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**TESTIMONY OF
VICE ADMIRAL KEITH W. LIPPERT
DIRECTOR, THE DEFENSE LOGISTICS AGENCY**

**BEFORE THE UNITED STATES HOUSE OF REPRESENTATIVES
HOUSE ARMED SERVICES COMMITTEE**

November 9, 2005

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Statement of
Vice Admiral Keith W. Lippert
Director of the Defense Logistics Agency
Hearing before the
House Armed Services Committee
November 9, 2005

Good morning Mr. Chairman, Mr. Skelton, and distinguished members of the Committee. It is my privilege to represent the men and women of the Defense Logistics Agency (DLA). For more than forty years, DLA has provided around-the-clock, around-the-world logistics support to America's armed forces in peace and in war. We are a critical combat enabler to the warfighters. I welcome today's opportunity to describe the benefits that our entire Prime Vendor program brings in supporting these warfighters with high quality products at the lowest possible total cost to the taxpayer. I will also address specific issues recently raised regarding the relatively small food service equipment segment of our Prime Vendor program.

Before I proceed, I would like to put in perspective DLA's overall role in Department of Defense (DoD) logistics support, and the importance of Prime Vendor in fulfilling that role. As DoD's logistics combat support agency, we are the source for nearly every consumable item, whether for combat readiness, emergency preparedness or day-to-day operations, across all of DoD. The Combatant Commanders, their Army, Navy, Marine and Air Force warfighters and DoD's maintenance and support facilities all rely on DLA's four Supply Centers to provide food, fuel, medical supplies, clothing, construction and barrier material, and more than ninety percent of their weapons systems repair parts, both in peace and war, as does the Coast Guard. We also support numerous allied nations and other authorized customers.

Our scope is enormous. We manage over 5 million line items. We receive over 54,000 requirements daily involving over 8,200 supporting contractual actions per day. In Fiscal Year (FY) 2005, which ended just over a month ago, we provided over 31 billion dollars of materiel and services. This is an almost 80 percent increase over the FY 2001 sales volume. If we were publicly traded, DLA's revenue would rank us 54th in the Fortune 500, above companies such as Northrop Grumman and Disney. In addition, we receive, store, and issue both DLA and Military Service assets at our 26 distribution depots located in the continental United States and at key sites overseas. Our Defense Reutilization and Marketing Service oversees the re-use or disposal of excess, obsolete or unserviceable DoD property. Overall we have a presence in 48 states and 28 countries, including over 100 DLA personnel deployed in support of combat forces, and many others who have been on scene in humanitarian efforts such as post-Katrina support. We are truly a 24/7 global operation.

Given the scope and importance of our mission and our customers' increasingly complex requirements, DLA has been enhancing its business processes to be more agile and flexible in response to the logistics support challenges faced today in Iraq, Afghanistan and the overall Global War on Terrorism, as well as those that may arise in future years. We have done so while steadily constraining related costs. We have been well supported by the DoD leadership and this Committee as we pursued these goals. One of the principal ways we have been achieving them is by utilizing the best practices available in either the private or public sectors. We have incorporated many commercial supply chain sourcing and delivery practices that significantly reduce inventories and related costs while enabling more rapid and flexible response. Today a major portion of the warfighter's supplies are shipped directly from manufacturers, distributors, and strategic suppliers with whom we have prearranged contracts that include surge provisions. Prime Vendor is a key element in this approach. Not only does it support these supply chain enhancements, but in many cases it enables us to offer increased product quality by directly accessing commercial grade items that clearly meet military needs.

As a result of Prime Vendor and other initiatives, our average customer wait times for receipt of items---the time from placing the order until it has reached the customer---have improved significantly in recent years, including a 50 percent improvement in customer wait time for forces in Iraq. Our overall materiel availability metric that tracks the proportion of customer requests that we are able to issue immediately upon request has been consistently above DoD target levels. Delayed satisfaction of customer requests, known as “backorders,” reached record lows despite significantly increased demands during Operation Iraqi Freedom. Besides improved performance in these and other key readiness support metrics, our cost recovery rate---which reflects the fee DLA charges the customer to cover our costs for procuring, storing and arranging delivery ourselves, or via Prime Vendor or related direct delivery contractual arrangements made by DLA---has been proportionally reduced by close to 40 percent over the past five years, and by almost 60 percent since the early 1990s. Many of our initiatives also provide our customers with benefits from cost avoidances in their own internal operations. These benefits are not reflected in DLA’s own metrics, but they reduce total taxpayer costs for logistics support and help enable our customers to allocate available funding to more pressing needs. As I will discuss shortly, Prime Vendor has been a major contributor to all of this progress, including helping enable an 18 percent staffing reduction in the past six years at the DLA Supply Center in Philadelphia that manages our Prime Vendor programs.

