

CHUCK GRASSLEY, IOWA, CHAIRMAN

MIKE CRAPO, IDAHO	RON WYDEN, OREGON
PAT ROBERTS, KANSAS	DEBBIE STABENOW, MICHIGAN
MICHAEL B. ENZI, WYOMING	MARIA CANTWELL, WASHINGTON
JOHN CORNYN, TEXAS	ROBERT MENENDEZ, NEW JERSEY
JOHN THUNE, SOUTH DAKOTA	THOMAS R. CARPER, DELAWARE
RICHARD BURR, NORTH CAROLINA	BENJAMIN L. CARDIN, MARYLAND
JOHNNY ISAKSON, GEORGIA	SHERROD BROWN, OHIO
ROB PORTMAN, OHIO	MICHAEL F. BENNET, COLORADO
PATRICK J. TOOMEY, PENNSYLVANIA	ROBERT P. CASEY, JR., PENNSYLVANIA
TIM SCOTT, SOUTH CAROLINA	MARK R. WARNER, VIRGINIA
BILL CASSIDY, LOUISIANA	SHELDON WHITEHOUSE, RHODE ISLAND
JAMES LANKFORD, OKLAHOMA	MAGGIE HASSAN, NEW HAMPSHIRE
STEVE DAINES, MONTANA	CATHERINE CORTEZ MASTO, NEVADA
TODD YOUNG, INDIANA	

KOLAN DAVIS, STAFF DIRECTOR AND CHIEF COUNSEL
JOSHUA SHEINKMAN, DEMOCRATIC STAFF DIRECTOR

United States Senate

COMMITTEE ON FINANCE

WASHINGTON, DC 20510-6200

October 7, 2019

VIA ELECTRONIC TRANSMISSION

The Honorable Ellen M. Lord
Under Secretary of Defense for Acquisition and Sustainment
U.S. Department of Defense
3010 Defense Pentagon
Washington, DC 20301-3010

Dear Under Secretary Lord:

I am writing to raise additional questions about the Department of Defense's (Department) commitment to aggressively confront and route out the long-standing, well-documented, and excessive price-gouging of spare parts by the TransDigm Group, Inc. (TransDigm).¹

On May 13, 2019, I sent a letter to the Department regarding TransDigm overcharging the Department on spare parts and how the Department plans to address this problem in the future.² I also joined, as a co-requester, House of Representatives Committee on Oversight and Reform Chairman Cummings's, June 6, 2019 letter requesting a second audit of TransDigm.³ In a statement to the House committee, Principal Deputy Inspector General Glenn Fine and Assistant Inspector General for Audit Acquisition, Contracting, and Sustainment Theresa Hull agreed with broad congressional concerns about TransDigm's ability to set market prices as a sole-source provider, and that this sole-source position leaves the Department susceptible to

¹ See INSPECTOR GEN., U.S. DEP'T OF DEF., D-2006-055, SPARE PARTS PROCUREMENT FROM TRANSDIGM, INC. (2006), <https://media.defense.gov/2018/Oct/10/2002049899/-1/-1/1/D-2006-055.PDF> [hereinafter 2006 DoD OIG REPORT]; See also INSPECTOR GEN., U.S. DEP'T OF DEF., DODIG-2019-060, REVIEW OF PARTS PURCHASED FROM TRANSDIGM GROUP, INC. (2019), <https://media.defense.gov/2019/Feb/27/2002093922/-1/-1/1/DODIG-2019-060.PDF> [hereinafter 2019 DoD OIG REPORT].

² Letter from Sen. Charles E. Grassley, Chairman, S. Comm. on Finance, to Patrick M. Shanahan, Acting Sec'y of Def. (May 13, 2019), <https://www.finance.senate.gov/imo/media/doc/DOD%20Oversight.%2005-13-19.%20CEG%20Letter%20to%20SecDef%20on%20TransDigm%20Price%20Gouging%20PDF.docx.pdf>.

