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# JOURNAL *of* CONTRACT MANAGEMENT

*Linking scholarly research with best practices in the contract management field*

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# Editor's Welcome

The National Contract Management Association (NCMA) is pleased to present this edition of the *Journal of Contract Management (JCM)*. Since 1966, the *JCM* (originally called the *National Contract Management Journal*) has been supporting NCMA's mission of advancing the contract management profession through advocacy and the execution of programs to connect NCMA members and enable their professional development. Specifically, the *JCM* does this by publishing research aimed at expanding the contract management body of knowledge, serving both the buying and selling communities of the private and public sectors.

The *JCM* scope spans a wide range of topics in the contract management field. It strives to comprehensively cover the contract management body of knowledge by publishing conceptual, empirical, and practice-based application research that demonstrates substantial conceptual development, appropriate methodology, proven-best practices, and value-added topics.

We hope that the *JCM* will promote and foster discussion of both theory and practice across the *Contract Management Body of Knowledge*® (*CMBOK*®) competencies. To this end, the *JCM* brings together key theory and practice applications, making the research available not only to the

academic community but also to the private- and public-sector buying and selling communities. The *JCM* seeks research on both cutting-edge theories and practice applications in areas impacting the contract management profession. We invite both academics and practitioners to contribute to and read the *JCM*.

The *JCM* uses a double-blind peer-review process. Neither the authors nor the reviewers are made aware of each other's identity during the manuscript review process. This approach removes potential biases in the review process, thereby retaining quality and objectivity. The authors submit manuscripts with findings based on their own perspective, and the blind peer reviewers provide comments related to the quality, impact, and technical accuracy of the research.

This year's issue contains five peer-reviewed articles covering a range of contract management topics. In the first article, "Progress Payments Acquired Property: The Government's 'Convenient Chameleon,'" John Wyatt provides a discussion of the federal government's interest in progress payments property. His critical analysis of applicable federal statutes, regulatory provisions, contractual clauses, and divergent court and board case law decisions specifies whether the federal government's interest in

progress payments property is an actual authentic title or a paramount security interest. He discusses the “convenient chameleon” and its adverse ramifications in government contracting and proposes a solution to resolve this problem.

The second article is authored by the late Kenneth Allen and Allie Stanzione and is titled “Good Faith in Contract Management: A Real Duty.” (Ken Allen passed away in May 2019. Ken was an extraordinary supporter of NCMA and his influence on the association was immeasurable. *JCM* is honored to publish this article coauthored by Ken.) The authors address the duty and obligation of every acquisition professional for good faith in contract management and illustrate it with case law and references. The authors explain the relationship between this duty and the government’s “constructive change” to a contract by failing to cooperate, which is the framework for most litigation alleging the government’s violation of the duty. The authors also address the confusion created by a 2010 opinion of the Court of Appeals for the Federal Circuit that would make the federal government practically immune from violating this duty.

In the third article, “Federal Procurement Reform: A Mixed Record at Best,” Joe Pegnato discusses why attempts to reform the federal procurement system have been unsuccessful. He does this by providing a brief history of procurement reform efforts over the last 70 years in an attempt to identify the reasons why these reforms have not been more successful.

In the fourth article, titled “Internal Communication within a Multisite Government Contractor,” Laura Lemon and Nathan Towery discuss the findings of a case study approach using data collected through interviews and focus groups. Their research investigates how the frequent shifting of contracts impacts internal communication for

employees of a government contractor and provides recommendations for improving internal communications.

Our final article is “Improving Economic Price Adjustment Clauses in Air Force Contracts” by authors Trevor Enos, Jonathan Ritschel, Edward White, and Scott Drylie. This article uses historical data from U.S. Air Force contracts and contract modifications to analyze Economic Price Adjustments (EPAs). The authors investigate the frequency and magnitude of triggered EPA clauses in Air Force aircraft production contracts and suggest improvements to current EPA clauses.

As you can see from the above description of these articles, the *JCM* covers a wide range of topics included in the *CMBOK*. Additionally, for each article, we identified the related *CMBOK* competencies and listed them in the article abstract. After reading the articles, the reader is encouraged to reference the *CMBOK* to learn more about these competencies.

This edition of the *JCM* would not have been possible without the support of our editorial board and their volunteer efforts in conducting the manuscript reviews. I would like to thank the editorial board members for taking the time out of their busy schedules to perform the reviews of these manuscripts. I sincerely appreciate the sharing of their time and expertise to ensure that the *Journal of Contract Management* continues to be the top contract management journal for both scholars and practitioners across the globe.

**RENE G. RENDON, DBA, CPCM,  
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Editor-in-Chief  
*Journal of Contract Management*



# Progress Payments Acquired Property: The Government's "Convenient Chameleon"

BY JOHN B. WYATT III

## Abstract

**Purpose:** This article investigates the inconsistencies in the federal government's regulatory/statutory and judicial assertions (with resulting contradictory judicial conclusions) regarding the appropriate classification of its interest in progress payments property.

**Approach:** The methodology used is a critical analysis of the applicable federal statutes, *Federal Acquisition Regulation* provisions, contractual clauses, and divergent federal court and board case law decisions specifying whether the federal government's interest in progress payments property is actual authentic title or a paramount security interest.

**Findings:** The federal government desires to perpetuate the confusion resulting from the conflicting viewpoints as to whether its interest in progress payments property is actual title. This position affords the opportunity to the government to proffer whichever classification best suits interest at the given time. Consistent with that scheme, the government rejected a regulatory amendment that would have clarified the issue. Likewise, it ignored the application of a federal statute that definitively elucidated that its interest in military contracts was actual title, when the identification of its interest as a paramount security interest in that litigation would have potentially avoided liability.

**Value:** The conflicting case law that has emerged from this confusion has resulted in significant adverse consequences, such as the inability to successfully prosecute for the theft of progress payments property and contracting officer confusion as to when progress payments property is owned by the government. The result has been needless and counterproductive litigation. In conclusion, this article offers recommendations for curative regulatory and statutory amendments to end this needless confusion.

## Keywords

federal contracting, progress payments financing, federal government property management, title to progress payments property

## **Contract Management Body of Knowledge® (CMBOK®) Competencies:**

2.0, "Management"; 3.0, "Guiding Principles"; 6.0, "Post-Award"

## About the Author

John B. Wyatt III, JD, Fellow, is a professor of finance, real estate, and law at the California State Polytechnic University in Pomona, California. He also serves as the lead professor and coordinator of the university's College of Business Administration's program in contract management.

The legal issue of classifying the U.S. government's<sup>1</sup> interest in progress payments property has been the subject of much disagreement with resulting confusion. This misunderstanding was created because of the government's contradictory actions in describing its rights in progress payments acquired property.

Most of the time, the government identifies its entitlement in progress payments property as authentic title. However, at other times, the government maintains the exact opposite position. This about-face contention by the government is that its legal right in progress payments property is not a title, but a paramount security interest. These contradictory government arguments can be described as the government treating progress payments property as its "convenient chameleon"—i.e., the government chooses to "change the color" of the classification of its entitlement in progress payments property at its whim.

Underlying the government's inconsistent assertions regarding progress payments property is a common stratagem: The government wants the power to indiscriminately identify its entitlement in progress payments property as title or conversely as a paramount security interest. The government wants the flexibility to argue either classification as it pleases and whenever it wants. By treating progress payments property as its "convenient chameleon," the government can assert whichever argument best serves the government's purposes at that given time.

In support of that power, the government has issued conflicting regulatory language regarding progress payments property. That contradictory regulatory language has resulted in inconsistent case law being issued by the courts in their interpretations of that erratic language. The U.S. Supreme Court has refused to grant a *writ of certiorari* to resolve that conflicting case law, meaning that the case law diversion continues to exist.

A proposed regulatory amendment that would have definitized that the government's interest was actual authentic title was proposed. Unfortunately, it was withdrawn with a weak and confusing explanation.

In response, Congress, stepped in and passed a statutory change stating that the government's entitlement is an authentic title but that its application was limited to military contracts. Faced with potential liability in Superfund litigation, the government once again played its convenient chameleon card by claiming that its rights amounted to no more than a paramount security interest. In doing so, the executive branch chose to completely ignore that statute's plain meaning because the government believed it was in its best interest to do so. Thus, the convenient chameleon continues to live on.

As this article will discuss, the chameleon's existence has created some adverse ramifications. However, a solution to eliminate the chameleon for good exists—and this will also be discussed. Before examining the above issues, an overview of the relevant regulatory provisions relating to progress payments property will be provided.

## An Overview of Progress Payment's Property

Progress payments property is property acquired by a contractor in a fixed-price contract for noncommercial items that is paid for by government progress payments—a common method of financing in government acquisition contracts.<sup>2</sup> Per *Federal Acquisition Regulation (FAR)* 32.102, progress payments can be based on costs incurred by the contractor as the work progresses under the contract but cannot exceed the contract price (including authorized modifications).<sup>3</sup>

It is important to note that progress payments differ from payments made under a cost-reimbursement contract in that contractors are paid 100% of their actual costs—provided the costs are allocable, allowable, and reasonable. In contrast, under fixed-price contracts, a contractor will receive a percentage of its incurred costs in accordance with the progress payment rates as outlined in FAR

<sup>1</sup> Hereinafter "government."

<sup>2</sup> *Federal Acquisition Regulation (FAR)* 32.000, et seq., outlines the policies and procedures for contract financing (including "progress payments based on percentage or stage of completion")

<sup>3</sup> See also FAR 32.001(1)(iv), FAR Subpart 32.5, and the progress payments clause at FAR 52.232-16.

Subpart 32.501. Per FAR 32.007, progress payments can be made on the basis of costs incurred or on the basis of completed work.

The current customary progress payment rate is 80% (85% for small business concerns) of the total costs of performing the contract.<sup>4</sup> If enumerated conditions exist, the contracting officer may authorize unusual progress payments at higher amounts.<sup>5</sup> The *Defense Federal Acquisition Regulation Supplement* (DFARS) maintains the same 80% customary rate for large business concerns, but increases the customary rate for small businesses to 90%.<sup>6</sup> The DFARS likewise spells out the procedure for the authorization of unusual progress payments for Department of Defense (DOD) procurements.<sup>7</sup> FAR 32.503-4 outlines the procedures for administrative contracting officer (ACO) approval of a contractor's progress payment request.<sup>8</sup>

Progress payments are repaid to the government via a procedure called "liquidation." By liquidation, the government recoups progress payments through the deductions from payment amounts that would otherwise be due to the contractor for completed contract items.<sup>9</sup> To determine the amount of the liquidation, the contracting officer applies a liquidation rate to the contract price of contract items delivered and accepted. The ordinary method is that the liquidation rate is the same as the progress payment rate.<sup>10</sup> An alternate liquidation rate may be deemed acceptable by the contracting officer, provided the alternate liquidation rate is high

enough to result in the government's recoupment of the applicable progress payments on each billing and supported by documentation included in the administration office contract file.<sup>11</sup>

If the contracting officer authorizes progress payments, then the applicable provisions and clauses must be included in the precontractual documents and the final contract. FAR 32.502-4(a) requires the "Progress Payments" clause<sup>12</sup> to be inserted in fixed-price contracts under which the government will provide progress payments based on costs. This clause specifically describes the government's rights in progress payments property as "title," and this subpart is commonly referred to as the "title-vesting provision." As the clause states:

Title to the property described in this paragraph... shall vest in the Government. Vestiture shall be immediately upon the date of this contract, for property acquired or produced before that date. Otherwise, vestiture shall occur when the property is or should have been allocable or properly chargeable to this contract.<sup>13</sup>

That specific language appears to clearly indicate that the government is claiming actual title to progress payments property. However, other provisions portray the government's right as more akin to a paramount security interest. These contrary indications displayed by the FAR have been a salient factor in the creation of a divergence of case law as to whether the government's property interest constitutes actual title (ownership) or a paramount security interest. These mixed signals are indicative of the government's treatment of progress payments property as a convenient chameleon in action.

<sup>4</sup> FAR 32.501-1(a).

<sup>5</sup> FAR 32.501-2(a), in pertinent part, provides: "The contracting officer may provide unusual progress payments only if...(1) [t]he contract necessitates predelivery expenditures that are large in relation to contract price and in relation to the contractor's working capital and credit; (2) [t]he contractor fully documents an actual need to supplement any private financing available, including guaranteed loans; and (3) [t]he contractor's request is approved by the head of the contracting activity or a designee." (See *also* FAR 32.502-2.)

<sup>6</sup> DFARS 232.501-1.

<sup>7</sup> DFARS 232.501-2, referencing the advance approval procedures for unusual progress payments per PGI 232.501-2.

<sup>8</sup> See *also* FAR 32.503-3, which provides guidance for the ACO's assessment of the reliability of the contractor and the adequacy of its accounting system.

<sup>9</sup> FAR 32.503-8.

<sup>10</sup> *Ibid.*

<sup>11</sup> FAR 32.503-9(a) and FAR 32.503-10(a).

<sup>12</sup> FAR 52.232-16.

<sup>13</sup> *Ibid.*, at (d)(1).

## FAR 52.232-16(d)'s Description of Title Is Diametrically Opposed to Its Commonplace Definition

*Title* has been defined as "all the elements constituting legal ownership."<sup>14</sup> Conversely, *ownership* has been defined as "the state of being an owner,"<sup>15</sup> with an *owner* defined as "one who has the legal or rightful title to something."<sup>16</sup> The National Contract Management Association's *Contract Management Body of Knowledge*® (*CMBOK*®) concurs with these characterizations of *title* and *ownership* by reiterating that they share the common inherent right to use, enjoy, control, and dispose of the given property: The *CMBOK* defines *title* as "the right to control and dispose of property,"<sup>17</sup> and *ownership* as "[t]he collection of rights to use and enjoy property, including the right to transmit or convey these rights to others."<sup>18</sup>

These definitions/characterizations share one clear theme—i.e., that title is clearly inseparable from ownership. These two terms go hand in hand. Being an "owner" or "title holder" of property carries with it both rights and responsibilities. The failure to fulfill those responsibilities can result in civil and criminal liability for the owner.

Contrary to the commonly understood meaning of *title*, the Progress Payments clause<sup>19</sup> reflects the government's plan of possessing the best of both worlds. The clause's language affords the government the luxury of having all the rights associated with title with virtually none of its corresponding responsibilities. By treating progress payments property as its convenient chameleon, the government's clause can talk out of both sides of its mouth.

As previously discussed, the Progress Payments clause states at (d)(1) that the government's entitlement is title,<sup>20</sup> and additional statements within the

clause echo that sentiment. If the contractor wants to use such property for its own purposes, not connected with the government contract, governmental approval must first be obtained and the corresponding allocable costs of the utilized property must be excluded from the costs of contract performance.<sup>21</sup> Further, the contractor must also repay the government for any unliquidated progress payments involved.<sup>22</sup>

That said, other parts of the clause support the "none of the responsibilities" standpoint. The responsibility of handling, disposition,<sup>23</sup> and the risk of loss due to theft, damage, or destruction of the progress payments inventory is on the contractor.<sup>24</sup> The contractor must maintain an accounting system for both costs and control of such property and provide applicable reports, certificates, financial statements, and other pertinent information as the government may reasonably request.<sup>25</sup> Bolstering that viewpoint, the clause provides that the vesting of title in the government shall neither relieve the contractor from any obligations under the contract nor constitute any waiver of any party's rights or remedies.<sup>26</sup>

The Progress Payments clause and its applicable regulations, when examined in light of the commonly accepted definition of *title* and its associated responsibilities, represents a paradox in the minds of the courts examining that clause. The clause's mixed signals have led to the differing Court of Appeals judicial interpretations in typecasting the government's interest in progress payments property.

<sup>14</sup> <https://www.merriam-webster.com/dictionary/title>.

<sup>15</sup> <https://www.merriam-webster.com/dictionary/ownership>.

<sup>16</sup> <https://www.merriam-webster.com/dictionary/owner>.

<sup>17</sup> *The Contract Management Body of Knowledge*® (*CMBOK*®), fifth ed. (Ashburn, VA: National Contract Management Association, 2017): 140–141.

<sup>18</sup> *Ibid.*

<sup>19</sup> FAR 52.232-16.

<sup>20</sup> *Ibid.*, at (d)(1).

<sup>21</sup> *Ibid.*, at (d)(5).

<sup>22</sup> *Ibid.*

<sup>23</sup> *Ibid.*, at (d)(3).

<sup>24</sup> *Ibid.*, at (e).

<sup>25</sup> *Ibid.*, at (g).

<sup>26</sup> *Ibid.*, at (i).

## The Differing Court of Appeals Interpretations of the Government's Interest in Progress Payments Property

### *The Marine Midland Viewpoint: The Government Has a Paramount Security Interest, Not Title*

In *Marine Midland Bank v. United States*,<sup>27</sup> the U.S. Court of Claims was confronted with the dilemma of determining the government's interest in a contractor's inventory. The government had advanced progress payments that remain unliquidated and the contractor had declared bankruptcy. The government wanted to obtain possession of the progress payments property. Marine Midland Bank alleged that it had a perfected security interest in that property because it had been used as collateral for a loan. The bank opposed the government's repossession of the inventory, claiming that it had a superior security interest.

The Court held that the government's interest in the progress payments property was, in reality, a paramount security interest. It reached this conclusion for four reasons:

- The advancement of progress payments from the government was intended to be a method of financing and not buying property outright;
- The classification of "title" was solely used by the government to protect its financial security interest in the progress payments property;
- The Progress Payments clause's portrayal of "title" was inconsistent with the normal meaning of "ownership"; and
- Historical reasons had existed that mandated using the word "title," which statutory amendments had eliminated.<sup>28</sup>

The Court concluded that the government never really wanted authentic title and that its entitlement amounted to a security interest that was paramount

to the liens of general unsecured creditors.<sup>29</sup> This government lien is paramount because the government, as the sovereign, needs to prevail in a conflict over the possession and recovery of the progress payments inventory.<sup>30</sup>

### *The American Pouch Perspective: "Title" Means "Authentic Title"*

The *In re American Pouch Food, Inc.*<sup>31</sup> decision represents the majority perspective<sup>32</sup> among the courts that have considered the "title" versus "paramount lien" issue. *American Pouch* and its progeny conclude that the Progress Payments clause is to be interpreted literally, and that the government acquires authentic title.

Like *Marine Midland*, the case involved a contractor bankruptcy resulting from the government imposing a termination for default. The government claimed title/ownership of the military food rations that were the progress payments property in dispute. The contractor argued that, as a debtor in possession, it possessed a superior lien to that of the government. The court decided that the title-vesting language was clear and must be given its literal meaning. If the sovereign is vested with title, it will always prevail over any other interest in the property. That power is essential to be able to repossess the progress payments property quickly, especially when it is essential to the national defense.<sup>33</sup>

The *American Pouch* perspective has been affirmed in numerous decisions. It also represents the predominant opinion by the U.S. bankruptcy courts.<sup>34</sup>

<sup>27</sup> *Marine Midland Bank v. United States*, 687 F.2d 395, cert. den., 460 U.S. 1037, 103 S. Ct. 1427, 75 L. Ed. 2d 788 (1983) (hereinafter "*Marine Midland*").

<sup>28</sup> In the past, the government had been prohibited from advancing money without acquiring anything of equivalent value in return, and the term "title" had been used to sidestep this obstacle. (*Pub. L. 85-800* (1958), codified at 10 U.S.C. §2307 and 41 U.S.C. §255, effectively removed that prohibition against advancing progress payments.)

<sup>29</sup> See Dakin, Timothy J., "The Government's Policies Toward Contractor Financing, Are They Consistent?" *Contract Management* 30, no. 12 (1992): 14.

<sup>30</sup> *Marine Midland*, *supra* note 27, at 400.

<sup>31</sup> *In re American Pouch Food, Inc.*, 769 F.2d 1190 (7th Cir. 1985), cert. den., 475 U.S. 1082, 106 S. Ct. 1459, 89 L. Ed. 1107 (1986) (hereinafter "*American Pouch*").

<sup>32</sup> I.e., the greater number of decisions.

<sup>33</sup> *American Pouch*, see note 31, *op. cit.*, at 1193-1196.

<sup>34</sup> See *Quality Plus Equipment, Inc. v. Windham Power Lifts, Inc.*, 91 B.R. 598 (Bankr. M.D. Ala.1988); *U.S. v. Economy Cab & Tool Co.*, 47 B.R. 708 (Bankr. D. Minn.1985); and *U.S. v. Wincom Corporation*, 76 B.R. 1 (Bankr. D. Mass.1987).

Unfortunately, both *Marine Midland* and *American Pouch* were denied writs of *certiorari* by the U.S. Supreme Court. This means that both decisions still remain valid legal precedent for their respective jurisdictions. However, those two conflicting opinions have caused a very unfortunate ramification in criminal cases—i.e., the inability to successfully prosecute for alleged theft of progress payments property.

### The Differing "Title" Interpretations Inhibit the Successful Prosecution of Theft of Progress Payments Property

The conflicting opinions in *Marine Midland* and *American Pouch* have prevented the successful criminal prosecution for the theft of progress payments property. A classic case illustrating this undesirable result was United States Court of Appeals for the Fifth Circuit's decision in *United States v. Hartec Enterprises, Inc., et al.*<sup>35</sup> In *Hartec*, the defendant contractor had been convicted for the criminal theft of progress payments property owned by the government, which he appealed.

The alleged criminal act (per 18 U.S.C. §641<sup>36</sup>) was the selling of scrap to a third party without crediting the government with the proceeds from the sale. The scrap was derived from unliquidated progress payments property, which the government claimed that it owned by virtue of the title vesting provision of FAR 52.232-16(d). The contractor conceded that the property involved (wire mesh panels) was fabricated with materials purchased with government progress payments. He argued that the panels were defectively fabricated and nonconforming to the applicable contractual requirements and claimed that those panels were properly sold by him to a third party as scrap.

<sup>35</sup> 967 F.2d 130 (5th Cir. 1992).

<sup>36</sup> 18 U.S.C. §641 provides in pertinent part: "Whoever embezzles, steals, purloins, or knowingly converts to his use or the use of another, or without authority, sells, conveys or disposes of any record, voucher, money, or thing of value of the United States or of any department or agency thereof, or any property made or being made under contract for the United States or any department or agency thereof;...[s]hall be fined under this title or imprisoned not more than ten years, or both; but if the value of such property in the aggregate, combining amounts from all the counts for which the defendant is convicted in a single case, does not exceed the sum of \$1,000, he shall be fined under this title or imprisoned not more than one year, or both."

On appeal, the contractor argued that his criminal conviction was erroneous because the government did not own the scrap that had been paid for by progress payments. It was the contractor's position that under *Marine Midland*, the government possessed only a security interest in the scrap. Therefore, if the government did not own the scrap, the defendant could not be convicted of stealing property owned by the government under 18 U.S.C. §641.

The Fifth Circuit Court of Appeals agreed with the contractor's argument and adopted the *Marine Midland* rationale that the government only acquired a security interest and not title under the Progress Payments clause. However, the court emphasized that it reached such a conclusion in this case because a person's liberty and not just property interests were at stake. The court cited well-established case precedent stating that, in order for a person to be convicted criminally, there must be fair warning or notice of what constituted the prohibited activity. "Fair warning refers to the requirement that a criminal statute...[must] define an offense with enough accuracy so as to enable a reasonable person to know what conduct is prohibited, and so that a reasonably skilled lawyer can predict what conduct falls within the statute's scope."<sup>37</sup>

In view of the conflicting and inconsistent interpretations of the title vesting language by two different Federal Courts of Appeal, the court reasoned that the contractor could have reasonably believed that he, not the government, owned the scrap. Therefore, the contractor had not been afforded the requisite fair warning that the sale of scrap financed by progress payments, without applying the proceeds of that sale to the government's benefit, was a criminal act.

What happens when the contractor allegedly steals the government's pants? In *U.S. v. Salvador Ribas Dominicki*,<sup>38</sup> defendants were indicted for wrongfully selling to a third party 16,135 pairs of trousers that were manufactured and financed by government progress payments. As the court reasoned:

<sup>37</sup> See <https://definitions.uslegal.com/f/fair-warning/>.

<sup>38</sup> 899 F. Supp. 42 (D.P.R. 1995).



If the government took title to the trousers in the traditional sense, then the merchandise arguably constitutes a "thing of value" of the United States, and prosecution under 18 U.S.C. §641 for its conversion, theft, or unauthorized sale is proper. On the other hand, if the government took only a lien interest over the property, instead of traditional title, then as a matter of law, prosecution under §641 is improper....<sup>39</sup> In this respect, it is telling that the government itself appears unsure as to the exact point in time when it became entitled to ownership of the trousers.<sup>40</sup>

As in *Hartec*, the court determined that defendant could not be prosecuted under §641 because the contractor had not been afforded fair warning that its actions were criminal due to the inconsistent interpretations by the courts as to whether the government did have title to the trousers at the time of their transfers to the third parties. Potentially, the *Hartec* and *Dominicci* courts would probably not have followed the *Marine Midland* precedent if the "fair notice" requirement had not been at issue.

## Government Hinders Regulatory and Statutory Efforts to Definitize That the Government Has Title

In response to the *Marine Midland* decision declaring the government's interest to be less than title, NASA initiated FAR Case 89-31<sup>41</sup> due to its concerns about protecting the federal government's interest in progress payments property, especially in the event of a contractor bankruptcy or termination for default. The proposed rule attempted to clarify that the interest the government takes is "absolute title and not a lien."<sup>42</sup> The language of the paragraph titled "Background" from the FAR Case also provides some useful insight as to the intent behind the proposed regulatory change:

The objective of [this proposed amendment to the

*FAR*] is to emphasize that *it is and always has been the intent of the Federal Acquisition Regulation policies and contract clause [52.232-16(d)] that the interest taken by the government in property covered by the clause is title in the form of ownership and not a mere lien*.<sup>43</sup>

This language is significant because, for the first time, the government admitted in a public declaration that the government now and always had intended that its interest in progress payments property was title, which equated to ownership. Did this mean that the convenient chameleon could not change its colors anymore?

Yet, six years later, the government changed its mind. It withdrew the proposed FAR Case 89-31 with its clarifying language of "absolute title" and rationalized its retraction by stating that the proposed amendment has "been determined to be unnecessary because the *FAR* adequately covers the issues addressed by the proposed rule."<sup>44</sup>

Publicly stating there was no need to clarify the *FAR* completely understated the *Marine Midland* and *American Pouch* disparity in case law precedent. Some insight as to the government's mindset in withdrawing the FAR Case can be gleaned from a letter written by Ms. Eleanor Spector, Director of Defense Procurement of the Office of the Under Secretary of Defense, in reply to an inquiry from Dr. Steven Kelman, Administrator of the Office of Federal Procurement Policy. As Ms. Spector explained in that letter:

FAR Case 89-31...was intended *as a restatement... of a long standing government position, i.e., that the government acquires title to the property in question under a literal reading of the Progress Payments clause [and] we believe that the government's right to title is clearly stated in the current clause and that our interpretation is supported by a majority of court decisions*.<sup>45</sup>

<sup>39</sup> *Ibid.*, at 43.

