THE UNDER SECRETARY OF DEFENSE
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WASHINGTON, DC 20301-3010

ACQUISITION,
TECHNOLOGY
AND LOGISTICS

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MEMORANDUM FOR SECRETARIES OF THE MILITARY DEPARTMENTS
DIRECTOR, DEFENSE LOGISTICS AGENCY

SUBJECT: Supplemental Guidance for the Utilities Privatization Program

In 1997, Congress provided authority to privatize utility infrastructure. This authority has enabled the Department to significantly improve the reliability and safety of utility services with a cost avoidance of over $730 million. Significant progress has been made toward conducting privatization evaluations of each utility system at every active and reserve component installation within the United States and overseas, other than those designated for closure under a base closure law. To ensure the completion of this effort and incorporate lessons learned, the DoD Components shall take immediate action to implement the procedures outlined in the attached guidance.

Each Component shall provide DUSD(I&E) with a plan of action and timeline by November 18, 2005, for the completion of all remaining evaluations. The Components shall continue to conduct privatization evaluations and provide quarterly updates to DUSD(I&E) until all remaining evaluations are complete. My point of contact is CAPT Rick Marrs. He can be reached at 703-571-9077 or Richard.Marrs@osd.mil.

Kenneth J. Krieg

Attachment:
As stated

cc:
USD(C)
Director, PA&E
President, DAU

DEPARTMENT OF DEFENSE
SUPPLEMENTAL GUIDANCE
FOR
PRIVATIZING DEFENSE UTILITY SYSTEMS

I. REFERENCES

(a) DEPSECDEF memorandum dated Oct 9, 2002
(b) DUSD(I&E) memorandum dated Mar 11, 2002
(c) DUSD(I&E) memorandum dated Aug 5, 2004
(d) D, DPAP memorandum dated Oct 20, 2004
(e) GAO Report 05-433, dated May 12, 2005

II. PURPOSE

Update guidance and supplement guidance provided by references a through e, above. As DoD Components continue to utilize the authority of 10 U.S.C. § 2688 to improve the reliability and cost efficiencies of providing utility services, this updated guidance will ensure that the Government's long-term interests are protected.

III. POLICY

Reference (a), DEPSECDEF memorandum of October 9, 2002, directed DoD Components to privatize every Government-owned electric, water, wastewater, and natural gas utility system unless security concerns required Federal ownership or privatization was uneconomical. DoD Components are required to complete privatization evaluations for each utility system at every active and reserve component (including National Guard) installation, within the United States and overseas, that is not designated for closure under a base closure law. These evaluations shall continue to be based on the "should cost" which is defined as an independent Government estimate of the cost required to bring the system up to and maintain it at current industry standards. Evaluations shall not be considered complete until all requirements of references (a) and (c) are fully met. Affordability is not a criterion for exempting a utility system or failing to complete an evaluation. For those cases where this guidance cannot be met, submit a waiver request with justification to the Under Secretary of Defense (Acquisition, Technology, and Logistics).

Where the aforementioned utilities privatization evaluation results in an exemption, the Secretary concerned is encouraged to consider the conveyance of a lessor estate to improve utilities services. Though there is no requirement to report progress on these efforts, this guidance applies to all efforts to utilize the authority of 10 U.S.C. § 2688 to convey utility systems. Since these efforts are likely to continue for many years, it is imperative to incorporate procedures for the effective execution of this authority.

Reference (e) identified a number of concerns. The Department's response to that report outlined a plan of action that was developed in coordination with the DoD Components. Immediate actions must be taken to fully incorporate the identified improvements in the evaluation process. This updated guidance provides further details on the necessary actions.

IV. RESPONSIBILITIES

A. DEFENSE COMPONENTS

1. Program Oversight

DoD Components shall take immediate steps to ensure remaining utility systems are evaluated in a timely and efficient manner. In particular, steps shall be taken to reduce the length of time required to complete the evaluation of proposals and reduce the average time to make an award following a Source Selection Authority Decision. In the Fourth Quarter Utilities Privatization Report to USD(AT&L), DoD Components shall include an updated schedule for completing all the required utilities privatization evaluations. The report will also include a summary of efforts taken to address the items in the DoD plan of action for addressing the GAO concerns and efforts taken to improve the timeliness of evaluations. To ensure continued interest in the program, regular and accurate feedback must be provided to the industry participants in the utilities privatization process.

Until all utility privatization evaluations are complete, the DoD Components shall continue to monitor and track the progress of all system evaluations and provide quarterly electronic database updates to DUSD(I&E) within 45 days following the end of each calendar quarter. When submitting updates, all fields of the database shall be accurately and completely populated. The DoD Components shall also submit quarterly status reports to DUSD(I&E) that compare actual progress to the planned schedule and provide comments explaining deviations. These reports shall include updated dates for the privatization milestones "Initial Source Selection Authority Decision Made" and "Final Recommendation to the Service Secretary" for each system.

