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DOD INSPECTOR GENERAL REPORT ON EXCESS PROFITS BY TRANSDIGM GROUP, INC.

HEARING

BEFORE THE

COMMITTEE ON OVERSIGHT AND REFORM HOUSE OF REPRESENTATIVES

ONE HUNDRED SIXTEENTH CONGRESS

FIRST SESSION

May 15, 2019

Serial No. 116–22

Printed for the use of the Committee on Oversight and Reform

Available on: *http://www.govinfo.gov*
http://www.oversight.house.gov
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U.S. GOVERNMENT PUBLISHING OFFICE

36–511 PDF WASHINGTON : 2019

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DOD INSPECTOR GENERAL REPORT ON EXCESS PROFITS BY TRANSDIGM GROUP, INC.

Wednesday, May 15, 2019

HOUSE OF REPRESENTATIVES
COMMITTEE ON OVERSIGHT AND REFORM
Washington, D.C.

The committee met, pursuant to notice, at 10 a.m., in room 2154, Rayburn House Office Building, Hon. Rho Khanna presiding.

Present: Representatives Maloney, Norton, Clay, Connolly, Krishnamoorthi, Raskin, Rouda, Hill, Wasserman Schultz, Sarbanes, Welch, Speier, Kelly, DeSaulnier, Lawrence, Khanna, Ocasio-Cortez, Tlaib, Jordan, Foxx, Meadows, Hice, Grothman, Comer, Cloud, Gibbs, Miller, and Steube.

Mr. KHANNA.

[Presiding.] The committee will come to order.

Without objection, the chair is authorized to declare a recess of the committee at any time; and if the witnesses would like a recess, let me know.

This full committee hearing is convening to examine the results of a review by the Department of Defense Inspector General of contracts for spare parts supplied by TransDigm Group, Incorporated.

I now recognize myself for a five-minute opening statement.

Good morning. Thank you for being here. As everyone knows, our Nation has been at war for almost two decades. We owe it to our servicemembers to give them everything they need to fulfill their missions on the battlefield. What we will not tolerate is war profiteers, those who seek to use the fact that we are at war to hold us hostage and hike their prices on mission-critical Defense articles to astronomical levels.

Now, this is a bipartisan hearing in the tradition of Harry Truman during World War II to make one thing clear: Defense contractors cannot rip off the American taxpayers.

Unfortunately, the Inspector General of the Department of Defense, after investigating TransDigm, concluded that they owe millions of dollars back to the taxpayers for overcharging for parts. TransDigm supplies parts for a number of our most critical missions in Afghanistan, Iraq, and around the world.

Today, we will hear directly from the Inspector General about TransDigm's actions and to understand what took place. TransDigm's basic business model consists of identifying relatively small companies that make spare parts for the military, especially

parts that no other companies make. TransDigm then, according to the report, buys up these small companies, purchases the rights to produce the products, and then, unfortunately, jacks up the prices. The Pentagon has to pay, knowing that they have a monopoly.

As a result, contracting officers are in an impossible position. They have generals calling them from the field and demanding these spare parts to get their aircraft off the ground, but the prices they are charged are unconscionable. Let me give you an example. TransDigm manufactures a small part for the Freedom Fighter F–5. This part is called a quick disconnect coupling half.

According to information that TransDigm provided to the Inspector General, the part costs only $173 to make, but the company charged the Defense Department $6,986 for a part that costs $173 to make. This is not rocket science; this is just wrong. The Inspector General found that even after factoring in all the costs and assigning a generous profit margin of 15 percent that TransDigm charged the Pentagon an excess profit of nearly 4,000 percent.

Now, TransDigm argues that the Inspectors General's $173 cost figure isn't fair because it doesn't incorporate the costs associated with restarting production or making a small number of parts. This is economic nonsense. We've consulted with leading economists, and they will tell you that argument wouldn't pass Economics 101.

The Inspector General's cost figure is based on TransDigm's own information. If TransDigm thought that making small parts and not having economies of scale would have additional labor hours or additional capital costs, they would have incorporated it into the Inspector General's analysis. That's because the cost is based on the labor hours and capital that TransDigm provided, including the cost for making small parts as opposed to economies of scale.

These are, unfortunately, not isolated incidents; they are the norm. The Inspector General reviewed 47 TransDigm contracts of about 2,000, and identified excess profits for 46 of 47 parts that they reviewed. TransDigm also isn't a first-time offender. In 2006, the Inspector General found that TransDigm engaged in the exact same type of behavior, to overcharge the Department of Defense by $5.3 million.

While companies are bilked by taxpayers, the CEOs have done very well. In 2017, Mr. Howley earned a total compensation of $61 million, receiving more compensation than the CEOs of Microsoft, IBM, and Boeing combined. I am glad that Mr. Howley has agreed to appear today and to cooperate with our investigation, but we are going to have some difficult questions for him on behalf of the American taxpayer.

As part of this committee's investigation, on both sides of the aisle, we talked to whistleblowers and former company officials who condemned these activities. For example, one former company official told us that TransDigm overcharging the Pentagon was like taking candy from a baby. These whistleblowers also told us how company officials concealed information from the Department of Defense about their true costs of production.

The committee also obtained documents showing TransDigm employees and Pentagon officials communicating about breaking contracts into multiple smaller contracts to avoid reporting requirements. One director of sales told us the employees were coached

not to provide cost data. As the director of operations of TransDigm said, we were going out of our way not to disclose the costs to our government.

Overall, the Inspector General found that TransDigm made more than $16 million in excess profits just from the contractors reviewed in 47 samples out of 2,000. The Pentagon asked to pay that money back, but so far the company has refused. Well, here is the deal: We will not leave here today without a commitment from TransDigm that they will repay the excess profits.

Mr. Stein, we are demanding that TransDigm pay back an amount that is less than TransDigm paid you this year. I hope you will make that commitment in your opening statement or sometime in this committee. It would go a long way.

Finally, I want to thank Ranking Member Jordan and his staff for their cooperation and assistance on this hearing and making it bipartisan.

And I now yield to him for his opening statement.

Mr. JORDAN. Chairman, thank you for this hearing today. And to our witnesses, thank you for being here. In particular, Assistant Secretary Fahey, we appreciate you being with us this morning.

I understand the Department had reasons for preferring to testify on a government-only panel, but I am glad we were able to work with you to accommodate the committee's interest today for this important matter.

The worldwide threats confronting our Nation have never been more complex, uncertain, and daunting. It is because of that that Defense procurement is more important than ever. This issue reaches almost all our districts through enlisted men and women who come from our districts or, frankly, the manufacturing that takes place in our respective congressional districts.

The system must provide the warfighter with the most capable, innovative, and cost-effective equipment, but it has clearly faltered. It is too complicated, too slow, and too expensive, does not consider how businesses operate and the goals that they have. Because of this, I think it imposes a massive burden on supplies and fails to utilize the private sector's research, development, and innovation.

The system employs upwards of 200,000 Federal employees. Think about that. That's more than all our Active Duty Marine Corps. There are now over 180,000 pages of regulations, with about 2,000 more every single year. In 2008, when there were only about 160,000 pages, the Office of Management and Budget and the Small Business Administration estimated the regulatory compliance cost to be $1.7 trillion. That is certainly a problem. It is too expensive to do business with this government and it is driving away innovation and competition, and it's time to bring Defense procurement into the 21st century, with a commonsense reform aimed at reaching nontraditional contractors, increasing competition, and obviously driving innovation.

All that said, it is also important that the Department of Defense not overpay for its products. Fiscal year 2017, DOD obligated about $320 million on contracts, more than all the other agencies combined. It is important for us to be responsible stewards of taxpayer dollars. We must ensure that the Department is paying a fair and reasonable price for all products, including those at issue today. We

must balance the needs of the contracting officers with the burdens placed on the industry. I think we should recognize that this is not an easy goal, but certainly one worth striving for.

It is important to note that while this is an important issue, it is broader than one company. As I understand it, DOD is already working tirelessly to root out bad actors. The DOD Criminal Investigative Service is consistently investigating issues related to defective pricing, averaging about 32 investigations per year.

So I want to thank Mr. Khanna today and Chairman Cummings for holding this important hearing, for all our witnesses and for their testimony.

With that, Mr. Chairman, I would yield back.

Mr. KHANNA. Thank you, Ranking Member Jordan.

Now I want to welcome our witnesses: The Honorable Glenn Fine, who is the Acting Inspector General of the U.S. Department of Defense; Theresa Hull, the Assistant Inspector General for Acquisition of the U.S. Department of Defense; Kevin Stein, the chief executive officer of TransDigm; Nicholas Howley, the founder and executive chairman of TransDigm; and the Honorable Kevin Fahey, who is the Assistant Secretary of Defense for Acquisition, U.S. Department of Defense.

If you all could please rise and raise your right hand.

Do you swear or affirm that the testimony you are about to give is the truth, the whole truth, and nothing but the truth, so help you God?

Thank you. Let the record show that the witnesses answered in the affirmative.

The microphones are sensitive, so please speak directly into them. Without objection, your written statement will be made part of the record.

With that, Inspector General Fine, you are now recognized to give an oral presentation of your testimony.

STATEMENT OF THE HONORABLE GLENN FINE, ACTING INSPECTOR GENERAL, U.S. DEPARTMENT OF DEFENSE

Mr. FINE. Representative Khanna, Ranking Member Jordan, and members of the committee, thank you for inviting us to appear before you today to discuss the Department of Defense Office of Inspector General report on the DOD's purchase of spare parts from TransDigm.

Our audit examined the prices that TransDigm charged the DOD for these spare parts. Specifically, we determined that TransDigm earned profits of over 15 percent on 46 of the 47 spare parts we reviewed in our audit. The profits ranged from 17 percent to over 4,400 percent for these parts.

We also determined that TransDigm declined to share cost data when requested by DOD contracting officers. We concluded that the inability of contracting officers under the current legal framework to compel TransDigm to provide cost data contributed to the DOD significantly overpaying for these parts.

I will briefly discuss in my oral testimony this morning the DOD OIG's longstanding concerns about sole-source procurements, such as those with TransDigm. While these concerns are not new, the

prices charged by TransDigm provide another clear and recent demonstration of the problem.

With me is Theresa Hull, our Assistant Inspector General for Audit, Acquisition, Contracting and Sustainment, the DOD OIG unit that conducted the audit of TransDigm. She will provide in her testimony a few more specific details about the findings of our audit as well as potential legislative changes to help address these issues.

First, it is important to note that the issues raised in our audit are not limited to just this company and its contracts with the DOD. These findings are representative of ones we have highlighted in our audit reports going back many years. Often, our reports have identified the lack of cost data available to DOD contracting officers as a root cause for contractors obtaining excessive profits on sole-source parts. Our prior audits, beginning as far back as 1998, have repeatedly found problems with determining a fair and reasonable price for sole-source parts. We discuss a series of those audits in our written statement.

With regard to TransDigm, we previously conducted an audit in 2006 that had similar findings to our recent report. In our 2006 audit, we concluded that the DOD was unable to effectively negotiate prices for spare parts procured from TransDigm subsidiaries and that DOD had paid approximately $5.3 million more than fair and reasonable prices for 77 parts.

Also, in 2015, we published a summary report, which noted that since 1998 we have issued 32 audit reports related to spare parts pricing. In only three of the 32 reports do we find that the DOD had obtained fair and reasonable prices for these parts.

Ms. Hull will now discuss our recent audit of TransDigm as well as some potential actions to help address these issues.

STATEMENT OF THERESA S. HULL, ASSISTANT INSPECTOR GENERAL FOR ACQUISITION, U.S. DEPARTMENT OF DEFENSE, OFFICE OF INSPECTOR GENERAL

Ms. HULL. Representative Khanna, Ranking Member Jordan, and members of the committee, more than three-quarters of TransDigm's net sales come from products for which TransDigm stated that it was the sole-source provider.

Sole-sourced parts are, by their nature, difficult to price on a fair and reasonable basis, because the normal market structure and market dynamics do not always exist for sole-sourced parts. Often, with sole-sourced parts, the price for the part is not what the commercial market would set. Rather, when competitive forces are absent, the price becomes what the DOD is willing to pay for the part that is essential for a DOD weapons platform, such as an aircraft.

In our audit of TransDigm, which we issued in February of this year, we reviewed a sample of 47 spare parts that TransDigm subsidiaries sold to the DOD between January 2015 to January 2017 on 113 contracts, with a total value of $29.1 million for the 47 parts. TransDigm was the sole manufacturer for 39 of the 47 spare parts that we reviewed in our audit.

Of the 47 spare parts, we only found one instance in which TransDigm received a profit less than 15 percent for that part when compared to the cost for TransDigm to make the part, which

we determined from the cost data we obtained from TransDigm. The remaining 46 spare parts that we reviewed had profits ranging from 17 percent to over 4,000 percent. In total, we determined that for these 46 parts, which cost the DOD $26.2 million, TransDigm earned $16.1 million in excess profit.

On 16 occasions, DOD contracting officers requested cost data from TransDigm. However, TransDigm was not obligated by law to provide that data and it refused to do so in response to 15 of the 16 requests. The one instance that TransDigm provided the requested certified cost data was for the only part that the contracting officer could not award the contract without obtaining the data. Significantly, of the spare parts we analyzed, this was the only time that TransDigm received a profit of less than 15 percent.

The more insight contracting officers have into the cost of a part, the better their chances are to negotiate a fair and reasonable price. However, the contracting officers had limited options once TransDigm refused to provide the requested cost data. Either buy the parts without receiving the cost data from TransDigm or not purchase the parts needed to meet mission requirements, which could potentially impact the warfighter.

We recommended in our report several administrative actions that the DOD could pursue: First, we believe that the DOD should seek voluntary refunds from TransDigm for the $16.1 million in excess profits that we identified.

Second, we recommend that the DOD update and enforce policy guidance that DOD contracting officers track and report within the DOD when a contractor that provides sole-source parts refuses to provide the cost data to the DOD.

However, current statutes do not deter companies where the statutory provisions have combined to hinder the government's ability to obtain sufficient information to ensure that reasonable prices are paid for those spare parts. We recommend that Congress consider several legislative reforms, such as amending existing acquisition statutes to require that contracting officers obtain, at a minimum, uncertified costs or pricing data before awarding a contract to a sole-source offeror for the procurement of spare parts, regardless of the contract dollar value.

In addition, the statutory and regulatory definitions of adequate price competition for spare parts could exclude those instances in which offerors of the spare parts obtain the part from a single source or from subsidiaries of that source.

We believe that with these changes, the DOD contracting officers would be better able to obtain crucial information necessary to level the playing field and award contracts for spare parts with these sole-source manufacturers that do not result in profits like those obtained by TransDigm and others. Without these steps, the DOD may continue to pay excessive prices for spare parts that it needs.

