S. HRG. 109–450

DEPARTMENT OF DEFENSE INSPECTOR GENERAL'S MANAGEMENT ACCOUNTABILITY REVIEW OF THE BOEING KC–767A TANKER PROGRAM

HEARING

BEFORE THE

COMMITTEE ON ARMED SERVICES
UNITED STATES SENATE

ONE HUNDRED NINTH CONGRESS

FIRST SESSION

JUNE 7, 2005

Printed for the use of the Committee on Armed Services

U.S. GOVERNMENT PRINTING OFFICE

23–606 PDF WASHINGTON : 2006

For sale by the Superintendent of Documents, U.S. Government Printing Office
Internet: bookstore.gpo.gov Phone: toll free (866) 512–1800; DC area (202) 512–1800
Fax: (202) 512–2250 Mail: Stop SSOP, Washington, DC 20402–0001

COMMITTEE ON ARMED SERVICES

JOHN WARNER, Virginia, *Chairman*

JOHN McCAIN, Arizona
JAMES M. INHOFE, Oklahoma
PAT ROBERTS, Kansas
JEFF SESSIONS, Alabama
SUSAN M. COLLINS, Maine
JOHN ENSIGN, Nevada
JAMES M. TALENT, Missouri
SAXBY CHAMBLISS, Georgia
LINDSEY O. GRAHAM, South Carolina
ELIZABETH DOLE, North Carolina
JOHN CORNYN, Texas
JOHN THUNE, South Dakota

CARL LEVIN, Michigan
EDWARD M. KENNEDY, Massachusetts
ROBERT C. BYRD, West Virginia
JOSEPH I. LIEBERMAN, Connecticut
JACK REED, Rhode Island
DANIEL K. AKAKA, Hawaii
BILL NELSON, Florida
E. BENJAMIN NELSON, Nebraska
MARK DAYTON, Minnesota
EVAN BAYH, Indiana
HILLARY RODHAM CLINTON, New York

JUDITH A. ANSLEY, *Staff Director*
RICHARD D. DEBOBES, *Democratic Staff Director*

CONTENTS

CHRONOLOGICAL LIST OF WITNESSES

DEPARTMENT OF DEFENSE INSPECTOR GENERAL'S MANAGEMENT ACCOUNTABILITY REVIEW OF THE BOEING KC–767A TANKER PROGRAM

JUNE 7, 2005

	Page
Schmitz, Hon. Joseph E., Inspector General, Department of Defense, Accompanied by: Thomas F. Gimble, Deputy Inspector General, Department of Defense	9
England, Hon. Gordon R., Acting Deputy Secretary of Defense	277
Dominguez, Hon. Michael L., Acting Secretary of the Air Force	280
Jumper, Gen. John P., USAF, Chief of Staff, United States Air Force	280
Wynne, Hon. Michael W., Under Secretary of Defense for Acquisition, Technology, and Logistics	303

DEPARTMENT OF DEFENSE INSPECTOR GENERAL'S MANAGEMENT ACCOUNTABILITY REVIEW OF THE BOEING KC–767A TANKER PROGRAM

TUESDAY, JUNE 7, 2005

U.S. SENATE,
COMMITTEE ON ARMED SERVICES,
Washington, DC.

The committee met, pursuant to notice, at 9:40 a.m. in room SR–325, Russell Senate Office Building, Senator John Warner (chairman) presiding.

Committee members present: Senators Warner, McCain, Collins, Talent, Thune, Levin, and Bill Nelson.

Committee staff members present: Judith A. Ansley, staff director; Marie Fabrizio Dickinson, chief clerk; and Leah C. Brewer, nominations and hearings clerk.

Majority staff members present: Regina A. Dubey, research assistant; William C. Greenwalt, professional staff member; Gregory T. Kiley, professional staff member; Thomas L. MacKenzie, professional staff member; Stanley R. O'Connor, Jr., professional staff member; Lynn F. Rusten, professional staff member; and Scott W. Stucky, general counsel.

Minority staff members present: Richard D. DeBobes, Democratic staff director; Gerald J. Leeling, minority counsel; and Peter K. Levine, minority counsel.

Staff assistants present: Andrew W. Florell, Benjamin L. Rubin, and Catherine E. Sendak.

Committee members' assistants present: Christopher J. Paul and Paul C. Hutton IV, assistants to Senator McCain; Mackenzie M. Eaglen, assistant to Senator Collins; Lindsey R. Neas, assistant to Senator Talent; Clyde A. Taylor IV, assistant to Senator Chambliss; and William K. Sutey, assistant to Senator Bill Nelson.

OPENING STATEMENT OF SENATOR JOHN WARNER, CHAIRMAN

Chairman WARNER. Good morning, everyone. This morning the committee meets to receive testimony on the "Management Accountability Review of the Boeing KC–767A Tanker Program," conducted by the Department of Defense (DOD) Inspector General (IG). This review was conducted in response to requests made by the committee, in particular myself joined by the ranking member and Senator McCain.

Over the past 3 years this committee and indeed my colleagues in particular have invested significant time and resources reviewing a number of issues surrounding the Department's proposed contract to lease the 100 KC–767A tanker aircraft. This oversight has included conducting hearings and briefings, requesting and receiving numerous studies, and examining extensive quantities of material, which took some difficulty to obtain from the Department.

I want at this time to commend my colleagues and members of the committee who have invested a great deal of time, and our committee staff as well as personal staff for the hours expended.

Early on this committee expressed concerns regarding this lease proposal and consequently as chairman I have the authority to accept or reject reprogramming and, in consultation with members of the committee, I made the decision to reject on July 11, 2003, a reprogramming request by the Air Force to initiate a new start on the tanker lease. Our action on that reprogramming request stopped the tanker lease contract. I thank again members of the committee for the support that they gave me in making this decision.

Numerous investigations have revealed that the problems associated with the contract lease represent the most significant defense procurement mismanagement in contemporary history. The implication of these violations of law and regulations go well beyond the tanker lease proposal. It is imperative that the Secretary of Defense and the Deputy Secretary now move to take necessary actions to hold those individuals responsible accountable for their actions, to restore necessary checks and balances in the aircraft acquisition process, and to instruct all defense officials to observe henceforth to the letter the law and regulation provided by Congress.

It was with these concerns in mind that on December 2, 2003, I first wrote then-Deputy Secretary of Defense Wolfowitz to request that the DOD IG conduct a thorough investigation of the tanker program. I asked that this inquiry, "This inquiry should examine the actions of all members of the DOD and the Department of the Air Force, both military and civilian, top to bottom, who participated in structuring and negotiating the proposed tanker lease contract which was submitted to Congress on July 2003."

A year went by and I decided I would write now the Secretary of Defense, and I was joined at this time by Senators Levin and McCain, and we are here today as a consequence after that long period of correspondence to receive the replies.

Our witnesses today who will give their perspectives on this issue are: the DOD IG, Joe Schmitz, and his Deputy, Tom Gimble, who I understand was the primary author of this report, and I commend both of you on the report, and you will give the findings of your report. They will be followed by the distinguished Acting Deputy Secretary of Defense, Gordon England; Acting Secretary of the Air Force, Mike Dominguez; the Chief of Staff of the Air Force, General John Jumper; and Mike Wynne, Principal Deputy Under Secretary of Defense for Acquisition, Technology, and Logistics.

I have tried to cut down a very long and well prepared opening statement, but we have a lot to cover here.

I am going to leave it to our witnesses to express their own views with regard to the involvement of the various committees of Congress other than this committee, although you can certainly comment on this committee as well, but I am specifically referring to the appropriations actions. But, as far as this Senator can determine, the appropriations language did not, and I repeat, did not waive standard DOD procurement procedures designed to protect the taxpayer. I believe the Inspector General concurs in that view. He points out Congress could have, but did not, give the Air Force the authority to "not follow DOD acquisition directives or comply with the five statutory provisions of law, the Federal Acquisition Regulation, and the DOD acquisition policy."

What is troubling is that it took the uncovering of the Darlene Druyun case to formally end the tanker lease contract and put any tanker replacement program back into the traditional acquisition process. The committee still has questions about how any one individual could have amassed so much power that she was able to perpetuate such a massive amount of fraud against the Federal Government and conduct other actions that were not in the best interests of the DOD or the American taxpayer.

Ms. Druyun did not operate in a vacuum. In fact, on the tanker program she left the government in November 2002, well before the contract negotiations were finished between Boeing and the Air Force and well before increasing questions raised by independent evaluators about the advisability of the lease proposal. We are left to wonder, what happened to the oversight and checks and balances in this program? At a minimum, it appears that the acquisition chain of the Air Force and perhaps the DOD was seriously inadequate.

It is my hope that with this hearing we can begin the process of putting this regrettable chapter in the history of the DOD behind us. However, we cannot do that if we do not learn from this experience, fix the acquisition process, and ensure that issues of individual accountability are squarely addressed.

Speaking for myself, I was intrigued with the observation in the Inspector General's report that there has to be a change in culture. In my humble judgment, it is going to take a lot more than a change in culture to correct this so there not be a repetition.

[The prepared statement of Senator Warner follows:]

PREPARED STATEMENT BY SENATOR JOHN WARNER

This morning the committee meets to receive testimony on the "Management Accountability Review of the Boeing KC–767A Tanker Program" conducted by the Department of Defense Inspector General. This review was conducted in response to requests that I made, together with Senator Levin and Senator McCain.

Over the past 3 years, the Senate Armed Services Committee, and Senator McCain in particular, have invested significant time and resources reviewing a number of issues surrounding the Department's proposed contract to lease 100 KC–767A tanker aircraft. This oversight has included conducting hearings and briefings, requesting and receiving numerous studies, and examining over 1.5 million executive branch e-mails and documents.

As a result of this committee's concerns with this tanker lease proposal, the committee did not approve a July 11, 2003 reprogramming request by the Air Force to initiate a new start for the tanker lease. Our action on that reprogramming request stopped the tanker lease contract dead in its tracks. Subsequent scrutiny—by this committee and others—dealt the lease program as originally formulated, a fatal blow.

Numerous investigations have revealed that the problems associated with the contract to lease 100 KC–767A tanker aircraft represent the most significant defense procurement scandal since the III Wind bribery and fraud cases of the 1980s. The implications of this scandal go well beyond the tanker lease proposal. It is imperative that the Department now move to take necessary actions to hold those individuals responsible, accountable for their actions and to restore necessary checks and balances in the acquisition process. Otherwise, the fallout from the Air Force procurement scandal could well have disastrous effects on the integrity of the entire acquisition system.

It was with these concerns in mind that on December 2, 2003, I first wrote to then Deputy Secretary Wolfowitz to request that the Department of Defense Inspector General conduct a thorough investigation of the KC–767A tanker aircraft program. I asked that "this inquiry should examine the actions of all members of the Department of Defense and the Department of the Air Force, both military and civilian, top to bottom, who participated in structuring and negotiating the proposed tanker lease contract which was submitted to Congress in July 2003." After almost a year went by with no action taken on my initial request, on November 19, 2004, I was joined by Senators Levin and McCain in a letter to Secretary Rumsfeld in which we reiterated the need for such an accountability review.

Quite simply, we wanted to know what happened, who was accountable, and what actions must be taken to prevent this situation from happening again.

On June 1, 2005, the Department announced the completion of the requested management review that is the subject of today's hearing.

I welcome today's witnesses. The Department of Defense Inspector General, Joe Schmitz and his Deputy, Tom Gimble will begin by outlining the findings of their report. We will then hear from: Acting Deputy Secretary of Defense Gordon England; Acting Secretary of the Air Force Mike Dominguez; Chief of Staff of the Air Force, General John Jumper; and Mike Wynne, Principal Deputy Under Secretary of Defense for Acquisition, Technology and Logistics who will provide the Department's comments on the IG report.

I look forward to our witnesses views on this report, particularly as it addresses individual accountability for management decisions and executive oversight. I am also interested in what lessons can be learned from the KC–767A tanker aircraft program and what needs to be done to restore the integrity of the acquisition system in light of recent Air Force acquisition scandals.

The proposed tanker lease was a departure from the traditional acquisition process, and the source of considerable debate within the administration and Congress. Legislation in an appropriations bill—section 8159 of the Department of Defense Appropriations Act of 2002—in effect "authorized" the lease. But a critical point that needs to be made is that this appropriations language did not require that the Department enter into such a lease.

The appropriations language as drawn was discretionary, not mandatory. The language contained some difficult criteria that had to be met before any such lease could be executed—such as the requirement for the lease to be an operating lease consistent with the requirements contained in OMB Circular A–11. But that requirement did not stop the Department from attempting to define what was in effect a long-term capital lease as an operating lease.

As far as I can determine, the appropriations language did not waive standard DOD procurement procedures designed to protect the taxpayer. As the DOD IG points out, Congress could have, but did not, give the Air Force the authority to "not follow DOD acquisition directives or comply with five statutory provisions of law, the Federal Acquisition Regulation, and the Department of Defense acquisition policy." It appears from the IG report that officials in OSD and the Air Force used the appropriations language as an excuse to not follow the Department's own system of checks and balances. The fact that these checks and balances were routinely overruled during this process bodes ill for the entire acquisition process. There is no excuse for such behavior. Individuals who engaged in such behavior must be held accountable.

What is troubling is that it took the uncovering of the Darleen Druyun scandal to formally end the tanker lease contract and put any tanker replacement program back into the traditional acquisition process. The committee still has questions about how anyone individual could have amassed so much power that she was able to perpetuate such a massive fraud against the Federal Government and conduct other actions that were not in the best interest of the Department of Defense or the American taxpayer.

But, Darleen Druyun did not operate in a vacuum. In fact, on the tanker program she left the government in November 2002, well before contract negotiations were finished between Boeing and the Air Force, and well before increasing questions

were raised by independent evaluators about the advisability of the lease proposal. We are left to wonder what happened to the oversight and checks and balances on this program. At a minimum it appears that the acquisition chain of the Air Force, and perhaps DOD, was woefully inadequate.

It is my hope that with this hearing we can begin the process of putting this chapter behind us. However, we can not do that if we do not learn from this experience, fix the acquisition process, and ensure that issues of individual accountability are squarely addressed.

Chairman WARNER. Senator Levin.

STATEMENT OF SENATOR CARL LEVIN

Senator LEVIN. Mr. Chairman, thank you. First let me start by thanking you, Mr. Chairman, for your leadership in this matter and thanking Senator McCain for the critical role that he has played in bringing to light the problems with the Air Force in their tanker lease program, and we will be hearing about those problems today. But, for Senator McCain's tenacity, these problems probably would not have come to light.

The Inspector General's Tanker Accountability Report identifies serious deficiencies in the tanker lease program. It is no small matter that the report finds a number of senior Office of the Secretary of Defense (OSD) and Air Force officials responsible for actions that are inconsistent with the requirements of law and regulation. Unfortunately, Mr. Schmitz, I believe that critical gaps in this report have placed a cloud over it, indeed over the Inspector General's office.

In my view, the report fails to discuss critical issues, omits critical material, and redacts key portions of the report in a manner that raises serious questions about whether this report meets applicable requirements for the independence of inspectors general. In particular, in a January 19, 2005, letter to the Inspector General the former Secretary of the Air Force defended his conduct of the tanker lease program in part by stating that the White House, Office of Management and Budget (OMB), and OSD officials played a significant role in moving the program forward and that it is therefore unfair to judge the actions of Air Force officials without reference to the actions of White House, OMB, and Office of Secretary of Defense officials.

The letter reads in part as follows. This is a letter now from the former Secretary of the Air Force: "Limiting any review to the Air Force and not OSD"—the Office of the Secretary of Defense—"only contributes to the myth that this, the tanker lease, was exclusively an Air Force proposal. It was not"—and he emphasized the word "not". "It was a proposal of the DOD and the administration, and it consistently was supported by three of the four congressional defense committees."

And he goes on: "Indeed it would be difficult to preserve the credibility of the Inspector General process or the investigation results if the investigation is arbitrarily limited to Air Force personnel or Air Force processes, or even DOD personnel and processes."

He continues: "Members and committees of Congress, as well as the White House, the Office of Management and Budget in particular, were involved from the earliest days and frequently along the way. You simply cannot gain a proper perspective of how good

and decent people tried to do the right thing by our warfighters and the American taxpayer without looking at every aspect of how this program developed and evolved. If you are going to undertake this investigation, then I believe you should in all fairness obtain the full cooperation of the Secretary of Defense, the White House, and congressional leadership for your inquiry."

Mr. Schmitz, the Tanker Accountability Report does not contain any response to that point. If in fact you inquired about the role played by the Secretary and Deputy Secretary of Defense and senior White House officials in the tanker lease program, that information is not reflected in the report. The extent to which the Secretary, Deputy Secretary, or senior White House officials authorized, approved, encouraged, or directed the actions of officials who are named in the report has a direct bearing on the responsibility of those officials and the omission of this information makes the report so incomplete as to be misleading.

Our ability to fully and fairly assess the responsibility of senior OSD officials is further undermined by the Inspector General's decision to redact references to the role of the White House out of the report. In the absence of this material, it is not possible for us to assess whether the responsibility of the officials named in the report is mitigated by the actions of other, unnamed officials who are their superiors. These redactions are made not only in e-mails between DOD officials, but also in Secretary Roche's letter, in Boeing emails, and even in the text of the report itself. There is no legal authority that would conceivably justify the redaction of this material from the report.

Equally disturbing is the fact that these omissions and redactions in the Inspector General's report appear to have been undertaken in consultation with staff in the Office of White House Counsel. In an April 29, 2005, letter to the committee, the Inspector General stated that in the report footnotes some, but not all, of the redactions, by the way, with the statement that the material has been omitted, "because staff of the White House Counsel has indicated its intent to invoke an agreement between Members of Congress and the White House."

I am told, Mr. Inspector General, that you conducted some 2 weeks of negotiations with the White House over these redactions and omissions.

Well, the quality standards for Federal offices of inspector general require full independence, unbiased and free from outside interference reports. Those standards state that the inspectors general "report both to the head of their respective agencies and to Congress." They also provide that "The Inspector General and the Office of the Inspector General (OIG) staff must be free both in fact and appearance from personal, external, and organizational impairments to independence. The Inspector General and the OIG staff should avoid situations that could lead reasonable third parties with knowledge of the relevant facts and circumstances to conclude that the OIG is not able to maintain independence in conducting its work."

The standards specifically enjoin inspectors general to avoid, "external interference or influence that could improperly or imprudently limit or modify the scope of OIG work or threaten to do so."

Now, regardless of any agreement that may have been reached between the White House and some Members of Congress relative to the handling of raw documents that were provided to them or to a congressional committee—and there was such an agreement and that involved the obtaining of documents from the executive branch to Members of Congress and to this committee. That is one matter which is a separate matter from your report, Mr. Inspector General. Your report is governed by the requirements of the Inspector General Act and the standards for Federal offices of Inspector General. You are required by these laws and standards to report your findings to the entire Congress independent of interference from any outside party. You are not and cannot be absolved of your duties as an Inspector General by an agreement between Members of Congress and the White House relative to material submitted by the executive branch to some Members of Congress or to a congressional committee.

You are required to issue a thorough and independent report, and it appears to me that you have done neither.

Again, I want to thank our chairman for his determined leadership in this matter, and particularly I want to focus on Senator McCain's role, again thanking him for his determination to bring this entire matter to light.

Chairman WARNER. Senator McCain, I join my colleague and indeed all members of the committee in thanking you for the extraordinary amount of wisdom and courage that you have applied to trying to get to the bottom of this case. Much remains to be done.

