



ACQUISITION,
TECHNOLOGY
AND LOGISTICS

THE UNDER SECRETARY OF DEFENSE

3010 DEFENSE PENTAGON
WASHINGTON, DC 20301-3010

MAR 20 2006

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

SUBJECT: Supplemental Guidance for the Utilities Privatization Program

The National Defense Authorization Act for Fiscal Year 2006 added several provisions to 10 U.S.C. § 2688 to facilitate the Department's ongoing efforts to complete evaluations on all remaining utility systems. The DoD Components shall take immediate action to implement the procedures outlined in the attached supplemental guidance.

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 CDR Rob Tomiak. He can be reached at 703-571-9074 or Robert.Tomiak@osd.mil.



Kenneth J. Krieg

Attachment:
As stated



**DEPARTMENT OF DEFENSE
SUPPLEMENTAL GUIDANCE
FOR
PRIVATIZING DEFENSE UTILITY SYSTEMS**

I. REFERENCES

- (a) OMB Circular A-94, dated Oct 29, 1992
- (b) DoD Instruction 7041.3, dated Nov 7, 1995
- (c) DEPSECDEF memorandum and guidance dated Oct 9, 2002
- (d) DUSD(I&E) memorandum and guidance dated Aug 5, 2004
- (e) DPAP memorandum dated Oct 20, 2004
- (f) GAO Report 05-433, dated May 12, 2005
- (g) USD(AT&L) memorandum dated Nov 2, 2005

II. PURPOSE

Update and supplement guidance provided by references (a) through (f), above. Address changes to 10 U.S.C. § 2688 enacted by Section 2823 of the National Defense Authorization Act for Fiscal Year 2006, Pub. L. 109-163.

III. POLICY

The National Defense Authorization Act for Fiscal Year 2006 updated and modified 10 U.S.C. § 2688, the conveyance authority for utilities privatization. The Department of Defense has reviewed the changes and is providing the following guidance to assist with implementing these changes in the utilities privatization program.

A. Cost Estimate

Section 2688 has been amended to reinstate the requirement for submission to Congress of an economic analysis for each privatized utility system in advance of contract award. The economic analysis will include an explanation as to how margin of error considerations are addressed in developing the independent government cost estimate and carried forward in the price analysis report and cost realism report. References (a) through (c) provide guidance on economic analyses, including margin of error considerations.

B. Fair Market Value

Section 2688 changes the requirements concerning how the Military Departments obtain fair market value when conveying utilities. Military Departments are no longer required to obtain fair market value exclusively through cash payments or rate credits. Military Departments now have the flexibility to seek consideration in a manner other than a payment of the fair market value when the economic analysis demonstrates it is in the best interest of the

government. In making such a decision, all economic impacts of the value estimate shall be considered, including value of money and cost of borrowing and the impact of taxes related to Contribution in Aid of Construction (CIAC). Military Departments may not dispose of the Government's property without receiving an appropriate return; the amount and nature of that return may be determined and represented in a number of ways, depending on the negotiated deal. If the consideration for the sale of the system, including any right-of-way granted in association with it, is represented by other than a payment of fair market value, the economic analysis will indicate what value the Government received for the system. Reference (e) provides further guidance related to Contribution In Aid of Construction (CIAC).

C. Contract Terms

Section 2823 now limits contract terms to 10 years, unless the Secretary concerned determines that a longer term contract not to exceed 50 years will be cost effective and provides an explanation of the need for the longer term contract, along with a comparison of costs between a 10-year contract and the longer-term contract. I hereby re-delegate to the Secretaries of the Military Departments and to the Director of the Defense Logistics Agency the authority to determine the cost effectiveness of a contract term in excess of 10 years, not to exceed 50 years, pursuant to 10 U.S.C. § 2688(d)(2).

Since 1999, the Department of Defense has been entering into 50 year service contracts in connection with privatization of utility systems. Longer term contracts avoid certain potential costs and risks associated with shorter term contracts. These potential costs and risks include: the costs of recurring solicitation and negotiation, increased costs to the Department as a result of requiring contractors to recover the costs of long lived capital equipment over a period matching the contract term rather than equipment's useful life, potentially large end of contract balloon payments, excess costs associated with negotiating with a monopoly supplier unconstrained by contract pricing provisions and potential costs of system reacquisition. The economic analysis shall address these factors, as well as any others of relevance, in its analysis of the question of cost effectiveness related to contract term.

The determination of the cost between a 10 year contract and a longer term contract may be made without requiring separate proposals for each contract term from offerors. The determination may be made by review of similar proposals, discussions with industry, making reasonable assumptions based on historical data or parametric estimating techniques, or any other reasonable means.

D. Temporary Limitation on Conveyance Authority

During each of fiscal years 2006 and 2007, the number of utility systems, or parts of utility systems, for which conveyance contracts may be entered into under 10 U.S.C. § 2688, shall not exceed 25 percent of the total number of utility systems determined to be eligible for privatization under this authority as of January 6, 2006.