Thank you for the opportunity to testify this morning, and we look forward to answering your questions.

The Chairman. Assistant Secretary Fahey.

STATEMENT OF THE HONORABLE KEVIN FAHEY, ASSISTANT SECRETARY OF Defense FOR ACQUISITION, U.S. DEPARTMENT OF DEFENSE

Mr. FAHEY. Mr. Chairman and Ranking Member Jordan and distinguished members of the Committee on Oversight and Reform, thank you for the opportunity to testify today on matters relating to the Department of Defense's ability to be a good steward of the taxpayers' dollars in cases where we are procuring spare parts from an exclusive sole-source buyer.

I am Kevin Fahey, the Assistant Secretary of Defense for Acquisition. I appreciate the opportunity today to discuss and review the conduct by the Office of the Inspector General at the Department of Defense relating to contract on military spare parts. My role as the Department acquisition lead is to ensure that the Department acquires goods and services at a fair and reasonable price at the time of need.

I join you here today to discuss an atypical situation in which we currently find ourselves within. A contractor has developed what I would call a disgraceful business model designed to exploit current statutes and regulations that are fair and reasonable pricing of supplies and services procured by the Department of Defense.

For the period of Fiscal Year 2015 to April 2019, the Department awarded nearly 47,000 contract actions in a total contract value of approximately $635 million to TransDigm and its subsidiaries. Of those contracts, 28 percent were sole-source transactions totaling $273 million, or 43 percent of the total value of the contracts awarded to TransDigm and its subsidiaries.

In their review, the IG determined that TransDigm earned excessive profits on 46 of the 47 sample parts, with a profit from 17 percent to over 4,000 percent. When our contracting officers requested cost data on 16 of the 47 received, TransDigm denied all but one of those requests, leaving our contracting officers with little choice but to pay TransDigm prices in order to ensure warfighters' needs were met. The singular instance where TransDigm agreed to pay the requested cost data was under a contract that met the threshold of Truth in Negotiations Act.

Unfortunately, existing statutes and regulations do not prohibit TransDigm's outrageous pricing practices nor, in fact, do they hinder their business model of acquiring ownership or intellectual property rights to be sole-source producers and then inflating those prices on those products. We do not condone the gouging of the American taxpayers or wasting the Department's finite resources, which could be better used to procure supplies and services to support our men and women in uniform.

In light of what the Department has seen today, we have taken several actions consistent with the IG recommendations. We continue to review the laws and regulations to make sure that they are sound, to protect the taxpayers' dollars, and can prevent companies from exploiting a position where they own the intellectual property in a sole-source position.

We directed the heads of contracting activities to report all contractors who refuse to provide cost and pricing information. Beginning in July of this year, this reporting will provide the Depart-

ment holistic insight into such denials and requests for cost pricing data.

Further, we have appointed a group of functional experts to review the information in this report to identify those sellers who routinely refuse to provide cost information and to identify and share information regarding those contractors that are deemed to be high risk for unreasonable pricing. To improve our negotiating position with sole-source contractors, the Defense Management Agency Commercial Items Group will engage to perform should-cost analysis on high priority parts.

We look forward to working with Congress to find ways to prevent companies like TransDigm from gouging the taxpayers with their sickening business practices. As we work to reform acquisition to support the National Defense Strategy to prepare for near-peer adversaries, we do this based on trust and that people and companies will be ethical and do the right thing for the country and the taxpayer.

But we have to deal with companies like TransDigm. This is a very small percentage of bad actors that results in necessary rules and regulations that bogs down the entire acquisition system, results in overhead and bureaucracy. This gets under my skin and makes me sick. Our warfighters are the best in the world, but also rely on some of the best equipment in the world.

We have a long and mutual benefit relationship with most of our industry partners. They are patriotic and honorable businesses, but occasionally a bad actor skews public opinion against the industry, diverts management attention and financial resources away from the challenges and, the worst, endangers our warfighters.

Thank you for the opportunity to testify today before Congress, and I look forward to your questions.

Mr. KHANNA. Thank you, Secretary Fahey. Mr. Stein.

STATEMENT OF KEVIN STEIN, CHIEF EXECUTIVE OFFICER, TRANSDIGM

Mr. STEIN. Thank you, Mr. Chairman, Ranking Member Jordan, and members of the committee. Thank you for your invitation to participate in today's hearing. I am joined by our executive chairman, Nick Howley.

TransDigm is a supplier of highly engineered aircraft components with products in nearly all commercial and military aircraft, but TransDigm is not a traditional Defense contractor. Its primarily a commercial company. Our primary customers are commercial aircraft manufacturers and airlines. About seven to eight percent of our sales represent U.S. Government aftermarket sales.

TransDigm operates through 54 independently run operating units, with 134 manufacturing locations and over 200,000 product SKUs. In general, each unit shoulders its own R&D costs. DOD rarely funds the cost of product development for us. Most of our Defense sales are of products developed from commercial parts or of a type sold commercially.

As TransDigm is primarily a commercial company, its business model is different from that of traditional Defense contractors receiving cost-based contracts. But its model is common in the commercial aerospace, automotive, and marine industries. In these in-

dustries, parts are often developed and sold to the OEM at lower margins. After selling parts to the OEM, suppliers are able to realize higher margins by selling the same parts or subcomponents to end users as spares. This razor/razor-blade pricing strategy is common in the industry.

It is also important to note that TransDigm makes specially designed made-to-order parts in small quantities. During production, we might make parts for a few hundred planes per year. After the airplane goes out of production, we have to support the aftermarket for as long as those planes fly, often decades. That means that we're supplying DOD in very small order sizes with sometimes years between orders.

For an order of out-of-production parts, we may have to order materials, switch machines and tooling, set up test equipment and the like. These investments of time and opportunity costs are not captured in the product cost as reported by the IG. These dynamics are, however, standard in the industry and drive our pricing.

Congress has enacted several laws to facilitate government reliance on the commercial marketplace and reduce the number of onerous government requirements applicable to commercial item procurements. The proposal of these laws is to encourage commercial contractors, such as TransDigm, to sell to the government. For parts that qualify as commercial items, the fairness and reasonableness of prices that the DOD pays is determined by commercial market prices.

Contracting officers should use historical prices, catalogues, government estimates or market research. Only as a last resort should contractors request cost data. In TransDigm's case, 43 of the 47 parts audited are, in fact, commercial items and all their prices were originally determined to be fair and reasonable.

But the IG appears to have ignored the FAR and congressional intent by using cost analysis and an arbitrary profit percentage. In doing so, the IG determined that TransDigm's profit was excessive. However, it also found that in purchasing those parts, contracting officers followed all applicable laws and regulations and, importantly, that TransDigm did nothing illegal in its pricing.

Further, the IG's conclusion is based on informal cost estimates that don't accurately capture many of the actual costs of doing business. The informal cost data provided by TransDigm is understated and the profit is overstated, because they were mere estimates and do not include many general and administrative costs, such as taxes, interest, as well as litigation, acquisition, and patent costs, which we do not and cannot allocate to a specific product.

It has been wrongly asserted that TransDigm doesn't develop any products itself, but, rather, only acquires businesses and raises prices. On the contrary, TransDigm undertakes significant engineering projects. We have about 3,000 engineers and spent almost $300 million in R&D over the last 5 years alone. Our written statement includes details about our development of a cockpit door locking system and module in response to 9/11 and our design of a missile actuation system. We are very proud to offer these kinds of innovative products to our commercial and government customers.

With regard to acquisitions, after we buy a business, we focus on how to improve quality, expand product offerings, and better pro-

vide value for our customers. For example, we acquired our Kirkhill business last year. Since then, we've added employees, improved quality and delivery, and this year we'll invest $9 million in capital projects. We invest significantly to own and provide high-quality engineered products and work hard to timely deliver zero defects. This has significant value to our customers.

Yes, pricing is one of a number of elements that we review when we analyze and acquire businesses, but it's one of many factors. We hope this will help dispel confusion about us and how we do business. Though our Defense sales are a minority of our business, we are proud of our contribution to the Nation's Defense.

Thank you for the opportunity to appear today. We look forward to your questions.

Mr. KHANNA. Thank you.

Mr. Howley, do you have a statement?

Mr. HOWLEY. No, I don't. We just have one statement.

Mr. KHANNA. Okay. Thank you.

The chair now recognizes Representative Speier of California for five minutes for questions.

Ms. SPEIER. Mr. Chairman, thank you. And this is the kind of hearing that this committee should be having, so I applaud the chairman and ranking member for doing so.

Mr. Fahey made a very compelling statement. He called your business model at TransDigm a disgraceful business model. So, Mr. Stein, let me ask you this question: The Inspector General has determined in two different reports now that you overcharged for parts. In one, they came up with a figure of $5 million. The last study they just did showed that you overcharged $60 million in excess of charges.

And my question to you is, are you going to pay back the taxpayers of this country the $16.1 million and the $5 million in overcharges, yes or no? Mr. Stein, you are the CEO, correct?

Mr. STEIN. Yes, I am. Thank you.

In terms of the——

Ms. SPEIER. Yes or no?

Mr. STEIN. No. We are still evaluating and we have not come to a conclusion. This meeting today is part of that evaluation and, you know, we will take all of this into account.

Ms. SPEIER. So one of the estimates was done back in a 2006 report. So you've been evaluating this since 2006 to determine whether or not you're going to pay back the taxpayers the $5 million in overcharges? How much longer do you need? That was 2006. That was 12 years ago, 13 years ago.

Mr. STEIN. I wasn't with the company in 2006, so I can't comment on what happened back then.

Ms. SPEIER. That to me is a cop-out. Either you are willing to repay the taxpayers of this country or you are not. I'm holding here a door handle. This door handle for the Black Hawk, you charged the taxpayers $977 for this door handle. The Department of Navy was able to reverse engineer this door handle and manufacture it itself for $503. So you charged almost twice as much for a door handle that they reverse engineered and were able to make for $503. That to me is outrageous.

How do you explain charging $907 for something that they were able to reverse engineer for $500?

Mr. STEIN. I'm not sure I can comment on the reverse engineering. I don't know if that information was made privy to us beforehand. Is this part of the should-cost analysis that was done, because I'm not—I can't comment on the rationale, process, or methodology that was used to calculate the should cost.

However, you know, if we're alleging that we're doing something wrong or, you know, not in the best interests, I think the answer is absolutely emphatically no. We're a commercial company. We're a commercial business that manufactures over 200,000 parts——

Ms. SPEIER. Okay, but you already said that.

Mr. STEIN [continuing]. over 50,000 parts in the military business alone.

Ms. SPEIER. Thank you. Thank you. Thank you.

That was made public back in 2008, so that's information that has been made available to you before.

Let me ask you this, Mr. Stein: On October 10th, 2018, you had a call with investors about the acquisition of Esterline. And it appears that you like to buy companies that can be sole source so you don't have to compete with anyone. And you commented to your investors: We just think that there's juice here. And, again, following the same TransDigm value creation drivers, there's juice here that we can go get.

What is the juice you're referring to? Is that the American taxpayer?

Mr. STEIN. Certainly not.

Ms. SPEIER. What's the juice?

Mr. STEIN. Important improvements in the business, important improvements in quality.

Ms. SPEIER. To investors?

Mr. STEIN. To investors and to customers.

Ms. SPEIER. Well, no, to investors who are looking for profits.

Mr. STEIN. We acquired a number of companies. Kirkhill was one of them that were part of the Esterline group before we acquired it. It was losing money. It's an F–35 supplier. It was in doubt of its long-term existence. It was losing money. Esterline no longer wanted them in their portfolio.

We bought that business. We've hired hundreds of people. We've solved some of the F–35 delivery issues on products. We're working on other ones now. We've, you know, regained the confidence of the Department of Defense.

Ms. SPEIER. Mr. Stein, my time is elapsing. When you refer to juice to a group of investors, I think we can all understand that what juice means, we can squeeze a lot of money out of this acquisition.

And from what I understand, part of your model is to increase the prices of spare parts and reduce the cost of making those spare parts by actually laying off people.

With that, I yield back.

Mr. KHANNA. Thank you.

The chair now recognizes Representative Foxx for five minutes.

Ms. FOXX. Thank you, Mr. Chairman.

I am going to direct this question to Mr. Fine, Ms. Hull, Mr. Fahey. Either of you or all of you can respond.

There's a section of your report that discusses contractor interference when determining fair and reasonable prices. Specifically, the report notes previous OIG reports that discuss instances where, quote, "contractor actions hinder contracting officers from determining a fair and reasonable price," end quote.

The report also mentions a contracting officer recounting that a, quote, "contractor benefited from its status as DLA Aviation's only approved source by arguing against or delaying responses to requests for supporting data on 22 occasions until the need to sustain the military aircraft in support of DOD missions became urgent and the contracting officer had to buy the part so the mission would not be negatively affected," end quote.

My question is, are there efficiencies available or ways to improve the source approval process at DLA and the military components that could encourage greater competition from small businesses or nontraditional Defense contractors?

Ms. HULL. Thank you for the question. In that particular case, it's referring to an instance in which the government contracting officer didn't have another option. It was a sole-source situation. So in those cases, what we've found, both in this report and in prior work, is that there isn't really a lot of other available options to that individual to get accurate pricing information.

So, in this case, there was not another company to go to. And in our findings, what we've highlighted is that it's important to get the right information into their hands, into the hands of the contracting officer, which is why we've laid out suggestions to look into providing, at a minimum, uncertified cost data. If they had had that information, they would have been in a much better situation to make a decision on the purchasing of those parts.

Ms. FOXX. Mr. Fine, would you like to add to that?

Mr. FINE. I think that is absolutely right. What we're trying to do is level the playing field, so that particularly in sole-source cases without adequate competition, the contracting officers have enough information to determine what is a fair and reasonable price.

In many of these cases, the contracting officer in the military needs that part, needs that aircraft, and they are over a barrel. And so it is not—they do not have options other than to take the part at exorbitant prices. And what we are trying to do is level the playing field with those suggestions.

Ms. FOXX. Well, I certainly can concur that we need to do that.

Mr. Fahey, when negotiating a contract for a sole-source part, do contracting officers explore the ability of obtaining intellectual property rights? If they do not, can you explain why?

Mr. FAHEY. So, ma'am, first I'd like to touch on your first question.

Ms. FOXX. Certainly.

Mr. FAHEY. The additional piece which Representative Speier talked about, which is the reverse engineering piece, right? We get into situations over and over again, we do look at reverse engineering. Just some of the parts that have been around for a while that are critical, sometimes the engineers won't touch them. But like the handle is a good example that we've reverse engineered. And

then we can compete it. And usually parts like that are good for small business.

Yes, I mean, we absolutely do explore—could you——

Ms. FOXX. Yes. Do you explore the ability of obtaining intellectual property rights?