Senator McCain.

Senator MCCAIN. Thank you very much, Mr. Chairman, and I want to thank you and Senator Levin for your leadership and your steadfast efforts to resolve this issue. I hope at least one aspect of this issue can be resolved today as we hear from the witnesses, so that we can move forward and address the problems that have been brought to light. But, this investigation I think should be completed because it makes us all very unhappy and uncomfortable to see this kind of wrongdoing that has been exposed here. So it is not good for morale and it is not good for the military. These are good and decent men and women who serve the United States of America and I hope that we can move forward.

I would like to just make a couple of very quick points, Mr. Chairman. One is that it is true that this issue was initiated in the Congress of the United States, not by the Pentagon. Now, there was a very close relationship here. On September 25, 2001, there was a meeting of Boeing, Air Force officials, and the staff director of the Senate Appropriations Committee. It is a fact that this was added as a line item in the appropriations bill without a hearing, without scrutiny, without any congressional oversight, and was approved by three of the four oversight committees. So, there is a failure of oversight responsibility by three different congressional committees.

It is disturbing to find so much uniformed involvement in this issue. Mr. Chairman, I was brought up that people in uniform stayed out of politics and stayed out of policy matters, that was a mission to be carried by the civilian leadership. When I see some of the things that were said and done by uniformed personnel, it

is extremely disturbing to me as a person who believes in that separation between uniformed and civilian authorities.

I would like to say a word about Mr. Schmitz, who I think has steadfastly done an outstanding job, not only on this occasion but on other occasions. I appreciate the courage he has shown. On one occasion he was called in to then-Secretary Roche's office and told to back off the investigation of Ms. Druyun, stating, among other things, do you know you can be sued for slander? Intense pressures were put on Mr. Schmitz not to conduct a thorough and complete investigation. I thank you, Mr. Schmitz.

Finally, Mr. Chairman, we do have a procurement problem. We do have to fix this system. I know that Secretary Wynne and Secretary England are going to address that in their testimony today. In the past couple of months we have had to take a C–130J that was being designated as a commercial procurement item, which bore no relationship to reality. The Army's Future Combat System, a $113 billion program, was designated as a procurement item which was specifically only for small contractors who wanted to get into the defense business.

Why were both of these designated this way? Because then they avoided all of the checks and balances and all of the requirements a normal defense contract would undergo. By the way, it is not an accident that both of those programs have had extraordinary and incredible cost overruns associated with them, and we cannot even find out from the contractor of the C–130J the cost data because it is under a "commercial contract."

So, Mr. Chairman, what this means to me is that we have a serious problem with the procurement system in the Pentagon today and all of us on both sides of the river need to work to make sure that we get the best value for the taxpayers' dollar.

Again, I thank you.

I thank Secretary England for being here, Secretary Wynne, Mr. Schmitz, Mr. Gimble, Secretary Dominguez, and General Jumper. I thank you for being here today. I know this is not a pleasant experience for any of us, but I hope we can now with this hearing get this issue behind us.

Thank you, Mr. Chairman.

Chairman WARNER. Thank you, Senator McCain. I associate myself with your observation with regard to the men and women in uniform. Having served in the building myself as Secretary of the Navy for a number of years, I know that it is the responsibility of the civilian-military team, particularly the civilian side, to provide in a timely way the best possible equipment for the men and women of our uniformed services. We have got to make certain that this procurement process is reconstituted and up and running to serve that end.

Also, Senator McCain, the only word you left out that I would like to add, and that is that the taxpayer is bearing the brunt of this problem.

Senator Collins, would you like to say anything?

Senator COLLINS. No.

Chairman WARNER. Senator Thune?

Senator THUNE. No.

Chairman WARNER. I want to first point out that we, the committee, consistent with practices going back many years of this committee and I think other committees of Congress, when we receive Inspector General reports we treat them differently than other material. There are certain portions of the report which have been redacted for the purpose of this hearing, but we will at the conclusion of this open hearing proceed to Room 222 in this building, the Armed Services Committee hearing room, to resume in executive session, at which time, Mr. Schmitz and Mr. Gimble, you are invited, and other witnesses. We hope that you can find the time to join us down there likewise.

If there are no other comments by members here, we will proceed to receive the Inspector General's report.

I would like to remind everyone that in this room the acoustics leave a little bit to be desired, and you will have to use those microphones, speaking directly into them.

Mr. Schmitz.

STATEMENT OF HON. JOSEPH E. SCHMITZ, INSPECTOR GENERAL, DEPARTMENT OF DEFENSE, ACCOMPANIED BY: THOMAS F. GIMBLE, DEPUTY INSPECTOR GENERAL, DEPARTMENT OF DEFENSE

Mr. SCHMITZ. Thank you, Mr. Chairman. Senator Levin, Senator McCain, Senator Collins, Senator Thune: I appreciate the opportunity to appear this morning and to answer your questions about our recent report, "Management Accountability Review of the KC–767A Tanker Program." As the publicly releasable version of our report has already been submitted and speaks for itself, I would ask that it be admitted as part of the record.

Chairman WARNER. Without objection.

[The information referred to follows:]

[redacted]

Report No. OIG-2004-171
May 13, 2005

OFFICE OF THE INSPECTOR GENERAL OF THE
DEPARTMENT OF DEFENSE

Management Accountability Review of the Boeing KC-767A Tanker Program

Special Warning

[redacted]

[redacted]

May 13, 2005

MEMORANDUM FOR DEPUTY SECRETARY OF DEFENSE

SUBJECT: Management Accountability Review of the Boeing KC-767A Tanker Program (Report No. OIG-2004-171)

On December 2, 2003, the Chairman of the Senate Armed Services Committee commended the Secretary and you for taking prompt action to task the Department of Defense Inspector General to conduct an independent assessment of the Boeing KC-767A Tanker Program. Subsequently, on November 19, 2004, Members of the Senate Armed Services Committee sent a letter to the Secretary requesting that the Inspector General conduct an accountability review of all members of the Department of Defense and the Department of the Air Force, both military and civilian, who participated in structuring and negotiating the proposed lease contract for the Boeing KC-767A Tanker Program, including the then-Secretary of the Air Force and the then-Assistant Secretary of the Air Force (Acquisition), to determine what happened, who was accountable, and what actions must be taken to prevent a situation like the Boeing KC-767A tanker aircraft lease from happening again.

The report addresses in Part I, what happened; in Part II, who was accountable; and in Part III, what actions must be taken to prevent a situation like the Boeing KC-767A tanker aircraft lease from happening again. The timeline included at Appendix B summarizes "what happened." The Under Secretary of Defense for Acquisition, Technology, and Logistics; the Secretary of the Air Force; the Assistant Secretary of the Air Force (Acquisition) and senior members of their respective staffs were accountable for the decisions associated with the tanker aircraft lease. Although required to do so by Department of Defense directive, these officials did not comply with the DoD 5000 series of guidance, the Federal Acquisition Regulation, and the Office of Management and Budget circulars during their efforts to lease Boeing KC-767A tanker aircraft; instead they focused on supporting a legislative decision to allow leasing tanker aircraft from Boeing rather than developing objective acquisition information that would have questioned, as a matter of procedure, whether such a decision was appropriate for the situation.

We appreciate the courtesies extended to the staff. Questions should be directed to Mr. John E. Meling at (703) 604-9091 (DSN 664-9091) or Mr. Henry F. Kleinknecht at (703) 604-9324 (DSN 664-9324).

Thomas F. Gimble
Deputy Inspector General
as First Assistant

[redacted]

[redacted]

Table of Contents

Executive Summary i

Background 1

Objective of the Review 1
Request From the Senate Armed Services Committee 1
Description of the Tanker Program 1

Scope and Methodology 1

Part I – What Happened? 6

Part II – Who Was Accountable? 32

Part III – What Actions Must Be Taken to Prevent a Situation Like the Tanker Lease From Happening Again? 47

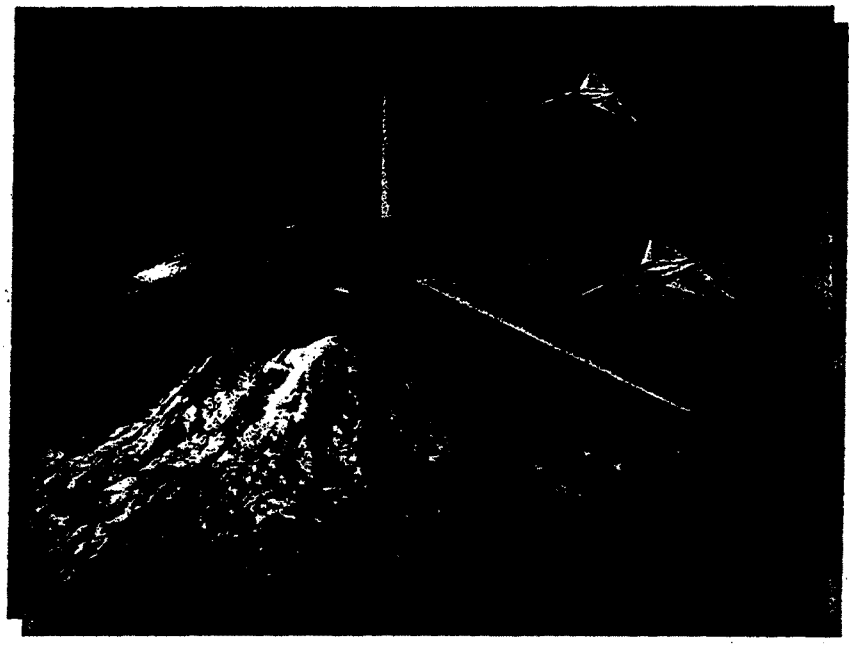
Appendixes

A. Related Coverage 50
B. Timeline 55
C. Chronology of Events 57
D. Members of the Office of the Secretary of Defense and the Air Force Who Were Interviewed 149
E. Operating Leases 155
F. Commercial Item Procurement Strategy – Pricing Issues 201
G. Placard Paradox 225
H. Key Air Force Players in the Placard Paradox 232
I. Original Placards Displayed 235
J. Initial Placard Submission 240
K. Final Placard Submission 245

Management Comments

Under Secretary of Defense for Acquisition, Technology, and Logistics 253
Department of the Air Force 255

[redacted]



Source: Office of the Assistant Secretary of the Air Force (Acquisition)

Proposed Boeing KC-767A Tanker Aircraft

[redacted]

Office of the Inspector General of the Department of Defense

Report No. OIG-2004-171 **May 13 2005**
(Project No. D2005AE-0092)

Management Accountability Review of the Boeing KC-767A Tanker Program

Executive Summary

Objective of the Review. Our overall objective of the review of the Boeing KC-767A Tanker Program was to determine what happened, who was accountable, and what actions must be taken to prevent a similar situation from happening again.

Scope and Methodology. To accomplish the objective, the review team analyzed selected e-mails and memorandums from the Department of Defense and the Boeing Company; interviewed members of the Office of the Secretary of Defense and the Department of the Air Force, both military and civilian, including the then-Secretary of the Air Force and the then-Assistant Secretary of the Air Force (Acquisition), who were involved in the Boeing KC-767A tanker aircraft lease; and evaluated prior Department of Defense Office of the Inspector General reviews of the Boeing KC-767A Tanker Program to gain insight into what happened and who was accountable during the structuring and negotiating of the proposed lease contract for the Boeing KC-767A Tanker Program. During the review, we included significant events along a timeline from inception of the idea until Congress terminated the Secretary of the Air Force authority to lease tanker aircraft (Appendix B).

Results. Senior officials of the Air Force acquisition community and the Office of the Secretary of Defense were focused on supporting a decision to lease tanker aircraft from Boeing rather than developing objective acquisition information that would have questioned, as a matter of procedure, whether such a decision was appropriate. Although required by Department of Defense directive, officials of the Office of the Secretary of Defense and the Air Force did not comply with the Office of Management and Budget circulars, the Federal Acquisition Regulation, and the DoD 5000 series of guidance to ensure that a tanker replacement aircraft was acquired to satisfy user needs with measurable improvements to mission capability and operational support, in a timely manner, and at a fair and reasonable price. Instead, the Air Force used Section 8159 of the Department of Defense Appropriations Act for FY 2002 to justify its inappropriate acquisition strategy with the primary goal to expeditiously lease 100 Boeing KC-767A tanker aircraft to replace its aging KC-135E tanker aircraft fleet. In doing so, as explained in DoD Inspector General Audit Report No. D-2004-064 of March 29, 2004, the Air Force "demonstrated neither best business practices nor prudent acquisition procedures to provide sufficient accountability for the expenditure of $23.5 billion for the KC-767A tanker program."

What Happened. Although several studies and proposals covering the Air Force tanker and Boeing commercial aircraft occurred before September 2001, Air Force officials began meeting with Boeing Company executives to enter into an agreement to lease 100 Boeing KC-767A tanker aircraft in September 2001. The proposed agreement

[redacted]

had support from White House officials, members of Congress, the Office of the Secretary of Defense, the Air Force, and the Boeing Company. At that time, the Air Force neither identified nor funded an urgent requirement for the replacement of the existing tankers.

On January 10, 2002, Section 8159 of the Department of Defense Appropriations Act for FY 2002 authorized the Air Force to make payments on a multiyear pilot program for leasing not more than 100 general purpose Boeing 767 aircraft for more than 10 years per aircraft, inclusive of any options to renew or extend the initial lease term. Further, the present value of the total payments over the duration of each lease can not be more than 90 percent of the fair market value of the aircraft obtained under the lease. Without conducting an analysis of alternatives, the Air Force used Section 8159 of the Department of Defense Appropriations Act for FY 2002 to justify an informal acquisition strategy, the focus and goal of which was to expeditiously lease 100 KC-767A tanker aircraft from Boeing through a business trust.

Decision makers in the Air Force and the Office of the Secretary of Defense undertook efforts to acquire this tanker capability without the benefit of key information on requirements and costs, which are derived from following established acquisition procedures. They made an inappropriate decision to only use Section 8159 for an acquisition strategy and bypassed following the prescribed procedures contained in DoD Directive 5000.1, "Defense Acquisition System." According to Dr. Marvin R. Sambur, Assistant Secretary of the Air Force (Acquisition), Mr. Edward C. "Pete" Aldridge, Jr., Under Secretary of Defense for Acquisition, Logistics, and Technology told him in November 2001 that the requirements of DoD Directive 5000.1 did not need to be implemented for the Boeing KC-767A tanker aircraft lease. By not following established acquisition procedures, the decision makers did not apply best business practices, adhere to prudent acquisition procedures, comply with statutory provisions for testing, and satisfy warfighter needs at a fair and reasonable price. Further, the Air Force considered the Boeing KC-767A tanker aircraft to be a commercial item even though significant modifications were required and no commercial market for this tanker aircraft existed to establish reasonable prices by the forces of supply and demand. As a result, and as explained in our earlier Report D-2004-064, the Air Force did not have sufficient cost or pricing data to demonstrate the level of accountability needed to conclude that the prices negotiated represented a fair expenditure of Department of Defense funds.

Because of revelations by The Boeing Company in November 2003 concerning apparent improprieties by the Boeing executives, Ms. Darleen A. Druyun (former Principal Deputy Assistant Secretary of the Air Force [Acquisition and Management]) and Mr. Michael Sears, Chief Financial Officer, Boeing; the Deputy Secretary of Defense placed the Boeing KC-767A Tanker Program on hold until our review and reviews by the National Defense University and Defense Science Board were completed. Our review concluded that the Air Force used an inappropriate acquisition strategy and demonstrated neither best business practices nor prudent acquisition procedures to provide sufficient accountability for the expenditure of $23.5 billion for the Boeing KC-767A Tanker Program. In our prior Report D-2004-064, we identified five statutory provisions that the Air Force did not satisfy relating to: commercial items; testing (two statutes); cost-plus-a-percentage-of-cost system of contracting; and leases. Therefore, we recommended that DoD not proceed with the program until it resolved the issues pertaining to the procurement strategy, acquisition procedures, and statutory requirements.

In April 2004, the National Defense University issued a report concluding that the Air Force and the Department of Defense bypassed many elements of the normal

[redacted]

acquisition system and that the Office of the Secretary of Defense Leasing Review Panel was not a substitute for the Defense Acquisition Board review of the tanker lease acquisition. The National Defense University also concluded that the Air Force did not use a competitive process for the tanker lease acquisition because contractor selection was a foregone conclusion based on Section 8159 of the Department of Defense Appropriations Act for FY 2002 and the Joint Requirements Oversight Council. Also, in May 2004, the Defense Science Board concluded that the KC-135 airframe would be capable until 2040 and that a corrosion problem was manageable. The Board also commented on tanker recapitalization noting a need to embark on a major tanker recapitalization program, but because total tanker requirements are uncertain, the recapitalization program can be deferred until the completion of the analysis of alternatives and the Mobility Capabilities Study.

Who Was Accountable. The Boeing KC-767A Tanker Program had significant support from senior decision makers, including three of four congressional Defense committees. However, the Office of Management and Budget; the Congressional Budget Office; Program Analysis and Evaluation, Office of the Secretary of Defense; the Defense Science Board; the Defense Acquisition University; the then-Principal Deputy Under Secretary of Defense for Acquisition, Technology, and Logistics; and the Department of Defense Inspector General raised several significant "red flag" issues concerning the program. These issues included inappropriate lease type, improper item definition, lack of cost data, analyses that supported buy rather than lease, lack of an urgent requirement, and failure to follow prescribed acquisition rules.

Although Department of Defense and Air Force officials are responsible for overseeing the acquisition process, those officials did not properly follow acquisition policies and procedures. Specifically, senior acquisition officials are accountable for providing an effective, affordable, and timely system to the users, which in this case was the Assistant Secretary of the Air Force (Acquisition) and the Under Secretary of Defense for Acquisition, Technology, and Logistics. Before the Boeing KC-767A Tanker Program became an Acquisition Category ID or Major Defense Acquisition Program on May 23, 2003, the Secretary of the Air Force and the Assistant Secretary of the Air Force (Acquisition) did not require an analysis of alternatives to identify the best possible system solution to meet warfighter requirements and did not require a formal, written acquisition strategy to guide the program during system development and demonstration. The Assistant Secretary of the Air Force (Acquisition) allowed the Air Force to use Section 8159 of the Department of Defense Appropriations Act for FY 2002 to justify an inappropriate acquisition strategy. The Congress could have but did not prescribe in the legislation that the Air Force need not:

- follow DoD acquisition directives or
- comply with five statutory provisions of law, the Federal Acquisition Regulation, and the Department of Defense acquisition policy.

