

## National Defense Authorization Act for FY 2006 Impacts Government Contracts Sector

Just before Christmas, Congress finally completed work and passed the National Defense Authorization Act for Fiscal Year 2006. The FY 2006 Act contains a number of provisions of interest to contractors which we discuss briefly below.

The insights into this latest legislation are provided in part by a new member of our firm, [Mary Ellen Fraser](#). Mary Ellen served as Counsel to the House Armed Services Committee. After completing work on the FY 2006 Act she joined McKenna Long & Aldridge LLP on January 3 as Of Counsel in the Government Contracts Department.

### Congress Strengthens Nunn-McCurdy

Uncontrolled cost growth in Pentagon major acquisition programs has been the subject of political and public attention inside and outside the Beltway for decades. In 1982, in what was titled the Nunn-McCurdy provision, Congress attempted to limit skyrocketing defense acquisition costs by requiring the Secretary of Defense to notify Congress when cost growth reached 15 percent of a program's baseline estimate and to cancel programs when cost growth hit 25 percent of the baseline. See 10 USC § 2433. To avoid cancellation at the 25 percent cost growth threshold, the Secretary needed to certify to Congress justification for continuation of the program.

Undaunted, the Pentagon interpreted the Nunn-McCurdy provision to provide that notice and cancellation were triggered only when cost growth reached the respective thresholds as measured against the *baseline estimate*. This permitted the Pentagon to *rebaseline* a program's estimated cost from time to time and, as a result, avoid either reporting or facing a cancellation.

In response to this perceived loophole in the Nunn-McCurdy provision, Section 803 of the FY 2006 Act modifies the way the Pentagon must examine cost growth for major defense acquisition programs. Effective immediately, the Secretary of Defense is required to measure cost growth for all major defense acquisition programs against not only the current baseline estimate, but also the *original baseline estimate*. No longer can the Pentagon rely on a "re-established baseline estimate" for purposes of determining whether there is a Nunn-McCurdy breach.

The new provision introduces two new terms: "significant cost growth threshold" and "critical cost growth threshold." "Significant cost growth threshold" means a 15 percent cost increase in the program over the *current* baseline estimate or a 30 percent cost increase over the *original* baseline estimate. A "critical cost growth threshold" is defined as a 25 percent cost growth over the *current* baseline estimate

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or a 50 percent increase over the *original* baseline estimate.

In those instances where a program reaches the “critical cost growth threshold” the program is cancelled unless the Secretary certifies to Congress that the program is essential to national security, there are no alternatives, and there is management control over the program. The Secretary must also assess the cost of alternative systems or capabilities. Each of these are additions to the certification provided for in 1982.

While this is a change to internal Pentagon management practices, we think it is important to industry as well. In the current environment of Pentagon restructuring and transformation, large defense acquisition programs are targets for cancellation particularly where cost growth cannot be explained or justified. This new provision makes it more difficult for the Pentagon to hide such programs which could put programs that are significant elements of a contractor’s portfolio in greater jeopardy. We have anticipated a rash of terminations for convenience of weapons systems and some already have occurred. This provision could heighten the trend leading to large program terminations.

### **New Hurdles in Defense Acquisition Process**

Section 801 of the FY 2006 Act makes it more difficult for the Pentagon to move major defense acquisition programs through the acquisition process. Congressional frustration with cost and the requirements growth of programs within the Department of Defense have outweighed any impetus to simplify the acquisition process. Section 801 adds a new certification the Pentagon must make before a major defense acquisition program may proceed to the system development and demonstration phase, commonly known as Milestone B. Under the new requirement, the Pentagon must certify that the program is affordable, not only in the current fiscal year, but also in context of the future years' defense program, that an analysis of alternatives has been completed and that the program “is affordable when considering the ability of the DoD to accomplish the program’s mission using alternative systems.” To further emphasize Congressional mistrust of the current process, the Pentagon also must certify that the Joint Requirements Oversight Council has accomplished its statutory duties, which include evaluating program alternatives, and that the program complies with all relevant policies, regulations and directives of the Department. Congress also codified the agency requirement that technology in the program must be demonstrated in a relevant environment.

The responsibility for the certification falls squarely on the Pentagon, but industry must take action to ensure the Pentagon can easily make the necessary certifications, or it will risk losing a major program.

### **Buy American**

Buy American requirements have been all the rage since 9/11 and the war on terror. This year was no different. However, the real news on this front relates to the Buy American provisions that were proposed but not included in the FY 2006 Act.

Representative Duncan Hunter (R-CA), chairman of the House Armed Services Committee, who has been and continues to be a major proponent of Buy American restrictions, dropped significant Buy American provisions this year during conference with the Senate. Dropped was a provision prohibiting the Pentagon from buying anything from a foreign company if the country in which that company was organized had any issue before the World Trade Organization. Also dropped was a provision that would stop the Pentagon’s use of the defense procurement memorandum of understanding, a legal mechanism used to waive the Buy American Act.

Chairman Hunter’s actions, however, should not be read as a reversal of interest in Buy American restrictions from the House Armed Services Committee. Rather, we believe it is merely a pause in the continuing debate. This year the conference report for the FY 2006 Act was completed in record time and several matters involving a significant or controversial change in policy were not included in the final conference report. Those matters left on the shelf will assuredly be dusted off in the next session of the 109th Congress.

## Buying Major Weapons Systems as Commercial Items

In the wake of the Air Force's attempt to lease mid-air refueling tanker aircraft under procurement provisions for commercial items, Senator John McCain (R-AZ) included a provision in the FY 2006 Act, which would prohibit the Pentagon from purchasing any major weapons system as a commercial item. Undoubtedly, the Darlene Druyun debacle in connection with the tanker aircraft lease program encouraged Senator McCain to make this proposal.

The conferees amended this proposal in Section 803 of the FY 2006 Act to authorize the purchase of a major weapon system as a commercial item if the Secretary of Defense determines that such treatment is necessary to meet national security objectives. It is unlikely there will be many weapons systems, if any, that will qualify under this requirement.

Should you have any questions about the impact of the FY 2006 Act on government contractors, please contact [Mary Ellen Fraser](mailto:MaryEllen.Fraser@mckennalong.com) at 202.496.7387, [Sandy Hoe](mailto:Sandy.Hoe@mckennalong.com) at 202.496.7562, or [John Clerici](mailto:John.Clerici@mckennalong.com) at 202.496.7574.

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