Mr. FAHEY. Yes, ma'am, we do, right. It's sort of the same thing you see here is what we find when we get in this situation when it's a spare part of an old part, our ability to buy it at a fair and reasonable price is almost impossible, because what industry values it as an opportunity, not as the cost of the IP. And so that's why it's so important when we start acquisitions to make sure that we negotiate the IP up front and have an IP strategy when we stop programs, because when we get in the situation we're here, it's hard to buy that intellectual property.

Ms. FOXX. When did you start looking at this issue of IP? How long has that been in existence?

Mr. FAHEY. So the Department has been looking at the issue of IP for quite a while. Me personally, my job is—just this past November there was a report done because, you know, Congress asked industry and the Department to get together, and they submitted the report. And now I'm in the process of writing what is the Department of Defense's new intellectual property strategy.

If you think about a lot of these parts, their legacy was back in the day where we didn't purchase the IP, right? So we have done a 180 and know that's important and up front. And it's really more about what is the data we need to sustain our equipment.

Ms. FOXX. Thank you.

Mr. Chairman, one quick comment. I have become aware of many situations where there is a claim of distinctiveness of parts when they really are not, and we are way overpaying for things than we should be.

Thank you, Mr. Chairman.

Mr. KHANNA. Thank you, Representative Foxx.

I'd now like to recognize Representative Sarbanes, for five minutes.

Mr. SARBANES. Thank you, Mr. Chairman. Thanks for doing this hearing. I appreciate it very much.

Mr. Howley, I think you were the CEO at the time when the parts were being sold that Congresswoman Speier was talking about a moment ago at these exorbitant prices. And I think the company at that time was asked to pay back $5 million in association with a contract, and that has not been paid back yet, has it? And if not, why not?

Mr. HOWLEY. No, it has not.

Mr. SARBANES. How come?

Mr. HOWLEY. We—let me—a couple things I'd like—I'd point out there. One, we went through an IG audit at the time. And the determination, as I recall—and I'm now saying this from 13 years ago—was that we had complied with all the rules and regulations and the company had done nothing wrong. And we decided—we didn't pay it back. We did not have an obligation to pay it.

Mr. SARBANES. That's going to be a refrain here today, I think, that you complied with all the rules and regulations, which may

get to why we need to tighten those up. And I know there are some recommendations on that.

But——

Mr. HOWLEY. I might just add there's some differences between the 2018 and the 2006 one. In the 2006 one, we probably were not as familiar with regulations, and about half of the parts were not determined to be fair and reasonable. We, frankly, didn't even know such a determination was made at that time.

In the last audit, I just want to point out that all 46 or 47 parts were determined to be fair and reasonable at the time the order was placed.

Mr. SARBANES. Let me ask you about something else, because you said, you know, you complied with all the regulations and so forth, which I imagine there may be some dispute over; but you then said, we did nothing wrong.

And I want to challenge you on that, because the committee got some testimony from a former director of operations that said that at quarterly meetings, Nick Howley—that's you—and management gave a wink-wink, nod-nod that we want to avoid disclosing any cost data. They told us under their breath we should see what we can do to avoid disclosing cost data. We don't want to talk about costs; we want to talk about price, in parentheses profit.

Have you or any senior official at TransDigm told an employee that they should avoid disclosing cost data?

Mr. HOWLEY. What we tell the employees—well, first on that, I don't know what that is. I don't know the situation. I don't know the specifics. I don't remember it. I don't—I simply don't know what it is.

Mr. SARBANES. Well, it's somebody saying that basically the message was don't talk about cost data.

Mr. HOWLEY. I'll repeat. I probably have not—I've been doing very few product reviews in the last 10 years.

Mr. SARBANES. Mr. Stein, are you aware of that happening?

Mr. STEIN. Am I aware of what happening again?

Mr. SARBANES. Are you aware of a senior official telling employees that they should avoid disclosing cost data?

Mr. STEIN. I'm not aware of that. I'm only aware of the——

Mr. KHANNA. If the gentleman would turn on his microphone.

Mr. STEIN. Sorry, my apologies. I'm not aware of that. I am aware that we continually stress with our employees to follow all rules, regulations, laws accordingly. That's what we stress with them.

Mr. SARBANES. Yes. So then there's another—there's a former sales director on the same theme said, told the committee: Quote, "we were coached to not provide cost data."

And then you sent a letter in May 2019, just now, to the committee, saying: "TransDigm has no written policy stating that employees should refuse to provide uncertified cost data on request." So that you don't have a written policy, right?

Mr. STEIN. We have no written policy.

Mr. SARBANES. That's convenient to not have a written policy.

Mr. STEIN. I'm not aware of any verbal policy either.

Mr. SARBANES. Well, it sounds like there was kind of an unwritten policy, based on the directives that were being given to these

various employees, according to the testimony that they provided to the committee.

So you're saying you have no policy, written or unwritten, to refuse cost data when it is requested by a contracting officer if it is not required by statute. Is that correct?

Mr. STEIN. If it's not required by statute, we have no policy.

Mr. SARBANES. And what's your justification generally for denying contracting officers cost data when they ask for that data?

Mr. STEIN. We are a commercial company. We develop——

Mr. SARBANES. Proprietary, all that kind of stuff?

Mr. STEIN. Sure. It's true.

Mr. SARBANES. So that will be another refrain here today. But I don't think it passes the smell test. I mean, you're hanging a lot of stuff on some technicalities here maybe. We can try to fix those to, you know, lock this down, but the notion that you didn't do anything wrong I think doesn't meet the laugh test, given what we've heard here today and the testimony and the documentary evidence and so forth.

And, with that, I yield back to the chairman.

Mr. KHANNA. Thank you, Representative Sarbanes.

The chair now recognizes for five minutes Representative Gibbs.

Mr. GIBBS. Thank you, Chairman.

Mr. Stein, you talked about it. I can appreciate you're a commercial company and then when you have to make things for the military, Defense, in small quantities as you stated and aftermarket and you got to do special things. Obviously, there's going to be some higher cost, and I can appreciate that. And you got legacy cost.

But where I'm struggling a little bit is I never heard of this company until just recently, and I Googled your company and there's from Bloomberg here a report and it talks about some of the items that were sold. And there's one here, the Defense Logistics Agency talking about paying $4,361 for a half-inch drive pin that they say should have cost $46.

Now, as the citizens, they Google that and they see that, that must be one hell of a drive pin. I'm a farmer. I kind of know what those are. I'd kind of like to see that drive pin. But I get my arms around things a little bit better when I see an example. Can you tell me about this drive pin that costs $4,300?

Mr. STEIN. I can't. I think, if I can, you know, again, we make a lot of parts for the Defense. I can't comment on the should cost because, again, that is a process and a methodology no one has shared with us, so it's hard for me to comment on that.

But, again, we—you know, we have this commercial heritage. This is how we develop parts. But I think even in the farming industry that you're referring to—I know because my family was also farmers. That's where my mother was raised. John Deere everywhere.

And if you go to buy a pin or a point for your corn planter that's 50 years old, you are going to pay more than that corn planter cost when you bought it originally, without a doubt.

Mr. GIBBS. Without a doubt.

Mr. STEIN. This is a model that is common in industry, the razor/razor-blade. You develop it, you sell it at extremely low cost, low profit up front, and you hope to recover that in the aftermarket.

In the military case, in many cases we're only making a couple parts over decades. The cost to go in and make——

Mr. GIBBS. I appreciate that, and maybe shame on the military aspect. You know, it's just a lot of engineering or whatever to let that happen, but I can tell you, as a farmer, there's no way I'm going to spend 43, 44 hundred dollars on a half-inch drive pin. I mean, we'll just get another piece of equipment or do something different.

But back to that, Mr. Fahey, on the procurement side, how do you justify—okay, let me ask the question this way: Sole source, I can understand that, especially in the Defense acquisitions and there's no competition.

So I guess back to Mr. Stein. Where would you think when there's no competition, it's sole source, is there a legitimate question to be overlooked for the Defense procurement people to come in and analyze what your costs are and, you know, keep it confidential? But since there's no competition there, would you agree that that's a fair thing for them to be able to do or not?

Mr. STEIN. Sorry, is that a question for me? I wasn't sure if you said Stein or Fine.

Mr. GIBBS. I changed my——

Mr. STEIN. So can you repeat it? I apologize.

Mr. GIBBS. Well, when there's no competition, okay—a wide level of competition keeps prices down and makes—that's how our system works. But in this case, where there is no competition and it's sole-sourcing, do you think it's unreasonable for the acquisition people in the Defense Department to come in and really ask questions and find out what your costs are? And it would be confidential, they shouldn't be talking to anybody else about that. But, you know, is that an unreasonable request when there's no competition?

Mr. STEIN. I don't know. It's difficult for me to speculate on policy or intent. So I fall back to that, you know, we want to deliver parts on time with the highest quality, the highest engineering standards for these mission-critical parts. That's——

Mr. GIBBS. Let me go back, go over to Mr. Fahey, the acquisition people.

Mr. HOWLEY. Could I clarify just a second on that? It would be helpful

Mr. GIBBS. Make it quick.

Mr. HOWLEY. The vast majority of what we do, we are a commercial supplier. You say, how are the parts prices generally regulated? Most of what we supply is of-a-kind commercial parts. So the commercial market essentially establishes the price.

Mr. GIBBS. I understand that. The commercial market is not going to pay $4,300 for a half-inch drive pin.

Mr. HOWLEY. Oh, they are if it's of a kind. That's how we're establishing the price for many of these parts.

Mr. GIBBS. I have a hard time believing that, but okay.

Mr. FAHEY. So I would take a variation of what the IG DOD is recommending. If you think about it, if we get to the situation

where, through sales data, market researches, reverse engine—we can't figure out whether they are giving us a fair and reasonable price, when we ask for the cost data, by law require that they do it. You know what I mean? When we ask for it and they don't give it to us, it makes it so we have no alternative. But there's no reason why when we get in those situations when we do ask for it, it is required for them to give it.

Mr. GIBBS. Currently, the law requires that?

Mr. FAHEY. No.

Mr. GIBBS. It doesn't, okay.

Mr. FAHEY. No. Today, they are only required if it falls above $2 million. That's the Truth in Negotiations. It is the recommendation for sole-source situations. I would argue when you can't get data that says that you know it's fair and reasonable and then when you request data like the procurement office have, by law, it should be required that they give it to them.

Mr. GIBBS. Thank you. I yield back my time.

Mr. KHANNA. Thank you, Representative Gibbs.

I now recognize myself for five minutes. Mr. Fine and Ms. Hull, thank you for your work and the work your staff did to expose this. You obtained, Mr. Fine, cost data from TransDigm to see how much the company spent on those parts, correct?

Mr. FINE. Correct.

Mr. KHANNA. Can you respond to TransDigm's obfuscation that they didn't give you all the cost information because of economies of scale and having to make small parts? Was that factored in?

Mr. FINE. We didn't hear that from them. We asked them for the cost data. This is cost data that the contracting officers had asked for. And in 15 out of the 16 times they were refused that, because the contracting officers could not force them to give that by law. They didn't give it.

We asked for it. We are backed by subpoenas. We didn't have to issue a subpoena, though. They gave us the information. They gave us information broken down with labor, materials, and overhead. The overhead did include other things, like marketing and supplies and other things.

We used that information. We examined it. We came up with our numbers. We provided the report to them. They did not contest the accuracy of our figures. The first time we heard about that was last night when we read their testimony. So they had a chance to discuss whether the cost calculations that we made were inaccurate. They did not say that.

And the final thing I'll say is even if there are some costs that are not captured in the information that they gave to us—we used their data—I doubt it is going to turn a $43 part into $4,300. There's no way that there is that delta.

And that's why we did a range of profit margins. And even if you give them a profit margin of—a significant profit margin, most of those parts are way, way above any reasonable profit margin. So that's how I would respond to the comments that we've heard this morning in the testimony.

Mr. KHANNA. And just to put it in perspective, Mr. Fine, the first on this chart it shows that one of the estimates is $799 for the cost and then the part is being sold for almost $11,000, correct? I mean,

so your analysis, even if you're saying it's $1,100 or $800, the idea is absurd that—the profits, the margins are absurd, correct?

Mr. FINE. We think the margins are excessive, given the cost of the part. And we provided the—the information, we analyzed the information that they gave to us, which they did not contest after we analyzed it.

Mr. KHANNA. Do you believe, Mr. Fine, that TransDigm should pay back the $16 million and the $5 million, as Representative Speier suggested?

Mr. FINE. Yes.

Mr. KHANNA. And some of my colleagues on the Republican side suggest?

Mr. FINE. Yes. Are they required to do it by law? No. Should they do it? I think they should.

Mr. KHANNA. Secretary Fahey, you represent the Department of Defense. Is it your view that they should pay back the $16 million?

Mr. FAHEY. Yes, they should pay it back.

Mr. KHANNA. Mr. Stein and Mr. Howley, a free bit of advice. You got a bipartisan Congress saying you should pay back $16 million you owe the taxpayers. We in Congress can almost agree on nothing. I mean, it's remarkable that we agree on this. You got the Secretary of Defense's representative saying you should pay back $16 million. Your big risk is that FOX & Friends will cover this and you'll have a Presidential tweet asking you to pay back the money. So before we get to that kind of point, why not just—the company is worth $1.2 billion. Why not just pay back $16 million?

Mr. HOWLEY. We're still evaluating that. I think a couple things I would like to point out on that. One, these contracts were placed, and they were all determined to be fair and reasonable by the Department of Defense when they gave us—when they placed the contracts with us. And I don't think anyone is disputing that that was the determination. Furthermore, we had an audit of the process, and no one is alleging that we have not complied with any FARs, with the FARs or the regulations.

The DOD is a good customer and we value the relationship, but we also have other constituencies that we have to think about. We have private shareholders. We have employees. We have management. We have commercial customers. And we're concerned about implying that we've done something wrong here or something illegal.

It's not—the money is not the issue here. We're trying to balance those sort of conflicting demands to come to a conclusion. And we also, frankly, like to hear what we hear at this committee hearing before concluding. That's where we—we're not saying no. We're trying to balance these different tensions, I'll say.

Mr. KHANNA. I think it would go a long way. One final question: When you purchase these companies at increased prices, what value are you adding? I mean, for example, you purchased a company that made a part for $5,500, solenoid, and then after you bought it the price went up to $11,790. The part only cost $3,000. So what is the additional value when you're purchasing this and raising the price?

Mr. HOWLEY. I can explain our acquisition process if you'd like and how we go about that. We seek to buy proprietary, highly engi-

neered aerospace components with some aftermarket in them. We do a fair amount of looking into it. We study whether the business is proprietary, in fact, what's its position, what's the quality of the product, what's the management like, what's the—and if we come to a conclusion that it makes sense, we buy it if the price is right.

