

Presenter: Under Secretary of Defense for Acquisition, Technology and Logistics
Frank Kendall
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Remarks by Under Secretary of Defense Frank Kendall in a Media Roundtable

STAFF: We are on, sir.

UNDER SECRETARY OF DEFENSE FRANK KENDALL: Okay. Well, thanks for coming in and for listening in on the phone.

We're releasing the -- the fourth of a series of reports that we've been doing on an annual basis on the performance of the defense acquisition system. Started this series of reports -- started the work on it about five years go.

We put together a -- a cell of analysts and statisticians, drawn largely from the FFRDCs, to work for us. Phil Anton, who is here with me, is a leader of that cell.

And the intent was to try to understand cause and effect in acquisition performance on a statistical basis -- try to correlate the things we were doing with the results we were getting.

My background in acquisition goes back about 40-odd years now, and I'd seen over a good part of that time a number of attempts to reform acquisition that seemed to me to be kind of intuitive and not driven by data. So the idea was to try to have data-driven policies that we could establish some evidence to support that they were -- they were preferred policies because they worked better.

So we set out to do that.

We're -- we relied upon a lot of existing databases, on contracting, and on programs, in particular. The major defense acquisition programs got a lot of attention because that's -- there's more data on them; they're also bigger, in terms of money, and they're more visible.

What I had seen over the years was this oscillation, in some cases, between policies that were tried, people weren't satisfied with the results they were getting; they tried something else, then they still weren't satisfied with the results they were getting so they tried something again -- sometimes repeating ourselves, sometimes not realizing what performance we had in the past, what reaction we had in the past.

The initial analysis kind of confirmed what I think is -- should be obvious, is that the -- the data is very noisy. It's hard to correlate specific action to its specific results.

But we think we have broken through that in a number of areas, and we think we have enough data now that demonstrates a couple of pretty important things.

Most important to me is that the last six years of work that we've put into this in -- while I've been back in the Pentagon has paid off. We are at a 30-year low in cost growth on our major acquisition programs, and we reversed a trend that was in the opposite direction. That's a pretty big deal.

The chart that you see up there on the -- on the screen, for those of you that have it, shows this. This is a weighted -- this is an average over five years of cost growth on contracts. These are our most risky contracts and the ones that we have earned value data on. There are about 1,100 contracts involved in this and there are about 240 programs involved in this.

And you can see how before Goldwater-Nichols things were getting much worse. Our cost growth was increasing substantially.

For the next decade or so after Goldwater-Nichols was put in place in 1986 things get better. I was in the Pentagon for that period of time and I was part of the effort to put more discipline into our system and to control costs and be more realistic in our projections and our planning.

We then went through an era of reinventing government, or transformation, or total system performance, depending upon the exact timeframe, in which things got, on the average, consecutively worse.

When we initiated Better Buying Power Secretary Carter -- then Undersecretary Carter -- and I in 2010, one of the things we wanted to do was focus the efforts in the acquisition workforce on cost control and cost consciousness. And we put a number of things in place to do that. We also wanted to provide better incentives to industry to perform more efficiently.

And the results indicate quite strongly that we were successful. For the last six years, which I've been here six-and-a-half now, we've had very (consistent policy ?) on this.

We've had three iterations of what we call Better Buying Power. The first one was the one that Dr. Carter and I did; the second one was one I did a year or so after he had moved on to be the deputy secretary; and the third one was initiated about a year ago.

All of these, though, have had at their heart sound management of our business relationships with industry so that we set up structures which motivate people to perform more effectively. They also include sound planning on our part, to make sure we're taking a reasonable amount of risk.

None of our new product development programs are zero-risk or low-risk, necessarily even. But you can manage that risk and you can avoid the disastrous programs which we've had occasionally in the past.

So during the last several years we've made what I think is pretty dramatic progress in controlling cost growth on our major programs. We've -- part of that we put affordability caps on our programs to constrain the requirements process so that we don't -- reach does not exceed our grasp, basically.

This latest volume kind of confirms the results that we had last year in our fourth -- our third report. We're continuing the trends on improvement. Most areas continue to look good.

There are a couple of areas which I'm a little concerned about. One of them is competition. Despite having a goal of increasing competition, we're seeing a little bit less competition in the results, so we're putting some attention on that.

