



ACQUISITION  
AND SUSTAINMENT

## THE UNDER SECRETARY OF DEFENSE

3010 DEFENSE PENTAGON  
WASHINGTON, DC 20301-3010

The Honorable Elizabeth Warren  
United States Senate  
Washington, DC 20510

MAY 15 2020

Dear Senator Warren:

Thank you for your April 30, 2020, letter concerning the Department's decision to increase the progress payment rate for certain defense contracts. As you know, progress payments are utilized on long term, fixed price contracts where time from contract award to commencement of delivery can span well over a year. As such, they are typically but not exclusively used on large weapon system contracts that are executed by our major prime contractors. Progress payment invoices represent about 0.1 percent of Department of Defense (DoD) monthly invoices but do account for 7-10 percent of the monthly dollars paid.

The Department shares your concern that our defense industrial base (DIB) at all levels remains viable and strong in order to support our mission. This is precisely why we moved forward quickly with the progress payment rate change once we started to understand the severe impacts experienced by the DIB as a result of the COVID-19 pandemic. By mid-March 2020, senior Department officials had multiple discussions with the leaders of major DIB companies who noted that many companies in the supply chain were experiencing financial distress because of COVID-19 impacts. Also in mid-March, the Department initiated calls three times a week with over a dozen industry associations that represent our defense companies, large and small. The associations all noted that the number one concern across the industrial base was liquidity.

Increasing the progress payment rate provided the Department an avenue to infuse much needed liquidity to small and medium sized companies, either directly or through the major primes. Even before the rate change was in effect, the major primes took initiative to identify and target financial assistance to struggling companies. Payment advances were made in the tens of millions of dollars to immediately assist those in need, and as DoD's increased payments went into effect, the primes have flowed hundreds of millions in payments to the supply base. At the time of your letter, DoD had sent \$1.1 billion in extra payments related to the rate increase to DoD contracts, and the major primes had flowed an equal amount to the supply chain. Since supplier cost tends to account for about 70 percent of the cost in major contracts, this means primes have advanced more payments to suppliers than payments received by DoD in the early stages of this pandemic. As stated in one of our calls with the industrial associations, "the flow down of cash from DoD and the prime contractors has been the key to many small businesses surviving or not."

Like you, the Department is committed to using taxpayer funds wisely and ensuring that contractors do not "profiteer" during the crisis. As you are aware, the Government pays progress payments to contractors at a rate less than the total cost incurred. While the Department raised the rate to improve contractor cash flow, contractors still have to complete deliveries in order to receive full payment on the contracts. Changing the progress payment rate does not directly

affect profitability on any contract nor does it serve as a subsidy; it is money DoD owes and will pay in the performance of the contract. We accelerated the amount of cash the contractor would have otherwise received which is what is needed during this time of economic distress. As noted, the large companies have flowed down and accelerated their payments to their suppliers. And as of this letter, it is our understanding that none of the major Defense primes have sought CARES Act loans.

The Department is diligent to guard against potential waste, fraud, and abuse. As discussed, these payments represent cost already incurred for work performed on our contracts. The Defense Contract Management Agency (DCMA) is responsible for administering and approving progress payment invoices submitted by contractors. At the start of a contract, any new progress payment request is thoroughly evaluated by a team of technical, quality assurance, and cost experts to perform a risk assessment and review metrics and processes like the payment baseline and the methodology used to calculate the percentage of performance. Subsequent invoices continue to be evaluated by DCMA experts before approval to issue the payment. Through this process, DoD believes the potential for waste, fraud, and abuse is mitigated. Administrative Contracting Officers are trained to monitor for waste, fraud, and abuse and to report any questionable activity to the dedicated Contract Integrity Center.

We are united with our industry partners in ensuring the supply base remains as healthy as possible both during this crisis and after. In addition, beyond our current national emergency, DoD continues to stress its desire that companies invest in capital and research and development (R&D) so that our industrial base stays on the cutting edge of production efficiency and innovation. Capital and R&D spending by the major companies have been consistent in recent years to historical trends across strong and weaker economic periods. As we meet with the large defense contractors and the major industry associations, training of the industrial workforce is a frequent topic. The information we have from them indicates they have spent hundreds of millions of dollars in the last couple of years in work force development and training. The enclosed provides answers to your specific questions.