<sup>40</sup> *Ibid.*, at 45.

<sup>41</sup> 54 *Federal Register* 1863 (May 1, 1989).

<sup>42</sup> *Ibid.*, where the replacement language for the word "title" in the current FAR 52.232-16(d)(1) would be "absolute title and not a mere lien": "Absolute title and not a mere lien, to the property described in this paragraph (d) shall vest in the government" (emphasis added).

<sup>43</sup> *Ibid.* (emphasis added).

<sup>44</sup> 59 *Federal Register* 5750 (February 8, 1994), 5750-5751.

<sup>45</sup> Letter from the Office of the Under Secretary of Defense to the Administrator of the Office of Federal Procurement Policy, dated October 13, 1994. A copy of this letter was attached as an exhibit and incorporated by reference in the *Amici Curiae* Brief (filed November

The key significance of this quote is that DOD professes that it has consistently asserted a long-standing position that the Progress Payments clause is to be read literally and that the government's interest is nothing short of actual title.

This author must question: How long is "long-standing"? That appears to be at the government's whim. The two cases discussed in the following section illustrate where the government chose to argue that its interest in progress payments property was not title but a paramount security interest. Why? This argument was made to avoid liability that was associated with ownership. The more accurate description of the government's perspective is, perhaps, that the "absolute title" position can be conveniently thrown aside when it best serves the government's interest.

The legislative branch of government apparently did not share Ms. Spector's confidence that the alleged "long-standing" government position that it has actual title was consistent and without reproach. In 1997, Congress, obviously frustrated with the aforementioned failure by DOD to resolve the title question, passed the 1998 National Defense Authorization Act.<sup>46</sup> That Act amended 10 U.S.C. §2307 by adding a new section (h), titled "Contract Financing," which states:

Vesting of title in the United States—If a contract [financed by progress payments] provides for title to property to vest in the United States, *the title to the property shall vest in accordance with the terms of the contract, regardless of any security interest in the property that is asserted before or after the contract is entered into.*<sup>47</sup>

Unfortunately, this clear declaration that "title"

means "*authentic* title" does not apply to all federal government contracts utilizing progress payments financing. Title 10, titled "Armed Forces," which is a positive law title,<sup>48</sup> applies only to military contracting and not to any other governmental contracting activities.

## Cases Exemplifying the Government's Treatment of Progress Payments Property as Its Convenient Chameleon in Action

Regarding its entitlement in progress payments property, the government frequently talks out of both sides of its mouth, asserting whatever position it desires that reflects its best interest at that time. Historically, the government has asserted the *American Pouch* authentic title theory to protect its purported title interest in progress payments property. As previously stated, it claims title in bankruptcy and termination for default cases because it wants to immediately obtain possession of the property.

But what if the government is confronted with potential liability by virtue of being the owner of the progress payments property? The following two cases illustrate how, in that circumstance, the government argues the exact opposite—that its interest is only a paramount security interest. Remember, in regarding progress payments property as its convenient chameleon, the government has no qualms about proffering a contradictory assertion whenever it furthers the government's agenda at that time.

1, 1999) in Support of Plaintiff/Respondent Hughes Aircraft Company on Behalf of the Boeing Company, Northrop Grumman Corporation, Science Applications International Corporation, and TRW Space and Defense Sector in *Hughes Aircraft Company v. County of Orange* (Court of Appeals, Fourth District, Division 2, California, Case No. E029745). (Emphasis added.)

<sup>46</sup> National Defense Authorization Act of 1998, Pub. L. 105-85, Div. A, Title VIII, Subtitle A (Amendments to General Contracting Authorities, Procedures, and Limitations), §802, 111 Stat. 1831 (1997).

<sup>47</sup> 10 U.S.C. §2307(h), current through Pub. L. 115-173 (emphasis added).

<sup>48</sup> See <http://uscode.house.gov/codification/legislation.shtml>, which states: "[a] positive law title of the Code is itself a Federal statute. A nonpositive law title of the Code is an editorial compilation of Federal statutes. For example, *Title 10, Armed Forces, is a positive law title because the title itself has been enacted by Congress*. Nonpositive law titles are *prima facie* evidence of the law, but positive law titles constitute legal evidence of the law in all Federal and State courts" (1 U.S.C. §204) (emphasis added). For an explanation of the purpose behind and the effect of positive law codification upon the FAR, see John B. Wyatt III, "A Critical Analysis of the *Federal Acquisition Regulation's* Adoption of Positive Law Codification Changes," *Journal of Contract Management*, Vol. 14, Issue 1, Spring 2017.



In *Faustino Furuc v. Ansul Corp. et al.*,<sup>49</sup> the government argued the *Marine Midland* paramount security interest theory to support a claim of liability indemnification from Lockheed Shipbuilding. The dispute arose from a personal injury suit by a worker injured on a ship being constructed in a Lockheed shipbuilding yard. The U.S. government was named by the injured worker as a defendant in the lawsuit. The government then brought a third-party claim against Lockheed as a third-party defendant.

The government could only win its indemnification action against Lockheed if it convinced the court that the government was not the "owner" (i.e., had actual title) of the ship. Therefore, the government argued *Marine Midland*'s reasoning that its legal interest, which was financed by the advancement of progress payments, amounted to a paramount security interest and not title.

The court determined that it was ludicrous to even consider that the government was not the owner of a Navy vessel that contained secret equipment and machinery specifically designed to be used in the national defense. The *Marine Midland* rationale was rejected because the plain meaning of the shipbuilding contract clearly established that the government's interest was actual title.<sup>50</sup>

The *Am. Int'l Specialty Lines Ins. Co. v. United States* decision<sup>51</sup> also shockingly exemplifies the government's treatment of progress payments property as its convenient chameleon. The government did a complete about-face, advocating that its entitlement was not title to escape probable liability in some environmental litigation.

The government was sued under the Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA)<sup>52</sup> for cost recovery as the owner of new rocket engines financed by progress payments. In the process of assembly of these rocket

engines, hazardous substances were wrongfully disposed of when the engines were test-fired. The government asserted the *Marine Midland* holding that the government's interest in the rocket engines was only a paramount security interest. This was done to avoid CERCLA liability. By making that argument, the government either ignored or was intentionally sidestepping 10 U.S.C. §2307(h), which succinctly states that its interest is *authentic* title.

The U.S. District Court completely saw through this flip-flop charade and determined that the government's interest was title by stating that a "literal reading of the title-vesting provisions is particularly compelling in the context of military contracts, when the contracted-for goods are needed for national defense."<sup>53</sup>

### The Government Doesn't Understand That Its Title Interest Is Intended to be Temporary

As if the confusion expressed in the *Marine Midland* and *American Pouch* decisions was not enough, it appears that the government does not fully comprehend that its title interest is intended by the FAR to be temporary. Government title exists solely to protect and serve as collateral for the government's advancement of progress payments. Government title is relinquished and passes to the contractor once the contract is fully completed and the applicable progress payments are repaid. The government does not intend through the advancement of progress payments to buy any property permanently. Again, progress payments are a mechanism of contract financing, not a primary method of government acquisition.

In *G&R Service Company, Inc. v. Department of Agriculture*,<sup>54</sup> a contractor was awarded a fixed-price construction contract by the U.S. Forest Service and delivered construction materials to the jobsite that were never incorporated into the work. The contract incorporated by reference the Payments clause set forth at FAR 52.232-5, titled "Payments Under

<sup>49</sup> 1983 WL 995 (W.D. Wash. 1983).

<sup>50</sup> This court concluded that the government's interest was title even before the *American Pouch* decision had been issued by the U.S. Fifth Circuit Court of Appeals.

<sup>51</sup> *Am. Int'l Specialty Lines Ins. Co. v. United States*, Case No. CV-09-1734 AHM (RZx) (C.D. Cal. January 31, 2013).

<sup>52</sup> 42 U.S.C. §§ 9607(a)(2), 9601(9)(A).

<sup>53</sup> Citing *Northrop Grumman Corp.*, 134 Cal. App. 4th at 428.

<sup>54</sup> *G&R Service Company v. Dept. Agriculture*, CBCA No. 121, 2007-1 BCA ¶33, 2007 CIVBCA LEXIS 29 (2007).

Fixed-Price Construction Contracts.” That Payments clause called for the government contracting officer to make progress payments to the contractor. The contract made no provision for the contractor to deliver material other than the items that were to be incorporated into the construction itself.

During the course of performance of this construction project, G&R submitted several progress payment invoices upon which payment to G&R was made. These progress payments financed the progress payments property to be incorporated into the construction, including some surplus construction materials that were leftover. G&R successfully completed performance of the contract as evidenced by the Forest Service issuing to G&R a Certificate of Final Inspection. Because of that acceptance of the work, all previously advanced progress payments were fully repaid and completely liquidated.

Despite the progress payments being fully repaid, the Forest Service seized the surplus construction materials before the contractor could remove them. The Forest Service justified its action by claiming that surplus progress payments property remained government property because it had been paid for by government progress payments and was delivered to the job site. Again, those materials were extras and had not been used in the contractual performance of the work. G&R sought the return of these surplus materials. The government refused to return them, which compelled G&R to file a claim for their monetary value. The contracting officer by final written decision denied the claim in its entirety.

As previously stated, the contract incorporated by reference the Payments clause set forth at FAR 52.232-5, which provided, in pertinent part:

Title, liability, and reservation of rights. *All material and work covered by progress payments made shall, at the time of payment, become the sole property of the government.*<sup>55</sup>

The contracting officer, seizing upon this language from the contract's Payments clause, denied G&R's claim by stating that the “material is the sole property of the government at the time payment is

made.” The contractor appealed that decision to the Civilian Board of Contract Appeals (CBCA).

The CBCA decided that G&R was legally entitled to recover monetary compensation for the unused materials that were wrongfully kept by the Forest Service after contract completion. The board emphasized that the words “sole property of the government at the time payment was made” was never intended as a permanent divestiture of title to any materials acquired with the progress payments, unless those materials had become part of the “discrete work items completed during the course of construction.”<sup>56</sup>

The underlying purpose behind that language was the creation of “a security interest in favor of the government in materials...covered by the progress payments” made to G&R.<sup>57</sup> Once G&R completed the construction and it was inspected and accepted by the Forest Service, the progress payments had been completely liquidated. There was no longer a need to secure the prior progress payments since all payments advanced had been repaid. As the CBCA stated in its decision:

Nothing in the contract indicated that the contractor was expected to furnish for the Government's use extra conduit, wire, and other materials that would not be needed for completion of this electrical and mechanical work. Thus, contrary to the Forest Service's contention that it “paid” for the unused materials, ...*the only thing specified and paid for under this fixed price construction contract was the construction work that G&R completed and that the Forest Service accepted. To interpret the Payments clause of this contract otherwise would result in an unjustified windfall for the Government, one that, as G&R correctly indicates, would unfairly deprive the contractor of a substantial portion, if not all, of the profit earned by reason of the successful completion of the work.*<sup>58</sup>

In further support of its decision, the CBCA referenced FAR 52.232-16, “Progress Payments,” and focused on the clear language of subsection (d)

<sup>56</sup> See G&R Service Company, *op. cit.*, at 11.

<sup>57</sup> *Ibid.*, at 12.

<sup>58</sup> *Ibid.*, at 12, 13 (emphasis added).

<sup>55</sup> FAR 52.232-5(f).

(6), which completely reaffirms that any excess progress payments property remaining after the successful completion of contractual requirements and liquidation of all progress payments is contractor property:

When the contractor completes all of the obligations under this contract, including liquidation of all progress payments, title shall vest in the Contractor for all property (or the proceeds thereof) not...[d]elivered to, and accepted by, the Government under this contract; or...[i]ncorporated in supplies delivered to, and accepted by, the Government under this contract and to which title is vested in the Government under this clause.<sup>59</sup>

## Conclusion

This article has demonstrated that the debate regarding the correct designation of the government's rights in progress payments property is still unresolved. Regarding military contracts, 10 U.S.C. §2307(h) has finally decided that issue once and for all. Hopefully, the government does not again attempt to disregard its own statute. No plausible explanation was ever proffered by the government as to why it believed that it could circumvent the clear-cut language of its own statute.

What is troublesome is perhaps that such conduct may speak to a cavalier government mindset that it is above the law and can sidestep its own statutes at its whim. Hopefully, the *Am. Int'l Specialty Lines Ins. Co. v. United States* decision<sup>60</sup> has taught the government an important lesson. Unfortunately, 10 U.S.C. §2307(h) addresses only military contracts and is not applicable to other government agency procurements. Thus, the government's ability to treat progress payments property as its convenient chameleon survives for every other nonmilitary agency's acquisitions using progress payments financing.

Remember, FAR Case 89-31 was withdrawn with the brief explanation that it was deemed to be "unnecessary because the *FAR* adequately covers the issues addressed by the proposed rule." That weak

and confusing rationale completely ignored the significance and potential adverse ramification resulting from the differing opinions of *Marine Midland* and *American Pouch*. Could the undisclosed reason that the FAR Case was rejected possibly be that the government wanted to maintain its flexibility to argue title versus paramount security interest at its discretion? Was the convenient chameleon intended to live another day?

This author believes the answer is clearly "yes." The withdrawal occurred because the government was determined to keep the convenient chameleon intact and beneficial. If that FAR Case had been enacted, the chameleon would be dead.

Even more disturbing is the government's conduct in the *GER* case. By refusing to surrender the seized leftover construction materials, the government's actions arguably amounted to conversion and theft of the contractor's property.

This author must question the wisdom of the contracting officer in believing that the government owned that property after the acceptance of all work and the full repayment of the applicable progress payments. Did the contracting officer read the *FAR* or was it merely a simple case of ignorance regarding its progress payments provisions? Was a legal opinion requested from agency counsel? Potentially even more disturbing would be whether that legal opinion advised the contracting officer that the surplus material was government-owned. Or, as the CBCA hinted, was the Department of Agriculture possibly in search of a monetary windfall that potentially would have erased the contractor's profit for the work accepted?

In this author's opinion, the contracting officer's final decision was not merely erroneous but also not substantially justified. Worse yet, a plausible argument can be made that the contracting officer's final decision constituted a breach by the government of its implied covenant of good faith and fair dealing.<sup>61</sup> As the CBCA determined, FAR 52.232-16(d)(6) succinctly provided the requisite guidance that if advance progress payments are fully repaid, then any leftover progress payments property

<sup>59</sup> FAR 52.232-16(d)(6).

<sup>60</sup> See note 51.

<sup>61</sup> See, e.g., *Metcalfe Construction Company, Inc. v. U.S.*, 742 F.3d 984, 2014 U.S. App. LEXIS 2515 (2014).

belongs to the contractor. What impeded the contracting officer from following that clear-cut direction? Did not the failure of the contracting officer to adhere to such unambiguous regulatory guidance result in arguably frivolous litigation?

This article has identified how the government's treatment of progress payments property as its convenient chameleon causes confusion to the courts, perpetuates litigation, and impedes the efficient and effective administration of federal government contracts. The solution to this frustrating situation is simple. Amend the *FAR* to include the "actual title" language as originally provided in FAR Case 89-31 or enact a statutory amendment similar to the pronouncements of 10 U.S.C. §2307(h) that applies to all federal government procurements. Until that happens, the government's "convenient chameleon" will still survive. *JCM*

# Good Faith in Contract Management—A Real Duty

BY KENNETH ALLEN AND ALLIE STANZIONE

## Abstract

**Purpose:** Understanding all of a contract's obligations is essential to good contract management. This article explains the implied duty of good faith as an actual contractual requirement and illustrates it with case law and references. It also explains the relationship between the duty and the government's "constructive change" to a contract by failing to cooperate, which is the framework for most litigation alleging the government's violation of the duty. Finally, the article addresses the confusion created by a 2010 opinion of the Court of Appeals for the Federal Circuit that would make the federal government practically immune from violating this duty.

**Approach:** Posit purpose—to inform on the law and also correct misimpressions; explain and illustrate key principles; show the relationship of the duty to a constructive change; and clarify when the federal government is held to a different standard.

**Findings:** The obligation of good faith and fair dealing applies with equal authority in private and government contracting. There is a special standard for the government in limited situations.

**Research Implications:** Like all legal principles, this topic is bound by case law and legal treatises.

**Value:** The authors do not know of another comparable approach to succinctly explaining this topic and clarifying an important misimpression—especially for an audience of readers beyond legal specialists.

## Keywords

constructive change, precision pine [leading court opinion], duty to cooperate, good faith and fair dealing

***Contract Management Body of Knowledge® (CMBOK®) Competencies:*** 3.0, "Guiding Principles"; 6.0, "Post-Award"

## About the Authors

**Kenneth Allen** was a government lawyer for 31 years and after retirement from the federal government, served as a corporate counsel and a private educator. During his last 10 years in the federal government, Ken was triple tasked as the Command Counsel for Programs, Acquisition, and Litigation for the U.S. Medical Research and Materiel Command, Ft. Detrick, Maryland; as Counsel to the Department of Defense's programs for biological, chemical, and medical defensive measures; and as a Special Assistant U.S. Attorney for procurement fraud. Following retirement from federal service, he served as an adjunct professor to the Naval Postgraduate School, teaching at its Monterey, California, campus and overseas, and authored and edited publications on defense acquisition. Ken passed away in 2019.

**Allie Stanzione, CPCM, CFCM, Fellow**, is a Senior Principal Contracts Manager at General Dynamics Cyber Systems. Her career has spanned contracting, procurement, and subcontracts positions in academia, international, commercial, state, and federal government contracts fields. She is a graduate of NCMA's Contract Management Leadership Development Program, served two consequent terms on NCMA's national Board of Directors, is a long-standing member of NCMA's Boston Chapter, and is a frequent contributor to NCMA publications—including *Contract Management Magazine*.

and the *Journal of Contract Management*. She is a past recipient of the *Boston Business Journal's* Top 40 Under 40 Award and NCMA's James E. Cravens Membership Award and received Honorable Mention in the Sixth Annual Macfarlan Excellence in Contract Management Research and Writing Program.

"It is well established that contracts can include implied duties, such as the duty of good faith and fair dealing."

—*CiyaSoft* (Armed Services Board of Contract Appeals, 2018)<sup>1</sup>

## Introduction—Law or Legend?

American common law, and indeed commercial law throughout the western world, imposes a requirement on both contracting parties to act in good faith and to deal fairly and cooperatively with each other. Most acquisition professionals have at least heard of this "Duty of Good Faith and Fair Dealing," which is also called an "implied duty not to hinder" and an "implied duty to cooperate";<sup>2</sup> however, many have not had much of an explanation for it. Some view it as a "throwaway" argument that comes up in litigation without much legal clout; some even think it is apocryphal or a *façon de parler* from a bygone legal era. This is unfortunate because it is a real duty, and contractors are citing a violation of the duty with increased frequency in their disputes and litigation.

Added to this, a 2010 decision of the Court of Appeals for the Federal Circuit, *Precision Pine*,<sup>3</sup> followed by a 2012 decision of the Court of Federal Claims, stirred up the already cloudy understanding of the government's duty. A panel of the Federal Circuit sought to clarify *Precision Pine* in its 2014 *Metcalf* opinion,<sup>4</sup> but misunderstandings about the

government's duty linger—and in some cases abound, some of the fault for which can be laid at the courthouse door.<sup>5</sup>

This article will explain and illustrate the duty, which applies to all contracts, and how the government's breach of the duty is commonly treated as a "constructive change" to a government contract. The article will also explain the Federal Circuit's 2010 *Precision Pine* decision, which it clarified in its 2014 *Metcalf* decision.

## Examining the Duty

### A Real Duty

The duty of good faith and fair dealing has a long history, but it really came into its own in America during the Nineteenth Century.<sup>6</sup> It is very much alive and well, and it applies in federal government contracting.

### An Implied Duty

In countries that follow the English Common Law tradition, such as the United States, England and its Commonwealth, and the nations of the former British Empire, the duty is seldom set out as an express contract requirement, but it need not be, and a party cannot disclaim it. If the duty is violated, the law provides the innocent party with a remedy.

### An Express Duty

In countries that follow a Civil Law tradition, which is most of the world, the duty is spelled out in the statutory law of contract, and it is often included in the express terms of contracts. Consider the

<sup>1</sup> *CiyaSoft Corporation*, ASBCA Nos. 59519, 59913, 18-1 BCA ¶37,084. (This case is discussed later in the article.)

<sup>2</sup> *Scott Timber Company v. United States*, 692 F.3d 1365, 1372 n. 2 (Fed. Cir. 2012), rehearing and rehearing en banc denied, 499 Fed. Appx. 973 (Fed. Cir. 2013) (unpublished).

<sup>3</sup> *Precision Pine & Timber, Inc. v. United States*, 596 F.3d 817 (Fed. Cir. 2010).

<sup>4</sup> *Metcalf Const. Co., Inc. v. United States*, 742 F.3d 984 (Fed. Cir. 2014).

<sup>5</sup> For an excellent discussion of how courts sometimes do not hold the government to the common law standard of good faith (which is supposed to be the law), see Claybrook, Frederick W. Jr., "A Twice-Told Tale: The Strangely Repeated Story of 'Bad Faith' in Government Contracts," *The Federal Circuit Bar Journal* 24, no. 1 (2014), at 34, and Johnson, W. Stanfield, "Mixed Nuts and Other Humdrum Disputes: Holding the Government Accountable Under the Law of Contracts Between Private Individuals," *Public Contract Law Journal* 32 (2003), 677 (discussing Federal Circuit cases that deviated from the common law in favor of the government).

<sup>6</sup> See Dubroff, Harold, "The Implied Covenant of Good Faith in Contract Interpretation and GAP-Filling: Reviving a Revered Relic," *St. John's Law Review* 80, no. 2 (2006), 559 (tracing the origins of the doctrine).



*Principles of International Commercial Law* of the International Institute for the Unification of Private Law (UNIDROIT):

Article 1.7 Good Faith and Fair Dealing

- (1) Each party must act in accordance with good faith and fair dealing in international trade.
- (2) The parties may not exclude or limit this duty.

Excepting the words “in international trade,” Article 1:201 of the *European Union Principles of Contract Interpretation* is verbatim to UNIDROIT’s Article 1.7. The duty is a universal requirement in contractual relationships.<sup>7</sup>

### The Conceptual Framework of the Duty

Like many legal doctrines, the duty of good faith rests on legal philosophies. In the United States, two influential commentators on the subject are professors Robert Summers and Steven Burton.

Professor Summers espouses what he calls an “excluder analysis,” under which concept certain conduct is “excluded” based on the context of the situation. In the contract administration stage, Professor Summers has categories of:

- Bad faith in contract performance,
- Bad faith in raising and resolving contract disputes, and
- Bad faith in taking remedial action.<sup>8</sup>

*The Restatement (Second) of Contracts* follows Professor Summers’ approach. Professor Burton focuses on one party’s responsibility for lost

opportunities for the other party.<sup>9</sup> The excluder analysis and forgone opportunities approaches have greatly assisted courts in applying the “notoriously abstract notion of good faith to hard facts.”<sup>10</sup>

### A Rule of Interpretation or Construction?

For at least the last 200 years, legal scholars have been debating the distinction (if any) between contract “interpretation” and “construction.”<sup>11</sup> In essence, *interpretation* seeks the meaning of a contract—i.e., the objective meaning of the words the parties signed; while *construction* involves the application of rules or principles to the interpreted document.

For example, if an adult and a minor enter into a contract, interpretation will tell us what the contract means. Construction will impose the rule that the minor can disavow the obligation, but the adult cannot.

In practice, the distinction between interpretation and construction—assuming the lawyers or judges even appreciate it—is largely ignored. The focus is on the end result of the litigation.<sup>12</sup> Yet there is a legitimate academic and legal distinction between the two functions, and familiar concepts in

<sup>9</sup> See Burton, Steven J., “Breach of Contract and the Common Law Duty to Perform in Good Faith,” *Harvard Law Review* 94 (1980): 369, 372; Burton, Steven J. and Eric G. Andersen, *Contractual Good Faith: Formation, Performance, Breach, and Enforcement* (New York: Little, Brown, 1995).

<sup>10</sup> Hough, Emily M.S., “The Doctrine of Good Faith in Contract Law: A (Nearly) Empty Vessel?” *Utah Law Review* 1 (2005): 13.

<sup>11</sup> For a thorough analysis of the interpretation/construction distinction, see Klass, Gregory, “Interpretation and Construction in Contract Law,” Georgetown University Law Center (2018).

<sup>12</sup> The Government Accountability Office, in its online multi-volume “Red Book” on government legal subjects, acknowledges the distinction, but following the lead of treatises such as *Sutherland’s Statutory Construction*, treats them the same. (See *Principles of Federal Appropriations Law*, Vol I, Ch. 2, §D; Scalia, Antonin and Bryan A. Garner, *Reading Law: The Interpretation of Legal Texts* (Thomson/West, 2012): 427 (in which Justice Scalia and Professor Garner appear to use the term “interpretation” synonymously with “construction”); and *The Farnsworth series* on contract law, specifically *Farnsworth on Contracts*, §7:7 (3rd ed.), which has long ago brushed aside the distinction (“The distinction between construction and interpretation is difficult to maintain.”).)

<sup>7</sup> See also UNIDROIT’s Article 5.2, “Implied Obligations,” and Article 5.3, “Cooperation Between the Parties”; as well as *Principles of European Contract Law*, Article 1:202, “Duty to Cooperate.”

<sup>8</sup> See Summers, Robert S., “‘Good Faith’ in General Contract Law and the Sales Provisions of the Uniform Commercial Code,” *Virginia Law Review* 54 (1968): 195–196; “The General Duty of Good Faith – Its Recognition and Conceptualization,” *Cornell Law Review* 67 (1982): 801, 816; Hough, Emily M.S., “The Doctrine of Good Faith in Contract Law: A (Nearly) Empty Vessel?” *Utah Law Review* 1 (2005); and Hough, “Critical Interventions: Toward an Expansive Equality Approach to the Implied Doctrine of Good Faith in Contract Law,” *Cornell Law Review* 88 (2003): 1025, 1088.

interpretation disputes—such as *contra proferentem*; i.e., which “rule” or “doctrine” penalizes the side that wrote an ambiguous contract—is really a rule of construction and not of interpretation. The same goes for the duty of good faith and fair dealing.<sup>13</sup>

### A Contract-Specific Scope of Duty

Some acquisition professionals and legal practitioners occasionally express frustration over the absence of a template for the duty that they can cast their contracts and cases into to gauge the parameters of the duty, or to test for the occurrence of a breach. That frustration is somewhat understandable because there is no one-contract-fits-all formula for the duty.

As the Court of Appeals for the Federal Circuit has explained, the purpose and value of the duty is—

[B]ecause it is rarely possible to anticipate in contract language every possible action or omission by a party that undermines the bargain.<sup>14</sup>

The scope of the duty is grounded in the terms of each individual contract:

What is promised or disclaimed in a contract helps define what constitutes lack of diligence and interference with or failure to cooperate in the other party’s performance.<sup>15</sup>

The scope depends on the reasonable expectations the parties bring with them when they enter into the contract. Depending on how readily a court will consider information from outside a contract,<sup>16</sup> the scope may be contoured by—

<sup>13</sup> See Klass, Gregory, “Interpretation and Construction in Contract Law,” *Georgetown University Law Center* (2018): §1:3.