Further, when the Under Secretary of Defense for Acquisition, Technology and Logistics designated the Boeing KC-767A Tanker Program as a major Defense acquisition program on May 23, 2003, he did so without convening a Defense Acquisition Board to ensure that the program acquisition strategy adequately addressed the acquisition approach, warfighter capability needs, test and evaluation, risk management, resource management, funding under an evolutionary acquisition strategy, systems engineering, interoperability, information technology, information assurance, product support, human system integration, and business considerations. Instead, the Under Secretary based his

[redacted]

decision on the ongoing review by the Office of the Secretary of Defense Leasing Review Panel and by the Secretary of Defense approval of the proposed lease. The objective of the Leasing Review Panel, which was subordinate to the Defense Acquisition Board, was to advise and assist the Secretary of Defense in establishing an internal review and approval process to assess the impact of leasing proposals on the Defense budget. The objective was not to focus on program management and readiness of the program to proceed to the next phase of the acquisition process. While many people provided input into the tanker aircraft lease decision, we concluded that Mr. Edward C. Aldridge, Jr., Under Secretary of Defense for Acquisition, Technology, and Logistics; Dr. James G. Roche, Secretary of the Air Force; Dr. Marvin R. Sambur, Assistant Secretary of the Air Force (Acquisition); and Ms. Darleen A. Druyun, Principal Deputy Assistant Secretary of the Air Force (Acquisition and Management) were the primary decision makers within the Department of Defense and the Air Force who allowed the Boeing KC-767A tanker aircraft lease to continue moving forward. Additionally, Mr. Michael W. Wynne, as the Principal Deputy Under Secretary of Defense for Acquisition, Technology, and Logistics raised concerns about the unit price and the conduct of an analysis of alternatives. However, he did not require the Air Force to follow the DoD Directive 5000 series after assuming the acting duties of the Under Secretary of Defense for Acquisition, Technology, and Logistics.

What Actions Must Be Taken To Prevent a Similar Situation. The Office of Management and Budget circulars, the Federal Acquisition Regulation, and the DoD 5000 series of guidance establish a system of management controls over the acquisition of weapon systems for the Department. The system, when properly implemented and followed, should place needed capabilities in the hands of the warfighter while appropriately mitigating the level of risk associated with properly performing the actual functions expected of the weapon system. Also, the DoD 5000 series establishes a system of management controls to maintain proper financial control of the program to protect the interests of both the warfighter and the taxpayer when contemplating different weapons acquisition strategies to include leasing as a financing option. The system of management internal control was either not in place or not effective because the existing acquisition procedures were not followed in the proposed lease of the Boeing KC-767A tanker aircraft. The Department of Defense must change the cultural environment in its acquisition community to ensure that the proper control environment is reestablished and followed for major weapon-system acquisitions.

In addition, as part of the cultural change, the Department must not tolerate situations where senior officials use their positions to have contractors put pressure on other senior officials to have them change their stance relative to a particular situation. For example, on June 20, 2003, Mr. Kenneth J. Krieg, Director, Program Analysis and Evaluation issued a memorandum stating that purchase was more cost effective than leasing the Boeing KC-767A tanker aircraft and that the lease as proposed did not meet Office of Management and Budget requirements. Consequently, according to [redacted] in an e-mail, Dr. Roche requested, in a meeting with [redacted] on June 23, 2003, that Boeing put pressure on Mr. Michael Wynne to have Mr. Krieg change his position on the Boeing KC-767A tanker aircraft lease.

Even though Department of Defense Instruction 5000.2, "Operation of the Defense Acquisition System," May 12, 2003, requires an analysis of alternatives at major milestone decision points for major Defense acquisition programs, the Office of the Secretary of Defense and the Department of the Air Force did not comply with the requirement because of guidance from Mr. Aldridge to Dr. Sambur that the requirements of DoD Directive 5000.1 did not need to be implemented for the Boeing KC-767A tanker

[redacted]

aircraft lease. Therefore, the Secretary should reemphasize the requirement to conduct an analysis of alternatives for all major Defense acquisition programs and major systems before major milestone decision points.

Further, the Under Secretary of Defense for Acquisition, Technology, and Logistics; the Assistant Secretary of Defense for Networks and Information Integration; and the Director, Operational Test and Evaluation should revise DoD Instruction 5000.2 to specify the procedures the Under Secretary of Defense for Acquisition, Technology, and Logistics and the Department of Defense Component Acquisition Executives must follow when leasing a major Defense acquisition program or a major system. Specifically, the guidance should emphasize that leasing is a method for financing the acquisition of a program and that the program should be treated the same as any acquisition program of like cost. Further, the guidance should require, at a minimum, that the acquiring Military Department prepare an analysis of alternatives for the lease and that the decision to enter into a contract to lease a major Defense acquisition program or a major system must be subject to the results of a Defense Acquisition Board or a System Acquisition Review Council review, as applicable.

Management Comments and Audit Response. We received comments from the Under Secretary of Defense for Acquisition, Technology, and Logistics and the Acting Secretary of the Air Force on the draft report. The Under Secretary stated that, by not acknowledging the expressed congressional approval for the Secretary of the Air Force to consider the lease of commercially configured tanker aircraft, the report seems to ignore the need for flexibility if the Department is to be capable of responding appropriately to an immediate requirement for a major end item. Further, he stated that the report implied that the mere consideration of an alternative to standard major systems acquisition practices was somehow wrong, even if congressionally permitted. The Under Secretary suggested that the Department devote more effort in the early stages of future innovative acquisitions to ensure a common appreciation of those transactions. While we are not opposed to acquisition reform initiatives, we believe that safeguards, such as conducting an analysis of alternatives and adhering to the Federal Acquisition Regulation and statutory testing requirements for items that do not meet the definition of a commercial item, need to be followed to ensure that warfighter needs are efficiently and effectively met and to protect the Government's and the taxpayers' interests.

In response to the draft report, the Acting Secretary concurred with the recommendations except the recommendation to legislate a requirement to conduct an analysis of alternatives. He stated that the requirement to conduct an analysis of alternatives was already contained in the DoD 5000 series of directives. Further, the Acting Secretary stated that "A statutory requirement would remove the agility the Defense Acquisition System requires in cases where a time imperative exists and the materiel solution is clear." For the Boeing KC-767A tanker aircraft, a time imperative did not exist, the material solution was not clear, and the Office of the Secretary of Defense and the Air Force did not follow the requirement to conduct an analysis of alternatives in the DoD 5000 series of directives. Therefore, the Secretary should reemphasize the requirement to conduct an analysis of alternatives for all major Defense acquisition programs and major systems before major milestone decision points. (See the Management Comments section of the report for the complete text of the comments.)

[redacted]

Background

Objective of the Review. Our overall objective in this review of the Boeing KC-767A Tanker Program was to determine what happened, who was accountable, and what actions must be taken to prevent an inappropriate acquisition and financial situation like the tanker lease from happening again.

Request From the Senate Armed Services Committee. On December 2, 2003, Chairman Warner of the Senate Armed Services sent a letter to the Deputy Secretary of Defense in which he commended the Secretary of Defense and the Deputy Secretary of Defense for their prompt actions regarding the Boeing KC-767A Tanker Program and for tasking the Department of Defense Inspector General to conduct an independent assessment of the Program. Chairman Warner indicated, however, that he believed that the independent assessment should also "examine the actions of all members of the Department of Defense and the Department of the Air Force, both military and civilian, top to bottom, who participated in structuring and negotiating the proposed tanker lease contract which was submitted to the Congress in July 2003."

On November 19, 2004, Chairman Warner of the Senate Armed Services Committee, Ranking Senator Levin, and Senator McCain sent a letter to the Secretary of Defense, enclosing a copy of the Chairman's December 2, 2003, letter, requesting that the Department of Defense Inspector General conduct an accountability review "of all members of the Department of Defense (DoD) and the Department of the Air Force, both military and civilian, top to bottom, who participated in structuring and negotiating the proposed tanker lease contract," including the then-Secretary of the Air Force and the then-Assistant Secretary of the Air Force (Acquisition) Specifically, the accountability review should determine what happened, who was accountable, and what actions must be taken to prevent a situation like the tanker lease from happening again. See the following pages for the specific request from Chairman Warner, Ranking Senator Levin, and Senator McCain.

Description of the Tanker Program. The Boeing Company planned to produce the Boeing KC-767A tanker aircraft from its core commercial B767-200ER aircraft. The plan included integrating features from other B767 models and adding extensive military-unique modifications for its primary air refueling mission and other missions, including cargo, passenger, aeromedical evacuation, communication relay, and passive sensor. As a tanker, the aircraft was to receive and dispense fuel through a drogue and boom from its centerline and to store more than 200,000 pounds of fuel.

Scope and Methodology

Introduction. To accomplish the objective, the review team analyzed selected e-mails and memorandums from the Department of Defense and the Boeing Company; interviewed members of the Office of the Secretary of Defense and the Department of the Air Force, both military and civilian, including the then-Secretary of the Air Force and the then-Assistant Secretary of the Air Force

[redacted]

(Acquisition), who were involved in the Boeing KC-767A tanker aircraft lease; and used prior Department of Defense Office of the Inspector General reviews of the Boeing KC-767A Tanker Program to gain insight into what happened and who was accountable during the structuring and negotiating of the proposed lease contract for the Boeing KC-767A Tanker Program. Using the results of what happened (Part I) and who was accountable (Part II), the review team determined what actions must be taken to prevent a situation like the tanker lease from happening again (Part III).

Interviews. After analyzing selected e-mails, memorandums, and prior reviews of the Boeing KC-767A Tanker Program, the review team determined who in the Office of the Secretary of Defense and the Department of the Air Force, both military and civilian, were involved in the management of the program. Based on that determination, the review team interviewed 88 individuals in the Office of the Secretary of Defense and the Department of the Air Force to gain further insight into what happened and who was accountable during the structuring and negotiating of the proposed lease contract for the Boeing KC-767A Tanker Program. See Part II for excerpts of selected interviews and Appendix D for a list of the members of the Office of the Secretary of Defense and the Air Force who were interviewed.

Timeline of Events. Using the results of the analysis of selected e-mails and memorandums; interviews of members of the Office of the Secretary of Defense and the Air Force, who were involved in the Boeing KC-767A tanker aircraft lease; and evaluations of prior reviews, the review team developed a timeline that identified significant events from inception of the idea until Congress terminated the Secretary of the Air Force authority to lease tanker aircraft. See Appendix B for the timeline.

Limitations. The review team did not interview White House officials, members of Congress, and the Boeing Company because the focus of the review was on members of the Office of the Secretary of Defense and the Department of the Air Force, both military and civilian, who were involved in the Boeing KC-767A tanker aircraft lease. In addition, the review team was unable to interview Mr Edward C. "Pete" Aldridge, Jr., former Under Secretary of Defense for Acquisition, Logistics, and Technology even after repeated attempts to contact him.

[redacted]

Senate Armed Services Committee Request

United States Senate
COMMITTEE ON ARMED SERVICES
WASHINGTON, DC 20510-6050

November 19, 2004

Honorable Donald H. Rumsfeld
Secretary of Defense
1000 Defense Pentagon
Washington, D.C. 20301-1000

Dear Mr. Secretary:

On December 2, 2003, Chairman Warner wrote to Deputy Secretary Wolfowitz to request that the Department of Defense Inspector General (DOD IG) conduct a thorough investigation of the KC-767A tanker aircraft program. According to Chairman Warner's letter "this inquiry should examine the actions of all members of the Department of Defense (DOD) and the Department of the Air Force, both military and civilian, top to bottom, who participated in structuring and negotiating the proposed tanker lease contract which was submitted to the Congress in July 2003." A copy of that letter is attached.

It was our understanding that the requested DOD IG review would assess not only individual responsibility for any allegations of criminal violations of law; but, equally important, individual accountability for management decisions and executive oversight. In essence, the Senate Committee on Armed Services, in order to conduct its necessary legislative oversight of the Department of Defense, needs to know what happened, who was accountable and what actions must be taken to prevent this situation from happening again.

It is astonishing to us that one individual could have so freely perpetrated, for such an extended period, this unprecedented series of fraudulent decisions and other actions that were not in the best interest of the Department of Defense.

We recently found out that no such managerial accountability review has been undertaken by the DOD IG. Rather, the DOD IG limited his review to determining whether there was evidence to press criminal charges. We are deeply concerned by this development. Given the Chairman's letter, why was a decision made not to do this work?

Congressional oversight of the proposed contract to lease 100 KC-767A tanker aircraft, a contract which is now prohibited by section 133 of the National Defense Authorization Act for Fiscal Year 2005, uncovered the most significant defense procurement scandal since the Ill Wind bribery and fraud cases of the 1980s. It is imperative that the Department take actions to hold those responsible accountable. Otherwise, the fallout from this Air Force procurement scandal will have disastrous effects on the integrity of the acquisition system.

DSD 18663-04

[redacted]

In our view, an assessment of accountability should include a review of all members of the Department of Defense and the Department of the Air Force, both military and civilian, who participated in structuring and negotiating the proposed tanker lease contract. Most importantly, this should include Secretary of the Air Force Jim Roche, and Assistant Secretary of the Air Force Marvin Sambur. We reiterate the Committee's request that the DOD IG immediately initiate such an accountability review.

Again, we do not understand how one individual could have amassed so much power that she was able to perpetuate such fraud against the federal government and other actions that were not in the best interest of the Department of Defense. Where was the oversight? Where were the checks and balances? At a minimum, the acquisition chain of the Air Force, and perhaps DOD, was woefully inadequate. The fact that no Departmental review of these questions has been conducted raises significant accountability and oversight questions that go far beyond this one case. We trust you will endeavor to rectify the situation and hold those who are responsible accountable.

Sincerely,

Carl Levin
Ranking Member

John Warner
Chairman

John McCain
U.S. Senator

Attachment

cc: Department of Defense Inspector General

2

[redacted]

United States Senate
COMMITTEE ON ARMED SERVICES
WASHINGTON, DC 20510-6050

December 2, 2003

The Honorable Paul Wolfowitz
Deputy Secretary of Defense
1000 Defense Pentagon
Washington, D.C. 20301-1000

Dear Secretary Wolfowitz:

I commend the Secretary of Defense and yourself for the prompt actions you have taken regarding the Air Force's tanker aircraft program, in light of recent extraordinary personnel actions taken by the Boeing Company. Your decision to require a "pause" in the execution of any contracts to lease and purchase tanker aircraft is a prudent management step.

Further, I concur in your judgment to tasks the Department of Defense Inspector General (DOD-IG) to conduct an independent assessment. However, I believe that the DOD-IG assessment should go further than the review described in your letter of December 1, 2003. The DOD-IG inquiry should pursue the trail of evidence wherever it leads, in accordance with standard IG procedures. This inquiry should examine the actions of all members of the Department of Defense and the Department of the Air Force, both military and civilian, top to bottom, who participated in structuring and negotiating the proposed tanker lease contract which was submitted to the Congress in July 2003.

Your recent actions clearly indicate that there are many outstanding questions that must be answered before proceeding with this program. I expect that you will consult further with the Congress as you receive the report of the DOD-IG and that no actions will be taken with respect to the lease and purchase of KC-767 tanker aircraft until the Congress has had an opportunity to review the DOD-IG report. Ultimately, this program, as restructured, must be executed in a manner that is fully consistent with Section 135 of the National Defense Authorization Act for Fiscal Year 2004 (Public Law 108-136).

With kind regards, I am

Sincerely,

John Warner

John Warner
Chairman

cc: Department of Defense Inspector General

U19766 /03

[redacted]

Part I – What Happened?

On November 19, 2004, Senators Warner, Levin, and McCain in a letter to Secretary of Defense Donald Rumsfeld requested that the Department of Defense Office of the Inspector General conduct an assessment of managerial accountability of the Boeing KC-767A Tanker Lease Program. Specifically, the Senators requested that the assessment address the questions, "what happened, who was accountable, and what actions must be taken to prevent this situation from happening again."

The Boeing KC-767A Tanker Lease Program was championed by senior DoD and Air Force officials. In addition, Boeing Company officials provided an intense lobbying support in the White House, Congress, and DoD.

DoD acquisitions are required to follow the requirements for analysis and oversight that are in DoD Directive 5000.1, "The Defense Acquisition System," May 12, 2003, and prior versions. The oversight mechanisms provide internal controls to ensure that the weapon systems acquired by DoD satisfy the needs of the warfighter and are acquired economically and efficiently using best business practices. When it is determined that a major acquisition program is warranted, the Senior Acquisition Executive[1] is required to notify Congress through formal reporting of a new start. When the acquisition program is established, the DoD and Air Force officials are responsible for ensuring the proper procedures are followed. Air Force and other DoD acquisition officials did not follow the proscribed procedures in DoD Directive 5000.1 for the tanker program. Dr. Marvin R. Sambur, Assistant Secretary of the Air Force (Acquisition) stated that Mr. Edward C. Aldridge, Jr., Under Secretary of Defense for Acquisition, Logistics, and Technology,[2] in November 2001, told him that the requirements of DoD Directive 5000.1 did not need to be implemented for the Boeing KC-767A tanker aircraft lease. As a result, many of the required oversight reviews, analyses and acquisition planning normally performed on acquisitions of this magnitude were not performed.

The Air Force did not identify tanker recapitalization as an immediate near-term requirement. Specifically, although the Air Force recognized that the tanker aircraft fleet, predominately KC-135 tanker aircraft, was aging and maintenance costs were likely to increase, the Air Mobility Command estimated in the Air Mobility Command Strategic Plan that the KC-135 tanker aircraft fleet

[1]In the Military Departments, the Secretaries delegate their acquisition responsibilities to the Assistant Secretary level, commonly called the Service Acquisition Executive. For the Air Force, the Service Acquisition Executive is the Assistant Secretary of the Air Force (Acquisition), who reports to the Secretary of the Air Force administratively and to the Under Secretary of Defense for Acquisition, Technology, and Logistics for acquisition management matters. Each Service Acquisition Executive also serves as the Senior Procurement Executive for their Military Department. In this capacity, they are responsible for management direction of their respective Military Department procurement system

[2]The Under Secretary of Defense for Acquisition, Technology, and Logistics serves as the Defense Acquisition Executive with responsibility for supervising the performance of the DoD Acquisition System and enforcing the policies and practices in DoD Directive 5000.1 and Office of Management and Budget Circular No. A-109, "Major System Acquisitions," April 5, 1976

[redacted]

retirements would begin in 2013 and continue to 2040. The KC-135 Economic Service Life Study, February 2001, concluded that, "The KC-135 fleet has an average age of approximately 41 years. The ESLS [Economic Service Life Study] does not foresee an economic catastrophe on the horizon; however, substantial cost increases are forecast and maintaining acceptable levels of availability will continue to be a struggle."

In February 2001, [redacted]

The Department had explored the leasing of aircraft on several occasions before the Boeing KC-767A tanker aircraft lease. For example, on May 7, 2001, Mr. William Schneider, Jr., Chairman, Defense Science Board, at the suggestion of [redacted] Chairman, National Economic Council met with finance specialists at Citicorp (New York) to brief Citicorp on DoD interest in applying commercial financing techniques to selected DoD assets, such as C-17 strategic airlift aircraft and a replacement aerial tanker for the existing fleet of 500 KC-135 tanker aircraft, and to obtain Citicorp views on statutory and regulatory obstacles that prevent the use of commercial lease finance techniques to permit DoD to finance capital asset acquisitions and the sale-leaseback of DoD real property. Subsequently, the Secretary of Defense asked Dr. Dov Zakheim, Under Secretary of Defense (Comptroller) on May 11, 2001, to initiate a process to get commercial financing techniques moving and to coordinate with the appropriate people, including the DoD Office of General Counsel.

Events of September 11, 2001, accelerated Air Force efforts to begin recapitalization of the aging KC-135 tanker aircraft fleet. On September 25, 2001, Ms. Darleen A. Druyun, Principal Deputy Assistant Secretary of the Air Force (Acquisition and Management) met with Messrs. [redacted] and [redacted] at Boeing to lay out a strategy to lease 100 Boeing KC-767A tanker aircraft by building 18 to 20 aircraft per year during a 10-year lease. After the meeting, [redacted] at Boeing was tasked to develop briefs on the tanker aircraft lease concept by September 26, 2001, for [redacted] and Ms. Druyun to take to Capitol Hill.

