STATEMENT OF
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BEFORE THE

SUBCOMMITTEE ON FEDERAL FINANCIAL MANAGEMENT, GOVERNMENT INFORMATION, FEDERAL SERVICES, AND INTERNATIONAL SECURITY
COMMITTEE ON HOMELAND SECURITY AND GOVERNMENTAL AFFAIRS
UNITED STATES SENATE

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Mr. Chairman, and members of the Committee, thank you for the opportunity to come before you today to present the Department of Energy's (DOE) views and perspectives on the recent U.S. Government Accountability Office Report entitled "Federal Contracting: Guidance on Award Fees Has Led to Better Practices but is Not Consistently Applied" (GAO-09-630). I am pleased to be here today to address how the Department is effectively using cost-plus-award-fee contracts to incentivize excellent contract performance and how DOE has implemented the Office of Management and Budget (OMB) December, 2007, guidance on the appropriate use of incentive contracts.

DOE is the largest Federal civilian contracting agency, based on Fiscal Year 2008 contract obligations of approximately $25 billion. A central element of DOE's contracting structure is a cadre of special contracts called Management and Operating contracts, which have their origins in the Manhattan Project and have endured under DOE and its predecessor agencies. These contracts for the management and operation of Government-owned national scientific, engineering, and research facilities are unique in all of Government and require a special and specific authorization by the Secretary of

Energy. Many of the scientific and research facilities are also DOE Federally Funded Research and Development Centers, a special designation applied to these facilities because of their criticality to DOE's mission. The laboratory contracts for these facilities were the focus of GAO's review of DOE.

Because of the broad mission and work scope of each of these contracts, they are, by design, cost-reimbursement contracts. DOE Program Offices responsible for overseeing the work performed under these contracts use an annual work authorization process to identify and authorize the execution of specific work and use award fee and other incentives to motivate high levels of contractor performance.

DOE has a number of other special contracts, called major site and facility management contracts, which are also cost-reimbursement type contracts. In these contracts, DOE relies on appropriately structured award fee incentives and, wherever possible, more objective incentives to accomplish the contract work. These contracts are primarily for environmental clean-up and other work in support of DOE's Office of Environmental Management. While critical to DOE's mission, these contracts are not designated as Management and Operating contracts.

In addition, DOE also awards and administers thousands of other contracts that represent the full range of fixed-price and cost-reimbursement type contracts for goods and services typically acquired by most Federal agencies.

In its study, GAO noted two particularly positive aspects of DOE's administration of cost-plus-award-fee contracts. Specifically, GAO concluded that, for two of the four fundamental practices recommended in the OMB guidance—linking award fees to acquisition outcomes and limiting the use of rollover—, DOE's supplemental guidance is in accordance with OMB's guidance.

GAO also noted that DOE should strengthen its policy for the other two practices OMB recommended—emphasizing excellent performance and prohibiting payments for unsatisfactory performance. DOE will address GAO's concerns immediately. Shortly, we will issue policy that more strongly emphasizes contractor performance results and prohibits payments for unsatisfactory performance in language that is unambiguous and consistent with OMB's guidance.

DOE's policy for use of award fee in its major contracts adheres to Federal Acquisition Regulation (FAR) requirements. There are, however, distinctions between DOE's management and operating and site and facilities management contracts and other contracts. These distinctions are meaningful both in the context of the GAO's conclusions and when compared to the cost-plus-award-fee contracts of other Federal agencies. One distinction is these are highly complex, long-term, high-dollar value contracts. DOE's laboratories are multi-functional institutions pursuing a myriad of scientific endeavors with thousands of scientists, engineers, and other staff and with annual budgets in many cases exceeding $500 million. The key distinction for management and operating contracts is, succinctly, contractors perform a substantial part of DOE's mission, rather than merely supporting the mission. By necessity, DOE's award fee plans incentivize the contractor's performance across the wide range of the laboratory's research programs and operations. Thus, when a contractor fails to achieve better than expected performance in one incentivized area of work, the contractor loses the award fee associated with that specific portion of the work. However, the contractor may still earn the award fee available for its performance of the other incentivized portions of the contract. As a result, a contractor may earn a significant portion of available award fee for a discrete evaluation period for overall outstanding performance, even though in some areas performance was less than outstanding.

DOE categorizes all of its cost-reimbursement incentive fee contracts as award fee contracts unless they are true cost-plus-incentive-fee (CPIF) contracts. Some agencies limit their definition of award fee contracts to only those with the more traditional subjective evaluation metrics. DOE policy and practice, in accordance with OMB guidance, has been to make our contracts more performance based. This has resulted in many of our award fee contracts having a mix of both objective and subjective incentives.

