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STATEMENT OF

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BEFORE THE

COMMITTEE ON SMALL BUSINESS

UNITED STATES SENATE

ON

GAO VIEWS ON S.2489

Mr. Chairman and Members of the Committee:

We are pleased to be here today to comment on S.2489, the Small Business Competition Enhancement Act of 1984. We support this legislation as containing many positive provisions for dealing with persistent causes of noncompetitive procurement and otherwise increasing competition where it is currently limited, especially for spare parts and other components. There are a few areas in the bill, however, where we believe refinements would be useful. We would be glad to work with the Committee on these matters.

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MAGNITUDE OF THE PROBLEM

Federal contract awards totaled $168 billion in fiscal year 1983. Awards exceeding the small purchase ceiling totaled $152 billion. Of this amount, only about one third, or $54.7 billion, was categorized as competitive.

To a large extent S.2489 deals with spare parts and related technical data. The bulk of spare parts are purchased by the military departments. The Department of Defense (DOD) spare parts purchases are estimated to be about $13 billion in fiscal year 1982 and $18 billion in fiscal year 1984.

Technical data for a spare part includes the plans, specifications, and manufacturing data on how to make the part and test its conformance to the specification. Technical data is needed to procure non-commercial items from suppliers other than the prime contractor. Technical data communicates the precise government needs to a prospective supplier.

Contractors at times provide the government with technical data that contains restrictions on its use (proprietary legends). When a contractor restricts the use of the technical data it generally means that the data cannot be used to obtain the part it describes from anyone other than the owner of the rights in the data.

The party that claims proprietary rights in technical data implies that the trade secret embodied in the technical data was developed at private (non-government) expense. The party further implies it is the owner of the data right in

question either by incurring the cost to develop the trade secret or has purchased it from the developer.

Recent reports by the Air Force Management Analysis Group, DOD Inspector General, and our Office provide some indications of the severity and causes of the lack of competition in spare parts acquisition. S.2489 proposes changes which address these problems.

Air Force report on spare parts acquisition

In an October 1983 report on spare parts acquisition, the Air Force Management Analysis Group noted several important facts.

--First of all, the extent of competition in spare parts has been steadily declining. Only 20.7 percent of the dollars expended in the procurement of spare parts in 1982 were competed whereas 10 years earlier 37.5 percent had been competed.

--Second, proprietary claims on data rights inhibit competition on 8 percent of spares with a procurement source code, that is where restrictions on competition are determined together with the rationale. Even though regulations require that proprietary claims be validated, minimum action has been taken to enforce these provisions. The Defense Acquisition Regulation does not adequately define the

term "developed at private expense", a key to determining validity of proprietary claims. Lack of a definition permits relatively unconstrained use of restrictive markings which inhibits competitive acquisition.

--A third point addressed in the report is that once technical data enters the system there are serious problems with storage, distribution, and the data needed for competitive procurement. The central facility for storing engineering (technical) data has been able to fill only 40 percent of the users' requests.

--Fourth, regulatory and legal constraints tend to inhibit competition. For example, suppliers seeking approval as a source for a restrictively coded item (must be purchased sole-source or from one of few qualified sources) are required to certify that the necessary technical data was obtained in a proper manner. Sole-source suppliers must be notified and allowed to comment if the government wants to compete an item. The report states, and I quote, "It is often difficult, time consuming, and costly for new suppliers to become qualified to do business with the Department of Defense".

DOD Inspector General's report on technical data

In an April 11, 1983, DOD Inspector General's report on the management of technical data and its use in competitive procurement, the following conclusions were reached

--Historically the largest part of DOD expenditures for spare and repair parts is noncompetitive and much is sole source through the prime contractors,

--Technical data are a prerequisite to competitive procurement and are often needed to buy from the actual manufacturers of the items, and

--DOD activities often ordered and paid for important data that they did not receive. Also, too often these activities did not make effective use of the data that were available or obtainable.

Our report on the Small Business Administration's breakout efforts

To implement the Small Business Act, as amended, the Small Business Administration (SBA) has assigned Procurement Center Representatives (PCRs) to 52 federal acquisition centers. Their major function is to maximize potential opportunities for small businesses to obtain Defense contracts. In late 1979 SBA initiated a pilot program to increase these efforts by adding a "breakout PCR" position at three Air Logistics Centers--Oklahoma

City, San Antonio, and Warner Robins. Breakout is the conversion of sole source purchases of spare parts from the prime contractor to either, procurement from the actual manufacturer or, competition. On August 2, 1982, we issued a report to Congressman Addabbo evaluating the effectiveness of SBA's breakout program.

It is important to note that the breakout program is most effective when needed technical data is obtained as part of the initial procurement package. In spite of difficulties posed by the initial lack of technical data, SBA's breakout efforts have resulted in large dollar savings in relation to the program's costs. We concluded that (1) the breakout specialists contributed to most of the breakouts reviewed, (2) SBA may actually be saving the government more money than its reports indicate since the breakout specialists are unable to identify savings in subsequent purchases of some items due to time and resource constraints, and (3) limited time and staff prevent SBA personnel from pursuing many additional procurements with breakout potential.

To strengthen SBA's breakout efforts and to increase its ability to identify the actual manufacturers of parts which are now supplied by prime contractors, we recommended that the Administrator of the SBA assign additional resources to the breakout efforts at the Air Logisitics Centers and consider assigning breakout PCR specialists to other DOD procurement centers.