One of the things that tracking all these different metrics allows you to do is understand where you're not performing where you want to be and do something about it. So competition is one of the places where we're doing that.

We have focused on the MDAPs. We have also focused on performance by industry.

We are looking now at some of the management information systems, and we also would like to look more at sustainment. We have some data in this volume on sustainment, but what correlates with sustainment cost, particularly. And so we -- we're -- now we're talking about that.

My -- my theme for this past year, 2016, is -- has been sustain the momentum. And there was enough in the results from last year, after a few years of consistent policies in acquisition, to show that we were going in the right direction. So rather than introduce a -- a -- a major new set of initiatives in the last year of the administration, I thought it was important to continue to reinforce the things we had already put in place, so that's what we've been doing.

Last comment I'll make is at the heart of all of this is not the policies that I talk about or even the fact that I'm measuring progress against performance; it's the work of all the people involved in the acquisition system. As my -- my preamble to the report says, it's the professionalism, the hard work, the dedication, the strong incentives, and the support that the workforce has that at the end of the day is going to improve acquisition.

I -- I think we have, frankly, tried to improve acquisition through various measures, which in some cases have been arbitrary, some cases have worked, and some cases have had the opposite of the desired effect. But focusing on the fundamentals and giving us the flexibility to do the right thing for whatever situation we have, and then rewarding our professionals when they do that, is, I think, overall the right approach, which is what -- exactly what we've been trying to do for the last few years.

So I'll stop there and take your questions.

STAFF: All right. We're going to have to bounce around a little bit because I've got people on the phone, as well. So just bear with me.

(Collin ?), why don't you lead off?

Q: Mr. Kendall, not much longer.

MR. KENDALL: We'll see.

Q: I wonder how much of the improvements are due to the fact that you have fewer programs to manage.

MR. KENDALL: There are several things in here, okay? The -- the number of new starts has diminished. That's one of the things I'm concerned about.

I don't think we're putting as many new products into the new product pipeline as we should be. That's related to my concerns that I've expressed many times about technological superiority.

The complexity of our products over time has gone up because of the types of things we're trying to buy, so that tends to push in the opposite direction.

We tried to analyze this data. I -- I didn't want to publish the chart you're looking at without being sure that it accurately reflected what we were doing.

So I think that overall trend to improve is valid, and we have discovered there is an underlying cycle that's budget-related. And it's kind of related to your question, Colin, about are we doing less.

But it's not about how many things you're doing; it's about the -- the budget environment in which you operate. And this is a -- a -- a correlation that Dave McNicol at IDA discovered a couple of years ago, that when budgets are tight we tend to take a lot more risk. And I think it's because we -- we want to do things and we talk ourselves into optimistic plans and funding levels, and then we launch off and find out that we've got problems.

So there is a (counter-budget cycle ?) thing in here where acquisition performance gets a lot worse when budgets are tight -- in terms of the end result, in terms of cost growth.

Even if you take that out -- and in fact, I think we're actually defying that -- that correlation a little bit right now because budgets have been tight, and despite that, we're improving. So we're -- we're -- I'm -- I'm convinced this is real and I'm convinced it correlates to the things we've been doing.

There are other factors. There always are. But I -- I -- I think that the evidence is pretty clear that -- that we're moving in the right direction.

STAFF: (Blaire ?)?

Q: Hey. I wanted to ask about KC-46.

Specifically, in the report it mentions a reach-forward loss of \$1.7 billion. That's a different number than what Boeing has put out, so I'm wondering is that their third-quarter earnings number, or what -- what is that figure?

And then also, have you decided on a penalty for missing the RAA deadline yet? And what's that going to be?

MR. KENDALL: The Air Force -- it's -- it's not a penalty, per se; it's a -- it's a consideration, I think, is the word we'd use in contracting.

But basically the Air Force is working with that and they have a number of possibilities that they're -- they're in discussions with Boeing.

The -- the -- we can get for you the number. The number that's in the book is the one we had at the time we -- we put this together.

Phil, I don't know if you can address that or not.

(UNKNOWN): That's not a quarterly loss. That was the --

MR. KENDALL: Yeah.