After we buy a business, we do a lot of things to the business. Typically, we have a fairly extensive evaluation of management. We almost invariably change the organization structure to a very clean simple structure with clear lines of responsibility.

Mr. HOWLEY. We give the businesses frequently much more autonomy than they're used to having, and that takes a fair amount of training. The ability to provide reliable technical product on time is very important. We put a lot of time into improving that, and I think Kevin pointed that out on the Kirkhill business. We look to make the businesses efficient, and we invest a lot of money in that. We substantially crank up the new business development process. We develop many, many new products, with something like 3,000 engineers working on them.

And, yes, we look at the prices. And if we look at the prices and we determine that the combination of the value provided, the market position, the contracts, the regulation, the customer perception would allow us to increase prices, we do so in cases. It is one of many things we do when we acquire.

By and large, we acquire businesses and we make them better businesses than they were before. We make them more sustainable, we make them better generators of products, and the like.

Mr. KHANNA. Thank you.

Mr. HOWLEY. And we rarely, I would add—we are not buyers and sellers. We are long-term owners of businesses.

Mr. KHANNA. I recognize Mrs. Miller for five minutes of questions.

Mrs. MILLER. Thank you, Mr. Chairman and Ranking Member Jordan.

And thank you all for being here today.

It is vitally important that our military does have the tools to do the job that they do well, which is protecting us and our freedom. However, the American taxpayers have entrusted their hard-earned money with our government to spend it wisely, both responsibly and effectively.

Mr. Fine and Ms. Hull, the majority of TransDigm contracts studied fell under the old TINA threshold of $750,000 and the new threshold of $2 million. Would the proposal to reverse this 2018 increase, which did not apply to TransDigm at the time, have any benefit?

Ms. HULL. Reversing the threshold to the $750,000 would only have benefit if combined with our suggestion that, in sole-source situations, contracting officers are able to obtain uncertified cost data at a minimum.

The issue at hand is, when they are negotiating with companies like TransDigm in sole-source environments, they are looking at information that they believe to be reasonable because there aren't any market forces at play that are controlling costs. And as TransDigm alluded to earlier regarding their value-based pricing approach, the cost, or the price, I should say, to the government be-

comes what the Department will pay and not what the market forces will bear. When you are limited to one source, there's very little leverage.

Mrs. MILLER. Mr. Fine?

Mr. FINE. I think it could help, but many contracts are for smaller than even $750,000, and there can be acquisitions that will have the same problem under that rate. The one time they were required to provide the information was because a contract was above the TINA rate, $2 million, and that's the only time they've received a profit of less than 15 percent. They received 11 percent.

So cost information and providing cost information, we think, is a helpful tool for contract officers. And that's why there ought to be consideration of all sorts of legislative fixes to allow the contracting officers to get that information when they need it.

Mrs. MILLER. The contracts studied are for low-dollar and low-quantity purchases that will almost always be below the threshold. What are the benefits to an increased threshold, which is sort of what you alluded to, such as increasing competition and the inclusion of nontraditional contractors?

Mr. FINE. I think the benefit and the reason for it was to streamline processes, to reduce the burden on contractors of providing information in all sorts of cases, even in cases when it is not necessary. In our view, some cases, it is necessary, particularly the sole-source context of what we are talking about here.

Mrs. MILLER. Same answer, Ms. Hull?

Ms. HULL. Yes. And I would say, our approach wouldn't be to raise thresholds, by any means. And, again, the threshold amount itself won't really have an impact. It's really getting to that information. Because without that more critical information, the contracting officer is pretty much put in a position where they don't have what they need to make the right decision for the warfighter.

Mrs. MILLER. Thank you.

Mr. Howley and Mr. Stein, has TransDigm ever coached employees from subsidiary companies on how to avoid exceeding the TINA threshold so that the cost data would not have to be provided to the government contract negotiator?

Mr. STEIN. No, absolutely not. We do not do that. The government contracting officer is the deciding factor on the contract size, what's ordered, number of pieces and parts. We have no ability to influence that.

Mr. HOWLEY. We do run—particularly after 2006, we do put some amount of time in training people on what the regulations are, and we absolutely insist people comply with whatever the rules and regulations are.

Mrs. MILLER. Thank you.

Another question for the two of you. Does TransDigm monitor the bidding process of its subsidiaries? Do you know when a bid is placed, for how much, and for what parts?

Mr. STEIN. Absolutely not. We have so many business units and parts, we have no ability to follow that. We have 150-plus business systems that run each individual business unit. There's no way for us to see this information.

Mrs. MILLER. Do your business practices vary significantly from companies in the industry?

Mr. STEIN. I do not believe so, no.

Mrs. MILLER. Okay.

Mr. Howley?

Mr. HOWLEY. I don't believe so.

And I'd expand. I think both in the commercial aerospace business, where we primarily compete, as in, I'll say, the automotive business, the mining, the power transmission, et cetera, the model of a razor-razorblade is a very common model. You pay all the money up front, you pay all your own development, you develop your own products, you put your capital in, you pay all your start-up costs, you don't make a whole lot of money on new equipment production, and you recover your investment in the higher prices and margins in the commercial after-market. That's very common.

You know, I would just give an example. As I say, if you go to buy a car, and you pay $35,000 for the car, and you like the car, and your spouse or your next-door neighbor says, "I'd like that car too, I think I'll go buy the parts and put it together in my garage," they'd probably pay $500,000 for that car. It's a very common razor-razorblade model in the commercial world.

Mrs. MILLER. Thank you. I yield back my time.

Mr. KHANNA. I recognize Mr. DeSaulnier for five minutes.

Mr. DESAULNIER. Thank you, Mr. Chairman. I want to thank the ranking member. And I'd also like to thank all of the sources you worked at, the whistleblowers who courageously came forward and helped us with this. And I do appreciate the bipartisan approach.

Mr. Howley, I think you just said that all of these contracts were found to be fair and reasonable. Is that correct?

Mr. HOWLEY. That's my belief. At the time of placement, they were fair and reasonable. That's what I understand.

Mr. DESAULNIER. Mr. Fine, that's not true. Eight of them where the excess profits came from, you actually found that they were best obtainable price. Is that correct?

Or Mr. Fahey?

Ms. HULL. If I may, eight of those parts were determined fair and reasonable by the reason of best obtainable price.

Mr. DESAULNIER. Right.

Ms. HULL. So what that means is the contracting officer didn't necessarily find it fair and reasonable but didn't call it unfair either. Just based on the information they had, they were put in a position where they had to purchase the part.

Mr. DESAULNIER. Another way of saying that in layman's terms is that was the only place to go to get the product.

Ms. HULL. Yes, they were sole source for those parts.

Mr. DESAULNIER. Is that historically the case, Mr. Fine? I'm sorry. I can tell by your body language you're anxious to get in here.

Mr. FINE. No, I think that's a really important point. It's determined to be fair and reasonable because there's no other source for this and they have to get the part to allow the aircraft to fly.

And so simply because they are over a barrel and saying we need this part at this price doesn't mean it's an appropriate practice or there are not excessive profits or this is an appropriate way to charge the government.

Mr. DESAULNIER. So what Mr. Howley just said is not accurate, just to——

Mr. FINE. Well, it's—you know, it's——

Mr. DESAULNIER. Were they all found to be fair and reasonable with—but eight of them have the exception is because they were the only possible place to get the product.

Ms. HULL. Yes.

Mr. FINE. Yes.

Mr. DESAULNIER. Okay.

We talked a lot about data. Mr. Fine, 47 of the TransDigm part sales that you reviewed, only 1 had a reasonable price. And as I understand that, it's because the contracting officer obtained certified cost data. On the other cases, you didn't get enough data. You've made some suggestions as to how we could change that. Would you like to elaborate?

Ms. HULL. Yes. For that particular part, the contracting officer negotiated a fair and reasonable price because they obtained the certified cost data. That particular part was over the TINA threshold.

Some of the changes what we recommend, based on our work here, is to amend the statutes to require that the contracting officers obtain, at a minimum, the uncertified cost or pricing data. And we specify that for sole-source situations because, again, there aren't any other options for that contracting officer, so it would benefit that government contracting officer to get that information.

The other change that we would recommend is regarding the definition of adequate price competition for spare parts. We would exclude the instances where the offerors of those parts obtain from that same source or subsidiaries of that source.

Mr. DESAULNIER. Mr. Fahey, the former Director of Defense Pricing and Contracts told the IG that recent changes Congress has made to make the contracting process easier for certain contracts has led to opportunities for abuse. Do you agree with that?

Mr. FAHEY. Yes. I mean, the one that was talked about previously is at $2 million. When you go from $750,000 to $2 million, by definition, you've increased the bandwidth that doesn't require TINA.

Mr. DESAULNIER. So, in Congress' desire to, I think As Mr. Stein said, get rid of burdensome regulations, we have actually, perhaps, incurred costs that Congress needs to look at correcting so you have the proper oversight, from my perspective. I don't want to put words in your mouth, but——

Mr. STEIN. Sir, I would agree. Working with you on what the right language—this is why this makes me really upset, right? Because as we try to attract small business and nontraditionals and those, it's part of the reasons we make these adjustments, right? So maybe the balance of, you know, the—when asked for price data, even uncertified price data, because it doesn't fall in—you have to give it, you can't choose not to—would be, I think, a reasonable thing to look into.

Mr. DESAULNIER. So, Mr. Fahey—and I think Congresswoman Foxx mentioned this, about small businesses and helping with competition. And no matter what the data you get, if they're the only

source to get it, and the military needs the part, you still have the same situation.

So, Mr. Fahey, we want to encourage competition. I assume we do. It's a problem in this country; there is a lack of competition. How do we do that? The data will help, but getting small businesses to compete against a large company like this is going to be difficult.

Mr. FAHEY. What I think is that, if you had the data, right, in a lot of those instances, the handle being a good example, reverse engineering, small business can compete, right? Because their overheads are low and those kind of things. Where it's hard for them to compete is when they don't have the high IP and there are specialized small parts that we know we're way overpaying, they may not have the ability to compete on those high-performance parts.

Mr. DESAULNIER. Well, I'd be particularly interested in a further discussion in this committee on how we make sure that we get that competition in the market. Otherwise, as long as they have a monopoly, you're not going to get the best price.

Thank you, Mr. Chairman. I yield back.

Mr. KHANNA. Thank you.

I now recognize Mr. Meadows for five minutes.

Mr. MEADOWS. Thank you, Mr. Chairman.

I thank each of you for your testimony this morning.

Mr. Stein, Mr. Howley, let me come to you. This is the type of thing that just drives me crazy. And I'll give you some advice. If you're looking for feedback, you better pay the money and start giving us the cost, even though it may not be required by statute. Because I can tell you that, once you raise an issue in a bipartisan way like this, it makes us look for other things.

And I can tell you that the trouble that I have with this—and there's going to be enough wrath to go around, so—but my encouragement to you is to do those two things: chalk it up to marketing expense, and pay the American taxpayer back immediately. Because I don't understand why you haven't done it. Instead of coming here today, you could've paid a few million dollars back and avoided all of this. And instead you're going to highlight it, where I'm going to have to, in a bipartisan way, start to look in a way that you would not find, I guess, supportive of future business.

I don't know, Mr. Fahey, why we continue to do business with a company that wouldn't pay it back.

So let me just be clear. When you have a sole source, no, I get that. I understand. I was a business guy. But what I'm saying is, with the types of moneys that we have here, the fact is we need to do a better job of showing the amount of money that is out there and available for a drive pin, $4,300.

I mean, here's the problem is, we've been alerted to this because of this hearing, but the average small-business guy has no idea, Mr. Howley, how much money is to be made, and so that's the reason why you don't have the competition. And so, at this point, my recommendation is to do that.

And, Mr. Fahey, I would recommend that you make several recommendations here in terms of how we can fix the procurement side of things. I'm big on making sure we have a strong national

defense. I also know that your audit, on a regular basis, is not something to brag about with DOD. We have these continued issues that are out there.

And so, Mr. Fahey, what I would ask of you is if you give three recommendations to this committee on how we can highlight the fact that competition could be there for some of these sole-source contracts. Are you willing to do that?

Mr. FAHEY. Yes, sir.

Mr. MEADOWS. All right.

Mr. Fine, in the two minutes I have left, I'm going to switch gears just briefly, because I've got you here today and I may not have you—Federal News Network actually has talked about an iCloud issue with two different companies, where we have—I believe it's Oracle and Amazon looking at a $10 billion contract. Are you investigating that particular conflict of interest?

Mr. FINE. That matter has been referred to us, and we are reviewing it.

Mr. MEADOWS. And so, as you're reviewing it, one of the issues—and I'm a big fan of the IGs. You know that. This is not our first rodeo. When you have people that leave DOD and go out into the private sector, is there an issue with your oversight and the ability to actually do a proper investigation?

Mr. FINE. It depends. If it's criminal, no. We have criminal authorities to that. If it's administrative, sometimes there is a problem with other IGs not having testimonial subpoena power. We in the DOD have testimonial subpoena power, which is good, because when we go to witnesses who have left and say we want to talk to you, they know that we can back that up with a subpoena, and they almost always talk with us.

My colleagues in the IG community have a problem with it. I had a problem with it when I was at Justice——

Mr. MEADOWS. Right.

Mr. FINE [continuing]. when people left and we couldn't force them to talk to us and there were gaps in our investigations.

Mr. MEADOWS. And so, in your investigation, the potential—and I want to stress, the potential—conflict of interest that is out there, is that something that you can report back to this committee? Obviously, with an IG's report, but is that something that you can brief this committee as you're going through your investigation or your—you didn't say you had an investigation, because there are two different words there. Did you say you were investigating it?

Mr. FINE. I did not say that. I said we have it, we are reviewing it. I don't really want to talk about an ongoing matter and characterize it. But I will represent that we absolutely will brief the committee when we are completed. We're always willing to do that, and we're willing to do that in this case too.

Mr. MEADOWS. And so, Mr. Chairman, I ask unanimous consent that the Federal News Network article that I mentioned be submitted as part of the record.

Mr. KHANNA. Without objection.

Mr. MEADOWS. And I thank the chairman.

And, Mr. Fine, I would just let you know, in terms of the IG community, this particular procurement issue has been raised to the

level where a number of us have a concern there, and so I appreciate your further insight on that matter.

And I'll yield back.

Mr. KHANNA. Thank you.

I just want to take this moment to thank Mr. Meadows and Ranking Member Jordan for the bipartisan nature of this committee hearing and your staff and teams' cooperation to put the country's interests first.

I now want to recognize Representative Tlaib for five minutes.

Ms. TLAIB. Thank you, Mr. Chairman.