However, earlier this year, SBA informed us that no additional breakout PCRs had been assigned.

Our report on component breakout by DOD

In a June 1, 1983 report on component breakout, we identified problems inhibiting breakout. We found that a significant part of the high-dollar value items that were reported as acquired from the actual manufacturer were in fact purchased from the prime contractor who obtained the item from a subcontractor. Thus, erroneous reporting tended to conceal the severity of the problem.

We also noted a lack of serious effort to determine the validity of prime contractors' restrictive legends on technical data. One of the apparent causes of low performance of the breakout effort was a shortage of personnel dedicated to this work. We were informed that military officials had great difficulty in determining who actually manufactures a part. An effective procedure for identifying the actual manufacturers of spare parts is lacking. We recommended that a provision be included in future contracts to require the prime contractor to identify actual manufacturers of components and spare parts.

S.2489

S.2489 proposes many important changes to address these and other problems that inhibit competition, reduce the opportunities for greater small business participation in meeting government needs, and generally cause spare parts to be acquired at higher prices. It also provides for needed flexibility as long

as adequate justification can be provided for deviating from requirements.

The bill first provides ways to plan for future competition by encouraging major systems development contractors to use components currently available in the supply system or components with unrestricted technical data. With respect to awarding production contracts, substantial consideration is to be given to those contractors who (1) are willing to identify any restricted data, (2) provide priced options for purchase or licensing of such restricted data, and (3) propose ways to expand small and small disadvantaged business participation.

Second, the bill would encourage the entry of new competitors by requiring the agency to (1) justify in writing the need for prequalification, (2) formalize and make known the standards required to prequalify, (3) provide opportunities for those desiring to qualify while excluding contractors that could benefit from the absence of additional qualified sources from qualifying others, and (4) provide test and evaluation services at no cost to a small business when insufficient qualified suppliers are available. In addition, solicitation announcements would be required to contain considerably more information to attract new competitors.

Third, the bill provides for improved management of technical data to promote competition. Future production contracts, for example, would be required to clearly identify (1) what technical data is deliverable and when; (2) what constitutes

acceptable data; (3) what payments are related to technical data delivery; (4) whether data rights are provided to the government or withheld, including a definition of "developed at private expense", and (5) any data restrictions in advance with the contractor to prepare and retain justification supporting the restriction. In addition, authority is to be provided for the government to retain another contractor to review the validity of data restrictions, with the provision that the contractor will be liable for liquidated damages and other costs if claimed proprietary rights are found to be invalid. Further, contractors would be required to (1) agree not to charge fees or royalties to subcontractors for use of data provided to them in the past without restriction, (2) identify actual manufacturers of any part, and (3) maintain lists of subcontractors as well as other firms solicited and make such information available to the government.

In addition, the bill would establish a requirement for a comprehensive plan for the management of technical data by federal agencies.

Fourth, the bill would enable the government to expeditiously challenge and resolve proprietary data restrictions. It authorizes contracting officials to validate proprietary claims, as appropriate, and require contractors to provide support within a specified time or face removal of restrictive legends on technical data. It would also require contracting officers to review any support provided and reach a decision, subject to

the disputes clause. If a contractor fails to provide adequate support and/or loses a dispute under the disputes clause in connection with a proprietary claim, the government would collect liquidated damages as stated in the contract and that contractor may be liable for the government's cost to prove its case.

We support those provisions of the bill, which should have a positive impact on increasing competition where it is currently limited. There are, however, a couple of provisions in the bill which we think should be refined or changed. These are discussed in the attachment to this statement.

This concludes my prepared statement. We will be happy to address any questions you or the Committee may have.

ATTACHMENT I

Suggestions Relating to S.2489

Section 5 of the bill (proposed subsection 15 (a)(9) of the Small Business Act) would prohibit a contractor from requiring a subcontractor or the government to pay a fee, royalty, or other charge for the subcontractor's use of any technical data, except that protected by patent, in the performance of a contract to furnish a component or other requirement directly to the government, if the same technical data was furnished or otherwise made available by the contractor to the subcontractor for the performance of a contract between them. This section appears to conflict with section 3 of the bill (proposed subsection 15 (m)(2)(A)(B) of the Small Business Act) that states contractors vying for major system production contracts are encouraged to offer

> "separately priced options for the purchase or licensing of such restricted technical data by the Federal agency so as to permit the competitive acquisition of requirements for such components".

In addition, with respect to this same section, it is conceivable that a subcontractor was provided with technical data with restrictive legends by a prime contractor under a non-government contract. Is it the intention of this legislation to cancel otherwise legitimate proprietary rights in technical data if a contractor had provided a subcontractor with clearly marked restrictions on its use?

ATTACHMENT I

Section 3 of the bill (proposed subsection 15 (b)(3) of the Small Business Act) would require the Comptroller General of the United States to provide the Congress with a report evaluating the plans of the Departments of Defense, Energy, and Transportation, and the National Aeronautics and Space Administration for the management of technical data for major systems within their jurisdiction. The Department of Defense Inspector General issued a comprehensive report dated April 11, 1983, dealing with the management of technical data and its use in awarding competitive contracts. The bulk of major systems are in the Department of Defense. We would suggest that the bill be changed to require the Inspector General in each of the named agencies to evaluate the plans of its respective agency.

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