<sup>14</sup> *Metcalf Construction Co., Inc. v. United States*, 742 F.3d 984, 991 (Fed. Cir. 2014).

<sup>15</sup> *Fortis Networks, Inc. v. Department of the Interior*, CBCA No. 4176, 15-1 BCA ¶36,066.

<sup>16</sup> In federal government contract litigation, the courts apply what is called the “Plain Meaning Rule,” which restricts consideration of information from outside the pages of the contract to situations where the judge has first determined that the contract is ambiguous—i.e., where both parties hold reasonable and competing interpretations. (See Allen, Kenneth J., *The Contract Interpretation Handbook, A Guide to Avoiding and Resolving Government Contract Disputes* (2018–2019 ed.) (Thomson Reuters, 2018): §6:12–29.)

- The parties’ pre-award communications and negotiations;
- How the parties carried out previous contracts between themselves (i.e., “course of dealing”)<sup>17</sup>; and
- How the parties carried out their current contract before they disputed it (i.e., “course of performance”).<sup>18</sup>

The scope of the duty cannot expand the terms of the contract, but it does guard against unreasonable conduct that is “inconsistent with the contract’s purpose and deprives the other party of the contemplated value.”<sup>19</sup>

The duty can serve as a standard for governing the parties’ conduct and obligations in discretionary circumstances and situations that are difficult to anticipate and impractical to capture in contract documents.<sup>20</sup> It has been described in various ways, from lofty goals such as honesty and other positive exhortations, to minimal standards, such as no bad faith or (at the very least) not hindering the other party’s execution of the contract. The duty can be a “safety valve to which judges may turn to fill gaps and qualify or limit rights and duties arising under rules of law and specific contract language.”<sup>21</sup>

### The Duty in Law and Legal References

“In every contract, there exists an implied covenant of good faith and fair dealing.”

—*Williston on Contracts*<sup>22</sup>

### The Duty in International Law

As previously noted, international compilations and national codes of commercial law all impose a duty of good faith and fair dealing on the contracting

<sup>17</sup> See *Restatement (Second) of Contracts* (1981): §223. (hereinafter “Restatement”)

<sup>18</sup> *Ibid.*, at: §202(4).

<sup>19</sup> *Metcalf Construction Co. v. United States*, 742 F.3d 984, 991 (Fed. Cir. 2014).

<sup>20</sup> See *North Star Alaska Housing Corp. v. United States*, 76 Fed. Cl. 158, 189 (2007) (citing *Craig-Buff Ltd. Partnership v. United States*, 69 Fed. Cl. 382 (2006)).

<sup>21</sup> Summers, Robert S. “The General Duty of Good Faith—Its Recognition and Conceptualization,” *Cornell Law Review* 67 (1982): 810, 812.

<sup>22</sup> Lord, Richard A., *Williston on Contracts* (fourth ed.): §38:15.



parties, as well as obligations to act reasonably in the execution of their contracts.

### **The Duty in the *Restatement (Second) of Contracts***

The most authoritative compilation and commentary on American contract law is the American Legal Institute's *Restatement (Second) of Contracts*.<sup>23</sup> The *Restatement* is often cited and relied on by the courts to establish, explain, and apply the duty in contract litigation, which is why this article has set out key sections of the *Restatement* on the duty.<sup>24</sup>

As the *Restatement* states, "[e]very contract imposes upon each party a duty of good faith and fair dealing in its performance and its enforcement."<sup>25</sup>

#### **Good Faith**

A party satisfies its obligations if it conducts itself in good faith, and the *Restatement* provides a definition of *good faith*:

The phrase "good faith" is used in a variety of contexts, and its meaning varies somewhat with the context. Good faith performance or enforcement of a contract emphasizes faithfulness to an agreed common purpose and consistency with the justified expectations of the other party; it excludes a variety of types of conduct characterized as involving "bad faith" because they violate community standards of decency, fairness, or reasonableness.<sup>26</sup>

#### **Bad Faith**

Acting in bad faith is obviously the absence of good faith, and hence would violate the duty of good faith and fair dealing. As the Court of Federal Claims has explained:

Because it is an implied term of every contract that each party will act in good faith towards the other, a party may breach a contract by acting in bad faith.<sup>27</sup>

The *Restatement* offers these comments about what constitutes "bad faith":

Subterfuges and evasions violate the obligation of good faith in performance, even though the actor believes his conduct to be justified. But the obligation goes further: bad faith may be overt or may consist of inaction, and fair dealing may require more than honesty. A complete catalogue of types of bad faith is impossible, but the following types are among those which have been recognized in judicial decisions: evasion of the spirit of the bargain, lack of diligence and slacking off, willful rendering of imperfect performance, abuse of power to specify terms, and interference with or failure to cooperate in the other party's performance.<sup>28</sup>

(...)

The obligation of good faith and fair dealing extends to the assertion, settlement, and litigation of contract claims and defenses.... The obligation is violated by dishonest conduct such as conjuring up a pretended dispute, asserting an interpretation contrary to one's own understanding, or falsification of facts. It also extends to dealing which is candid but unfair, such as taking advantage of the necessitous circumstances of the other party to extort a modification of a contract...without legitimate commercial reason.... Other types of violation have been recognized in judicial decisions: harassing demands for assurances of performance, rejection of performance for unstated reasons, willful failure to mitigate damages, and abuse of a power to determine compliance or to terminate the contract....<sup>29</sup>

<sup>23</sup> *Restatement*, *supra* note 17..

<sup>24</sup> The duty is also imposed on merchants in Article 2 of the Uniform Commercial Code (UCC), §1-203, "Obligation of Good Faith" ("Every contract or duty within this Act imposes an obligation of good faith in its performance or enforcement."). *Good faith* is defined in the UCC in §1-201 as "honesty in fact in the conduct or transaction concerned."

<sup>25</sup> *Restatement*, *supra* note 17, "Duty of Good Faith and Fair Dealing."

<sup>26</sup> *Ibid.*, at §205, Comment: a. ("Meanings of 'good faith'....").

<sup>27</sup> *North Star Alaska Housing Corp. v. United States*, 76 Fed. Cl. 158, 187 (2007).

<sup>28</sup> *Restatement*, *supra* note 17, at §205, Comment: d. ("Good faith performance").

<sup>29</sup> *Ibid.*, at §205, Comment: e. ("Good faith enforcement").

In government contracting, the case law states that proof of the government's bad faith "must be almost irrefragable,"<sup>30</sup> or show a "specific intent to injure the plaintiff by clear and convincing evidence [because] government officials are presumed to act in good faith and it takes clear and convincing evidence to prove otherwise."<sup>31</sup> However, these standards are not quite in line with the common law to which the government is supposed to be subject when it contracts.<sup>32</sup> Yet, one does not need proof of bad faith to show a breach of the duty of good faith and fair dealing.

### Dereliction of the Duty—Without Bad Faith

It is possible to violate the covenant of good faith and fair dealing without acting in bad faith. Depending upon the impact on the innocent party, the breaching party's bad faith, motives, bias, etc., need not be an issue as to whether there has been a breach of the duty. As the Court of Federal Claims has explained—

In order to show a breach of the covenant of good faith and fair dealing, the plaintiff need not provide evidence to show that the government acted in bad faith. This is because a claim that the government breached the covenant of good faith and fair dealing is not the same as a claim that the government acted in bad faith. An allegation of breach of the covenant of good faith and fair dealing is an allegation that the party's contracting partner deprived it of the fruits of the contract, and is often motivated by self-interest, while bad faith is motivated by malice and does not necessarily result in a deprivation of the fruits of the contract.<sup>33</sup>

In essence, the implied covenant of good faith and fair dealing provides that no party may act to

destroy the reasonable expectations of its contracting partner or to deprive its contracting partner of the fruits of the contract, and a breach of the duty does not require that the breaching party is acting in bad faith or even exclusively in its self-interest.<sup>34</sup>

### The Duty of Good Faith and Fair Dealing in Government Contracting

"An implied duty of good faith and fair dealing exists in government contracts and applies to the government just as it does to private parties."

—*Agility Public Warehousing v. Mattis* (Court of Appeals for the Federal Circuit, 2017).<sup>35</sup>

The duty of good faith and fair dealing has long applied in federal contracting. An early case, *United States v. Smith*,<sup>36</sup> held the government to the duty, but contractors are held to the duty as well. Today, when the government evaluates a contractor's performance, two of the factors to be considered are:

- A contractor's reasonable and cooperative behavior and commitment to customer (i.e., government) satisfaction<sup>37</sup>; and
- A contractor's business-like concern for the interests of the customer.<sup>38</sup>

The evaluation of these factors are important components of a contractor's record of past performance, which is considered for the award of future contracts ranging from multimillion-dollar contracts under *Federal Acquisition Regulation (FAR)* Part 15,<sup>39</sup> to the award of contracts using the "simplified" acquisition procedures of FAR Part 13.<sup>40</sup>

<sup>34</sup> See *Tecom, Inc. v. United States*, 66 Fed. Cl. 736, 770 (2005).

<sup>35</sup> *Agility Public Warehousing Company KSCP v. Mattis*, 852 F.3d 1370, 1382-83 (Fed. Cir. 2017).

<sup>36</sup> *United States v. Smith*, 12 Ct. Cl. 119, 94 U.S. 214, 24 L. Ed. 115 (1876).

<sup>37</sup> *Federal Acquisition Regulation (FAR)* 42.1501(a)(4).

<sup>38</sup> FAR 42.1501(a)(7).

<sup>39</sup> E.g., FAR 15.305(a)(2) (see *RMS Industries*, B-247229, B-247794, 92-1 CPD ¶451).

<sup>40</sup> See *John Blood*, B-290593, 2002 CPD ¶151 (evaluation of past performance noted that the contractor was "unprofessional" and "adversarial" in its relations with the government agency).

<sup>30</sup> *Galen Medical Associates, Inc. v. United States*, 369 F.3d 1324, 1330 (Fed. Cir. 2003).

<sup>31</sup> *Road and Highway Builders, LLC v. United States*, 702 F.3d 1365, 1368-1369 (Fed. Cir. 2012).

<sup>32</sup> For a discussion on how the common law does require that level of proof, see Toomey, Daniel E. et al., "Good Faith and Fair Dealing: The Well-Nigh Irrefragable Need for a New Standard in Public Contract Law," *Public Contract Law Journal* 20 (1990): 87, 88, 124-125; and the references in note 5 (*supra*).

<sup>33</sup> *Agredano and Leon v. United States*, 70 Fed. Cl. 564, 574 (2006).

The government has been found to have breached its obligation of good faith and fair dealing in the way it—

- Terminated a contract for default<sup>41</sup>;
- Assessed liquidated damages<sup>42</sup>;
- Ignored contractor claims and unreasonably scheduled contractors' work<sup>43</sup>;
- Refused to provide directions in response to clear requests by the contractor<sup>44</sup>; and/or
- Acted in a clearly improper manner.<sup>45</sup>

An example of the government acting “in a clearly improper manner” occurred in *Apex*,<sup>46</sup> where the government acted with “hostility” toward and “contempt” for the contractor by refusing to provide the keys to areas and equipment the contractor needed to do the work, and “even maliciously throwing them on the roof or in trash dumpsters,” and—perhaps more amazing—“removing telephones and tearing out telephone wiring and air conditioning equipment.”

The duty also extends to negotiating strategies. For example, in *Moreland*,<sup>47</sup> it was held that the contracting officer violated the duty by denying part of a claim that was justified in order to improve his negotiating posture on another claim. As another example, in *Bell BCI*,<sup>48</sup> the contracting officer was held to have violated the duty when he withheld authorized entitlements.<sup>49</sup>

<sup>41</sup> *Malone v. United States*, 849 F.2d 1441 Fed. Cir. 1988), *opinion modified*, 857 F.2d 787 (Fed. Cir. 1988) (in which the government acted in bad faith by evasive responses to the contractor's legitimate inquiries regarding contract requirements).

<sup>42</sup> *Abcon Assoc., Inc. v. United States*, 49 Fed. Cl. 678 (2001), *aff'd*, 52 Fed. Appx. 510 (Fed. Cir. 2002).

<sup>43</sup> *Nash Janitorial Serv., Inc.*, GSBGA No. 6390, 84-1 BCA ¶17,135, *recons. denied*, 84-2 BCA ¶17,355.

<sup>44</sup> *National Printing and Copying*, VABCA No. 7211, 06-1 BCA ¶33, 183.

<sup>45</sup> *Apex Int'l Mgmt. Servs., Inc.*, ASBCA No. 38087, 94-2 BCA ¶26,842.

<sup>46</sup> *Ibid.*

<sup>47</sup> *Moreland Corp. v. United States*, 76 Fed. Cl. 268 (2007).

<sup>48</sup> *Bell BCI Co. v. United States*, 81 Fed. Cl. 617 (2008), *vacated on other grounds*, 570 F.3d 1337 (Fed. Cir. 2009).

<sup>49</sup> See Nash, Ralph C. Jr. and John Cibinic, Jr., “Negotiating Ploys: A Common Practice?” *Nash & Cibinic Report*, 22 (August 2008): ¶48.

## An Affirmative Obligation to Reasonably Assist

Most jurisdictions view the duty as including an obligation for the parties to assist and cooperate with each other, and that is the law in government contracting. This was explained by the Court of Federal Claims:

[One party] must not only not hinder [the other party's] performance, he must do whatever is necessary to enable him to perform.... The implied obligation is as binding as if it were spelled out. Reading the contract at issue in conjunction with the long-recognized implied obligation of good faith and fair dealing, the court can come to no other conclusion than that the government was impliedly obligated to do what was necessary to enable the contractor to perform....<sup>50</sup>

In *R.W. Jones*,<sup>51</sup> the government breached the duty when it refused to help the contractor resolve a matter with an adjoining property owner—an issue that was impacting the performance of the contract. In *CRF*,<sup>52</sup> when the contractor sought the assistance of the contracting officer in obtaining the work-in-progress of its defaulted and bankrupt subcontractor, it was met with an “it's the sole responsibility of the contractor” response, and that was held to be a breach of the duty.

Of course, the duty does not extend to unreasonable assistance, such as modifying the terms of the contract to accommodate the contractor's financial inability to perform.<sup>53</sup>

## Litigating the Duty

In government contracting, the government may have a remedy against a contractor that breaches the duty.<sup>54</sup> However, it is usually contractors who allege

<sup>50</sup> *Blackstone Consulting Inc. v. United States*, 65 Fed. Cl. 463, 471 (2005), *aff'd*, 170 Fed. Appx. 128 (Fed. Cir. 2006).

<sup>51</sup> *R.W. Jones Construction, Inc.*, IBCA No. 3656, 99-1 BCA ¶30,268.

<sup>52</sup> *CRF v. United States*, 654 F.2d 1054 (Ct. Cl. 1980).

<sup>53</sup> See, e.g., *Symionics*, ASBCA No. 60335, 60612, 17-1 BCA ¶36,790, *citing Rashed Elham Trading Co.*, ASBCA No. 58383 *et al.*, 17-1 BCA ¶36,869.

<sup>54</sup> See, e.g., *Daewoo Engineering and Const. Co., Ltd. v. United States*, 73 Fed. Cl. 547 (2006), *aff'd*, 557 F.3d 1332 (Fed. Cir. 2009) (holding that the

a government breach of the duty as the basis for a claim, or a request for an equitable adjustment and a subsequent appeal, because of a “constructive change.”

### The Changes Clause

In practice, the Changes clause is the key to most litigation involving an allegation that the government failed to live up to the duty. The Changes clause is a noteworthy aspect of federal procurement. It not only avoids the need for a new contract every time there is a change, but it also has three components that ensure the government can make the needed changes and that the contractor is fairly compensated:

- It allows the government to unilaterally change certain aspects of the contract, including the specifications, as long as the changes are within the scope of the contract<sup>55</sup>;
- It requires the contractor to perform the work as changed<sup>56</sup>; and
- It requires the contracting officer to make an “equitable adjustment” of cost plus a reasonable fee.<sup>57</sup>

It is the Changes clause and its entitlement to an equitable adjustment that ties it into the so-called “constructive change doctrine,” and it is under the constructive change doctrine that most allegations of a government breach of the duty of good faith are litigated. In fact, there is case law for the proposition that if a claim can be viewed as a constructive change, and therefore can be adjudicated under a provision in the contract (e.g., the Changes clause), then a breach of contract claim will not be entertained.<sup>58</sup>

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contractor’s inflated claim breached the duty).

<sup>55</sup> FAR 52.243-1, “Changes—Fixed Price (Aug 1987),” at (a)(1).

<sup>56</sup> *Ibid.*, at (e). (In fact, a refusal to continue work as ordered by the contracting officer, or in conformance with the contracting officer’s interpretation of the contract, is a breach of the Disputes clause (FAR 52.233-1, “Disputes” (May 2014), at (i)), and that warrants a termination for default. See *Aero Products, Co.*, ASBCA No. 44030, 93-2 BCA ¶25,868.)

<sup>57</sup> *Ibid.*, at (b). (The contracting officer also must adjust the contract schedule if necessary.)

<sup>58</sup> See, e.g., *Johnson & Son Erectors*, ASBCA No. 24564, 81-1 BCA ¶15,082, *aff’d* 231 Ct. Cl. 753, *cert. denied*, 459 U.S. 971 (1982).

### The Constructive Change Doctrine

When the jurisdiction of the Boards of Contract Appeals was limited to disputes “arising under” a term of the contract, the Boards fashioned what became known as the “constructive change doctrine.” In essence, the doctrine applies in situations where two elements are present:

1. *The “change” element*: Occurs where the government—
  - Has done something it should not have done or fails to do what it should have done, and
  - Directs contractor performance outside the terms of the contract; and
2. *The “government order” element*: Occurs when the contractor has no choice but to follow the contracting officer’s directions when a change element has occurred.

To recover for a constructive change, a contractor must prove two things:

1. That it performed work beyond the contract requirements; and
2. That the additional work was ordered, expressly or impliedly, by the government.<sup>59</sup>

With the passage of the Contract Disputes statute,<sup>60</sup> the Boards’ jurisdiction was expanded to matters “related to the contract,”<sup>61</sup> and therefore the constructive change doctrine is actually no longer necessary. However, the Boards (and courts) apply it because it provides for a contractor remedy under

<sup>59</sup> As will be discussed later in this article, one example case features the government’s direction to discontinue military supervised crossings and transition to the use of the Safwan commercial crossing, which constituted a constructive change to the contract. (See *Anham Fzco, LLC*, ASBCA No. 58999, 2018 WL 6709694, *citing Bell/Heery, a Joint Venture v. United States*, 739 F.3d 1324, 1335 (Fed. Cir. 2014); and *AMEC Environment & Infrastructure, Inc.*, ASBCA No. 58948, 15-1 BCA ¶35,924.)

<sup>60</sup> 41 U.S.C. Chapter 71 (formerly known as the Contract Disputes Act of 1978 (CDA)).

<sup>61</sup> 41 U.S.C. §7105(e)(1)(A) and (B). (The Court of Federal Claims (and its predecessors), which is the other trial level forum for government contract appeals, always had jurisdiction over claims both “arising under” and “related to” a contract.)

the Changes clause in the form of an equitable adjustment, on which there is ample precedent for computing the amount of the contractor's entitlement. In short—

- The judges like a constructive change claim because it is easier to decide than a breach of contract claim,
- The government likes it because it avoids breach of contract damages, and
- Contractors like it because the Changes clause provides for an equitable adjustment.

Of course the contractors must prove their costs, and things such as increased costs from delays or for extra materials or labor hours are typical components of a request for an equitable adjustment or a claim—and courts like to see the actual costs caused by the change, the “actual cost method” of proof.<sup>62</sup>

There are five “types” of constructive changes<sup>63</sup>:

1. *Incorrect interpretation*: When the government misinterprets (unintentionally, of course) the contract and requires the contractor to conform to its incorrect interpretation.<sup>64</sup>
2. *Defective specifications*: When the government provides faulty design specifications.<sup>65</sup>
3. *Superior knowledge*: When the government withholds critical information from the contractor.
4. *Constructive acceleration*: When the government fails to grant the contractor a contractually entitled extension of the schedule.
5. *Failure to uphold the duty of good faith and fair dealing*: This is usually listed as the fifth type

of constructive change, and occurs when the government fails “to perform its obligation to cooperate with the contractor, or not to hinder or interfere with, or delay performance of the work.... This duty is a part of the duty of good faith and fair dealing, which is imposed on both parties.”<sup>66</sup>

As the Armed Services Board of Contract Appeals has explained, “[t]he duties to cooperate and not to hinder have been treated as aspects of the duty of good faith and fair dealing.”<sup>67</sup>

Yes, the same operative facts and conduct that are involved in litigation over an alleged breach of the duty of good faith and fair dealing are the basis for a contractor's allegation of a constructive change:

Normally, the same legal standards are applied to ascertain government liability in noncooperation or hindrance of performance cases, whether the claims are characterized as a breach of contract or constructive change.<sup>68</sup>

Constructive changes have been found based on the government's overzealous inspections of contractors' work, such as in the appeal of the *Neal* company.<sup>69</sup> In *Harvey Jones*,<sup>70</sup> the contractor prevailed because of incompetent government contract administration. In *Caesar Construction*,<sup>71</sup> the government failed to provide reasonable assistance. In *Summit*,<sup>72</sup> the contractor was denied reasonable and timely access to the required materials and the worksite. In *Turbine Aviation*,<sup>73</sup> there was an unreasonable delay in the government approval process, as well as a

<sup>62</sup> See, e.g., *Propellex Corp. v. Brownlee*, 342 F.3d 1335 (Fed. Cir. 2003).

<sup>63</sup> See 2018 *Contract Attorneys Deskbook*, The Judge Advocate General's Legal Center and School (Charlottesville, VA: 2018): 21–28.

<sup>64</sup> This is the most common “type,” and the one in which the “constructive change” to the contract is the most obvious.

<sup>65</sup> Constructive change “types” 2, 3, and 4 seem more like breaches than changes.

<sup>66</sup> Cibinic, John Jr., James F. Nagle, and Ralph C. Nash, Jr.: *Administration of Government Contracts*, fifth ed. (Wolters Kluwer, 2016): 414.

<sup>67</sup> *PBS&J Constructors, Inc.*, ASBCA No. 57814, 14-1 BCA ¶35,680, citing *Metcalf Construction Co. v. United States*, 742 F.3d 984, 991 (Fed. Cir. 2014).

<sup>68</sup> Cibinic et al. (2016), *op. cit.*, at 414.

<sup>69</sup> *Neal & Co., Inc. v. United States*, 36 Fed. Cl. 600 (1996).

<sup>70</sup> *Harvey C. Jones, Inc.*, IBCA No. 2070, 90-2 BCA ¶ 22,762.

<sup>71</sup> *Caesar Constr., Inc.*, ASBCA No. 41059, 91-1 BCA ¶ 23,639.

<sup>72</sup> *Summit Contractors, Inc. v. United States*, 23 Cl. Ct. 333 (1991).

<sup>73</sup> *Turbine Aviation*, ASBCA No. 51323, 98-2 BCA ¶29,945.



failure to provide the contractor with the timely information needed for contract performance. And, just to show that a bit of old time bad faith is always still out there, in *Libertina*,<sup>74</sup> the contractor won its appeal because of “personal animosity” toward the contractor, and in *Donahoe*,<sup>75</sup> the government withheld payments due, delayed in approving submittals, “over-interpreted” the contract, and rejected work that met the contract requirements.

### A Duty that is Enforced

For those that are tempted to view good faith arguments as an extra but empty argument, they should consider two decisions of the Armed Services Board of Contract Appeals that were handed down in 2018. In *CiyaSoft*,<sup>76</sup> an issue was whether the government breached the duty of good faith when it failed to guard against the unauthorized access and use of the software that the contractor licensed to the U.S. Army. The Army argued that the license agreement contained no such requirement. The Board had little trouble in rejecting that argument:

We agree with the government that there is no express duty set forth in the license with regard [to the alleged breach]. This does not necessarily lead to a finding that the license included no duty the government may have violated. It is well established that contracts can include implied duties, such as the duty of good faith and fair dealing. The implied duty...is limited by the circumstances involved in the contract. The implied duty prohibits acts or omissions that, though not proscribed by the contract expressly, are inconsistent with the contract’s purpose and deprive the other party of the contemplated value. The Supreme Court has addressed the implied duty in contracts stating “[A] contract includes not only the promises set forth in express words, but in addition all such implied provisions as are indispensable to effectuate the intention of the parties, and as arise from the language of the contract and the circumstances under which it was made.”<sup>77</sup>

The Board held that the duty required the Army to take reasonable precautions against the unauthorized use and copying of the software, which “could have a deleterious effect on the ultimate value of the software to the licensor.”

In *NALCO*,<sup>78</sup> the contractor and the U.S. Army Corps of Engineers had a contract dispute over payment. NALCO sought \$1,023,898 and the Corps offered \$375,000. The Board found that “[a]fter discussions, the contracting officer told NALCO that ‘\$375,000 was take it or leave it, and if NALCO did not take it, she would terminate the contract for default.’” NALCO “took it,” but appealed that it was coerced into signing the \$375,000 settlement.<sup>79</sup> The Board held that the Corps “had no right to terminate for default and therefore no right to threaten to terminate for default,” and that its administration of the contract showed “a degree of callousness unexpected from the government since the government caused NALCO’s cash flow crisis.” The Board recited the signs of coercive negotiating by the government, which are that the government’s conduct is “(1) illegal, or (2) a breach of an express provision of the contract without a good faith belief that the action was permissible under the contract, or (3) a breach of the implied covenant of good faith and fair dealing.” The Board found (2) and (3), and held that the contractor’s release for \$375,000 was unenforceable. As to (2), the Board found the Corps violated the Default clause of the contract<sup>80</sup> because its threatened termination was “without a good faith basis that the action was permissible under the contract.” The Board remanded the case for a determination of NALCO’s entitlement.

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*Salz*, 273 U.S. 326, 329 (1927) and citing *Williston on Contracts* (see note 22 (*supra*)) and a 1919 decision of the British House of Lords (*Brodie v. Cardiff Corporation*, [1919] A.C. 337, 358)).

<sup>78</sup> *North American Landscaping Construction and Dredge Co., Inc.*, ASBCA Nos. 60235 et al. 18-1 BCA ¶37,116.

<sup>79</sup> One of the bases upon which a party can avoid a contract is to prove that it was improperly forced or coerced into entering into the contract by the other party.

<sup>80</sup> FAR 52.249-10.

<sup>74</sup> *Libertina Assocs., Inc. v. United States*, 46 Fed. Cl. 702 (2000).

<sup>75</sup> *Donahoe Constr. Co.*, ASBCA No. 47310, 98-2 BCA ¶30,076, recons. denied, 99-1 BCA ¶30,387.

<sup>76</sup> *CiyaSoft Corporation*, ASBCA Nos. 59519, 59913, 18-1 BCA ¶37,084.

