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Dear Administrator Jordan:

The Center for Effective Government (formerly OMB Watch) works to ensure government is effective and responsive to the priorities of the American people; in support of that goal, we conduct policy research and develop policy proposals. As such, the Center for Effective Government supports the president's proposal in the Fiscal Year 2014 Budget Request that "urges the Congress to expand the Senate's proposal to cover all contractor employees—both defense and civilian..." with a lower contractor compensation cap than currently exists.<sup>1</sup> The Senate proposal last year would have lowered the cap to the vice president's salary, which is currently \$230,700.

The savings could be substantial. In response to a question from Sen. Claire McCaskill (D-MO), the Army stated that it alone could save \$6 billion annually on contract costs if a cap of \$400,000 were mandated.<sup>2</sup> The savings would be much greater if the cap was applied to all defense and civilian agency contracts, as well as if the cap was \$230,700 instead of \$400,000. The current cap of \$763,029 – set last year – is out of control and, if it is revised upwards again, many believe it would exceed \$800,000. As a White House blog post last year stated:

Congress put a cap on how much taxpayers would reimburse these executives in the 1990s, but that cap was tied to pay levels of the nation's top private sector CEOs and other senior executives. As a result of skyrocketing CEO pay, the tab for taxpayers has soared to unreasonable heights in the intervening years. Unfortunately, Congress failed to reform the current reimbursement formula for contractor executives and, until it does, taxpayers will continue to foot a bill that is both unjustified and unnecessary.<sup>3</sup>

Furthermore, the increases in the cap come as average American workers and federal employees have seen stagnant wages. The White House stated, "As a result of this rapid growth of private sector executive compensation over the past 15 years, taxpayers are being forced to reimburse contractors at a rate which has outpaced the growth of inflation and the wages of most of America's working families – as well as the growth of Federal salaries."<sup>4</sup>

Thus, we are in full support of the intent of the president's proposal.

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<sup>1</sup> Office of Management and Budget, "Fiscal Year 2014 Budget of the U.S. Government," page 49. Available online at: <http://www.whitehouse.gov/sites/default/files/omb/budget/fy2014/assets/budget.pdf> [Last accessed May 20, 2013].

<sup>2</sup> Jay Aronowitz, Deputy Assistant Secretary, Force Management, Manpower and Resources, U.S. Department of Army, Post-Hearing Questions for the Record. Available online at: [www.hsgac.senate.gov/download/mccaskill-qfr-to-aronowitz-for-march-29-2012-hearing](http://www.hsgac.senate.gov/download/mccaskill-qfr-to-aronowitz-for-march-29-2012-hearing) [Last accessed May 20, 2013].

<sup>3</sup> Lesley Field, "Ending the Overpayment of Federal Contractor Executives," Office of Management and Budget, Jan. 31, 2012. Available online at: <http://www.whitehouse.gov/blog/2012/01/31/ending-overpayment-federal-contractor-executives> [Last accessed May 20, 2013].

<sup>4</sup> Lesley Field, "Ending the Overpayment of Federal Contractor Executives," Office of Management and Budget, Jan. 31, 2012. Available online at: <http://www.whitehouse.gov/blog/2012/01/31/ending-overpayment-federal-contractor-executives> [Last accessed May 20, 2013].



However, we are concerned that some are suggesting that the proposal would or should only apply to cost-reimbursement type contracts. Such an approach would severely limit the efficacy of the president's proposal to save taxpayers significant amounts of money. For example, in an article opposing lowering the caps that appeared in the April 30, 2013, issue of *Federal Contracts Report*, the authors make such a reference: "...the government already caps what it will compensate contractors for executive compensation under *cost-type* contracts at a market-based amount of \$763,029..." (italics added).<sup>5</sup> (Also, note that at the Department of Defense, the cap currently applies to all contractor employees; it is the civilian agencies that currently only place a cap on the reimbursable compensation of the top executives.)

According to USAspending.gov data, fixed-price contracts of varying types made up over 60 percent of federal contracting in Fiscal Year 2012, worth over \$300 billion.<sup>6</sup> USAspending.gov does not include some agency contract data, and there are substantial data quality issues. However, it is clear that fixed-price contracts make up a substantial percentage of government contracts.

By excluding fixed-price contracts from contractor compensation cap coverage, taxpayers would not see a majority of the potential savings that would otherwise be possible. There is a legal basis in the current rules for buying goods and services with fixed-price contracts that allow the government to apply these caps.

Federal Acquisition Regulation (FAR) section 31.102, "Fixed-price contracts" states, "The applicable subparts of Part 31 shall be used in the pricing of fixed-price contracts ... whenever cost analysis is performed..." As you know, cost analysis is used to assess the reasonableness of a contractor's pricing proposal.

More specifically, cost analysis is the "review and evaluation of any separate cost elements and profit or fee in an offeror's or contractor's proposal, as needed to determine a fair and reasonable price or to determine cost realism, and the application of judgment to determine how well the proposed costs represent what the cost of the contract should be, assuming reasonable economy and efficiency" (FAR 15.404-1(c)(1)).