Mr. Howley, you were the CEO of TransDigm during the time period where you over-billed our country, the American people, $16 million. Is that correct?

Mr. HOWLEY. I was the CEO in 2016.

Ms. TLAIB. Sure. And 2017, I believe.

Mr. HOWLEY. And 2017.

Ms. TLAIB. Yes. According to The New York—so do you remember how much you were getting paid in 2017?

Mr. HOWLEY. Yes. I was getting paid—I believe I was paid $61 million in 2017 and $19 million the year before.

Ms. TLAIB. Yes. The New York Times said it was the sixth-highest-paid CEO in American business that year. Did you know that?

Mr. HOWLEY. I saw the article in The New York Times. I didn't——

Ms. TLAIB. Yes. Congratulations. Mr. Howley, you earn more than anyone at your—combined salaries of the CEOs of Microsoft, IBM, and Boeing. In fact, you are one of the 10 highest-paid CEOs in America 3 of the last 6 years.

You received that compensation all while you were price-gouging the military and American taxpayers. And then, of course, you can see this is very deeply troubling to both sides of the aisle. And, again, in a very bipartisan way, I think we're all very troubled by it.

Mr. Stein, you're not far behind. According to TransDigm's most recent proxy statement, you earned about $23 million in 2018, correct?

Mr. STEIN. That's right. It's mostly non-cash compensation——

Ms. TLAIB. Yes. So——

Mr. STEIN [continuing]. as I was promoted to the CEO and given a——

Ms. TLAIB. Yes. I'm just trying to find out where I can get $16 million back for our people.

So TransDigm is willing to pay its executives tens of millions of dollars, but still not agree to pay back the Department of Defense the American people's excess profits. Correct? You're not willing to pay it back.

Mr. HOWLEY. Is that a—that's a question?

Ms. TLAIB. Yes, I'm asking, are you willing to pay it back?

Mr. HOWLEY. We told we have not—we have not—we are still evaluating that, and we haven't—and we haven't decided.

Ms. TLAIB. Okay. So——

Mr. HOWLEY. I think I told you—I think I went through some of the reasons.

Ms. TLAIB. Yes, yes. No, I know. My kids, actually, my two boys always say "should" and come up with these kinds of excuses when it is stealing in some sort of way, right? I mean, you may not label it that way. I'm a lawyer; you nuance around it. But it is stealing when you overcharge people like this.

So Doug Hillman, a former CEO of a TransDigm subsidiary, told the committee staff, quote: TransDigm management used a one-two punch after acquiring the company. It involves two actions: one, raising the prices; two, cutting the costs. They cut costs by firing employees. The metric they used was, quote, revenue per head.

TransDigm provided the committee with a slide that was presented at a quarterly meeting in 2015. That slide details what is called the operations value creation. The slide identifies the actions taken at one of TransDigm's subsidiaries, including, and I quote, reduced current head count by three people, $135,000; eliminated overtime, $68,000; implemented shutdown for 1 week over the holidays, $65,000. The slide includes proposed actions such as cutting workweeks to four days and shutting down for an additional week.

Which subsidiary does this slide refer to? It's right up there. You can see——

Mr. STEIN. This slide refers to CDA, our smallest business in Florida.

Ms. TLAIB. How can you justify the compensation you received while TransDigm was overcharging taxpayers and you were cutting the pay of employees?

It is a question.

Mr. STEIN. We did not cut any pay of any employees. I'm confused by that statement.

Ms. TLAIB. Yes, it's in the slide. I mean——

Mr. STEIN. The slide does not say we cut pay. We looked at it, we had a business that was—you can see it up at the top, what we saw. The last 6 months, bookings on a $13.5 million annualized pace. That's significantly below the annualized pace——

Ms. TLAIB. Okay.

Mr. STEIN [continuing]. that the business currently operates at——

Ms. TLAIB. So I just got confirmation you actually fired people. The subsidiary fired people.

Mr. STEIN. We reduced current head count by three——

Ms. TLAIB. Yes.

Mr. STEIN [continuing]. people, absolutely. As the business——

Ms. TLAIB. You guys call it "head count." That's so interesting.

Mr. STEIN. As the business——

Ms. TLAIB. Yes.

Mr. STEIN [continuing]. goes up and down——

Ms. TLAIB. Yep.

Mr. STEIN [continuing]. you frequently have to do this to rightsize the costs so that we——

Ms. TLAIB. Yep, I understand.

Mr. STEIN [continuing]. can continue to return value to our shareholders.

Ms. TLAIB. So I'm really trying to help you all figure out how you can pay us back. And my good colleague from North Carolina and my colleague from California, I think—you know, look, I have the

third-poorest congressional district in the country. I have veterans that can't find homes. I have, on the front line, people that are looking to us.

And when they see this and they see us not holding you accountable, we're the ones they have to—they're looking to us to do our jobs. And that's what we're doing here. And we're urging you and encouraging you to please pay back the American people. Sixteen million dollars can do a lot for our residents at home.

And, again, it is really about oversight and responsibility. Government is supposed to be about people, and we have to put the people first. And you understand that, I hope, why we have to do our due diligence here.

And I thank you for coming before this committee, and I thank our chairman for bringing this forward.

Thank you. I yield the rest of my time, Chairman.

Mr. KHANNA. Thank you, Representative Tlaib.

I now recognize for five minutes Mr. Hice.

Mr. HICE. Thank you, Mr. Chairman. I appreciate it.

And, listen, I would just share with what has already been said. This is looking really bad for you guys. And the American people hate to be ripped off. All of us, all of us, in any deal, hate to be ripped off. And this is one of those issues that is inexcusable, and why the money is not paid back to the American people is beyond me.

Mr. Stein, let me ask you, how many long-term or multiyear contracts do you currently have with the government?

Mr. STEIN. I do not know.

Mr. HICE. Mr. Howley?

Mr. HOWLEY. I don't know the number.

Mr. HICE. Can you give me a ballpark?

Mr. HOWLEY. I just don't know.

Mr. HICE. You don't have any idea how many contracts you have? Isn't that the business you're in?

Mr. HOWLEY. I think we provided a very long list of contracts to the committee here, and I think it was thousands. I don't believe most of them were long-term. We run 55 autonomous businesses that are run with standalone management systems and run very autonomously. I simply don't know the number.

Mr. HICE. Can you get that number to me?

Mr. HOWLEY. I believe we gave the number to the committee already. We gave them a list of all our government contracts.

Mr. HICE. Would you confirm? I would like to know how many long-term or multiyear contracts there are with the government. And likewise for the subsidiaries, if you've got 55. I'd like to have a ballpark, at least, of what we're dealing with.

And it's amazing to me, the price-gouging that's taking place, and you don't even know how many contracts you have. I want that information.

Mr. HOWLEY. I think—I would just—I think we've given that to the committee.

Mr. HICE. We'll followup, and if not, I expect to hear.

Mr. HOWLEY. If not, we'll give it to you.

Mr. HICE. That's what I want to hear.

Mr. Fine, let me ask you this regarding contract splitting. Of course, this is where a large contract is split up into smaller ones to avoid anything from pricing threshold to helping acquisitions.

In the report or when you all were going through this, how often did you see contract splitting? Either one of you, Mr. Fine or Ms. Hull.

Ms. HULL. We found 32 of our 47 contracts, or our parts that we looked at, were under the simplified acquisition threshold. But I can't speak to splitting of contracts in that regard.

Mr. HICE. All right. So explain that to me. How does that work, what you described?

Ms. HULL. So the total dollar threshold of the contract is what drives the need to provide cost information——

Mr. HICE. Right.

Ms. HULL [continuing]. to the contracting officer. So in the 47 parts that we looked at, 32 were under the simplified acquisition threshold of $150,000 at the time.

Mr. HICE. So somehow that had to be made an agreement that this is a better route for us to go to get under the pricing threshold. Is that correct?

Ms. HULL. The company would've made a determination——

Mr. HICE. I mean, somebody had to make that determination.

Were you able to determine if it was TransDigm that made that request or that decision or if it was the government?

Ms. HULL. The contractor, in this case, would be the one that would bid on the particular part for the government.

Mr. HICE. Okay. But there could be a situation where DOD, for instance, wants to simplify the acquisition process and it would go more quickly with a smaller contract, pricing threshold, correct?

Ms. HULL. Potentially. I can't speak to that for this particular audit.

Mr. HICE. Okay. That would be worth knowing.

Mr. Fahey, let me ask you this regarding intellectual property rights. Is that ever considered when dealing with contracts and the contracting officers? Do they look at intellectual property rights?

Mr. FAHEY. So the answer is, yes, sir, we look at intellectual property rights, right? I mean, that's usually more of the program manager who would give the requirements to the contracting officer of, do we own the intellectual property rights? And if we don't, do we have a situation like we don't think we have fair and reasonable pricing, that we should reverse-engineer it to get the intellectual property rights?

Mr. HICE. Right. So are you saying, then, DOD does currently have some intellectual property rights on what would otherwise be sole-source-type——

Mr. FAHEY. Yes, sir.

Mr. HICE. Okay.

So there is a negotiating process to try to address the problem that could be—because that could lead to price-gouging——

Mr. FAHEY. Yes, there——

Mr. HICE [continuing]. by obtaining the intellectual property.

Mr. FAHEY. There is. The challenge here is it's usually easier to negotiate getting a fair and reasonable price for the IP early in a program, not when you're in an after-market spare-parts situation.

Mr. HICE. All right. So do you include in that, say, first right of refusal on——

Mr. FAHEY. So that—I had mentioned earlier that we had done a report we delivered to Congress last November. One of the recommendations in there was, if you're in a situation where somebody's in sole source and owns intellectual property and they are going to sell it, that the government has right of first refusal to buy that intellectual property before they could sell it to somebody else like TransDigm.

Mr. HICE. Okay. Thank you very much.

Thank you, Mr. Chairman.

Mr. KHANNA. Thank you, Mr. Hice.

I want to recognize Ms. Hill for five minutes.

[11:29 a.m.]

Ms. HILL. Thank you so much, Mr. Chairman.

I'd like to ask for unanimous consent to submit to the record two slides from TransDigm's own 2018 Analyst Day presentation.

Mr. KHANNA. Without objection.

Ms. HILL. Thank you.

Ms. Hull and Mr. Fine, as we've discussed today, TransDigm is the sole manufacturer in many of the spare parts sales you reviewed. However, as we've discussed, TransDigm has repeatedly refused to provide contracting officers with the cost data they requested during price negotiations. I don't want to belabor this point, but I want to dig in to sole-sourcing.

The IG report explains, and I quote, "contracting officers had the option of buying the parts without receiving cost data from TransDigm or not buying the parts needed to meet mission requirements."

Mr. Fahey, in a situation where TransDigm is the sole source for a part, the government and other private contractors have two options, either walk away or—either buy from TransDigm or walk away. And when we're talking about parts needed to keep military aircraft in the sky, from my perspective, there doesn't appear to be much of a choice. Would you agree?

Mr. FAHEY. I would agree.

Ms. HILL. In fact, according to the IG report, five contracting officers stated that they went forward with contracts even without the cost data they requested because, and I quote, "the need for the spare part was urgent enough that they had to buy the part at the price offered by TransDigm."

Mr. Fahey, is it harder for DOD to negotiate a fair price for parts when there is no market competition?

Mr. FAHEY. Yes, it is.

Ms. HILL. Thank you.

And, Mr. Howley, I want to dig in to a few facts and figures from TransDigm's 2018 Analyst Day presentation, which was just submitted into the record.

According to the slides, since 1993, through the acquisition and integration of over 64 companies, TransDigm has established itself as a sole-source supplier. In fact, 80 percent of TransDigm's revenues came from sole-source sales. Is this correct?

Mr. HOWLEY. To the best of my belief, that's correct.

Ms. HILL. Great.

So, in other words, TransDigm has a business model of buying companies that are the sole manufacturers of spare parts. When TransDigm acquires companies that are the sole manufacturer for parts used in military aircraft or other vehicles, you know you will be able to use that position to make significant profits. Is that right?

Mr. HOWLEY. I'd like to take a difference between we are a sole manufacturer, because we were typically selected in a competition at the beginning, at the time the airplane was designed——

Ms. HILL. No, no, no. But you have a business model of acquiring companies that are sole-source providers.

Mr. HOWLEY. They are companies that were—they were selected in a competition at the time the airplane was——

Ms. HILL. But you specifically seek out——

Mr. HOWLEY [continuing]. as are we regularly selected in competition.

Ms. HILL. Reclaiming my time, you specifically seek out sole-source manufacturers. That is part of the business model that is described in the slides that you presented and that I have entered into the record.

Mr. HOWLEY. We seek out proprietary, highly engineered aerospace components——

Ms. HILL. Great. Proprietary sole source. Okay.

Mr. HOWLEY. As a practical matter——

Ms. HILL. Reclaiming my time——

Mr. HOWLEY [continuing]. if you do a good job——

Ms. HILL. Reclaiming my time——

Mr. HOWLEY [continuing]. they end up being sole source.

Ms. HILL. Sir, I'm reclaiming my time.

So, Mr. Howley, even if the government was able to obtain cost data on all these parts, TransDigm would be able to charge whatever it wants, because DOD needed the parts to meet mission requirements, because TransDigm's business model is to own and hold exclusive rights to the products it sells, and that enables them to set the market price. Do you agree?

Mr. HOWLEY. I agree—we are a commercial supplier primarily. The market——

Ms. HILL. Just answer "yes" or "no." Do you agree?

Mr. HOWLEY. The market price is frequently established by the commercial of a kind.

Ms. HILL. Okay.

We just have to look at the examples in the IG report to see how well TransDigm's business model works.

Mr. Stein, TransDigm recently sealed a $4 billion deal to buy Esterline Technologies. TransDigm announced in its press release that Esterline expands, as it quotes, "a platform of proprietary and sole-source content for the aerospace and defense industries, including significant after-market exposure."

Will you commit that when it is time for TransDigm to negotiate the contracts currently held by Esterline that you will provide cost data when requested by a contracting officer?

Mr. STEIN. We will follow the law, the rules, and the regulations of the land.

Ms. HILL. So you're not committing.

Mr. STEIN. We will follow the rules——

Ms. HILL. So you're not committing.

Mr. STEIN [continuing]. and the laws and regulations of the land.

Ms. HILL. I would like to get it on the record that you are not committing to providing cost sharing data.

So will you commit that when TransDigm negotiates contracts currently held by Esterline that you will not take advantage of your sole-source position and charge DOD prices that give TransDigm excess profits?

Mr. STEIN. We will follow all rules and laws of the land.

Ms. HILL. Great. So you are not committing to that either.

Mr. HOWLEY. Yes. I could expand on——

Ms. HILL. Reclaiming my time. I have 30 seconds left.

