

insisted on separate agreements on each cost element. Separate agreements would be detrimental to the interests of the Government in the following respects:

1. In practice, even if not in theory, separate agreements would usually be consecutive rather than concurrent, making it extremely difficult to give proper weight to those contingencies that cut across cost elements. Further, negotiators would tend to lose sight of important relationships between cost elements; for instance, manufacturing costs and subcontracting costs may be so interrelated that it would be unreasonable to agree to one without simultaneously agreeing to the other. We wish to avoid the wasteful and time-consuming process of agreeing on cost element "A" only to find in negotiating cost element "B" that there are factors which cause us to try to re-open "A" and then, having agreed to "A" and "B," find in negotiating "C" that we must again re-open "A" and also "B," and so forth through dozens of "significant" elements.

2. A requirement for separate agreements would frequently involve substantial delays in negotiations, in addition to those just indicated, in that separate bargaining imposes on a number of separate cost elements would be likely to result. Reasonable trade-offs would be discouraged, with contractors insisting on contingency allowances for each cost element rather than a reasonable contingency factor applicable to all. We tend to lose our bargaining power in areas where the contractor is unyielding if we have already agreed on those where he is relatively acquiescent.

3. Separate agreements on individual cost elements would prevent us from reaching a proper balance of all the other elements of the contract pricing agreement—type of contract, profit, ceiling, and sharing arrangement—all of which are interrelated and each of which is also related to the total cost estimate. The balancing of all elements is necessary to sound prices.

4. Separate agreements would be apt to lead to bad pricing. The end result would be a seductively flawless package of discrete cost elements with the cost experience and cost forecast factors (including contingencies) in each element precisely defined. All that is needed is addition of a profit element, and the price is complete. Herein lies the seduction: everything adds up so precisely that there is no apparent need for the powerful negotiating leverage which price analysis and total price negotiation so often provide. The fact is that the sum of cost estimates and profit, no matter how carefully drawn and analyzed, may widely miss being a sound and equitable price. This is shown time after time when we manage to introduce competition (either direct price competition or indirect competition between different but comparable products) into a previously sole source situation. Analysis of value and cost effectiveness, as opposed to cost analysis, can lead to over-all price objectives which are substantially lower than those indicated simply by adding up the separate cost and contingency elements. A technique of negotiating separate agreements on each cost element, with its attendant forced compartmentalization of contingencies, points in the opposite direction.

Against the foregoing detriments of requiring agreements on individual cost elements, what benefits should be considered? Apparently, the only "benefits" are those suggested by the following excerpt from your Defense Accounting and Audit Division's recent draft report on the pricing of Contract AF 04 (647)-714: "Where * * * negotiation of a * * * price is concluded on a total price basis and questions on significant elements of cost are unresolved, the Air Force may believe that the reduction negotiated from the contractor's proposed price pertained to specific individual elements of cost which it had questioned. However, the contractor may have understood that the negotiations were concluded on an entirely different basis. Subsequently, when an adjustment to the price becomes necessary * * * because the contractor's cost estimates were overstated, the amount of cost originally included in the price for the area of contract performance to be adjusted is indeterminable."

Thus, it is suggested that separate agreements on individual cost elements are necessary so that accurate adjustments in the contract price can be made if it is later discovered that a part of the contractor's cost data was overstated.

Even if the separate cost element agreement technique would greatly facilitate price adjustments determinations in the event that cost data overstatements were later discovered, this benefit would be far outweighed by the detriments outlined above. Certainly it is important that we should make proper price adjustments in such cases, but we should not become so pre-occupied with simplifying price adjustments as to deny to ourselves those negotiation techniques best calculated to achieve a sound price when the contract is first agreed to. It is far more important that the contract price be the lowest reasonable price which can