On October 9, 2001, in a letter to a Representative, Dr. James G. Roche, Secretary of the Air Force expressed appreciation for the congressional interest in jump starting the replacement of the KC-135 tanker fleet. Secretary Roche stated, "I strongly endorse beginning the upgrade to this critical warfighting capability with new Boeing 767 aircraft. If Congress provides the needed supporting language, we could initiate this program through an operating lease with the option to purchase the aircraft in the future."

[redacted]

In late October 2001, the Air Force began to develop an operational requirements document for the tanker tailored to Boeing KC-767A tanker aircraft capabilities even though it had not performed an analysis of alternatives to determine whether the Boeing KC-767A was the preferred solution to the tanker replacement issue.

On November 1, 2001, Mr. Aldridge and Dr. Dov S. Zakheim signed a letter that formed a leasing panel to review all proposed leases with a cost of $250 million or more.

On November 8, 2001, according to an e-mail by [redacted] at Boeing, [redacted]

On December 3, 2001, [redacted] at Boeing sent an e-mail to [redacted]

- [redacted]
- [redacted]

On December 5, 2001, Ms. Druyun sent an e-mail to Dr. James G. Roche; General John Jumper, Air Force Chief of Staff; General Robert Foglesong, Air Force Vice Chief of Staff; and Dr Sambur in which she stated:

> [A Representative] and [a congressional staffer] faxed me the new language that will go to the conference. They have fixed some of the issues but as written it is still not executable. [A Representative] called again this a.m. to get my sense of executability and this is what I said to him: The language requires the Air Force lease green [Boeing] 767 aircraft but procure through separate Auth/Approp [Authorization/Appropriation] the mod [modification] to make it a tanker. This means the aircraft cost is [redacted] which I then do my fair market value 90% assessment. For a ten-year lease I bust the 90% to 116% under OMB [Office of Management and Budget] Circular A-11.

On December 5, 2001, in response to Ms. Druyun's December 5, 2001, e-mail, Dr. Sambur sent an e-mail to Dr. Roche, Ms. Druyun, General Jumper, and General Foglesong with a cc: to Mr. Willard H. Mitchell, Deputy Under Secretary of the Air Force (International Affairs) in which he stated that, "Since this email, Darleen [Druyun] has done an excellent job on the Hill to modify the language so that it [is] approaching the doable range."

[redacted]

On December 12, 2001, an Office of Management and Budget official sent a letter to a Representative that stated in part:

> In your letter you ask that the economic stimulus package include money for the lease or purchase of new B-767 aircraft as tankers for the Air Force. We have grave reservations about leasing these aircraft. Our analysis shows that over the long-term a lease-purchase program would be much more expensive than direct purchase of the same aircraft. With regard to the possibility of procuring the aircraft, we have now begun the programmatic and budget reviews necessary for the preparation for the FY 2003 Budget submission. In this process programs are evaluated in terms of their cost and potential military benefit. Please be assured that we will consider your request carefully as we prepare the FY 2003 Budget request.

On December 17, 2001, an e-mail from Major General Essex to Dr. Sambur stated that:

> Mrs. Druyun, Boeing, and Air Staff reps meet end of last week to develop and examine set of options which meet the requirements for an operating lease. Over weekend further refined these options and began building briefing which lays out an Integrated Master Schedule combining all Boeing and Government actions required to obtain congressional approval and initiate the program. We will brief this to Mrs. Druyun Wednesday at 0700, along with the matrix of options which meet the operating lease gates. The variables in the matrix are: purchase price, lease term, interest rate, residual value, and lease payment. All the options presented will meet the OMB [Office of Management and Budget] gates.

In January 2002, Section 8159 of the Department of Defense Appropriations Act for FY 2002 stated that the Air Force may lease up to 100 Boeing commercial KC-767A tanker aircraft. The Air Force used the language in Section 8159 as direction to move the lease forward. The program for the lease of 100 aircraft was moved forward despite the fact that the Air Force had not performed an analysis of alternatives to determine the need for 100 aircraft. In fact, the studies that were available did not indicate an urgent or immediate requirement for the replacement of existing KC-135 tankers. In addition, the Air Force used Section 8159 of the Department of Defense Appropriations Act for FY 2002 to justify its inappropriate acquisition strategy with the primary goal to expeditiously lease 100 Boeing KC-767A tanker aircraft to replace its aging KC-135E Tanker fleet. In doing so, the Air Force did not demonstrate best business practices and prudent acquisition procedures in developing this program and did not comply with statutory provisions for testing.

On February 14, 2002, Ms. Druyun responded to an e-mail from Dr. Roche with a cc: to Dr. Sambur; Mr. John P. Janecek, Air Force Deputy General Counsel (Acquisition); Ms. Mary L. Walker, Air Force General Counsel; and Major General Essex. In her response, Ms. Druyun stated that:

> You are right on about doing this as a prelude to a buy. I am hopeful we can smoke out the data we need to be able to look anyone in the eye and tell them why we are or are not conducting a competition. I am working with Jon Janecek. Speedy's idea is great or [sic]. We will get on your calendar.

[redacted]

On February 20, 2002, Brigadier General Darryl A. Scott, Deputy Assistant Secretary (Contracting), Office of the Assistant Secretary of the Air Force (Acquisition) signed out a request for information to The Boeing Company and Airbus North America, Inc. (European Aeronautic Defence and Space Company, Incorporated) to begin the Air Force's market research and assess market capabilities in the area of commercial aerial tankers.

On March 28, 2002, Dr. Sambur sent a letter to Mr. Aldridge [redacted] The guidance states that, if a contracting officer is unable to obtain information on prices at which the same item or similar items have been sold in the commercial market to use for evaluating, through price analysis, the reasonableness of the price of the contract, the contracting officer may require cost or pricing data. The guidance from the Director reminds contracting professionals to include the applicable Federal Acquisition Regulation clause in solicitations for sole-source commercial items.

On July 30, 2002, the Joint Requirement Oversight Council approved the operational requirements document, which the Air Force issued on October 22, 2002. However, using the legislation as the informal acquisition strategy, Air Force officials did not tailor the first spiral or increment of the operational requirements document to warfighter requirements in the mission needs statement for future air refueling aircraft. Instead they tailored it to correlate closely with the capabilities of the Boeing 767 tanker variant that Boeing was producing for the Italian government. As a result, the first 100 Boeing KC-767A tanker aircraft will not meet the operational requirement for interoperability and will not meet the mission capabilities in the operational requirements document to conduct secondary missions, such as cargo/passenger and aeromedical evacuation missions.

On August 20, 2002, Mr. Wayne A. Schroeder, Deputy Under Secretary of Defense (Resource Planning/ Management), Office of the Under Secretary of Defense (Comptroller) sent an e-mail to Dr. Dov S. Zakheim, Under Secretary of Defense (Comptroller). In the e-mail, Mr. Schroeder stated:

> Dov,
>
> Due to some schedule conflicts and absences, [redacted] requested that we reschedule the 767 tanker meeting with OMB [Office of Management and Budget] to later this week or next. But I did have a chance to speak with [redacted] about OMB's high profile. [redacted] said that OMB has been responding to letters from [a Senator] (they also just received a letter on the issue from [a Representative]). So part of their public profile has to do with responding to congressional requests for their position on the issue – [a Senator] wanted to get it 'on the record.' But [redacted] did say that the political leadership at OMB feels very strongly

[redacted]

about the lease, and has decided to take a public posture knowing the effects this might have He suggested you talk directly with Robin [Cleveland] if you want more information on the politics of the lease at OMB. He also gave me some insights into what OMB has learned about the lease from technical questions the Air Force has posed to them:

1. The deal is looking 'worse and worse.'
2. OMB is getting a lot of Air Force questions about A-94 and lease-purchase analysis.
3. *Boeing will not finance this deal. It would be financed through an investment group or special purpose company partly owned by Boeing, the engine manufacturer and other investors. The Air Force would lease the tankers from this investment group, which would issue a set of bonds at different terms and interest rates*
4. The Air Force had questions for OMB about what interest rate they can use. Predicting interest rates is problematic, and could have a major impact on the analysis. OMB thinks the Air Force will want a very low interest rate and very high discount rate to make the lease-purchase analysis work.
5. The marketability of the aircraft is an issue. The Air Force will likely propose for purposes of calculating the residual value of the aircraft, that at the end of the lease they be sold as either freighters or tankers. Not all 100 could be sold as tankers in the open market
6. OMB thinks the Air Force could have gotten a much better deal on the purchase price than what they will show in the analysis.
7. To convince investors that this is not a risk, the Air Force will tell them that they will buy the aircraft at the end of the lease. This raises the question of why this will be structured as an operating lease, when the intent is clearly lease-to-buy. If this turns out to be the case, it will be an issue.

As we get more details, I will pass more information on to you and Larry after we hold the meeting with OMB Rob said he thought the Air Force and Boeing might finalize negotiations toward the end of next week.

On August 20, 2002, in response to Mr. Wayne A. Schroeder's e-mail, Dr. Dov S Zakheim sent an e-mail to Mr. Wayne A Schroeder with a cc: to Mr. Lawrence J. Lanzillotta in which he stated that:

[T]his does seem very troubling

On August 20, 2002, Mr. Lawrence J Lanzillotta forwarded Mr. Wayne A. Schroeder's e-mail to Mr. John Roth, Deputy Comptroller (Program/Budget), Office of the Under Secretary of Defense (Comptroller); and Mr. Ronald G. Garant, Director, Investment, Office of the Under Secretary of Defense (Comptroller).

On August 21, 2002, in response to Mr. Wayne A. Schroeder's e-mail, Mr. Ronald G. Garant sent an e-mail to Mr. Lawrence J. Lanzillotta with a cc: to Mr. John Roth, and Mr. Wayne A. Schroeder in which he stated:

I talked to [redacted] a month or so ago. He was the AF [Air Force] deputy comptroller. The AF hired him to give their proposal the grandmother test and as far as he was concerned it didn't pass. He contends that the purchase price is probably over stated by 50% and he contends that the residual value is also very much overstated for a non-Air Force market. He was also concerned about the discount and interest rates used in the calculations.

[redacted]

> Since we all know that this is a bailout for Boeing why don't we just bite the bullet and do what we did when we were bailing Douglas out on the KC-10's. We didn't need those aircraft either, but we didn't screw the taxpayer in the process. The 767 is not the latest in technology. If we were going to get serious about buying the best I am sure that some rendition of the 777 would win out
>
> I don't know of anyone who is dissatisfied with the outcome of the KC-10 deal. The Air Force should be made to come back with an analysis of why we couldn't do the same with the 767. **What we in effect would be buying is the tail end of the production line and should be getting the best price, not the inflated price that they want to put in the lease formula. The key of course is to include some competition into the purchase process.** [Emphasis added]

During 2002, questions began to surface concerning the unit price of the aircraft as well as cost analysis of lease versus purchase. The Air Force submitted the tanker lease acquisition business case to the Office of the Secretary of Defense Leasing Review Panel in September 2002. An independent analysis of the price of the tanker aircraft contracted for by the Leasing Review Panel and conducted by the Institute for Defense Analyses indicated that the negotiated individual Boeing KC-767A tanker aircraft price was excessive. Further, the Air Force negotiating team did not have sufficient information without Boeing cost or pricing data or complete information on Boeing prior sales to calculate an accurate price for the "green aircraft" (basic Boeing 767 aircraft). The Air Force stated "By relying on other cost and price data and techniques, a fair and reasonable price is represented by a wide range. Calculating the best price within this range must reflect the medium risks of the effort." The degree to which prices can differ is evident from the Air Force and Institute for Defense Analyses results that use a different mix of Boeing 767-200ER and 767-400ER aircraft and different preferred customer discount rates in their calculations for "green aircraft" prices. For example, the analysis by the Institute for Defense Analyses showed a [redacted] price differential (savings) from the Air Force negotiated price for the "green aircraft." The price differential (savings) from the analysis by the Institute for Defense Analyses would increase from [redacted] to [redacted] when using a preferred customer discount rate of 35 percent to 50 percent for a significant competitive order. The Boeing Web site showed 941 orders for Boeing 767 model aircraft to 66 different customers since 1978, or an average purchase of 14 aircraft per customer. The single largest customer, [redacted] procured 117 aircraft on 6 different orders from 1978 to 1997. Consequently, the Air Force order for 100 Boeing KC-767A tanker aircraft and the potential for the Air Force to order several hundred additional aircraft should have entitled the Air Force to a higher preferred customer discount rate than was included in the Air Force's negotiated price for the "green aircraft."

In September 2002, the Air Force began to address criticism as to whether the Air Force had an urgent requirement for jump starting the recapitalization of the KC-135 tanker fleet. Justifying the urgent need, the Air Force indicated that it had discovered a significant corrosion problem that coupled with the average age of the fleet and increasing operations and maintenance costs required immediate recapitalization of the tanker fleet. *However, formal studies both before and after* this problem was identified in the Air Force presentations indicated that the problem was manageable and did not recommend moving the replacement date of

[redacted]

the tankers as an immediate and urgent requirement. Specifically, in April 2004, the National Defense University issued a report concluding that the Air Force and the Department of Defense bypassed many elements of the normal acquisition system and that the Office of the Secretary of Defense Leasing Review Panel was not a substitute for the Defense Acquisition Board review of the tanker lease acquisition. The National Defense University also concluded that the Air Force did not use a competitive process for the tanker lease acquisition although contractor selection was a foregone conclusion based on Section 8159 of the Department of Defense Appropriations Act for FY 2002 and the Joint Requirements Oversight Council. Also, in May 2004, the Defense Science Board concluded that the KC-135 airframe would still be capable until 2040 and that the corrosion problem was manageable. The Board also commented on tanker recapitalization noting that the Air Force needed to embark on a major tanker recapitalization program, but because total tanker requirements are uncertain, the recapitalization program can be deferred until the completion of the analysis of alternatives and the Mobility Capabilities Study.

On September 11, 2002, Dr. Sambur sent an e-mail to Dr. Roche in which he stated:

> Boss
> I kicked off the effort to establish a 'need' justification for the tankers. Hope to have a conceptual framework ready by the end of the week.
> Spoke to Robin [Cleveland] after the meeting to tell her that the economic justification is not a slam dunk for either position (purchase or lease). It is more a push and a slight change in the interest rates can flip the analysis. At the end of the day, we have to prove that there is a TRUE need and that there are other advantages to leasing (earlier delivery, affordability, etc) that make it a good business deal. It is going to be a tough sell given the other factors such as liability and indemnification.
> Marv

On September 20, 2002, Major General Leroy Barnidge, Air Force Director of Legislative Liaison sent an e-mail to Dr. Roche; General John Jumper, Air Force Chief of Staff; General Robert Foglesong, Air Force Vice Chief of Staff; and Lieutenant General Joseph H. Wehrle, Jr., Air Force Assistant Vice Chief of Staff. In his e-mail, Major General Leroy Barnidge stated:

> Sirs –
>
> Late yesterday, [a Representative] made a late notice visit to Andrews to see the new 737s. He was pleased with what he saw. Of note, however, he pulled [redacted] over (who had run to support [the Representative's visit) and related that he, [the Representative], had talked with [* * * * *] ref [Boeing] 767 lease. Said, '[* * * * *] agreed that we need to make this work.' Also told [redacted] that he ([the Representative]) '...will work with SAC

*The Report does not include full verbatim text of this e-mail because staff of the White House Counsel has indicated its intent to invoke an agreement between Members of Congress and the White House covering the production of tanker-related e-mails – the inclusion of which full verbatim text in the Inspector General's independent judgment would have circumvented the agreement. (The reference is also on page 102.)

[redacted]

[Senate Appropriations Committee] leadership to ensure initiative comes together.'

Additional data point: Proposed HASC [House Armed Services Committee] language is [s]till more restrictive:

'The Secretary of the AF [Air Force] shall not enter into any lease for tanker aircraft until the Secretary submits the report required by section 8159 (c) (6) of the Department of Defense Appropriations Act, 2002 and obtains authorization and appropriation of funds necessary to enter into a lease for such aircraft consistent with his publicly stated commitments to the Congress to do so.'

Dr. Roche, we will rehighlight [the Representative's] position in your email prep [preparation] before your office call with [the Representative] next Wed, 25th, 1800.

On October 7, 2002, Dr. Sambur sent an e-mail to Dr. Roche in which he stated:

* * * * *

OMB concerns are all answerable, but not irrefutably so. For example,
Requirements – They view our requirements chart and maintain that the delta between need and availability is bogus given that we have been able to live with the deficit for so many years (and especially during the present conflict). Our answer is that we have been playing Russian roulette
Refund scheme They view the scheme as very clever but violates the congressional rules and the operating lease requirements Our answer is that we have no commitment to buy the tankers Only an agreement to get a payback should they sell the tankers for more than $30M [million].
Commercial lease. They view the market for tankers as only being military (which violates the operating lease rules). We assert that they may be correct but the residual value is based on the commercial use of the planes as commercial cargo transports and not as tankers. The residual value has the conversion to transport already baked into the price
Modification of the [Boeing] 767. They argue that we have violated the congressional language that requires a green plane We answer by pointing to the congressional dialog that defines a green tanker
You may have to have another high level meeting (Robin [Cleveland]) to discuss these issues
Marv

On October 22, 2002, Dr. Sambur sent an e-mail to Dr. Roche in which he stated:

Boss
Our problem is that we do not have a good answer to why we claim that we have a[n] urgent need for tankers BUT we are retiring 67 KC135E's in the FDYP [FYDP (Future Years Defense Program)] to save $1B [billion] BUT we need an additional [redacted] to lease the tankers.

*Removed for reason stated in the initial asterisked footnote (The reference is also on page 109.)

[redacted]

> Our other problem is that we have a parametric approach to deriving pricing that has black magic associated with the weighing function I tried to give an intuitive interpretation that went down better but our inability to explain in a concise manner the complicated weighing function is an issue I am working with our people to develop a more concise explanation.
> Marv

On October 29, 2002, [redacted]

On November 5, 2002, Ms. Druyun, who had been involved in all aspects of the Boeing tanker aircraft lease efforts to date, submitted a letter to the Air Force ethics office, recusing herself from further negotiations with Boeing; retired mid-month; and accepted an executive position with Boeing.

On November 20, 2002, Mr. William C. Bodie, Special Assistant to the Secretary of the Air Force sent an e-mail to Dr. Roche in which he stated:

> Good for you, boss. [Mr.] Aldridge may deny he's been weakening, but the smoke signals are thick. Aldridge interviewed with Anne Marie [Squeo, 'The Wall Street Journal'] yesterday, and although he wouldn't comment on specifics of any deal and was keeping an open mind, he indicated that in general terms he would have concerns about leasing

Congressional Record

[redacted]

when/if buying was cheaper. That doesn't jibe with his previous support for the lease from a NPV [net present value]/cash flow management perspective. In addition, the spores seem to be pushing a 'what's the rush?' line: buying is cheaper (we 'exaggerate' the purchase cost of a green [Boeing] 767), therefore better; such a large expenditure requires more 'rigorous analysis' than the back-of-the-envelope assertions by the AF [Air Force], hence an AoA [analysis of alternatives]; the AF hasn't *POM'ed [program objectives memorandum] for the lease, so how serious* can we be? There is no 'urgent' need because the AF is starting to retire the E's next year even without an immediate replacement, so why can't we be more deliberative? Boeing will still be there, making airplanes, so what's the rush? Anyway, Airbus could make planes with enough American content if need be. I rebutted all these arguments with Jaymie [Durnan, The Special Assistant to the Secretary and the Deputy Secretary of Defense] (as you did with Pete [Aldridge]), but we might be in the 'power' phase with OSD [Office of the Secretary of Defense] on this issue. If anyone can talk sense to Aldridge, however, it's you

Congressional Record

On November 20, 2002, in response to Mr. William C. Bodie's e-mail, Dr. Roche sent an e-mail to Mr. William C. Bodie in which he stated:

Congressional Record

Right. I'm relaxed on this one. They have to take the bureaucratic position. Jim

On December 18, 2002, [redacted] Chief of Mobility and Special Operations Forces, Weapons Systems Liaison Division, Office of Air Force Legislative Liaison sent an e-mail to Major General Leroy Barnidge, Jr., Air Force Director of Legislative Liaison in which he stated:

Maj Gen [Major General] Barnidge,

As you know, there has been some conversation about a possible meeting with [a Representative's] office (generated from the [Representative's] office through [congressional staff]), OSD [Office of the Secretary of Defense] and one AF [Air Force] representative. OSD/LA [Office of the Assistant Secretary of Defense (Legislative Affairs)] [redacted] called [congressional staff] this morning to determine the [Representative's] desire for the meeting.