<sup>77</sup> *Ibid.*, quoting *Sacramento Navigation Co. v.*

## Misconceptions About the Duty—*Precision Pine*

### A New Standard?

In a 2010 opinion in *Precision Pine and Timber*,<sup>81</sup> a panel of the Court of Appeals for the Federal Circuit articulated and applied a seemingly new standard, which was reinforced in the Federal Circuit's *Scott Timber II* opinion.<sup>82</sup> As those decisions were understood by much of the contracting community, the government could only violate the duty of good faith and fair dealing if it specifically targeted the contractor's expectations in order to "reappropriate" the fruits of the contract to itself. As shown by the Court of Federal Claims' reading of *Precision Pine* in its 2012 *Metcalf* decision,<sup>83</sup> and the contract law blogs of several prestigious law firms and commentators,<sup>84</sup> the general understanding was that there were new rules now, and they were stacked against the contractors. As the Court of Federal Claims explained its understanding of *Precision Pine* in *Metcalf*:

[O]ur appellate court [i.e., the Court of Appeals for the Federal Circuit] requires that *a breach of the duty of good faith and fair dealing claims against the government can only be established by a showing that it "specifically designed to reappropriate the benefits the other party expected to obtain from the transaction, thereby abrogating the government's obligations under the contract"....* Therefore, incompetence and/or failure to cooperate or accommodate a contractor's request do not trigger the duty of good faith and fair dealing, *unless the government "specially targeted" action to obtain the "benefit of the*

*contract," or where government actions were "undertaken for the purpose of delaying or hampering of the contracts."*<sup>85</sup>

In the wake of *Precision Pine*, it was almost anyone's guess as to what qualified as a government breach of the duty—an intent to injure (*Precision Pine*) or unreasonable behavior, which was the previous standard. However, careful observers noted that *Precision Pine* may not have signaled the end of the duty as it was once known.<sup>86</sup> As it turned out, they were right.

### The *Metcalf* Appeal—A Clarification of *Precision Pine*

In the appeal of the Court of Federal Claims' 2012 *Metcalf* decision, a different panel of the Federal Circuit wrote that the Court of Federal Claims "misread *Precision Pine*," and reversed and remanded the case with considerable instruction and clarification on the basic duty of good faith and fair dealing and the meaning of *Precision Pine*.<sup>87</sup> The court explained that *Precision Pine* "does not purport to define the scope of good faith and fair dealing claims for all cases, let alone alter earlier standards,"<sup>88</sup> and that specific targeting and reappropriation is only applicable where the contract also involves the government "implementing a separate government authority and duty independent of the contract." In other words, only in situations where the objectionable impact on the contractor is due to the government's exercise of its responsibilities, authorities, and discretion in executing or complying with law—usually laws that affect the subject matter of the contract—does the "specific targeting" standard come into play.<sup>89</sup> These situations have been called

<sup>81</sup> *Precision Pine & Timber, Inc. v. United States*, 596 F.3d 817 (Fed. Cir. 2010).

<sup>82</sup> *Scott Timber Co. v. United States*, 692 F.3d 1365 (Fed. Cir. 2012) (*Scott Timber II*), rehearing and rehearing en banc denied, 499 Fed. Appx. 973 (Fed. Cir. 2013) (unpublished).

<sup>83</sup> *Metcalf Construction Co. v. United States*, 102 Fed. Cl. 786 (2012).

<sup>84</sup> See, e.g., "The Story of Metcalf Construction and Why It's Bad for Federal Construction Contracting," Husch Blackwell (December 4, 2013), <https://www.contractorsperspective.com>; and Nash, Ralph C. Jr. and John Cibinic, Jr., "Postscript: Breach of the Duty of Good Faith and Fair Dealing," *Nash & Cibinic Report* 24 (May 2010): ¶22 ("The troublesome language in the [*Precision Pine*] decision bodes ill for government contractors.").

<sup>85</sup> 102 Fed. Cl. at 346, quoting *Precision Pine*, 596 F.3d at 829 (emphasis added).

<sup>86</sup> See, e.g., Ferrell, Elizabeth A., Frederick M. Levy, Jason M. Workmaster, and Justin N. Ganderson, "Feature Comment: Reports of the Death of the Duty to Cooperate and Not to Hinder Have Been Greatly Exaggerated," *The Government Contractor* 55 (2013): ¶271.

<sup>87</sup> *Metcalf Const. Co., Inc. v. United States*, 742 F.3d 984 (Fed. Cir. 2014).

<sup>88</sup> *Ibid.*, at 993.

<sup>89</sup> The Federal Circuit applied the specific targeting test in *Century Exploration New Orleans, LLC v. United States*, 745 F.3d 1168 (Fed. Cir. 2014). That case involved, as did *Precision Pine*, government decisions on the application of laws affecting the subject matter of the contract. In *Precision Pine* it was environmental laws, and in *Century*

“sovereign act” scenarios where the complained-of conduct rests on the government’s decisions *as a government*. Where the complained-of conduct is based on the government’s contract administration *as a contracting party*, the traditional duty of good faith and reasonable conduct applies.

As to the traditional standard, the Federal Circuit explained:

Although in one sense, any “implied” duty “expands” the “express” duties, our formulation means simply that an act will not be found to violate the duty (which is implicit in the contract) if such a finding would be at odds with the terms of the original bargain, whether by altering the contract’s discernable allocation of risks and benefits, or by conflicting with a contract provision. The implied duty of good faith and fair dealing is limited by the original bargain; it prevents a party’s acts or omissions that, though not proscribed by the contract expressly, are inconsistent with the contract’s purpose, and deprive the other party of the contemplated value.<sup>90</sup>

The Federal Circuit remanded *Metcalf* to the Court of Federal Claims with instruction to apply the duty, as explained in its decisions in *Centex* and *Malone*.<sup>91</sup>

### Some Case Studies

After its 2012 decision in *Metcalf*, the Court of Federal Claims decided *D’Andrea Brothers*.<sup>92</sup> The decision seemed a bit incongruous with the 2012 *Metcalf* decision, but it was right in line with the previous and conventional understanding of the duty. It should be noted that the case was litigated as a breach of contract, because the contract was a cooperative research and development agreement (CRADA), and not a procurement contract with a Changes clause and accompanying constructive changes doctrine.<sup>93</sup> Under the CRADA, the U.S.

Army licensed to D’Andrea the use the recipe of the Army-developed energy bar it put in Meals Ready to Eat (MREs), as well as the name of the bars the Army used (“HooAH,” the Army battle cry), as the brand name for D’Andrea’s energy bars. D’Andrea would pay the Army a royalty in return. The agreement broke down and the Army deliberately refused to communicate with D’Andrea, and the Army (without even telling D’Andrea in advance) changed the name of its MRE energy bars, which D’Andrea proved was a key component of its marketing strategy—i.e., its bar would be the same as the ones put in MREs. D’Andrea alleged that the Army breached the obligation of good faith and fair dealing.

As the court explained:

[N]ot all misbehavior...breaches the implied duty of good faith and fair dealing owed to other parties to a contract. This implied duty is breached when the government unreasonably fails to cooperate with the other party’s performance, or commits actions that unreasonably cause delay or hindrance to contract performance. The covenant also imposes obligations of diligence and forthrightness, and a breach of these obligations is a contractual breach. The question of reasonableness depends on the contract, its context, and the surrounding circumstances. Although the implied covenant of good faith and fair dealing cannot be used to expand a party’s contractual duties beyond those in its express contract, the object of the contract is presumed to be subject to the covenant of good faith and fair dealing, and the exact conduct need not be expressed.<sup>94</sup>

The court found that the government breached its obligation of dealing in good faith, and left D’Andrea “in the dark” as to how to proceed, during which time D’Andrea was missing marketing time and the use of the bargained-for opportunity to effectively market its product with the phrase “HooAH.” While D’Andrea could not prove that the

*Exploration* it was gas and oil laws and regulations.

<sup>90</sup> *Metcalf Const. Co., Inc. v. United States*, 742 F.3d 984 (Fed. Cir. 2014).

<sup>91</sup> I.e., *Centex Corp. & CTX Holding Co. v. United States*, 395 F.3d 1283 (Fed. Cir. 2005), and *Malone v. United States*, 849 F.2d 1441 (Fed. Cir. 1988), *opinion modified*, 857 F.2d 787 (Fed. Cir. 1988).

<sup>92</sup> *D’Andrea Brothers LLC v. United States*, 109 Fed. Cl. 243 (2013).

<sup>93</sup> A CRADA is a contract under the Federal Technology

Transfer Act of 1996 (*Pub. L.* 99-502), which amended the Stevenson-Wydler Technology Innovation Act of 1980 (*Pub. L.* 96-480). Because it is not a procurement contract, it is only within the jurisdiction of the Court of Federal Claims.

<sup>94</sup> *D’Andrea Brothers LLC, op. cit.*, at 255–256.



Army caused the financial losses it claimed,<sup>95</sup> the Army's breach of the duty at least saved D'Andrea from the \$60,000 in royalties the Army demanded.

More recently, in *Relyant*,<sup>96</sup> the contractor proposed, even before contract award, a modified version of the government specifications for shipping containers, and even submitted a post-contract award sample that the government inspectors approved. However, the contracting officer took his time responding to the contractor's formal request to change the specifications, during which time the contractor was incurring delay costs. Because the government knew all along of the contractor's proposal, and even had a sample of the proposed product, the delay in responding (with the eventual response denying the request), was viewed by the Armed Services Board of Contract Appeals as letting the contractor "figuratively twist in the wind" in violation of the obligation of good faith.

In *Kelly-Ryan*,<sup>97</sup> the U.S. Army Corps of Engineers awarded a contract knowing (and without informing the contractor) that funding for the project in the future period was not expected to be appropriated. Nevertheless, the Corps included the standard funding clause rather than the incrementally funded clause. During the contract, the Corps unilaterally switched clauses. The Board described this "bait and switch" as a "material breach of an express term of the contract." More on point for our purposes, the Board also found that the Corps' ignoring the contractor's "repeated notifications of incurrences of increased costs throughout performance of the contract, all the while directing that [the contractor] complete the contract" violated the duty of good faith and fair dealing.

## Conclusion

The duty of good faith and fair dealing requires both parties to conduct themselves so as to preserve the expectations that prompted them to enter into the

contract in the first place. This means not only not frustrating or hindering the other party, but even taking reasonable steps to assist each other and to cooperate:

In short, the duty "prevents a party's acts or omissions that, though not proscribed by the contract expressly, are inconsistent with the contract's purpose and deprive the other party of the contemplated value."<sup>98</sup>

A breach of the duty does not require a breach of a specific term of the contract—if it did, there would be no need for it as a legal principle. A breach does not require that the breaching party acted in bad faith—although that will qualify as a breach of the duty. It does not matter that the breaching party acted in good faith—unreasonable conduct will violate the duty. Finally, except in "dual authority" circumstances, where the government is making decisions in a sovereign capacity that affect the contract, the law does not require proof that the government acted with the intent to deprive the contractor of the benefits of the contract.

As to what is "reasonable," and what is "right" or "wrong" in contract management, we offer the advice of an eminent commentator: "Always let your conscience be your guide." —Jiminy Cricket. *JCM*

<sup>95</sup> D'Andrea apparently misread the market. It was losing money without the Army's conduct. Consumers apparently did not widely know what "HooAH" meant, even though the fine print on the wrapper tried to explain the military connection.

<sup>96</sup> *Relyant, LLC*, ASBCA No. 59809, 18-1 BCA ¶37,085.

<sup>97</sup> *Kelly-Ryan, Inc.*, ASBCA No. 57168, 18-1 BCA ¶36,944.

<sup>98</sup> *Mansoor International Development Services, Inc. v. United States*, 121 Fed. Cl. 1, 7 (2015), quoting the *Restatement (Second) of Contracts*, §205 cmts. a & b (1981).



# Federal Procurement Reform: A Mixed Record at Best

BY JOSEPH PEGNATO

## Abstract

**Purpose:** The purpose of this article is to help the reader understand why attempts to reform the federal procurement system have not been more successful.

**Approach:** This article includes a brief history of procurement reform efforts over the last 70 years. Using this overview of reform, an attempt has been made to identify the reasons why these reforms have not been more successful.

**Findings:** Reformers need to lower their expectations. They need to recognize that government is different than the private sector, the procurement system is better than advertised, and there are significant barriers to achieving radical and permanent reform.

**Value:** A review of the literature shows that this study is completely unique.

## Keywords

federal procurement reform, public procurement

***Contract Management Body of Knowledge® (CMBOK®) Competencies 3.0, “Guiding Principles”***

## About the Author

**Dr. Joseph Pegnato** has close to 40 years of contracting experience in the public and private sectors, including nearly 20 years as the Director of Acquisition Management at the U.S. Government Accountability Office. He ended his career as a procurement consultant at The MITRE Corporation.

“A government ill executed, whatever it may be in theory, must be in practice a poor government.”  
— Alexander Hamilton<sup>1</sup>

Given the enormous sum of public money funneled through the U.S. federal procurement system, Alexander Hamilton’s warning in *Federalist 70* is extremely relevant. How well the procurement system performs is crucial to how well the federal government performs, because \$1 of every \$6 spent by the federal government is spent by that procurement system. In 2017, that amounted to \$522 billion.<sup>2</sup>

The government buys a wide variety of products and services—including office supplies, professional services, information technology, space exploration, and complex weapon systems. The widely held perception is that it takes too long and costs too much to buy the goods and services the government needs. Moreover, it is widely believed that too many contractors deliver inferior and defective products. Questions over the performance of the federal procurement system have persisted over the last 70 years.

Attempts to reform the so called “poorly” performing federal procurement system are almost too numerous to count. Nevertheless, the federal procurement system seems to be subjected to incessant reform initiatives with every new Congress and presidential administration. According to Peter Eide and Charles Allen, “The history of acquisition reform reflects much has been done to study the problem, identify candidate solutions, and execute reforms, only to return to the conclusion that more reform is needed.”<sup>3</sup> Ronald J. Fox calls defense acquisition reform an elusive goal.<sup>4</sup>

On October 29, 2013, the House Committee on Armed Services held hearings on acquisition reforms,<sup>5</sup> during which Moshe Schwartz of the Congressional Research Service testified that there had been more than 150 major studies on acquisition reform since World War II.<sup>6</sup> Despite the numerous acquisition reform efforts, Schwartz suggested that Department of Defense (DOD) acquisition programs continue to experience significant cost increases.<sup>7</sup> “Despite the many acquisition reforms and other DOD management initiatives over the years, the development and cost growth of military systems has not been reduced,” Schwartz said.<sup>8</sup> Moreover, Schwartz cited reports arguing that some previous acquisition reform efforts had made the acquisition process *less* efficient and effective, instead of improving the system.<sup>9</sup> Despite this pessimism, Schwartz did see a possible framework for improving the acquisition process, and it dealt with improving the acquisition workforce. Schwartz pointed out that most of the acquisition reform reports arrived at the same conclusion: The key to awarding good contracts is having a good acquisition workforce.<sup>10</sup>

In addressing the importance of the acquisition workforce, former Under Secretary of Defense Frank Kendall stated:

Policies and processes are of little use without acquisition professionals who are experienced, trained, and empowered to apply them effectively. At the end of the day, qualified people are essential to successful outcomes and professionalism, particularly in acquisition leaders, who drive results more than any policy change.<sup>11</sup>

<sup>1</sup> Hamilton, Alexander, James Madison, and John Jay; *The Federalist Papers* (New York: Signet Classics, 1961): 423.

<sup>2</sup> As per USASpending.gov data (see [www.usaspending.gov](http://www.usaspending.gov)).

<sup>3</sup> Eide, Peter K. and Charles D. Allen, “The More Things Change, Acquisition Reform Remains the Same,” *Acquisition Reform Journal*, vol. 19, no. 1 (January 2012): 99–120.

<sup>4</sup> Huitink, Zachary S. and David M. Van Slyke, “Beyond Business as Usual: Improving Defense Acquisition Through Better Buying Power.” IBM Center for the Business of Government (2015): 15.

<sup>5</sup> U.S. House of Representatives, House Armed Services Committee hearings, 113th Congress, 1st Session (Washington, DC: October 29, 2013).

<sup>6</sup> Schwartz, Moshe, Congressional Research Service, “Twenty-Five Years of Acquisition Reform: Where Do We Go From Here?” Report #7-5700 (Washington, DC: U.S. Library of Congress, 2013).

<sup>7</sup> *Ibid.*, at 3.

<sup>8</sup> *Ibid.*, at 5.

<sup>9</sup> *Ibid.*, at 6.

<sup>10</sup> *Ibid.*, at 16.

<sup>11</sup> *Ibid.*, at 17.

In late 2017, however, Steven Kelman, the former Administrator of the Office of Federal Procurement Policy (OFPP), indicated that he did not see any improvement in the procurement system's performance over the past 25 years.<sup>12</sup>

The performance of the federal procurement system matters for many reasons. When it performs well, an agency can acquire necessary capabilities to support the mission. When it performs poorly, the mission suffers. Poor performance leads to contract cost overruns and delays.

As will be shown, the history of procurement reform consists of mostly unmet promises. This unfortunate result contributes to a lack of trust in government. Trust in government is widely believed to be at an all-time low. Any further reduction in such trust will adversely affect the government's ability to execute laws and programs.

Why haven't procurement reforms been more consistently successful? It will be argued here that there are at least four overarching reasons:

1. The constitutional design of divided government leads to a lack of permanence of such reforms.
2. The government's capacity deficit inhibits successful implementation of various procurement reforms.
3. The swinging, ever-changing pendular nature of procurement reform undermines most reforms.
4. Many reforms rely on business principles, but the government cannot be run exactly like a business.

## A (Very Brief) History of Key Procurement Reforms Over the Last 70 Years

### The Armed Services Procurement Act of 1947 and the Federal Property and Administrative Services Act of 1949

During World War II, the procurement system consisted of a large mass of uncoordinated legislation. Many laws conflicted. The procurement system was inefficient. The Armed Services Procurement Act of 1947<sup>13</sup> and the Federal Property and Administrative Services Act of 1949<sup>14</sup> were reactions to this chaos and should be considered the first modern procurement reform attempts. These laws consolidated all the various contract laws that had proliferated over the years—one for defense agencies and one for civilian agencies. The laws also led to the formation of two sets of regulations: *The Armed Services Procurement Regulation* (for defense) and the *Federal Procurement Regulation* (for civilian).

While the regulations were eventually replaced by a single regulation in 1984 (i.e., by the *Federal Acquisition Regulation (FAR)*), both laws and implementing regulations represent major, successful, long-lasting procurement reforms.

### The Hoover Commission of 1949

The Hoover Commission found that—

[O]ne of the major weaknesses in Federal purchasing stems from the lack of any central body to coordinate Government purchasing activities.... A maze of laws and regulations surrounds the whole process with unnecessary red tape. The emphasis of the laws is not on promoting efficiency and economy but upon preventing fraud.<sup>15</sup>

One of the key Hoover Commission recommendations to address these weaknesses was the establishment of the "Office of General Services" in an

<sup>12</sup> Kelman, Steve, "Reinventing Government, 25 Years Later," *Federal Computer Week* (December 2017), available at [www.fcw.com/articles/2017/12/06/Kelman-25-years-of-acquisition-reform.aspx](http://www.fcw.com/articles/2017/12/06/Kelman-25-years-of-acquisition-reform.aspx).

<sup>13</sup> Armed Services Procurement Act of 1947, Ch. 65, 62 Stat. 21.

<sup>14</sup> Federal Property and Administrative Services Act of 1949, 40 U.S.C. §101.

<sup>15</sup> Hoover, Herbert, chair, *The Hoover Commission Report on Organization of the Executive Branch of the Government* (New York: McGraw-Hill, 1949): 89, 97.

attempt to centralize all purchasing.<sup>16</sup> On July 1, 1949, the General Services Administration (GSA) became an independent agency after the passage of the Federal Property and Administrative Services Act.

While GSA survives and serves as an important central purchasing organization for the government's commercial needs, a large percent of federal spending is done by individual agencies. If the goal was to centralize all procurement, it was not achieved. There continue to be attempts to centralize procurement with mixed success (e.g., shared services and category management).

### McNamara Reforms of the Early 1960s

Secretary of Defense Robert S. McNamara implemented acquisition reforms intended to eliminate cost overruns that plagued many defense programs of the 1950s and early 1960s.<sup>17</sup> The McNamara acquisition reforms included formal source selection procedures, contractor performance evaluations, total package performance requiring fixed-price contracting for development and production, incentive contracting, and other contract administration innovations.<sup>18</sup> However, these reforms proved to be ineffective: Total package performance was applied to the Lockheed C-5A cargo plane, the General Dynamics F-111 fighter aircraft, and the Grumman F-14A *Tomcat* fighter aircraft, all of which experienced large cost overruns.<sup>19</sup> In 1969, the U.S. General Accounting Office (GAO; now known as the Government Accountability Office) reached a similar conclusion.<sup>20</sup>

To be fair, many McNamara reforms provided permanent improvement to the defense acquisition process. These reforms included adoption of the program manager concept, systems engineering, and cost control techniques, which subsequently became "Earned Value Management."<sup>21</sup> However,

regarding the more substantive reform of preventing cost overruns, the McNamara reforms must be judged as ineffective.

### The Truthful Cost or Pricing Data Statute<sup>22</sup>

Originally passed into law as the Truth in Negotiations Act (TINA), the Truthful Cost or Pricing Data statute requires contractors to disclose accurate cost data to the government prior to certain contract negotiations. Reports by GAO of overpricing and excessive profits by government contractors led directly to the enactment of TINA. Before TINA, government contract negotiators had to rely on cost and pricing data furnished by contractors, which created the opportunity for excessive profits.

Today, the statute requires contractors to certify that cost or pricing data provided to the government is complete, current, and accurate.

In general, the Truthful Cost or Pricing Data statute should be viewed as a permanent and successful reform.

### The Brooks Automatic Data Processing Act of 1965<sup>23</sup>

In March of 1965, the Office of Management and Budget (OMB) sent Congress a report citing serious information technology (IT) management problems.<sup>24</sup> These problems included lack of standardization, computer incompatibility, and decentralized decision making, and government purchasing practices were contributing to a hardware monopoly.<sup>25</sup> The Brooks Act attempted to address these problems by centralizing computer purchasing authority within the GSA and directing that the National Bureau of Standards (now known as the National Institute of Standards) set standards for IT.<sup>26</sup>

However, the changing procurement and technology environments eventually rendered the Brooks Act ineffective. The problem that the Brooks Act

<sup>16</sup> *Ibid.*, at 98.

<sup>17</sup> Fox, J. Ronald, *Defense Acquisition Reform, 1960-2009: An Elusive Goal* (CreateSpace, 2011): 35, 36.

<sup>18</sup> *Ibid.*, at 37.

<sup>19</sup> *Ibid.*

<sup>20</sup> *Ibid.*, at 40.

<sup>21</sup> *Ibid.*, at 37.

<sup>22</sup> Previously known as the Truth in Negotiations Act of 1962 (TINA), 41 U.S.C. Chapter 35.

<sup>23</sup> Pub. L. 89-306 (hereinafter the "Brooks Act").

<sup>24</sup> See Traaen, Timothy S., "The Brooks Act: An 8-Bit Act in a 64-Bit World?" (Washington, DC: 1995): 7.

<sup>25</sup> Schwartz, see note 6.

<sup>26</sup> *Ibid.*

attempted to address—ineffective procurement of IT products and services—remains a challenge today as evidenced by numerous GAO reports and a proliferation of legislative proposals to reform IT procurement. It seems as if every new Congress pushes an IT acquisition reform bill.

### **The 1972 Commission on Government Procurement**

After extensive hearings in the late 1960s, Congress created the Commission on Government Procurement with the goal of achieving fundamental improvement in federal procurement.<sup>27</sup> The Commission had four main concerns with existing procurement regulations:

- The regulatory environment consisted of a proliferation of uncoordinated agency regulations,
- There was a lack of uniformity among agency procurement regulations,
- The regulations were unnecessarily complex and ambiguous, and
- There was limited public participation in the development of procurement regulations.

The Commission released its report in 1973 containing 149 recommendations. How successful were the Commission's reforms? In 1979, GAO assessed the Commission's work:

Important structural changes are now in place on procurement reforms first proposed in 1972, but the program is far from complete and momentum is slowing. The outlook for at least half of the reforms is not encouraging.<sup>28</sup>

This comprehensive procurement reform effort fell short.

### **The Competition in Contracting Act of 1984 (CICA)<sup>29</sup>**

With the passage of CICA, full and open competition was established as the preferred method for

federal agencies to award contracts. The act called for allowing all prospective contractors to submit proposals if they met certain criteria.

In 1983, prior to the law taking effect, the percentage of contract dollars awarded noncompetitively was 35%.<sup>30</sup> During a five-year period from fiscal years 2011 through 2015, the percentage of contract dollars competed was 53–55%.<sup>31</sup> Moreover, since the law's enactment in 1984, the percentage of contract dollars awarded competitively has never returned to the pre-act levels of below 50%.

The CICA must be considered a permanent and successful procurement reform.

### **The Federal Acquisition Streamlining Act of 1994 (FASA)<sup>32</sup>**

FASA can be credited with bringing about important, long-lasting, and effective acquisition reforms—unlike many of the previous reforms. However, not all the act's objectives were realized.

FASA raised the dollar threshold for simplified acquisition procedures from \$25,000 to \$100,000. This higher threshold expanded the streamlined process for making small purchases, reduced administrative overhead, and produced significant savings for the government. The higher threshold allowed the use of simplified procedures on tens of thousands of procurement actions. The newly authorized use of purchase cards and indefinite delivery/indefinite quantity (IDIQ) contracts are two important reforms.

FASA also allowed the purchase of commercial items on a commercial basis. It was often the case that commercial businesses encountered great difficulty in doing business with the federal government due to the unique laws and regulations—such as invasive and burdensome audit practices, cost information disclosure requirements, and drug-free workplace terms. Such practices were foreign to the normal commercial business environ-

<sup>27</sup> GAO, *Recommendations on the Commission on Government Procurement: A Final Assessment*, PSAD-79-80 (Washington, DC: 1979), available at <http://www.gao.gov/products/psad-79-80>.

<sup>28</sup> *Ibid.*

<sup>29</sup> 41 U.S.C. §253.

<sup>30</sup> Office of Federal Procurement Policy, "Federal Procurement Data System Standard Report FY 1983 Year End" (Washington, DC: 1983).

<sup>31</sup> *Annual Review of Government Contracting*, 2016 Edition (Herndon, VA: Deltek, 2016).

<sup>32</sup> *Pub. L.* 103-355.



ment. FASA waived most of these uniquely federal requirements on commercial buys.

In response to a concern at the time that the number of protests were increasing, FASA called for debriefings upon request. The assumption was that the number of protests would decline as offerors learned that the award process was fair, or that their concerns were without merit. Given that the number of protests continue to increase (even to this day), this provision of the law has not achieved its objectives. The number of protests grew from 1,652 in fiscal year 2008 to 2,474 in fiscal year 2018.<sup>33</sup>

In sum, several goals were met, but not all.

