THE UNDER SECRETARY OF DEFENSE
3010 DEFENSE PENTAGON
WASHINGTON, D.C. 20301-3010

ACQUISITION AND
TECHNOLOGY

MAY 16 2001

MEMORANDUM FOR SECRETARIES OF THE MILITARY DEPARTMENTS
DIRECTOR, DEFENSE RESEARCH AND ENGINEERING
DIRECTORS OF DEFENSE AGENCIES

SUBJECT: Contractor Cost Sharing

In order to ensure that the companies the Department of Defense does business with are able to provide innovative, technologically excellent weapons and equipment at affordable prices, we must be concerned about the financial health of the defense industry. Financially sound companies are able to attract the resources and talent necessary to provide best value solutions to warfighters and taxpayers alike.

One of the ways to ensure these companies remain financially sound is to consider carefully the degree of investment they are making in defense programs. In today's environment of reduced defense spending and fewer new program starts, it is short-sighted to require contractor investment in defense research and development contracts. Instead, we should permit contractors to earn a reasonable return on these contracts in exchange for good performance. The only exception to this policy would be unusual situations where there is a reasonable probability of a potential commercial application related to the research and development effort.

Contractor investment in defense programs may take the following forms:

- Use of contractor independent research and development (IR&D) funds to subsidize defense contract research and development.

- Cost ceilings that in essence convert cost-type contracts into fixed-price contracts.

- Unreasonable capping of annual funding increments on research and development contracts.

- Award of development contracts at prices that are known to be less than the contractors' probable costs of performance.

None of these is an acceptable practice. Contractors should not be encouraged or required to supplement DoD appropriations by bearing a portion of defense contract costs, whether through use of their IR&D funds or profit dollars. I have asked my staff to carefully examine the acquisition strategy and execution for ACAT I programs to ensure that contractor cost sharing is not included, and to revise the DoD 5000 series directives to more completely incorporate this policy.

I believe this is a particularly important issue, and I expect the full support of the Military Departments and Defense Agencies to ensure that contractor investment is curtailed.

E. C. Aldridge, Jr.