* * * * *

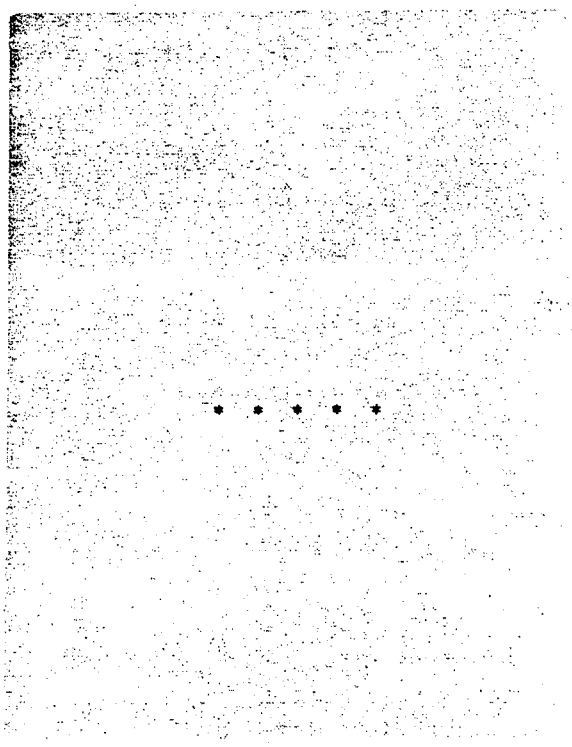
This eliminates the need for a meeting in which the AF, OSD, and the [Representative's] office were going to talk about the need for tankers right now, [Boeing] 767 ability to fill this need, and the 767 acquisition strategy

Way Forward: Where we are at right now is that OSD at the highest levels is getting together (DepSecDef [Deputy Secretary of Defense], Mr. Aldridge, Dr. Zakheim, Powell Moore [Assistant Secretary of Defense (Legislative Affairs)], etc) to decide the DoD way forward. The decision will be to support the lease now or show why decision should wait until a later time. I am not sure when the meeting will occur, but waiting until March (the date previously given by OSD) is no longer an option. According to [redacted] this will be decided soon and it is more now an issue of OSD explaining why DoD shouldn't do the lease then [sic] it is the AF explaining why we should (a reversal of the normal process). I will keep you posted.

*Removed for reason stated in the initial asterisked footnote. (The reference is also on pages 117 and 185.)

[redacted]

On January 30, 2003, General John Jumper, Air Force Chief of Staff sent an e-mail to Dr. Roche in which he stated:



* * * * *

On January 31, 2003, in response to General John Jumper's e-mail, Dr. Roche sent an e-mail to General Jumper in which he stated:

> And, I had at Himself on the deal in the morning, noting as I poin[t]ed to them that, unlike businessmen who would understand how good an opportunity this was, these Corporate Staff bureaucrats (Dov and Stevie) can't get it. Don asked if I was special pleading. I said 'yes.' And, further, would continue to do so. [Lawrence] DiRita [Principal Deputy Assistant Secretary of Defense (Public Affairs)] announced that my comments 'were brought to you by the Boeing Company.' I didn't rip his heart out. Don had been programmed by the Tall Spore and asked about 'opportunity costs', etc to which the Spores jumped. But, when asked what was in the budget, I had the chance to take a shot at the TS [Tall Spore] by telling Don that we wouldn't beartrap [sic] him by assuming that he approved the lease; thus, the budget had a buy. Pete

*Removed for reason stated in the initial asterisked footnote. (The reference is also on pages 120, 188, and 210.)

[redacted]

> then told him the 'when' of the buy, and Don said: 'Not soon enough!' Through the day, I have been asked by the Spores to consider a lease of 50 with an option for 50, and a 67/33 split. Each time I remind them that these hairbrained [sic] ideas would only be more expensive. Don asked that the decision be delayed until after he testified!!! Note: he doesn't want to touch it. But there is no doubt that he understands our position.
> * * * * *
> Jim

In February 2003, Dr. Sambur sent a memorandum to senior DoD management arguing for the lease rather than procurement of the Boeing KC-767A tanker aircraft even though the Air Force had not conducted an analysis of alternatives to justify the lease, had not justified an urgent need for the Boeing KC-767A tanker aircraft based on previous studies, and had not shown how leasing instead of purchasing the aircraft was a prudent expenditure of taxpayer money.

As previously stated, the Air Force, at the direction of Mr. Aldridge, did not follow the procedures for a major Defense acquisition program. Further, the proposal that started to move forward was improperly identified as an operating lease which meant that it would be funded in current year Operation and Maintenance funds versus the multiyear procurement funds. In addition, the Air Force improperly identified the Boeing KC-767A tanker aircraft as a commercial item subject to the rules of the Federal Acquisition Regulation, Part 12, "Acquisition of Commercial Items," rather than Federal Acquisition Regulation, Part 15, "Contracting by Negotiation," to meet Office of Management and Budget requirements for leasing the aircraft rather than procuring the aircraft. As a result of this improper designation, the Government forfeited the ability to obtain cost and pricing data. The Air Force determination was improper because the Boeing KC-767A Tanker Program did not meet the statutory definition of a commercial item. No commercial market for this tanker aircraft existed to establish reasonable prices by the forces of supply and demand. Consequently, the commercial item procurement strategy did not provide the Air Force with sufficient cost or pricing data to make multi-billion dollar decisions for the Boeing KC-767A Tanker Program and did not demonstrate the level of accountability needed to conclude that the prices negotiated represented a fair expenditure of DoD funds.

In March 2003, the issue concerning price was raised again by the Under Secretary of Defense (Comptroller). The underlying issue with the price was that the Air Force improperly determined that the tanker aircraft was a commercial item, thereby preventing the Government from having the rights to Boeing's cost and pricing data. Without a competitive market place and the inability to obtain cost and pricing data, the Air Force was unable to determine whether the Boeing offering price was fair for the aircraft as modified into a tanker configuration. The Comptroller also recommended that the acquisition be properly classified and declared a major Defense acquisition program (Acquisition Category I). Also in March 2003, the Secretary of Defense met with senior Office of the Secretary of Defense and Air Force officials to consider the status of the Office of the Secretary of Defense assessment of the Air Force Boeing KC-767A tanker lease

*Removed for reason stated in the initial asterisked footnote (The reference is also on page 121)

[redacted]

proposal and to make a decision on whether to accept the tanker lease proposal or to request multiyear procurement authorization to purchase the tanker aircraft

On April 7, 2003, [redacted]

On April 10, 2003, [redacted] at Boeing sent an e-mail to [redacted] at Boeing in which he stated:

[redacted]

On April 15, 2003, Mr. Wynne sent an e-mail to senior DoD executives detailing his efforts to reconcile the Institute for Defense Analyses values with the Boeing Company values by resetting the baseline to achieve a price reduction. Mr. Wynne concluded:

> This will not be easy, given the long history on this deal, and the consequences of a sudden change of heart. I would have expected that the concessions should have and could have come as a result of configuration changes which would have provided some cover for both teams. Recall, I gave them that opportunity over the past two weeks. In that absence ...
>
> We should afford Boeing this last opportunity, and then call it a day for the lease.

On May 3, 2003, [redacted] a consultant to Boeing sent an e-mail to Dr. Roche in which he stated:

[redacted]

[redacted]

On May 9, 2003, Dr. Roche sent an e-mail to Ms. Robin Cleveland, Director, Office of Management and Budget, the subject of which was Peter Cleveland resume and cover letter attached for export. In the e-mail, Dr. Roche stated:

> Be well. Smile. Give tankers now (Oops, did I say that? My new deal is terrific.) ☺
> Jim

Congressional Record

On May 23, 2003, Mr. Aldridge signed the "Air Force Boeing 767 Tanker Lease Decision Memorandum" approving the Air Force request to lease 100 Boeing KC-767A tanker aircraft before:

- the Office of the Secretary of Defense Leasing Panel finalized its review or made a recommendation concerning the viability of the lease;
- the Air Force conducted an analysis of alternatives and developed an acquisition strategy and an independent cost estimate; and
- the Defense Acquisition Board conducted a review of the lease.

Further, the May 23, 2003, "Air Force Boeing 767 Tanker Lease Decision Memorandum" stated that "The Secretary of Defense approved this lease proposal contingent upon securing a waiver of the requirement to fund termination liability and approval of the Office of Management and Budget."

On May 27, 2003, Mr. Aldridge resigned as Under Secretary of Defense for Acquisition, Technology, and Logistics and Mr. Wynne was appointed as the Acting Under Secretary Defense for Acquisition, Technology, and Logistics.

On May 28, 2003, Mr. Wynne forwarded the Acquisition Decision Memorandum to the Office of Management and Budget detailing the intent to move forward with the proposed operating lease.

On June 20, 2003, Mr. Kenneth J. Krieg, Director, Program Analysis and Evaluation issued a memorandum stating that purchase was more cost effective than leasing the Boeing KC-767A tanker aircraft. In addition, he stated in the memorandum that the lease as proposed did not meet the requirements of Office of Management and Budget Circular No. A-11, "Preparation, Submission, and Execution of the Budget (2003)."

On June 23, 2003, according to [redacted] in an e-mail, Dr. Roche requested, in a meeting with [redacted] that Boeing put pressure on Mr. Wynne to have Mr. Krieg change his position on the Boeing KC-767A tanker aircraft lease.

*Removed for reason stated in the initial asterisked footnote. (The reference is also on page 127.)

[redacted]

On July 8, 2003, Dr. Roche sent an e-mail to Mr. Jaymie Durnan, The Special Assistant to the Secretary and the Deputy Secretary of Defense in which he stated:

> Jaymie, Mike Wynne has fallen for [Robin] Cleveland's line that our letter must show the bogus calculation which is NPV [net present value] negative by $1.9 billion
> Why bogus? If we had the budget, we wouldn't need to turn to a lease. But, we don't. Thus, to assume that it exists (wrong premise), and then to assume the Congress passed legislation which it didn't, and then to condemn ourselves in writing by stating the calculation based on a fantasy simply is crazy. It is a bureaucratic trick to make a fool out of Don [Rumsfeld] as well as the Air Force. All this was 'resolved' by Pete Aldridge before he left. To quote him: 'We need to go forward with DoD's position. If OMB [Office of Management and Budget] wants to comment, let them.'
> Point: we are running aground because PA&E [Program Analysis and Evaluation] and OMB want me to sign a suicide note, BUT I WILL NOT. This whole drill has gotten our of hand! Jim.

Congressional Record

On July 22, 2003, the Acting Under Secretary of Defense for Acquisition, Technology, and Logistics requested that the Department of Defense Office of the Inspector General:

- review the decision process used by the Air Force and the Office of the Secretary of Defense to lease the Boeing KC-767A tanker aircraft, and
- assess whether DoD interaction with Congress following the "Air Force Boeing 767 Tanker Lease Decision Memorandum," May 23, 2003, was timely and reasonable.

On August 20, 2003, the Secretary of the Air Force halts the performance of an analysis of alternatives for the tanker aircraft pending the direction of the Authorization Bill.

On August 29, 2003, in response to the July 22 request by the Acting Under Secretary of Defense for Acquisition, Technology, and Logistics, we issued Department of Defense Office of the Inspector General Report No. D-2003-129, "Assessment of DoD Leasing Actions." The report states that, although not required by statute, applying a best business practice of weighing the need to conduct a formal analysis of alternatives to achieve the best possible system solution could have improved the Air Force Leasing process. Further, a best business practice would have been to expand the charter of the Office of the Secretary of Defense Leasing Review Panel to include the Panel's role in the acquisition process and in the life cycles of the leases. We also determined that of the six letters from the Chairman, Committee on Commerce, Science, and Transportation and the one letter from the Congressional Budget Office, five were generally timely and two were not timely. Further, two responses could have been improved by a more comprehensive answer to portions of the requests. However, we did not identify a reason to not proceed with the lease of the Boeing KC-767A tanker aircraft based on the limited scope of our review.

On November 24, 2003, in Section 135 of the National Defense Authorization Act for FY 2004, Congress limited the number of tanker aircraft that the Air Force could lease to 20 and authorized procurement of up to 80 aircraft. In addition,

[redacted]

Section 135 of the National Defense Authorization Act for FY 2004 required that the Secretary of Defense perform a study of long-term aircraft maintenance and requirements.

On December 1, 2003, the Deputy Secretary of Defense requested an audit by the Department of Defense Office of the Inspector General, stating that "In light of recent revelations by The Boeing Company concerning apparent improprieties by two of the company's executives, please determine whether there is any compelling reason why the Department of the Air Force should not proceed with its Tanker Lease Program. In particular, I would appreciate knowing whether any of these revelations affect any of your previous analysis of this program."

On February 1, 2004, the Deputy Secretary of Defense requested that the Defense Science Board evaluate aerial refueling requirements and that the National Defense University conduct a comprehensive analysis of lessons learned for the Air Force Tanker Lease Program.

On February 24, 2004, Mr. Wynne sent a memorandum, "Analysis of Alternatives (AoA) Guidance for KC-135 Recapitalization," to the Secretary of the Air Force. In the memorandum, Mr. Wynne directed the Secretary of the Air Force to conduct an analysis of alternatives for analyzing potential courses of action for recapitalizing the KC-135 fleet, under the oversight of a Senior Steering Group.

On March 29, 2004, the Department of Defense Office of the Inspector General issued Report No. D-2004-064, "Acquisition of the Boeing KC-767A Tanker Aircraft," stating that the Air Force used an inappropriate procurement strategy and demonstrated neither best business practices nor prudent acquisition procedures to provide sufficient accountability for the expenditure of $23.5 billion for the Boeing KC-767A Tanker Program. The report identified five statutory provisions that had not yet been satisfied relating to: commercial items; testing (two statutes); cost-plus-a-percentage-of-cost system of contracting; and leases. Therefore, the report recommended that DoD not proceed with the program until it resolved the issues pertaining to the procurement strategy, acquisition procedures, and statutory requirements.

On April 20, 2004, the National Defense University issued its report in response to the Deputy Secretary of Defense tasking on February 1, 2004. The National Defense University was tasked to answer six questions dealing with the tanker lease acquisition. Based on interviews and literature reviews, the National Defense University concluded that the:

- Air Force and the Department of Defense bypassed many elements of the normal acquisition system;
- Office of the Secretary of Defense Leasing Review Panel was not a substitute for the Defense Acquisition Board review of the tanker lease acquisition; and
- Air Force did not use a competitive process for the tanker lease acquisition although contractor selection was a foregone conclusion

[redacted]

based on Section 8159 of the Department of Defense Appropriations Act for FY 2002 and the Joint Requirements Oversight Council.

The National Defense University made several recommendations to include that the Department of Defense publish guidance on leasing in policy directives, the Federal Acquisition Regulation, and the Defense Federal Acquisition Regulation Supplement; and that the Department establish procedures to require both cost and pricing data on sole source or monopoly, commercial leases.

In May 2004, the Defense Science Board issued its report in response to the Deputy Secretary of Defense tasking on February 1, 2004. The Aerial Refueling Defense Science Board Task Force reviewed the KC-135 program and concluded that, based on fatigue life, the KC-135 airframe would be capable to 2040 and that corrosion was manageable. With regard to KC-135 operation and support costs, the Defense Science Board concluded that cost growth was manageable. The Board also commented on tanker recapitalization, noting that the Air Force needed to embark on a major tanker recapitalization program, but because total tanker requirements were uncertain, the recapitalization program could be deferred until the analysis of alternatives and the Mobility Capabilities Study are completed. The Defense Science Board did not endorse the Boeing KC-767A tanker aircraft as the only Air Force near-term solution to the tanker recapitalization problem. The Defense Science Board suggested several options for replacing the KC-135Es including:

- obtaining additional DC-10s that could be converted into tankers,
- retiring half of the KC-135Es under a hybrid recapitalization program and replacing them with commercial entities as commercial tankers for missions in the Continental United States,
- phasing out the other half of the KC-135E and replacing them with converted KC-10, and
- working with major airframe manufacturers to develop new tanker options with more modern airframes than the 20-year-old Boeing 767 design.

On October 28, 2004, in Section 133 of the "Ronald W. Reagan National Defense Authorization Act for Fiscal Year 2005," Congress terminated the authority of the Secretary of the Air Force to lease tanker aircraft; however, it authorized the Secretary to procure up to 100 tanker aircraft.

In summary, Office of the Secretary of Defense and Air Force senior officials allowed the proposed tanker aircraft lease to move forward even though the Boeing KC-767A Tanker Program had not undergone the rigid oversight required by DoD Directive 5000 1 for major acquisitions. As a result, the program was not subject to the benefits of full and open competition, an analysis of alternatives to determine the most cost effective manner to satisfy the operational deficiency, and a proper identification of the urgency and optimal number of assets needed to satisfy the requirement. There were many external influences that helped move this program along. However, the decision by the Under Secretary of Defense for Acquisition, Technology, and Logistics not to implement the requirements of

[redacted]

DoD Directive 5000.1 was the major failure associated with managing and making decisions on the program. The failure to follow the prescribed acquisition rules resulted in the attempt by the Office of the Secretary of Defense and the Air Force to enter into a $23 billion program that did not satisfy validated requirements and was not cost effective for the American taxpayer.

Internal Control

DoD acquisitions are required to follow the requirements for analysis and oversight in DoD Directive 5000.1, "The Defense Acquisition System," May 12, 2003, and prior versions. The oversight mechanisms provide internal control to ensure that weapon systems acquired by DoD satisfy the needs of the warfighter and are acquired economically and efficiently using best business practices. Air Force and other DoD Acquisition Officials did not follow the proscribed procedures in DoD Directive 5000.1 for the tanker program. Instead, the Air Force used Section 8159 of the Department of Defense Appropriations Act for FY 2002 to justify an informal acquisition strategy.