(UNKNOWN): -- reported subtotal --

MR. KENDALL: Yeah. That was the net. It's not a quarterly. Their quarterlies have been smaller than that.

Q: Yeah, but does -- but, I mean, does it include the third --

MR. KENDALL: The latest -- the latest one?

(UNKNOWN): It's supposed to, yeah. We got it out of their (SEC ?) --

Q: Okay.

MR. KENDALL: We'll double check and make sure we have the correlation for that.

Q: Okay. Thank you.

STAFF: (Cassandra ?)?

Q: Thank you, Secretary Kendall.

To your point about competition, you see less competition: Does that mean that you are more likely to be cracking down on mergers and acquisitions more than you have in the past? How is that going to change your policy on mergers?

MR. KENDALL: No, I -- I think that the reduction in competitions are an effect of the budget situation. We tend to get competition more at the earlier stages of the big programs, and we tend to -- and for services it's a fairly continuous chain of recompeting on -- for services. But for major programs, at the beginning we have competition up through usually an EMD decision, and then for the production that follows it's sole source.

So I think -- I think that's part of what we're seeing there. It's not a huge shift; it's just in the wrong direction for me. It's a few percentage points.

It does not correlate to the merger and acquisition policy. That policy existed independent of those results. They're not related to each other.

Q: So you don't think that mergers have contributed to the -- to -- to having less competition?

MR. KENDALL: To the lack of competition? I don't think so so far. Nothing that's happened recently, okay, in the M&A rule.

For the most part what drives us to not have competition is that it's not economically viable. You know, we get to EMD and then we have a big bill for EMD. We don't want to pay that twice in order to have competition.

And then when we get into -- and when we get to the point of production our quantities that we're buying aren't enough to sustain two suppliers and drive the cost down enough to justify it, so we end up with a sole source. I think we're just -- more things are at that part of the cycle than there were before.

Q: Can I follow up on that?

Have you seen any evidence of competition at the subsystem level? You've been pushing that, as well.

MR. KENDALL: We're -- that's one of the areas in which we're trying to increase competition. We're trying to break things up more. We're trying to provide paths for more modern technology to get onto programs.

I don't have any analysis in -- in the -- in the -- in this volume at that level, but we're going to try to take a look at lower tiers than the primes going forward. Because a lot of that is managed by the primes, right? So it's harder for us to get the data on that.

Q: (Are you seeing ?) the services do that or require that? Do you --

(CROSSTALK)

MR. KENDALL: I'm not sure how we're going to get at that, but it's one of the things we'd like to try to understand.

STAFF: Let me switch to the phone for a second.

(Doug Cameron ?), are you on the line?

(Steve Terpack ?)? (John Terpack ?), I'm sorry.

Q: (John Terpack ?).

STAFF: Yeah. Do you have any questions?

Q: Yes.

STAFF: Go ahead.

Q: Mr. Kendall, with -- with respect to munitions, right now the Air Force is struggling to build its -- (inaudible). Can you hear me?

MR. KENDALL: Somebody's coming --

(CROSSTALK)

STAFF: Whoa, guys. Just (John Terpack ?) speaking right now. Everyone else, please mute your phones.

Go ahead, (John ?).

Q: Thank you.

Once again, the Air Force is using more munitions right now than they can actually make. And I've talked with the Air Force acquisition people. They say this is one of those situations where they didn't buy the -- the (tech data package ?) back in the '90s -- (inaudible).

So there anything you can do retroactively or -- (inaudible)? Is there any way to use competition to increase the number of munitions you're making for what's obviously a very serious situation?

MR. KENDALL: We do have some situations historically where we did not acquire intellectual property rights to allow us to bring in a second source. Our -- our -- our problem with munitions right now, because the expenditure rates in the ongoing conflicts, is something that's very hard to address in the short term.

We're looking at how we're managing our stockage and we're trying to increase production. But the lead time on production for a lot of these munitions is on the order of two years, so that -- that's really not fast enough. So we are increasing production rates in some areas because we do expect that the need for some of these munitions is going to continue for some time.

We also have the balancing act in every budget of trying to, you know, fund within the constraints that we have the right balance of capabilities. And I think it's probably fair to say that traditionally and historically munitions have tended to be a bill-payer of that process.