Thank you again for your support of the Department and its mission.

Sincerely,

A handwritten signature in black ink, appearing to read "Ellen M. Lord". The signature is fluid and cursive, with the first name "Ellen" being more prominent.

Ellen M. Lord

Enclosure:  
As stated

**RESPONSES TO QUESTIONS**  
**Senator Warren Letter dated April 30, 2020**

1. What analyses did the Department conduct to determine if the additional progress payments are necessary for national security purposes?

**Response:** Service Acquisition Executives, who had been in contact with major prime contractors, and industry associations, which represent supply and service providers of all sizes and geographic locations, identified liquidity as the paramount issue facing the Defense Industrial Base during the COVID-19 national emergency.

Accordingly, a qualitative approach was used to establish the timeliest and most efficient way to prevent the loss of critical skilled labor, sources of supply, and warfighter capabilities to support the President's March 13, 2020, "Proclamation on Declaring a National Emergency Concerning the Novel Coronavirus Disease (COVID-19) Outbreak." The Service Senior Acquisition Executives and Senior Procurement Executives agreed with the policy decision that raising the progress payment rate increased liquidity for businesses of all sizes, thus, having a positive impact on labor retention and material throughput. Cost-based progress payments are a form of government financing used for fixed price contracts in recognition of the need for working capital, long lead items, and work in process expenditures. Progress payments provide interim financing for a contractually stated percentage of allowable costs incurred for undelivered and uninvoiced items. For large businesses, the progress payment rate was increased from 80 percent to 90 percent; for small businesses, the progress payment rate was increased from 90 percent to 95 percent. As contract items are delivered and accepted, progress payments are reduced (liquidated) against payments due to the contractor for completed items stated in the contract. Furthermore, the Progress Payments clause gives the Government title to all of the materials, work-in-process, finished goods, and other items of property for which progress payments have been made (Federal Acquisition Regulation (FAR) 32.503-14). We see this policy as the best way to increase liquidity while continuing to align payment with performance.

2. In a press conference on April 30, 2020, you noted that the Department of Defense (DoD) has allocated \$3 billion worth of increased progress payments to defense contractors under the new rates and that you project this figure to be the total amount of payments under this policy, given that you identified approximately 1,400 outstanding contracts that would receive these payments. Which five contractors will receive the most funds?

**Response:** According to the Defense Contract Management Agency (DCMA), the five contractors that will receive the largest disbursements through the increased progress payment rate are Northrop Grumman Systems; United Launch Services, LLC; Raytheon Company; Lockheed Martin Corporation; and the Boeing Company. It is important to remember that disbursements to prime contractors include payments to all tiers of its supply chain.

3. What measures are in place to ensure that large defense contractors do not divert the increased progress payments from the Department to share buybacks, dividends, or executive salaries?

**Response:** These payments represent costs incurred on our contracts and therefore are used to pay those associated bills (e.g., supplier costs, labor costs). Companies do not divert payments for incurred costs to share buybacks, dividends or executive salaries because contractors must have already incurred costs before they receive the increased progress payments. Progress payments afford protection to the government as they may be suspended based on unsatisfactory progress, contract noncompliance, or delinquency in payment to subcontractors (FAR 32.503-6).

4. In your April 30 press conference, regarding the extent to which large defense contractors will share some of the extra funds they receive from DoD with their smaller supply chain partners, you said, “We have spoken with each of our major prime companies, and they have each confirmed their detailed plans to work with their supply chains to accelerate payments, and to identify distressed companies and small businesses.” You commended Lockheed Martin, which “publicly committed to accelerating \$450 million to their supply chain.” But when asked whether large contractors are being honest and forthcoming about how they are using these extra taxpayer funds, you said, “I always like to trust yet verify [...] So I encourage all of those companies to be as transparent and forthcoming as they can be [...] However I need to rely on CEOs of major primes to come forth with that data.” Aside from relying on voluntary disclosures by executives, what measures are in place to ensure that large defense contractors use the more generous progress payments from the Department to financially sustain smaller contractors? If any of these major companies fail to do so, how will DoD hold them accountable?