### The Clinger-Cohen Act of 1996 (CCA)<sup>34</sup>

The CCA was designed to improve the way the federal government acquires and manages IT. The Act called for each agency to appoint a chief information officer (CIO) to establish clear accountability for IT. Stressing businesslike principles, the CCA required that the planning and management of technology be treated as a capital investment. In ending the GSA's monopoly on IT purchases, the CCA opened the door for agencies to make their own IT purchases. This was a major step toward decentralization of the government's acquisition activities. The CCA also stripped the GSA of its authority to adjudicate bid protests.

In August 2018, GAO concluded that—

None of the 24 agencies have policies that fully addressed the role of their [CIOs] consistent with federal laws and guidance.... Further, GAO noted that agencies continue to lack consistent leadership in the CIO position.<sup>35</sup>

<sup>33</sup> GAO, "GAO Bid Protest Annual Report to the Congress for Fiscal Year 2008" (Washington, DC: 2008); and GAO, "GAO Bid Protest Annual Report to the Congress for Fiscal Year 2018" (Washington, DC: 2018).

<sup>34</sup> Encompassing both Division D and Division E of the National Defense Authorization Act for Fiscal Year 1996 (*Pub. L. 104-106*)—i.e., the Federal Acquisition Reform Act of 1996 (FARA) and the Information Technology Management Reform Act of 1996 (ITMRA).

<sup>35</sup> GAO, "Federal Chief Information Officers: Critical Actions Needed to Address Shortcomings and Challenges in Implementing Responsibilities," GAO-18-93 (Washington, DC: 2018), available at <http://www.gao.gov/products/gao-18-93>.

As with many acquisition reforms, the CCA cannot be considered a complete success. As will be shown, subsequent IT reform legislation has been enacted to achieve some unmet CCA goals. In addition, actual CIO authority fell short of the law's intent. In general, the CCA represents another reform effort that made some progress but fell short on many of its goals.

### The Federal IT Acquisition Reform Act (FITARA)<sup>36</sup>

FITARA required that each agency develop a streamlined plan for its acquisitions, make use of private-sector best practices, and have only one CIO who reports directly to the head of the agency. Other key requirements included:

- Federal data centers would be consolidated,
- Agencies must justify any purchase not made from the Federal Strategic Sourcing Initiatives (FSSI) when such items were available from the FSSI, and
- Agencies would be required to make fixed-price awards where competitions were based solely on nonprice factors.

The act was intended to save the government billions annually by reducing IT procurement-related waste.

To measure the government's performance under the act, the House Oversight and Government Reform IT Subcommittee began releasing annual FITARA scorecards in 2015. The first FITARA scorecard showed extremely low grades for most agencies—13 "D" scores and three "F" ratings.<sup>37</sup> The fifth and most recent FITARA scorecard showed agency scores dipping for a second consecutive time—six agency scores dropped, three went up, and 15 were unchanged.<sup>38</sup> As a whole, however, the scorecards show that agencies are slow to use the tools given to them via FITARA.

<sup>36</sup> Passed on February 25, 2014, as Subtitle D of Title VIII of the National Defense Authorization Act for Fiscal Year 2015 (*Pub. L. 113-291*).

<sup>37</sup> See Rydman, Adelle, "FITARA Shortcomings are a Failure of Network Monitoring," Federal News Network (October 2016), available at <http://federalnewsradio.com>.

<sup>38</sup> Konkel, Frank, "Agency Scores Fall in Latest FITARA Scorecard," Nextgov.com (November 2017), available at <http://www.nextgov.com/cio-briefing/2017/11/agency-scores-fall-fitara-scorecard>.



TABLE 1. SUCCESS OF MAJOR PROCUREMENT REFORMS

Procurement Reform	Major Goals	Level of Success
The Armed Services Procurement Act of 1947 (Ch. 65, 62 Stat. 21) and the Federal Property and Administrative Services Act of 1949 (40 U.S.C. §101).	Consolidate various procurement laws that had proliferated during WWII.	Both laws were very successful and produced long-lasting reforms.
The Hoover Commission of 1949.	Centralize all purchasing. Establish Office of General Services.	The existence of thousands of separate procurement offices indicates the main goal of centralized purchasing was not achieved.
McNamara Reforms of the Early 1960s.	Eliminate defense weapon system cost overruns.	Main goal not achieved. Some process reform achieved (e.g., Systems Engineering and Earned Value Management).
The Truth in Negotiations Act of 1962 ( <i>Pub. L. 87-653</i> ).	Require contractors to disclose accurate cost data to the government prior to certain contract negotiations.	Goal was achieved. The law is still current. This is a permanent and successful reform.
The Brooks Act of 1965 ( <i>Pub. L. 89-306</i> ).	Centralize computer purchasing in GSA.	Not achieved due to changing technology environment.
The 1972 Commission on Government Procurement.	149 recommendations to achieve fundamental improvement in federal procurement.	GAO assessed reforms as far from complete.
The 1984 Competition in Contracting Act ( <i>Pub. L. 98-369</i> , Section 2701).	Increase contracting competition.	Considered a completely successful and permanent reform.
1994 Federal Acquisition Streamlining Act ( <i>Pub. L. 103-355</i> ).	Raise simplified acquisition thresholds. Authorize purchase cards and IDIQ contracts. Encourage commercial practices. Attempt to reduce bid protests.	Mixed results. (Some goals achieved; some not achieved.)
1996 Clinger-Cohen Act ( <i>Pub. L. 104-106</i> ).	Improve the way the federal government acquires and manages IT.	Some progress but fell short of achieving most goals.
Federal IT Acquisition Reform Act (2014).	Increase CIO's oversight over IT acquisitions to reduce IT procurement waste.	Not yet achieved according to GAO.
Category Management (OFPP, December 4, 2014).	Have the federal government act like a single buying enterprise to produce large savings.	Not yet achieved according to GAO.
Section 809 Advisory Panel on Streamlining and Codifying Acquisition Regulations (2016).	Streamline the DOD acquisition process.	Too soon to assess.

In 2017, the CIO for the U.S. Department of Health and Human Services (HHS), Frank Baitman, complained that FITARA did not provide the control over HHS' tech spending that he had expected, and further that he did not think the law had actually brought about any change.<sup>39</sup> As Baitman stated:

I don't believe that FITARA has really addressed the fundamental problem.... When a department [CIO] tries to exercise control over part of the budget, the affected operating division then goes to appropriators and complains because they're not able to use the money that was appropriated to them for how they see fit. And ultimately that undermines the intent of FITARA.<sup>40</sup>

In testimony before the House Oversight Subcommittee on Information Technology on March 28, 2017, Dave Powner of GAO stated: "More than half of the 24 CIOs reported they do not have authority over IT acquisitions."<sup>41</sup>

### Category Management

According to GSA:

Category management is an approach the federal government is applying to buy smarter and more like a single enterprise. Category management enables the government to eliminate redundancies, increase efficiency, and deliver more value and savings from the government's acquisition programs.<sup>42</sup>

On December 4, 2014, OFPP issued a policy on category management aimed at shifting the management of purchases across thousands of

separate procurement organizations to managing entire categories of purchases across the federal government.<sup>43</sup>

The 2014 OFPP policy has been updated by a regulation issued in 2019 by OMB,<sup>44</sup> which superseded the earlier 2014 policy. According to M-19-13, OMB expects that this policy "will help agencies shift time, effort, and funding currently spent performing repetitive administrative tasks toward accomplishing mission outcomes."<sup>45</sup>

While it is too soon to assess the effects of the 2019 policy update, in an October 2016 report, GAO found that use of the FSSI was low.<sup>46</sup> The FSSI is a precursor initiative to category management. In its report, GAO claimed there was a risk of agencies underusing existing FSSI and category management solutions and diminished cost savings if OFPP does not take certain actions based on lessons learned from the FSSI experience.<sup>47</sup>

It does not seem that the category management initiative has yet realized its intended results.

### Section 809 Advisory Panel on Streamlining and Codifying Acquisition Regulations

Section 809 of the National Defense Authorization Act for Fiscal Year 2016<sup>48</sup> established the Advisory Panel on Streamlining and Codifying Acquisition Regulations (a.k.a., the "Section 809 Panel"). This 18-member advisory panel of acquisition experts was

<sup>39</sup> Ehlinger, Samantha, "FITARA Law Is Failing to Give IT Chiefs the Power of the Purse, Insiders Say," FedScoop.com (February 10, 2017), available at <https://www.fedscoop.com/fitara-law-still-failing-give-chiefs-power-purse-insiders-say/>.

<sup>40</sup> *Ibid.*

<sup>41</sup> Gunter, Chase, "Agencies Backsliding on FITARA," *Federal Computer Week* (March 28, 2017), available at <https://fcw.com/Articles/2017/03/28/hearing-IT-procurement.aspx?p=1>.

<sup>42</sup> U.S. General Services Administration (GSA), "Category Management" (2017), available at <https://www.gsa.gov/buying-selling/category-management>.

<sup>43</sup> U.S. Office of Federal Procurement Policy (OFPP), Memorandum for Chief Acquisition Officers and Senior Procurement Executives, "Transforming the Marketplace: Simplifying Federal Procurement to Improve Performance, Drive Innovation, and Increase Savings" (Washington DC: OFPP, December 4, 2014).

<sup>44</sup> U.S. Office of Management and Budget (OMB), OMB M-19-13, "Category Management: Making Smarter Use of Common Contract Solutions and Practices" (Washington, DC: OMB, March 20, 2019).

<sup>45</sup> *Ibid.*

<sup>46</sup> GAO, "Federal Procurement: Smarter Buying Initiatives Can Achieve Savings, but Improved Oversight and Accountability Needed," GAO-17-164" (Washington, DC: GAO, 2016), available at <http://www.gao.gov/products/gao-17-164>.

<sup>47</sup> *Ibid.*, at 23.

<sup>48</sup> Pub. L. 114-92.

charged with providing recommendations to amend or repeal DOD acquisition regulations to streamline the acquisition process.

The panel published an Interim Report and a three-volume Final Report, containing a total of 98 recommendations aimed at fundamentally changing defense acquisition. Some of the recommendations would remove unnecessary layers of approval in the many steps that contracting officers and program managers must take to award and manage acquisitions. Other recommendations would remove unnecessary and redundant reporting requirements. And other recommendations are more strategic and call for buying more commercially available products and services in the way the private sector buys. The Final Report also called for managing capabilities from a portfolio, rather than a program, perspective.

Obviously, it is too soon to assess the effects of the Section 809 Panel.

### Review

**TABLE 1** on page 37 provides brief summaries of these reforms, and shows that while some reforms achieved their goals, others missed their mark. The results are mixed at best.

The question then becomes, why haven't more procurement reforms been successful?

## Four General Explanations for a Low Level of Success by Numerous Attempts to Reform Federal Procurement

As previously mentioned, it is believed there are four overarching reasons for this mixed record (at best) of success by countless attempts to reform federal procurement:

1. The constitutional design of divided government leads to a lack of permanence of such reforms;
2. The government's capacity deficit inhibits successful implementation of various procurement reforms;
3. The swinging, ever-changing, pendular nature of procurement reform undermines most reforms; and
4. Many of the reforms rely on business principles, but the government cannot be run exactly like a business.

### 1. Divided Government

The first reason countless procurement reforms have produced mixed results is because the reforms are based on a model that assumes the government is an efficient, businesslike organization. Clearly this approach is a mismatch for the existing governmental design. The founders designed the U.S. federal governmental system based on preventing tyranny rather than on promoting business efficiency; it was designed to rein in the potential tyrannical power of a strong king-like leader. To counter such a threat, the founders divided power among three federal branches of government, and further between the states and the federal government. The founders also built in checks and balances to counter excessive power accumulating in any one branch. Their intent was to have political power divided and shared. Historically, Americans have had a healthy distrust for a strong central government. As will be discussed, the limitations on the executive branch as well as the political forces inherent in the American democratic system undermine the permanence of various procurement reforms.

As James Q. Wilson declared: "The governments of the United States were not designed to be efficient or powerful, but to be tolerable and malleable."<sup>49</sup> On the other hand, Wilson notes that Social Security checks arrive on time, that federal prisons are decent and humane institutions, that letters are delivered in a day, and that "one can stand on the deck of an aircraft carrier during night flight operations and watch two thousand nineteen-year-old boys operate one of the most complex organizational systems ever created. There are not many places where all this happens. It is astonishing it can be made to happen at all."<sup>50</sup> Is this a contradiction of the idea of

<sup>49</sup> Wilson, James Q., *Bureaucracy: What Government Agencies Do and Why They Do It* (New York: Basic Books, 1989).

<sup>50</sup> *Ibid.* (This writer also experienced aircraft

inefficient government? Happily, yes. But it is more the exception than the rule.

Divided government also leads to an inefficient executive branch. The political environment is a direct cause of ambiguous goals. Unlike the private sector's simple unitary goal of profit, the executive branch has multiple, conflicting goals: efficiency, equity, legality, democracy, due process, fairness, transparency, and accountability. Efficiency as a goal competes with other public-sector goals and must become subordinate to legal and democratic goals.

The federal procurement process is endlessly criticized for taking too long to buy critical weapon systems that cost too much and underperform. However, the procurement system must serve congressionally mandated social goals such as quotas for small businesses (including specific socioeconomic categories of small businesses), purchasing American-made products that protect the environment, and pay established labor rates for services. It may be viewed as inefficient in buying complex goods quickly, but it also may be viewed as fulfilling America's small business goals. One person's inefficiency is another man's accountability.

In short, procurement reforms intended to make buying more efficient are facing a big head wind. The Ancient Greek myth of Sisyphus comes to mind (i.e., pushing an enormous rock to the top of a mountain only to have it fall back to its starting point).

## 2. The Government's Capacity Deficit

The second reason that there is a mixed record on procurement reform is directly related to the government's *capacity deficit*, a recent governmental trend that has further decreased the chances for success of these reforms. Capacity deficit is the label given to the recent phenomenon where the federal government, having assumed far more complex administrative obligations than ever before, but with its resources diminishing over the last 40 years,

lacks the capacity to fully implement and administer its responsibilities to do what is needed to ensure that the laws are faithfully executed by the president and his administration.<sup>51</sup> By the time that Barack Obama came into office, capacity deficit was at a crisis level<sup>52</sup>—and was especially critical around the area of government contracting. The contracting out of federal services increased rapidly under the Bill Clinton and George W. Bush administrations, but the capacity to administer policies that relied on contracting continued to decline.<sup>53</sup>

Another view of this capacity problem is offered by James L. Perry, former editor-in-chief of *Public Administration Review*.<sup>54</sup> Perry sees a real erosion of administrative capacity. He cites Paul Volker's concern that "government has lost its capacity to execute public policies and implement programs."<sup>55</sup> To make his point, Volker cites the government's response to Hurricane Katrina and the HealthCare.gov rollout. Perry also describes relevant research by Paul Light, who has documented 48 federal government breakdowns since 2000.<sup>56</sup> These breakdowns, according to Light, suggest significant disinvestment in the government's capacity to implement policy and provide warnings about the future.

The capacity deficit problem can also be understood by observing the growth or lack of growth in the federal workforce as compared to the growth of the federal budget. The federal workforce reached a peak of 3.4 million workers during World War II. In the years following, the level of employment dropped below 2 million and remained there until 1966 except for a brief period during the Korean War. From 1966 until 2014 the level stabilized at around 2 million.<sup>57</sup> In essence, the number of

<sup>51</sup> Cooper, Phillip J., "The Duty to Take Care: President Obama, Public Administration, and the Capacity to Govern," *Public Administration Review* 71, No. 1 (2011): 7–18.

<sup>52</sup> As argued by Cooper, *ibid*.

<sup>53</sup> *Ibid*.

<sup>54</sup> Perry, James L., "Is Public Administration Vanishing?" *Public Administration Review* 76, No. 2 (2016): 211–212.

<sup>55</sup> *Ibid*.

<sup>56</sup> Light, Paul, "Fact Sheet on the New True Size of Government" (The Brookings Institution, September 5, 2003), available at <https://www.brookings.edu/wp-content/uploads/2016/06/light20030905.pdf>.

<sup>57</sup> Office of Personnel Management, Historical

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carrier night flight operations and gained enormous respect and admiration for the men and women of the U.S. military and U.S. government for their efficiency, competence, and courage.)

federal workers remained relatively stable in the face of phenomenal growth of the scope and influence of the federal government, including the number and size of federal programs. The federal budget grew from \$130 billion in 1966 to \$3 trillion in 2014. Some argue that the federal workforce has been supplemented or replaced in part by a contracting workforce. But this outsourced workforce has its own problems, including accountability.

Federal procurement is a complex administrative function. It is extremely hard to do procurement well, even with adequate resources and competent staff. The Federal Acquisition Institute has developed a plethora of guides and manuals that have a significant positive effect on the practice of federal procurement. Nevertheless, successful and permanent procurement reforms are difficult to achieve under any capacity deficit.

### 3. The Pendular Nature of Procurement Reform

The third reason, or alternative theory, for the mixed record of procurement reform has to do with the lack of permanence of procurement reform. In other words, while procurement reforms may have been instituted to streamline the procurement system to, for example, quickly arm the nation in a time of war, events such as a procurement scandal may occur leading to elimination of the reform and reinstitution of overregulation of the procurement system. This lack of permanence or swinging back and forth between strong and weak procurement regulation can be thought of as a swinging pendulum, a frequently used metaphor. In 1998, Steven Kelman said:

Sure, right now, federal procurement has been moving in the direction of fewer rules and more leeway for government folks to use their judgment. But the pendulum will swing back. After a while we'll go back to the way things were before procurement reform, and the regulations and distrust will return....<sup>58</sup>

This pendulum swings between two poles or two conditions of the federal procurement system. At one pole the procurement system may be operating in a largely unregulated condition where the regulations may have been purposefully relaxed to allow streamlined purchases (e.g., in a time of war). At the other pole the procurement system may be operating in an overregulated condition (e.g., a result of laws enacted by Congress in reaction to wartime scandals of profiteering or waste).

The swinging pendulum receives a constant oiling from our two-party system, especially when the politics of this two-party system become negative and nasty. Any real or imagined procurement scandal is exploited by the party out of power. A cost overrun or a delay in the procurement of a weapon system is often criticized as administrative incompetence or worse by the party out of the White House; the usual result is a clarion call for procurement reform and new procurement reform legislation. The steps in this dance are the same for either party.

This swinging pendulum pattern is easily discerned throughout the history of federal procurement. To award federal contracts quickly during the Civil War, a loophole was created in the law requiring advertising on all government contracts,<sup>59</sup> which essentially eliminated the advertising requirement. After the war, a joint Senate-House commission established a board to review every proposed contract award because of extensive wartime profiteering. The pendulum swung between a relaxed condition of procurement rules during the war to expedite buying and a reapplication of procurement rules after the war is a consequence, it seems, of the relaxation of rules.

The swinging pendulum can again be observed during and following World War I. Again, to expedite the procurement of goods and services needed for the war effort, advertising on all contracts was eliminated. Another indication of the relaxed condition of procurement regulation was the widespread use of cost-plus-a-percentage-of-cost contracts. This type of contracting gave contractors

Federal Workforce Tables (Washington, DC: 2015).

<sup>58</sup> Kelman, Steven, "Pendulum Metaphor Need Not Dictate Our Destinies," *Federal Computer Week* 12, No. 4 (1998): 21.

<sup>59</sup> Culver, C.M., "Federal Government Procurement: An Uncharted Course Through Turbulent Waters," *Contract Management Magazine* (1984).

no incentive to control costs and is now deemed illegal. After the war, Congress passed an excess profits tax in large part due to contractor profiteering and influence peddling scandals at least partially related to the relaxed regulatory environment.

Yet another swing of the pendulum can be seen during World War II. On December 18, 1941, just a few days after the attack on Pearl Harbor, the president signed the War Powers Act. According to the act, any agency engaged in the war effort could award contracts without public advertising or competitive bidding. Congress restored competitive bidding after the war. During the Korean War, Congress rescinded the requirement for advertising before contract award.<sup>60</sup>

These historical examples reveal the swinging, pendular nature of government contracting. At one extreme of the swinging pendulum, procurement regulations are very loose or relaxed; at the other extreme, procurement regulations are very tight and restrictive. This pattern has been confirmed time and again by several histories of federal procurement.<sup>61</sup>

This swinging pendulum leads to a lack of permanence of procurement reforms and creates an almost insurmountable challenge for procurement reformers.

#### 4. It May Not be Wise to Run Government Exactly Like a Business

“Government shouldn’t be run like a business; it should be run like a democracy”<sup>62</sup>; but, on the other hand, “[g]overnment needs to be as well managed as it is well meaning.”<sup>63</sup>

There has been a noticeable push to make the federal

government more businesslike at least since the Carter administration in the late 1970s. It is believed that more businesslike government can help to reduce the cost of government and lower budget deficits. However, making the government more businesslike has had its share of challenges and failures. A brief discussion of the implications of entrepreneurial governance follows.

An example of government entrepreneurialism not working concerns a U.S. Army contract for private-sector interrogators awarded in 1993. To obtain the interrogators, the Army used a contract reserved for information technology. The \$20 million contract was awarded by a fee-for-service procurement office in the Interior Department. Interrogation services seem far outside the scope of the information technology contract. To add such a task to the basic contract would be to stretch procurement rules to their breaking points. Indeed, the Department of Interior Inspector General blamed the out of scope contract on an inherent conflict in a fee-for-service operation. “Procurement personnel in their eagerness to enhance organizational revenues have found shortcuts to federal procurement procedures and procured services for clients whose own agencies might not do so.”

In the mid-1990s, the GSA became one of the most entrepreneurial organizations in government. The fees it earned for its procurement services and the bonuses it gave its employees were tied to the revenue it generated. From 1998 to 2003, that revenue more than doubled. However, an investigation uncovered serious contracting abuses. Several offices purchased millions of dollars of building construction products and services with IT funds. It looks as if the pressure to maximize revenue and make the customer happy led to stretching the procurement rules too far. Entrepreneurialism may not be a good fit for government.

Under the Government Management Reform Act,<sup>64</sup> Congress authorized franchise funds to provide common support services to other government organizations. Common support services include payroll processing, information technology support, employee assistance programs, and contracting.

<sup>60</sup> Culver, C.M., “Federal Government Procurement: An Uncharted Course Through Turbulent Waters, Part 5—Korea to Vietnam—The Fifties,” *Contract Management Magazine* (1985): 13–17.

<sup>61</sup> See, e.g., the Commission on Government Procurement, “Report of the Commission on Government Procurement” (Washington, DC: December 1972).

<sup>62</sup> Denhardt, Janet V., and Robert B. Denhardt, *The New Public Service* (New York: M.E. Sharpe, Inc., 2003): 3.

<sup>63</sup> Mondale, Walter, presidential nomination acceptance speech at Democratic convention, San Francisco, California (July 19, 1984).

<sup>64</sup> *Pub. L.* 103-356. S. 2170.



Franchise funds must recover the full cost of providing the service and charge fees to do so. In 2005, GAO issued a report critical of franchise funds.<sup>65</sup> GAO referred to these franchise fund entities as “entrepreneurial, fee-for-service organizations, which are government-run but operate like businesses.”<sup>66</sup> According to GAO:

The fee-for-service arrangement provides incentives to emphasize customer service at the expense of proper use of contracts and good value.... The fee-for-service arrangement creates an incentive to increase sales volume because revenue growth supports growth of the organization. This incentive can lead to an inordinate focus on meeting customer demands at the expense of complying with contracting policy and required procedures.... [F]ranchise funds sometimes face incentives to provide customer service at the expense of proper use of contracts and good value.<sup>67</sup>

In 2001, Steven L. Schooner warned against pushing too far in the direction of businesslike government.<sup>68</sup> Schooner suggests that the government is different than the private sector; it lacks “the profit motive.” According to Schooner, “Government is not a business, nor can a market-based private sector model sustain the public trust.”<sup>69</sup>

Recent history reveals serious problems and challenges associated with operating the government like a business. While many aspects of government administrative activities are businesslike and can benefit by the efficiencies and economies of businesslike operations, the stories previously mentioned call for a cautious approach to wholesale installation of business methods.

“Government is different—and especially the federal government—is different in many ways than

<sup>65</sup> GAO, “Interagency Contracting: Franchise Funds Provide Convenience, but Value to DOD Is Not Demonstrated Federal Procurement,” GAO-05-456 (Washington, DC: GAO, 2005), available at <https://www.gao.gov/products/gao-05-456>.

<sup>66</sup> *Ibid.*

<sup>67</sup> *Ibid.*

<sup>68</sup> Schooner, Steven L., “Fear of Oversight: The Fundamental Failure of Business-Like Government,” *American University Law Review*, 50(3) (2001).

<sup>69</sup> *Ibid.*

running a business or anything else.”<sup>70</sup> Business doesn’t have the multiple goals the government has. Business doesn’t have the oversight the government has. Business doesn’t have the press scrutiny the government has. Business does not need to be as concerned as government with equity, justice, and fairness.

## How Likely Is It to Achieve Meaningful Reform of the Federal Procurement System?

Given the bleak history and poor record of past procurement reforms, can we be optimistic about future reforms? Probably not.

Is the federal procurement system in serious need of reform? Is it broken? The answer is yes if you listen to its critics, or if you listen to each new presidential administration. On the other hand, the federal procurement system is the envy of the world. It produces sophisticated weapon systems sought by many countries. Every year the system successfully processes millions of procurement transactions.

This article argues there are significant barriers to achieving radical and permanent reform. This reality is the justification for this author’s pessimism. Another reason for this pessimism is almost 40 years of intimate federal procurement experience inside the government as a contracting officer and contract manager, and outside it as a procurement consultant to government agencies.

The federal procurement system is what it is. It was never designed to make buys as fast as possible. If that were the case, all buys would be done on a sole-source basis to avoid the time-consuming competitive process. The federal procurement system has a multitude of goals and responsibilities. Federal procurement professionals cannot simply focus on a singular goal, such as “buy as fast as you can.” Further, it needs to be mentioned that the practice of federal procurement is greatly aided by the *Contract Management Body of Knowledge*® (CMBOK®),<sup>71</sup> a reference book that details the

<sup>70</sup> Gates, Robert, interview by Chuck Todd, *Meet the Press*, NBC (January 24, 2016).

<sup>71</sup> *The Contract Management Body of Knowledge*® (CMBOK®), 6th Edition (Ashburn, VA: National



professional competencies that make up the contract management profession.

This overview of procurement reform over the last 70 years suggests federal policy makers have been obsessed with the idea of reforming the federal procurement system. The proliferation of proposed procurement reforms has left no time for the goals of each reform to be implemented. There has been little evaluation and evidence of reform success or failure before the next round of reforms. Future reformers would be well served by mining this mixed record for lessons that could guide future attempts at reforming the very complicated federal acquisition process. Such analyses could be a rich subject for future research. I have seen up close how constant reform adversely affects the federal procurement community as it is pushed and pulled in opposite directions as administrations come and go.