We're addressing that as we go through building this budget to see if we need to make some corrective action there. In prior budgets we did it up to a certain point, but going back two or three years, I don't think we foresaw the -- the usage rates that we're seeing right now.

STAFF: All right.

(Tony ?), I saw you down there. Go ahead.

Q: Hi, Mr. Kendall. (Tony ?), from Inside Defense.

So this is a point you've made before, in terms of outside legislative tinkering to try and improve the acquisition system, but the report seems to really crystalize all those points -- the myth-busters going through each point.

Has this become a legacy concern for you, that this is something you feel you need to do to defend the progress that has been made in the last six years over what has become just one of the largest reams of suggestions that have come from the Hill?

MR. KENDALL: There's never in my career been a shortage of ideas about how to make acquisition better. What's been -- what there's been a shortage of is data to support whether those ideas are good or not, and that's why we do the report. And I hope it will inform, you know, people in the legislature who are -- who are drafting other -- other provisions.

The thing I've asked the Hill repeatedly to do is -- is not over-constrain us. We deal with so many different situations. There are so many different levels of risk; there are so many different levels of urgency; there -- there are a whole host of factors that affect what kind of a business deal we want to have and -- and what kind of an acquisition strategy and plan we want to have to set up a program to do whatever we're trying to do. So we need flexibility.

A lot of the things that are good practices -- competitive prototyping, for example -- aren't always necessary or -- or the right thing to do. They can be a waste of money.

In some cases we start a program at a milestone A: We need to do risk reduction. In some cases we start at a milestone B: We need to do development

for production. In some cases we can start at production because there's already a product out there that's very close to what we need.

So we need the flexibility to do all those things.

We also need the flexibility to use different contracting vehicles depending upon the risk profile that we're dealing with, level of maturity of the technology, and how we want to incentive industry. And so all of those things -- and the urgency. All of those things come together when we try to lay out the best program that we can.

I -- I -- you know, I -- I know it's frustrating. It's frustrating to me to see programs that get in trouble. I'm dealing with a couple of those right now. And it would be nice to just write a rule that prevented that from happening.

The problem is that the tool that the legislature has is very limited and it tends to be rigid. There is only so much you can do to make somebody a better program manager or a better engineer by writing a law.

Unfortunately, the real work to do that has to happen within the department. And the real work to work with the -- working with industry to get the best possible performance out of industry has to happen within the department. And there are only so many -- so far you can go by writing, you know, regulations, essentially, to help you do that.

There really is -- at the end of the day there is no substitute for dedicated, professional people who understand what they have to do and how to do it based on their experience and their expertise. And one of the elements of Better Buying Power since the second iteration -- and I think if Secretary Carter and I talk he would agree that we probably should have put it in the first one -- was building professionalism.

So one of the things that the -- the Congress can do that really does help is things that make it easier for us to attract people into acquisition and make it easier for us to maintain the workforce and to develop the professional skillsets and expertise of the workforce.

You do have to be a little bit careful, again, about rigid rules. There is a proposal right now that -- I think this actually may be in statute, but we're forced to waive it quite a bit -- about how long a program manager stays with a program.

It -- it's generally -- we didn't, by the way, in all this analysis see a strong correlation between program manager tenure and success on a program. I see a very strong correlation all the time between program manager capability and success on a program, but that's a harder thing to measure.

The -- but anyway, the -- the provision that was put in the law is -- would -- is a career-killer for people who are in uniform who are in acquisition because they just can't stay in one job that long and expect to ever be promoted. They haven't done the things they need to do to broaden themselves.

So anyway, again, it's a case where what I would really welcome and do welcome, and we -- we do have a lot of this, is a dialogue with the -- with the Congress to try to work through all this and make sure that they're well-

informed, frankly, before they make any decisions about what to put in -- into statute.

STAFF: Sir, go ahead.

Q: Yeah --

STAFF: What's your name?

Q: (James Drew ?), from (MJ Shwink ?).

STAFF: (James ?). Go ahead.

Q: Two -- two of the -- the longest programs that are out there were the F-22 and the F-35. Now in January the Air Force is going to embark on its analysis of alternatives for penetrating counterair, it's next -- next fighter. Meanwhile, you've got the Navy working on F/A-XX.