The House Armed Services Committee Report to accompany the "National Defense Authorization Act for Fiscal Year 2006", H.R. Report 109-89, directs DoD to provide a report on the utilities privatization efforts. To assist in developing the report to Congress as soon as practical and minimize the length of the potential suspension discussed in the report, each Military Department and the Defense Logistics Agency shall provide a report to USD(AT&L) by November 18, 2005 containing:

- A discussion of the methodology by which the Component conducts the economic analyses of proposed utility system conveyances, including the economic analysis, and any guidance issued by the Component related to conducting such economic analysis;

- A list of the steps taken to ensure the reliability of completed economic analyses, including post-conveyance reviews of actual costs and savings to the government versus the cost and savings anticipated in the economic analyses;
- A review of costs and savings to the government resulting from each utility system conveyed using the authority of 10 U.S.C. §2688;
- A discussion of the requirement for consideration equal to the fair market value of a conveyed utility system, and any guidance issued by the Component related to implementing the requirement to obtain the consideration, and the effect of that requirement and guidance on the costs and savings to the government resulting from procuring by contract the utility services provided by the utility system;
- A discussion of the effects that permanent conveyance of ownership in a utility system may have on the ability of the Component to renegotiate contracts for utility services provided by the utility system or to procure such services from another source;
- A discussion of the efforts and direction within the Component to oversee the implementation and use of the utility system conveyance authority of 10 U.S.C. §2688 and to ensure the adequacy of utilities services for a military installation after conveyance of a utility system;
- A discussion of the effect of utility system conveyances on the operating budgets of military installations at which the conveyances were made; and
- Impact of utilities privatization on base operating budgets.

By February 14, 2006, the DoD Components shall provide to USD(AT&L) a Cost/Benefit Analysis Report on the utilities privatization program. This report shall list the number of systems privatized by December 31, 2005 and discuss the aggregate cost avoidance identified in the economic analyses and the combined plant replacement value of privatized systems relative to all utility systems. The report will summarize the costs and benefits identified during program execution. In particular, this report will provide an analysis of the information provided per reference (c) and a discussion of the barriers that prevented privatization, efforts to overcome those barriers, and suggestions for dealing with those barriers in future privatization efforts. Progress on developing specific procedures for providing post award contract management, quality assurance and plans for controlling long term cost growth will be discussed. Any funding shortfalls for full execution of the privatization program shall also be identified. An In-Process Review will be conducted in March 2006 for the DoD Components to brief their reports.

2. Resource Requirements

The DoD Components shall consider and plan for increased costs for utility services contracts resulting from potential privatization projects and system conveyance, and prepare operation and maintenance budgets based upon the expected costs under privatization. If significant shortfalls are anticipated that will impact the utilities privatization efforts, the Components shall advise DUSD(I&E) during the annual program review or earlier, as appropriate.

3. Exemption Procedures

For each exemption submitted, the Military Department Secretary shall certify, with justification, the basis for the exemption to the USD (AT&L). Exemption certifications should include the documentation and justification outlined in reference (c). In the Cost/Benefit Analysis Report required by February 14, 2006, the DoD Components will include an executive summary of the barriers and obstacles identified in the exemption justification. This report should also include a detailed discussion of each of the barriers, efforts taken to overcome them and a list of lessons learned for use in future privatization efforts.

4. Independent Reviews

Under 10 U.S.C. § 2688, the Military Department Secretaries have the responsibility to ensure a proper economic analysis is conducted. The DoD Components shall ensure independent reviews are being conducted for all economic analyses supporting a proposed conveyance. At a minimum, the reviews should verify all relevant guidance has been met and the privatization option is in the best interest of the Government. The results of the reviews and appropriate lessons learned shall be shared with the Utilities Privatization Working Group on a regular basis.

To be considered an independent review, the review shall be performed by personnel with the appropriate expertise for analytical analysis and the reviewer shall be independent from the team that conducted the economic analysis for the Source Selection Authority. A review by headquarters staff may be considered independent, if they were not involved in the original analysis.

5. Validity of Economic Analyses

After a Source Selection Authority Decision (SSAD), communication between the Contracting Officer, Contracting Officer's Technical Representative, and other stakeholders is essential. These stakeholders must identify and account for any changes that may have occurred or errors that have been identified after the economic analysis is complete. Together, this team shall monitor and coordinate post SSAD activity and post award management. Because delays in making contract awards may increase the risk of significant changes after the economic analysis has been conducted, the Military Department Secretary must carefully consider the potential for impacts on the validity of the economic analysis.

6. Procurement Procedures

Prior to awarding a services contract resulting from a utility conveyance, DoD Components are responsible to ensure:

1. Applicable utilities privatization guidance was followed.
2. The scope and economic analysis is valid and current.
3. The Government should-cost estimate reflects the most accurate information available.