We are proud of our results in providing best value logistics support to the warfighter, but I can assure you we are not stopping here. We are still an Agency in transition. With 13 major transformational programs underway at DLA to enhance our business practices and related key enablers such as business systems and human capital management, we are on track to be even more capable, while also projecting achievement of an additional proportional cost recovery rate fee reduction of approximately 15 percent over the next five years.

That said, Mr. Chairman, I can assure you and this Committee that we learned the lessons of the 1980s regarding logistics procurement practices. Prime Vendor is a broadly recognized

commercial “best practice” that is championed by, among others, the Government Accountability Office. The Department of Veterans’ Affairs has had similar success with its own large-scale Prime Vendor program. Prime Vendor has enhanced DoD logistics support at reduced overall cost to our customers and the taxpayers. It is better than any alternative approach available. As I will address shortly, recent concerns regarding a relatively small subset of our seven billion dollar per year Prime Vendor program neither reflect a decline in overall procurement practices nor any significant systemic issues.

I will now outline our Prime Vendor program in greater detail. As background, a DLA Prime Vendor arrangement is one in which a distributor of a commercial product line provides those products and related services to all of DLA’s customers in an assigned region within a specified period of time after order placement. By contract, the Prime Vendor either provides the product at the cost to the Prime Vendor to obtain it, or at a price agreed upon in advance with DLA, plus there is typically a negotiated management fee that includes inventory management, order processing and delivery. In certain circumstances, there is recovery of costs for incidental services that might apply to meet the customers’ specific needs, such as installation or extended maintenance. The benefits to the customer include improved access to a wide range of high-quality commercial products, rapid and predictable delivery from a single vendor at the time and in the manner most conducive to the customer’s needs, and reduced overhead charges.

As noted earlier, the benefits to the taxpayer also include significant reductions in the manpower needed to manage these items at DLA, since that function is primarily provided by the Prime Vendor; elimination of any DLA inventory investment, since inventory is no longer held by the Government; reduction of the infrastructure and related costs associated with warehousing that inventory; and reduced transportation costs via multiple-item Prime Vendor deliveries to the customer rather than transportation from vendors to the military depots for subsequent transportation to the ultimate customer. In addition, Prime Vendor contracts provide for surge

and broader mobilization capabilities, and worldwide customer support. The end result is a lower total system cost for the products and services delivered.

DLA began implementing its Prime Vendor program in the early 1990s in response to widespread customer dissatisfaction with the limited products then available through the traditional supply system for food and medical items, as compared to those available from the commercial market. There were also concerns with untimely deliveries and the large DLA cost recovery fee incorporated into the price of the products at that time. DLA's troop support Supply Center in Philadelphia, now titled the Defense Supply Center Philadelphia (DSCP), benchmarked with the commercial sector to determine best practices. Beginning with pharmaceuticals, DSCP awarded contracts to distributors to apply the same business rules in supporting DoD customers as they did in servicing their commercial accounts. DSCP subsequently implemented Prime Vendor programs for medical and surgical supplies and food items using the same model.

The results achieved with these first efforts were significant. As reported in the Government Accountability Office (GAO) report "Opportunities Exist to Expand the Use of Defense Logistics Agency Best Practices" in January 2000, we estimated that we were able to reduce the DLA wholesale inventory of medical items by 177 million dollars from FY 1993 through FY 1997. We realized comparable savings at DoD hospitals and in providing food products, through lower prices and reduced stock levels and holding costs. Prime Vendor continues to be significantly less expensive than either reverting to prior practices or doing direct contracting with individual manufacturers or wholesalers. This is based upon the on-going savings categories I outlined earlier, bolstered by periodic sample audits for price reasonableness and delivery timeliness and quality. Our customers are not required to use our Prime Vendor services, so their continued increase in Prime Vendor usage further confirms the value of the program. Our Prime Vendor program has grown from 181 million dollars in FY 1994 to approximately 7 billion dollars in FY 2005. We expect continued growth based on the wide popularity of the program.

Based on our success with the initial Prime Vendor implementations in the 1990s, and supported by the DoD leadership and GAO's recommendations to expand the use of Prime Vendor programs, we have since established Prime Vendor support for more than fifteen additional product lines. These range from lumber to firefighting equipment to food service equipment to ecclesiastical items. Unless required by specific military considerations, there are no unique military specifications ("MilSpecs") applied. Prime Vendor sources provide proven quality, commonly available commercial items. Each of these contracts was awarded competitively using best value source selection, which means that in addition to price reasonableness, we directly considered the ability of each offeror to provide high-quality products and services in selecting contractors to provide the best support solutions for our customers.

