HOW TO IMPROVE INSTALLATION SUPPORT SERVICES

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### ABSTRACT (Continue on reverse if necessary and identify by block number)

Each year, DoD contracts for more than $11 billion in services. Many of these services are installation support services ranging from groundskeeping to complex aircraft maintenance. These services directly affect the lives and performance of the people who live and work at military installations. Making sure they are of high quality is an important and difficult contracting responsibility.

We believe the Military Departments can improve contracted services by taking into account past performance and providing incentives for quality. To help achieve this goal, we recommend that the Military Departments make greater use of negotiation (i.e., competitive proposals) rather than relying on traditional sealed-bid contracts, which must be awarded solely on the basis of price and price-related factors. Despite common perceptions, negotiated contracting need not be complex for either the Government or the prospective contractors. We recommend that in their solicitation and evaluation of offers, the Military Departments develop simplified procedures that include appropriate assessment of past and proposed quality assurance measures.

As an incentive for quality, we propose that the Military Departments expand the use of award fees. Modest monetary awards can have an immediate and positive impact on contractor performance. Awards would be based upon the quality of service rendered, as judged by the contracting officer’s technical representative, subject to review by an award determination board whose decisions would not be subject to appeal.
To test and measure the effectiveness of the proposed changes, we recommend that the Military Departments undertake a program of internal evaluation, supported by top management endorsements, procedural changes, feedback and anecdotal exchanges, and — after 2 or 3 years — a follow-up assessment by a neutral evaluator.
Executive Summary

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CHAPTER 1
BACKGROUND

INCREASING EMPHASIS ON QUALITY IN GOVERNMENT PROCUREMENT

The U.S. Government has become increasingly concerned about the quality of goods and services being procured and increasingly aware that not enough attention has been focused on it. Quality enhances efficiency by minimizing waste and the need for redundancy; it enhances effectiveness because higher-quality products and services make possible superior performance in the machines or people they affect.

Within DoD, this concern and awareness have led to forceful policy statements and to revised regulations, programs, and incentives. Deputy Secretary Taft has asserted:

For too long, the standard of too many American companies has been to produce the "minimum acceptable" quality to reap the maximum short-run profit. That standard is not acceptable for our defense. . . We must replace the common but outdated concept of an "acceptable level of quality" to maximize profits with a philosophy of "continuous quality improvement."

In response, DoD has initiated a Defense Industries Quality Excellence Program. DoD regulations have been revised to upgrade the significance of quality relative to that of other variables, including price.

In a similar vein, the Congress has pressed for increased emphasis on quality in DoD's purchase of services. The conference report accompanying the FY 1987 National Defense Authorization Act stated:

The conferees generally believe that the Department of Defense places too little emphasis on the quality of the product or service provided. Many reasons are postulated for the priority placed on price rather than quality, and without agreeing on the cause of such over reliance on price, the conferees have highlighted the procurement of services as one area in which clearly the quality of the service provided is at least as significant as price, if not more significant. The conferees also agreed that, if an agency determines that the quality of the services, rather than cost or price, is the highest priority, the agency should reflect that determination through appropriate weighting and evaluation factors.
IMPORTANCE OF QUALITY IN INSTALLATION SUPPORT SERVICES

DoD annually contracts for more than $11 billion in services. A large proportion of them are installation support services, and the amount is growing. Their impact on DoD's mission is even larger than the dollar value indicates. Installation support services range from such simple ones as janitorial service and grounds maintenance to such complex activities as aircraft maintenance and transportation. Most installations require contracted support for at least a few functions, and support for some is provided totally under contract.

An important consideration concerning these services is their effect upon the people who live and work at military installations. Virtually everyone in DoD — military or civilian — is supported by a contracted service. Such services as food service, laundry, and family housing maintenance have a pervasive and direct impact on the everyday lives of sailors, soldiers, marines, and airmen. Even if the dollar volume of contracted services is relatively small for a specific installation, problems in providing them can severely disrupt morale; poor food, dirty surroundings, and lost and late laundry are demoralizing. Beyond that, poor quality when tolerated in contracted services affects the expectations military personnel have of themselves and of their subordinates, and hence performance. Attitudes toward quality are infectious: quality begets quality. It is for these reasons that installation services should not be exempt from the general pressure for quality; in fact, special efforts should be made in this area.

PROBLEMS INHIBITING THE SEARCH FOR QUALITY

Why then have installation support services not been swept up in the overall campaign for quality? We note five factors that militate against this development. First, individual installation support contracts tend to be small. Quality can be raised by sophisticated systems of service specification, procurement, and inspection, but this process is invariably expensive, and most installation service contracts are not deemed worth the expense. Second, services are not easily standardized or described in terms of quality. The quality expected in products can usually be described in terms of performance: a defined percentage of computer chips, for example, must produce a given output assuming given inputs under given conditions. In contrast, while most people recognize when a house is well painted,
relatively few can effectively articulate the objective factors leading to that conclusion.

