the PBL offering, to ensure the buyer both understands the content of the PBL and desires all the elements contained within the PBL offering.

In summation, the buyer can use the BCA to assist in determining fair and reasonable prices based upon (a) the value of support services offered, and (b) the value of "traditional" costs that will be reduced, or avoided, during the execution of a PBL support program. It is a better evaluation of best value per dollar spent.

Other than Cost and Pricing Data

It may be necessary to examine historical costs and other data that was used to construct the PBL offering in order to provide insight and understanding into the value being provided. The buyer needs to be able to justify a fair and reasonable price. Other than cost and pricing data should be provided by the contractor. The Government and industry need to share the relevant data that is used to construct a proposal.

Attachment D-1 provides a summary of the type of information that could be considered in constructing and evaluating a PBL proposal.

Weighted Guidelines

Under a PBL arrangement, risk formerly assumed by the Government is transferred to the contractor. Buyers have been trained and ingrained with perceptions of reasonable profit as a result of working in the traditional transaction-based environment, such as ordering spares or repairs, where risk is lower and the assets employed by the contractor are lower than a typical PBL, where the contractor may actually carry an inventory of spares and repair parts. Furthermore, the contractor bears the risk of forecasting demand, obsolescence of the inventory if not used promptly, damage,

losses, etc. The PBL environment should allow the contractor to receive higher profits as a reward for reducing cost to the Government by improving cycle times, reliability, availability and support processes.

Recommendations:

1. Contracting officers need to be trained in the techniques of price-based best value contracting and to use "Other than Cost and Pricing Data" to make a price reasonableness determination.

2. The concept of "Weighted Guidelines" and profit needs to be reevaluated in light of the new PBL environment that necessitates a different approach.

3. DAU should incorporate into an appropriate course education to aid program managers, logisticians, and contracting officers to adopt and implement these concepts and techniques.

4. Contractors need to provide appropriate "Other than Cost and Pricing Data" as a part of the price reasonableness process. Having buyers trained and comfortable with this data for determining reasonableness and Alpha contracting-type IPTs with sharing of data on both sides will facilitate movement to the new environment.

Attachment D-1
Sample PBL Proposal Information & Format

Program Management

Functions / responsibilities

Logistics

Warehouse - price associated with adding new product lines such as additional warehouse space

Warehouse size

Number of personnel, if any, to support new product lines and description of tasks associated with new bodies

Price for outbound transportation

Competitive 3PL quotes

Website

Repair

Level of Repair - overhaul vs. IRAN

Consolidated BOM with top cost drivers

Labor (by NIIN) - unit material

Material (by NIIN) - unit labor

BOM sample - in descending dollar value order and source of estimate - vendor quote, FEDLOG

CSI / CAI costs - recurring and non-recurring % of DLA material / % of CSI vendors

PEB - depot allocates % of total PEB to each product line, e.g., % of hours attributed to fuel control product line, so % of total PEB

Cost allocated to this effort

Engineering

Price associated with reliability improvement / obsolescence management

Description of reliability improvements and percentage increase associated with the reliability improvements

Time associated for reliability improvements to be accomplished – phased in over 4-5 years

Technical Publications

Price to update and distribute

The following needs to be broken out by Government Fiscal Year:

The total dollars for each year of the contract for purposes of evaluating cash flow

The projected number of demands for each year of the contract

The "number" associated with reliability improvements for each year of the contract ("number" equates to Mean Flight Hours Between Removal) or whatever metric we agree to use

Additional Information

Commercial item justification

Commercial item pricing, if any (PBFH, etc.)

Differences between military vs. commercial item prices

Listing of DLA items

Maintenance level and maintenance plan assumptions

Inflation index - O&MNLF

DCMA / ACO - certification / representations from DCMA for accounting and cost systems, recent audit reviews of overhead rates

Section E

PBL - Supply or Service Contract?

Issue:

Currently the Services differ in interpretation of whether a PBL contract is fundamentally a supply or service contract. This will need to be reconciled for a number of reasons, including how the Basic Agreement and PBL contracts placed under the BA shall be structured, applicability of the Service Contract Act, funding and accountability for funds such as working capital, etc.

