Strategic Institute
INNOVATION IN GOVERNMENT CONTRACTING

Milestone Payments – Understanding a Powerful Technique

2
JUL 2019

posted in: Other Transactions | 0

Share this:

In discussing a topic like milestone payments, the aphorism, "*OT's are FAR out*" should be kept in mind. It is easy to drift into FAR conceptual boxes. One of these is that contracts are structured either as cost-reimbursement or fixed-price type. The FAR contains many either/or – this box or that box – concepts.

Milestone Payments – what are they? They are one of many ways to structure payments in an OT agreement. As the DOD Other Transactions Guide (Nov. 2018) states: "Project payment structures are negotiable."

1. Milestone payments are a series of payments each of which is made upon the accomplishment of defined objectives. They can serve multiple purposes. Since most OT efforts involve research and development unexpected problems and opportunities can arise in project performance.
2. Although milestones are defined up front and connected to fixed payments, if a milestone objective is not achieved the result is not necessarily a yes/no decision.
3. Failure to achieve a milestone objective should result in a "*why?*" The why is part of a management decision: forego the payment and press on to the next objective, redefine the milestone, terminate the project, or whatever other decision makes sense. The management decision might result in reimbursement of some incurred costs.

The third item above emphasizes the point that in R&D efforts unexpected problems and opportunities arise, and therefor the agreement should provide a way of making changes that is quick and easy.

Milestone Payments – what they are not. OT milestone payments are not to be confused with FAR *performance-based payments* (PBP). FAR PBP's were introduced in 1996 a few years after OT's pioneered milestone payments. Unlike OT milestone payments, which have multiple potential functions, PBP's are considered only a method of financing a project under FAR. PBP's are only authorized for fixed-price type efforts. Illogically, despite being fixed-price type they require tracking incurred costs (DFARS 232.1001(a)). While milestone payments have been extensively used on OT's, PBP's are but little used in FAR procurement contracts. The DOD Performance Based Payments Guide (2014) says "most contracting and acquisition professionals are not familiar with a…PBP arrangement."

The DOD Other Transactions Guide. The November 2018 DOD OT Guide discusses payments in section III.K. The first subject discussed is payable milestones:

Well-structured, payable milestones can serve the dual purpose of meeting cash flow needs of the performer and as a management tool to verify achievements on the critical path to project success. Failure to achieve milestone/technical goals forces a management analysis and decision.

The phrase *critical path to project success* suggests the Critical Path Method (CPM) may be used to identify key nodes or gateways that can become defined goals or milestones. Engineers and program managers often use CPM in project planning and can play a key role in identifying and defining critical events that are candidates for payable milestones.

Payable Milestone Pointers. A few "how to" comments and some examples may be useful.

I often point out that two important events in negotiating an OT agreement are agreeing on a "vision statement" of mutual goals of the parties. This often is incorporated as Article I, Scope of the Agreement. Next in importance is the structure and definition of milestone payments. The importance of these two parts of the agreement is sometimes not appreciated by Agreements Officers (AO) schooled in the FAR. An industry representative at a Strategic Institute conference came up to me after I had made these points to relate his recent experience in negotiating an OT. When he proposed negotiating a vision statement the AO said, "You write it." When the industry representative proposed negotiating a schedule of milestone payments the AO said, "You write it." This is not the collaboration these authorities are meant to encourage. Negotiating a clear vision of the mutual benefits of the project can facilitate negotiation of detailed terms and conditions. Well-structured payable

Subscribe to the SI news feed!

Get the latest thought in innovative government contracting delivered to your inbox.