Some concern has been expressed by the GAO regarding the amount of award fee earned, expressed as a percent of total available award fee, on DOE's laboratory contracts (96% in FY2008). It should be noted that each laboratory's performance in science is evaluated regularly by outside peer review. The results of these reviews are taken into account in the overall evaluation of the laboratories' performance. This approach to assessing scientific research conducted by the laboratories has confirmed that the country's premiere scientific resources are providing consistently outstanding performance and the earned award fees reflect this. While typical award fee contracts provide available award fees of 7 to 9 percent of the contracts' estimated costs, DOE's Office of Science laboratory contracts provide only 1% on average. This reflects the unique nature of our laboratory contracts where the quality of research being performed and the reputation attained are far more important to the laboratories than the fees available. While some may think the percent of award fee earned by DOE's laboratories is high, the total award fee amount, as a percent of contract price, is actually substantially lower than that found in other agencies' award fee contracts.

In contrast to DOE's laboratory contracts, our environmental management site and facility management contracts contain predominantly objective performance-based incentives and contractors earned less than 92% of the available award fees in FY2008. Under DOE's non-management and operating contracts, which are more typical of other agencies' award fee contracts, contractors earned an average of 81% of the available award fees. In the National Nuclear Security Administration, laboratory contractors earned 70% in FY2008, while production, construction, and site and facility management contractors earned 90% on average.

In addition, DOE's agency-specific policy sets out several unique provisions that enhance the effectiveness of award fee arrangements. One such provision is the "Conditional Payment of Fee" clause. This clause is a big hammer—it subjects contractors' receiving earned fee on the condition that they comply with contract provisions on environmental, safety, and health and the safeguarding of information. A contractor that commits a significant environmental or safety violation, for example, will have its otherwise earned award fee reduced based on the severity of the violation—regardless of whether the activity was covered by the contract's award fee plan. For the most severe infractions, all of the contractor's earned fee will be lost. DOE's policy also requires the Senior Procurement Executive to approve, in management and operating contracts, the use of any base fee or the rollover of any unearned award fee.

DOE's policy reflects an aggressive implementation of the Government-wide policies to optimize performance-based contracting approaches and techniques. All of our award fee management and operating contracts are performance based. Our policy explicitly recognizes that objective performance measures provide greater incentives for superior performance than subjective performance measures. At Rocky Flats, for example, the use of objective performance based incentives was instrumental in the closure of the site ahead of schedule and below budget.

There is a need for consistency and rigor in the use of award fee, which should incentivize the contractor to performance excellence. I fully support the GAO's recommendation that DOE ensure it has established evaluations factors, definitions of performance, associated fees, and evaluation scales that motivate excellent performance and prohibit award fee for unsatisfactory performance. In implementing GAO's recommendation, DOE will fine-tune its approach by improving award fee metrics and rating scales across the Department. We will do this while recognizing our major programs’ award fee regimens are tailored to their different mission portfolios and contract objectives. Using the science award fee program to illustrate, it currently includes a common structure and scoring system across the ten science national laboratories. It contains eight performance goals covering Science and Technology and the conduct of Operations. These goals are comprised of a small number of common objectives, and performance measures are established and used as key indicators for determining performance. The scoring system does define the level at which no fee will be earned, which equates roughly to the “unsatisfactory” rating in GAO’s parlance. In implementing GAO’s recommendation, we will ensure the science award fee program and all other award fee programs use evaluations factors, definitions of performance, associated fees, and evaluation scales that are clearly congruent with OMB guidance.

There are three salient aspects of Office of Science’s appraisal program that bear mentioning. The first is that the amount of fee available (only 1% or less in most cases) is far less than that available in typical award fee contracts. The second is that the Office of Science program’s expectations are set to incentivize exceptional performance, not just satisfactory performance). Therefore, it is not appropriate to rate a contractor’s performance unsatisfactory if any one expectation is not completely met. The third is that the Office of Science award fee process for its laboratory contracts does not equate the term "not meeting expectations" with "unsatisfactory performance". Where a laboratory contractor receives an unsatisfactory rating during an award fee evaluation, the contractor does not earn fee.

In closing, the Department's procurement policy assures it is effectively using cost-plus-award-fee contracts to incentivize excellent contract performance and is in line with OMB guidance released in December 2007. We will strengthen that policy by issuing amplifying guidance that addresses the concerns raised by GAO in the specific areas of choosing the right contract type, defining terms and rating categories, defining standards of performance for each rating category and the fee paid for meeting the standards, and ensuring fee is not paid for unsatisfactory performance. We are committed to work with, and participate in, any interagency working group to be established to determine how best to evaluate the effectiveness of award fee as a tool for improving contractor performance and achieving desired program outcomes and to develop methods for sharing information and successful strategies.

This concludes my formal remarks. I would be happy to respond to your questions.