

TransDigm: DOD OIG Finds TransDigm Earned “Excessive Profits” on 99 Percent of Contracts Reviewed, DOD Management Endorses Aggressive Legislative Changes to Prevent Future Price Increases; SAM Registration Discrepancies Referred to Defense Criminal Investigative Services

This morning, the Department of Defense Office of Inspector General released its audit [report](#), “Review of Parts Purchased from TransDigm Group, Inc,” finding that “TransDigm earned excess profit on DOD Parts.”

The DOD reviewed 113 contracts covering 47 parts and determined that “only one part purchased under one contract was awarded with a reasonable profit of 11 percent. The remaining 112 contracts had profit percentages ranging from 17 to 4,451 . . .” The OIG determined profit percentages of 15 percent or below to be reasonable.

In its report, the DOD OIG also endeavored to answer questions posed in letters from Representatives Khanna and Ryan who, along with Senator Warren, wrote letters to the DOD OIG raising concerns about TransDigm’s (TDG) business practices.

Importantly, one question that was not answered was Question 5, which pertained to TransDigm appearing “to have failed to properly report its subsidiaries’ corporate ownership on System for Award Management filings for 12 of its subsidiaries. . .”

The DOD OIG said in a footnote of the report that “the DOD OIG Audit did not address question 5 because it was referred to the Defense Criminal Investigative Service for action deemed appropriate.” The outcome or status of the DCIS investigation is not known.

Warren, Ryan and Khanna issued a joint statement in response to the DOD OIG report, saying “We’re pleased that the DOD Inspector General acted on our request. The audit’s findings clearly show that egregiously excessive profit was the norm on virtually all of TransDigm’s contracts and parts. We also look forward to the completion of the GAO report on monopolistic practices in the military spare parts market that we requested in the FY18 NDAA [National Defense Authorization Act] to see if there are more TransDigms out there.”

The GAO stated that the report on monopolistic practices would be released sometime in the coming summer, though did not give an exact date.

The OIG’s review of the contracts it deemed excessive found \$16.6 million in excess profits on \$26.3 million in contracts. The OIG recommended that the DOD request voluntary refunds from TransDigm for that \$16.6 million.

On the most recent earnings call, TransDigm Executive Chairman Nick Howley said, “There has been no allegation of any wrongdoing or illegality. As in the past, the Department of Defense buying agencies are requesting a voluntary refund of some profits. The sum of the various individual requests appears to total about \$16 million. Again, this is a voluntary request, and there is no assertion that this is a financial obligation of the company.”

TransDigm did not respond to request for comment.

In addition to the refunds, the OIG report highlighted several businesses practices by the company that had enabled it to raise prices on the government and made several recommendations that could affect the company’s ability to do so going forward. DOD management largely agreed with those recommendations but said that it would pursue more aggressive changes both administratively and through Congress.

Below, we take a closer look at the OIG’s findings and recommendations for corrective action.

Report highlights lack of cost information. The report found that the DOD’s inability to obtain cost and pricing information largely enabled TransDigm’s ability to raise prices on the government.

According to the report, TransDigm denied defense contracting officers cost and pricing information 15 out of 16 times that it was requested. The only contract for which TransDigm gave cost and pricing information to the government was when it was legally required to do so under provisions of the Truth in Negotiating Act (TINA), as the contract had exceeded the \$750,000 TINA threshold. That contract was also the only contract out of the 113 reviewed that did not have excessive profits.

Th OIG recommended that the Director of Defense Pricing seek changes to the Defense Federal Acquisition Regulations to allow contracting officers more access to cost and pricing data. It also recommended that the DOD establish “quarterly reporting and validation of consolidated information on the denial of cost data for acquisitions of parts produced by one manufacturer, as well as for other sole-source acquisitions, by the DOD Components.”