Mr. Fine, TransDigm has the ability to grow its business as large as it wishes. Does it concern you, however, that the more businesses TransDigm acquires, the harder it will get for DOD to get fair prices on spare parts?

Mr. FINE. It concerns me when there's only one entity that can manufacture a part that is critical to the Department of Defense. And to the extent that increases, that's problematic.

Ms. HILL. Okay.

So, last, Mr. Fahey, from my perspective, this is about more than just data. TransDigm has based its business on becoming the sole-source provider of critical parts needed by the warfighter. It seems what we urgently need is a vibrant industrial base that fosters healthy competition.

So, Mr. Fahey, what is the Department of Defense doing to address the issue of diminishing manufacturers and sole-source providers in the defense industrial base?

Mr. FAHEY. So, ma'am, we have a lot going on, as you probably know. In the Presidential order 13806, we did a complete evaluation of the industrial base and identified over 300 risk areas, where a lot of it was, you know, stuff that is foreign sole source or sole source here.

The hard part is, when you get into the after-market like this, it gets to be—one of questions that I got asked previously—you know, if a foreign company is buying a company here, we do have a national security input to it. If a U.S. company is buying a U.S. company, the only input we have is, will it affect competition? So, obviously, if you're buying a sole source and a sole source, it doesn't affect competition. It would be valuable if we had input to say, do we believe it could affect national security?

Ms. HILL. That is a really great point and something that I believe we need to investigate further.

Thank you so much, and I yield back.

Mr. KHANNA. Thank you, Ms. Hill.

I would now like to recognize Mr. Grothman for five minutes.

Mr. GROTHMAN. Thank you.

The inspector general, you folks' report on TransDigm's contract dealings indicate that historical prices for 34 different parts were inflated and could not be used as an accurate determination of price reasonableness.

This is for either Ms. Hull or Mr. Fine. Could you walk the committee through the process that the IG's office used to determine that the historical prices for these 34 products were inflated?

Ms. HULL. The process that we applied in analyzing the historical prices is we accessed a data base that holds the pricing history for those particular items in our sample, so 47 parts. So we looked at the prices over time that the government has paid for these particular items.

Then we also obtained uncertified cost information from TransDigm and analyzed what we thought to be a reasonable profit. And, in doing that, we selected 15 percent as simply a benchmark. And I want to emphasize that we did not, in this report, state that 15 percent should be or is the reasonable profit across the board; it's just simply a benchmark. And then beyond 15 percent, we classified those costs as excessive.

Mr. GROTHMAN. Okay.

And how did the prices then become inflated? Did they not go through an initial review process?

Ms. HULL. Anytime a part is purchased, it becomes part of that particular part's history. So if a part is inflated at the first time it's purchased and then the next contracting officer comes along and negotiates a new part and then adds a couple percent on top of that, that already originally inflated price becomes more inflated over time.

Mr. GROTHMAN. Okay.

Could a part that you originally deemed inflated have any valid explanation, or were you given any valid explanations?

Ms. HULL. No, we were not able to determine any reason for justification for the excess profit on those particular items we looked at.

Mr. GROTHMAN. Okay.

We have a question of Mr. Fahey.

It is my understanding that several factors play on cost and pricing on a daily basis. Isn't looking at prices in a vacuum like this dangerous?

Mr. FAHEY. Looking at pricing? Absolutely, right? Just looking at the price, versus the cost.

Mr. GROTHMAN. Okay. Do you want to elaborate at all?

Mr. FAHEY. Yes. I mean, obviously, if you know the cost of what it costs to produce a part, then you have the difference between what they're trying to charge you versus the cost, and then you know whether you believe it's a fair and reasonable price, right?

When you don't have that cost data—as you've seen, it was the best available price, so, by definition, it was fair and reasonable. But you didn't have the information to really be able to negotiate that.

Mr. GROTHMAN. Okay.

Mr. Howley and Mr. Stein, do you ever give the government cost or pricing data to back up a reasonableness claim even if it's not mandated by law or regulation?

Mr. HOWLEY. Well, I would like to make the difference here between price data and cost data. And I don't allege to be an expert on the FAR, but I believe for the type of parts we make, where we are primarily a commercial supplier, the rules state that the first

place to go is to look at the price data, of which most of what we make is what I would call commercial of a kind, so that the commercial prices are the first place to look for reasonableness of the price.

I think, of the 47 or 46 parts, I think upwards of 40 of them were commercial of a kind, of which we have submitted commercial comparable price data to show that there's a comparable commercial market for them.

Mr. GROTHMAN. Are there some parts so vital to the Department—and this is really for Mr. Fahey. Are there some parts so vital to the Department that they're willing to pay more to have them, even excessively?

Mr. FAHEY. I'd say we have to pay the price if that's our only alternative to keep the readiness of our equipment, but we should never be paying excessive pricing.

Mr. GROTHMAN. Okay. Are there any instances where the Department is priced out of a transaction, where you just say no?

Mr. FAHEY. There have been situations. Where it becomes difficult is when it's a readiness issue.

Mr. GROTHMAN. Can you give me an example?

Mr. FAHEY. I can't give you one off the top of my head, but I was a program executive officer in the Army over 10 years, and there were many times that we walked away from the table because we didn't think we got a fair and reasonable price.

Mr. GROTHMAN. Okay.

Do you think for mission-critical parts that having cost or pricing data would change the analysis of a purchase?

Mr. FAHEY. It could change the analysis, but you should never be paying, quote/unquote, excessive pricing, right? It should be always be fair and reasonable.

Mr. GROTHMAN. Okay.

I yield the remainder of my time.

Mr. KHANNA. Thank you, Mr. Grothman.

I now recognize Ms. Ocasio-Cortez for five minutes.

Ms. OCASIO-CORTEZ. Thank you, Chairman.

And thank you, everyone, for joining us here on this panel today.

Today is my lucky day. Because for ages we're consistently told that single-payer healthcare is too expensive. We're told constantly, how are you going to pay for it? How are you going to pay for covering the insulin costs of everyday Americans? And I seem to have found part of my answer here today.

Because it seems that TransDigm sold a part called a non-vehicular clutch disk. You have to excuse how small the image is here, but it's up there on that screen. But if I blew it up much larger, it wouldn't even be to scale, because this disk is only about 3 inches anyway.

And it seems as though TransDigm sold 149 non-vehicular clutch disks to DOD. It costs about $32 to make the part, and TransDigm charged us $1,443 for each of these 3-inch disks. As a result of the upcharge, the inspector general determined that TransDigm profited 4,436 percent.

A pair of jeans can cost $32. Imagine paying $1,000—over $1,000 for that.

But the good news here is that what I found is that the cost of about 149 of these clutch disks will cost, at cost, about $4,768, except TransDigm charged the public $215,007. That is a margin of about $210,239.

Mr. Howley, are you aware of how many doses of insulin we could get for that, for that margin?

Mr. HOWLEY. I'm not.

Ms. OCASIO-CORTEZ. In a single-payer healthcare system, an insulin dose can cost about $137 a vial. I could've gotten over 1,500 people insulin for the cost of the margin of your price-gouging for these vehicular disks alone.

The incidence of diabetes, according to the CDC, is about seven people in 1,000, which means I could've covered the insulin costs of a community of 21,400 people for the cost of your price-gouging of the public on a non-vehicular clutch disk alone.

I could've sent 21 kids to college.

I could've sent 18 toddlers to free preschool for a year in the most expensive city in America.

So my question to you is, why should we give you another dime?

Mr. HOWLEY. It seems to me the government always has the choice of what to buy and what not to buy from us.

Ms. OCASIO-CORTEZ. Uh-huh. My——

Mr. HOWLEY. We believe we provide the government with well-designed, well-manufactured, high-quality product, we deliver in a timely fashion, and we support it when there's a problem.

Ms. OCASIO-CORTEZ. Uh-huh.

How much competition do you have? How many competitors do you have in this market?

Mr. HOWLEY. We have in—I don't know this individual part, just because we make 200,000 parts, but I would say there is almost no product we make where there aren't other alternatives to buy the part. We typically——

Ms. OCASIO-CORTEZ. But it could be one alternative, two alternatives, or 1,000 alternatives.

Mr. HOWLEY. But not 1,000.

Ms. OCASIO-CORTEZ. Not 1,000.

Mr. HOWLEY. Some number of alternatives. We are almost always——

Ms. OCASIO-CORTEZ. So it's not a perfectly——

Mr. HOWLEY [continuing]. selected originally in a competitive process when the airplane's designed, where we are selected because of our price, our technology, our delivery, our contract terms, whatever.

Ms. OCASIO-CORTEZ. Uh-huh.

You know, I find this interesting, because this term "free market" comes up very often, but I don't think people really understand what that means. Because, so often, it's not a free market at all. It's a captive market. It's one where we're forced to choose between two to three people.

Oftentimes, in these processes, there is significant argument and there's significant evidence that there's collusion in these markets, that it's not a perfectly competitive market, because a perfectly competitive market requires a large amount of competitors.

But I'll move on.

Mr. Fahey, what can Congress do to break this cycle?

It seems that the inspector general has been calling attention to the unreasonable prices for TransDigm, in particular, since 2006. So I think about all those insulin doses from just this one part in this one contract times 10, 15 years.

What can we do to break this cycle?

Mr. FAHEY. So, ma'am, you know, first, you know, I would support, you know, the recommendations of the DOD IG and working with Congress to figure out—what I'd say is I would absolutely like to work with Congress on what are the right things to do, and I'd rather not talk about it in front of TransDigm because they'll go out and try to figure out ways to overcome those too.

Ms. OCASIO-CORTEZ. Understood.

Mr. FAHEY. So it just—as I've said, it just bugs me that we have to do this, right? And what it does is it's additional bureaucracy within my system to account for these bad situations.

Ms. OCASIO-CORTEZ. Well, I look forward to us having a confidential meeting sometime soon.

Thank you very much.

Mr. KHANNA. Thank you, Ms. Ocasio-Cortez.

I now want to recognize Ranking Member Jordan for five minutes.

Mr. JORDAN. Thank you, Mr. Chairman.

Earlier, Mr. Stein, I forget whom, but someone on the Democrat side asked whether you would pay back the—I think they used $16 million, and you said it's really not about the money. But it kind of seems like it is. You said there was other factors you had to look at—you know, the message that would send to your customers—and I get that.

So let me just walk through a couple things. How many parts do you make for the government?

Mr. STEIN. I don't know the exact figure. I know that I have over 50,000 parts that are military parts.

Mr. JORDAN. Fifty thousand.

Mr. STEIN. Yes.

Mr. JORDAN. Any idea how many you make for DOD?

Mr. STEIN. No. I know—sales I could split out, but not part numbers.

Mr. JORDAN. Mr. Fine, you said you guys looked at 47, I think was the number you said earlier. Is that right?

Mr. FINE. Correct.

Mr. JORDAN. Do you know how many they make for the government?

Mr. FINE. I don't know how many parts they make. I know that 34 percent of their business is with the defense industry.

Mr. STEIN. Yes. I can talk about revenue.

Mr. JORDAN. Okay. So 34 percent——

Mr. HOWLEY. I might add, that's not all with the Department of Defense.

Mr. JORDAN. I understand. So 34 percent is with the government. What percent is with DOD?

Mr. HOWLEY. No, it's not with the government. Thirty-four percent is not with the government.

Mr. JORDAN. Oh. Straighten me out then. Thirty-four percent is with who?

Mr. STEIN. Is military——

Mr. HOWLEY. Military some way, shape, or form around the world. About 6 or 8 percent is the government, the U.S. Government.

Mr. STEIN. Is Defense—is after-market to the U.S. Government.

Mr. JORDAN. When you say the U.S. Government, you're talking about Defense.

Mr. STEIN. Yes.

Mr. JORDAN. Okay.

Mr. STEIN. Sorry.

Mr. JORDAN. So 7 percent is with the United States Department of Defense. The other percent, you know, whatever, 34 minus 7, the other 27 percent is with foreign governments?

Mr. STEIN. Foreign governments and OEMs for U.S. production.

Mr. JORDAN. Oh, Okay. Okay.

Percent of your—so when it comes to profits, what's your profit margin on the 7 percent, the 34 percent, and then on the commercial?

Mr. STEIN. I don't know the profit margin on the individual segments. What I can tell you is that our profits in the defense after-market spares business is significantly lower than our commercial after-market profit margin, just the way it works out with the regulations——

Mr. JORDAN. But that's not—based on everything we've heard today——

Mr. STEIN. I know, but——

Mr. JORDAN [continuing]. that's not what you'd be—that's not the conclusion I think we'd all reach. We would assume that it would've been higher.

Mr. STEIN. Yes. It's because this process has nonstatistically selected a couple parts that, you know, would show a certain direction of price increase. I can just as easily select 46 part numbers or 47 that show dramatic changes the other way. We have——

Mr. JORDAN. So are you saying, like, on the commercial side, the non-defense side, you're getting 4,000 percent profits on parts there?

Mr. STEIN. Yes. The parts that were analyzed had commercial equivalents, and the commercial price is listed as reference points. And that's a leading indicator of——

Mr. JORDAN. So Ms. Ocasio-Cortez just had up this valve or ring or——

Mr. STEIN. Yes.

Mr. JORDAN [continuing]. whatever that was. Do you sell that to commercial folks as well?

Mr. STEIN. Yes, we do. Would you like—so I have a data on that.

Mr. JORDAN. I'm just curious, what do you charge them?

Mr. STEIN. So it was sold to British Air for $2,400. And it currently sits on a Satair price list—they're a commercial after-market distributor—for somewhere around $1,000.

Mr. JORDAN. Mr. Fine, do you agree with all that?

Ms. HULL. We don't——

Mr. JORDAN. Frankly, that's not what I expected when I started my line of questioning. I was just curious where this all was going, and I expected something different.

Ms. HULL. We don't have that information. I'm sorry. I can't speak to that particularly.

Mr. STEIN. We do provide that information. When commerciality packages are submitted, we do provide that reference point.

Mr. JORDAN. Let me go to the inspector generals.

This all happened when? When you did this investigation, this was for what years and what timeframe?

Mr. FINE. January 2015 to January 2017.

Mr. JORDAN. And since that time, it's my understanding that the threshold amount has been increased when you can—the sole source and the dollar amount——

Mr. FINE. The Truth——

Mr. JORDAN. Go ahead.

Mr. FINE. The Truth in Negotiations Act and the 2018 National Defense Authorization Act increased the threshold for when they have to provide certified cost information from $750,000 to $2 million.

Mr. JORDAN. And if I understood correctly earlier, a line of questioning, it's not the threshold that is maybe the determining factor; it's the fact that you just don't get the information to—if there's a way to get the information, it's not so much the threshold.

