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THE ADVANTAGES OF COST PLUS AWARD FEE CONTRACTS

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Personal experiences in the management of projects and shared experiences with colleagues have convinced me that a Cost Plus Award Fee contract is the best procurement vehicle for the high-tech, one-of-a-kind, development projects that constitute most of NASA's projects. But, like most things, success isn't automatic. It takes work to make it happen, and the successful implementation of award fee contracts is no exception. In fact, the use of this type of contract requires more government and contractor effort than other forms of contracts. But, in my opinion, it's worth every hour spent.

Over the years, I've collected a list of "lessons learned" related to the use of award fee contracts. I'll try to articulate those lessons adequately in the following text. Keep in mind that I'm not speaking from the standpoint of a procurement officer. My observations come from the day-to-day use of these contracts in various positions I've held—project manager, director of flight projects (project manager's supervisor), and fee determination official.

An award fee contract is described as an arrangement whereby the government periodically awards a fee consistent with the cost, schedule and technical performance that is achieved by a contractor during a preset period with preset award fee pools.

Rationale

Let me explain why I like award fee contracting. First, it's the only contracting method where both government and contractor goals are closely linked. The government wants cost, schedule and technical performance; the contractor wants profits. The better the total performance, the better the fees (profits) will be. Compare that with a fixed price contract where the total price (cost plus fee) is fixed. If the cost of a fixed price effort is underestimated, the contractor may sometimes make adjustments that impose risks to the technical performance. This protects the contractor's profits but imposes risk on the government's goal for technical performance. Other ways exist for contractors to protect their fees in a fixed price arrangement (all of them bad for the government), but that subject deserves a separate paper.

Second, an award fee contract has a built-in mechanism to conveniently alter and emphasize program events in order to satisfy current external and internal situations—and the government is involved in these adjustments. Prior to each award fee period, the government and contractor project managers review the plan for the upcoming period, agree on the planned events, and place the appropriate emphasis on each event. Should problems arise (and they always do), the plan and the fee emphasis can be adjusted accordingly. This is considered by most project managers to be the most important feature of award fee contracts.

And while I'm on adjustments, I'd like to mention the use of "rollovers," in which lost fee from prior periods is used to "sweeten the pot" on future events that have become so critical that additional emphasis is warranted. Rollover is a powerful award fee tool to motivate contractors if used properly.

Third, the award fee process demands good communication between the government and contractor participants. And every project manager knows or should know that good communication is a necessary ingredient of every successful project. The meetings required by award fee contracting reinforce the need for clear communication.

Fourth, I have learned that contractor performance on award fee contracts is superior to performance by the same contractors on other types of contracts. The quality of the product is certainly superior. The fee earned by those contractors is better than they could have received on other cost type contracts, and it should be. Remember: better performance, which the government wants, results in higher fees, which the contractor wants. I don't have any data on fixed price contracts because there is no government knowledge of final costs of those types of contracts. But I'll bet award fees are close to the profits customarily realized by contractors, even on fixed price development contracts.

The downside to award fee contracting is the additional contractor and government personnel required to implement award fee contracts. It is certainly true that more people are needed to formally assess contractor performance, conduct performance evaluation board meetings, and report findings to the fee determination official. But I maintain that most of that work should be done under any circumstances, and the improved communication is worth the effort. So I'm not sympathetic to those complaints.

Implementation

All the good features discussed above can go down the drain with faulty implementation. I've found the following nine ground rules to be effective in properly implementing the award fee contracts in which I've been involved. I will readily admit that there should be many ways to skin this cat, but frankly, I've found no effective alternatives to the following rules. I've also seen instances where both the government and the contractor failed to reach their objectives as a direct result of deviations from one or more of the following rules.

First, the government project manager must chair the Performance Evaluation Board (PEB). After all, the project manager is the key official selected by NASA to be responsible for the project cost, schedule and technical performance. The project manager is in the best position to evaluate the importance of the performance during the project evolution and obviously has the most to gain or lose from that performance or lack thereof. If that's not true, the Agency should find another project manager. On the other hand, it's crucial that the contractor understand that the government project manager is the most influential government individual for all project activities, and looking elsewhere for project-level influence is unproductive.

Second, the PEB should consist of institutional members who are participating in the project: procurement, business (program control in some Centers), engineering, and product assurance (quality control and safety at some Centers). Depending on the end item or service, science and operations should also be added. It's advisable to keep the PEB membership as small as possible, and it's important to select individuals with experience applicable to the end item or service delivered. In other words, make sure they are capable of understanding what the contract monitors are telling them.

Third, the Fee Determination Official (FDO) should be no higher than one level above the project manager and, in fact, should be the project manager's line supervisor. The FDO must have more than a passing knowledge of the project's status. This requires frequent interactions with the project manager, which the supervisor's position provides. Deviations from this rule can result in some awfully dumb fee determinations. I might add that if the project manager reports to the Center director, the deputy Center director should be the FDO. Center directors should not be FDOs and should be reserved to resolve institutional or project issues should they arise.

Fourth, use adjectives that can be understood and that properly describe performance levels. I prefer the academic model where "Satisfactory" is used for barely passing performance (a 60 or 70 percent performance rating, depending on your preferences.) Levels below "Satisfactory" can be identified as "Poor" and "Failing." Levels above "Satisfactory" can be called "Good" and "Excellent." It's confusing to everyone when fee curves are set so that the fee letter indicates a contractor got a "Superior" rating but received only 65 percent of the available fee for that period. Don't laugh; that's actually happened.