In the Management Comments section of the report, Shay Assad, the former Director of Defense Pricing agreed with the recommendations but stated that the DOD should go further to “address and combat the unconscionable greed exhibited by companies like TransDigm,” noting that “traditional recommendations of increased reporting and oversight... do not get at the root of the problem. We will need legislative change to address price gouging and war profiteering.”

Assad also expressed concern that the recent raising of the TINA threshold from \$750,000 to \$2 million would be “disastrous for those contracting officers buying spare parts” and recommended legislative revisions to the reporting requirements for contracts below the TINA threshold.

For more information on how TransDigm employees may have been trained to deny cost information to contracting officers and split up contracts to stay below the TINA threshold, click [here](#).

Commerciality concerns. The report found that TransDigm had claimed that 32 of the 47 parts reviewed were commercial and therefore did not require cost and pricing information. However, upon closer review, the OIG determined that only four out of the 47 parts reviewed were actually commercial.

In response to this finding, Assad stated that he would request that Congress re-establish some form of the Vinson Trammell Act in order to compel companies to provide cost and pricing information or stronger evidence of commerciality.

For more information on how TransDigm has used the commerciality exemption to its benefit, please click [here](#).

Historical prices unreliable. One of the most commonly used ways for contracting officers to determine whether a price is reasonable is to compare it to previous prices. However, this process has a flaw, in that it only requires contractors to push through one high price in order to establish a base price.

The report found that historical prices for 34 of the 37 parts were inflated and “could not be used as an accurate determination of price reasonableness.” Additionally, of those 34 parts, 29 appeared to have had inflated prices when the government first purchased them from TransDigm.

For example, the report found that a part that had increased in price by 491 percent between 2007 and 2017 already contained an excess profit of 275 percent when it was first purchased in 2007 and deemed “fair and reasonable.”

The OIG recommended that the DOD establish a team of experts to “assess parts and contractors deemed to be at high risk for unreasonable pricing and identify trends and perform price analysis and cost analysis of high-risk parts to identify lower cost alternatives or fair and reasonable pricing for future procurements.”

DOD management agreed with this recommendation, stating that it would create a group of experts from across the different military departments as well as the Defense Contract Management Agency and the Defense Logistics Agency in order to identify and address high risk parts.

For more information on TransDigm's ability to establish fair and reasonable pricing, please click [here](#).

Exploiting exigent needs of military. Several times, the OIG found that TransDigm was able to benefit from the unique and exigent needs of contracting officers to support military personnel in the field. The report found that “at least five contracting officers stated that the need for the spare part was urgent enough that they had to buy the part at the price offered by TransDigm.”

While the OIG had no recommendation for alleviating the exigent need of contracting officers, Assad stated that this situation was “untenable,” stating “our contracting officers are being placed in the vice on unconscionable greed and the absolute need to support our warfighters... in many cases they have no choice but to hold their nose and issue the order.”

Distributors distort competition. The DOD OIG focused on TransDigm's use of exclusive distributors to help make inflated prices appear reasonable, something that was not reviewed in the 2006 audit. Previous reporting has found that TransDigm would use a series of distributors that would bid on contracts to supply TransDigm parts. As a result, TransDigm could effectively raise the price on parts because the presence of multiple bids made the acquisition appear “competitive.”

The report confirmed this practice, finding that “TransDigm was the only manufacturer at the time for the majority of the parts competitively awarded, giving TransDigm the opportunity to set the market price for those parts because the other competitors planned to buy the parts from TransDigm before selling them to the DLA.”

The report recommended that the DOD update its guidance on “Access to Records with Exclusive Distributors/Dealers,” which will expand the reporting requirements for contractors up and down the supply chain.

Kim Harrington, the acting director of the Defense Pricing and Contracting Department, responded to the OIG by stating that she had already directed her staff to draft updates to the current guidance on use of distributors. Effective implementation of this policy could reduce TransDigm's ability to pass off its sole-source products as “competitive.”

For more information on TransDigm's use of distributors, click [here](#).