Because my understanding was the Armed Services Committee thought this made sense for our military to get access to parts in a quicker fashion and get what our warfighters need. That's why they raised it. But you guys are saying it's not so much the threshold, it's we need information. Is that accurate?

Mr. FINE. So it is a little bit the threshold. It does change the equation of when they have to provide the information——

Mr. JORDAN. I understand.

Mr. FINE [continuing]. in order to streamline things.

But it has side effects. And one of the side effects is contracting officers can't require companies like TransDigm to provide cost information when it's below $2 million and TransDigm declines to provide that information.

In 15 of the 16 times that was below that threshold, that the contracting officer asked for cost data, TransDigm declined. They weren't required by law to do it.

Mr. JORDAN. And is that happening with other companies too?

Mr. FINE. We haven't looked at other companies, but I assume it is happening. I'm not sure to the same extent as TransDigm.

Mr. JORDAN. And I'm running out of time here, or I guess I ran out of time, but I appreciate the chair's——

Ms. HULL. Well——

Mr. JORDAN [continuing]. indulgence.

Ms. HULL. I'm sorry.

Mr. JORDAN. So what do we need to do so that you get the—we all want this to work. We want people to make a reasonable profit. We don't want excessive profit. We want it to work. We want our military to be equipped. We want it all to work. So what needs to happen? We need to say, certain information has to be given to the Department of Defense?

Mr. FINE. I would say that we ought to look at the legislative structure to require companies to provide cost information when asked for by contracting officers. They don't have to ask for it each time. There may be times they don't need it. But there are times they need it, particularly in the sole-source environment, that when they ask for it, they should get it.

Mr. JORDAN. And the message—if it happens just a few times, the message gets sent: When you ask for it, you've got to give it, so you better be doing it right from the get-go.

Mr. FINE. Exactly. I mean, TransDigm keeps saying that we weren't required to do it and the law didn't require them to do it. But that's the problem. There ought to be a requirement so that companies who are asked for the information, like TransDigm, provide that information.

Mr. JORDAN. Thank you.

Thank you, Chairman.

Mr. KHANNA. Thank you, Ranking Member Jordan.

I'd now like to recognize Ms. Kelly for five minutes of questioning.

Ms. KELLY. Thank you, Mr. Chair, and thank you to the ranking member for holding this very important hearing.

Ms. Hull, in the inspector general's report, you considered a 15 percent profit to be reasonable and any profit over 15 percent you considered excess profit. How did you select that as your benchmark?

Ms. HULL. The 15 percent is certainly a benchmark. We researched Federal supply codes with similar contracts to the parts that we selected for our sample and found 15 percent to be a reasonable number to apply. And then anything in excess of 15 we claimed as excess profit.

Ms. KELLY. And it seemed like many of TransDigm's contracts you reviewed had profit margins, as we've been discussing, well over 15 percent.

And one of the contracts your office reviewed was a contract for a filter subassembly used in the Hercules C–130 aircraft. This contract, according to your report, had an excess profit margin of 356 percent. To be clear, the profit margin excludes the 15 percent in reasonable profits you used as a benchmark for your review?

Ms. HULL. Yes, it does.

Ms. KELLY. Mr. Howley, Federal Acquisition Regulations recognizes that contractors need to make a reasonable profit on their government contracts, but there is a difference between a reasonable profit margin and profits over 300 percent on a single contract.

Do you agree with the inspector general that a 356 percent profit margin is a bit unreasonable?

Mr. HOWLEY. What I would say is we are primarily a commercial business. They have a method of checking the reasonableness of the prices, and this is the preferred method, I believe, that the regulations describe, is to check price data, not cost data. You know, most all the parts that were inspected, we provided commercial pricing data. And that is the preferred method, I understand, by the regulations to confirm the reasonableness of the price.

Ms. KELLY. So let me ask——

Mr. HOWLEY. In other words, what the commercial market is paying for that.

Ms. KELLY. Let me ask you this. Could you sell to the DOD these parts at a lower price and still make a reasonable profit?

Mr. HOWLEY. I don't believe that's the question for us. The question for us is, what——

Ms. KELLY. But I'm asking the questions, sir.

Mr. HOWLEY. Yes, I understand.

Ms. KELLY. Let me——

Mr. HOWLEY. I understand.

Ms. KELLY. Let me——

Mr. HOWLEY. But the reasonable—I'd say again, we run under a commercial model. In other words, we don't get paid by the government for our development expenses. We don't get paid for our engineering. We don't get paid for the capital we put into a project. We don't get paid——

Ms. KELLY. But 356 percent?

Mr. HOWLEY. We make our money—we make our money in the after-market on the spare parts. We don't make—and we even lose money up front. This is a razor-razorblade model——

Ms. KELLY. Well, reclaiming my time, my colleague asked about the part she asked about, my colleague Ms. Ocasio-Cortez. And what you are selling to us, the staff just informed me, you're the only person that sells that. So there is no competition; you're a sole source for that. And, again, I would think that you could still make a reasonable profit, very reasonable profit, that would be less than 356 percent despite your expenses.

The committee received documents from TransDigm that showed that TransDigm's starting offer for the filters that I talked about was $5,581 for each filter. I'm holding up the report. TransDigm's own data shows that it costs per part, however, $1,189.

Do you feel like you were acting in good faith when you offered to sell these parts for over four times the cost?

Mr. STEIN. Yes. So we do have—this is a commercial part. It's of a commercial type. And we have sold that commercially, and it's on a price list commercially at almost $5,000—$4,848.

Ms. KELLY. The government cannot determine that this was a commercial item.

You know, when the contracting officer pushed back on this unreasonable price, one of your employees stated, and I quote, "Given our costs on this part, it's the lowest we can go at this quantity." That statement was false, right? Based on TransDigm's own data, the company had plenty of room to lower the price and still make a profit.

Mr. STEIN. Given the laws and rules of the land, I don't think they were wrong in the way they approached it. There is a commercial price out there, and we're allowed to use commercial prices as justification for the pricing that we set to the government. If it's on an identical or a part that is similar of type, this is allowed. And so the pricing is set that way.

Ms. KELLY. Ms. Hull, are these parts commercial?

Ms. HULL. Ms. Kelly, I think it's important to point out that only 4 of the parts of the 47 that we looked at are indeed commercial items or determined by the contracting officer to be commercial. So,

although TransDigm has said several times during the hearing that all the parts were commercial, it is our belief that four are commercial.

Ms. KELLY. I'm going to squeeze in another question.

Mr. Stein, you know it's a crime to provide false information to a contracting officer. How is the statement that "given our costs on this part, it's the lowest we can go at this quantity" not a false statement?

Mr. STEIN. I do not have the information on that individual part at that time which would have led him to—him or her to make that comment. So it's impossible for me to provide background on that.

Ms. KELLY. Well, you're giving the appearance that you don't always negotiate in good faith. And I do think that you should pay a refund for these excessive profits immediately.

I yield back.

Mr. KHANNA. Thank you, Ms. Kelly.

I now want to recognize Mr. Raskin for five minutes.

Mr. RASKIN. Mr. Chairman, thank you. And thank you for calling this important hearing.

There really are two Americas now. There's the America that we all represent, where we know there to be homeless veterans and people going bankrupt because they can't afford to pay their medical bills; diabetics rationing their insulin; public schools closing art and music classes.

And then we've got the military industrial complex that President Eisenhower warned us of more than a half-century ago, a place where 15 percent, which is a pretty good return in most parts of America, isn't remotely enough for the greed and the avarice and the seclusion from the rest of society. You've got to make 50 percent or 100 percent profit or 200 percent profit or 500 percent profit or, in some of these cases, more than 1,000 percent profit—something simply unheard of and unseen in the real America that we represent.

Mr. RASKIN. Let me come to—let me come to you, Mr. Howley. A former director of operations at your company, TransDigm, told this committee, quote: "At quarterly meetings, Nick Howley, management, gave a wink-wink, nod-nod that we want to avoid disclosing any cost data. They told us under their breath we should see what we can do to avoid disclosing cost data. We don't want to talk about costs; we want to talk about price."

Now, I want to ask you this and I want you to think about your answer carefully, because I know that you're under oath. Have you or any senior official at TransDigm told an employee that they should avoid disclosing cost data?

Mr. HOWLEY. First, I presume we're talking about these various business unit review meetings we make. I've rarely attended them in the last 10 years, to begin with. I would tell you we regularly tell people what the rules are for contracting with the government.

Mr. RASKIN. Have you ever told anyone to avoid disclosing cost data?

Mr. HOWLEY. Not that I recall. We always tell people, here are the rules. When you deal with the government, you have to comply with all the rules and regulations. We have an outside law firm

come in and run those training classes for employees. We have our in-house counsel run them.

Mr. RASKIN. Okay. Mr. Howley, you were, according to your testimony, in 2017, the sixth highest paid CEO in America. You made $61 million, right? Was the business model to find these sole-source contracts and then to jack up the price as far as it could go?

Mr. HOWLEY. The business model is to—we buy and operate proprietary, highly engineered aerospace component businesses with significant—with aftermarket content. That's the business model.

Mr. RASKIN. Let me ask you——

Mr. HOWLEY. We buy them and we improve them. The long-term owners——

Mr. RASKIN. I was interested in your exchange with my colleague, Ms. Ocasio-Cortez. Is your business model, the way you do business, is that socialism or capitalism?

Mr. HOWLEY. Capitalism.

Mr. RASKIN. So you're defining capitalism as one business can basically charge the taxpayers whatever it wants, 50 percent, 100 percent, 500 percent, 1,000 percent, that's what capitalism is?

Mr. HOWLEY. Any buyer can buy from someone else if they want. In almost no cases are we the only one in the country that can provide the part. At such point as we don't deliver a quality product, we don't deliver it on time, it doesn't work well, we're not technically competent, they can go somewhere else.

Mr. RASKIN. Let me ask you about one specific case, Mr. Howley. One of the contracts reviewed by the inspector general was for a part called an actuator cover assembly which was used in the KC–135 aircraft. You charged $12,000 for actuator cover assemblies. TransDigm's cost for getting the same part was $800. Now, how do you justify getting the part for $800 and then selling it to the taxpayers for $12,000?

Mr. HOWLEY. I'm going to defer to—I'm going to defer to Kevin Stein, because I don't know the individual part.

Mr. RASKIN. But in principle, in principle, how do you defend that?

Mr. HOWLEY. I don't know the—I don't know how to answer in general. All I can do is address it specific.

Mr. RASKIN. But that's the business model. But that is your business model that you've described this as capitalism, and that's what capitalism——

Mr. HOWLEY. No. Our business model is we are primarily a commercial business. Our business model is we——

Mr. RASKIN. Aren't all businesses commercial businesses? I don't know what you mean.

Mr. HOWLEY. No. I make the distinction between a primary defense contractor. We invest our own money to develop products. We invest our own money to design them, to qualify them on airplanes——

Mr. RASKIN. All right. Let me ask you a different question.

Mr. HOWLEY [continuing]. to do the testing, to invest the product. And we make our money back.

Mr. RASKIN. Maybe you can help us—maybe you can help us find out how pervasive this is. One of the things that impresses me about the testimony is the kind of indignation you're demonstrating

about being asked about this. Is this, in fact, the pervasive business model in the work that you do? Are you aware that other businesses are basically doing the same thing with DOD contracts?

Mr. HOWLEY. I think the model of a razor/razor-blade type of model where you invest your money upfront and you make your money back in the aftermarket is very common across many highly engineered niche products.

Mr. RASKIN. So if we did a thorough investigation of Defense Department contractors, you're saying we would find other businesses that are essentially taking the taxpayers for 100, 200, 300, 400, 500 percent profits on the products that are being sold to the government?

Mr. HOWLEY. I'm going to say this from memory now, and the other people at the table know much better than I do about this, but I think this is a relatively common audit result when the IG goes out and audits component manufacturers that they come to the conclusion that the spare parts prices are higher than they'd like. I think that's a fairly common conclusion, and I think—I believe that's one of the reasons that they are proposing regulatory changes.

Mr. KHANNA.

[Presiding.] Thank you, Mr. Raskin.

Mr. RASKIN. I yield back.

Mr. KHANNA. Thank you, Mr. Raskin.

I now want to recognize Ms. Wasserman Schultz for five minutes of questioning.

Ms. WASSERMAN SCHULTZ. Thank you, Mr. Chairman.

I want to clear something up for the record, so I'll ask you, Mr. Howley or Mr. Stein, whichever one can answer the question. My understanding is that for thousands of the parts that you make available for sale commercially, you are the sole-source provider on most of them, and that there are no options besides you for the military to be able to make those purchases.

Mr. STEIN. That's, I think, not true. During the qualification phase, there are many people involved in qualification and quoting on parts who all have the capability to make these. So there is competition out there. Because of the extremely small volumes, you end up taking it as a sole source, but that's simply the way that the business is awarded.

Ms. WASSERMAN SCHULTZ. Okay. That's not my understanding and, thankfully, we have people here who can testify to that.

So, Mr. Fahey, TransDigm owns the rights for thousands of parts used to fix and maintain our military equipment. And my understanding is when DOD needs a mission-critical part, you are oftentimes forced to buy it at an inflated price from TransDigm who, as has been stated here today, may earn a profit of more than 4,000 percent. That's obviously not only an egregious swindling of taxpayer money, it also would appear to be a huge additional expense that is grossly irresponsible for the Department of Defense to have to bear.

Do TransDigm's inflated prices impact military readiness, in your assessment, by pulling funding that could be spent on other mission-critical acquisitions?

Mr. FAHEY. Absolutely. Absolutely.

Ms. WASSERMAN SCHULTZ. Could you elaborate a little bit?

Mr. FAHEY. I mean, every time you're paying, you know, a cost that is outrageous, right, you could be spending that money somewhere else, right? So, for example, if we got our $60 million back, we could be buying other spare parts to increase readiness. As you know, if you go across the Department, one of our major concerns is the readiness of our fleets.

Ms. WASSERMAN SCHULTZ. Exactly. I'm pretty familiar with that, given my other job in Congress, which is chairing the Military Construction VA Appropriations Subcommittee.

Does DOD—Mr. Fahey, does DOD currently have unfunded acquisitions that could potentially have been funded if you weren't expending extra dollars to meet TransDigm's inflated prices?

Mr. FAHEY. Absolutely.

Ms. WASSERMAN SCHULTZ. Do you have any examples that come to mind?

Mr. FAHEY. I don't have any examples that come to mind, but I know, given the time of year as we're going through that process now to figure out, you know, what money we're going to ask for to have reprogrammed, because there are significant programs that need—important programs that need funding.

Ms. WASSERMAN SCHULTZ. Pricewise, what would you say is the amount of unfunded acquisitions that are sitting on that list?

Mr. FAHEY. I don't have that, ma'am, off the top of my head.

