

Defense News

By: Maj. Gen. Darryl Scott (ret.), Lt. Col. Sam Kidd | June 3, 2019

TransDigm's excess profits show weakness in supply chain management, not pricing practices

The recent high-profile case of yet another federal contractor accused of "price gouging" the U.S. Department of Defense has led to renewed condemnation of unacceptable "[waste, fraud, and abuse](#)" in the management of taxpayer dollars. In February, the DoD Inspector General [reported](#) that TransDigm Group earned excess profits on 46 of 47 spare parts and overcharged the DoD by \$16.1 million on contracts worth \$29.7 million.

The response from Congress and others has been rightly outraged, but criticism has focused too narrowly on price, profit and the tools available to government contracting officers for determining price reasonableness. These are just symptoms of a larger, underlying problem with the DoD's supply chain management.

As happened with TransDigm, the DoD often finds itself in "vendor lock" with only one source for critical spare parts for a number of reasons. A program may have lacked meaningful, long-term sustainment planning, and the parts have either always been unique to the DoD or they are commercial parts for which the DoD is the only remaining customer. It may be that the DoD was unwilling or unable to fund the necessary investment in data rights, licenses or reverse engineering that would ensure the DoD has, or can develop, multiple sources of supply.

Unfortunately, the DoD IG report does not address why each of these parts in question is only available from one manufacturer. All we know is that TransDigm [acquired a number of sole-source manufacturers](#), locking the DoD into negotiating with a single vendor for a number of parts. TransDigm could charge whatever price it wanted.



[Op-Ed: Tax dollars should fund defense, not lavish lifestyles of contractors](#)

Too much of the defense budget is being misspent says U.S. Sen. Chuck Grassley of Iowa

By: Chuck Grassley

Cost or pricing data will *not* save us all

The DoD IG's recommendation that the DoD require contractors to provide greater access to cost or pricing data seems like a reasonable solution if the cause of TransDigm's "excessive" profit margins is the inability of contracting officers to negotiate fair and reasonable prices.

But Congress and the DoD should be more concerned that critical components of C-17s, Apaches, Chinooks, F-16s and other systems are only available from sole-source manufacturers like TransDigm. This puts DoD contracting officers in a position where they have little to no leverage in price negotiations but must still deliver the parts on time.

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It is easy to see why the DoD and Congress are fixated on requiring more cost or pricing data. In the single instance in which the IG found TransDigm was required to provide cost data, the company only received 11 percent profit. (In this case, the procurement exceeded the \$2 million Truth in Negotiations Act threshold.) One instance of good behavior does not instill confidence that a little bit of sunshine will cause TransDigm and others like it to abandon their business model. Even with additional cost information, if an F-16 is grounded because it needs a part from a sole-source manufacture, the DoD will be forced to pay whatever that company charges.

The IG's report does not mention what the DoD's rights are in the technical data for the parts in question. There are no recommendations for increasing sources of supply for these and other parts only available from sole-source manufacturers.

Instead of requiring more cost or pricing data, the IG should have recommended that the DoD develop and execute a deliberate supply chain management strategy designed to ensure it has the appropriate rights in the technical data for spare parts to maintain a competitive supply base. That recommendation could have driven a conversation about what, if any, additional authorities the DoD needs to be able to maintain competitive vendor bases, especially for DoD-unique parts.

It's all about the data rights

Kevin Fahey, the assistant secretary of defense for acquisition, [testified before Congress in May](#) regarding this egregious case of contractor profit. His prepared statement briefly touched on the intellectual property problem. Unfortunately, it did not take long for Mr. Fahey and most of the committee members to shift the focus of the hearing back to how the DoD might compel sole-source companies to provide cost or pricing data, even for commercial parts. But a firm that does not want to provide cost or pricing data cannot be compelled to sell to the government.

In 2017, the [Government Accountability Office reported](#) that traditional and nontraditional DoD contractors alike identified cost or pricing data requirements as one of the most onerous challenges in doing business with the government. For many nontraditional vendors, investing in an approved accounting system is an expensive nonstarter. Requiring more cost or pricing data would likely make it harder for the DoD to develop a broader supply base. Contracting officers need more competition, not more data!

Fortunately, the DoD is taking some action to solve the real problem. Mr. Fahey testified about efforts the DoD is making with new programs to ensure it has the appropriate data rights to efficiently sustain those systems. Experience shows that the DoD will likely continue operating current and future systems for decades. Committing funding early for longer-term sustainment, as the Section 809 Panel recommended in its [sustainment program baseline recommendation](#), is a way to prevent sole-source "vendor lock" in the future.

For legacy systems, the DoD and potentially Congress must provide flexibility in the use of sustainment funding to develop new sources of supply. Parts could be generated using additive-manufacturing or reverse-engineering capabilities readily provided by small and nontraditional engineering firms. In the aeronautical world, the DoD should invest in a process for rapidly certifying commercially available parts that have already been certified by the Federal Aviation Administration.

A missed opportunity

TransDigm's decision to [repay the government](#) for its [excess profits](#) appears to be a positive resolution to the problem, but it does not address the lack of competition that led to these inflated prices.



[Pentagon requests voluntary refund of millions of dollars from contractor TransDigm](#)

TransDigm, a parts manufacturer, made more profit than it should have off of its DoD contracts, per a new report.

By: Aaron Mehta

Rep. Jim Jordan, R-Ohio, stated during the May hearing: "It is too expensive to do business with this government and it is driving away innovation and competition." Increasing the cost of doing business with the DoD by requiring more data from contractors is not the answer to increasing competition. Yet, that is how the DoD and its IG recommend solving the TransDigm problem.

Instead, the DoD should seize this opportunity to change policy and, where necessary, propose legislation to improve its strategic sustainment planning.

To begin solving this systemic problem, the DoD should allow more flexibility in how operations and maintenance dollars may be used to develop additional sources of supply, invest in innovative solutions to supply chain challenges and more efficiently utilize commercially available solutions. It is possible for the DoD to increase competition and improve access to innovation — two steps necessary to maintaining the U.S. military's competitive advantage and protecting taxpayer dollars.

Retired U.S. Air Force Maj. Gen. Darryl Scott is a commissioner on the Section 809 Panel. He previously served as the assistant deputy assistant secretary of the Air Force for acquisition (contracting) and as the head of the Defense Contract Management Agency. Lt. Col. Sam Kidd is the executive direc-

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