Third, sophisticated services (such as software production, architect-engineer services, and analysis) and sales of goods typically deliver a product to a central point and therefore can be reviewed. Installation support services, in contrast, do not always deliver a product that can readily be reviewed. Fourth, we think there is a persistent inclination to assume that because those who perform installation services are often less educated, ambitious, or stable on the job, they are more impervious to pressures and incentives for quality. Finally, installation services are sometimes assumed to be so simple, mundane, and routine as to make minimal performance entirely satisfactory.

These five factors have thus far conspired to minimize the priority given to quality in procuring installation services. In this context, despite Secretary Taft's admonition, the procurement philosophy of least cost and "acceptable quality" still prevails for service contracts.

In a search for means of improving installation support services, the Deputy Assistant Secretary of Defense for Installations tasked LMI to study the problem in 1987–88. The following chapters outline some of the results of that study.
CHAPTER 2
APPROACHES TO IMPROVING QUALITY

We suggest two approaches to improving the quality of installation support services. The first is to implement a preaward system designed to enhance the probability that only high-performance vendors will be awarded contracts. The second is to create incentives (or penalties) so that contractors that have received awards are motivated to deliver quality. The two approaches interact, but it is useful to consider them separately.

PREAWARD SCREENING

Current Screening Process

Most installation service contracts are awarded through sealed bidding; thus, virtually the only preaward screening for quality is the responsibility determination.¹ A contracting officer who receives a low bid from a contractor he/she believes may prove nonresponsible can request a preaward survey. However, such surveys and the responsibility determinations based on them have three limitations:

- **Scope:** Preaward surveys evaluate economic ability to perform (resources, facilities, etc.) and ascertain that what was asserted to exist in the bid does exist. These surveys do not determine quality.

- **Small Business Administration (SBA) Certification:** Because most service vendors are small businesses, SBA is often the final authority for assessing competence. SBA operates the Certificate of Competency (COC) program to ensure that small businesses are afforded a fair opportunity to receive Government contracts. If a DoD contracting officer finds a small business nonresponsible, he or she must inform SBA of the decision. SBA then offers the prospective contractor the opportunity to apply for a COC. If SBA certifies the business as competent, the business must receive the contract.

¹Bids are solicited from all responsible offerors, which means that any firm not currently debarred, suspended, or ineligible is allowed to compete. After the contracting officer determines that the low bidder has met the solicitation’s terms, but before award, the contracting officer must determine the apparent winner’s responsibility in terms of financial resources, capability, performance record, and integrity and ethics; if the low bidder is found nonresponsible, the award goes to the next lowest responsible bidder.
Some procurement people regard SBA as excessively lenient in issuing COCs. That perception may not be accurate. A 1986 Government Accounting Office (GAO) report\(^2\) states that only about one-third of all contractors denied a contract on the basis of a responsibility determination apply for a COC. The report also shows that SBA issues COCs to slightly more than half of those who do apply. COCs may be issued more readily for service contracts than for other types of procurements. (The GAO report states that there is very little to examine when looking at offers to perform services since there are no production facilities, materials, or equipment to inspect.)

Whatever the reason for the contrast between the GAO's findings and the perception that COCs are automatically granted, the belief that SBA will side with marginal contractors does persist in the service contracting community and may inhibit contracting officers from finding small businesses nonresponsible. In any case, the SBA screen is rudimentary and focuses, like the preaward survey screen, on available resources rather than on the history or prospects of quality performance.

- **An all-or-none determination:** Preaward surveys and SBA reviews make only threshold evaluations. Mediocrity is sufficient to pass screening. Nothing in the sealed-bid process assesses the relative qualities of two responsive bidders or makes any tradeoff between their cost differential and their quality differential.

A more significant evaluation occurs when a contracting officer issues a request for proposals (RFP) instead of an invitation for bids (IFB). (An IFB is the solicitation document used for sealed bidding; an RFP is the solicitation document used for competitive negotiations.) Negotiation improves upon sealed bidding by allowing for (1) judgments about the relative quality of offerors and (2) integrating those judgments with other factors including price. Negotiation is the dominant mode of procurement for weapon systems, but it has not been used widely for installation support services because of habit and because, in comparison with IFBs and bids, RFPs and proposals are more difficult to issue and evaluate.

**Strengthening the Screening Process**

We considered a number of alternatives to the current methods of screening contractors that propose to perform installation services. Three alternatives appeared to be worth further investigation and are described here.

Rejected Alternatives

The first alternative that seemed attractive involves creating an automated performance valuation system. Theoretically, a centralized database would enable DoD to identify exceptionally high-quality and low-quality contractors systematically.