Email Address

Subscribe

Search SI Articles

Search

Top Posts

- Special Acquisition Forces & Looking at Defense Acquisition from the Inside Out
- From Biplane to Spaceflight. From Lowest Bid Over Regulation to "Other Transactions" – The Saga of Bennie Schriever
- Appropriate Appropriations – Other Transactions
- Milestone Payments – Understanding a Powerful Technique
- Defense Acquisition Superheroes: Rise to the Challenge and Bring Home the Win
- Using SBIR Funding to Award Other Transactions Agreements (OTA)
- Other Transactions: The Agreements Officer Conundrum
- FAR vs OTs: Regulation vs Freedom | What is more conducive for innovation?
- Unrecognized and Underutilized OT Authority (DOE)
- The Other Transactions & Partnership Intermediary Connection

milestones can be the primary means of managing the project. Both need to be done collaboratively seeking win/win outcomes for the project. Collaboratively means not only mutually between the government team and industry but key members of the government team, not just an AO, need to be involved.

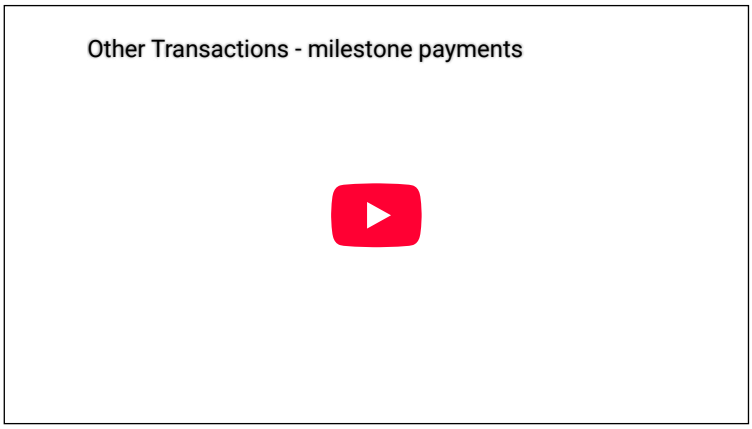
How many milestones are the right number? "*It depends*" while true, is not particularly helpful. Slightly more helpful might be the Goldilocks rule, not too many, not too few, just right. The goal of milestone payments is at least two-fold: generating operating cash for the performer and providing insight to manage the project. Too few milestones may starve the performer of cash or provide insufficient granularity to be an effective management tool. Too many can become an administrative burden. In one early multi-party OT, the program manager was concerned the lead company would not get payments to smaller companies on a timely basis. Milestones were negotiated that were clearly associated with tasks to be performed by each company that was a party to the OT. This resulted in the program manager spending an inordinate amount of time reviewing and approving milestone payments.

How rigorous should milestone payments be? Rigor can have various implications. Rigor might imply an association between achievement of the milestone and its estimated cost. It might imply the level of technical detail in the milestone definition. There is no absolute requirement for strict association of estimated cost to achieve a milestone and amount of milestone payment. One or more *soft* milestones at the front end of an agreement may be necessary to acquire long lead time items of to finance a poorly financed small company. The payable event may be something like hold an organizational meeting or update the operating plan contained in the proposal. In many projects that are fully funded by the government it may make sense for the cumulative milestones payments and their estimated cost to be closely aligned. However, in projects with a high risk of technical failure that may not be the case. Likewise, where successful performance may result in a breakthrough worth many times the cost of achieving it. Cumulative milestone payments may be less than estimated cost, a kind of informal cost sharing. The equities of relative market distribution and the intention of the parties (as memorialized in the vision statement) will inform that decision. In any case milestones should be well defined to serve their intended purpose.

The discussion above begs the question, are payable milestones always technical in nature? The answer is an unequivocal, no. A good example is NASA's Space Act OT with SpaceX that resulted in development of the Falcon9 space launch vehicle. In addition to technical milestones the agreement incorporated financial milestones. Some government payments were triggered by the infusion of specified amounts of third-party capital into the agreement.

written by Richard L. Dunn

Related Video Content:



2371, 2371b, Contract management technique, Contract milestones, DoD milestone payments, Milestone Payments, OTA, Other Transactions Milestones, Payable Milestones, Program management technique

Subscribe to the SI news feed

Enter your email address to subscribe to our news feed and receive notifications of new articles by email.

Email Address

Subscribe

©2021 Strategic Institute for Innovation in Government Contracting - Other Transactions