³ Letter from Sen. Charles E. Grassley, Chairman, S. Comm. on Finance, to Glenn A. Fine, Principal Deputy Inspector Gen., U.S. Dep't of Def. (July 29, 2019), <https://www.grassley.senate.gov/sites/default/files/constituents/2019-07-29%20CEG%20Letter%20to%20DoDIG%20re%20Co-request%20TransDigm.pdf>.

overcharges without having access to adequate cost data.⁴ In response to these widespread concerns in Congress, DoD IG now plans to conduct a second audit of TransDigm, specifically analyzing TransDigm's business model and how it affects spare parts pricing.⁵ As part of that audit, DoD IG will examine the impact that exclusive-dealer agreements, like those between TransDigm and certain of its subsidiaries, have on the pricing of spare parts.

I was pleased to learn that TransDigm agreed to return to the taxpayers \$16.1 million – the amount that DoD IG found TransDigm overcharged the Department in their February 25, 2019 report.⁶ However, in your June 6, 2019 letter to my office, you stated that TransDigm currently has \$634,718,073.64 in contracts with the Department.⁷ The current dollar amount committed to TransDigm contracts, knowing that TransDigm has vastly overcharged the Department on multiple occasions⁸ and that the Department does not track voluntary refund requests, raises serious concerns about the Department's stewardship of taxpayer money.

Pursuant to my May 13, 2019 letter, I requested that the Department provide my office the quarterly report regarding DoD IG recommendation 4.c detailed in the DoD IG audit.⁹ I have yet to receive the quarterly report. I reiterate my May 13, 2019 request and further ask that the Department provide the quarterly reports issued to date along with the answer to the following questions no later than October 25, 2019:

1. Your June 6, 2019 correspondence to my office stated that the Department has \$634,718,073.64 in current contracts with TransDigm.
 - a. Are you concerned that TransDigm is overcharging the Department on any of these contracts, as it has done repeatedly in the past?
 - b. Have you ordered a review of each TransDigm contract to ensure that overpricing is not occurring within these contracts? If not, why not?
2. According to information obtained by my office, a TransDigm subsidiary may be overcharging the Defense Logistics Agency by more than \$50 million through a

⁴ *DOD Inspector General Report on Excess Profits by TransDigm Group, Inc.: Hearing Before the H. Comm. on Oversight & Reform*, 116th Cong. (2019) (statement of Glenn A. Fine, Principal Deputy Inspector Gen., U.S. Dep't of Def., & Theresa S. Hull, Assistant Inspector Gen. for Audit Acquisition, Contracting and Sustainment, U.S. Dep't of Def.), <https://docs.house.gov/meetings/GO/GO00/20190515/109477/HHRG-116-GO00-Bio-HullT-20190515.pdf>.

⁵ See *id.* at 6–8; Memorandum from Theresa S. Hull, Assistant Inspector Gen. for Audit Acquisition, Contracting and Sustainment, U.S. Dep't of Def., to the Under Secretary of Def. for Acquisition and Sustainment, et al. (July 8, 2019), https://media.defense.gov/2019/Jul/08/2002154470/-1/-1/1/D2019-D000AT-0181_REDACTED.PDF

⁶ Jared Serbu, *TransDigm Agrees to Reimburse Pentagon Following Allegations of Price Gouging*, FED. NEWS NETWORK (May 27, 2019), <https://federalnewsnetwork.com/defense-main/2019/05/transdigm-agrees-to-reimburse-pentagon-following-allegations-of-price-gouging/>; 2019 DOD OIG REPORT, *supra* note 1, at 8.

⁷ Letter from Ellen M. Lord, Under Sec'y of Def. for Acquisition and Sustainment, to Sen. Charles E. Grassley, Chairman, S. Comm. on Finance (June 6, 2019) (on file with author).

⁸ See 2006 DOD OIG REPORT, *supra* note 1, at 3; See also 2019 DOD OIG REPORT, *supra* note 1, at 7–8.

⁹ See 2019 DOD OIG REPORT, *supra* note 1, at 44.

recent contract. Has the Department conducted an assessment of this contract to ensure no price-gouging or overpricing has occurred?