What's your advice to these programs as they go forward and to the services about not repeating these extended timelines for achieving (IOC ?)?

MR. KENDALL: The timelines for achieving (IOC ?) come from the complexity of the product that we're trying to build. And the reason the F-35 has taken so long is because it's an incredibly complex weapon system.

It's also an incredibly good weapon system. So there is a relationship between the complexity and what you get. It has incredibly sophisticated sensors. It has great stealth characteristics. It has an integrated suite of capabilities that is -- is very, very useful to the operator and to teams of operators in different aircraft working together.

So all of that capability came at a cost of complexity, which means more time, more engineering, more testing. At the end of the day, I think we're getting a remarkable product in the F-35.

There are some things I would have done differently, okay? I think looking forward to the next generation, if you will, I -- I would prefer not to structure something so that we put so much capability in the hands of one prime contractor.

I just think it's healthy to have, as we were talking about earlier, more -- more competition. And we made a decision which really limited competition for that class of aircraft. We're trying to reopen it as we -- as we go forward.

We have some work going on already with the potential primes for next-generation air tactical capability. There are still more questions than answers about what type of aircraft we're going to buy. There are questions about manned versus unmanned; there are questions about range payload; how sophisticated an aircraft we're going to want this to be; whether -- where it fits in the spectrum of things relative to the current fleet, relative to the F-35, in particular.

So we're -- we're working together on that. The services are working together. I do not envision a common aircraft, but I do envision a lot of common subsystems and systems between the different services' aircraft.

They -- there is an appetite for increased range, and there is an appetite for increased payload, which is always the case, but I think it -- it -- it's more so now, given some of the missile threats that we're seeing. And it's not the missile threats to the aircraft themselves, necessarily; it's the threats to our airbases and to our aircraft carriers.

Q: And just on that, do you think that they need to put some more realism into their baseline program schedules and cost estimates so that you don't have these --

(CROSSTALK)

MR. KENDALL: Every program should put realism into its cost estimates, and it's -- and that's one of the things that I -- that I basically try to do. There is a -- the reason my position was created back in 1986 -- predecessor, anyway -- was to have someone who would bring in -- somebody's got a call coming in -- someone who would bring in some independent and objective look at the realism in the projected programs that people were planning.

That deteriorating performance that's on the chart prior to Goldwater-Nichols is the reason there was a Packard Commission. There had been a lot of optimism in programs and a lot of major, you know, significant overruns.

So one of the things I try to do is to keep that -- keep -- keep our -- make sure our programs are executable. I -- I tell the services that I have two requirements. I want their programs to be affordable, which means that they'll be able to fit in future budgets; and I want them to be executable, which means that they have a reasonable chance of being executed with the money that's been put in the -- in the budget and with the schedule and the cost and content and so on.

That's why we do the independent review of the programs and -- for which I am the Milestone Decision Authority. And it -- it has not always been appreciated.

There are times when I have directed services to add money because I didn't think what they had was realistic. There have been times when I've told them to add test assets because I didn't think that was appropriately structured. And there have been times when I told them to add schedule because I thought they were being unrealistic there.

Our history is, and I think will probably remain to some degree, more overruns than underruns. We do have some underruns. It's not (universal ?).

And what I'm trying to prevent fundamentally is the disastrous outliers, the things that blow up in a factor of two or three over what was anticipated.

I -- F-35 is in that category. It's R&D phase at least doubled. The FCS program, the Future Combat Systems program for the Army is another one that I had some experience with. Going back quite a few years, the A-12, okay?

I -- I -- and the person in our office has not always been successful in doing this. Some -- a lot of those programs happened when there wasn't an AT&L or the equivalent.

But overall I think we have prevented a lot of those, and we continue to do that. The record for my six years in -- in the position so far looks pretty good.

But unfortunately, there is a long lag time. It takes several years from the time you make a decision about a program plan till you get far enough into the plan to understand how well you're going to be able to execute.

But I -- I think we have created a culture where there is a much more realistic set of plans than -- than there might be otherwise -- (inaudible).

Q: Have --

STAFF: (Collin ?), let me -- let me give (Aaron ?) a chance to ask.

And then, Ellen, I know you're -- (inaudible).

It's true. He needs it.