DLA's Prime Vendor programs have proven their value, not only in meeting the peacetime needs of our Military Service customers, but also in providing the supplies urgently needed by the warfighter in combat, and by both military and civilian customers in times of natural disasters and other emergencies. For example, our Maintenance, Repair and Operations Prime Vendors deliver barrier materials and a wide variety of construction items directly to our troops where they are deployed in Iraq and Afghanistan. In addition, in 2003 we completed a major effort to get the one thousand bed hospital ship USNS Comfort underway to support Operation Iraqi Freedom. With very short notice, we had eighty percent of the planned items ordered by the Comfort on board within 3½ business days, with the balance delivered en route and in-theater. Prime Vendor was critical to this success story, just as it was when USNS Mercy supported tsunami relief in late 2004 and when Comfort deployed again in support of Hurricane Katrina relief efforts this year.

As noted, our Prime Vendor program does include a relatively small and unique segment for food service equipment (FSE). This segment comprises less than one percent of our overall Prime Vendor annual sales. It has been the subject of recent newspaper articles and editorials that gave rise to Congressional questions regarding the overall effectiveness of the Prime Vendor

program. I appreciate the chance to describe why I believe the FSE segment continues to provide effective and efficient service to our Military Service customers.

First, some background. We awarded the initial generation of FSE Prime Vendor contracts in 1999. At that time our customers were very dissatisfied with the lack of responsiveness of the then-existing system for supporting their FSE requirements. We competitively awarded six contracts representing three zones to four contractors, three of which were small businesses. They were responsible for providing FSE ranging from garbage disposals to warming ovens, as well as necessary incidental services such as installation, to all customers in their assigned zones. For example, the services of these Prime Vendors directly addressed the needs of Navy ships with limited time in which to take delivery of FSE and have it installed before deploying. At the same time, this program allowed us to significantly reduce DLA costs, including a one-time savings of the entire 3.5 million dollar inventory DLA previously held, an annual reduction in inventory holding costs of approximately 600 thousand dollars, and an annual staffing savings of about one million dollars by reducing the number of full-time Government employees managing the FSE segment from twenty five to nine. Our program also supports more efficient management practices by our customers and it has become very popular with them, with the result that our FSE Prime Vendor sales have more than doubled since 1999.

While the first generation contracts contained pricing provisions that we believed were adequate, we learned during the life of those contracts that improvements were required. Thus in June 2005, we competitively awarded eight second generation contracts for six geographic zones to four prime vendors, three of which are small businesses. These contracts contain provisions that will result in monthly, quarterly and annual reviews that will significantly reduce, if not completely eliminate, any vulnerability to overpricing.

With regard to media accounts of overpricing of specific food service equipment, we have conducted a thorough review of the eleven items mentioned in various newspaper articles, as

well as of the entire list of 122 items referred to in the initial press coverage. We found that with due consideration of a reasonable fee to the Prime Vendors to reflect the benefits to DoD of their role, then many of the FSE Prime Vendor items in this sample were not overpriced as compared to the cost of the same items when previously purchased from other sources. In addition, our analysis showed that those items that might be overpriced reflected a limited proportion of the total value of the program---in other words, many of the potentially overpriced items involved small quantities. Moreover, since the items in question were bought under the FSE Prime Vendor program's first generation contracts, this review confirmed that we made the right decision in our approach to the second generation FSE contracts to better ensure price reasonableness.

As I have just indicated, we acknowledge we made some errors in day-to-day execution of business under the old first generation contracts. There is no justification for paying 20 or 15 dollars for a plastic ice cube tray, even if the total cost of that Prime Vendor's many items provided was better than any alternative approach. Nonetheless, we paid unreasonable prices for a total of just eight such ice cube trays, while we paid reasonable prices of \$1.15 to \$2.03 for more than 300 similar ice cube trays during the same period. The key point is the additional pricing controls in our second generation contracts will preclude recurrence of even this limited type of problem.

Most importantly, I assure you we take very seriously our responsibility to pay fair and reasonable prices whenever we spend the taxpayer's dollar. With that in mind, not only have we instituted enhanced second generation contracting practices for managing the FSE Prime Vendor program, but we are also reviewing all of our FSE Prime Vendor purchases to identify any instances in which we might have overpaid. If any overpayments are confirmed, we will seek and obtain refunds from our Prime Vendors.

I trust this helps to put the recent media speculation in perspective and addresses related Congressional concerns. I acknowledge that in our extraordinary scope and volume of worldwide

operations, there will be some mistakes. When this happens we learn from them, rectify them through improved practices such as our second generation FSE Prime Vendor contracts, and provide refunds to affected customers whenever feasible. While we regret any errors, we do not believe they reflect an impact on warfighting support nor any systemic issues in our Prime Vendor program.

Mr. Chairman, in closing, DLA remains fully committed to ensuring that America's fighting forces are the best equipped in the world and that we are using America's resources wisely on their behalf. We appreciate this Committee's support of our on-going logistics operations at DLA and our many transformational initiatives. With your help we will continue to enhance our support to the warfighter.

Thank you for the opportunity to testify before the Committee on this important issue. I would be happy to address any questions.