

What Happened to Collaboration?

Written by Nick Sanders
Monday, 12 March 2018 00:00 -

Recent news reports indicate that Lockheed Martin and its F-35 customer are having difficulty negotiating an acceptable price for the next tranche (Lot 11) of aircraft.

Again.

This seems to be a frequent issue, as we've noted before. For example, in this [2012 article](#), we quoted several high-ranking military commanders expressing concerns about the adversarial relationship between Lockheed Martin and its customer. ("Air Force Major General Christopher Bogdan, nominated to be the head of the F-35 Joint Strike Fighter Program Office, declared the relationship between his organization and Lockheed Martin ... to be 'the worst he has ever seen.'") In this

[2016 article](#)

, we discussed how, after the parties had failed to agree on a price, the government used a "rarely invoked" contract clause to unilaterally establish a price.

Now here we are in 2018 and negotiations are difficult, and the parties are making public comments in order to pressure the other side.

USNI News [reported](#) that—

Lockheed Martin submitted its Lot 11 proposal about a year and a half ago, but [Vice Admiral] Winter said the first offer from Lockheed Martin didn't arrive at the Pentagon until more recently. Winter conceded he had hoped to have the deal finalized by the end of 2017. ... 'I will tell you I am not as satisfied with the collaboration and the cooperation by Lockheed Martin,' Winter said. 'They could be much more cooperative and collaborative. We could seal this deal faster. We could. They choose not to, and that's a negotiating tactic.'

'The price is coming down but it's not coming down fast enough,' Winter said. 'We don't know to the level of granularity that I want to know, what it actually costs to produce this aircraft.'

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Readers of this blog may find issues with Vice Admiral Winter's quoted comments. For instance, the submission of the Lot 11 proposal was, in all likelihood, Lockheed Martin's first offer. (Which is why a contractor that responds to an RFP is usually called an "offeror.") In another for instance, let's talk about cost "granularity." The program WBS and OBS is a matter of EVMS adequacy, and Lockheed Martin (finally) received a determination that its EVMS was adequate years ago, after becoming a poster child for failed business systems. MIL-STD-881C is the governing document. As one EVMS consultancy states: "The summary WBS is developed by the procuring agency, approved by the Cost Analysis Improvement Group (CAIG), and normally provided to the contractor in a Request for Proposal. The contractor is expected, to expand the WBS down to a level where work will be authorized, planned and managed." Thus, if the government customer wanted more granularity it could have easily specified the level it wanted.

But Lockheed Martin didn't point to any of those issues in its public response. Instead, Lockheed Martin's CFO asserted that Pentagon negotiators have become "less predictable" and are trying to reduce costs in areas that have previously been accepted. In [this article](#), LockMart CFO Tanner was quoted as saying—

'It's not like negotiations were always easy, but I'll say they were more predictable than they are today,' Tanner said in an interview Monday. 'There's just more things that are being changed or things that you thought were sort of foundational elements of negotiation that maybe weren't up for negotiation that now seem to be up for negotiation.' For example, he said, the government now wants companies to eat various costs they once would have been reimbursed for. 'Everyone should be interested in cost reduction, not simply not reimbursing elements of cost that you historically reimbursed,' Tanner said. 'That's a strange way to get cost reduction and, I would argue, a very short-sighted, not helpful, not healthy for the industry and ultimately not healthy for the folks in the Pentagon buying under that strategy to use that approach.'

Further details regarding the costs that the Pentagon negotiators wanted Lockheed Martin to "eat" were not publicly released. But it really doesn't matter much, does it? The point here is that this is a high-stakes game where the animosity between Pentagon and contractor is, once again, being played out in the public eye.

Shay Assad has been a consistent proponent of contractor price reductions through stronger negotiating tactics from the beginning. In 2011, we quoted: "Speaking at the Credit Suisse 2011 Aerospace & Defense Conference, Shay Assad said that the Pentagon is concerned with cost reduction, not margin reduction, and that he would be surprised if profitability went down even as spending is decreased." In 2013 we [wrote](#) about Mr. Assad's pet "should-cost" initiative—

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Should-cost negotiations that do not result in significant price reductions (when compared to the contractor's own estimate) seem to be seen as a failure by the government's negotiators. In other words, the objective of 'should cost' does not seem to be to arrive as a 'best guess' or "most probable" estimated product cost; the objective appears to be to brow-beat the contractor into price concessions so that victory can be claimed in the fight against contractor profits.

In that same article, we discussed Frank Kendall's Better Buying Power 2.1 comments about contractor profit, in which he stated—

Current profit levels in the aggregate are reasonable and sustainable, but they are not tied tightly enough to successful performance in meeting DoD goals. Traditionally, the Government's objective position for contract profitability has been a function of perceived risk and the anticipated value to be achieved by successful contract performance. DoD profit policy and our acquisition strategies should provide effective incentives to industry to deliver cost-effective solutions in which realized profitability is aligned and consistent with contract outcomes.

So here we are in 2018, and Lockheed Martin, as the prime contractor for the largest single military weapon system program in the history of this country, is experiencing the fruits of those seeds planted long ago.

But it's not just Lockheed Martin, of course. It's many contractors in many diverse industries that support the Federal government. Many contractors are feeling the animosity from their government customers. The days where the official Pentagon policy of "partnering" with contractors—a policy that culminated in "alpha contracting" where the parties worked side by side in the same room to arrive at estimated costs—have long departed the scene. Its use seems to have peaked in the mid-2000's, and not much can be found on the topic today.

If you are a government contractor entering into negotiations—particularly sole-source negotiations—you need to be prepared for a rough ride. The negotiators on the other side are trying to squeeze every nickel out of your price. And there is absolutely nothing wrong with that approach; that is their job. You need to be prepared for unpredictable and perhaps "unfair" negotiating tactics. You can best counter those tactics by strictly complying with the FAR requirements, and by bringing facts and figures to support your position.

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Good luck.