Discussion:

PBL programs are comprised of the same key tenets as the CPFH programs as negotiated in the private sector. The efforts both include repair / overhaul of repairables or replacement of assets at the contractor's option in order to meet availability goals (SMA). Both CPFH and PBL require the contractor(s) develop and implement material management processes, such as inventory management, requirements forecasting to include repairable and consumable parts, procurement make-or buy decisions and subcontractor selection, receiving and inventory management and the holding of inventory for distribution to field users as needed. Maintaining configuration control for changes not impacting from, fit or function (Class II) is also common between the programs, thus enabling the contractor to make timely technology upgrades based on their own internal affordability decisions.

In reviewing the FAR guidelines pertaining to commerciality, the definition of a "commercial item" as set forth in FAR 2.101 is as follows:

> "Commercial" means
> (a) Any item, other than real property, that is of a type customarily used for non-governmental purposes and that
> 1) Has been sold, leased or licensed to the general public, or,
> 2) Has been offered for sale, lease, or licensed to the general public.

Under specific PBL programs being contemplated as commercial, the line item or the "commercial item" is the program itself, i.e., system support and availability, rather than the specific part number or system designation. Therefore, since CPFH programs are sold to the general public, the definition is met and the effort qualifies for contracting in accordance with FAR Part 12. Additional, FAR 2.101(c)(1) and (2) allow that minor modifications to the commercial item does not exempt that item from being considered commercial. This is significant in that it will allow the Government some flexibility in negotiating slight variation to the specific terms and conditions of individual programs to best suit the military environment.

It should be noted that paragraph (f) of FAR Part 2.101 addresses commercial <u>services</u> and excludes "...services that are sold based on hourly rates without an established

catalog or market price for a specific service performed." PBL is a method of contracting for an output "…that is of a type customarily used for non-governmental purposes…" not a service, per se. It has been NAVICP's legal position that its repair of repairable contracts are not considered services, but rather are supply contracts. The repair efforts more closely resemble a remanufacture or overhaul program and as such are subject to the provisions of the Walsh-Healy Act rather than the Service Contract Act. PBL further expands upon that distinction in that it also requires the contractor to provide replacement spares in addition to overhauling and remanufacturing. As a result, paragraph (f) is not deemed applicable to this effort.

Summary:

A service contract requires a certain level of effort to be reached and does not guarantee an outcome. It guarantees a particular number of man-hours will be expended. It also limits the contractor's ability to make trade-offs within the funding profile allotted to provide the outcome as the contractor is forced to accumulate and track costs associated with the required level of effort associated with the various Service Contract Act requirements.

The result of a PBL arrangement is the availability of an asset, and that it requires assets (such as spares) as well as repairs, inventory tracking systems, professional services such as engineering for obsolescence management and reliability improvements, etc. to achieve this availability. The PBL requires and outcome-delivery of an end item to the war fighter and measures the performance of the contractor in meeting the desired outcome. Generally, the courts have held that these types of acquisitions and activities lay outside the Service Contract Act and are governed instead by Walsh-Healy. Specifically, aircraft engine repair and overhaul is not subject to the SCA.

Recommendation:

In concert with DPAP and the DoD General Counsel, USD-AT&L is urged to provide guidance to the Services on the proper classification of PBL contracts. PBL is a method of buying an outcome that results in hardware; therefore, it is a supply contract and not a service contract.

Section F
Appropriations / Budget Categories (Color of Money)

Issue:

Referring to Figures B-1 and B-2 shown in Section B, PBL contracts inherently involve some or all logistics functions, including purchasing of spares and repairs, overhaul and maintenance, updating tech manuals, training, and other required support. The more of these functions that can be integrated, the more likely the PBL effort will be cost-effective compared to the stove-piped way many of these are funded, budgeted and implemented today. In some cases, these stovepipes have lead to companies receiving two contracts from different buying commands, each with different funding for separate but interrelated aspects of the PBL. At a minimum, PBL contracts normally have many CLINs and ACRNs to reflect different funding sources. Funding cannot be readily shifted to the area of need to provide optimal support. Payment and accounting for funds becomes nightmarishly difficult.

Discussion:

The Deputy Secretary of Defense approved MID 917 to pilot using a single budget element, and therefore source of funding, for PBL on six selected programs. Initial reviews of the impact on these programs for this streamlining pilot have been impressive.

