DoD Service Contracting Cuts Lower Than Feared

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After much confusion and distress over Secretary Gates' plans to cut service contract spending, it looks like the impact will be less than what was initially feared. Back in August, Defense Secretary Gates sent shockwaves through the contracting community when he **announced plans** to cut service contractor spending by 10% over the next 3 years as part of strategy to cut $100B in defense spending in 5 years. The main questions contractors have been pondering are, "What kind of service contracts?" and "How much money is that 10%?"

While federal contractors were trying to understand the types of contracts that would be impacted, the Undersecretary of Defense for Acquisition, Technology and Logistics (USD ATL) Ashton Carter released a guidance document in September entitled, **"Obtaining Greater Efficiency and Productivity in Defense Spending."** One of its major themes was "Improving Tradecraft in Services Acquisitions". In this document, Carter pointed to $200 billion in services contract spending that must be reined in.

On December 21, Deltek participated in a meeting conducted by Deputy Secretary of Defense, William Lynn and including Virginia Congressional delegation members and representatives from the Professional Services Council (PSC) and the Northern Virginia Technology Council (NVTC). Deltek's **Clarity Advisor report** provides details of this meeting, but the bottom line is that, based on a data call to DoD components to determine the extent of support service contracts (particularly those that provide staff augmentation), Lynn estimates that the spending cut applies to $4.3 billion out of a reported $143 billion (rather than $200 million) in total services contracts for FY2009. Although contractors holding those targeted contracts have some reason to worry, 10% of $4.3 billion is a lot less worrisome than the $14.3 billion originally feared.

While this 10% spending cut is pretty straight forward, there are other factors at play that stand to significantly impact all services contracts to some degree. Carter's initiatives under the "Improving Tradecraft in Services Acquisitions "address a few primary problems:

- **Lack of a common taxonomy of service types** - all DoD components must begin to use a common taxonomy across all of DoD's PSC-based portfolios: knowledge-based services, electronics and communications services, equipment-related services, medical services, facility-related services, and transportation services.
- **Lack of standardization in requirements for service contracts** – components must maximize use of standard Performance Work Statement (PWS) templates and create market research teams to increase understanding of industry capabilities and pricing.
- **Not enough frequency in competition for knowledge-based services** - components must review length of services contracts before recomplete to establish strategies to enhance competition by conducting more frequent re-competes for knowledge-based services.
- **Contracts types used** – components must develop preference for Cost-Plus-Fixed-Fee (CPFF) or Cost-Plus-Incentive-Fee (CPIF) contracts to be used when competition or pricing history is limited.
- **Lack of productivity and cost efficiency provisions** - USD ATL will require that services contracts in excess of $1 billion contain productivity and cost efficiency provisions.
- **Lower-than-desired small business participation in service contracts** - OSD Office of Small Business Programs will review services acquisition plans for procurements over $1 billion to identify suitable tasks for small business set-asides.
- **Lack of leadership for services contracts implementation** - each component must create a Sr. Manager of Acquisition of Services position responsible for planning, execution, strategic sourcing and service contract management.

The implications of these initiatives are numerous:

    - Much more scrutiny on services contracting (requirements, redundancy, cost and performance)
    - Consistency in definitions of services types will help vendors translate previous work from one component to the next
    - Better developed requirements for services will minimize scope creep (and likely bringing more scrutiny to changes to requirements)
    - More emphasis on market research to meet growing demands for data and analysis around the services market
    - More frequent recompetes implies:
    - Incumbents' more frequent costs to maintain position
    - Opportunities for non-incumbents (incl. through on-ramp provisions)
    - Shorter contracts

- Contractors must adjust to preference for Cost-Plus-Fixed-Fee and Cost-Plus-Incentive-Fee service contracts
- Vendors must build cost efficiency into projects – particularly those above $1 billion. Also keep in mind that cost efficiencies gained by incumbents will drive down the cost baseline for new bidders on recompetes.

So where do contractors go from here? The Clarity Advisor report nicely summarizes the point:

"A sign of relief from the industry is certainly warranted, but this is only the beginning of the new culture of conservation and restraint at DoD. Secretary Gates' goal of $100B in savings over five years remains, and if cuts in "service support contracts" will only contribute $1.2B ($400M a year for three years), where will the rest come from? For firms who see themselves in Secretary Lynn's description of service support contractors, the large question is still 'What do I do?' "

Deltek's **original paper** on Gates' cuts provides solid advice to contractors operating in this space. What is clear is that DoD is coming at this problem from multiple angles, so whether your specific type of service offering is part of the targeted spending cut or not, it is critical that service contractors examine the elements and performance of contracts. With more oversight and more frequency in competition, contractors will need to dedicate time and resources to ensuring the stability of existing work.