Required Documentation for Program Milestone Reviews. DoD Instruction 5000.2, "Operation of the Defense Acquisition System," May 12, 2003, requires that the following documentation requirements be completed and reviewed by the Defense Acquisition Board at program initiation:

- Initial Capabilities Document
- Analysis of Alternatives
- Capability Development Document
- Affordability Assessment
- Acquisition Strategy
- Independent Cost Estimate and Manpower Estimate
- Acquisition Program Baseline
- Information Support Plan
- Test and Evaluation Master Plan
- Exit Criteria

For the DoD decision to acquire 100 Boeing KC-767A tanker aircraft (which could be considered a low-rate [Milestone C] or full-rate production decision), DoD Instruction 5000.2 requires that the following documentation be completed and reviewed by the Defense Acquisition Board before making those decisions:

- Capability Production Document
- Analysis of Alternatives (updated as necessary)
- Affordability Assessment
- Acquisition Strategy

[redacted]

- Independent Cost Estimate and Manpower Estimate
- Acquisition Program Baseline (updated as necessary)
- Information Support Plan
- Operational Test Agency Report
- Exit Criteria

Importance of Required Program Documentation. The above program documentation is required and prepared for milestone decision authorities for the following purposes:

Capabilities Documents. The initial capabilities document establishes the need for a material approach to resolve a specific capability gap derived from the Joint Capabilities Integration and Development System analysis process. The initial capabilities document proposes the recommended material approach(s) based on analysis of the relative cost, efficacy, sustainability, and risks posed by the material approach(es) under consideration. The analysis that supports the initial capabilities document helps to shape and to provide input into the analysis of alternatives. The capability development document provides the operational performance attributes, including supportability, that the acquisition community needs to design the proposed system, including key performance parameters that guide the development, demonstration, and testing of the current increment. The capability production document addresses the production attributes and quantities specific to a single increment of an acquisition program. The program sponsor prepares the initial capabilities document, the capability development document, and the capability production document, and the Joint Requirements Oversight Council is responsible for validating the key performance parameters in the capabilities documents and then approving the documents.

Analysis of Alternatives. The focus of the analysis of alternatives is to refine the selected concept documented in the approved initial capabilities document. The purpose of the analysis of alternatives is to assess the critical technologies associated with the selected concept, including technology maturity and technical risks. In accomplishing the analysis of alternatives, innovation and competition should be emphasized to achieve the best possible system solution. An independent analysis activity is to prepare the analysis of alternatives and the responsible DoD Component Head designates the approval authority.

Affordability Assessment. The program office is required to assess system affordability at each milestone decision point beginning with program initiation. Milestone decision authorities are not to approve a program to proceed beyond program initiation unless sufficient resources, including manpower, are programmed in the most recently approved Future Years Defense Program, or will be programmed in the next Program Objective Memorandum, Budget Estimate Submission, or President's Budget. The Office of the Secretary of Defense Cost Analysis Improvement Group reviews the accuracy of cost data used in affordability assessments presented at milestone decisions for major Defense acquisition programs.

[redacted]

Acquisition Strategy. Program managers are required to prepare and the milestone decision authority is to approve an acquisition strategy at program initiation. The acquisition strategy guides a program during system development and demonstration and includes a technology development strategy for the next technology spiral. To meet the tenets of Office and Management Circular No. A-109, "Major Systems Acquisition," and best practices of acquisition management principles, the acquisition strategy should include:

- a viable acquisition approach to rapidly deliver to the warfighter an affordable, sustainable capability that meets their expectations and adequate consideration for best business practices, applicable laws, and prudent acquisition procedures;
- a discussion of development, production, life-cycle support and costs, and test evaluation activities that provide teaming among the warfighters, developers, acquirers, engineers, testers, budgeters, and sustainers;
- program risk management to mitigate the risk and not simply accept it; and
- life-cycle sustainment of the acquisition program, including subsequent spiral development.

Independent Cost Estimate and Manpower Estimate. Program managers are required to prepare a life-cycle cost estimate in support of program initiation and all subsequent program milestone reviews, including full-rate production decisions. For major Defense acquisition programs, the milestone decision authority may not approve those program decisions unless an independent estimate of the full life-cycle cost of the program and a manpower estimate for the program have been completed and considered by the milestone decision authority (Section 2434 of title 10, United States Code, "Independent cost estimates; operational manpower requirements"). In addition, the Office of the Secretary of Defense Cost and Analysis Improvement Group is required to prepare an independent life-cycle cost estimate for the program and to submit a report to the milestone decision authority at all milestone reviews for all major Defense acquisition programs.

Acquisition Program Baseline. The program manager, in coordination with the user, is required to prepare an acquisition program baseline at program initiation and at each subsequent major milestone decision. The acquisition program baseline documents the program's approved cost, schedule, and performance objectives and thresholds. The Program Executive Officer and the Component Acquisition Executive are required to concur with the acquisition program baseline prepared by the program manager, and the milestone decision authority is responsible for approving the document at milestone decision reviews. An approved acquisition program baseline satisfies requirements in Section 2435 of Title 10, United States Code, "Baseline description."

Information Support Plan. Program managers are required to prepare an information support plan to identify the capabilities that information technology and national security systems require or the information needed to meet the

[redacted]

proposed capability. Those capabilities need to be identified to enable the program manager to plan and manage system interoperability, interface, and infrastructure requirements before award of program contracts. The program manager submits the information support plan to the Director for Command, Control, Communications, and Computers Systems Directorate (J-6) who certifies that the information support plan addresses information requirements adequately and identifies dependencies and interface requirements among DoD acquisition programs. The milestone decision authority is required to review the certified information support plan at program initiation and subsequent milestone reviews.

Operational Test Agency Report. Program managers are required to prepare a test and evaluation master plan for Under Secretary of Defense for Acquisition, Technology, and Logistics and Director, Operational Test and Evaluation approval before program initiation and subsequent program milestone reviews. The test and evaluation master plan is to describe planned developmental, operational, and live-fire testing; an integrated test schedule; and the resource requirements to accomplish the planned testing. Section 2366 of Title 10, United States Codes, "Major systems and munitions programs: survivability testing and lethality testing required before full-scale production," states that a covered system, one that is being overseen by the Office of the Director, Operational Test and Evaluation, may not proceed beyond low-rate initial production (low-rate initial production is normally 10 percent of the total production quantity documented in the acquisition strategy) until realistic survivability testing of the system is completed and any design deficiency identified by the testing is corrected. Section 2399 of Title 10, United States Code, "Operational test and evaluation of defense acquisition programs," states that a major Defense acquisition program may not proceed beyond low-rate initial production until initial operational test and evaluation of the program is completed. It further states that a final decision within the Department of Defense to proceed beyond low-rate initial production may not be made until the Director, Operational Test and Evaluation has submitted to the Secretary of Defense the Director's report on the adequacy of the test and evaluation completed and the effectiveness and suitability of the program

Exit Criteria. At each milestone review, beginning at program initiation, the program manager is required to propose exit criteria appropriate to the next phase of the program. The milestone decision authority approves the exit criteria. The exit criteria selected to track progress in important technical, schedule, and management risk areas serve as gates that, when successfully passed, demonstrate that the program is on track to achieve its final program goals and should be allowed to continue into the next acquisition phase.

Complying with DoD Directive. The KC-767A System Program Office has not developed and documented an acquisition strategy that serves as a disciplined process for acquiring a quality product that satisfies the warfighter needs at a fair and reasonable price. Instead, the KC-767A System Program Office[3] used Section 8159 of the Department of Defense Appropriations Act for FY 2002 to

[3]Program officials stated that although the KC-767A System Program Office reports through the program executive officer structure, it is technically not a program office because it is a pre-major Defense acquisition program

[redacted]

justify its inappropriate acquisition strategy, the focus and goal of which was to expeditiously lease 100 Boeing KC-767A tanker aircraft without adequate consideration of best business practices, prudent acquisition procedures, and compliance with statutory provisions for testing.

The Air Force did not apply prudent acquisition procedures because according to Dr. Sambur, Assistant Secretary of the Air Force (Acquisition), Mr. Aldridge, Under Secretary of Defense for Acquisition, Logistics, and Technology, in November 2001, told him that the requirements of DoD Directive 5000.1 did not need to be implemented for the Boeing KC-767A tanker aircraft lease. However, neither the Office of the Under Secretary of Defense for Acquisition, Logistics, and Technology nor the Office of the Assistant Secretary of the Air Force (Acquisition) had documentation showing that the Deputy Secretary of Defense had approved the Under Secretary of Defense for Acquisition, Logistics, and Technology waiving the DoD Directive 5000 1 requirements for the Boeing KC-767A tanker aircraft lease. In our interview of the Deputy Secretary of Defense, he stated that documents you would expect to see or have approved were never prepared or staffed with anybody for the leasing decision. As a result, the Air Force did not perform many of the required oversight reviews, analyses, and acquisition planning processes normally performed on acquisitions of this magnitude.

Operational Requirements

Developing an Operational Requirements Document. In late October 2001, the Air Force began to develop an operational requirements document for the tanker aircraft tailored to Boeing KC-767A tanker aircraft capabilities even though it had not performed an analysis of alternatives to determine whether the Boeing KC-767A tanker aircraft was the preferred solution to the tanker aircraft issue. On July 30, 2002, the Joint Requirement Oversight Council approved the operational requirements document, which the Air Force issued on October 22, 2002.

Meeting Requirements. Although the operational requirements document, "Air Refueling Aircraft Program," October 22, 2002, for the tanker aircraft incorporated the warfighter requirements from the Mission Needs Statement, "Future Air Refueling Aircraft," November 1, 2001, it did not require that the first 100 Boeing KC-767A tanker aircraft acquired meet those requirements. Specifically, the Air Force planned to address the requirements through evolutionary acquisition in three spirals. However, for the first 100 Boeing KC-767A tanker aircraft acquired, the Air Force only included 6 of the 7 key performance parameters in the operational requirements document and did not include the key performance parameter for information exchange requirements, which was a spiral-one requirement in the operational requirements document. Further, the Air Force has no plans to incorporate 12 of the 48 spiral-two and all 17 of the spiral-three capabilities into the first 100 aircraft. By not including the key performance parameter for information exchange requirements in spiral one, the Air Force may not achieve the objectives of the remaining key performance parameters because of their dependency on interoperability capabilities.

[redacted]

Office of the Secretary of Defense Leasing Review Panel

Establishing the Leasing Review Panel. On November 1, 2001, Mr. Aldridge, Under Secretary of Defense for Acquisition, Technology, and Logistics and Dr. Dov S. Zakheim, Under Secretary of Defense (Comptroller) established the Leasing Review Panel (the Panel), which they co-chaired. The Panel was responsible for reviewing all lease proposals costing $250 million or more; however, the Panel was subordinate to the Defense Acquisition Board and its review activities with the Defense Acquisition Executive having decision-making authority on programmatic and contractual issues related to leasing proposals offered as alternatives to acquisitions of potential major Defense acquisition programs. In instances when leasing proposals were being considered as alternatives to potential major Defense acquisition programs, the Panel was to make recommendations to the Defense Acquisition Executive concerning the financial efficacy of the proposed lease. The Panel was established for the FY 2003 budget cycle; however, its continuation is subject to approval by the Secretary of Defense.

Completing Review and Providing Recommendations. Although required to do so, the *Office of the Secretary of Defense Leasing Review Panel did not* complete its review or provide recommendations concerning the Boeing KC-767A tanker aircraft lease to the Defense Acquisition Board. Accordingly, on May 23, 2003, when the Under Secretary of Defense for Acquisition, Technology, and Logistics signed the memorandum, "Air Force Boeing 767 Tanker Lease Decision Memorandum," approving the Air Force decision to lease the 100 Boeing KC-767A tanker aircraft, he did so without the Panel making a recommendation concerning the viability of the lease. He thereby circumvented the primary objective of Defense acquisition process to acquire quality products that satisfy user needs with measurable improvements to mission capability and operational support, in a timely manner, and at a fair and reasonable price.

Further, Mr. Aldridge stated in his "Air Force Boeing 767 Tanker Lease Decision Memorandum" that, "After a comprehensive and deliberative review by the Leasing Review Panel, the Secretary of Defense has approved the Air Force's proposal to enter into a multiyear Pilot Program for leasing general purpose Boeing 767 aircraft under the authority in section 8159 of the Department of Defense Appropriations Act, 2002." However, he made the decision to lease the Boeing KC-767A tanker aircraft without the Air Force completing the following:

- Independent Cost Estimate and Manpower Estimate
- Acquisition Program Baseline
- Information Support Plan
- Testing Requirements
- Exit Criteria

[redacted]

Operating Leases

Senior members of the Administration, Congress, DoD, and the Air Force worked together in an effort to use commercial financing, an operating lease, to start recapitalizing the Air Force aerial tanker fleet with Boeing KC-767A tanker aircraft. The purpose of the operating lease was to preserve budget authority for other higher priority items because the Air Force did not have money in the budget to purchase tanker aircraft.

Although senior Air Force officials consistently argued that the Boeing KC-767A tanker aircraft lease met the Office of Management and Budget criteria for an operating lease, the Office of Management and Budget, the Congressional Budget Office, the DoD Office of Program Analysis and Evaluation, and other Air Force officials had different opinions as to whether the Boeing KC-767A tanker aircraft lease should be considered an operating lease. Some of the actions that the Air Force took to "make the lease fit" were highly questionable, such as:

- paying 90 percent of the tanker aircraft's fair market value over 6 years for a 25-to 40-year asset,
- selling the tanker aircraft at fair market value and then receiving a refund for the difference between the fair market value and the remaining 10 percent value after 6 years,
- waiving termination liability for the lease peaking at over [redacted] and
- using a multiyear aircraft lease price and a non-multiyear buy price for the net present value analysis.

Congressional budget committees, the Office of Management and Budget, and the Congressional Budget Office have historically had concerns with various financing schemes involving lease-purchase arrangements because they understate the cost of capital acquisitions in the budget. When Government officials do not appropriately score lease-purchases in the budget, managers may be encouraged to purchase assets that are lower priority and that could not otherwise compete in the budget process.

See Appendix E for the complete discussion of the operating lease for the Boeing KC-767A Tanker Program.

Commercial Item Procurement Strategy – Pricing Issues

In order to use an operating lease to recapitalize the Air Force KC-135 tanker fleet, the Boeing KC-767A tanker aircraft had to be a commercial item. Department of Defense Office of the Inspector General Report No. D-2004-064 states that "contrary to the Air Force interpretation, the military tanker aircraft is not a commercial item as defined in Section 403 of title 41, United States Code. Further, there is no commercial market to establish reasonable prices by the forces of supply and demand."

[redacted]

Throughout the negotiation process, Boeing maintained a hard line commercial pricing strategy and provided virtually no transparency into the costs of the basic Boeing 767 aircraft, tanker development and modification costs, and logistics support costs totaling almost $25 billion for the first 100 Boeing KC-767A tanker aircraft. Boeing also failed to provide any information on prices at which the same or similar items (Boeing 767 aircraft) had been sold in the commercial market and refused to accept any type of cost reimbursable contract for the tanker development and modification costs. This lack of insight into commercial prices for 767 aircraft and cost data to support development, modification, and contract logistics support costs plagued the negotiation process and placed the Air Force at a disadvantage during the negotiation process. Again, similar to the operating lease analysis, senior member of the Office of the Assistant Secretary of the Air Force (Acquisition) consistently reported that the Air Force was getting a fair and reasonable price for the Boeing KC-767A tanker aircraft; however, the Office of Management and Budget, the Institute for Defense Analyses, and the Department of Defense Office of the Inspector General did not agree.

Several of the most serious issues identified with obtaining a fair and reasonable price include:

- Improper influence by Ms. Druyun to increase tanker modifications prices and the failure by other senior Air Force officials to support the Air Force negotiator/cost price analyst on June 17, 2002;
- Incorrect statements made by Senior Air Force officials [originating from Ms. Druyun, October 26, 2002] relating to the discount on the "green aircraft" made to * * * * *, the Office of Management and Budget, and the Office of the Secretary of Defense Leasing Review Panel about the Air Force receiving a 7 percent better discount than a preferred airline customer;
- Questionable statements from Boeing on whether the Air Force was getting a better or equal deal than a major airline;
- Continuous "battle of BOE's [Basis of Estimate] among the White House, the Office of Management and Budget, the Office of the Secretary of Defense, and the Air Force as a result of the commercial pricing strategy.

See Appendix F for the complete discussion of the commercial item procurement strategy and pricing issues associated with the Boeing KC-767A Tanker Program.

*Removed for reason stated in the initial asterisked footnote. (The reference is also on page 202.)

[redacted]

Part II – Who Was Accountable?

The following are findings and analyses derived from interviews with members of the Office of the Secretary of Defense and the Department of the Air Force, both military and civilian, including the then-Secretary of the Air Force and the then-Assistant Secretary of the Air Force (Acquisition), to gain insight into what happened and who was accountable during the structuring and negotiating of the proposed lease contract for the Boeing KC-767A Tanker Program. See Appendix D for a list of the members of the Office of the Secretary of Defense and the Air Force who were interviewed.

Using Best Practices and Acquisition Procedures

Who within DoD and the Air Force was responsible for making decisions not to use best practices and acquisition procedures in planning to lease the Boeing KC-767A tanker aircraft?

Issue

Office of the Secretary of Defense and Air Force acquisition management officials did not manage the Boeing KC-767A Tanker Program consistent with statute and regulatory requirements. Specifically, DoD Instruction 5000.2 documentation and review requirements that are mandatory at program initiation and before a low-rate or full-rate production decision were not enforced. Additionally, the Defense Acquisition Executive made the decision on May 23, 2003, to lease 100 Boeing KC-767A tanker aircraft without review by the Defense Acquisition Board or the completion of the review by the Office of the Secretary of Defense Leasing Review Panel. In addition, after the last Leasing Review Panel meeting held before the leasing decision, Mr. Wayne Schroeder, who represented the Under Secretary of Defense (Comptroller/Chief Financial Officer) as co-chair of the Leasing Review Panel, advised the Under Secretary of Defense (Comptroller/Chief Financial Officer) in a memorandum that he recommended that DoD should not proceed with the lease and that instead DoD should procure the tanker aircraft by multiyear procurement.

Policy

DoD Directive 5000.1, "The Defense Acquisition System," May 12, 2003; DoD Instruction 5000.2, "Operation of the Defense Acquisition System," May 12, 2003; and Air Force Instruction 63-101, "Acquisition System," May 11, 2004, establish management principles that are applicable to all DoD, including Air Force, acquisition programs. Jointly, the Under Secretaries of Defense for Acquisition, Technology, and Logistics and Comptroller/Chief Financial Officer issued a memorandum for the Office of the Secretary of Defense Leasing Review Panel, "Multiyear Leasing of Capital Assets," November 1, 2001, that identified the role of the Leasing Review Panel in the Defense Acquisition Board review process.

[redacted]

DoD Directive 5000.1. DoD Directive 5000.1 states that the Defense Acquisition Executive, who is the Under Secretary of Defense for Acquisition, Technology, and Logistics, is responsible for supervising the Defense Acquisition System. It further states that the milestone decision authority for a program has the authority to approve entry of an acquisition program into the next phase of the acquisition process and is accountable for cost, schedule, and performance reporting to higher authority, including Congressional reporting. Also, DoD Directive 5000.1 states that program managers will manage programs consistent with statute and regulatory requirements.