Also, PBL could be considered a "Nonseverable deliverable", i.e., in the case of F/A-18 FIRST where the Government is buying availability, re: (Part 204.7101) **" Nonseverable deliverable, as used in this subpart, means a deliverable item that is a single end product or undertaking, entire in nature, that cannot be feasibly subdivided into discrete elements or phases without losing its identity."** See Attachment F-1 below for additional information from the DFARS Part 204.

The key to this definition is anchored in the "feasibility" of subdividing - causing a loss of discrete deliverable identity. The deliverable is a performance outcome - a level of operational performance. The contract is not buying maintenance, supplies, engineering, infrastructure, etc., but rather the composite of all these elements, when fully integrated become the enabler for performance (the product purchased) at the specified (metric) level.

It would certainly appear not feasible to attempt to break this down and thereby lose the ability to buy performance at its optimum level. Buy buying piecemeal resources to support the true end product; the optimum application of resources by level and sequence of appropriateness to achieve this end product is restricted.

Recommendations:

1. Implement MID 917 as DoD policy for all PBL programs.

2. PBL possibly meets the definition of a “Nonseverable deliverable”; therefore guidance for budgeting for PBL could recognize this provision in DFARS 204. DoD should evaluate the feasibility of applying this provision to PBL. Industry could participate in the evaluation by providing supporting rationale / examples of how the subdividing of a PBL contract (e.g., FIRST) would not be feasible and the negative impact of forcing subdivision would have on mission support and cost.

3. Working Capital Funds should be viable candidate for funding PBL efforts. Currently some Services do so while others do not; although, it does not appear there are any DOD Financial Management regulations that would prohibit this.

Attachment F-1
Extract from DFARS 204, Nonseverable Deliverable

204.7101 Definitions.

"Nonseverable deliverable," as used in this subpart, means a deliverable item that is a single end product or undertaking, entire in nature, that cannot be feasibly subdivided into discrete elements or phases without losing its identity.

204.7103-1 Criteria for establishing.

(4) *Single accounting classification citation*.

(i) Each contract line item shall reference a single accounting classification citation except as provided in paragraph (a)(4)(ii) of this subsection.

(ii) The use of multiple accounting classification citations for a contract line item is authorized in the following situations:

(A) A single, nonseverable deliverable to be paid for with R&D or other funds properly incrementally obligated over several fiscal years in accordance with DoD policy;

(B) A single, nonseverable deliverable to be paid for with different authorizations or appropriations, such as in the acquisition of a satellite or the modification of production tooling used to produce items being acquired by several activities; or

(C) A modification to an existing contract line item for a nonseverable deliverable that results in the delivery of a modified item(s) where the item(s) and modification are to be paid for with different accounting classification citations.

(iii) When the use of multiple accounting classification citations is authorized for a single contract line item, establish informational subline items for each accounting classification citation in accordance with 204.7104-1(a).

Section G
Implementation

Issue:

The Department of Defense is a large complex organization as are many of the entities with which it acquires its systems and support. There is a tradition of business process methodologies that have been in existence for many years that have shaped organizational structure; how people are trained and evaluated; how money is budgeted, allocated and spent, etc. As we have migrated from the traditional cost-based transactional business environment to the Performance-base Business Environment as it applies to logistics, product support and sustainment, many changes have to yet to take place.

Discussion:

This white paper has proposed several recommendations to facilitate the acceleration of PBL implementation. In order to facilitate the implementation of these recommendations, there is a need for a single focus for contracting and implementation of PBL Corporate Contracts.

- Will ensure consistent implementation of OSD PBL policy
- Will facilitate cross service use of PBL Corporate Contracts
- Will facilitate Maturity Level Stage 3 or Stage 4 PBLs for Corporate Contracts (Individual services contracting for the same or similar systems may target different Stages of PBL maturity.)
- Will facilitate more standardized and favorable Terms and Conditions for the Government in PBL Corporate Contracts

There are several bodies that can help promote the concepts put forth, but a single focal point is need to coordinate this effort.. High level OSD and service logistics executives participate in forums such as the Total Life Cycle Systems Management (TLSCM) Board, Defense Logistics Board (DLB), Joint Logistics Commanders (JLC), Joint Aeronautical Logistics Commanders (JALC) Group, JCS Functional Capabilities Board – Focused Logistics, etc. As mentioned in the overview in Section A, several services and agencies are implementing supply chain management initiatives to establish strategic relationships with key suppliers.

