
RDT&E Cost Recovery: Revised 1989 Contract Clause

By

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Commercial sales to foreign governments, and even to companies within the U.S. and to sub-contractors, require the recoupment of applicable nonrecurring costs to the U.S. government. In the current budget climate, DOD efforts continue to insure that these costs are recovered. This article summarizes the current cost-recovery policy and highlights the procedures involved.

The DOD policy for the recoupment of nonrecurring costs is reflected in the language embodied in the 1989 contract clause published in the *DOD Federal Acquisition Regulation Supplement* (DFARS). The clause is entitled "Recovery of Nonrecurring Costs on Commercial Sales of Defense Products and Technology and of Royalty Fees for Use of DOD Technical Data (Feb. 1989)," and is appended at the end of this article for additional information and reference. The philosophy behind this recoupment requirement is that a contractor, which acquires technical knowledge in performing a defense contract financed with USG appropriations, should reimburse the U.S. Treasury for a proportionate share of the economic benefits realized when such information is converted to a non-government use. The recoupment requirement applies to anyone who sells or licenses defense-related articles, services or training, technology, computer software or material, or "derivatives" of these categories; and to anyone who provides advice, or licenses know-how, concerning the development or production techniques that were developed or improved where DOD appropriated funds were involved in the process. The policy for collection is without regard to ownership rights to technical data and patents.

APPLICATION OF CHARGES

Recoupment charges may be applied to both hardware and technology which can be subdivided into: Major Defense Equipment (MDE) and its derivatives, non-MDE, and technology (transfer and use). A discussion of these subcategories follows:

- **Major Defense Equipment (MDE)** includes any item of military equipment having a nonrecurring research and development cost of more than \$50 million, or a total production cost of more than \$200 million. To establish the charge per item, DOD adds together all relevant nonrecurring costs into a "cost pool" and then divides the cost pool by the estimated number of units (DOD and commercial) to be produced (past, current, and future) to establish the pro rata charge. Once the charge is established, it is applicable from that date forward unless changed or a waiver is granted. The charges are published in Table 700-6 of the *Security Assistance Management Manual* (DOD 5105.38-M) and in Appendix D of the *Foreign Military Sales Financial Management Manual* (DOD 7290.3-M).

- **Derivative or Essentially Similar Items** include those commercial items that are similar, but not identical, to items developed under DOD contracts. The recoupment charge is determined through a comparison of the commercial items with the DOD item. If the item contains more than 10 percent common parts, it is considered substantially similar. A comparison of technological similarity may also be used. The non-recurring cost recoupment charge for the derivative items is established by applying the percentage of commonality to the established

recoupment charge. DSAA approves these charges. The charges are published in Appendix D of the *Foreign Military Sales Financial Management Manual (DOD 7290.3-M)*

- **Non-Major Defense Equipment** includes all items of equipment not included as MDE. When such items reach the threshold of \$2 million of DOD investment for RDT&E only, a non-recurring cost recoupment charge is applicable. This \$2 million threshold is measured against a pool of costs, not just the cost paid by the DOD to one manufacturer. Therefore, manufacturers may be subject to this charge even though their contract cost does not, by itself, meet the threshold. The current nonrecurring cost recoupment method involves establishing a charge by using 5 percent of the DOD inventory price of the item. Military Departments approve the charges for non-MDE items. The charges are published in Appendix D of the *Foreign Military Sales Financial Management Manual (DOD 7290.3-M)*. If a non-MDE item is a component of an MDE item, the manufacturer does not pay the recoupment charge when the prime contractor assumes responsibility for payment of the non-recurring cost recoupment charge to the DOD. DSAA approves any exception to delete the charge for non-MDE from the non-recurring cost recoupment charge for MDE.

- **Transfer and Use of Technology** includes all defense articles. For MDE items, the established recoupment charge is applicable. For non-MDE items, a royalty fee, which is a percentage of surcharge based on the DOD current inventory price is applied. The amount of the charge depends on who is manufacturing the items, and for what use. For foreign manufacturers, a 5 percent charge is applicable for items to be used in the respective country, and 8 percent is applied to items for third-party use. For U.S. contractors, a 3 percent charge is applicable for items used domestically and 5 percent for items to be exported. The Military Departments approve royalty fees.

