

What the F-35 Should Cost Remains to be Seen

Written by Nick Sanders
Tuesday, 26 June 2012 00:00

Not so long ago, [we predicted](#) that the phrase, “should-cost” would become DOD’s FY 2012 buzz-word of choice. As we reported, in DOD’s new mindset, a program’s “should-cost” is based on the identified set of cost reduction opportunities that exists below the government’s “independent cost estimate” and which will become the basis for the government’s negotiating position.

More recently, [we reported](#) that the CEO of Lockheed Martin publicly complained that DOD’s “should-cost” initiative hindered its ability to cut overhead costs, because it “meant the company needed more people to generate thousands of pages of additional paperwork.” According to the article we quoted, Mr. Stevens said—

The Pentagon’s focus on what weapons programs ‘should cost’ - as opposed to estimates focused on what they ‘would cost’ - had resulted in increasing requests for more certified cost and pricing data. Lockheed submitted 6,000 pages of data with its initial F-35 proposal, but had been required to generate an additional 7,000 pages of data for the negotiations in recent months, [Stevens] said.

Not having heard much about “should-cost” in recent weeks, we wondered how the initiative was working out for DOD. Well, as if to answer our questions, we saw [this article](#) at Defense News. It continues Mr. Stevens’ discussion of “should-cost” and notes some interesting tactics the Pentagon seems to be planning to deploy in its negotiations with LockMart over the pricing of the next tranche of F-35 JSFs.

The article reports that, even though negotiations “began earlier this year,” LockMart has “yet to be told what the Pentagon believes the upcoming production lot should cost.” The DOD negotiators will be keeping that figure a secret. The article quotes Shay Assad as follows—

Assad said that during the contract talks, Pentagon officials will share with Lockheed elements of the department’s should-cost calculation — namely, areas where savings are expected. But the department will not share its internal should-cost figures, he said.

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Lockheed's CFO (Bruce Tanner) stated that the company does not know if its proposed price will meet the price point that the Pentagon is seeking—because the Pentagon won't tell the company its negotiating position. The Defense News article reported—

And while DoD has said it would also find ways to improve its processes and create savings, Lockheed has not seen that effort, Tanner said. Instead, the department seems to have based its should-cost estimate on what the program would cost if everything was working under optimal conditions, which could be risky, he said.

'It serves no purpose to either side to negotiate to a level you can't perform and then overrun to a level that you expected when you began the contract, and call that overrun,' Tanner said. 'It's frustrating to both sides.'

The article further reports that some "acquisition experts" are skeptical regarding the "should-cost" initiative. It stated—

'It's an interesting way to try to impose discipline on what has become an undisciplined process. But I don't think it gets at the core problem here,' said Todd Harrison, senior fellow at the Center for Strategic and Budgetary Assessments. The major cost driver on weapon programs is requirements that are added over time with little regard for costs, Harrison said. 'Until they get that process under control — and [until] they develop a rational way to understand the cost they're imposing on the system with every additional requirement they put on it — I don't think they're going to be successful,' he said. ...

Should-cost estimates would be more useful as DoD decides which weapon systems to buy, Harrison said. Defense officials could compare their should-cost estimates to the proposals they receive from contractors to see if it's worth pursuing, he said. But when programs are already in production, the should-cost is more like a 'wish-it-would-cost,' Harrison said.

Assad said the Pentagon has developed ways to measure any savings the should-cost initiative yields. 'We have specific targets for program execution, very specific targets for the size of a program office or other areas that program managers will have defined,' Assad said. 'So we can measure that, we can examine that and we can know at the program level whether or not we accomplished it.'

Well, we here at Apogee Consulting, Inc. think it's nice that Mr. Assad and his Pricing Directorate have very specific "should-cost" targets that they are aiming for. We just think it would be a whole lot easier to hit those targets if they would be shared with the contractor. You know: the entity that is actually designing and building the plane.

We understand that the government has little appetite for sharing its negotiating position with the contractor's guy/gal across the table. But the fact is, unless the Pentagon treats this new

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“should-cost” initiative in a different manner from the way it has treated past initiatives (*e.g.*, CAIV), it will carry little weight and ultimately amount to nothing.

To be clear: it likely does not matter to LockMart *how* DOD negotiators generated their negotiating position. We suspect it doesn’t matter whether the government’s negotiating position was generated via sophisticated computer models using terabytes of data or via the reading of tea leaves under a full moon at midnight. The point is that LockMart has its negotiating position, based on its analysis of what the planes will likely cost (including use of certified cost or pricing data) while the government has its negotiating position (however generated). Negotiations are what happen after that point.

That’s the way it is and that’s the way it has been for decades. The “should-cost” initiative was supposed to change that paradigm. But if DOD is treating “should-cost” as if it were the government’s independent cost estimate or any other pre-negotiation analysis, then the initiative has changed nothing.

If the entire “should-cost” initiative boils down to a new analytical process to derive the government’s negotiating position—if that’s all it is—then the initiative is wasting quite a bit of time and effort, on both sides of the negotiating table. It has to be more, else it’s in essence *nothing at all*.

. We sincerely hope it is much more than a new Pentagon approach to contractor negotiations.