The Deputy Secretary of Energy
Washington, DC 20585

December 13, 2012

MEMORANDUM FOR HEADS OF ALL DEPARTMENTAL ELEMENTS

FROM: DANIEL B. PONEMAN

SUBJECT: Aligning Contract Incentives for Capital Asset Projects

Recently, Department officials and I met with senior OMB officials and the Comptroller General of the United States to discuss DOE's continuing efforts to improve project management. In this connection, it is incumbent on all of us to strive continuously to adhere to best business practices, including optimal alignment of contract incentives. Contractors perform energy and scientific research, enhance nuclear safety and security, and clean up the legacy of nuclear weapons research and production activities. Many of these activities involve large complex capital asset projects. While we have made substantial efforts to improve project management, we still experience significant delays and cost overruns in our major capital projects. As our management principles dictate, we will only improve – and succeed – through teamwork and continuous improvement.

To improve acquisition planning and contract management, DOE will adhere to two primary principles. First, we must always seek to align contractor interest to the taxpayer interest. Second, we must structure contracts so that each party bears responsibility for its own actions. The attachment provides guidance and direction on implementing these principles.

Your leadership is needed to assure that we make the necessary improvements in structuring and managing our contracts for the oversight of capital asset projects. The Office of Acquisition and Project Management will assist programs with implementation by providing applicable contract clauses to ensure consistency in implementation and use.

Attachment

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Attachment

Principles for Aligning Contract Incentives

Effectively managing the Department's capital asset projects and contracts is essential to the Department's success. As stewards of taxpayer dollars, we must do all that we can to assure that contract terms are consistently met and to achieve expected results.

To improve the structure and management of our contracts (inclusive of capital asset project work authorizations issued under our M&O contracts), the Department will adhere to two primary principles.

- **First**, the Department will align contractor with taxpayer interests. In other words, no contract should be structured so that the contractor is rewarded if the taxpayers are not well served.

- **Second**, the Department will structure these contracts so that the contractors will bear responsibility for their actions, i.e. taxpayers should not pay for contractor negligence, poor performance, or error, but should share in savings or gains that contractors generate through better-than-promised performance. Going forward, the Department will consistently apply these principles, especially in awarding and negotiating contracts for capital asset projects, and will adhere to the guidance set forth below.

- *Improved Upfront Planning and Requirements Definition.* To position the Department to successfully procure goods and services on behalf of taxpayers, we must understand and be able to articulate the expected results in clear, concise, easily-understood, measurable terms. Program officials and contracting officers will assure proper upfront planning has been conducted and that requirements are clearly defined prior to issuing a solicitation. This includes, for example, making certain that sufficient design has been completed for a construction project before construction activities are authorized and that appropriate technical readiness assessments have been completed in accordance with DOE Order 413.3B, *Program and Project Management for the Acquisition of Capital Assets.* Establishing clear requirements and performing necessary up-front planning benefit both the taxpayer and the contractor by minimizing the risk of cost overruns, the need to negotiate contract modifications for changes in scope, cost, and schedule, and misunderstandings about expected outcomes.

- *Selecting Contract Type*. In accordance with Administration policy, contracting officers will first consider the use of a firm-fixed-price contract to complete work requirements. This contract type is most appropriate for services that can be objectively defined in a statement of work and the risks involved can be estimated with an acceptable degree of certainty. Long-standing views about the unique and sometimes unpredictable nature of work performed by the Department have resulted in the limited use of firm-fixed-price or other

fixed-price type contracts. However, improved upfront planning and requirements definition, as well as appropriate scoping of the contract to clearly-defined, will allow for the greater use of firm-fixed-price contracting.

In instances where a contracting officer concludes that a firm-fixed-price or other fixed-price contract may not be the best contracting vehicle, the program and contracting officer will first identify the additional planning and risk reduction that would be needed to use a fixed-price approach before resorting to a cost-reimbursement contract. Using fixed-price contracts benefits the Department by providing greater budget stability. At the same time, it motivates the contractor to identify improved methods of performance in order to increase profits, thereby aligning taxpayer and contractor interests.

- *Performance Measures.* In instances where a fixed-price contract is not deemed to be in the best interest of the government and a cost-reimbursement contract is selected, objective performance measures will be used as much as possible to incentivize optimal contractor performance and reduce costs. Subjective performance measures will only be used when objective measures are not feasible.

- *Fee Strategies.* Recognizing that one approach does not meet the needs of every project or contract, and to assure that each party in a contract bears responsibility for its own actions, the following strategies may be used at the time of contract formation:

    - *Provisional Fee.* Performance measures will link all or a substantial portion of the fee to the achievement of final outcomes rather than interim accomplishments. Contracts shall be structured such that all or a significant portion of the fee for interim milestones will be provided provisionally and must be returned if the contractor does not fulfill its ultimate contractual obligations in accordance with the terms of the contract (e.g. delivery of project on cost, on schedule, etc.).

    - *Hard Cost Caps or Cost Share Approach.* Using this approach effectively transforms a cost-reimbursement contract into a fixed-price contract if the contractor incurs costs beyond a certain amount. This approach is appropriate for contracts where the total cost to perform can be estimated with reasonable certainty. If a contractor does not meet performance targets, the cost cap and/or cost share will shift the cost burden to the contractor. In this context, the contractor must still perform regardless of the costs it incurs and the Department will not reimburse some or all of the costs beyond the stated amount as set forth in the contract, subject to certain legal limitations.

- *Documenting Performance.* Contracting officers and program officials shall consistently and accurately document real-time contractor performance and ensure that it is recorded both in detail in the contract file and in the appropriate format in the Contractor Performance Assessment Reporting System (CPARS). Meaningful past performance assessments are critical to ensuring that the government does business with companies that deliver quality goods and services on time and within budget. The information documented in CPARS will

help assure taxpayer interests are met by aiding efforts to hire only those contractors that consistently provide good performance.

- *Actionable Performance Data.* Acquisition executives are responsible for maintaining real-time situational awareness of costs, performance, and other important metrics for the execution of their contracts. In that spirit, as discussed in my June 19, 2012, Memorandum on Project Assessment and Reporting System (PARS II) Data Quality, Contracting Officers and Federal Project Directors must ensure contractors provide timely, accurate, reliable and actionable project and contractor cost, schedule, performance, risk, and forecast data, reports and information. Project cost and schedule performance data uploaded in PARS II must be real time and reflect reality, providing an early warning to program officials and Acquisition Executives so they can proactively engage and mitigate potential issues.