At the end of every contract above a certain value (e.g., $25,000), performance would be graded against specified criteria. The performance data would be entered into the database and made available to all DoD contracting officers. Contracting officers would accordingly be alerted to past problems and could take past performance into account if contracting by negotiation, provided the solicitation listed performance as an evaluation factor. If performance was repeatedly bad enough, suspension or debarment could be considered. High-quality contractors, on the other hand, would be actively encouraged or solicited to make offers on projects even outside their geographic areas. With such a system, DoD could monitor the overall satisfaction with contractors' services and identify contractors with repeated problems or successes.

A second, more ambitious alternative is a variation of this concept. In it, the Government would establish a system of contractor rating. Under such a system, contractor performance in mess hall services, for example, might be rated at the end of a term. That rating would then be reflected in the evaluation of future bids by the contractor.

A contractor that repeatedly rendered high-quality service might receive a multiplier of 0.95; one that was repeatedly rated low might receive a multiplier of 1.05. If the two contractors competed on a new contract, the offer of the highly rated contractor would be treated as though it were 95 percent of the stated dollar cost; that of the lower-rated contractor would be treated as though it were 5 percent higher than its stated cost. A new offeror would presumably enter the process with a multiplier of 1.0.

By mechanically integrating past quality scores into future offers, one could create a screening process that was powerful and, at the same time, avoided the clumsiness of the current all-or-nothing responsibility determination. Moreover, such a system could be expected to have substantial incentive effects.
After investigation, however, we think both of these ideas—the automated performance evaluation system and the contractor rating system—have disadvantages that are likely to outweigh their advantages. Both require DoD to carry out five functions entailing substantial challenges. To operate such a system, DoD must:

- **Offer incentives:** The performance evaluation must be related to some practical consequence or it will be ignored. Unfortunately, applying the system in its most obviously relevant context—in future evaluations for award—would make it most vulnerable to legal and political attack as inadequately documented, unfair, irrelevant, etc.

- **Inspect:** The rater must periodically sample the services rendered in order to evaluate them. This sampling is both a practical challenge that demands significant skills and resources and a legal challenge because the inspection system will undoubtedly be disputed.

- **Evaluate:** The rater must assess the inspection data against criteria standardized from job to job and installation to installation. The criteria must be accepted as relevant, and the raters as impartial, informed, and consistent with one another. Available precedents indicate that the rating process is time-consuming.

- **Document:** The results of an evaluation need to be recorded in a manner that preserves them for future users. This is more difficult than it sounds. In order to withstand challenges, the documentation must be detailed, yet in order to be administratively feasible, it must be simple.

- **Disseminate:** Documented results need to be advertised, distributed, or centralized at a known distribution point within the bureaucracy. Large systems of this type are both expensive and difficult to administer. The information tends to be incomplete, sometimes inaccurate, hard to retrieve, and out of date.

Because of these practical considerations and complexities, we recommend against establishing a formal system for rating and evaluating contractor performance.

**Recommended Alternative**

The Competition in Contracting Act (CICA), Public Law 98-369, was enacted in 1984 primarily to increase competition for Government contracts. Just as important, however, was CICA's recognition that negotiation using competitive proposals and sealed bidding (formerly called formal advertising) are equally acceptable methods of procurement.
In the past, DoD had to use sealed bidding unless the procurement fell within one of 17 exemptions, in which case the agency could negotiate a contract. The old standard equated sealed bidding with competition but did not sufficiently recognize that negotiated procurements could also be competitive. The former requirement to justify the use of negotiation obscured the real intent of Federal law, that of ensuring that procurements were competitive.

In the pre-CICA environment, persons acquiring installation support services correctly presumed that an IFB was the appropriate procurement instrument in most circumstances. To use a method other than IFB required special approvals. Under CICA, however, negotiation on the basis of competitive proposals is clearly on a par with sealed bidding. This is important because the RFP method of procurement allows the contract award decision to be based on factors in addition to price. Past performance can be considered explicitly in choosing the winning contractor. Federal Acquisition Regulation (FAR) 15.605(b) says:

The evaluation factors that apply to an acquisition and the relative importance of those factors are within the broad discretion of agency acquisition officials. However, price or cost to the Government shall be included as an evaluation factor in every source selection. Quality also shall be addressed in every source selection. In evaluation factors, quality may be expressed in terms of technical excellence, management capability, personnel qualifications, prior experience, past performance, and schedule compliance. Any other relevant factors, such as cost realism, may also be included.

Despite the fact that CICA removed the preference for sealed bidding, the use of IFBs continues to be the dominant form of soliciting installation support services for two reasons:

- Changes in the huge DoD procurement bureaucracy take a long time. Large numbers of installation-level contracting personnel have yet to be trained on the changes introduced by CICA. Many in the procurement community still do not understand that negotiation (using competitive proposals) is a legitimate form of competition.

- RFPs are perceived as complicated and administratively burdensome by both Government and contractors. This perception stems partly from the fact that RFPs once required special justifications and approvals and, traditionally, have been used for large, complex procurements.