Can we expect continued attempts to reform the federal procurement system? Absolutely! Such proposals are just good politics. The current fashionable reform ideas include improving the workforce and performance-based acquisition. It is hoped that reformers would have more realistic expectations about what can be achieved. They need to recognize that government is different than the private sector, that the procurement system is better than advertised, and that there are significant barriers to achieving radical and permanent reform.

*JCM*

# The Trickle-Down Effect: Internal Communication within a Multisite Government Contractor

BY DR. LAURA L. LEMON AND NATHAN A. TOWERY

## Abstract

**Purpose:** The purpose of this study is to investigate how internal communication manifests for employees of a government contractor. Because of the frequent shifting of contracts every few years, government contractors present a unique research setting that requires additional internal communication research.

**Approach:** A case study approach was used; data was collected via interviews and focus groups (n=77).

**Findings:** The findings uncover an inherent undervaluing of and an antiquated approach to internal communication. Suggestions for moving internal communication forward also emerged from the data.

**Research Implications:** Implications focus on employee-centric communication approaches and the need for more specialized training for internal communication practitioners. In addition, unconventional sources of internal communication are suggested, including an internal influencer.

**Practical Implications:** This study demonstrates the important role of internal communication practitioners and what happens when that role is not being adequately fulfilled. Specifically, the value of

the internal communication practitioner is enhanced when he or she can show the value of the work, take responsibility for that work, and have a presence across the organization.

**Value:** This is the first study to recognize the unique role of the internal influencer—who is an important yet unconventional internal communication source for government contractors.

## Keywords

internal communication, government contractor, case study, internal influencer

**Contract Management Body of Knowledge® (CMBOK®) Competencies**  
1.0, “Leadership”; 2.0, “Management”; 3.0, “Guiding Principles”

## About the Author

**Laura L. Lemon, PhD**, is an assistant professor in the Department of Advertising and Public Relations at The University of Alabama. Her research interests include public relations, employee engagement, internal communication, and mindfulness.

**Nathan A. Towery** is a doctoral candidate in Communication and Information Sciences at The University of Alabama. His research interests include strategic communication as well as motivations for consumption of sports media.

## Introduction

Internal communication is fundamental to the success of all organizations as it is the mechanism and approach that keeps employees, a key stakeholder group, informed. The field of internal communication is growing and transforming into an independent field of study, with many scholars suggesting that it warrants further investigation on its own, instead of being lumped with other public relations strategies.<sup>1</sup> As the field evolves into an independent subsection of public relations, new contexts need to be explored as well. The present study examines a unique context: government-contracted organizations (commonly referred to as “government contractors”). These organizations are currently exempt from investigation from the field of communication, especially public relations. In addition, limited scholarship investigates the integral function of internal communication within the government contractor context from the employees’ perspective.

Because of the frequent shifting of contracts every few years, government contractors are a unique research setting that require additional internal communication research; without successful internal communication processes, government contract changes might fail. Given the lack of research in this area, a case study approach was used and data was collected via interviews and focus groups (n=77). The findings uncover an inherent undervaluing of and antiquated approach to internal communication. Suggestions for moving internal communication forward also emerged from the data. Implications focus on employee-centric communication approaches and the need for more specialized training for internal communication practitioners. In addition, unconventional sources of internal communication are suggested, including an internal influencer, making this the first study to identify this type of information source.

<sup>1</sup> See Grunig, James E., “Symmetrical Systems of Internal Communication,” In *Excellence in Public Relations and Communication Management*, ed. James E. Grunig, (Hillsdale, NJ: Erlbaum, 1992): 531–576; Quinn, Dennis, and Owen Hargie, “Internal Communication Audits: A Case Study,” *Corporate Communication* 9, no. 2 (2004): 146–158, doi:10.1108/13563280410534348; and Ana Verčič, Ana Tkalac, Verčič, and Krishnamurthy Sriramesh, “Internal Communication: Definition, Parameters, and the Future,” *Public Relations Review* 38 (2012): 223–230, doi:10.1016/j.pubrev.2011.12.019.

## Literature Review

While some studies have shown the positive relationship between internal communication and organizational effectiveness,<sup>2</sup> and others have demonstrated the link between internal communication and organizational success,<sup>3</sup> internal communication still receives minimal attention compared to other areas, like social media, in public relations.<sup>4</sup> Verčič *et al.* suggested that internal communication should be an independent department in an organization, demonstrating its organizational significance and value.<sup>5</sup> As a topic warranting its own area of study, the following is a discussion of internal communication: definitions, contexts studied, and inherent value. The section concludes with limitations of the current scholarship, which suggests the opportunities for future investigations to extend current understanding.

### Internal Communication

*Internal communication* is anything, from informal office chatter to formal communication sent to all employees from senior-level management,<sup>6</sup> where

<sup>2</sup> See Dickson, David, Seanenne Reiney, and Owen Hargie, “Communication Sensitive Business Issues. Part 1,” *Corporate Communications: An International Journal* 8, no. 1 (2003): 35–43, doi:10.1108/13563280310458902; Quinn and Hargie (2004), *ibid.*; and Robson, Paul J.A., and Dennis Tourish, “Managing Internal Communication: An Organizational Case Study,” *Corporate Communications: An International Journal* 10, no. 3 (2005): 213–222, doi:10.1108/13563280510614474.

<sup>3</sup> See Kim, J.N., and Yumie Rhee, “Strategic Thinking About Employee Communication Behaviors (ECB) in Public Relations: Testing the Models of Megaphoning and Scouting Effects in Korea,” *Journal of Public Relations Research* 23, no. 3 (2011), 243–268, doi: 10.1080/1062726x.2011.582204; Omilion-Hodges, Leah M., and Colin R. Baker, “Everyday Talk and Convincing Conversations: Utilizing Strategic Internal Communication,” *Business Horizons* 57, no. 3 (2014): 435–445, doi:10.1016/j.bushor.2014.02.002; and Waymer, Damion, and Lan Ni, “Connecting Organizations and Their Employee Publics: The Rhetorical Analysis of Employee-Organization Relationships (EOR),” In *Rhetorical and Critical Approaches to Public Relations II*, eds. Robert L. Heath, Elizabeth L. Toth, and Damion Waymer (New York: Routledge, 2009): 216–232.

<sup>4</sup> Neill, Marlene S., and Hua Jiang, “Functional Silos, Integration & Encroachment in Internal Communication,” *Public Relations Review* 43, no. 4 (2017): 850–862, doi:10.1016/j.pubrev.2017.06.009.

<sup>5</sup> Verčič *et al.* (2012), see note 1.

<sup>6</sup> Welch, Mary, “Appropriateness and Acceptability: Employee Perspectives of Internal Communication,” *Public Relations Review* 38 (2012):

the communication is bound by the organization. To define the term, Welch and Jackson separated internal communication into four sectors: internal line management communication, internal team peer communication, internal project peer communication, and internal corporate communication.<sup>7</sup> The first three sectors are predominately two-way communication models, with the last being primarily one-way.<sup>8</sup> Most of the internal communication scholarship tends to assume an internal corporate communication approach, with limited focus on the other ways communication occurs internally.<sup>9</sup>

Some form of internal communication exists in every organization, thus justifying research in terms of its function, process, and value in many different contexts. For example, internal communication has been examined in a crisis context,<sup>10</sup> in connection with intranets/internal social media,<sup>11</sup> and as a

function of government agencies.<sup>12</sup> In addition, internal communication spans across many different disciplines as well—from hospitality,<sup>13</sup> to marketing,<sup>14</sup> to general business,<sup>15</sup> and finally to public relations.<sup>16</sup> Internal communication continues to grow as a field of study for public relations as it is the mechanism to create shared, organizational identity<sup>17</sup> and helps eliminate the distance between employees in globally based organizations.<sup>18</sup>

As the world shrinks with globalization and technology, the lines between internal and external communication become blurred. Cheney and Christensen<sup>19</sup> suggested that internal and external

246–254, doi:10.1016/j.pubrev.2011.12.017.

<sup>7</sup> Welch, Mary, and Paul R. Jackson, “Rethinking Internal Communication: A Stakeholder Approach,” *Corporate Communications* 12 (2007): 177–198, doi:10.1108/13563280710744847.

<sup>8</sup> *Ibid.*

<sup>9</sup> See, e.g., Duthler, Gaelle, and Ganga S. Dhanesh, “The Role of Corporate Social Responsibility (CSR) and Internal CSR Communication in Predicting Employee Engagement: Perspectives from the United Arab Emirates (UAE),” *Public Relations Review* 44, no. 4 (2018): 453–462, doi:10.1016/j.pubrev.2018.04.001; and Karanges, Emma, Kim Johnston, Amanda Beatson, and Ian Lings, “The Influence of Internal Communication on Employee Engagement: A Pilot Study,” *Public Relations Review* 41, no. 1 (2015): 129–131, doi:10.1016/j.pubrev.2014.12.003.

<sup>10</sup> See, e.g., Kim, Young, “Enhancing Employee Communication Behaviors for Sensemaking and Sensegiving in Crisis Situations,” *Journal of Communication Management* 22, no. 4 (2018): 451–475, doi:10.1108/JCOM-03-2018-0025; Mazzei, Alessandra, and Silvia Ravazzani, “Internal Crisis Communication Strategies to Protect Trust Relationships: A Study of Italian Companies,” *International Journal of Business Communication* 52, no. 3 (2015): 319–337, doi:10.1177/2329488414525447; and Simonsson, Charlotte, and Mats Heide, “How Focusing Positively on Errors Can Help Organizations Become More Communicative,” *Journal of Communication Management* 22, no. 2 (2018): 179–196, doi:10.1108/JCOM-04-2017-0044.

<sup>11</sup> See, e.g., Madsen, Vibeke Thøis, “The Challenges of Introducing Internal Social Media—The Coordinators’ Roles and Perceptions,” *Journal of Communication Management* 21, no. 1 (2017): 2–16, doi:10.1108/JCOM-04-2016-0027; and Uysal, N., “Social Collaboration

in Intranets: The Impact of Social Exchange and Group Norms on Internal Communication,” *International Journal of Business Communication* 53, no. 2 (2016): 181–199, doi:10.1177/2329488415627270.

<sup>12</sup> See, e.g., Cao, Yiwen, Alicia C. Bunker, Jill Hoffman, and Hillary A. Robertson, “Change Communication Strategies in Public Child Welfare Organizations: Engaging the Front Line,” *Human Service Organizations: Management, Leadership & Governance* 40, no. 1 (2016): 37–50, doi:10.1080/23303131.2015.1093570; and Šliburytė, Laimona, “Internal Communication in Organizations Undergoing Change,” *Management of Organizations: Systematic Research* 29 (2004): 189–200, doi:10.1515/mosr-2017-0010.

<sup>13</sup> See, e.g., King, Ceridwyn, and Hyemi Lee, “Enhancing Internal Communication to Build Social Capital Amongst Hospitality Employees—The Role of Social Media,” *International Journal of Contemporary Hospitality Management* 28, no. 12 (2016): 2675–2695, doi:10.1108/ijchm-06-2015-0321.

<sup>14</sup> See, e.g., Im, Subin, and John P. Workman, Jr., “Market Orientation, Creativity, and New Product Performance in High-Technology Firms,” *Journal of Marketing* 68 (2004): 114–132, doi:10.1509/jmkg.68.2.114.27788.

<sup>15</sup> See, e.g., Omilion-Hodges and Baker (2014), note 3.

<sup>16</sup> See, e.g., Duthler and Dhanesh (2018), note 9; Men, Linjuan Rita, “The Internal Communication Role of the Chief Executive Officer: Communication Channels, Style, and Effectiveness,” *Public Relations Review* 41, no. 4 (2015): 461–471, doi:10.1016/j.pubrev.2015.06.021; and Men, Linjuan Rita, and Don W. Stacks, “The Effects of Authentic Leadership on Strategic Internal Communication and Employee-Organization Relationships,” *Journal of Public Relations Research* 26, no. 4 (2014): 301–324, doi:10.1080/1062726X.2014.908720.

<sup>17</sup> See Madsen, Vibeke Thøis, “Constructing Organizational Identity on Internal Social Media: A Case Study of Coworker Communication in Jyske Bank,” *International Journal of Business Communication* 53, no. 2 (2016): 200–223, doi:10.1177/2329488415627272.

<sup>18</sup> *Ibid.*

<sup>19</sup> Cheney, George, and Lars Thøesger Christensen, “Organizational Identity: Linkages Between Internal and

communication be integrated with one another and that there is no value in separating them because the differences among the two are insignificant. However, Verčič *et al.*<sup>20</sup> argued that there is value in having internal and external communication independent of each other, as they have very different tasks and purposes. For example, internal communication occurs between employees or members of an organization and creates a shared, internal understanding. External communication achieves cohesiveness between the organization as a whole and interested external audiences—like media and customers. Given the complexity surrounding defining the internal audiences, specialized internal communication approaches and training are needed.<sup>21</sup>

### Value of Internal Communication

Employees are one of the most important audiences for organizations. Kim and Rhee found that when employees have a strong relationship with the organization, they will be willing to speak on behalf of the organization externally (i.e., “megaphoning”) and look for external information (i.e., “scouting”) that may help prevent organization crises.<sup>22</sup> In addition, employees are the most critical stakeholder group when it comes to financial performance compared to any other audience.<sup>23</sup> Unfortunately, despite the value of employees, internal audiences are often assumed, which minimizes the strategy put forth for communication efforts.

Internal communication is the exchange of information between all employees of an organization, which generates a shared understanding that can foster more employee engagement.<sup>24</sup> In addition, internal communication can create an understanding of current market developments amongst employees from all areas of the organization.<sup>25</sup> As long as the content is updated and free of confusion,<sup>26</sup> internal communication can help increase employees’ knowledge base, especially during times of organizational change.

In some large organizations, silos can develop between organizational units, which causes different departments to begin operating as their own independent functions. Neill and Jiang<sup>27</sup> suggested that by tasking specialists in the internal communication department with strategic communication efforts, those silos may disappear, and functions will begin to work as a whole.

### Government Contractor Environment

While there may be similarities between government agencies and government contractors, government-contracted organizations see many different hierarchical shifts in management within relatively short periods of time. Contracts may form and only be in force for a few years until a new contract is produced with a new management team. Contact transitions result in changes to the name of the organization or its identity, top management teams, overall goals and objectives, employee benefits, and even day-to-day roles. These changes can happen overnight and occur every five to 10 years depending on the negotiated contract. This frequent change is unique to government contractors, which is unlike any other organizational context that has

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External Communication,” In *The New Handbook of Organizational Communication: Advances in Theory, Research, and Methods*, eds. F.M. Jablin and L.L. Putnam (Thousand Oaks, CA: Sage, 2001): 231–269.

<sup>20</sup> Verčič *et al.* (2012), see note 1.

<sup>21</sup> See Whitworth, Brad, “Internal Communication,” In *IABC Handbook of Organizational Communication: A Guide to Internal Communication, Public Relations, Marketing, and Leadership* (second ed.), ed. Tamara Gillis (Hoboken, NJ: Jossey-Bass, 2011): 195–206.

<sup>22</sup> See Kim, Jeong-Nam, and Yunna Rhee, “Strategic Thinking about Employee Communication Behavior (ECB) in Public Relations: Testing the Models of Megaphoning and Scouting Effects in Korea,” *Journal of Public Relations Research*, 23, no. 3 (2011): 243–268, doi:10.1080/1062726X.2011.582204.

<sup>23</sup> de Bussy, Nigel M., and Lokweepun Suprawan, “Most Valuable Stakeholders: The Impact of Employee Orientation on Corporate Financial Performance,” *Public Relations Review* 38, no. 2 (2012): 280–287, doi:10.1016/j.pubrev.2011.11.006.

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<sup>24</sup> See Verčič *et al.* (2012), note 1; and Walden, Justin, Eun Hwa Jung, and Catherine Y.K. Westerman, “Employee Communication, Job Engagement, and Organizational Commitment: A Study of Members of the Millennial Generation,” *Journal of Public Relations Research* 29, no. 2/3 (2017): 73–89, doi:10.1080/1062726X.2017.1329737.

<sup>25</sup> See Im and Workman (2004), note 14.

<sup>26</sup> See Tippins, Michael J., and Ravipreet S. Sohi, “IT Competency and Firm Performance: Is Organizational Learning a Missing Link?” *Strategic Management Journal* 24 (2003): 745–761, doi:10.1002/smj.337.

<sup>27</sup> Neill and Jiang (2017), see note 4.

been previously studied. Navigating such changes makes strategic, compelling, and efficient internal communication paramount to success.

After reviewing the literature in depth, the only identified fields that have investigated the government contractor context are finance, engineering, and law. As such, it can be anticipated that the public relations, communication field as a whole, and business arenas have not explored the complexities of government contractors and the function of communication within this setting.

Further, the government contractor research setting is unique in that these organizations are independently owned and operated, yet they often are supported and/or funded by the government, inherently linking the two. In addition, as mentioned, government contractors experience several frequent changes in leadership and rebranding, which demonstrates the complexity of this particular research setting. Given the gaps in the current literature regarding the perceptions and use of internal communication within the government contractor research setting, this study proposes one research question:

*“How do employees of a government contractor perceive internal communication?”*

## Methods

A qualitative case study approach was chosen as the method to answer the research question. Several other studies in public relations have used the case study approach to examine internal communication practices and implications.<sup>28</sup> Heath<sup>29</sup> suggested using cases is an ideal approach to understand the multifaceted experiences within organizational life and to answer questions that address such experi-

ences. Case studies are not exploratory research,<sup>30</sup> but instead provide context-based information that can contribute to the development of scientific understanding.<sup>31</sup> The goal of the study is to create “concrete case knowledge” instead of predictable knowledge.<sup>32</sup> In communication research, case studies can assist in answering important research questions that focus on processes and practices in applied contexts.<sup>33</sup> The following is a discussion of the case chosen for this particular study.

## Case Background

Given the lack of research of government contractors in public relations, a multisite government contractor production facility was chosen as the single-unit research case. Despite two sites, the organization was treated as a holistic case with no subunits to develop a deeper understanding of the phenomenon within this context. The contractor has five member organizations that manage the two sites, both located in the United States—one in the Southeast and the other in the South. The sites have longstanding histories in the communities in which they serve and have been around for over 50 years. The multibillion-dollar sites are production-focused and provide services to the U.S. Department of Energy.<sup>34</sup>

## Sample

Sampling began with a purposive approach. Purposive sampling shadows the study’s purpose by selecting a sample from which the most can be learned using the most informative sources.<sup>35</sup> The initial purposive sample included communication professionals at both sites. Following interviews with

<sup>30</sup> See Yin, Robert K., *Case Study Research: Design and Methods* (Thousand Oaks, CA: Sage, 2014).

<sup>31</sup> See Flyvbjerg, Bent, “Five Misunderstandings about Case-Study Research,” *Qualitative Inquiry* 12, no. 2 (2006): 219–245, doi:10.1177/1077800405284363.

<sup>32</sup> *Ibid.*, at 175.

<sup>33</sup> See Levenshush, Abbey B., “Building Context-Based Knowledge of Government Social Media Communication through an Ethnographic Study of the U.S. Coast Guard,” *Journal of Applied Communication Research* 44, no. 2 (2016): 174–193, doi:10.1080/00909882.2016.1155727.

<sup>34</sup> Due to the sensitive nature and high security of the work completed at both sites, the description of the case shall remain vague.

<sup>35</sup> See Merriam, Sharan B., *Qualitative Research: A Guide to Design and Implementation* (San Francisco, CA: Jossey-Bass, 2009).

<sup>28</sup> See, e.g., Hume, Jessica, and Anné Leonard, “Exploring the Strategic Potential of Internal Communication in International Non-Governmental Organizations,” *Public Relations Review* 40, no. 2 (2014): 294–304, doi:10.1016/j.pubrev.2013.10.011; King and Lee (2016), note 13; and Madsen (2016), note 17.

<sup>29</sup> Heath, Robert L., “The Journey to Understand and Champion OPR Takes Many Roads, Some Not Yet Well Traveled,” *Public Relations Review* 39 (2013): 426–431, doi:10.1016/j.pubrev.2013.05.002.



the communication team, focus groups were conducted with employees in various positions at both sites. The next stage of sampling followed a theoretical sampling approach, where the data collected was grounded in concepts derived from previous data collection.<sup>36</sup> Theoretical sampling provides an opportunity to maximize variation, where data collection identifies varying viewpoints, instances, or outliers from the initial findings to check if the data fit with the emerging themes.<sup>37</sup> The theoretical sample included the senior executives, site managers, and middle managers—all of which were chosen following data collection with the purposive sample.

The rigor of the research is demonstrated by the number of people who were involved in this case study. For the interviews, 21 people participated—11 women and 10 men. For the focus groups, 56 people participated across seven focus groups at the two sites, including 29 women and 27 men. The sample met maximum variation with a diverse range of perspectives based on the sample population's different ages, genders, sites, levels within the organization, functions, and years with the company.

### Data Collection

Data collection was triangulated using two different methods of collection—interviews and focus groups—and took place over three months. The researchers used an IRB-approved, semistructured guide for interviews. Interviews began with rapport building and grand tour questions that focused on work experiences and current position in the company. The next phase of questioning was categorically based, focusing on internal communication practices within the organization and experiences with internal communication. Prompts were used to encourage more detailed responses from participants.

The focus groups also relied on an IRB-approved, semistructured guide. The focus groups began with

an icebreaker, where participants were asked to share their internal communication preferences with the group. The next set of questions was more specific to instances involving informal and formal internal communication. When needed, prompts were used to help participants further articulate their experiences.

In both methods, data collection concluded once saturation or information redundancy was reached. In other words, data collection continued until no new insights emerged from the focus groups or interviews.

### Procedures

For the interviews, 21 people participated with 17 of the 21 interviews conducted at the sites in a private location. Four interviews were then conducted over the phone. Only two participants declined audio recording, which meant the researchers had to take notes during the exchange to ensure the participants' viewpoints would be used in the study. The 21 interview participants included three site managers, 12 people from the communication department, two middle managers, and four members of the C-suite (including the CEO). The interviews ranged from 33 to 100 minutes; the average interview was 50 minutes. Interviews were transcribed by a professional; the study had 260 single-spaced pages of interview data.

For the focus groups, 56 people participated with 21 participants in three focus groups at site A and 35 participants in four focus groups at site B. The focus group participants represented various organizational functions and departments, including employees paid both hourly and salary, lower management, and craftsmen. Focus groups were conducted onsite in remote conference rooms, and each lasted roughly 60 minutes to fit within the lunchbreak. All participants agreed to be audio-recorded; no one besides the researchers were present for the focus groups nor were the audio recordings made available to the organization, which ensured confidentiality. Lunch and/or snacks were provided during the focus group, but no additional benefits were offered. The same hired professional transcribed the focus groups; the study had 144 pages of single-spaced focus group data. Data collection concluded when saturation was reached.

<sup>36</sup> See Corbin, Juliet, and Anselm Strauss, *Basics of Qualitative Research: Techniques and Procedures for Developing Grounded Theory* (Thousand Oaks, CA: Sage, 2008).

<sup>37</sup> See Miles, Matthew B., A. Michael Huberman, and Johnny Saldana, *Qualitative Data Analysis: A Methods Sourcebook* (third ed.) (Thousand Oaks, CA: Sage, 2014).



## Data Analysis

Given the qualitative approach, the researchers relied on an inductive strategy to analyze the data. Inductive analysis examines all transcripts for emergent themes and categories; those themes are then adjusted and condensed from additional data analysis.<sup>38</sup> The first stage of data analysis included listening to audio recordings and reading transcripts for accuracy. The next stage included an open coding process, where each line or word was treated with equal value,<sup>39</sup> and if relevant to the research question, it was given a code. The third stage included identifying coding patterns and condensing repetitive codes. The fourth stage focused on developing and defining the emergent themes using a coding tree to illustrate the connections between the initial open codes. The final stage sought rival explanations of the data to uncover any alternate explanations of the case to ensure no theme was missed.<sup>40</sup> Throughout data collection, the researchers used a Computer Assisted Qualitative Data Analysis Software (CAQDAS)—NVivo for Mac. This software allowed the researchers to maintain the integrity of the data given the large data set.

To ensure the trustworthiness of the data, the researchers followed Lincoln and Guba's<sup>41</sup> criteria. To ensure credibility, member checks were conducted, and the two researchers provided input and debriefed during data collection and analysis. For transferability, the researchers used theoretical sampling and verbatim transcripts, which means theoretical concepts are represented in the data. Dependability was achieved by using two data sources (focus groups and interviews), and themes were found in all the transcripts. More than 300 pages of data were used in data analysis, and a clear audit trail demonstrates confirmability.

## Findings

From the data, three themes emerged regarding how government contractor employees perceive internal communication. Those themes include:

- Perceptions of internal communication,
- Relying on trickle-down communication, and
- Moving internal communication forward.

The following is a discussion for each of these themes.

### *Perceptions of Internal Communication*

Overall, internal communication was perceived as being undervalued. Many of the communication staff discussed this issue of devaluing both within the department and from management's perceptions. One public affairs specialist at site A said:

[W]hen I've worked with other teams, I've definitely felt like they respected my area, my knowledge, and felt that I had value. Within my group, I don't feel that at all.

Another public affairs specialist said:

They don't take input from communications people like we previously had. I think in the past, we were seen more as equals and now we're [seen] more as, like I said, advisors.

One communication team member said, "I don't think our expertise as communicators is seen"; while another team member had a similar thought about management and said, "We just tend to underfund and undervalue the communications aspect."

One major reasoning for the undervaluing is because the entire communication department lacks the metrics to demonstrate its organizational worth. For example, a public affairs specialist said:

So, it'd be nice, if we try to go to the CEO and say, "We've got to do this because that's what people want," "Well, how do you know that?" "I feel it in my gut." That's not good enough.

Another communication team member expressed a similar view by saying:

<sup>38</sup> See Haley, Eric, "Exploring the Construct of Organization as Source: Consumers' Understandings of Organizational Sponsorship of Advocacy Advertising," *Journal of Advertising* 25, no. 2 (1996): 19–35, doi:10.1080/00913367.1996.10673497.

<sup>39</sup> See Miles et al. (2014), note 37.

<sup>40</sup> See Yin (2014), note 30.

<sup>41</sup> I.e., Lincoln, Yvonna S., and Elon Guba, *Naturalistic Inquiry* (Beverly Hills, CA: Sage, 1985).

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I feel like we rely too much on our gut and what we think. We rely a lot on assumptions.... I'm stuck because I don't have data. I don't have that on-the-ground interaction.

The above quotes illustrate that the communication staff is very aware of the issue and are actively making strides to get the data to demonstrate its organizational contribution.

In addition to gathering more data, measuring impact, and taking responsibility for the content they create and disseminate, the internal communication staff could really move the mark by having an actual presence across the organization. This would aid in environmental scanning to tap into the rumor mill and establish connections that could help with content creation and circulation. One communication team member referred to this as "going on a roadshow."