3. A voluntary refund request occurs when the Department does not have a contractual or legal remedy to recover money that the Department has, whether through an audit of a contract or other means, determined to be an overcharge. Your June 6, 2019 correspondence to my office stated that the Department has no record of voluntary refunds that were not related to regulatory or contractual requirements.
 - a. If the Department requests a voluntary refund, is it the Department's position that the Department was overcharged, and thus owed the amount deemed to be an overcharge?
 - b. Does the Department use pending voluntary refund requests that the Department has deemed to be overcharges on previous contracts in subsequent negotiations with contractors? If not, why not?
 - c. If the Department does not track voluntary responses, and does not attempt to recover the overcharged amount by other legal means, why does the Department request a voluntary refund in the first place?
 - d. How does the Department's failure to track voluntary refund requests affect its role as a key steward of taxpayer money?
 - e. Does the Department plan to begin tracking voluntary refund requests in the future? If not, why not?
4. Are there sufficient avenues for the Department to pursue money that it finds was erroneously paid out due to price-gouging schemes? If not, what does the Department believe would help recover the money that was over-charged?
5. Your June 6, 2019 correspondence to my office stated that TransDigm rejects the Department's request for cost data in most cases, invoking "[TransDigm's] interpretation of the statutory and associated regulatory limitations" of the commercial of a type definition.
 - a. What is the Department's interpretation of the statutorily and regulatory defined commercial of a type definition, and how does it differ from TransDigm's interpretation?
 - b. Does the Department agree with TransDigm's interpretation of the "commercial of a type" definition?

- c. Was the interpretation by TransDigm referred to the Office of the Secretary of Defense Office of the General Counsel for review? If not, why not?
 - d. Do the different services, when in the course of contracting, share denials of cost data by whatever company they are doing business with? If so, is this data available in a central database?
6. Your June 6, 2019 correspondence to my office stated that the Department has concluded current laws and regulations do not prohibit a company from exploiting a position where the company owns the intellectual property (IP) and is in a sole-source relationship with the Department.
- a. If the Department believes its regulations do not prohibit this abuse, why has the Department not issued updated regulations?
 - b. If the Department believes that current law is insufficient to prohibit abuse by entities, why has the Department failed to communicate these concerns to the Congress so that the Congress can address these abuses?
 - c. Does the Department own, or has it ever owned, IP rights to any of the spare parts that it buys from contractors? If so, did the Department conduct lifetime cost analyses comparing manufacturing costs with purchasing costs?
7. In a separate correspondence, I asked for a detailed breakdown of the 1,200+ different parts the Department has purchased from TransDigm over the past few years. The Department stated that it has no legal mechanism to require TransDigm to disclose data related to its IP licensing agreement, or to disclose whether it is the actual manufacturer of these parts, or whether it is simply in an exclusive licensing agreement with other manufacturers to provide the part to the Department.
- a. Experts disagree with this assessment and suggest that this information is, in fact, readily available upon request. Additionally, whether an item is bought or made is not proprietary information. Did the Department attempt to obtain from TransDigm, or any other company TransDigm does business with, pertinent IP licensing information? If not, why not?
 - b. As the Under Secretary for Acquisition and Sustainment, do you believe that the Department needs this information to make proper acquisition decisions? If not, why not?
8. In many cases, when an item is purchased and not manufactured by a company, there are markings on the part which would presumably identify which contractor or subcontractor manufactures the item. Experts further state that every program

at inception has a “make or buy clause” that requires the company under contract to identify what it plans to make, and what it plans to buy.

- a. Did the Department attempt to compile the data on the 1,200+ parts that I requested, using this readily available information? If not, why not?
- b. Without knowing basic information such as who makes, buys, sells, and owns IP rights to individual parts, how can the Department devise a strategy to counter TransDigm’s monopolistic and price-gouging behavior?
- c. If the Department ever sought to reverse-engineer spare parts, without having this information, how would the Department know which parts it can reverse-engineer and which to buy from other sources?
- d. Did the contracts that the Department granted to TransDigm lack crucial language regarding a “make or buy clause”? If so, why?
- e. According to Haystack, a spare parts and logistics management system, the Department is buying parts from TransDigm as a sole-source provider although there are, in many instances, other suppliers offering the same part at dramatically lower prices.
 - i. Why is the Department paying higher prices on certain parts when there are cheaper, readily available, alternatives?
 - ii. What is the Department doing to ensure it gets the best deal on all of its contracts, including these with TransDigm?
- f. The DoD IG report states that the competition for the parts the Department purchased from TransDigm was not adequate. Do you agree with the DoD IG that there was inadequate competition for the 47 parts described in the DoD IG audit? If so, what steps are you taking to address the lack of competition in the spare parts market?
- g. Under current contract price certification procedures, contracting officers declare that prices are fair and reasonable even when they lack the cost data to make that determination. DoD IG indicated that those procedures “are not optimal” and are, in fact, “flawed,”¹⁰ leaving contracting officers in a very compromising position. Has the Department taken steps to modify those procedures? If not, why?