Despite those perceptions, an RFP does not have to be complex either for the Government or for prospective contractors. A simplified RFP, an easy negotiation
process, and short, page-limited proposals appear to be entirely feasible for acquiring quality services. We recommend that the Military Departments develop simplified procedures for soliciting and evaluating contractor proposals for installation support services. The procedures must include (1) methods for giving weight to past performance and (2) plans for controlling quality in the proposed activity.

PERFORMANCE INCENTIVES

Negative Incentives

The simplest and most commonly invoked incentives to quality service are deductions for poor performance or, in extreme cases, contract termination. While such actions may be taken for poor performance, they have the following disadvantages:

- Deductions require very close, detailed inspections and recordkeeping and often lead to disputes.
- Termination is extremely disruptive for both the Government and the contractor. Thus, the threat of termination is used only in extreme situations.
- Minimally adequate performers can usually “get through” a contract without facing termination or losing a significant portion of their profit margin to deductions.
- These negative incentives lead to an adversarial situation that can increase rather than decrease performance problems.

Positive Incentives

A positive and more effective approach is to offer incentives for good performance, such as an option to extend a contract for an additional year or two. Field reports suggest that offering such an option enhances contractor responsiveness with a minimum of formality. However, it has the following disadvantages:

- The force of inertia and the disruption caused by recompeting a contract create a presumption in favor of renewal. Though more credible than a threat of a mid-year termination, the threat of not exercising an option merely because quality is less than optimal is not usually credible.
- If the Government declines to exercise the option to renew, the contractor is free to bid on the new contract, may have a price advantage based on experience and incumbency, and may very well win.
Strengthening Incentives

In recent years, the inadequacies of other incentives have provoked experimentation with another possibility, the award fee. Award-fee contracts (described in the LMI Report *Smarter Contracting for Installation Support Services*, May 1986) provide for a contractor to perform on a fixed-price basis with an "award" of a variable "fee" to be determined at the sole discretion of an award determination board in response to the value (or quality) of the service rendered. The award fee has the attraction of being a variable incentive that exists as a carrot throughout the term of all contracts framed in this manner, and it provides for a cooperative attitude on the part of the contractor. Its disadvantages are:

- The time and energy required to determine appropriate awards
- The risk that awards will be set by habit or in response to personalities rather than in response to actual variations in levels of service
- The risk of higher cost to the Government
- Some risk of improper influence in determining a discretionary-type award.

The critical characteristic of the award fee approach is that it rewards performance on a particular contract with a payment *for that contract*. Thus, it:

- Creates an immediate and certain incentive
- Avoids problems of generalizing from one contract experience to another
- Minimizes problems of equity, because comparisons do not have to be made between contractors
- Avoids elaborate recordkeeping, data integration, and retrieval
- Creates no barrier to entry by new businesses
- Avoids complicating or distorting the original process of solicitation, offer, and contract award.

If an award fee system works properly, it should also have screening effects. Faced with a 10 percent award fee offer that might normally be priced at $100,000, a low-quality contractor would be expected, after experience with the system, to bid the project at close to $100,000 because experience would show the contractor that it could expect little or no additional revenue from the award. A higher-quality contractor, by contrast, should have the experience of receiving much or all of the
available award. Evaluating the contract accordingly, that contractor can be expected to bid under $100,000. If properly administered, award fees should prompt contractors to reflect realistic judgments of their own quality in their bids; thus an award fee system should bias bidding in favor of quality contractors.

The Government is in a better position when it properly sets the incentives and leaves the contractors to calculate their own positions. As long as each contractor makes a judgment about its prospects, fewer reasons exist for litigation, the Government has lower administrative cost and less complexity in source selection and contract award, and the probability of accurate pricing (contractors know who their good people are, how much they can save by adopting various processes, etc.) is greater.

Administering an award system does not, however, represent an easy transition or offer an unqualified or uncomplicated benefit to DoD. Such a system involves some legal, administrative, and economic problems.

We believe existing FAR language would permit the use of award fees with all types of contracts. This conclusion results, however, from a relatively fine parsing of the language of the FAR — and this is an exercise that individual contracting officers cannot be expected to undertake. Accordingly, it would be helpful to clarify the status of award fees by amending the FAR or DoD FAR Supplement (DFARS). Such a clarification could eliminate any ambiguities and promote the use of award fees in diverse settings.

At present, the FAR’s only mention of award fees is a discussion of cost-plus-award-fee (CPAF) contracts. Under the FAR, CPAF contracts provide for a base amount plus:

... an award amount that the contractor may earn in whole or in part during performance and that is sufficient to provide motivation for excellence in such areas as quality, timeliness, technical ingenuity, and cost-effective management. [16.404-2(a)]

Use of CPAF contracts is rather narrowly restricted to situations in which:

(i) ... it is neither feasible nor effective to devise predetermined objective incentive targets applicable to cost, technical performance, or schedule;

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(ii) The likelihood of meeting acquisition objectives will be enhanced by using a contract that effectively motivates the contractor toward exceptional performance; and

(iii) Any additional administrative effort and cost required to monitor and evaluate performance are justified by the expected benefits. [16.404-2(b)]

The FAR limits award fees to 10 percent of the contract's estimated cost [16.404-2(c)(2) and 15.903(d)] and states that award determinations are not subject to the Disputes clause [16.404-2(a)]. The CPAF contract is distinguished from the cost-plus-incentive-fee contract, which provides a base amount subject to adjustment on the basis of the relationship of total allowable costs to total target costs [FAR 16.404-1(a)].