DoD Instruction 5000.2. DoD Instruction 5000.2 requires that the Defense Acquisition Board advise the Under Secretary of Defense for Acquisition, Technology, and Logistics on critical acquisition decisions for major Defense acquisition programs, such as the Boeing KC-767A Tanker Program. In this respect, the Instruction requires that the following documentation requirements be completed and reviewed by the Defense Acquisition Board at program initiation:

- Initial Capabilities Document
- Analysis of Alternatives
- Capability Development Document
- Affordability Assessment
- Acquisition Strategy
- Independent Cost Estimate and Manpower Estimate
- Acquisition Program Baseline
- Information Support Plan
- Test and Evaluation Master Plan
- Exit Criteria

For the DoD decision to acquire 100 Boeing KC-767A tanker aircraft (which could be considered a low-rate [Milestone C] or full-rate production decision), DoD Instruction 5000.2 requires that the following documentation be completed and reviewed by the Defense Acquisition Board before making those decisions:

- Capability Production Document
- Analysis of Alternatives (updated as necessary)
- Affordability Assessment
- Acquisition Strategy
- Independent Cost Estimate and Manpower Estimate
- Acquisition Program Baseline (updated as necessary)
- Information Support Plan
- Operational Test Agency Report
- Exit Criteria

[redacted]

The importance of the required program documentation in the program decision making process was discussed earlier in the Internal Controls section of the report.

Memorandum for the Office of the Secretary of Defense Leasing Review Panel. The empowering memorandum for the Office of the Secretary of Defense Leasing Review Panel, "Multiyear Leasing of Capital Assets," states that the role of the Leasing Review Panel is to advise and assist the Secretary of Defense in evaluating the financial and budget implications of leasing proposals submitted by the Military Departments that are projected to cost a total of $250 million or more over the life of the lease. It also stated that the Leasing Review Panel is subordinate to Defense Acquisition Board activities. In instances when leasing proposals are being considered as alternatives to potential major Defense acquisition programs, the Panel will make recommendations to the Defense Acquisition Executive concerning the financial efficacy of the proposed lease.

Air Force Instruction 63-101. Air Force Instruction 63-101 states that the Assistant Secretary of the Air Force for Acquisition is the senior corporate operating official for acquisition, the Air Force Acquisition Executive, who is responsible for overseeing Air Force acquisition activities. The Instruction further states that the Assistant Secretary of the Air Force for Acquisition makes decisions on program issues, directs the program, sets Air Force acquisition policy, and is the source selection authority for major Defense acquisition programs that are delegated to the Air Force for decision authority by the Under Secretary of Defense for Acquisition, Technology, and Logistics.

Who Was Accountable?

Mr. Aldridge. Mr. Edward C. "Pete" Aldridge, Jr., Under Secretary of Defense for Acquisition, Technology, and Logistics was accountable for making the decision not to comply with statutory and regulatory requirements in DoD Instruction 5000.2. Although we were unable to interview Mr. Aldridge, Dr. Sambur, Assistant Secretary of the Air Force for Acquisition advised that, in November 2001, Mr. Aldridge told him that the requirements of DoD Directive 5000.1 did not need to be implemented for the Boeing KC-767A tanker aircraft lease. Although this decision was not documented, Mr. Aldridge's actions did not show that he intended for the Air Force to comply with the statutory and regulatory requirements in DoD Directive 5000.1.

Mr. Wynne. Mr. Michael W. Wynne, Acting Under Secretary of Defense for Acquisition, Technology, and Logistics was accountable for tacitly accepting Mr. Aldridge's decision to go forward with the Boeing KC-767A tanker aircraft lease by sending a memorandum discussing the decision to an Office of Management and Budget official on May 28, 2003. In the memorandum, Mr. Wynne stated that, "After a comprehensive and deliberative review by the Leasing Review Panel, the Secretary of Defense has approved the Air Force's proposal to enter into a multiyear Pilot Program for leasing general purpose Boeing 767 aircraft under the authority in section 8159 of the Department of Defense Appropriations Act of FY 2002." The memorandum was seeking approval of the proposed lease from the Office of Management and Budget. At that point in time, the Leasing Review Panel had not completed their deliberations

[redacted]

or made recommendations to Mr. Aldridge concerning the decision to go forward with the lease proposal. In addition, Mr. Wynne previously had expressed concerns with the Air Force's negotiated unit price for the Boeing KC-767A tanker aircraft lease proposal.

Dr. Roche. Dr. James G. Roche, Secretary of the Air Force stated that he was responsible for making the decision in August 2003 to not perform an analysis of alternatives as required in DoD Instruction 5000.2.

Dr. Sambur. Dr. Marvin R. Sambur, Assistant Secretary of the Air Force for Acquisition was also accountable for not making the decision to comply with statutory and regulatory requirements in DoD Directive 5000.1. Regardless of Mr. Aldridge's advice, Dr. Sambur was responsible, as the Air Force Acquisition Executive, for exercising his fiduciary responsibilities to the DoD and the American taxpayer by ensuring that best practices and prudent acquisition procedures were implemented to provide sufficient accountability for the expenditure of $23.5 billion for the Boeing KC-767A tanker aircraft lease.

Ms. Druyun. Ms. Darleen A. Druyun, Principal Deputy Assistant Secretary of the Air Force (Acquisition and Management) was also accountable for not making the decision to comply with statutory and regulatory requirements in DoD Directive 5000.1. Ms. Druyun, in actively directing and overseeing System Program Office activities in managing the Boeing KC-767A tanker aircraft lease before her retirement, was accountable for ensuring that best practices and prudent acquisition procedures were implemented.

Deciding that the Boeing KC-767A Tanker Aircraft Are Commercial Items

Who within the Office of the Secretary of Defense and the Air Force was responsible for making the decision that the Boeing KC-767A tanker aircraft was a commercial item?

Issue

The Air Force contracting officer decided to use a commercial item procurement strategy that Air Force management strongly encouraged for the sole-source Boeing KC-767A Tanker Program. However, contrary to the Air Force interpretation, the military tanker aircraft is not a commercial item as defined in Section 403 of Title 41, United States Code. Further, a commercial market for the Boeing KC-767A tanker aircraft did not exist to establish the reasonableness of prices by forces of supply and demand.

By using a commercial item procurement strategy, the Air Force was also required to use a fixed-price type contract where the contractor retains all of the savings if the contractor's actual costs are lower that the estimates rater than a more appropriate mix of cost and fixed-price incentive type contracts. The commercial strategy also exempted Boeing from the requirement to submit cost or pricing data, which places the Government at high risk for paying excessive prices and profits and precludes good fiduciary responsibility for DoD Funds.

[redacted]

Without the Air Force gaining insight into Boeing's actual costs, the Air Force will also be at disadvantage in any future tanker procurement negotiations. See Department of Defense Office of the Inspector General Report No. D-2004-064, "Acquisition of the Boeing KC-767A Tanker Aircraft," March 29, 2004, for further details.

Policy

Federal Acquisition Regulation Part 2, "Commercial Item Definition," Part 12, "Acquisition of Commercial Items," and Part 15, "Contracting by Negotiation;" Section 403 of title 41, United States Code, "Definitions" (Commercial items); Under Secretary of Defense for Acquisition, Technology, and Logistics memorandum on "Commercial Acquisitions," January 2001, "the Federal Acquisition Streamlining Act of 1994" or "FASA," and Section 2306a of title 10, United States Code, "Cost or pricing data: truth in negotiation," provide guidance on commercial items and exceptions to obtaining cost or pricing data.

The Federal Acquisition Streamlining Act of 1994 and the Federal Acquisition Reform Act of 1996 streamline acquisition laws, facilitate the acquisition of commercial products, and eliminate unnecessary statutory impediments to efficient and expeditious acquisition. One impact of the Acts was to significantly broaden the commercial item definition and allow more items to qualify for the "commercial item" exception to cost or pricing data. The Truth in Negotiations Act of 1962 allows DoD to obtain cost or pricing data (certified cost information) from Defense contractors to ensure the integrity of DoD spending for military goods and services that are not subject to marketplace pricing.

In June 1995, the Director, Defense Procurement provided comments on the benefits of the Truth in Negotiations Act, marketplace pricing, and the differences between DoD and commercial procurement environments. He stated that:

> The requirements of TINA [Truth in Negotiations Act] are necessary to ensure the integrity of DoD spending for military goods and services that are not subject to marketplace pricing. When there is a market that establishes prices by the forces of supply and demand, the market provides the oversight. DoD procures many highly complex military systems in the absence of supply/demand situations for these relatively low volume, unique military goods. The requirements of TINA address legitimate and necessary differences between DoD and commercial procurement environments.
>
> While DoD recognizes the need for TINA, it also is moving to increase competition and decrease the number of pricing actions that would require cost or pricing data. The implementation of FASA [Federal Acquisition Streamlining Act], with its emphasis on encouraging the acquisition of commercial end items and increased competition, will bring the requisite market forces to bear on prices, and thus exempt contractors from the requirement to submit cost or pricing data. Absent this competition, the quantitative benefit to the Government of TINA compliance far exceeds the cost of Government oversight.

Over the last 7 years, the Department of Defense Office of Inspector General has issued a series of reports that identified problems DoD contracting officers were having making commercial item determinations and using catalog prices and price

[redacted]

analysis to determine fair and reasonable prices for sole-source commercial and noncommercial spare parts. The audits consistently showed that little, if any, commercial marketplace identical or "of a type" items existed and that contracting officers relied on either catalog prices or price analysis to determine price reasonableness. Based on cost information (cost analysis) that was not made available to the contracting officers, the audits showed that commercial and noncommercial prices were significantly too high.

Who Was Accountable?

Air Force Acquisition Officials. Air Force acquisition officials, including Dr. Roche; Dr. Sambur; Ms. Druyun; Major General Paul Essex, Director of Global Reach Programs, Office of the Assistant Secretary of the Air Force (Acquisition); [redacted], Office of the Air Force Director of Global Reach Programs, Office of the Assistant Secretary of the Air Force (Acquisition) and most senior Air Force officials strongly encouraged the contracting officer to use a commercial item procurement strategy for the Boeing KC-767A Tanker Program to comply with the requirements for an operating lease. If the military tanker aircraft could not be classified as a commercial item, the Air Force could not use an operating lease, and the program could not proceed as defined in the legislation.

[redacted], the contracting officer at the Aeronautical Systems Center inappropriately determined that the Boeing KC-767A military tanker aircraft was a commercial item and inappropriately signed the "Commercial Determination for the KC-767A Aircraft System."

[redacted], Air Force Materiel Command Law Office reviewed and approved the contracting officer's commercial item determination and finding, and stated that:

[redacted]

Mr. Hughes. Mr. James "Ty" Hughes, Office of the Air Force General Counsel, also reviewed and did not take exception to the contracting officer's commercial item determination and finding that the Boeing KC-767A tanker aircraft was a commercial item.

[redacted]

Deciding that the Boeing KC-767A Tanker Aircraft Met Operating Lease Requirements

Who within the Office of the Secretary of Defense and the Air Force was responsible for making the decision that the Boeing KC-767A tanker aircraft lease proposal met Office of Management and Budget Circular No. A-11 operating lease requirements and Office of Management and Budget Circular No. A-94?

Issue

The contract lease for 20 Boeing KC-767A tanker aircraft did not meet three of the six criteria requirements for an operating lease as described in Office of Management and Budget Circular No. A-11, "Preparation, Submission, and Execution of the Budget (2003)." Meeting the Office of Management and Budget criteria for leases is a statutory requirement of Section 8159 of the Department of Defense Appropriations Act for FY 2002. Further, Office of Management and Budget Circular No. A-11 requirements for the use of an operating lease and Office of Management and Budget Circular No. A-94 requirements for cost benefit analysis (net present value) were not met. In addition, the Air Force long-term lease was contrary to the actual intended use of operating leases, which may be cost effective when the Government has only a temporary need for the asset. Accordingly, the lease for the Boeing KC-767A tanker aircraft was incorrectly classified as an operating lease. In addition, the use of an operating lease for long-term use is a high-cost way to acquire a capital asset. See Department of Defense Office of the Inspector General Report No. D-2004-064 for further details.

On May 22, 2003, Ms. Robin Cleveland, Office of Management and Budget notified Boeing that Boeing KC-767A tanker aircraft lease proposal met Office of Management and Budget Circular No. A-11 operating lease requirements and Office of Management and Budget Circular No. A-94 cost-benefit analysis requirements "deal done." The Office of the Secretary of Defense Leasing Review Panel officials stated that they relied upon Office of Management and Budget for making the determination as to whether the Boeing KC-767A tanker aircraft lease proposal met Office of Management and Budget Circular No. A-11 operating lease requirements.

On May 23, 2003, Mr. Aldridge signed the "Air Force Boeing 767 Tanker Lease Decision Memorandum," stating that "The Secretary of Defense approved this lease proposal contingent upon securing a waiver of the requirement to fund termination liability and approval of the Office of Management and Budget."

On June 20, 2003, the Director, Program Analysis and Evaluation sent a memorandum to the Acting Under Secretary of Defense for Acquisition, Technology, and Logistics that stated his office's analysis of Office of Management and Budget Circular No. A-94 showed that the provisions of the draft Boeing KC-767A tanker lease proposal cost more than the equivalent purchase of tanker aircraft by $6.0 billion measured in then-year dollars and $5.1 billion if measured in constant FY 2002 dollars. His office's analysis also

[redacted]

showed that the current draft lease failed to meet the requirement in Office of Management and Budget Circular No. A-11 that the present value of the lease payments be less than 90 percent of the fair market value at lease inception.

Policy. Office of Management and Budget Circular Nos. A-11, "Preparation, Submission, and Execution of the Budget (2003)," and A-94, "Guidelines and Discount Rates for Benefit-Cost Analysis of Federal Programs," provide guidance on operating leases.

To qualify as an operating lease, the Air Force lease for the Boeing KC-767A tanker aircraft must meet the six criteria, as described in Office of Management and Budget Circular No. A-11:

- The asset is a general-purpose asset rather than being for a special purpose of the government and is not built to the unique specification of the government as lessee;
- There is a private-sector market for the asset;
- The present value of the minimum lease payments over the life of the lease does not exceed 90 percent of the fair market value of the asset at the beginning of the lease term;
- The lease does not contain a bargain-price purchase option;
- Ownership of the asset remains with lessor during the term of the lease and is not transferred to the government at or shortly after the end of the lease term; and
- The lease term does not exceed 75 percent of the estimated economic life of the asset.

If the lease does not meet all six criteria, the lease should be considered either a capital lease or a lease purchase. A lease purchase is a lease where ownership of an asset is transferred to the Government at or shortly after the end of the lease term but does not have to include a bargain-price purchase option. A capital lease is different from an operating lease in that the Government consumes most of the useful life of the asset. For either a capital lease or a lease purchase, the Air Force would have to have funds budgeted in the Future Years Defense Program to pay for the asset lease. Further, to qualify under Office of Management and Budget Circular No. A-94, in net present value terms, the cost of the operating lease must be less than or equal to the cost to purchase the aircraft.

Who Was Accountable?

Dr. Sambur. Dr. Sambur, Assistant Secretary of the Air Force (Acquisition) was accountable for decisions made to manipulate the lease terms to demonstrate the satisfaction of operating lease criteria requirements in Office of Management and Budget Circular No. A-11. For example, in February 2003, Dr. Sambur, in reference to the price comparison between leasing or purchasing Boeing KC-767A tanker aircraft, directed his staff to remove in the purchase comparison the use of multiyear contracting. He stated on the purchase side, DoD would not be able to enter a multiyear contract similar to the lease. This direction skewed

[redacted]

the Air Force's results of the price comparison between purchasing or leasing the aircraft and closed the Air Force price differential between the two options.

Ms. Druyun. Ms. Druyun, the Principal Deputy Assistant Secretary of the Air Force (Acquisition and Management) was accountable for manipulating the Congressional language on leasing tankers. In December 2001, she notified a Representative and congressional staff that the proposed language of leasing tankers was not executable. The leasing language was not executable because of the Congressional Budget Office position on scoring the lease as a capital lease. The proposed language required the lease of "green aircraft" (basic Boeing 767 aircraft) and then modification through a separate appropriation. She recommended that the congressional language be modified to describe the lease for "commercial aircraft tanker" versus "green" Boeing 767 aircraft because the Air Force did not have the money for the modification and would not meet the 90 percent fair market value rule. Ms. Druyun had [redacted] Office of the Air Force Director of Global Reach Programs, Office of the Assistant Secretary of the Air Force (Acquisition), who controlled the lease analysis, report to her and Major General Essex, Director of Global Reach Programs, Office of the Assistant Secretary of the Air Force (Acquisition).

Proposing to Lease Boeing KC-767A Tanker Aircraft

Who within the Air Force was responsible for making the decision to propose leasing Boeing KC-767A tanker aircraft?

Issue

Recapitalization of tanker aircraft was not a budget priority, yet the Air Force, with support from certain Senators and Representatives as well as three of the four congressional Defense committees, supported the lease of Boeing KC-767A tanker aircraft.

Policy

Chairman of the Joint Chief of Staff Instruction 3170.01D, "Joint Capabilities Integration and Development System," March 12, 2004, requires that:

- the Joint Capabilities Integration and Development System analysis process document capability gaps,
- determine the attributes of a capability or combination of capabilities that would resolve the gaps, and
- identify material and or nonmaterial approaches for implementation and roughly assess the cost and operational effectiveness of the joint force for each of the identified approaches in resolving capabilities gaps.

Before program initiation, the Instruction requires the Military Departments to prepare an initial capabilities document to make the case to establish the need for a material approach to resolve a specific capability gap, or set of capability gaps,

[redacted]

derived from the Joint Capabilities Integration and Development System analysis process. The initial capabilities document supports the preparation of an analysis of alternatives.

Who Was Accountable?

Dr. Roche. Dr. Roche, Secretary of the Air Force made the decision to make the leasing of Boeing KC-767A tanker aircraft as one of his vision items. Accordingly, he signed and sent a letter that Ms. Druyun had drafted to a Representative indicating the need for "jump-starting" a replacement program for the KC-135 tanker aircraft fleet by leasing.

Ms. Druyun. Ms. Druyun, the Principal Deputy Assistant Secretary of the Air Force (Acquisition and Management) made the decision to promote the leasing of tanker aircraft. In September 2001, Ms. Druyun stated that the Air Force favored leasing Boeing KC-767A tanker aircraft rather than purchasing because the budget did not contain money for purchasing Boeing KC-767A tanker aircraft and a lease deal was favorable to a certain Senator and Representative. Boeing helped Ms. Druyun with a briefing for the Senator on leasing that illustrated the need to waive legal impediments and provide relief under Office of Management and Budget Circular No. A-11 criteria requirements. In October 2001, Ms. Druyun had a letter drafted for Dr. Roche's signature to be sent to a Representative indicating the need for "jump-starting" a replacement program for the KC-135 tanker aircraft fleet by leasing. Ms. Druyun's actions took place before the approval of a mission need statement and the preparation of an operational requirements documents (predecessor documents to the initial capabilities document) supporting the need to fill a capabilities gap (a validated urgent need for replacement tankers) as required in Chairman of the Joint Chief of Staff Instruction 3170.01D.

Need to Accelerate the Recapitalization of the KC-135 Tanker Aircraft Fleet

Was there an urgent and compelling need to accelerate the recapitalization of the KC-135 tanker fleet?

Issue

DoD and Air Force acquisition officials determined that an urgent and compelling need existed to accelerate the recapitalize the KC-135 tanker aircraft fleet after legislation was signed that allowed the lease of up to 100 Boeing KC-767A tanker aircraft. The Air Force managers used corrosion problems and higher than expected maintenance costs as their reason to accelerate the recapitalization effort. However, independent reviews and other testimony on the KC-135 tanker aircraft fleet, such as the Defense Science Board, did not support the need to accelerate the recapitalization of the tanker fleet.

[redacted]

Policy

The Federal Acquisition Regulation states that acquisition planning should begin as soon as the agency need is identified but requirements personnel should avoid issuing requirements on an urgent basis since it generally restricts competition and increases prices.