Ms. WASSERMAN SCHULTZ. Is it in the hundreds of millions of dollars? Even billions?

Mr. FAHEY. It's in the billions.

Ms. WASSERMAN SCHULTZ. It's in the billions of dollars, okay. So I think it's safe to say that if we're spending 4,000—if we have a 4,000 percent unfair, egregious, outrageous profit, that we are really affecting our military's readiness and our ability to make sure we can address mission-critical projects.

Mr. FAHEY. Absolutely.

Ms. WASSERMAN SCHULTZ. Okay. Mr. Stein—I'm sorry, Mr. Fahey, or any of you who are there and can answer the question, is what Mr. Howley just said accurate? Is there the kind of competition that they are suggesting, and am I wrong that the military appears to only have them as an option in many cases when it comes to these purchases?

Mr. FAHEY. I'll give—they are wrong, right. What he explained was accurate, that way back like 10 years ago when we were doing the development, there was probably competition to the part; but at this time, on most of those parts, they are sole-source providers.

Ms. WASSERMAN SCHULTZ. And that would be because they bought up every single company that—with the business—using the business model, as my colleague Ms. Hill entered into the record, specifically focused on sole-source providers as their business model to acquire.

Mr. FAHEY. Correct. And I'll let Mr. Fine answer.

Mr. FINE. So if I could, of the 47 parts in our sample, we determined that 39 were manufactured only by TransDigm.

Ms. WASSERMAN SCHULTZ. Okay. So, Mr. Howley, Mr. Stein, what you're saying is completely inaccurate, and I'll just remind

you, you're under oath. Today, there is not competition apparently in 39 parts that——

Mr. HOWLEY. There are other—there are other suppliers.

Ms. WASSERMAN SCHULTZ. Excuse me. Reclaiming my time. The way it works here is that we ask the questions and you answer them when we're ready for you to answer them, okay?

So there are 39 parts that Mr. Fine just mentioned that you are the only source for the military to be able to purchase. Is that accurate?

Mr. HOWLEY. We are not the only one that could supply them. We're the only—they have—apparently, it's not worth the cost or effort or time to qualify another source at this time. There are other people that could do it.

Ms. WASSERMAN SCHULTZ. Okay. Reclaiming my time, which I am now out of. In legislative speak, in a setting like this, we call that not passing the straight face test. What you just said doesn't pass the straight face test because it's tap dancing, inaccurate, and incongruent with the facts.

So you are grossly robbing the American taxpayers and impacting our military readiness and our ability to make sure that we have the ability to accomplish mission-critical goals. You ought to be ashamed of yourself, and you owe the taxpayers millions of dollars that I hope your company decides to make sure that you do on your own.

I yield back.

Mr. KHANNA. Thank you, Ms. Wasserman Schultz.

I now want to recognize Mr. Connolly for five minutes of questioning.

Mr. CONNOLLY. Thank you, Mr. Chairman.

Mr. Stein, your testimony is—let me ask this. Mr. Fine made the point that you declined to provide DOD or his office with data because it fell at or below the $2 million threshold in contract value. Is that correct?

Mr. STEIN. I think at the time of the contracting, it was $750,000, but I would defer to my colleague.

Mr. CONNOLLY. No, my question is you declined. I'm asking you to corroborate what he asserted.

Mr. STEIN. Okay. I think it was $750,000 at the time of the awards, not $2 million, because that was a——

Mr. CONNOLLY. But is it accurate that you declined to provide that information voluntarily?

Mr. STEIN. We agreed to all the laws and rules and regulations.

Mr. CONNOLLY. Yes, we stipulate that, Mr. Stein. My question again is, is Mr. Fine accurate that, in fact, you declined to provide information his office requested using the threshold as the reason why you did not have to?

Mr. FINE. If I could, they declined to provide to the contracting officer when the contracting officer requested it 15 of the 16 times.

Mr. CONNOLLY. Okay. Mr. Stein, is that accurate?

Mr. STEIN. I'm confused. Can you rephrase the question?

Mr. CONNOLLY. Yes. Mr. Fine said that the contract officer had requested information and you said, we're not going to provide it because we're not required to because it falls below $2 million.

Mr. STEIN. That's not true. If it falls below $750,000, at the time, we said that——

Mr. CONNOLLY. Mr. Fine.

Mr. FINE. I think he's debating the issue of what the threshold was at the time. Whatever the threshold was at the time, they were asked to provide the cost and they declined to do it in——

Mr. CONNOLLY. Is that accurate?

Mr. STEIN. That is accurate.

Mr. CONNOLLY. That is accurate. Thank you.

Now, is it the policy of your company deliberately to restructure the value of contracts so that you fall below that threshold? For example, we had one former TransDigm sales director who told the committee, and I quote: "We were coached on how to structure agreements. It was suggested to us that we use shorter agreements. Don't sign long-term agreements. We were encouraged to use excuses."

Is that an accurate statement, in terms of the policy of your company?

Mr. STEIN. I don't think so. We do not have a policy that does anything but to agree with——

Mr. CONNOLLY. You're under oath. Is it your testimony that nobody was ever coached to do that?

Mr. STEIN. No, no one was ever coached to split a contract. I'm not aware of any instance where that happened, period.

Mr. CONNOLLY. All right. Good. You're on record.

Mr. STEIN. Yes. I'm not aware of any instance where that happened.

Mr. CONNOLLY. That employee went on to provide an example. He said, and I quote: "The government asked for a multiyear solicitation of Black Hawk parts. We, however, shortened the term of the contract to 9 months so that we wouldn't go over TINA.

Is it your testimony that he's wrong, that that did not happen?

Mr. STEIN. I have no idea the details of this part or the testimony that this person is giving.

Mr. CONNOLLY. That's not my question. Are you familiar with the fact that there was a——

Mr. STEIN. No.

Mr. CONNOLLY [continuing]. multiyear solicitation of Black Hawk parts?

Mr. STEIN. No.

Mr. CONNOLLY. That doesn't ring a bell with you?

Mr. STEIN. No, it didn't ring a bell with me.

Mr. CONNOLLY. All right. So we have testimony from one of your former employees that contradicts what you've just said here under oath; that, in fact, it was the strategy of your company to do that.

Mr. Fine or Ms. Hull, any evidence about that?

Ms. HULL. For the purposes of our audit, I can't speak to TransDigm intentionally keeping dollar values under a certain threshold, but what I can say is that the majority of the parts in our sample, which is proportionate to the percentage of contracts they have, are predominantly under the simplified acquisition threshold.

Mr. CONNOLLY. Sure looks like a strategy to me.

Mr. Stein, you have repeatedly said in your testimony today in response to questions that you look at the commercial value of products, and what you provide is largely commercial. Ms. Hull, you said, if I understood correctly, of I think you said 47 parts you looked at, only 4 would fit that category.

Ms. HULL. Only 4 of the 47 parts were commercial.

Mr. CONNOLLY. Right. Do you dispute that, Mr. Stein?

Mr. STEIN. I do.

Mr. CONNOLLY. Do you want to elaborate?

Mr. STEIN. We have commercial packages that have been submitted on all of these. These are commercial parts. They fall under the FAR Part 12 of commercial in type. So the commercial prices are legitimate.

Mr. CONNOLLY. Ms. Hull?

Ms. HULL. The contracting officer in this case made the decision that four were commercial, not more than four per our sample.

Mr. CONNOLLY. Mr. Stein says that's just not accurate.

Ms. HULL. It is up to the contracting officer to determine whether a part is commercial. And in this case, for those four parts, they made the commercial item determination that just four were commercial.

Mr. CONNOLLY. Mr. Fine or Mr. Fahey, before—my time is up, but I'd like to give you an opportunity to comment on that.

Mr. FAHEY. I would agree. And we have——

Mr. CONNOLLY. You would agree with what?

Mr. FAHEY. That the low number that is considered commercial. And we have a more laborious process to decide whether somebody is commercial or not.

Mr. CONNOLLY. So, Mr. Fine.

Mr. FINE. I agree with Ms. Hull. This is a decision made by the contracting officer and DLA in this case, what was commercial. And four times they were determined to be commercial; the rest were not.

Mr. CONNOLLY. So, Mr. Chairman, as I yield back my time, I just want to note this is very troubling, because we have the government saying that only four of the parts, in fact, would be defined as commercial; and we have the contractor saying, no, no, they're all commercial. We have employees who have told us that they were told not to talk about cost directly by Mr. Howley; and Mr. Howley says he does not recall ever making that statement to employees.

We have employees telling this committee that the company deliberately restructured contracts and agreements to fall below a certain dollar threshold so that they would not have to provide data to the government; and we have Mr. Stein under oath denying that, that that was not the policy of his company.

It just seems to me we have an awful lot of contradictions and a very different point of view between the government, who is the recipient of these services, and the company providing them, and the company's own former employees.

And I would just say to both Mr. Stein and Mr. Howley, you'd better be right, because you're under oath. And it would be my hope that this committee will vigorously followup on this testimony and corroborate or not what we've just heard here today.

I thank the chair.

Mr. KHANNA. Thank you, Mr. Connolly.

The chair now recognizes Ms. Norton for five minutes of questioning.

Ms. NORTON. Thank you very much, Mr. Chairman.

Mr. Howley, I think this is an opportunity to clear up for the public, not only for this committee, some of—make us understand something about these private margins. For example, one of the findings of the inspector general was that TransDigm actually denied 15 separate requests from contracting officers for uncertified cost data. And the dates given us are between January 2015 and January 2017. You might understand that it creates a kind of suspicion right there that you can't get the information that normally a buyer would ask for.

So let's test this. On one of the parts you refused to provide data for was a position indicator, it is called, purchased by the Army Contracting Command. And according to the cost data TransDigm provided to the inspector general, this part cost $2,161 to manufacture, but you charged the government $11,733 for each part.

So my question is pretty straightforward. How is nearly $12,000 a reasonable price for something that cost TransDigm about $10,000 less than that to manufacture?

Mr. HOWLEY. Congresswoman, I don't know the details of the individual parts. We have 55 independent operating units that we operate.

Ms. NORTON. Would you regard that as a reasonable price?

Mr. HOWLEY. I don't know the context of it. I think——

Ms. NORTON. So under some circumstances——

Mr. HOWLEY. We are generally—we are a commercial business, primarily. And our business model, again, is to pay our own money upfront, to invest and not make money in the beginning, to pay our engineering capital, et cetera, to sell things for aircraft——

Ms. NORTON. Look, I understand what your business model is. Reclaiming my time, Mr. Howley, because you're not answering my question.

The inspector general found that TransDigm received 428 percent, 428 percent excess profit in the sales of this part, position indicators.

So we may disagree and you may need some context and you don't answer the question directly, but let me ask you if you will answer this question directly. Will TransDigm provide a refund to the Army of the excess profit the company received for this part?

Mr. HOWLEY. I think I answered that earlier, but I'd be glad to do it again. We're still in the process of evaluating that. We have——

Ms. NORTON. No. My question is, after you evaluate it—there may be some differences on how much excess profit or not. If you find that there was some amount that was in excess, will TransDigm provide a refund to the Army for your excess profit? After you've done all your study, will you provide the excess—will you provide a refund to the Army?

Mr. HOWLEY. And I think I would say we're still in the process of evaluating how we're going to deal with this voluntary refund request.

Ms. NORTON. That's not my question. Will you provide—let me just ask a general question. When you've had an opportunity to evaluate what the inspector general has found, if you find that there was some excess profit on any of these, after comparing your information with the inspector general, will you provide a refund to the Government of the United States, yes or no, Mr. Howley?

Mr. HOWLEY. We're in the process of evaluating how we're going to handle that. I would say we are a commercial company that operates primarily in a commercial model. And there is a set of rules, as I understand, by which the government buys commercial of a type product. I think many of what we sell is commercial of a type product. So we have to put that in its context.

Ms. NORTON. Mr. Chairman, I will note for the record that I have tried on at least three separate occasions to get a response from this witness that almost any manufacturer or any seller of a product to either the government or the public would have given. If I find I'm wrong, expect that I will give back whatever amount you should have received.

And I think it should be noted for the record that this witness has refused to say—and I must say, in the way in which we do business in the future, it should be noted that this witness has refused to say that even if he finds there has been excess profits, he will return that excess to the government.

And I thank you, Mr. Chairman.

Mr. KHANNA. Thank you, Ms. Norton.

I'd like to thank our witnesses for testifying today. I'd like to thank Assistant Secretary Fahey, Ms. Hull, Mr. Fine for your service to our country.

Without objection, all members will have five legislative days within which to submit additional written requests, written questions for the witnesses to the chair, which will be forwarded to the witnesses for their response. I also ask our witnesses to please respond as promptly as you are able, and would note that, Mr. Stein, there is an outstanding letter with a number of requests to you. And our understanding and expectation is that all of those requests will be answered fully and comprehensively.

Before I give Mr. Grothman a chance for his closing, I would just like to note the bipartisan commitment in this committee to continue to investigate this, to note Mr. Meadows' comments as well as Ms. Speier's comments, that TransDigm should reimburse the taxpayers for the excessive profits. You've heard that over and over again from both Republican and Democratic members.

Now, you could do that personally, given the amount at stake and given the amount you were making as CEOs, or you could do it as a company, after you consult your lawyers, without admitting liability. People do that all the time. You don't have to admit liability to do the right thing.

My strong recommendation, speaking for many members on the committee, would be that you consult your lawyers, maybe over lunch, and do it by the end of the day, to seem responsive to a body that represents so many constituencies in this country.

I now yield to Mr. Grothman for any final words.

Mr. GROTHMAN. Right. I'd just like to thank you for having the hearing. I thought it was illuminating for everybody here. At a

time when we're borrowing about 20 percent of our Federal budget, it is again and again amazing the degree to which we seem to shovel money out of this city without regard to the fact that we're driving people deeper into debt.

I would hope the military itself weighs in a little bit stronger here. I mean, they've gotten huge increases in spending the last few years. And the military is No. 1. I mean, if we ever doubt we're the No. 1 military in the world, we're in a lot of trouble. But it's frustrating when people in that business who should be, above all, committed to making sure every dime is well spent, seem to view things as an opportunity to make ridiculously huge profits. I realize it's not unique to this industry, but it amazes me how people who do not found an industry are making tens of millions of dollars of salary. I mean, I don't know whether I was ever in that position, if I'd feel guilty about cashing such a check or not.

But I'd like to thank you for having this hearing and, hopefully, something will come of it.

Mr. KHANNA. Thank you, Mr. Grothman.

I also just want to recognize the staffs, both on the Republican side and on the Democratic side, for their extraordinary work in making sure that we had this oversight hearing.

With that said, this hearing is adjourned.

[Whereupon, at 12:27 p.m., the committee was adjourned.]