

We are convinced that it would often be impossible to negotiate on the basis you suggest and that contract negotiations on a total price basis will, in most cases, far better protect the Government's interests than would insistence on separate agreements on individual cost elements. For reasons that will be shown below, negotiation of a meaningful separate agreement on each significant cost element would often be impractical and almost always be uneconomical. Moreover, contract prices will generally tend to be lower if negotiated on a total price basis, since total price negotiation results in one over-all contingency factor and avoids contractor insistence on a separate contingency allowance for each cost element. Although it is impossible in any particular case to prove absolutely that total price negotiation resulted in a lower price, since there is no way of establishing that a price negotiated on one basis would have been different if it had been negotiated on another basis, it is the judgment of our most able negotiators and—we believe—that of experienced price negotiators and purchasing agents in other agencies and private industry that insistence on separate agreements on individual cost elements would generally lead to significantly higher prices. Not infrequently, contractors have agreed to very substantial over-all reductions in their "last best offers" even though adamant that their cost estimates and projections on each cost element were at rock bottom.

To put the matter in perspective, consider the nature of the negotiation process in pricing fixed-price type contracts where neither adequate price competition nor an established catalog or market price is available and the negotiation must be largely based on cost or pricing data. Insofar as costs are concerned, both the buyer and the seller start from their separate understandings of two things: first, cost experience (i.e., relevant data showing what it has cost in the past to accomplish tasks comparable to the contract work), and second, forecasts of what it should cost to perform the contract, the forecasts generally being based in large part on projections of the relevant cost data in the light of contingencies which may affect future costs. The first is essentially factual and is normally based on the contractor's cost or pricing data, which is required to be current, accurate, and complete. The second is essentially a matter of applying judgment to the possibility of various contingencies occurring and involves recognizing the degree to which these contingencies will be within the control of the buyer, the seller, or neither. The first depends heavily, in most cases, on the contractor's books and accounting records, which reflect past costs by individual cost elements; whether the books and records accurately reflect costs in a way that will not mislead is the proper concern of accountants and auditors. The second depends not only on cost trends and projections based on past costs, which again are of concern to accounts and auditors, but also on assessments of how risks should best be distributed between seller and buyer, how much potential there is for reducing costs by controlling contingencies, and how pricing can best be used to exploit this potential—assessments that call for judgments outside the normal sphere of accountants and auditors on matters that cut across individual cost elements and may be entirely unrelated to any specific cost element.

Insofar as cost experience is involved in price negotiations, we expect our negotiators and the contractor to reach a mutual understanding as to facts on each significant cost element. In this area, as noted above, we are concerned with facts rather than judgment. There is no intrinsic reason for the parties to differ on what costs have been experienced or on how these costs should be distributed to individual cost elements. Insofar as forecasts of what it should cost to perform the contract are concerned, the situation is very different. We are here concerned with judgment—not facts. There are intrinsic reasons for the parties to differ on how to provide for contingencies—reasons as valid as they are elementary. On the one hand, we expect our negotiators to work toward a negotiation objective which would require maximum effort by the contractor to earn a fair profit; our negotiators will tend to minimize contingencies. On the other hand, the contractor will tend to maximize contingencies and work toward a negotiation objective that reflects his fear that most, if not all, unfavorable contingencies will become realities before contract performance is complete. Thus, we do not expect our negotiators to agree with the contractor's forecasts, nor him with ours, but rather that both forecasts will be founded on the same factual basis and that both parties will bargain in the understanding that the total of all forecasts is a sum of possibilities—not certainties—and that compromise of extremes may be necessary to a fair settlement.

Viewed in the perspective outlined above, as it should be, it becomes clear that the negotiation of fixed-price type contracts would be severely hampered if we