### **Relying on Trickle-Down Communication**

When it comes to how internal communication was perceived in terms of processes within a government contractor, the approach is to rely on trickle-down communication. The idea is that senior executives craft a message that needs to reach over 8,000 employees. To do so, the message is communicated to the next upper management level, then to middle management, then to the front line, and so on. As one participant from a focus group held at site A said:

I think it's like the telephone game or gossip or whatever. When something's communicated through more heads, the message gets distorted in the end. We've all played that, I guess, when we were kids.

Electronic channels are used to disseminate the message, and the expectation is that the message will make it "all the way down to the floor," as one public affairs specialist said.

Not surprising, in a majority of cases, the information does not trickle down for various reasons, and most participants recognized this problem. One executive said:

There could be eight levels, and you're counting on

every manager hearing the message and articulating it to their staff the way you intended it to be handed it down, times seven. By the time you get to the bottom layer, the odds that that happened? Close to zero.

One focus group participant from site A said, "I know there's stuff I don't flow down because I probably didn't read it"; another focus group participant from site A said "[c]ommunication stops because it's not relevant and it's not getting spread to the end user"; while a site B focus group participant said "I have a lot of chiefs and lots of information flowing all different directions and they may think they've communicated clearly, but it's not getting to the right people that it needs to get to."

When information does not trickle down, employees are left to their own devices and begin to fill in the information gaps with rumors. As a focus group participant from site A said, "[t]hen the rumors get out of control and you can't even get ahead of them"; while, as an executive said, "our fastest communication... is the rumor mill. It's fast and it's efficient and they'll make stuff up sometimes."

Participants discussed the reasons for trickle-down internal communication not being a viable strategy, and the response most often shared was issues with upper management—the level right below the executive team. A member of the executive team described this level and said:

They have a hard job, and they don't have all the information and are not in direct contact with employees on the front line.

A focus group participant at site B said:

When you set the communication style up on a trickle-down theory and you put a bunch of sponges at the top, there's not going to be a trickle down. There's a disconnect.... So, then you feel blindsided.

One site B focus group participant said:

They could've put it on [the company intranet], but you would think, okay, the upper management has their meeting. You would think they would go back

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and tell their [managers] who would tell their [managers]. That's how it should flow down, but it never seems to leave that top layer.

Most of the upper management in this case is hired for scientific knowledge, not communication skills. Upper management are not communication experts nor trained in this area, which is ironic given the emphasis placed on ability to communicate. As a public affairs specialist said:

They just don't have the [communication] skills. We have a lot of engineers here and they just don't. They want to be managers, but they don't want to do the management part.

Provided the severity of the issue, one communication team member suggested the following:

I think the ideal solution for [for the upper management communication issue] would be some formal set of expectations that is baked into managers' jobs and it is part of performance reviews.

### Moving Internal Communication Forward

Given the antiquated nature of current internal communication processes within this government contractor, suggestions emerged from the data and are rooted in the participants' lived realities. The recommendations include:

- Targeting internal audiences,
- Developing meaningful content and sources, and
- Instituting successful feedback mechanisms.

#### Targeting Internal Audiences

Many of the participants discussed the different types of internal audiences within the organization and that one improvement would be to better reach certain groups. According to some communication staff, the organization only has two audiences:

1. Management, and
2. Nonmanagement.

As one public affairs specialist said:

I think they're really lumped together. Everything I

deal with is very "everyone." It's either going to go on our intranet or on our monitors.... [E]verything's gone sitewide and it's either for everyone or it is management only.

The problem with a lack of targeted communication is that when communication is for everyone, it is for no one. Another public affairs specialist described this issue and said:

I see how people could get tired of it and easily start ignoring it because so much of it's not applying to them, so that when something actually does apply to them, it's still being ignored.

Some members of the communication team were more skilled in understanding the benefits of targeting specific internal audiences. For example, one communication manager said:

I don't think we do a great job of that right now, especially getting people without computers. And I don't necessarily think we do a good job of hitting... engineers[. W]e probably loop them all together when they have different needs.

Others were not. For example, when asked if audiences were segmented for communication purposes, one communication manager said, "What do you mean?" Therefore, more strategic approaches could be developed to first segment audiences and then develop content that is meaningful to each audience.

#### Developing Meaningful Content and Sources

Participants shared what types of internal communication (and from whom) would be most meaningful, and most often it was content from the executive team, especially the CEO. The request is for honest communication that humanizes the executives, which currently is not the approach being taken. As one communication team member said, "[e]mployees want to hear from senior leadership in an authentic way"; while one focus group participant at site A said "[t]he thing that's been missing from a lot of the communication is honesty."

Participants also stated they were able to identify if the content was "ghostwritten" by another source—a practice that also comes across as disingenuous. A

focus group participant from site B said:

When you see somebody speaking from the heart, it just seems a whole lot more meaningful than words. I've read some [content] and I thought, "Gosh, did he write that or was it a really good person in communications that wrote that?"

If genuine communication is not developed and disseminated, it "almost feels like propaganda," as said by a participant from a focus group at site B.

Despite the desire for such content, the executive team is perceived as absent from internal communication. For example, one communication team member said:

I don't think they understand that you have to come out of that floor. You can't cocoon yourself up there.

Further, as a middle manager suggested:

[An executive should be] someone that's personable, that doesn't mind doing something...maybe they look goofy one day, just so they relate to people. I just think it's really important. If you have someone that just sits in their office all day, doesn't want to say anything to people, that's not great.

The desire of employees is to not only hear from their executives, but also see them frequently. Some executive team members understand the value in this and spend time communicating face-to-face with employees. As one executive team member said:

My preference is to be communicating out of the floor and answering questions.... [T]hat is the piece we are missing the most—having the conversation with employees.... [M]anagers don't spend enough time out walking the floor.

Being present while delivering content is important because it gives employees an opportunity to provide feedback.

### *Instituting Successful Feedback Mechanisms*

The last component necessary to move internal communication forward at this government contractor would be instituting a successful feedback mechanism. At present, none exists. Such feedback could start with simple questions asking for feedback, as suggested by one participant from a site A focus group who said:

I hadn't heard anybody come out...from an executive team or even a department manager's level and ask you or put out something, "How does everybody feel about this?"

A focus group participant from site B had a similar suggestion and said:

That's kind of where I would like to see communication, where they would ask us, "What's not working for you? How can we help?"

One member of the executive team recognized that feedback is an issue and said:

I think we need to have a means of getting feedback, so that we know if it's getting out there or not.

However, other participants did express that a form of feedback process existed and was actively being used, which they referred to as an "escalation process." One executive championed its use and said:

The intent of an escalation process...is really about empowering those lower levels to do things on their own. So, when something is escalated to the next level, it's an opportunity for that supervisor, mid-manager, senior manager, to provide a resource rather than to solve the problem.

Yet others were more critical of this process and the requirements necessary for it to be successful. As one communication team member said:

We have nothing, no vehicles that bring it back up.... If you have a problem, you go to your supervisor. If your supervisor can't fix it, then escalate it up.

Just as the trickle-down approach is not successful, escalating feedback up the layers most likely has the same success rate, requiring a return to the drawing board to craft more successful feedback strategies.

## Discussion

The findings from this study provide insight into the role of internal communication within government contractors. This study has three primary implications for government contractors, which include:

- Turning off the faucet of trickle-down communication,
- The need for internal communication practitioners to become specialists, and
- The consideration of unconventional sources of internal communication.

### Turning Off the Faucet of Trickle-Down Communication

The internal communication approaches used by the government contractor in this study are similar to the “command-and-control” model that assumes employees need to be targets of persuasion,<sup>42</sup> with little consideration for the actual communication needs of different internal audiences. Internal communication is more complex and multidimensional than how it manifests in practice as an uncomplicated, linear exchange,<sup>43</sup> which in this case was a trickle-down approach. When the complexity is missed, internal communication is undervalued and strategically simplified.

The intricacies of internal communication require an in-depth understanding of who is being communicated to and how; yet, as this study demonstrated, negative implications develop when internal audiences are assumed to be one, homogeneous group via trickle-down communication. L’Etang<sup>44</sup>

criticized most public relations research as oversimplifying audiences to one public. Other studies have found support for considering employees as a multidimensional audience with varying needs instead of just clumping all internal stakeholders together.<sup>45</sup> When communication professionals who work for a government contractor assume employees to be a single public, it limits the effectiveness of internal communication because strategy is eliminated when all internal communication content is communicated the same way via the same channel to all employees. While many different channels are needed to reach the different internal audiences, strategic consideration should also be made for the content that is disseminated to the different audiences to ensure it is meaningful. In doing so, internal communication transitions from management-focused to employee-focused by fulfilling the communication needs for employees.<sup>46</sup>

An employee-centric approach also shifts internal communication away from the trickle-down approach, which was found in the case of this multisite government contractor to ensure—

- Employees are actually receiving the communication, and
- That the communication is consequential to its intended audience.

As previous research has suggested, when employees are able to express their voice, a greater chance for engagement exists.<sup>47</sup> Therefore, if employee communication operates within silos and is stifled by the previously mentioned escalation process, then no employee engagement will exist because no opportunities for employee voice exist. Internal communication should be strategically driven in a way that cultivates feedback mechanisms and features ample, curated content that lends itself to feeding employee engagement.<sup>48</sup>

<sup>42</sup> See McKie, David, and Paul Willis, “Renegotiating the Terms of Engagement: Public Relations, Marketing, and Contemporary Challenges,” *Public Relations Review* 38, no. 5 (2012): 846–852, doi:10.1016/j.pubrev.2012.03.008.

<sup>43</sup> See Jimenez-Castillo, David, “Beyond Mere Information Transfer: The Important of Relational Approach to Market-Related Internal Communication,” *Journal of Public Relations Research* 28, nos. 5–6 (2016): 268–281, doi:10.1080/1062726x.2016.1258564.

<sup>44</sup> L’Etang, Jacquie, “Critical Public Relations: Some Reflections,” *Public Relations Review* 31, no. 4 (2005): 521–526, doi:10.1016/j.pubrev.2005.08.011.

<sup>45</sup> See, e.g., Welch (2012), note 6.

<sup>46</sup> See Ruck, Kevin, and Mary Welch, “Valuing Internal Communication; Management and Employee Perspectives,” *Public Relations Review* 38, no. 2 (2012): 294–302, doi:10.1016/j.pubrev.2011.12.016.

<sup>47</sup> See Ruck, Kevin, Mary Welch, and Barbara Menara, “Employee Voice: An Antecedent to Organizational Engagement?” *Public Relations Review* 43 (2017): 904–914, doi:10.1016/j.pubrev.2017.04.008.

<sup>48</sup> See Verčič, Ana Tkalc, and Nina Poloski

Avoiding trickle-down communication and transitioning to more intentional internal communication approaches offers a more long-term, sustainable strategy, especially for government contractors. Walden *et al.*<sup>49</sup> argued that when the communication system values the communication needs of individual employees and facilitates the continual flow of information internally, the overall commitment to the organization is strengthened. In addition, internal communication should have programing that can be sustained over time,<sup>50</sup> which means government contractors need to develop internal communication programs that outlive the current contract to ensure organizational commitment even when the contract changes.

### The Need for Internal Communication Practitioners to Become Specialists

This study demonstrated the important role of internal communication practitioners and what happens when that role is not being adequately fulfilled. Specifically, the value of the internal communication practitioner is enhanced when he or she can show the value of the work, take responsibility for that work, and have a presence across the organization. The internal communication staff can and should take on the responsibility of encouraging employee voice and taking those contributions to management and leadership.<sup>51</sup> This position provides an opportunity to develop formal processes for critical feedback and information to flow upward.<sup>52</sup> However, when an organization is heavily laden with layers, like in the case of this multisite government contractor, moving that information upward is difficult, especially if internal communication staff are undervalued.

Internal communication practitioners need training and education to become internal communication specialists, not just public relations generalists. Many of the internal communication staff in this case study were trained as generalist practitioners, with an educational focus in media relations. This

could explain the assumed, singular internal audience expressed by several of the internal communication staff, as well as the lack of strategy surrounding internal communication practices; it simply comes down to limited education and knowledge. Given this dearth of training and education, it is hard to have a seat at the table, which may lead to the undervaluing of internal communication practices and practitioners as experienced in this study. Therefore, educational programs should be developed to emphasize expert internal communication training that could enrich the role and experience of the specialist, not the generalist.<sup>53</sup> Such programs would lead to greater expertise in assessing and evaluating internal communication practices.<sup>54</sup> The executive leadership team should encourage internal communication staff to pursue additional training that develops this particular skill set so they become subject-matter experts.

### Unconventional Sources of Internal Communication

The government contractor employees in this study wanted to hear from top management or those managers they have relationships with, not the middle managers who are tasked with disseminating internal communication. Who says what and to whom is how meaningful content is achieved, and in this case, those frontline managers are often the most valuable sources of information.

Ortiz and Ford<sup>55</sup> demonstrated the value of the frontline managers; they are the ones “in the trenches” with employees, which makes them the catalyst for beneficial internal communication. Additional important sources of information for employees were the CEO and C-suite executives.

Vokic, “Engaging Employees Through Internal Communication,” *Public Relations Review* 43 (2017): 885–893, doi:10.4135/9781452204536.

<sup>49</sup> Walden *et al.* (2017), see note 24.

<sup>50</sup> *Ibid.*

<sup>51</sup> See Ruck *et al.* (2017), note 47.

<sup>52</sup> *Ibid.*

<sup>53</sup> See Welch, Mary, “Mastering Internal Communication: Knowledge Foundations and Postgraduate Education,” *Public Relations Review* 39 (2013): 615–617, doi:10.1016/j.pubrev.2013.04.003.

<sup>54</sup> See Sebastião, Sonia Pedro, Giovana Zulato, and Alice Donat Trindade, “Internal Communication and Organizational Culture: The Management Interplay in the View of the Portuguese Communication Consultant,” *Public Relations Review* 43 (2017): 863–871, doi:10.1016/j.pubrev.2017.05.006.

<sup>55</sup> I.e., Ortiz, Lorelei A., and Julie D. Ford, “The Role of Front-Line Management in Anti-Unionization Employee Communication: America West Airlines vs the Teamsters Union,” *Journal of Communication Management* 13, no. 2 (2009): 136–156, doi:10.1108/13632540910951759.



However, employees in this study wanted to engage in dialogic exchanges, not formal, top-down communication. This is somewhat counterintuitive, especially for the C-suite, because often management-centric internal communication comes in the form of e-mail or another formal source. In this study, employees desired to have the top leaders meet them where they are and experience a dialogic exchange that emphasized interpersonal relationship building, not just delivering content. Therefore, management should be required to listen to different internal audiences by recognizing and acknowledging the other to achieve understanding that leads to an adequate response.<sup>56</sup>

Another source of communication to consider is colleagues. Many of the discussions with government contractor employees involved connections with colleagues and how employees have specific, individual sources they may visit to gather information, especially when information is not being trickled down via management. Often, managers and the C-suite are considered to be the most powerful information sources,<sup>57</sup> but this study highlights how valuable some nonmanagement employees are, serving as internal influencers for specialized audiences, which are built through interpersonal relationships.

The term *influencer* is most notably associated with social media, where the person is a “new type of third party endorser who shape audience attitudes.”<sup>58</sup> The same approach could be applied to an organizational setting, where the internal influencer is a “new type of third party” communicating on behalf of management with the role of “shaping [internal] audience attitudes.” The internal influencer would have established social capital among internal audiences and would be a trusted information source. Therefore, this new public relations ap-

proach would help build social capital,<sup>59</sup> which would assist in sustaining the government contractor during a contract turnover.

### Government Contractor Managerial Implications

This study illustrated how internal communication is perceived within the government contractor research setting. The following are a few practical, managerial implications that could be implemented by those tasked with managing and implementing internal communication programs in multisite government contractors.

First, as suggested by Ruck *et al.*,<sup>60</sup> internal communication programs should focus on developing mechanisms that cultivate employee voice to listen and better understand employee communication needs—such as preferred channels, sources, and content. In doing so, employees receive the appropriate information and have more opportunities to feel heard, which has the potential to lead to more employee engagement.

Second, internal communication practitioners who work for government contractors should consider seeking out educational training programs to extend their knowledge surrounding strategically communicating to and with employees. Management should also support this additional training. This will assist with enhancing the aforementioned approaches to internal communication strategies and ensure the internal communication staff become true subject-matter experts.

The third suggestion is for management. Employees want to physically see both the leadership team and top management. They prefer in-person, dialogic exchanges, especially with management. They want to be able to share the work they are doing as well as hear firsthand the changes the organization may be experiencing so questions can be asked if need be. Therefore, top management needs to be available in person and engage face-to-face, meeting employees in their workspaces. This may require more of

<sup>56</sup> See Macnamara, Jim, “Organizational Listening: Addressing a Major Gap in Public Relations Theory and Practice,” *Journal of Public Relations Research* 28, nos. 3–4 (2016): 146–169, doi:10.1080/1062726X.2016.1228064.

<sup>57</sup> See McKie and Willis (2012), note 42.

<sup>58</sup> Freberg, Karen, Kristin Graham, Karen McGaughey, and Laura A. Freberg, “Who Are Social Media Influencers? A Study of Public Perceptions of Personality,” *Public Relations Review* 37 (2011): 90–92, doi: 10.1016/j.pubrev.2010.11.001.

<sup>59</sup> See Taylor, Maureen, “Building Social Capital Thought Rhetoric and Public Relations,” *Management Communication Quarterly* 25, no. 3 (2011): 436–454, doi: 10.1177/0893318911410286.

<sup>60</sup> Ruck *et al.* (2017), see note 47.



management's time, but it will help ensure employees feel understood, appreciated, and part of the overall team.

## Conclusion

The present study examined the perceptions of internal communication for government contractors. The findings uncovered an inherent undervaluing of and an antiquated approach to internal communication. Suggestions for improving internal communication also emerged from the data, providing insight for those tasked with managing such communication. Taken together, this study provided important insight into the under-researched, yet complex, setting of government contractors.

Given the use of a case study method and its lack of generalizability to the entire population of government contractors, future research could consider using quantitative methods to examine the internal communication practices across many government contractor sites. However, this study does demonstrate reliability, in that the operations of the study can be replicated, and construct validity, in that the correct concepts were identified and then examined. The procedures in this study should be replicated in other multisite government contractors to better understand and compare the unique internal communication approaches and practices.

This is the first study to recognize the unique role of the “internal influencer,” who is an important yet unconventional internal communication source for government contractors. Future research could consider conducting a network analysis to determine who in the organization is serving as an internal influencer. Strategy could then be developed to ensure that person has the appropriate information to disseminate to internal stakeholders—not in a typical hierarchal, vertical fashion, but instead more horizontally. This approach would be a revised version of trickle-down communication, transforming the method into an effective internal communication strategy. *JCM*

# Improving Economic Price Adjustment Clauses in U.S. Air Force Contracts

BY TREVOR A. ENOS, JONATHAN D. RITSCHEL, EDWARD D. WHITE, AND SCOTT T. DRYLIE

## Abstract

**Purpose:** The purpose of this article is to investigate the frequency and magnitude of triggered economic price adjustment (EPA) clauses in U.S. Air Force aircraft production contracts and to suggest improvements to current EPA clauses.

**Approach:** Historical data from Air Force contracts and contract modifications from 1982–2017 were analyzed for EPA adjustments. Next, a change point analysis was conducted on historical values of the producer price index utilized in aircraft EPAs to determine whether significant changes in the dataset were influencing the accuracy of forecasts. Then an alternative approach to current forecasting techniques was compared to the status quo through Mean Absolute Percentage Error (MAPE) calculations.

**Findings:** Upward and downward EPA adjustments were found to be approximately equal between the contractor and the government. Total EPA adjustments were small, comprising less than 1% of the full contract value, with approximately \$45 million in opportunity costs identified. Lastly, changing from a prospective to a retrospective technique in EPA indexing resulted in a 13% decrease in MAPE.

**Value:** This article details the impact of EPA clauses in Air Force production contracts and recommends

future Air Force aircraft fixed price with EPA clause contracts be modified to incorporate the retrospective approach.

## Keywords

economic price adjustment, contract management, defense procurement, escalation

***Contract Management Body of Knowledge® (CMBOK®) Competencies***  
4.0, “Pre-Award”; 5.0, “Award”; 6.0, “Post-Award”

## About the Author

**Trevor A. Enos (USAF)** is the lead cost analyst for the Spectrum Efficient National Surveillance Radar Program and has served as a cost estimator for Kessel Run at Hanscom Air Force Base, Boston, Massachusetts. He received a BS from the U.S. Air Force Academy and an MS in Cost Analysis from the Air Force Institute of Technology (AFIT).

**Dr. Jonathan D. Ritschel** is an Assistant Professor of Cost Analysis in the Department of Systems Engineering and Management at AFIT. He received his BBA in Accountancy from the University of Notre Dame, MS in Cost Analysis from AFIT, and PhD in Economics from George Mason University.

**Dr. Edward D. White** is a Professor of Statistics in the Department of Mathematics and Statistics at AFIT. He received his BS in Mathematics from the University of Tampa, MAS from The Ohio State University, and PhD in Statistics from Texas A&M University.

**Lt. Col. Scott T. Drylie (USAF)** is an Assistant Professor of Cost Analysis in the Department of Systems Engineering and Management at AFIT. He received his MS in Cost Analysis from AFIT and PhD in Economics from George Mason University.

## Introduction

The U.S. Air Force (USAF) contracts with private-sector companies to manufacture individual aircraft platforms. The conventional construct for production of major USAF aircraft platforms is a fixed-price contract spanning multiple years. Adjusting these fixed-price contract prices over long periods of performance is vital to protect both the government and contractor from market price fluctuations. This protection is accomplished via an economic price adjustment (EPA) clause in the contract.

In 2008, the Department of Defense (DOD) Inspector General (IG) investigated EPA clause anomalies of up to \$1.9 billion related to Boeing contracts on the USAF C-17 *Globemaster III* aircraft, the U.S. Navy F/A-18 E/F *Super Hornet* aircraft, and the U.S. Army AH-64D *Apache Longbow* helicopter.<sup>1</sup> In this role, the IG served to overcome what is known in economics as the “principal-agent problem”—which occurs when an agent, acting on behalf of a principal, imperfectly represents the wishes of the principle.<sup>2</sup> In DOD acquisitions, the acquisition and contracting professionals are the agents, and Congress is the principal. It is the inability of Congress to perfectly monitor DOD that creates opportunity for the principal-agent problem to arise.<sup>3</sup>

Because perfect or continuous monitoring is costly and time-consuming, one alternative method for

overcoming the principal-agent problem is through a “fire-alarm.”<sup>4</sup> A fire-alarm acts as an urgent signal that action taken by the agent may have significantly deviated from the outcome desired by the principal. The projected \$1.9 billion inordinate payments from the three Boeing EPA clauses triggered the fire alarm, which led to the IG investigation. The IG investigation, however, was narrow in scope—only investigating these three specific instances. There are broader issues, motivated by the specific IG instance, that warrant investigation.

EPA clauses should be constructed such that there is no systemic bias. In other words, properly constructed EPA clauses should provide equal protection to both the contractor and the government. This is one area for analysis. Additionally, this article serves to highlight the broader concern of accurate forecasting. Triggered EPA clauses have downstream budgetary effects through liability payments. Improvements to current forecasting methods can militate against these budgetary effects.

Thus, this article has two goals:

- First, this article examines whether the limited finding by the IG is a pervasive problem resulting in inequitable adjustments. This is accomplished by greatly expanding scope to include an analysis of USAF aircraft contracts with EPA adjustments from 1982–2017.
- Second, this article explores current EPA index calculations and methodologies to provide recommendations for improvements in future USAF fixed-price with EPA clause aircraft contracts.

## Background and Literature Review

Why does the cost to develop, produce, and maintain DOD systems increase year by year? Three primary interrelated factors contribute to the escalation of prices over time. The first is a decrease in the number of systems ordered per production lot.<sup>5</sup> Second, in today’s rapidly growing economy,

<sup>1</sup> Department of Defense Inspector General (DODIG), “Effect of Payments into Boeing Pension Funds on Economic Price Adjustment Clauses in DOD Contracts,” Rep. No. D-2008-099 (2008), available at <https://www.dodig.mil/Reports/Compendium-of-Open-Recommendations/Article/1118752/effect-of-payments-into-boeing-pension-funds-on-economic-price-adjustment-clause/> (hereinafter “DODIG Report (2008)”).

<sup>2</sup> See Ross, S.A., “The Economic Theory of Agency: The Principal’s Problem,” *The American Economic Review*, 63(2) (1973): 134–139; and Mankiw, N.G., *Principles of Economics*, seventh edition (Stamford, CT: Cengage Learning, 2015).

<sup>3</sup> See Kehl, B.T., “The Pentagon vs. Congress: The Political Economy of Military Base Closures during BRAC,” doctoral dissertation (Fairfax, VA: George Mason University, 2003).

<sup>4</sup> See McCubins, M.D., and T. Schwartz, “Congressional Oversight Overlooked: Police Patrols versus Fire Alarms,” *American Journal of Political Science*, 28(1), (1984): 165–179, <https://doi.org/10.2307/2110792>.

<sup>5</sup> Office of the Secretary of Defense, “Cost Analysis and Program Evaluation,” *Inflation and Escalation Best Practices for Cost Analysis*:

constant technological advances lead to technological turnover within programs.<sup>6</sup> Third, consistent with the private sector, DOD's expenditures are affected by increases in prices and wages.<sup>7</sup> This article focuses on the third reason.

Changes in prices and wages necessitate an understanding of two concepts:

- *Inflation*—i.e., the general rise in the average price level over a period of time<sup>8</sup>; and
- *Escalation*—i.e., price changes in specific goods and services.<sup>9</sup>

Escalation contains inflation as a component, but also incorporates real price changes such as market effects germane to the specific sector of the economy. These characteristics make escalation the preferred metric for forecasting future USAF weapon system costs. More specifically, the USAF utilizes published Producer Price Indices (PPI) from the Bureau of Labor Statistics (BLS) for aircraft contract escalation. These PPIs become the basis of EPA clauses and adjustments.<sup>10</sup>

Government contracts comprise a spectrum of contract types from “firm-fixed-price” to “cost reimbursement.” The contract type chosen determines which party bears the cost risk.<sup>11</sup> With a fixed-price contract, the cost risk shifts to the contractor. Historically, USAF aircraft production and aircraft modification contracts are constructed as “fixed-price with economic price adjustment” contracts based on a cost index of labor or material.

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*Analyst Handbook* (2017), available at [https://www.cape.osd.mil/files/Escalation%20Handbook\\_\\_20170118.pdf](https://www.cape.osd.mil/files/Escalation%20Handbook__20170118.pdf) (hereinafter “OSD CAPE”).

<sup>6</sup> *Ibid.*

<sup>7</sup> *Ibid.*

<sup>8</sup> Mankiw, N.G., *Macroeconomics*, 10th edition (New York: Worth Publishers, 2019).

<sup>9</sup> OSD CAPE, see note 5.

<sup>10</sup> McGlothen, D., “Revision of the AFLCMC Approach to Economic Price Adjustment to Reduce Improper Payment for Escalation Impacts Already Assumed in Contract Pricing,” unpublished report (Wright-Patterson Air Force Base, OH: Air Force Life Cycle Management Center, 2017).

