

be obtained than that possible determinations of future adjustments (which will almost always involve but a small fraction of the total price) be made as easy as possible to compute. We should not surrender our total price bargaining power, and therefore agree to higher over-all prices, merely to simplify possible price adjustments for which the need may never arise.

Separate agreements on each significant cost element would not, however, resolve the problem of how to determine the proper price adjustment when a cost data overstatement is discovered. This becomes clear upon close examination of the nature of the problem. Price adjustments should be made where—in the words of Public Law 87-653—the “price was increased *because* the contractor * * * furnished cost or pricing data which * * * was inaccurate, incomplete, or noncurrent * * *.” (Emphasis added.) Accordingly, if an overstatement of cost data is discovered, the first question is: Did the overstatement *cause* an increase in the contract price? And the second question: If so, how much? Separate agreements on each significant cost element would *not* normally provide answers to these questions.

To illustrate, suppose that a contractor furnishes us cost data showing that his experienced costs on a given vendor item have been running at \$100 per unit for six months prior to the price negotiations. Assuming that we are attempting to negotiate to agreement on each individual cost element, the next step is to reach agreement on the contingency factor for this element. The contractor may press for an additional \$25, citing—for instance—rising materials cost trends or wage trends in the vendor's industry. The Government will bargain downward, citing—perhaps—learning curves or price trends for different but functionally comparable items. Eventually, a deal is struck for \$105. Sometime later, after the contract is executed, it is discovered that the contractor had actually bought the vendor item for \$90 per unit during the month prior to price negotiation—a cost data overstatement of \$10 per unit. Then the questions arise: Did the overstatement cause an increase in the contract price? If so, how much? The important point here is that the answers may be anything but obvious, even though the separate cost element agreement technique was used. It may be that we would have agreed to \$105 even if the \$90 price had been known. Under some circumstances, what an item has cost in the past is but a poor guide to what it should cost in the future, and it is the latter that counts in forward pricing. The contractor might have had reasons for not agreeing to less than \$105 that were as good, in his view, regardless of whether his cost experience was \$100 or \$90. The Government's maximum of \$105 may have derived from an analysis which did not depend on the experienced costs for the item. Or the \$90 price might not have had any real significance for the future—as in the case of an extraordinary distress sale. In short, the separate agreement on this cost element involved an implied understanding that the contingency factor was \$5 so long as the cost experience factor was assumed to be \$100, but this understanding did not and could not necessarily imply that the \$5 contingency factor would hold good if the cost experience factor had been \$90 or some other amount, since the contingency factor in forward pricing is the result of bargaining rather than the product of a mathematical calculation.

To fix correctly the effect, if any, that an overstatement of cost data had on a contract price, it is necessary for the Government's price negotiator to determine to what extent—in his best judgment—the agreed price would have been different if the cost data had been properly disclosed. We do not suggest that negotiation of separate cost element agreements, if otherwise practicable and consistent with the Government's interests, would not simplify the difficulties of making such determinations in some cases. We simply point out that the separate agreement technique would not eliminate these difficulties and that—as shown above—it is generally impracticable and inconsistent with the Government's interests.

In conclusion, let us reiterate that the right to price adjustments to compensate for defects in contractor cost data is important; we have every intention of exercising it fully whenever it arises. But this does not mean that we should try to force price negotiations into rigidly separate cost-element agreements for the sole purpose of making it easier to invoke the right to price adjustment if defects should later appear. It would be equally wrong to deny ourselves use of our most effective negotiating techniques simply to facilitate after-the-fact audit. The requirements for accurate, complete, and current cost or pricing data and for price adjustment provisions were intended to aid sound pricing techniques—not to stifle them.

Sincerely,

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