Q: Sir. So you mentioned potential commonality at subsystems with the next-generation fighter. You've mentioned something similar, I believe, in the past on GBSB and some of the Navy weapon programs, as well.

So I guess a two-part question: One, what does commonality for GBSB for the nuclear architecture -- (inaudible) -- look like to you? And two, is commonality at the subsystem level something that you want to (see driven ?) more to the programs in the future kind of broadly across the Pentagon?

MR. KENDALL: Yeah. Complete commonality in weapon system depends upon people having basically the same requirement. So we can get that in the ground forces between the Marine Corps and the -- and the Army fairly often.

Commonality in other cases is at the component or subsystem level. In the case of the -- the ICBM, the GBSB, ground-based strategic deterrent, we're looking for some commonality between that system and the weapon system that the Navy's developed for the SSBNs. It's not going to be 100 percent. We've looked -- that's not practical.

The way we're proceeding on GBSB right now is we're letting the competitors sort out how to be more competitive through introducing commonality into their designs. And where they have a case for that they -- they'll propose it, but where there is a case to do something new that might be less expensive or even more capable, then they can propose that.

So we use a competitive process to try to -- try to get that -- to get the right balance between commonality and -- and -- and a distinct, different product.

Q: And then just, I think, more broad-based is that going forward, understanding (the base ?) on each weapon system. But is that something that you want competitors to look at? I mean, do you just say, there is stuff you can find that's --

MR. KENDALL: Oh, yeah. Absolutely. They have been encouraged to do that. That's right.

When you can use an existing component it'll reduce your cost. Cost is usually one of the major determiners in all of our source selections.

But we are also doing something to incentivize the performance. This is a new thing. It's part of Better Buying Power.

It's the -- it -- it -- my experience has been that traditionally people would bid the lowest cost threshold level of capability product because they would assume that would give them a better chance to win. And, in fact, it has.

What we've been doing for the last few years is tell people how much more we're willing to pay for higher levels of performance, and then if they bring in that higher level of performance in their bid and can justify it, we give them a credit in source selection for that value that they've provided. So it enhances their chance to win even if they're more expensive, as long as they're below that delta that we're willing to pay.

And that's worked very successfully on a number of programs. So it -- I'm -- one of the central tenets of Better Buying Power 3.0 is about increasing innovation and technical excellence and getting better performance to our warfighters. And that mechanism I just described is one of the ways we're trying to do that.

STAFF: Ellen, you've been waiting longest.

Q: Mr. Kendall, Ellen Mitchell with POLITICO.

You said pretty early on in your report that most attempts to direct legislative acquisition magic have been counterproductive, and then you said today that you've asked the Hill not to over-constrain Pentagon acquisition. Do you see Senator McCain's attempt to dismantle your position as one of these counterproductive actions? And have you talked --

MR. KENDALL: You're asking me that?

(Laughter.)

Q: Have you talked to the lawmakers since this rule has come up?

STAFF: (I might ?) -- is this report a reason to keep your position?

MR. KENDALL: Well, I -- I think abolishing my position in the face of that is probably a bad decision.

I think my position has worked successfully. I think the secretary of defense needs someone in the secretary of defense's office who can effectively oversee service acquisition programs for him, and I -- I think that's a very important feature of how you -- anybody would -- would, I think, want to organize a department of defense, at least as far as acquisition is concerned.

I think sometimes the role of -- my role, my office's role, is misunderstood. I do not manage any programs. The services manage all of the programs.

I make a small number of key decisions that basically set our programs up for success or failure, and those are the milestone decisions. That's what the

Milestone Decision Authority is. He makes milestone decisions. He doesn't manage a program.

And the milestones are the start of development, the start of production, and full-rate production. And those -- those are basically the times at which you commit large amounts of money and -- and a significant amount of time to a major effort, and usually a contract or contracts, to do a body of work.

And the point of those milestone decisions is to review the plans and the funding and the schedule to do that work to make sure it's adequate and reasonable and has a fair chance of success. Then the services are in charge of executing, and they are basically entirely in charge of executing.

There have been a couple of exceptions where I've been much more engaged. I was very engaged on health records -- electronic health records, because Secretary Hagel asked me to take that one on personally. I've also been very engaged on the OCX program. And for a time I was very engaged on F-35, when it was having much more trouble than it is now.