4. The period of the analysis shall be at least as long as the anticipated utility service contract.
5. The benefit of residual value is appropriately included in the analysis.
6. An independent review of the analysis has been conducted.
7. The proposed contract price reflects the appropriate consideration for the conveyance.
8. Performance standards reflected in the best value proposal shall be equal to or better than the standards reflected in the updated Government cost estimate.
9. A quality assurance plan has been developed and approved by the appropriate authority.
10. An acquisition plan adequately addresses cost growth control, which includes specifying the appropriate price re-determination methodology, and post award contract administration.
11. Resources required to properly administer the contract have been identified.
12. The contract includes appropriate clauses to protect the Government's interests at the end of the initial contract period.
13. The solicitation is reviewed for legal sufficiency.

B. CONTRACTING AGENCIES

As the DoD contracting center of expertise for utility privatization, the Defense Energy Support Center (DESC) shall develop specific pre-award and post-award procurement procedures for the effective management of utilities services contracts resulting from a utility conveyance. These procedures shall also provide guidance on termination procedures. These standard operating procedures shall incorporate current best business practices and guidance from the DoD Components to effectively deal with the unique aspects of utilities privatization. The procedures shall be made available to other contracting agencies serving the DoD Components. The DoD Components may use these procedures or establish similar procedures. As a minimum, contracting agencies involved in utilities privatization must utilize procedures that address the below issues. Additionally, DESC shall coordinate with the Defense Acquisition University to develop a training program for all contracting officers and DoD Components involved in utilities privatization efforts. By February 14, 2006, DESC shall provide a progress report on efforts to establish these procedures and a training program to DUSD(I&E). DESC and the DoD Components should plan to provide an overview of their progress in these efforts during the In Process Review brief in March 2006.

1. Unique Considerations of Utilities Privatization

Contracting agencies shall adequately train and prepare personnel involved in the administration of the utilities services contracts resulting from a utilities conveyance. Contracting officers and contracting officer's technical representatives must be able to recognize the unique requirements and considerations for these contracts. Contracting officers must be able to use guidance for post-award contract management and contract provisions to ensure that the Government's interests are protected in the long-term utility service contracts and associated real estate documents. In particular, the procurement contracting officer must ensure a smooth

transition to the contract administration officer and the post-award management team. Contracting agencies must provide specific operating procedures to address this critical aspect of the program. Feedback from the DoD Components should be incorporated in making improvements to the procedures.

2. Fair Market Value

Each procurement contracting agency shall publish current standard operating procedures to incorporate Military Department guidance for establishing fair market value of utility systems being considered for conveyance using the authority provided by 10 U.S.C. §2688.

3. Pricing Guidance

By reference (d), contracting agencies are provided with a general deviation from Federal Acquisition Regulations (FAR) Part 31, and specific deviations for interest, other financial costs, and Federal income tax. The reference also provided a waiver to the Cost Accounting Standards (CAS) for certain utilities services contracts resulting from a utility conveyance. Contracting officers shall be knowledgeable of, and proficient in the use of, these FAR deviations and CAS waiver.

4. Asset Purchase Price Recovery

Contracting agencies shall ensure all contracting officers are adequately trained on the concepts of asset purchase price recovery. Contracting officers must understand the ways in which contractors recover outlays for capital investments and associated costs, such as interest and potential income taxes related to a transaction determined to be a Contribution In Aid of Construction (CIAC).

In virtually all cases, the combined amount the contractor receives for the recovery of the purchase price, interest on investment, return on investment, and taxes related to CIAC will exceed the original purchase price of the system. As long as the reviewed costs are determined to be justified and reasonable, and the long-term benefits of the contract exceed the long-term costs relative to continued ownership, this is an acceptable transaction structure to the Government.

5. Post Award Transfer

The Procuring Contract Office (PCO) shall transfer contract administration to a Contracting Administration Office (CAO) as outlined in FAR 42.202. Procedures for transferring this authority must be coordinated with the DoD Component soon after a Source Selection Authority Decision. Those procedures should include an on-site contract transfer briefing with Government and contractor personnel. At a minimum this customized briefing includes discussions of these issues: Administration Contracting Officer (ACO), Contracting Officer's Technical Representative (COTR), and contractor designated representative responsibilities; specific and unique aspects of the contract; terms and conditions; price redetermination period; transition period; operations and maintenance schedules; renewal and

replacement schedules; capital investment and improvement schedules; required submittals; billing method/invoicing procedures; outage reports; meter reading reports; system efficiency reports; recovery plans; excavation permits; controlled access of vehicles; building coordinators; real estate easement/right-of-way; joint inventory requirement; bill of sale; secure area access; performance metrics; points of demarcation; service call procedures/response times; service interruption/contingency plan; digging permit process; new service connections; five year capital improvement plan; contract inspection and oversight and construction standards. The ACO shall ensure that personnel are adequately trained and fully cognizant of the contract prior to assuming responsibility.

6. Post Award Management

ACOs will coordinate with the Procurement Contracting Officer and the DoD Component to:

- Validate the accuracy of the system inventory and required upgrades,
- Validate the Quality Assurance plan,
- Ensure adequate safeguards are in place to ensure reliability of utility service, and
- Ensure contract administration efforts are adequately resourced.