Although fixed-price-award-fee (FPAF) contracts are not mentioned in the FAR, they are used, and their use would seem to be authorized under FAR 16.102(b), which permits contracts "of any type or combination of types that will promote the Government's interest." The apparent purpose of this provision is to make available to the Government "a wide selection of contract types" and "provide needed flexibility" in responding to the diverse requirements of Federal agencies. [FAR 16.101(a); see also F.R. 52429, 23 December 1985.] This purpose is best served by permitting the use of award fees in a variety of situations, including the fixed-price contract, and the intent of the FAR would appear to support this result.3

The fact that the FAR does not expressly contemplate the use of FPAF contracts, can, however, create confusion. Our discussions with installation-level contracting officers revealed a widespread lack of awareness concerning the availability of FPAF contracts. Although a few installations and commands are aggressively using this and other contract types, use of award fees is generally avoided with fixed-price contracts, in part because of the absence of authorization in the FAR.

Furthermore, legitimate questions arise with respect to the rules governing the use of award fees. The FAR requires the use of firm-fixed-price contracts or fixed-price contracts with economic price adjustment when the method of contracting is sealed bidding. [FAR 14.104, 16.102(a).] Does this mean that FPAF contracts can-

3On the other hand, the FAR goes on to say that "contract types not described in this regulation shall not be used, except as a deviation under Subpart 1.4." Presumably, the agencies that have been using FPAF contracts are operating under such a deviation.
not be allowed when source selection is by means of sealed bidding? That would be a significant impediment to the expanded use of award fees since resources for conducting negotiated procurements are often severely limited.

Fortunately, the FAR’s description of a firm-fixed-price contract — "[one that] provides for a price that is not subject to any adjustment on the basis of the contractor’s cost experience in performing the contract" [FAR 16.202-1] — appears to be able to be extended to embrace FPAF contracts. That is, contract award would be made on the totally objective and quantitative basis of firm specifications and bid prices alone, and any later price adjustment would be unrelated to cost experience, as is the case with fixed-price contracts with economic price adjustment. Thus, the factors that make cost-reimbursement and fixed-price incentive and price-redeterminable arrangements unsuitable for sealed bidding are not present; nothing is incompatible between using sealed bidding and using FPAF contracts.

However, the issue is not free from doubt. One arguing the contrary position might point to the language at FAR 16.401(a), implying that firm-fixed-price and incentive contracts are two different and mutually incompatible forms of contracting: "Incentive contracts as described in this subpart are appropriate when a firm-fixed-price contract is not appropriate." [16.401(a)] Since award fees are clearly a form of incentive, it may be argued that they accordingly cannot be used when sealed bidding is the method of contracting.

On the other hand, award fees are neither structured incentives nor are they cost-related. Finally, it is worth noting that the DFARS [at 216.404-2(70)] specifically provides that, upon approval of the chief of the contracting office, "the 'award amount' portion of the CPAF contract may be used in conjunction with other types and kinds of contracts for the Government’s benefit.” This provision has been employed to justify the utilization of FPAF contracting in DoD.

On balance, we regard the more liberal and expansive reading of the FAR, permitting use of award fees with either cost-reimbursement contracts or fixed-price contracts, as the sounder of the two views. Furthermore, we believe that, like fixed-price contracts with economic price adjustment, FPAF contracts should be permitted in conjunction with sealed bidding. However, contracting officers deserve more control and guidance on this point than the FAR currently provides. Thus, we
recommend amendment to clarify this and other matters relating to the use of award fees.

Administratively, the use of award fees alleviates several of the problems that we observed with respect to an automated performance evaluation system. Dissemination of evaluation results is not required to make this system effective, and documentation requirements can be significantly eased. Nevertheless, the award fee evaluations, which become part of the contract record, could be useful information for a contracting officer evaluating past performance for subsequent contract awards. Under an RFP, submittal of previous award fee evaluations could be required. Through this approach, the "screen" and the incentive system become an integrated, ongoing quality improvement mechanism.

The core challenges of inspection and evaluation still remain, and both DoD and contractor personnel are likely to be uneasy with them. An award fee system demands that central decision makers delegate discretionary authority to installation personnel; that installation officers make judgments that are unfamiliar and sometimes contentious; and that contractor personnel live with the uncertainties and undoubtedly disputable judgments that such a system entails.