The major logistics commands such as AFMC, AMC, NAVSUP, NAVAIR, DLA, TRANSCOM need to be involved. Industry associations can also play a role. And, the education and training entities such as DAU can help to intuitionalize the changes that are needed.

The BRAC recommendation that moves select Inventory Control Point functions (Budget/Funding, Contracting, Cataloging, Requisition Processing, Customer Services, Item Management, Stock Control, Weapon System Secondary Item Support,

Requirements Determination, and Integrated Materiel Management Technical Support) to DLA could help in facilitating PBL corporate contracts in a consistent approach.

Recommendations:

1. OSD should be the single focal point for PBL Corporate Contracts. If OSD can implement the standardized guidelines/policies, the award of PBL contracts would be streamlined and it would allow for more intra-service contracting. The increased efficiencies will allow a lead-time reduction on PBLs on a go forward basis.

2. We recommend that there be a session(s) with senior executives from Government and industry to explain and gain acceptance in order to initiate and facilitate this process.

3. To support implementation of these changes, DAU should establish or incorporate into an appropriate course education to aid program managers, logisticians, and contracting officers to adopt and implement these concepts and techniques.

Appendices

Appendix 1
PBL Corporate Contracting Working Group Charter
December 11, 2004

Name of Group: PBL Corporate Contracting Working Group

Authority: This working group is chartered by the DUSD (L&MR) Logistics Plans & Programs.

Chaired by: The working group will be co-chaired by a representative from Government selected by the DUSD (L&MR) Logistics Plans & Programs and a representative from the Aerospace Industries Association Product Support Committee.

Membership: The PBL Corporate Contracting Working Group will be composed of representatives from the Military Departments and industry who are knowledgeable of PBL and the issues relating to the effective implementation of single contracts that can cross and be used by sectors/groups/divisions of corporations and/or entities within agencies/departments of DoD.

Goal: To develop a set of recommendations for accelerating the implementation of PBL through the use of corporate contracting. The end-state is one DoD contract per company that is utilized by all DoD services and agencies that need to contract with that company (consistency across the company and across DoD). An interim end-state will be the assessment of potential for initial multiple (i.e., by major OEM commodity lines) corporate contracts as either prototype efforts or initial implementation steps leading towards a single, all-encompassing corporate contract per company as the ultimate end-state.

The working group will make recommendations regarding:

- Establishing standard definitions (e.g., commerciality) and application of rules
- Common approaches to contracting across large organizations (both industry and government)
- Small Business participation
- Appropriate application of FAR Part 12 or FAR Part 15 in contracting for PBL
- Methodologies for implementing the Working Group's recommendations

Problem Statement: Despite the success of programs where PBL has been utilized to contract for results instead of parts/repairs, it is recognized that the rate of implementation needs to be accelerated to reap the benefits on a larger scale across

DoD. Currently, it is very difficult and time consuming to establish a PBL contract. The difficulties include:

- Organizational structure – both industry and government
- NIH (not invented here mentality)
- Where is the decision authority? - both on industry and government side there are typically many participants and no clear lines of approval authority
- Inconsistent interpretation of rules and guidance
- Fear of making errors and audits (GAO, IG, etc.)

Duration: The period for existence of the PBL Corporate Contracting Working Group is not to exceed eight months.

Activities / Tasks: The Working Group will perform the following activities/tasks:

- Conduct a survey of existing PBL and corporate contracts
- Identify impediments, motivators and best practices
- Develop a set of recommendations

Deliverables: The Working Group will provide the following:

- A White Paper that describes the issues and provides recommendations for accelerating the implementation of PBL through corporate contracting and FAR Part 12 contracting (this may be a phased recommendation – steps over time)
- A briefing that DUSD (L&MR) Logistics Plans & Programs can present as a senior executive Road Show for the Admiral / General / SES / CEO / VP levels
- A targeted training presentation that can be presented to working level contracting personnel in each of the Services relating to a practical implementation of corporate contracts. (Not a DAU course, but rather a PowerPoint Road Show presentation.)

Appendix 2
Acknowledgments

We would like to express appreciation to the following individuals for their involvement to the meetings, briefings, data collection, discussions, writing, etc. that led to the creation of this study. Considerable time and effort was contributed by several of the participants.

The recommendations that are presented in this report may not reflect the opinions or approval of the Government participants or the organizations that they represent.

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