**Response:** The Department acted quickly and decisively to mitigate the effects of the COVID-19 pandemic by increasing cash flow to the defense industrial base to preserve its ability to meet mission requirements by insuring its economic viability at all levels. A key element of this effort was to increase the progress payment rate to 90 percent for large businesses and 95 percent for small businesses. DoD has sought to ensure that the major prime contractors are likewise flowing down increased payments to its supply chain.

Concurrently, major prime contractors swiftly took action as the defense industrial base was confronted with the challenges of COVID-19. In some cases, major prime contractors used corporate funds to accelerate payments to at-risk suppliers in advance of payments received from DoD. Major primes are in regular communication with their suppliers to monitor financial issues and have prepared mitigation plans to lessen the impact of COVID-19, targeting small and medium-sized businesses, by providing experts to advise small businesses, facilitating delivery by modifying inspection and delivery terms, and revising payment terms. Although there is no privity of contract between DoD and its prime contractor’s lower tiered vendors, each of the major prime contractors has committed to share with DoD its efforts to maintain and monitor its supplier base. Lockheed Martin is publicly tracking its commitment to flow down \$450 million of advanced payments to its distressed supplier base.

Through triweekly phone calls with industry associations and major prime contractors, and other regularly-established forums, Department representatives have communicated DoD's desire for increased prime contract financing to be flowed down to suppliers. DCMA Contract Note 20-11, accompanying modifications increasing the progress payment rate explicitly stated, “[t]his deviation is applicable to all subcontracts; therefore, should be flowed down to the prime contractor’s subcontractors as well.” The “Contractor's Request for Progress Payment” form provides a breakdown of subcontractor financing, which the Department expects prime

contractors to execute to the fullest extent in conjunction with their obligations to their suppliers. We expect to see significant increases in these values, reflecting the cash infusion provided to prime contractors. We have received confirmation from the major prime contractors that they have expedited payments and/or flowed down increased progress payment rates to its subcontractors.

In parallel, DCMA and the Defense Logistics Agency (DLA) are also tracking distressed contractors on a regular basis. As of the first week of May, the number of company closures is continuing to decline, which we believe is the result of combined government and prime contract efforts to increase liquidity throughout the defense industrial base.

5. Given the Department's recent guidance designating the Defense Industrial Base as "critical infrastructure" and directing contractors to continue work is apparently not legally binding, and that you "expect our Defense Industrial Base to follow [Centers for Disease Control and Prevention] guidelines for worker safety," what is the Department's plan to reconcile efforts to continue contract work with mandatory orders by state and local governments to cease work in order to stop the coronavirus?

**Response:** The Department expects contractors to reconcile efforts to continue performance with mandatory state and local stop work orders. Every state and local shutdown or stay at home order contains exceptions for essential workers or government operations, and the Department of Homeland Security has determined that the Defense Industrial Base, along with other key market sectors like Communications, Healthcare and Public Health, Transportation Systems, Energy, Financial, Food and Agriculture, and Information Technology are all considered essential critical infrastructure workforce. Therefore, wherever reasonably possible, we expect contractors to continue performing on contracts that support critical national defense. We provided additional guidance to contractors allowing them to consider ways of balancing their "essentiality" against reasonable protections for their employees, such as requiring the wearing of personal protective equipment, enabling social distancing, and increasing shifts to reduce the number of employees per shift. Every situation is different, and we expect each contractor to strike an appropriate balance to achieve the desired outcome of stopping the spread of disease while supporting mission needs.

6. In your April 30 press conference, you observed, "There may well be another significant [coronavirus] outbreak this fall." If another coronavirus outbreak were to occur later this year, will the Department extend this progress payments policy, and what are the criteria for deciding when to end it?

**Response:** In Class Deviation 2020-O0010, the Department states that increased progress payment rates are in effect until rescinded. The Department anticipates that the class deviation increasing the progress payment rate will be rescinded when the national emergency is over or the clause is no longer needed. We intentionally decided not to tie this policy to a specific date or event due to the uncertainty of the current crisis. We will monitor the situation and the operational and economic need for its use.