So there are times when I think someone in my position needs to step in and take a more hands-on approach, but it's generally when there's a problem that's a serious problem that needs to be solved.

So anyway, I -- I -- I think it would be a mistake to change that. I don't know how the legislation will come out. I know they're in conference and they're -- they're -- they're working on it.

I -- I think it's fair to say that the services don't always like the fact that I can change their plans, and I think that industry doesn't always like the fact that I'm setting up incentives that make them work harder to -- to earn the money that they earn. But I think at the end of the day it's better for the taxpayers, better for the department.

Q: Have you tried to meet with the Senate Armed Services or McCain to discuss --

MR. KENDALL: I have. I've met with both committees. I've met with staff. I haven't recently met with Senator McCain.

I'll give you an example of the type of thing where we had a dialogue and I thought it was very constructive. The original bill that the HASC put out -- and they put it out as -- they -- they -- they filed it as a piece of legislation for the purpose of having some discussion about it before it went into -- came in the NDAA. And one of the things that was in that original draft was a very rigid requirement about open systems and (modular ?) designs.

And I spoke with Chairman Thornberry on more than one occasion, I think, about this, kind of explained to him why that very rigid thing would constrain our flexibility too much, that there are times when the design is too compressed, too tight, too integrated to have those features, and we need the flexibility to make good decision to do that when it's -- when it's necessary. And he agreed with that, so he changed the legislation. I thought that was a very constructive and helpful process.

STAFF: Bloomberg, (Andrew ??)?

Q: To -- just to follow up on that a little bit, in addition to the changes contemplated in the NDAA, yesterday at the Defense Business Board (General Panaro ?) gave a presentation that suggested that there would possibly be efficiencies unlocked by moving logistics out from your office. Does the data you collect suggest any, to you, any need for structural changes within your office?

MR. KENDALL: I'm not aware of the presentation, but I will address the topic.

One of the things that I think is critical is to keep the various phases of the acquisition of a product under the same management structure, that the things you do in development and the things you do in production determine the cost you're going to have to bear when you're in sustainment and doing logistics. So as far as program management is concerned, those phases need to be overseen by the same person.

And there's a tendency if you don't have that -- and I did live in the Pentagon when it was different than that -- there is a tendency to ignore those longer-term costs in favor of some near-term things, such as current cost and schedule, and such as current technical performance.

That's a mistake. You need to take those into account in the trade space when you make those earlier decisions, because all those costs are determined by what you do early on, what you do in the design. So it would be a mistake to separate them.

The next round of Better Buying Power, should I be here to do it, -- or somebody else do it, maybe -- is going to be focused on the sustainment phase because that's where we spend most of the money.

The development phase gets all the attention because that's where we have the biggest overruns. It's the hardest phase; it's the most risky phase. But it's only about 10 percent or so of the cost of a weapon system. Then there's another 40, 50 percent that's the cost of production, and the balance is all in sustainment.

So by far most of the cost that we bear is in the sustainment phase.

We don't have as good a data on it. There's not -- there's a little bit of data now in the report on that. Phil and I have been talking about how we get better -- a better understanding of where our sustainment costs are coming from and how we can address them.

We've done a lot of work in F-35 to bring sustainment costs down. That's -- that's gotten an enormous amount of attention.

We need to provide that same kind of attention on other programs, and we need to identify best practices that will allow us to do that. Part of that will be having the willingness to do upfront investments that get you a more maintainable and supportable product when it gets to the field. That -- that happens when you have all of that under the same individual for -- for management.

STAFF: Couple more.

(Collin ?)?

Q: Have there been any programs that met the requirements of the legislation passed last year that the services would actually have authority on? Are there any yet?

MR. KENDALL: Well, the -- the way the law is structured -- and it went into effect on I think the 1st of October -- the way the law is structured the secretary has some discretion. So what we've been doing is looking at the programs and deciding, and he has just recently made a decision about some of the programs that are coming up, in terms of whether I'll be the MDA or the service will be the -- be the MDA.

Q: And what programs are those?

MR. KENDALL: We can get you that information. There are about eight -- we've looked at about eight programs, and -- and six of them, I think, I will be the MDA until we decide the risk is under -- under control, and -- and then we'll delegate.