Economically, there are important open questions about the use of award fees. It is clear that this approach involves some increased transaction costs. It is not clear what its effect will be on bid behavior or on net payments to contractors, nor is adequate evidence now available as to the behavior of different participants under such a system. Will contractors provide better services as a result of the incentive? Early evidence shows they will, but the point has not yet been widely demonstrated. Will evaluators vary their judgments according to the services rendered, or will they cluster their awards in the middle (or at a polar position) on the spectrum so that the system becomes — like tipping — less a response to the character of service than a pro forma expectation? Uncertainty on these points prompts our recommendations in the next chapter.
CHAPTER 3
IMPLEMENTING IMPROVEMENTS

The uncertainties attendant on broader use of award fee contracts suggest that carefully monitored field experience would be valuable. Two methods of securing this experience suggest themselves: a controlled test or a partial implementation combined with an ongoing evaluation. For reasons explained below, we recommend the latter.

A CONTROLLED TEST

A well-designed test mechanism would appear at first to provide the best information about the costs and benefits of the use of an award fee system. Such a test might solicit the participation of a specified number of installations (e.g., eight) and might identify four installation support services areas within the test's domain of interest. A matrix might then be developed that sorted the installations into four quadrants:

\[
\begin{array}{c|c|c}
\text{Activity \#1} & \text{Activity \#2} & \\
\hline
\text{All four service areas with award fee} & \text{First two service areas with award fee} & \\
\text{Next two as at present} & \text{Next two as at present} & \\
\hline
\text{Activity \#3} & \text{Activity \#4} & \\
\text{First two service areas as at present} & \text{No award fee} & \\
\text{Next two with award fee} & & \\
\end{array}
\]

FIG. 3-1. MATRIX FOR TESTING AWARD FEE CONCEPT

With the sample thus arrayed, an evaluator would collect information on cost to the Government for award fee as compared with other contracts in each of these
contexts. He would use objective measures, as suggested by Air Force (AF) 400-28 and similar sources, to assess performance, and he would complement the data with subjective indicators such as the comments of the contractor, the contractor's employees, the contracting officer and contracting officer's technical representative, and base personnel. After a test period of perhaps 2 years, these data would also be enriched by use of a market test: if given a free choice at the end of the test, would those who had become familiar with award fee expand it to other areas or revert to previous methods of contracting?

A test of this character could be designed now and implemented in the next fiscal year at a cost for the evaluation effort of perhaps a quarter of a million dollars. For the reasons stated below, we do not recommend it.

A SUPPORTED EVALUATION

An alternative procedure would encourage and support greater use of the award fee mechanism on the basis of the evidence that is now available, and would monitor the adoption of that mechanism within the system of procurement of base services. This procedure would be less rigorous because it would not be controlled. Results would permit less authoritative comparison because bases and activities utilizing the award fee would not be randomly selected. Those who were drawn to the process would be using it. For the same reason, comparison groups would be difficult to establish.

Despite these disadvantages, this evaluation procedure seems preferable to us. A test is doomed, in our view, to be both too short and too long. It would be too short because a 2-year period is too brief to absorb and to work effectively with so significant a change as an award fee system at the installation level. One result of the system, for example, is anticipated to be changes in contractor behavior in making offers as a result of experience in receiving award fees. Our hypothesis is that contractors finding themselves consistently receiving high awards would begin making lower offers than contractors finding themselves receiving low awards. As noted in the appendix, there are already some signs of this where award fees are now utilized. Over a 2-year period, however, it is unlikely that enough experience would be accumulated to demonstrate this point. It is also unlikely that in its first years, such a system would operate in its pattern of awards as it would in its later years. Also, as with all such efforts, an evaluation that entailed external review would be
subject to distortion when all participants knew their work would be subject to unusual scrutiny.

On the other side of the coin, a 2-year test is likely to outlast almost any enthusiasm for reform. If this test began in FY90, its results would not be available until FY92, and implementation could not begin until FY93. We regard that prospect as discouraging.

Most fundamentally, we believe that the attractiveness of award fees needs to be taught. OSD's position, in our view, should not be that of investigating a concept, but instead that of an innovator attempting to promote an idea. The idea should be pressed with increasing vigor if it appears to be succeeding and with increasing caution and withdrawal if it appears to be failing.

Toward that end, in the next chapter we offer recommendations designed to spread and at the same time to assess the use of award fees in procuring installation services. If the process were successful, perhaps 10 percent of installation service contracts would be awarded by this mechanism over the next 2 years, rising to 40 or 50 percent over the next decade. If experience suggested that the disadvantages of award fees outweighed their advantages, we would anticipate that their use might rise toward 10 percent over the next 2 years (while such use was ill-advisedly encouraged by OSD) and then would relapse to less than 1 percent as it became apparent that this was not a good system.

The particular methods by which such a supported evaluation might be conducted are described in the next chapter.
CHAPTER 4
IMPLEMENTING A SUPPORTED EVALUATION

We recommend that a supported evaluation of the simplified RFP procurement and award fee concepts be undertaken, with these five components:

1. Advertisement and endorsement
2. Legal validation
3. Provision of procedural infrastructure and information
4. Feedback and anecdotal exchange
5. Outside evaluation.