<sup>11</sup> Darst, B.A., and M.K. Roberts, “Government Contract Types: The U.S. Government’s Use of Different Contract Vehicles to Acquire Goods, Services, and Construction,” *Contract Management Magazine* (December 2010): 16–31.

The EPA clauses in this contract type are necessary to protect both the contractor and the government, given the nature of aircraft procurement.

The *Federal Acquisition Regulation (FAR)* states the conditions under which EPAs are to be appropriately applied:

- (i) The contract involves an extended period of performance with significant costs to be incurred beyond 1 year after performance begins;
- (ii) The contract amount subject to adjustment is substantial; and
- (iii) The economic variables for labor and materials are too unstable to permit a reasonable division of risk between the Government and the contractor, without this type of clause.<sup>12</sup>

Upon inclusion of an EPA clause in a DOD fixed-price contract, upward or downward revision of the stated contract price can occur under three general types of contractually specified scenarios:

1. Revisions may occur due to adjustments based on established prices.<sup>13</sup> Changes in an agreed-upon level of prices for specific items enact this type of EPA clause.
2. Revisions may occur due to adjustments based on actual cost of labor or material.<sup>14</sup> If the actual costs of specified labor or material change during contract performance, this type of EPA may be enacted.
3. Last, and most relevant to this analysis, an EPA can result from adjustments based on cost indexes of labor or material.<sup>15</sup> These can either be forecasted index values or actual values of the index as reflective of the market.

The previous discussion helps explain price changes, the regulatory reasons for selecting an EPA, and the instances where EPA adjustments are triggered, but

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<sup>12</sup> FAR 16.203-4(d).

<sup>13</sup> FAR 16.203-1(a)(1).

<sup>14</sup> *Ibid.*, at (a)(2).

<sup>15</sup> *Ibid.*, at (a)(3).

does not answer the question as to why the decision was made to contract in the first place, nor does it explain the long duration of USAF contracts that incorporate EPAs. The “transaction cost economics” (TCE) literature undergirds the discussion.

The TCE theory from Coase and Williamson explicates the “make or buy” decision.<sup>16</sup> The TCE literature suggests that the chosen governance structure will be the one that executes the transaction most efficiently.<sup>17</sup> Asset specificity, which has the effect of placing contracting parties in a bilateral dependency, is the subject of numerous TCE studies<sup>18</sup>; however, some have suggested that many studies have ignored the analysis of a third option to the make or buy decision—that of long-term contracting.<sup>19</sup> These examinations of defense aerospace contracts have found that transaction cost factors have significant influence on the type of contract employed.<sup>20</sup> Other empirical TCE research examines both agency theory<sup>21</sup> and TCE considerations<sup>22</sup> as important factors in the structure and duration of contract relationships.

The TCE literature helps explain the rationale for long-duration USAF aircraft production contracts to incorporate EPA clauses. Beyond EPAs helping the contracting parties to properly index the price of a good, they can also reduce opportunistic behaviors

and breach of contracts,<sup>23</sup> as well as help to avoid the transaction costs associated with writing a contract that can properly respond to all possible dynamic scenarios. It has been suggested that price renegotiation provides important flexibility in contracts.<sup>24</sup> When there is potential risk for changes, it is advantageous (in terms of time and money) for both parties to include in their initial agreement a clause for price adjustments.<sup>25</sup>

The salient point in these long-term contract relationships is that the nature of the relation-specific investment moves the contracted parties away from market alternatives. Under these conditions, EPAs may be a superior solution. In one study of long-term coal contracts,<sup>26</sup> it was concluded that a base-price-plus-escalation construct is a better alternative to a cost-plus contract. While moving from cost-reimbursement to fixed-price contracting is not necessarily the optimal solution for major defense acquisition programs where large technological uncertainties exist,<sup>27</sup> the production of USAF aircraft is one area where fixed-price contract types have been traditionally employed.

As shown through the literature, price adjustments or EPAs are an important component for the success of these fixed-price, long-term contracts.

## Methodology

Phase one of the current analysis measures the magnitude of enacted EPA clauses in Air Force Material Command (AFMC) aircraft platforms from 1982 to 2017. Data comes from the ConData

<sup>16</sup> See Coase, R.H., “The Nature of the Firm,” *Economica*, 4(16), (1937): 386–405; and Williamson, O.E., *Markets and Hierarchies* (New York: Free Press, 1975).

<sup>17</sup> Williamson, O.E., *The Economic Institutions of Capitalism* (New York: Free Press, 1985).

<sup>18</sup> For a comprehensive review of the empirical studies, see Macher, J.T., and B.D. Richman, “Transaction Cost Economics: An Assessment of Empirical Research in the Social Sciences,” *Business and Politics*, 10(1), (2008): 1–63.

<sup>19</sup> See Adler, T.R., R.F. Scherer, S.L. Barton, and R. Katerberg, “An Empirical Test of Transaction Cost Theory: Validating Contract Typology,” *Journal of Applied Management Studies*, 7 (1998): 185–200.

<sup>20</sup> *Ibid.*

<sup>21</sup> Hart, O., and B. Holmstrom, “The Theory of Contracts,” in T.F. Bewley (ed.), *Advances in Economic Theory: Papers Presented at Symposia of the Fifth World Congress of the Econometric Society* (Cambridge University Press: 1987).

<sup>22</sup> Masten, S., and S. Saussier, “Econometrics of Contracts: An Assessment of Developments in the Empirical Literature on Contracting,” *Revue d'économie industrielle*, 92(1) (2000): 215–236.

<sup>23</sup> See Goldberg, V.P., and J.R. Erickson, “Quantity and Price Adjustment in Long-Term Contracts: A Case Study of Petroleum Coke,” *The Journal of Law and Economics*, 30(2), (1987): 369–398, <https://doi.org/10.1086/467141>; and Joskow, P.L., “Price Adjustment in Long-Term Contracts: The Case of Coal,” *The Journal of Law and Economics*, 31(1) (1988): 47–83, <https://doi.org/10.1086/467149>.

<sup>24</sup> Crocker, K.J., and S.E. Masten, “Pretia ex Machina? Prices and Process in Long-Term Contracts,” *Journal of Law and Economics*, 34 (1991): 69–99, <https://doi.org/10.1086/467219>.

<sup>25</sup> *Ibid.*

<sup>26</sup> Joskow, see note 23.

<sup>27</sup> See Wang, C., and J.G. San Miguel, “Are Cost-Plus Defense Contracts (Justifiably) Out of Favor?” *Journal of Governmental & Nonprofit Accounting*, 2(1) (2013): 1–15, <https://doi.org/10.2308/ogna-50558>.

EQUATION 1.

$$S_n = S_{n-1} + (x - \bar{x})$$

EQUATION 2.

$$S_{diff} = S_{max} - S_{min}$$

EQUATION 3.

$$SSE(m) = \sum_{n=1}^m (x_n - \bar{x}_1)^2 + \sum_{n=m+1}^{384} (x_n - \bar{x}_2)^2$$

where

$$\bar{x}_1 = \frac{\sum_{n=1}^m x_n}{m} \text{ and } \bar{x}_2 = \frac{\sum_{n=m+1}^{384} x_n}{384-m}$$

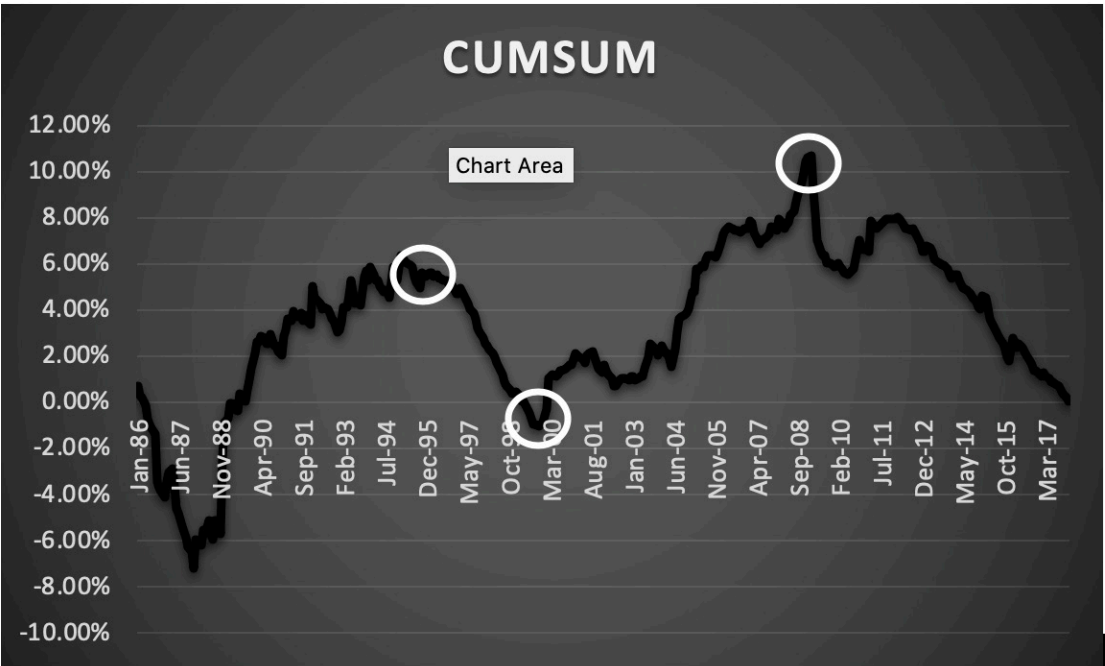
EQUATION 4.

$$\left( \frac{1}{n} \sum \frac{|Actual - Forecast|}{|Actual|} \right) \times 100$$

TABLE 1. ECONOMIC PRICE ADJUSTMENT AMOUNT BY AIRCRAFT (CP 2017\$)

Aircraft Platform	EPA Modification Count	Total Contract Price	Total EPA Amount	Percent of Contract
A	2	\$ 29,653,250,814	\$ (7,475,916)	-0.0252%
B	4	\$ 10,285,600,121	\$ 22,744,725	0.2211%
C	3	\$ 18,374,457,653	\$ 52,862	0.0003%
D	5	\$ 3,572,044,461	\$ (3,363,143)	-0.0942%
E	6	\$ 19,172,108,357	\$ (11,264,891)	-0.0588%
Absolute Value	20	\$ 81,057,461,406	\$ 44,901,537	0.0554%
Net Total	20	\$ 81,057,461,406	\$ 693,636	0.0009%

FIGURE 1. CHANGE POINTS



database collected by the Air Force Life Cycle Management Center (AFLCMC) cost and economics division. The ConData database is derived from the Contract Writing System (ConWrite). ConWrite is the contract document software package that prepares contracts, modifications, and orders for multiple USAF agencies.<sup>28</sup> Specifically, ConWrite is

<sup>28</sup> Air Force Life Cycle Management Center, Center for Business and Enterprise Systems (AFLCMC BES), "AFLCMC BES Reference Guide" (Gunter Annex, AL: AFLCMC BES, 2017), available at [https://www.airforcebes.af.mil/Portals/23/documents/BES%20Vendor%20Communication/BES%20Reference%20Guide\\_28%20Mar%2017\\_FINAL.pdf?ver=2017-09-26-142445-197](https://www.airforcebes.af.mil/Portals/23/documents/BES%20Vendor%20Communication/BES%20Reference%20Guide_28%20Mar%2017_FINAL.pdf?ver=2017-09-26-142445-197).

utilized in all aircraft pre- and post-award contract activities in AFMC.

Phase two evaluates USAF EPA methodologies in fixed-price with EPA clause aircraft contracts for potential improvement. The status quo approach for USAF aircraft EPAs is based solely on changes in *forecasts* of the aircraft manufacturing price index, PPI 336411, as reported by the Bureau of Labor Statistics. This approach is called "prospective" estimating. These PPI 336411 forecasts are provided to the USAF through a private company. However, such an approach is subject to error when there are



significant changes in trends at different points in time. An alternative methodology exists that relies on changes in *historical* averages, called “retrospective” estimating. The desired outcome from phase two is to examine the accuracy of the prospective status quo approach in comparison to this alternative approach.

When a data set has significant shifts in the average, basing future values of the data set on a forecasting model may not be advantageous because other factors are influencing the data that may not be able to be predicted. In these instances, forecasting models such as ARIMA or regression are less appropriate. To discern whether shifts occur, we follow the methodology of Taylor<sup>29</sup> to conduct a change point analysis on historical values of PPI 336411. Monthly PPI values from 1986 to 2017, totaling 384 data points, are the basis of the change point analysis. Historical values of PPI 336411 are converted to a monthly escalation rate. The average of these values,  $\bar{x}$ , is calculated and the difference between each year’s escalation rates to the average escalation rate is determined by  $x - \bar{x}$ . Next, a moving sum of the  $x - \bar{x}$  values (a “cumulative sum” (CUMSUM)) is calculated as shown in **EQUATION 1** on page 67, where  $S_n$  is the CUMSUM in time  $n$ ,  $S_{n-1}$  is the CUMSUM in time  $n - 1$ ,  $x$  is the escalation value in time  $n$ , and  $\bar{x}$  is the average of the escalation values.

From the  $S_n$  results in Equation 1, a range,  $S_{diff}$  is calculated on the values. The range calculation is shown in **EQUATION 2** on page 67.

<sup>29</sup> Taylor, W.A., “Change-Point Analysis: A Powerful New Tool for Detecting Changes” (2000), available at <https://variation.com/wp-content/uploads/change-point-analyzer/change-point-analysis-a-powerful-new-tool-for-detecting-changes.pdf>. (Taylor’s model is undergirded by the works of Page (see Page, E.S., “A Test for a Change in a Parameter Occurring at an Unknown Point,” *Biometrika*, 42 (1955): 523–527, <https://doi.org/10.1093/biomet/42.3-4.523>); Hinkley (see Hinkley, D.V., “Inference about the Change-Point from Cumulative Sum Tests,” *Biometrika*, 58(3) (1971): 509–523, <https://doi.org/10.1093/biomet/58.3.509>); Pettitt (see Pettitt, A.N., “A Simple Cumulative Sum Type Statistic for the Change-Point Problem with Zero-One Observations,” *Biometrika*, 67(1) (1980): 79–84, <https://doi.org/10.1093/biomet/67.1.79>); and Hinkley and Schechtman (see Hinkley, D.V., and E. Schechtman, “Conditional Bootstrap Methods in the Mean-Shift Model,” *Biometrika*, 74(1) (1987): 85–93, <https://doi.org/10.1093/biomet/74.1.85>).

Next, the CUMSUM values are bootstrapped. Bootstrapping is a process of random sampling with replacement from the original data set, deriving a statistic from the randomized sample and comparing to the original sample. Utilizing the process of bootstrapping generates an estimate of the variability and distribution of a sample statistic, thereby improving the veracity of the inferential results regarding this sample statistic. The small sample size of the data lends to the bootstrapping technique. In this case, one bootstrap sample is manually created, and then a simulation is run with 10,000 iterations using @Risk software, effectively creating 10,000 bootstrap samples. An average is calculated for the sample. Then,  $S_n$  values are calculated for the sample and a  $S_{diff}$  value is calculated for the bootstrap. The  $S_{diff}$  value of the bootstrap is compared to the original  $S_{diff}$  value. If  $S_n^{diff} < S_{diff}$  then there is evidence to suggest there was a significant change in the average of the data in the given timeframe. If  $S_n^{diff} > S_{diff}$  then there is not sufficient evidence to suggest a significant change occurred in the average of the data during that timeframe. For both situations,  $S_{diff}$  is the range of the original data and  $S_n^{diff}$  is the range of the bootstrapped data. From the simulation, a distribution of the  $S_n^{diff}$  values are created and the delimiters are adjusted so the right-most delimiter is equal to the  $S_{diff}$  value of the original data set and the left-most delimiter is on the far left of the distribution. This represents the frequency of when  $S_n^{diff} < S_{diff}$ . The resulting percentage between the two delimiters is the empirical coverage of a change occurring in the given time frame. The  $\bar{x}$  used is 0.05. Thus, if the empirical coverage is greater than 95% then there is significant evidence to suggest a change occurred in the timeframe analyzed.

Once the range of times are identified where a change occurred in the average of the data from the bootstrapping, an estimate of the specific month and year the change occurred is calculated. The estimator used to identify the change point is the Sum Squared Error (SSE). The formula used to calculate SSE is shown in **EQUATION 3** on page 67.

In Equation 3,  $m$  represents the point at which it is determined there may be a change point,  $x_n$  is the monthly escalation rate,  $\bar{x}_j$  represents the average of

the data prior to point  $m$ , and  $\bar{x}_2$  is the average of the data after point  $m$ . This equation breaks the data into two segments on either side of the tested point, and it estimates the average of each one of the segments. The point  $m$  is then compared to the average of the two segments. The value of  $m$  that minimizes SSE is the best estimate of the last point before a change occurred.<sup>30</sup>

Lastly, utilizing the results from the change point analysis, a retrogressive approach can be tested as a potential alternative to the current prospective approach. The retrogressive approach focuses on changes in historical averages of PPI 336411 to calculate EPAs. The two approaches are compared through “mean absolute percentage error” (MAPE) calculations. A 10-year period of performance for the purposes of the EPA clause is assumed. Therefore, the base year of the forecast will be adjusted every 10 years. The MAPE calculation is shown in **EQUATION 4** on page 67.

## Results

### Magnitude Study: 1982–2017

Phase one examines the historical prevalence of enacted EPA clauses in aircraft production contracts. The database contained 46,367 different USAF contracts and contract modifications from 1982–2017. Of those 46,367 contract actions, 266 contained fixed-price with EPA clauses relating to 12 different aircraft platforms. The aircraft platforms are: B-1, B-2, C-5, C-17, C-130, KC-46, F-15, F-16, F-22A, T-1, and T-38. From those 266 contract actions, 20 instances triggered EPA clause adjustments. The contract and adjustment amounts were normalized to 2017 constant price (CP) dollars with producer price index 336411, the aircraft manufacturing index. This escalation PPI was used because it is the PPI referenced as the baseline for current EPA clauses such as the KC-46. **TABLE 1** on page 68 shows the result. Specific aircraft platforms are masked and labeled A-E to protect contract data. Positive values indicate upward adjustment payments to the contractor while negative values are downward adjustments resulting in government savings.

There are three interesting findings from the historical analysis. First, the EPA clauses appear to be providing equal protection to both the government and the contractor. Of the 20 EPA modifications, nine were downward adjustments returning money to the government while 11 were upward adjustments providing money to the contractor. In other words, there does not appear to be a systematic bias toward either the government or the contractor.

The second interesting finding relates to the 2008 Boeing “fire-alarm.” As previously discussed, the IG projected large potential EPA payments—\$647.5 million of which was attributable to the C-17.<sup>31</sup> However, the largest single EPA adjustment found in the dataset was only \$8.4 million, even with the originally cited C-17 contract included. Why the disparity? The root cause was a large accounting anomaly of Boeing pension costs. These pension charges were responsible for 99% of the change in the BLS index used in the contract EPA clauses.<sup>32</sup> From this finding, a negotiated settlement with Boeing resulted in a significantly reduced liability for the USAF and the large projected EPA adjustment was not realized.

The third insight gained from the historical analysis pertains to the magnitude of EPA adjustments. EPAs are found to be a very small amount of the total original contract value at less than 1%. The 2008 C-17 “fire alarm” does not appear to be a pervasive problem. As shown in **TABLE 1**, the largest upward adjustments for an individual aircraft platform totals just over \$22 million from four contract actions. As a percentage of the total contract price, this is not a large amount. On the other hand, it represents over \$22 million that could have been used for higher-priority items. This loss of obligation authority for other priorities represents the opportunity cost of inaccurate forecasts. This presents potential opportunity for finding improvements in EPA clauses.

<sup>31</sup> The other portions of the projected payments were from other military services and are outside the scope of this analysis.

<sup>32</sup> DODIG Report (2008), see note 1.

<sup>30</sup> Taylor, *ibid.*

### Prospective vs. Retrospective EPA Clause Analysis

Phase two analyzes current USAF EPA methodologies. Current EPA clauses use producer price index PPI 336411, “Aircraft Manufacturing,” as the benchmark from which EPA eligibility is measured.<sup>33</sup> This index is indicative of the economic trends of the work performed on aircraft and aircraft modification contracts. Thus, the validity of the use of PPI 336411 as a benchmark is not in question. Rather, the issue is with the prospective approach (i.e., use of forecasts provided by a private company) for that index as the basis for calculating EPAs.

A change point analysis was conducted on historical values of PPI 336411. When change point analyses identify ranges of time where significant changes in the average of the data occur, then traditional forecasting models may not be appropriate, as outside factors may be influencing the model. The change point analysis of PPI 336411 identified three change points from 1986 to 2017. **FIGURE 1** on page 68 depicts the potential change points through the CUMSUM results. Bootstrapping of the three ranges (1986–1996, 1996–2005, and 2005–2017) found empirical coverage of 99.7%, 99.9%, and 99.5%, respectively, that a change occurred in the average escalation rate during those time periods. These changes are potentially caused by factors not directly related to the aircraft manufacturing industry, and hence make it difficult to accurately forecast future values of the PPI.

When basing an EPA clause on changes in forecasts of a baseline index, the error of the forecast is inherently included in the value of the EPA. The *Defense FAR Supplement (DFARS)* explains how to construct an EPA clause,<sup>34</sup> but does not mandate whether this clause should be based on *historical* values of the PPI or *forecasts* of the PPI. Therefore, it may be more advantageous to base the EPA payments on how the current PPI value compares to historical averages of the index (i.e., retrospective EPA), as opposed to basing the EPA on changes in forecasts of the index (i.e., prospective EPA).

The prospective and retrospective approaches are compared through MAPE calculations. A 10-year period of performance for the purposes of the EPA clause was assumed. The retrospective approach MAPE using 2000–2009 base years to the current year were calculated using the historical index escalation rates of PPI 336411. The beginning year, 2000, was selected because it was identified as a change point in the data. The year 2009 was the end year due to the 10-year period of performance.<sup>35</sup> An average of the MAPEs from 2000–2009 was then calculated at 47%. This retrospective result is compared to the current prospective approach. To ensure an “apples-to-apples” comparison, this article *does not* compute the MAPE of a base year forecast to future forecast values. While a MAPE calculation of this type may provide good results, the inherent error in comparing forecasts to future forecasts is undesirable. Rather, the prospective MAPE computation consists of the index forecasts (as currently provided by the private company) to the historical PPI index values. This resulted in a MAPE of 60%. The retrospective approach is therefore found to have 13% less error.

### Managerial Implication

The change from a prospective to retrospective approach will have impacts to both the government and the contractor. The greater accuracy achieved through the retroactive forecasting approach will provide more stability to government budgets. If fewer EPAs are triggered due to better forecasting, then the government will have less in future liabilities realized. Triggered liabilities place stress on current year budgets. This budgetary stress will be reduced. Government program managers will therefore have a more stable environment from which to work from. This is a well-known critical success factor in the program management profession.<sup>36</sup> At the same time, contractors can expect their revenue streams to be more accurately projected. This provides internal clarity on revenue available for internal company investment decisions.

<sup>33</sup> McGlothen, see note 10.

<sup>34</sup> Via *Procedures, Guidance, and Instruction* (PGI) 216.203-4.

<sup>35</sup> There are only historical index values up to 2018, so the last base year that can be used is 2009.

<sup>36</sup> See Nasir, M.H.N., and S. Sahibuddin, “Critical Success Factors for Software Projects: A Comparative Study,” *Scientific Research and Essays*, 6(10) (2011): 2174–2186, <https://doi.org/10.5897/SRE10.1171>.

It also provides company management the ability to more accurately forecast financial performance metrics to shareholders. However, the downside for contractors is the loss of unexpected payments from EPAs that cover costs and boost financial performance.

While this study was scoped to an investigation of USAF aircraft production contracts, the potential for broader impacts in other government contracts is vast. EPA clauses are prevalent in contracts across the government. A query of the Federal Procurement Data System (FPDS) for “fixed price with economic price adjustment” shows that there are over 10.9 million contract actions. This is not to say those actions are triggering EPAs, rather that the contract type (regardless of the specifics of the contract action) contains an EPA clause. Narrowing down the query to just DOD returns over 4.6 million contract actions—with the USAF, Army, and Navy responsible for 153,355 of those actions. To determine the number of individual contracts (rather than contract actions) is problematic as the FPDS system only allows data exportation of 30,000 items. Examining 30,000 actions each from the USAF, Navy, and Army indicates over 13,300 unique contracts with EPA clauses. The main point being that issues discovered in this study’s limited investigation of USAF aircraft production contracts are likely to exist in a grander scale across government contracts.

## Conclusion

EPA clauses are an important protection against abnormal economic fluctuations when fixed-price, long-term contracts are used. Enactment of EPA clauses are triggered by breaches in preestablished thresholds (typically 2–2.5% bounds in the data examined). Based on the infrequency and magnitude of historical EPA modifications in USAF aircraft contracts, this article does not recommend changes to the current upper and lower thresholds. The analysis of data from 1982–2017 demonstrated that enacted EPAs comprise a very small portion of total contract value. While the 2008 IG report raised a concern of potential large liabilities in a particular instance, this is not found to be a pervasive problem. In addition, the EPA clauses that have been enacted were found to be evenly split

between upward and downward adjustment. This indicates that equal protection for both parties is being achieved.

Despite these positive outcomes, the analysis does find improvement in current USAF aircraft EPA clauses to be possible. Moving from a prospective to a retrospective clause can more accurately reflect true market changes while maintaining the 2–2.5% upper and lower bound thresholds. Changing future USAF EPAs to a retrospective clause guards against inaccuracies inherent in the prospective approach that is solely reliant on changes in forecasts of forecasts. At the same time, the retrospective approach may establish more appropriate parameters for an adjustment indicative of market price fluctuations. The retrospective approach is not, however, a panacea. Inaccuracies are inevitable in any approach taken. The proposed change is simply meant to mitigate errors to the greatest extent possible. More specifically, the historical analysis showed there is an opportunity cost of up to \$45 million that has the potential for more efficient allocation.

Further, there are several limitations to the results. Only EPA clauses on USAF aircraft were examined. Other commodity types and military Services were not included. Results should not be extrapolated outside of aircraft production contracts. Additionally, data analysis on historical EPA modifications are reliant upon the ConWrite system. As such, any aircraft EPA modifications incorrectly annotated or excluded from the ConWrite system are not captured. One opportunity for future research includes EPA clause analysis in other USAF systems, other military Services, or other government contracts. Additionally, calculations of specific cost impacts to potential changes in EPA clauses should be investigated. If trends in these areas hold with the findings here, then DOD-wide policy changes may be warranted. *JCM*

*Disclaimer: The views expressed in this article are solely those of the authors and do not reflect the official policy or position of the U.S. government.*





NATIONAL CONTRACT MANAGEMENT ASSOCIATION  
21740 BEAUMEADE CIRCLE, SUITE 125  
ASHBURN, VA 20147