Most programs are delegated to the service already. In my six years I have delegated somewhere between 50 and 60 programs to the services over that period of time, and it's largely a -- been a question of the risk and the -- and the cost. If it's a high-cost program with a lot of risk then the tendency would be to keep me under -- as the MDA, I think.

There are some other exceptions in the current law, such as joint programs, right? That's a factor also. If it's a joint multi-service program it makes more sense, perhaps, to have somebody in -- in DOD do it.

We -- we take all those factors into account. We use the law as it's currently written as the basis for those decisions.

STAFF: (inaudible)

Q: Just quickly on F-35, can I get an update on contract negotiations?

And then also, the block buy -- when are you expected to finalize the structure of the block buy? And it seems like none of the partner nations, including the U.S., have signaled any interest to sign onto the first year. Norway and the U.S. are both talking about the second year. But without anyone interested in the first year does the whole thing --

MR. KENDALL: We -- we decided not to pursue it this year. We're looking at it as a possibility for next year and haven't made a final decision about that yet.

Q: So you might not pursue it?

MR. KENDALL: We -- we would like to pursue it. I would like to pursue it. There are some other factors that -- that we have to take into account, one of which is, you know, do we want to do that before we do OT&E first.

I -- I -- I'm prepared to do that, but I -- I -- I -- there are arguments the other way. So I -- I think that's still a -- a good thing for us to do.

Ultimately we'll get to multi-years, so if enough time goes by before we implement a block buy we'll do a multi-year instead, but we think the block buy vehicle can save us quite a bit of money.

There was another part to your question.

Q: Yeah, just the contract award --

MR. KENDALL: We're still in discussion -- (inaudible):

Q: So it -- it --

STAFF: Christmas present?

Q: It sounds like you're moving away from the block buy idea, then.

MR. KENDALL: No, no, no. We -- we're -- we're not. We still think it's a good idea and we'd still like to do it as soon as possible.

Q: Are you getting pushback from DOT&E then about doing it before the -- the IOT&E phase is over?

MR. KENDALL: I think in a -- in a -- in a pure world you wouldn't do a block buy until you'd done OT&E.

F-35 is a very unusual program. We're 10 years into production now. We're on our 10th lot. We're working on our 10th lot. And -- and I don't think there's any doubt that we're going to try to ramp up production and get more economic buys.

So if I felt that there was doubt about that then I wouldn't want to do a block buy, if I thought there was any chance we'd stop production. But the results we're getting from the operators are so positive.

The costs are coming down. The costs of F-35 have been coming down, beating our -- our projections for about four or five years now. So the costs are under control.

We're still working through the last phase of the development program. I just did a review of the F-35 yesterday, so we do have some cost issues we're working in our budget in terms of finishing STD -- finishing development. But I am not worried about the viability of the product at all at this point in time.

So we're going to do it. The only --

(CROSSTALK)

Q: You're worried about getting testing done, then?

MR. KENDALL: We'll get testing done. It's just a question of the schedule.

Q: And that might -- think that might increase cost if testing --

MR. KENDALL: It could conceivably increase cost a little bit, yeah.

STAFF: And last question, guys.

(Amanda ?), quickly?

Q: Hi. (inaudible)

So with the upcoming election how confident are you with pushing forward on major acquisitions, (repositions ?), budget?

MR. KENDALL: I'm not aware of any decisions that are pending that we would defer because of the election. You know, the products we're -- we're -- we're requiring are products that the military needs. There's an established requirement.

The only uncertainty there is probably the budget. And because sequestration comes back in '18 we're going to have to deal with that.

But we're -- we're -- we expect '17 will be consistent with the, you know, the agreement that was reached. We have not since 2013 had to endure the actual implementation of sequestration, so I think we're in reasonable basis to assume it won't happen in 2018, but it could. It depends upon the political environment.

So we'll have to be prepared to deal with that if it happens, but our planning is not based on that. We're trying to plan our program and we're working on building a budget that obviously the new administration will want to take a look at and may make some changes to, but we're planning on building a budget that's essentially consistent with what we did last year.

STAFF: All right, guys. That's it. I gotta get him up to his next meeting.

Thank you very much, folks. Embargoed until Monday morning. Thanks.

-END-

