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The Honorable Adam Smith  
Chairman, HASC  
2216 Rayburn House Office Building  
Washington, D.C. 20515

Subject: Proposed Chair Markup for NDAA for FY 2023 Regarding Industry/DoD Differences on Award Fee Incentives Guidance

Dear Chairman Smith:

Industry (CDSIA and NDIA) and DoD disagree regarding the use of award fee incentives on EMD contracts for Major Capability Acquisitions. DoD guides that the Earned Value Management System (EVMS), tied to any incentive, should measure the quality and technical maturity of technical work products. Industry disagrees.

#### **DoD Guidance**

DoD guidance is stated in the *Engineering of Defense Systems Guidebook*, Feb. 2022, (Eng Guidebook), as follows:

#### Eng Guidebook CH 2.5 Systems Engineering Role in Contracting

Another area to which incentives are tied is the EVMS. The PM should ensure that the EVMS, tied to any incentive, measures the quality and technical maturity of technical work products instead of just the quantity of work. If contracts include EV incentives, **the criteria should be stated clearly and should be based on technical performance**. EV incentives should be linked quantitatively with:

- Technical Performance Measures (TPM)
- Progress against requirements
- Development maturity
- Exit criteria of life-cycle phases
- Significant work packages and work products

#### **NDIA and CDSIA Warnings**

Both NDIA and CDSIA oppose linking award fee incentives to achieving EVM cost and schedule metrics. They warned that incentive fees based on EVM metrics have been or could be misused by contractors to sacrifice objective program status reporting in favor of “making the number” or to promote “poor behavior” in the establishment of program baselines and EVMS implementations.

The attached NDIA Letter to DOD, May 11, 2007, with its attached position paper, “*Award Fee Incentive Provisions Using EVM Reporting*,” admitted that:

"in recent years, some defense contracts have misused these incentives (to achieve program contractual outcomes) by tying achievement of certain EVM cost and schedule metrics to award and incentive fees and thereby *sacrificing objective program status reporting* in favor of "making the number." ...A greater risk posed by the use of these monthly incentives is that they can provide the wrong focus (i.e., *management of data and reports*). Managing a program using these data outcomes could cause contractors to ...taking other *actions that might be less than optimal in order to maintain high ratios* (I.E., Indices) *between budgeted cost and schedule and actuals*...EVM will reveal the truth about a program but meanwhile at-completion projections become constrained and *project managers will not receive reliable information on contract status throughout most of the Program.*" ... "The NDIA also feels strongly that the use of EVM metrics (I.E., Cost Performance Index (CPI) and Schedule Performance Index (SPI) in award and incentive fee contracts detracts from the true application of EVM."

A similar warning was issued by Council of Defense and Space Industry Associations (CODSIA) in the attached letter to DOD, Ref: *DOD Report to Congress on Implementation of EVM: Request for Industry Input*, July 2, 2009. CODSIA warned that incentivizing contractors based on performance data could promote "poor behavior." The pertinent CODSIA excerpt follows:

"In addition, inappropriate contractual incentives, such as focus on incentivizing or penalizing contractors based on performance data, **promote poor behavior** in the establishment of program baselines and EVMS implementations. An example would be the continuing use of incentives based on reported performance metrics, such as the CPI and/or SPI."

#### **Examples of Allegedly "Making the Number" from F-35 Whistleblower Lawsuit**

In my whistleblower lawsuit against Lockheed Martin and Northrop Grumman on the F-35 System Design and Development (SDD) contract, I alleged that these contractors "made the number" to gain F-35 program award fees.

Excerpts from court documents follow:

Source: Northrop

The link between defendants' EVMS practices, including their misuse Of Management Reserve (MR), and their entitlement to award fees was publicly disclosed...The DCMA EVMS Compliance Report found the "same patterns of MR abuse, cost report falsification, and other EVMS violations throughout the JSF program that were very similar to the violations Relator had previously reported to DCMA.

Source: Appeals Court ruling

The public disclosures must therefore provide "*specific details about the fraudulent scheme and the types of actors involved in it sufficient to 'set the government on the trail of the fraud.'*"

We also conclude that the DCMA and GAO reports allege facts that make a potentially fraudulent scheme readily identifiable: LMC and its subcontractors were violating contracting regulations by using their MR budgets to compensate for over-budget expenditures that would have otherwise raised their CPIs and estimates at completion reported to the government.

The model Joint Strike Fighter SDD contract...explicitly cites CPI reporting as a criteria for the disbursement of award fees.

## **Recommended Markup for GAO Assessment**

I have sent several letters to you regarding authorization of GAO assessments of the use of award/incentive fees, including:

Subject: HR 6395 EH, Sec. 1710N, Agile Program and Project Management; Maximum Viable Profit for Minimum Viable Product? dated Oct. 6, 2020

Subject: Repeated Request for GAO Assessment of F-35 Block 4 Modernization Incentive/Award Fees dated July 14, 2021

An excerpt from the first letter follows:

I am concerned that the current policies, guidance, and regulations do not provide sufficient incentives to deliver the MVP within cost and schedule objectives and to reduce the technical debt. More importantly, the lack of disincentives or financial penalties provide no deterrence to contractors from continuing to receive undeserved award fees. Without more contractual definition and oversight, contractors are enabled to earn the Maximum Viable Profit despite delivering a subjectively defined and downwardly revised MVP.

Based on the information in those letters, I recommend that you markup the NDAA for FY 2023 to include the following provision:

Conduct a study of the incentive or award fees most recently paid on the F-35 Block 4 Software Modernization contract

(2) ELEMENTS.—The study (1) shall include an assessment of the following

(A) the extent to which the Department has established award or incentive fee criteria that are based on the verification, on a timely basis, of the quality and technical maturity of the features and functions of the product being developed and tested and that the Department has defined and documented technical performance objectives such as technical performance measures, progress against requirements, exit criteria of the MVP, and exit criteria of life-cycle phases.

(B) the extent to which the prime contractor and subcontractors have reported schedule performance in its their contract performance reports for the most current incentive or award fee period that is based on verified, objective measures of technical performance including progress towards meeting the exit criteria of the MVP.

(C) the extent to which the contractors have been paid award or incentive fees, in the most recent period, that is based on verified technical and schedule performance including progress towards meeting the exit criteria of the MVP.

(D) The extent to which reported earned value is linked quantitatively with verified technical and schedule performance, including:

- Technical Performance Measures
- Progress against requirements
- Development maturity

- Exit criteria of MVPs and life-cycle phases
- Significant work packages and work products

This letter and the cited letters may be downloaded from my website, [www.pb-ev.com](http://www.pb-ev.com) at the Acquisition Reform tab. Additional information regarding the whistleblower lawsuit may be downloaded from the F-35 Whistleblower Case tab.



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