SUMMARY OF CHANGES

Overall, the 1989 changes in the DFARS reflect the application of policies and procedures in the latest iteration of DOD Directive 2140.2, which has been in effect since 1967. Administratively, the general provisions for the recoupment were moved from the RDT&E section of the DFARS to a separate and distinct section called "PART 271—Recovery of Nonrecurring Costs on Commercial Sales of Defense Products and Technology and of Royalty Fees for Use of DOD Technical Data." A requirement for the clause was also added to "PART 234—Major System Acquisition" and PART 235 on RDT&E was modified to refer to PART 271 and the revised clause. Changes found in the new clause and PART 271 include:

- **Procedures.** Definitive procedures are now included on who in the DOD establishes nonrecurring cost recoupment charges and the process for collection. Previously, the clause appeared to require that the manufacturer determine all of the DOD costs—both DOD in-house and contract costs. It also identified specific thresholds of costs and different methodologies for establishing recoupment. The clause now refers to the DOD Directive.

- **Certification.** The inclusion of a certification requirement by the contractor is one of the most important changes in the 1989 clause. Contractors must now certify, on or before the 60th day following each calendar year in which recoupments are due, that DOD has been properly notified of all applicable sales and charges.

- **Prompt Payment.** Cost recoupment payments are due to the Government within 30 days of acceptance of the items or delivery to the purchaser, whichever is earlier.

- **Request for Review.** The 1989 clause expressly states that contractors may request a review of the recoupment charge if significant changes have occurred to the underlying assumptions on which the charge is based.

- **“Disputes” Clause.** The wording of the 1980 clause provided that the determination of the amount on a given item was not subject to challenge under the contract’s “Disputes” clause. This provision was omitted from the 1989 clause language. DOD has proposed the reinstatement of this language but as yet no final decision has been made.

- **Technical Data Packages (TDPs).** A “Royalty Fee” is the term used for the nonrecurring recoupment charges for the use of DOD technical data used for the purpose of manufacturing an item for a non-U.S. government customer.

- **Responsibility to Determine Charge.** Normally the manufacturer determines if there is a charge for the items published in the aforementioned DOD Manuals. If a charge is not scheduled and there is reasonable assurance that the DOD has a material investment in the items, it is up to the manufacturer to obtain the amount of the charge by contacting a focal point identified in the DFARS. The responsibility of the contractor to obtain the charge has not been altered by the DFARS. The change is that the mechanism is now specified. Also, the new general provisions provide for a resolution process. When there is an issue with a recoupment charge that the military department cannot resolve, the problem must be raised within 90 days to the Defense Security Assistance Agency. This process also accommodates requests by manufacturers for the DOD to review a charge due to significant changes of which the manufacturer is aware.

WAIVER OF CHARGES

The nonrecurring cost recoupment charges may be waived on a case-by-case basis. The general provisions in PART 271 of DFARS, identify the specific circumstances and procedures to be followed for waiver requests in connection with foreign and domestic sales.

Requests for waivers on foreign sales are submitted to the Defense Security Assistance Agency and normally originate with foreign governments. Requests for waivers are generally approved for eligible countries when the request involves weapons standardization and interoperability with U.S. forces. Requests for waivers on domestic sales are submitted to the Under Secretary of Defense for Acquisition and originate with either a DOD component or defense contractor. Considerations for waivers may involve demonstrable rights of the manufacturer or findings that technologies are available to the general public.

SUMMARY

The 1989 change to the DFARS reflects the current policies and procedures of DOD Directive 2140.2. Since 1967, policies and procedures have been continuously reviewed and refined to reflect the concerns of DOD organizations, the audit community, the Congress, and the public. However, the philosophy to recoup a fair share of the U.S. government investment costs has remained unchanged.

REFERENCES

DFARS 252.271-7001, Feb 1989

DFARS 151.235-7002, Feb 1980

ASPR 4-110,7-403.42 (approved 14 Dec 1966 and published in Defense Procurement Circular No. 53 (21 April 1967); later renumbered 7-104.64, "Recovery of Nonrecurring Costs on Commercial Sales of Defense Products and Technology."

DOD Directive 2140.2, 15 March 1967, amended 23 Jan 74, 5 Jan 77, 5 Aug 85, and 7 Jul 87.

DOD 7290.3-M, *Foreign Military Sales Financial Management Manual*

DOD 5105.38-M. *Security Assistance Management Manual*.

ABOUT THE AUTHOR

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