All of these steps merely embody common sense. However, since the idea of a supported evaluation is somewhat novel and has rarely been articulated (although supported evaluations are used in practice), it may be worth specifying some of the particular actions recommended under each of these headings.

ADVERTISEMENT AND ENDORSEMENT

If our recommendations are accepted, we would encourage the DASD (Installations) to use the same modes of persuasion previously used for urging installations to adopt the award fee and simplified RFP mechanisms. Speeches, publications (including simplified brochures), recordkeeping indicating participation in the program, recognition and awards, positive language in training manuals, and appearance at training courses all are useful methods of endorsement. They lead rather than direct; they effectively convey the notion that DoD leaders view the steps described here as worth the effort. Such persuasion is particularly important because fear of the unknown and the weight of inertia will be against adopting changes; a supported evaluation will fail unless DoD leadership makes it attractive and safe.
LEGAL VALIDATION

We have noted the uncertainty in the field about the legitimacy of the award fee option, particularly with respect to sealed-bid contracts. Accordingly, we recommend that this report be made available to OSD counsel and that a written opinion supporting the flexible use of award fees and simplified RFPs be solicited and circulated. Appropriate coordination with the Defense Acquisition Regulatory Council should also be undertaken.

PROVISION OF PROCEDURAL INFRASTRUCTURE AND INFORMATION

If the contract documents to support an award fee system or a simplified RFP are not readily available, contracting officers will be hesitant about using award fees and simplified RFPs. Document creation simply takes too much time and entails too much risk to make sense for the individual contracting officer. Accordingly, a supported evaluation must provide centrally drafted forms (although on-the-spot adaption and amendment may be encouraged), and contracting officers must be trained or at least instructed in how to use these forms.

FEEDBACK AND ANECDOTAL EXCHANGE

The first conceptions of this program are not likely to be ideally well suited to the uses to which the program ultimately may be put. If its proponents simply advocate implementation and await evaluation, they will diminish the chances of success. A supported evaluation – as opposed to controlled, objective testing – has the advantage of permitting discussion, information exchange, and midcourse corrections.

OUTSIDE EVALUATION

After 2 or 3 years (and, if the program is continued, 2 or 3 years after that), the program should be evaluated. The evaluation should be simple and be conducted by someone other than the program's proponents. An evaluation might be undertaken at no DoD budget cost by, for example, the GAO or at modest cost by an outside consultant. The evaluator should be engaged at a low level of effort from the onset of the program in order to encourage the retention of data. The evaluator should not be asked to assess the experiment, however, until at least 2 years after it has been initiated. Even then, as we have suggested, the evaluator's judgment should be tentative and should be directed in significant measure to simply determining
whether the program warrants additional effort, or less effort, over the next 2-year period. During that period, the degree to which the simplified RFP and award fee concepts have succeeded in improving installation support services should become apparent.
This appendix seeks to help policymakers put this report's recommendations in context by describing the experience of a particular installation in its acquisition of support services. Our description, based mostly on a short visit, is not intended to be evaluative or necessarily representative of all installations; it simply recounts the experience of one.

Our sample installation is an Air Force base located in a spacious rural setting an hour's drive from a metropolitan area. It was established about 35 years ago and currently employs over 3,000 military and almost 1,000 full-time civilian personnel. About 1,000 of the airmen and officers and 2,000 dependents live on the installation (essentially no civilians live on site). Of the civilian workers, about a quarter are wage board (i.e., blue collar) employees, half are general schedule Federal employees, and the others work for private financial institutions or nonappropriated fund activities.

About a half of the installation operating budget is allocated to payroll costs; in FY86, those costs came to about $100 million for military personnel and about $22 million for civilians. Within the other half of the $240 million budget, approximately $20 million has been spent in each recent year on contract and construction services under contracts let by the Base Contracting Division. That division employs some 30 civilians and military personnel (in roughly equal proportions) under the direction of an Air Force captain and a civilian deputy. The captain's tour is typically 3 to 4 years. His deputy has been in the division for over 30 years and in the deputy's job for 5 years.

Following standard Air Force procedures, the Division is organized into four roughly equal-sized branches: Services Contracting, which publicizes contract opportunities, evaluates offers, and makes awards — this branch carries an average load of about 120 contracts in a typical month; Supplies Contracting, which handles about 1,200 contracts per month for the acquisition of relatively small-scale supplies (bedding, nuts and bolts, screwdrivers, typewriters, etc.); Systems Management,
which handles the essentially clerical arrangements for documenting contracts, controlling payments, etc.; and Contract Administration, which is charged with assisting performance and resolving disputes after contracts are awarded.