¹⁰ *Id.* at 28.

9. Does the Department have access to Haystack? If so, does the Department provide access to contracting officers so that they may make assessments on pricing proposals on parts?
10. In a separate correspondence, I asked if there were any additional contracts awarded to TransDigm for any of the 47 parts identified in the DoD IG audit,¹¹ and you indicated that the Defense Logistics Agency has completed four buys of the parts included in the audit and that “for three of those four procurements . . . the unit prices have continued to increase.”¹² This assessment covered four additional purchases of these parts since the DoD IG audit was issued.
 - a. Does the Department possess current, complete, and accurate cost data of these parts to make a determination of reasonable price? If not, why not? If it does, has this data been distributed to contracting officers?
 - b. Is the Department capable of making accurate cost assessments using similar methodology that DoD IG used to make reasonable price determinations? If not, why does the Department lack this ability?
 - c. Do you believe that the Department should investigate these price increases given that TransDigm was found to have overcharged the Department on previous contracts? If not, why?
 - d. If the Department found that TransDigm, once again, overcharged the Department on these parts, do you believe that TransDigm should be ordered to return that money to the Department?
 - e. Has the Department made any additional purchases of these parts? If so, has the price increased or decreased?
11. Section 875 of the FY 2016 NDAA established a requirement to set up an “independent” organization “with appropriate expertise to conduct a review of the Department of Defense regulations, practices, and sustainment requirements related to Government access to and use of IP rights of private sector firms and . . . to facilitate competition in sustainment of weapon systems.”¹³
 - a. Has the Department established a comprehensive list of claims of proprietary IP in a central registry? If so, who in the Office of the Secretary of Defense manages this effort? If not, why not?

¹¹ *Id.* at 6.

¹² Response on file with author.

¹³ National Defense Authorization Act for Fiscal Year 2016, Pub. L. No. 114-92, § 875(a)(1)(A)-(B), 129 Stat. 726, 941 (2015).

- b. Additionally, Section 875 requires the Department to release a report on the findings, along with a description of any actions that the Secretary proposes to revise. Did the Department ever produce such a report? If so, please provide a copy to the Committee.
 - c. If the Department has created this independent organization, has the creation of this organization resulted in significant savings to the Department? How much savings has the Department realized?
12. In a June 14, 2019 memorandum, Acting Principal Director of Pricing and Contracting Kim Herrington instructed contracting officers to require TransDigm and its subsidiaries to submit uncertified cost or pricing data to support their pricing decisions.
- a. Has TransDigm complied with this mandatory disclosure requirement regarding uncertified cost or pricing data?
 - b. What steps is the Department taking to ensure TransDigm provides the required data?

While I commend Acting Principal Director Herrington on the June 14, 2019 memorandum, this should not be the end of the road.¹⁴ It is imperative that the Department work with Congress to ensure the Department can access necessary cost data.

Should you have questions, please contact Quinton Brady of my Committee staff at (202) 224-4515. Thank you for your attention to this important matter.

Sincerely,



Charles E. Grassley
Chairman
Senate Committee on Finance

¹⁴ See Memorandum from Kim Herrington, Acting Principal Dir., Defense Pricing and Contracting, U.S. Dep't of Def., to Commander, U.S. Cyber Command, et al. (June 14, 2019), https://www.acq.osd.mil/dpap/policy/policyvault/Review_of_Prices_Proposed_by_TransDigm_and_Affiliated_Companies.pdf.