Fifth, skew the fee curve (fee earned vs. performance rating) so that most of the available fee falls above "Satisfactory," or whatever you've decided to call passing performance. This clearly shows our desire for high performance and motivates the contractor to exceed a mere passing grade.

Sixth, make the award fee periods sufficiently long to allow time to correct deficiencies after a midterm review by the project managers. I prefer six-month periods. This allows the project managers to assess the performance status three months into the period in order to identify performance problems, and then still provides three months to correct the situation before final evaluation and scoring of that period's performance. Periods of less than four months preclude this important process.

Seventh, offer contractors an opportunity to present self-assessments of their performance to the PEB and the FDO. Some contractors will choose not to do this, but the invitation ought to be given. If the offer is accepted, I believe the PEB should hear the contractor's self-assessment before making the final rating. As an FDO, I definitely preferred hearing the contractor's self-assessment before hearing the PEB's story. I've found that the major advantage of contractor self-assessments is that they indicate faulty communication between the government and the contractor—which will kill a successful project more quickly than anything I know.

Eighth, rollovers should be allowed in the award fee plan but never promised. They should be left to the discretion of the FDO and result from recommendations by the PEB. They should be used infrequently and always targeted to specific events that have become crucial to the success of the project. Specific "go/no-go" performance criteria must be established for these events and announced in the fee letter for the period preceding the period in which the selected event falls.

Finally, and most importantly, the contractor project manager and the government project manager *must* jointly agree on milestones and criteria, and the emphasis to be placed on each, *before* the beginning of each award fee period. And then *everyone must stick to the agreements*. This won't eliminate disagreements with the amount of fee awarded, but it does eliminate surprises, which are simply unacceptable. Nothing can kill an award fee process quicker and demoralize contractors more than to be "dinged" for something they didn't know.

Fee Determinations

Now let's look at the lessons learned in the awards themselves. The first and most important ground rule is: *don't play games*. If the contractor earned all of the fee, by all means award it. Don't fall into the trap of telling yourself, "If I give 100 percent, the contractor will start expecting it every time." Or: "The contractor earned 100 percent, but I'll give 80 percent to give some room to improve." Or just as bad: "If I give the contractor the 20 percent really earned, I'll get the project manager fired." Awards that are too high or too low are equally bad. Awards that are too high tell the contractor to under perform and get away with it. Awards that are too low tell the contractor that no matter how hard the work and how much the accomplishment, efforts will be in vain. Both situations are bad and will demoralize the contractor. Stick to the prior agreements and award the fee consistent with the actual performance.

If the performance is deficient and your awards are consistently fair, you'll soon see the performance improve. If the performance is good, and the contractor is convinced that fees will be lost by backsliding, the performance will remain high. In case you didn't notice, the operating word is *fair*. By the way, it's a good idea to keep histograms for the percentage fee earned as the program develops. If the awards have been consistent (fair), you'll see the hills (good times) and valleys (problems) that occur in any development activity.

Award Fee Letter

Now for the important fee letter where you tell the contractor about the determination. Believe me, you can ruin a good award fee process and all the work you've done by issuing an award fee letter that no one understands. It would be impossible to overstate the importance of these letters.

I've found the letters should have four basic parts. The first paragraph is really a boilerplate paragraph that references the contract title and number, identifies the period for which the award is given, states the percentage of the award earned and the specific dollar amount, and gives the performance adjective rating. The second paragraph should identify the instances of commendable performance. Be specific, even if you have to use bulleted items. Be clear. The contractor must understand which ratings were high so as to pass the accolades along to the working troops. The third paragraph should identify deficiencies. Again, it's extremely important to be specific and clear. I call the final fourth paragraph the "message" paragraph. The content of this paragraph can range from "keep up the good work" to "be advised that continued inferior performance in (a certain area) will have serious effects on future overall fee determinations."

A good contractor general manager will do several things with the fee letter; that is, if it is understood. First, a meeting with the project manager will be held to review the letter. The project manager will be commended for the things done properly (second paragraph), actions will be identified to correct recurrence of the deficiencies (third paragraph), and the message (fourth paragraph) will be discussed and actions (project or institutional) will be identified to respond to the thrust of the message.

Next, the good general manager will send a letter to the FDO stating that the award has been reviewed with the project manager, the recognition of the commendable items is appreciated, the deficiencies and message are understood, and appropriate actions have been assigned. In addition, the general manager will now be in a good position to report the profit status on this contract and articulate the details of the award. All of these good things transpire when the contractor understands the fee letter. Otherwise, there is no follow-up or feedback, the situation cannot be explained to corporate reviewers, and everybody loses.

The understanding of the awarded fee is so important that I added one more step to the process. As an FDO, if a general manager called and verbally complained about certain elements of the award, I would discuss the call with the government project manager and provide verbal feedback to the general manager. If the complaint came in writing, I would reconvene the PEB with instructions to draft a written response to *only the specific concerns* stated in the general manager's letter, not every element of the award. I would then discuss the recommended government response with the PEB. If I agreed with the

PEB position, I would send the written response to the general manager. I have changed a prior award in the contractor's favor after learning that the PEB used erroneous information. In that case, the general manager was correct and the contractor earned the fee increase. After all, that was the *fair* thing to do. The contractor response to that small dollar change was tremendous, and performance improved markedly.

So in summation, I believe that award fee contracting is particularly suited to the one-of-a-kind development projects which constitute most of NASA's efforts. I do not believe fixed price contracts or fixed price plus incentive contracts belong in this environment. Perhaps someone else may wish to argue the advantages of the latter types, but my experience suggests that award fee contracting is the better way to go.