The Base Contracting Division projects a sense of stable efficiency and success. An Inspector General (IG) inquiry in the early 1970s revealed major problems, which have not recurred, since the IG inquiry triggered a change in personnel and significant reorganization. Regular IG inspections every 18 months or so generally yield satisfactory-to-excellent ratings for each of the Division's four branches.

Problems that do arise may be divided into two categories: internal and external. Internal problems arise because of difficulties in meshing the work of the Base Contracting Division with the other bureaucracies on the base and in the Air Force above the base level. On the base, the principal problem appears to relate to coordination of efforts of the QAEs (Quality Assurance Evaluators) with the Contract Administration Branch. Each contract normally prescribes quality standards (e.g., contractor personnel shall be on duty during prescribed hours, litter shall be collected a certain number of times per week, photographs shall be developed within a specified number of hours of delivery). A random sampling inspection program, frequently relying on Air Force (AF) 400-28, is developed for testing conformance with these criteria, and a system is described for preparation of Contractor Deficiency Reports (CDRs) if a given number of inspections are failed in any month. Multiple CDRs lead to prescribed consequences, terms of "deducts" from contract payments or, in severe cases, termination of the contract. QAEs are the inspection agents who implement this system.

Understandably, there are difficulties in training, directing, and organizing these QAEs. Typically, and desirably, they have functional expertise in the areas they are inspecting. Unfortunately, they do not have significant training in the QAE function. Sometimes they appear to resent the function and/or the contractor – the contractor may, in fact, have displaced the QAE and his former colleagues from performance of the job they are now evaluating as the result of an A-76 competition. Frequently, also, the QAEs will find themselves with a large number of other duties. These factors apparently tend to cause significant variations in performance; some QAEs are excessively demanding while others will skip inspections and thereby undercut any case against the contractor that is built upon
random sampling. The Contract Administration Branch must deal with difficulties arising from this situation, but it does not itself direct, train, or evaluate the QAEs.

Another problem involves requirements imposed by the Air Force Service Contract Advisory Group (AFSCAG). AFSCAG publishes contract forms for use throughout the Air Force, but — as one might expect — some of these standard forms contain clauses and specifications inappropriate to conditions at the installation. For example, AFSCAG garbage hauling contracts contain specifications for the amount of loose debris permitted at a garbage site. Those specifications are too lax for the installation, which is located in a high-wind area where any loose debris quickly spreads. Although waivers can be sought to most AFSCAG requirements, as a practical matter, delays prevent such requests from being useful in all but the most unusual cases.

Problems also arise in dealings with those outside the Air Force, including members of the contracting community and other Government bureaucracies. Most significant is the "low-bidder" problem, or practice of many service contractors to submit bids too low to permit adequate performance. Because, in the great majority of procurements, the Division is required to award to the low bidder, this practice creates substantial problems and strains Division resources. On the one hand, the Division can award to a contractor that has bid too low, and then manage the problems that arise by means of change orders or threats to terminate for nonperformance. Alternatively, the Division can try to dissuade the contractor through informal discussions or seek to disqualify the contractor on a determination of nonresponsibility. These alternative procedures are the ones most often employed, but the effort involved can be substantial. According to members of the Division, it is not unusual for an award to go to a bidder other than the low one (sometimes even to the sixth or seventh lowest bidder) after a lengthy process of elimination using persuasion and/or attempts at disqualification. Division officials said they would prefer the flexibility to award to a contractor other than the low bidder.

The process of making responsibility determinations regularly brings the Division into contact with the Small Business Administration (SBA). In the event of a determination of nonresponsibility, SBA can step in and issue a Certificate of Competency (COC) to any small business it deems competent, overriding the contracting officer's determination. Although base-level contracting officers often
complain that SBA too readily grants COCs, Division officials offered a less critical assessment. They estimated that perhaps 50 percent of COC requests submitted to SBA by local businesses are denied - an estimate similar to that offered by the General Accounting Office (GAO) in a recent study, which found that nationwide slightly more than half of the businesses that apply for COCs receive them.\(^1\) Nevertheless, as at other installations, problems often arise when the SBA grants COCs to contractors whose performance subsequently proves to be substandard or poor.

In an attempt to improve support service contracting, the installation uses an award fee system. Under one of its existing award-fee contracts, payments are made quarterly, with awards representing up to 10 percent of each disbursement; awards have varied from the full 10 percent to a small fraction of that amount. Division officials were enthusiastic about their experience with award fees, calling the contract type "the best thing since sliced bread." They believe the awards are largely responsible for motivating the high quality of performance under this major service contract. They also think that award fees permit the best contractors (since they can more confidently expect to receive award payments) to bid lower than inferior competitors and therefore win more contracts. Division officials believe that an expanded use of award fees is "around the corner."

Division officials appear comfortable with their ability to obtain information about prospective contractors. They thought a formalized report-card system unnecessary, in part because information on contractors is available from officials at other bases. All contractors are required to list previous Government contracts as part of each bid or proposal, and that information, together with an informal information network, provides sufficient data with respect to prospective contractors.