Cost realism analysis is used to independently review and evaluate "specific elements of each offeror's proposed cost estimate to determine whether the estimated proposed cost elements are realistic for the work to be performed," among other things (FAR 15.404-1(d)(1)) and can be used with fixed-price-type contracts as well (FAR 15.404-1(d)(3)).

In these analyses, the cost principles would apply. Contractor compensation caps are covered by the cost principles.

Additionally there is a danger with the continued overuse and misuse of commercial item-type contracts. Thanks to contractor-friendly acquisition "reform" laws passed in the 1990s, the definition of commercial item defies logic. Weapons systems such as the Lockheed C-130J, which is not sold on the commercial market and is specifically tailored for the U.S. military, was originally deemed a commercial item. More common examples of "commercial items" are major subsystems such as avionics that are not commercially available whatsoever – thus depriving the government of the cost control mechanisms of the market, which is the only legitimate rationale for using "commercial item" contracts. Yet these non-commercial items continue to be acquired as "commercial items" without the contractual cost and pricing

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<sup>5</sup> Kathy C. Weinberg and Damien C. Specht, "DOD: Myths and Misunderstandings Related to Contractor Executive Compensation Caps," *Federal Contracts Report*, 99 FCR 536, April 30, 2013. Available online at:

<http://jenner.com/system/assets/publications/11871/original/Jenner.pdf?1367609136> [Last accessed May 20, 2013].

<sup>6</sup> All contracts in Fiscal Year 2012 on USAspending.gov:

[http://usaspending.gov/search?form\\_fields={%22spending\\_cat%22%3A\[%22c%22\]%2C%22fyear%22%3A\[%222012%22\]}](http://usaspending.gov/search?form_fields={%22spending_cat%22%3A[%22c%22]%2C%22fyear%22%3A[%222012%22]}) [Last accessed May 20, 2013].

All fixed price contracts in Fiscal Year 2012 on USAspending.gov:

[http://usaspending.gov/search?form\\_fields={%22recip\\_state%22%3Anull%2C%22recip\\_congdist%22%3Anull%2C%22recip\\_country%22%3Anull%2C%22spending\\_cat%22%3A\[%22c%22\]%2C%22tocp%22%3A\[%22\]22%2C%22M%22%2C%22L%22%2C%22B%22%2C%22A%22%2C%22K%22}%2C%22fyear%22%3A\[%222012%22\]}&sort\\_by=dollars&per\\_page=25](http://usaspending.gov/search?form_fields={%22recip_state%22%3Anull%2C%22recip_congdist%22%3Anull%2C%22recip_country%22%3Anull%2C%22spending_cat%22%3A[%22c%22]%2C%22tocp%22%3A[%22]22%2C%22M%22%2C%22L%22%2C%22B%22%2C%22A%22%2C%22K%22}%2C%22fyear%22%3A[%222012%22]}&sort_by=dollars&per_page=25) [Last accessed May 20, 2013].

checks and controls the taxpayer needs in place in order to ensure we are not overpaying, with the corresponding means of contractual legal recourse if this should occur.<sup>7</sup> Many commercial item-type contracts should be converted to more appropriate contract types, where contractor compensation caps would also apply.

Finally, whatever the cap is, the U.S. government has authority to negotiate lower compensation levels if the prevailing wage rate for an occupation is lower than the cap. A few months ago, the Department of Energy Inspector General released a report that highlighted the risk to taxpayers if there is a myopic focus on simply whether the cap is exceeded or not. The report found that:

The consulting firm officials indicated that their assessment focused on determining whether the proposed total compensation of UCOR key personnel exceeded the per executive total compensation benchmark (\$693,951 at the time of the assessment) established by the Office of Federal Procurement Policy. We discussed the results with ORO senior management officials and they acknowledged the fact that the consulting firm did not perform a reasonableness assessment of contractor executive salaries.

As a result, in this instance, taxpayers may be paying \$3.45 million more for the salaries of 10 contractor executives over the life of a five-year contract.<sup>8</sup>

Again, we support the president's proposal in general, but we believe if it contains these significant loopholes, the policy will miss out on the potential for tens of billions of dollars in savings over several years.

Sincerely,

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CC:

Senator Barbara Boxer  
Senator Chuck Grassley  
Senator Claire McCaskill  
Representative Paul Tonko  
Representative Jackie Speier

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<sup>7</sup> Scott Amey, "Defense Department's New Definition of 'Commercial Item' Will Save Money," Project On Government Oversight, May 2, 2012. Available online at: <http://pogoblog.typepad.com/pogo/2012/05/defense-departments-new-definition-of-commercial-item-will-save-money.html> [Last accessed May 20, 2013].

<sup>8</sup> Department of Energy Office of Inspector General, "Approval of Contractor Executive Salaries by Department of Energy Personnel," March 2013. Available online at: <http://energy.gov/sites/prod/files/DOE-IG-0882.pdf> [Last accessed May 20, 2013].