DoD Instruction 5000.2 states that the program manager and milestone decision authority may tailor the phases and decision points for a program due to risk and urgency of need.

Who was Accountable?

Mr. Aldridge. Mr. Aldridge, Under Secretary of Defense for Acquisition, Technology, and Logistics was accountable because he signed the "Air Force Boeing 767 Tanker Lease Decision Memorandum" on May 23, 2003. The memorandum gave the Air Force conditional approval to enter into a multiyear lease pilot program for leasing general purpose Boeing 767 aircraft. Mr. Aldridge also stated that the combined effects of aging and the surge in demand due to the Global War on Terrorism have increased the need to replace the KC-135 tanker aircraft. Although the lease was more expensive, Mr. Aldridge preferred the lease because it would accelerate the delivery of the first new tanker and minimized the financial impact to other on-going programs.

Mr. Wynne. Mr. Wynne, Acting Under Secretary of Defense for Acquisition, Technology, and Logistics accountable because he issued a memorandum on May 28, 2003, which was almost identical to Mr. Aldridge's "Air Force Boeing 767 Tanker Lease Decision Memorandum," to notify the Office of Management and Budget regarding the Office of Secretary of Defense decision to lease the Boeing KC-767 tanker aircraft.

Dr. Roche. Dr. Roche, Secretary of the Air Force was accountable because he disagreed with the Air Force's plan to begin the recapitalize of the KC-135 tanker aircraft beginning in 2013. Dr. Roche wanted to begin recapitalizing the tanker fleet sooner because of the opportunity to lease the Boeing KC-767A tanker aircraft presented in legislation. Dr. Roche testified numerous times regarding the urgency to recapitalize the KC-135 tanker aircraft fleet because of severe corrosion problems and the increased maintenance costs. Dr. Roche stated that the previous studies conducted on the KC-135 tanker aircraft fleet were faulty and that the cost to sustain the KC-135 tanker aircraft fleet was significantly increasing and approximately 30 percent for depot maintenance hours were dedicated to fixing corrosion. Dr. Roche stated that the Air Force had done a comprehensive and deliberate review that both validated the urgent need to start modernizing our tankers now and the advantages of leasing; however, the Air Force was not able to provide any supporting details supporting Dr. Roche's position. Dr. Roche subsequently recognized that an urgent and compelling need to expedite the recapitalization of the KC-135 tanker aircraft fleet did not exist.

Dr. Sambur. Dr. Sambur, Assistant Secretary of the Air Force (Acquisition) was accountable because he was the Air Force acquisition executive and knew that an urgent requirement to recapitalize the KC-135 tanker aircraft fleet did not exist

[redacted]

because of corrosion and maintenance costs growth; however, he supported those claims. Dr. Sambur acknowledged to Dr. Roche in October 2002 that the Air Force did not have an urgent need to expedite the replacement the KC-135 tanker aircraft and needed a reason to justify the lease of the Boeing KC-767A tanker aircraft. Dr. Sambur understood that the Air Force could fix the corrosion problems identified in the KC-135 tanker aircraft fleet and that depot maintenance would take between six and nine months for each KC-135 tanker aircraft. Dr. Sambur also implied that the Boeing KC-767A tanker aircraft lease was as an insurance policy for the Department in the event that the KC-135 tanker aircraft fleet experienced unexpected significant mission failures. Dr. Sambur stated that, if the Department waited until corrosion was a lethal problem and airplanes were falling out of the sky, then the recapitalization effort would be too late. Further, he stated that the Air Force would need 10 years to recapitalize, even a 100 tanker aircraft. Dr. Sambur recognized the inconsistency in his claim because after testifying that the Air Force was not seeing the same type of problems in the KC-135R tanker aircraft models and the Air Force planned to retire some of its KC-135E tanker aircraft models even without leasing the Boeing KC-767A tanker aircraft as replacements for the KC-135E tanker aircraft models.

General Jumper. General Jumper, Chief or Staff of the Air Force was accountable for supporting the Air Force sense of urgency to initiate the lease of the KC-767A tanker aircraft. General Jumper believed that the lease was a pilot program and would be difficult to execute so the Air Force accepted the risk that the program may not work. From the beginning, General Jumper believed that, if the Boeing KC-767A tanker aircraft lease did not work, then the Air Force would resume the program of record to recapitalize the KC-135 tanker aircraft fleet starting in 2013.

Major General Essex. Major General Essex, Director of Global Reach Programs, Office of the Assistant Secretary of the Air Force (Acquisition) was accountable for the sense of urgency associated with corrosion because he testified on the health of the KC-135 tanker aircraft fleet. Major General Essex stated that the Air Force was in denial early on about the KC-135 tanker aircraft corrosion problem and that the economic service life study portrayed an optimistic picture of the KC-135 tanker aircraft corrosion problem and repair costs. Major General Essex stated that the Air Force did a thorough review in early 2002 and recalculated all the costs associated with maintenance of the KC-135 tanker aircraft fleet. However, the Air Force was unable to provide support for the recalculated costs.

[redacted]

Performing an Analysis of Alternatives on the KC-135 Tanker Aircraft Recapitalization

Who within the Department of Defense and the Air Force was responsible for making the decision to forego performing an analysis of alternatives on the KC-135 tanker recapitalization effort?

Issue

DoD and Air Force leadership and acquisition officials did not prepare an analysis of alternatives before accepting the Boeing KC-767A tanker aircraft as the materiel solution to recapitalization of the aerial refueling tanker fleet. An analysis of alternatives was not conducted because:

- the language of the Section 8159 of the Department of Defense Appropriations Act for FY 2002 provided a materiel solution to the KC-135 tanker aircraft recapitalization effort;
- conducting an analysis of alternatives would delay the recapitalization effort by a year and a half to two more years and with the opinion of Dr. Roche, produce the same materiel solution; and
- an informal analysis could substitute for the more formal analysis of alternatives.

Policy

DoD Instruction 5000.2, Chairman of the Joint Chiefs of Staff Instruction 3170.01D, "Joint Capabilities Integration and Development System", March 12, 2004, and Air Force Instruction 10-601, "Capabilities Based Requirements Development", July 30, 2004, provide guidance concerning an analysis of alternatives.

DoD Instruction 5000.2. DoD Instruction 5000.2 states that an analysis of alternatives is required for all major Defense acquisition programs at Milestone A, Milestone B, and Milestone C (updated as necessary). Further, the Instruction requires the DoD Component to designate responsibility for completion of the analysis of alternatives, but it may not be assigned to the program manager. The milestone decision authority for Acquisition Category ID programs is the Under Secretary of Defense for Acquisition, Technology, and Logistics.

Chairman of the Joint Chiefs of Staff Instruction 3170.01D. Chairman of the Joint Chiefs of Staff Instruction 3170.01D requires that an analysis of alternatives to be conducted for all potential Acquisition Category I programs after the approval of the initial capabilities document to refine the initial materiel approach recommended for implementation in the initial capabilities document. Chairman of the Joint Chiefs of Staff Instruction 3170.01D requires the Under Secretary of Defense for Acquisition, Technology, and Logistics to be engaged early to ensure that the analysis plan adequately addresses a sufficient range of materiel approaches.

[redacted]

Air Force Instruction 10-601. Air Force Instruction 10-601 requires that, in the case of a potential Acquisition Category I proposal, an analysis of alternatives must be conducted in accordance with DoD Instruction 5000.2.

Who Was Accountable

Mr. Aldridge. Mr. Aldridge, Under Secretary of Defense for Acquisition, Technology, and Logistics was accountable for making the decision to not to comply with the statutory and regulatory requirements in DoD Directive 5000.1. Although we were unable to interview Mr. Aldridge, Dr. Sambur stated that Mr. Aldridge told him that the requirements of DoD Directive 5000.1 did not need to be implemented for the Boeing KC-767A tanker aircraft lease. Mr. Aldridge made the decision to lease Boeing KC-767A tanker aircraft without the benefit of an analysis of alternatives when he authored his Leasing Decision Memorandum. Mr. Aldridge's actions showed that he did not intend the Air Force to comply with the statutory and regulatory requirements of the DoD Directive 5000.1.

Mr. Wynne. Mr. Wynne, Acting Under Secretary of Defense for Acquisition, Technology, and Logistics was also accountable for making the decision to forego the analysis of alternatives. As Acting Under Secretary of Defense for Acquisition, Technology, and Logistics, Mr. Wynne had a responsibility of ensuring the analysis plan adequately addresses a sufficient range of materiel approaches. Mr. Wynne upon assuming the position of Acting Under Secretary of Defense for Acquisition, Technology, and Logistics continued execution of the Boeing KC-767A tanker aircraft lease effort without the benefit of an analysis of alternatives.

Dr. Roche. Dr. Roche, Secretary of the Air Force was accountable for making the decision to forego the analysis of alternatives. In August 2003, Dr. Roche directed Major General Wayne Hodges, Director of Global Reach, Office of the Secretary of the Air Force (Acquisition) to halt the effort by the Office of the Assistant Secretary of the Air Force (Acquisition) to conduct the analysis of alternatives. As early as November 2002, Dr Roche felt that conducting an analysis of alternatives would not be beneficial to the Boeing KC-767A tanker aircraft lease, as it would inhibit the progress of the leasing deal with Boeing In addition, Dr. Roche felt that the pilot program designation of the KC-767A tanker aircraft lease deal, excused the Air Force from following the statutory and regulatory provisions in DoD Directive 5000.1. Moreover, an analysis of alternatives was not conducted because the language of Section 8159 had already specified the Boeing KC-767A tanker aircraft as the materiel solution. Dr. Roche felt that an analysis of alternatives became unnecessary because the Air Force was only complying with the language of the legislation.

Dr. Sambur. Dr. Sambur, Assistant Secretary of the Air Force (Acquisition) was accountable for supporting the decision to forego the analysis of alternatives. Even though Mr. Aldridge told Dr. Sambur that the requirements of DoD Directive 5000.1 did not need to be implemented for the Boeing KC-767A tanker aircraft lease, Dr. Sambur was responsible, as the Air Force Acquisition Executive, for exercising best practices and prudent acquisition procedures to

[redacted]

ensure the justification and the reasonableness of the $23.5 billion expenditure for the Boeing KC-767A tanker aircraft lease.

Major General Essex. Major General Paul Essex, Director of Global Reach Programs, Office of the Assistant Secretary of the Air Force (Acquisition) from April 2001 to January 2003, was accountable for accepting the decision to forego the analysis of alternatives. His office was primarily responsible for being the link between the acquisition community and the operating command. Major General Essex also used the language of Section 8159 as a means of jump starting the KC-135 recapitalization effort without identifying any alternatives to the desired capability.

Major General Hodges. Major General Wayne Hodges, Director of Global Reach, Office of the Secretary of the Air Force (Acquisition) was accountable for accepting the decision to forego the analysis of alternatives. Because of the language in Section 8159, Major General Hodges assumed that an analysis of alternatives was not required because the language specifically stated that the Air Force was to lease Boeing KC-767A tanker aircraft.

[redacted]

Part III – What Actions Must Be Taken to Prevent a Situation Like the Tanker Lease From Happening Again?

Cultural Change

The Office of Management and Budget circulars, the Federal Acquisition Regulation, and the DoD 5000 series of guidance establish a system of management controls over the acquisition of weapon systems for the Department. The system, when properly implemented and followed, should place needed capabilities in the hands of the warfighter while appropriately mitigating the level of risk associated with properly performing the actual functions expected of the weapon system. Also, the 5000 series establishes a system of management controls to maintain proper financial control of the program to protect the interests of both the warfighter and the taxpayer when contemplating different weapons acquisition strategies to include leasing as a financing option. The system of management internal controls were either not in place or not effective because the existing acquisition procedures were not followed in the proposed lease of the Boeing KC-767A tanker aircraft. The Department of Defense must change the cultural environment in its acquisition community to ensure that the proper control environment is reestablished and followed for major weapon-system acquisitions.

In addition, as part of the cultural change, the senior leadership of the Department must not tolerate situations where senior officials use their positions to have contractors put pressure on other senior officials to have them change their stance relative to a particular situation. For example, on June 20, 2003, Mr. Kenneth J. Krieg, Director, Program Analysis and Evaluation issued a memorandum stating that purchase was more cost effective than leasing the Boeing KC-767A tanker aircraft and that the lease as proposed did not meet Office of Management and Budget requirements. According to [redacted] in an e-mail, Dr. Roche subsequently requested, in a meeting with [redacted] on June 23, 2003, that Boeing put pressure on Mr. Wynne to have Mr. Krieg change his position on the Boeing KC-767A tanker aircraft lease.

Regulatory Options

Even though Department of Defense Instruction 5000.2, "Operation of the Defense Acquisition System," May 12, 2003, requires an analysis of alternatives at major milestone decision points for major defense acquisition programs, the Office of the Secretary of Defense and the Department of the Air Force did not comply with the requirement because of guidance from Mr. Aldridge to Dr. Sambur that the requirements of DoD Directive 5000.1 did not need to be implemented for the Boeing KC-767A tanker aircraft lease. Therefore, the Secretary should reemphasize the requirement to conduct an analysis of

[redacted]

alternatives for all major Defense acquisition programs and major systems before major milestone decision points.

Further, the Deputy Secretary of Defense should require the Under Secretary of Defense for Acquisition, Technology, and Logistics; the Assistant Secretary of Defense for Networks and Information Integration; and the Director, Operational Test and Evaluation to revise Department of Defense Instruction 5000.2 to specify the procedures the Under Secretary of Defense for Acquisition, Technology, and Logistics; and the Department of Defense Component Acquisition Executives must follow when leasing a major Defense acquisition program or a major system. Specifically, the guidance should emphasize that leasing is a method for financing the acquisition of a program and that the program should be treated the same as any acquisition program of like cost. Further, the guidance should require, at a minimum, that the acquiring Military Department prepare an analysis of alternatives for the lease and that the decision to enter into a contract to lease a major Defense acquisition program or a major system must be subject to the results of a Defense Acquisition Board or a System Acquisition Review Council review, as applicable.

Assessment Recommendations

The Secretary of Defense should instruct his staff to monitor implementation of the recommendations that the Defense Acquisition University made in its September 3, 2004, report in response to tasking memorandum, "Lessons Learned from the Independent Assessments of Proposed 767 Tanker Lease Buy," that the Acting Under Secretary of Defense for Acquisition, Technology, and Logistics issued on May 25, 2004.

Using the results of reviews of the Boeing KC-767A Tanker Program by the Defense Science Board, the Industrial College of the Armed Forces, and the Department of Defense Office of the Inspector General, the Defense Acquisition University concluded that policy for commercial item acquisitions and the leasing process needed clarification. Specific recommendations included several proposed policy changes in the areas of Acquisition Management and Oversight, Commercial Item Policy and Leasing Policy. The Under Secretary of Defense for Acquisition, Technology, and Logistics adopted all of the proposed recommendations and is in the process of implementation. The most significant of the proposed recommendations were that the Under Secretary of Defense for Acquisition, Technology, and Logistics:

- Follow DoD Instruction 5000.2 oversight, review, and decision processes - Cancel Leasing Review Panel;
- Change the Federal Acquisition Regulation and the Defense Federal Acquisition Regulation Supplement to clarify the authority of the contracting officer to obtain all necessary cost information needed to determine prices are fair and reasonable in commercial item acquisitions;

[redacted]

- Develop specific guidance for analyzing whether a significant military unique modification effects a commercial item determination and for determining a fair and reasonable price for the modified item;
- Rewrite the Commercial Item Handbook to incorporate recent changes resulting from legislation and best practices; and
- Evolve the Department's existing body of knowledge for the management of major systems to include systems acquired using Federal Acquisition Regulation Part 12.

[redacted]

Appendix A. Related Coverage

Since January 10, 2002, when the Department of Defense Appropriations Act for FY 2002, Section 8159 authorized the Air Force to make payments on a multiyear pilot program for leasing general purpose Boeing 767 aircraft in a commercial configuration, the Department of Defense Office of the Inspector General has conducted three analyses of the Boeing KC-767A Tanker Program. Those analyses were in response to requests by the Chairman, Committee on Commerce, Science, and Transportation, U.S. Senate; the Acting Under Secretary of Defense for Acquisition, Technology, and Logistics; and the Deputy Secretary of Defense.

Chairman Request. On April 17, 2002, the Chairman, Committee on Commerce, Science, and Transportation requested that we assess the Air Force decision to select the Boeing 767 rather than the Airbus 330 for its air refueling tankers. On May 3, 2002, the Department of Defense Inspector General issued a memorandum, stating that the Air Force did not fully accomplish the purpose of Federal Acquisition Regulation Subpart 15.201, "Exchanges With Industry Before Receipt of Proposals," which was to improve the understanding of Government requirements and industry capabilities through the exchange of information with potential offerors. However, because Section 8159 of the Department of Defense Appropriations Act for FY 2002 specified Boeing aircraft, the Air Force stated that the normal processes of a request for information were not necessary. Consequently, we did not take exception to the selection of the Boeing 767, because it was specified in legislation.

Acting Under Secretary Request. On July 22, 2003, the Acting Under Secretary of Defense for Acquisition, Technology, and Logistics requested that we:

- review the decision process used by the Air Force and the Office of the Secretary of Defense to lease the Boeing KC-767A Tanker aircraft, and
- assess whether DoD interaction with Congress following the "Air Force Boeing 767 Tanker Lease Decision Memorandum," May 23, 2003, was timely and reasonable.

On August 29, 2003, we issued Department of Defense Office of the Inspector General Report No. D-2003-129, "Assessment of DoD Leasing Actions," stating that, although not required by statute, applying a best business practice of weighing the need to conduct a formal analysis of alternatives to achieve the best possible system solution could have improved the Air Force Leasing process. Further, a best business practice would have been to expand the charter of the Office of the Secretary of Defense Leasing Review Panel to include the Panel's role in the acquisition process and in the life cycles of the leases. We also determined that of the six letters from the Chairman, Committee on Commerce, Science, and Transportation and the one letter from the Congressional Budget Office, five were generally timely and two were not timely. Further, two responses could have been improved by a more comprehensive answer to portions of the requests. However, we did not identify a reason to not proceed with the lease of the Boeing KC-767A Tanker aircraft based on the limited scope of our review.

[redacted]

Deputy Secretary of Defense Request. On December 1, 2003, the Deputy Secretary of Defense requested an audit by the Department of Defense Office of the Inspector General, stating that "In light of recent revelations by The Boeing Company concerning apparent improprieties by two of the company's executives, please determine whether there is any compelling reason why the Department of the Air Force should not proceed with its Tanker Lease Program. In particular, I would appreciate knowing whether any of these revelations affect any of your previous analysis of this program."

On March 29, 2004, we issued Department of Defense Office of the Inspector General Report No. D-2004-064, "Acquisition of the Boeing KC-767A Tanker Aircraft," stating that the Air Force used an inappropriate procurement strategy and demonstrated neither best business practices nor prudent acquisition procedures to provide sufficient accountability for the expenditure of $23.5 billion for the KC-767A tanker program. We identified five statutory provisions that have not yet been satisfied relating to: commercial items; testing (two statutes); cost-plus-a-percentage-of-cost system of contracting; and leases. Therefore, we recommended that DoD not proceed with the program until it resolves the issues pertaining to the procurement strategy, acquisition procedures, and statutory requirements.

Based on our findings, we also recommended that the Deputy Secretary consider the following options.

1. After implementation of audit recommendations to resolve contracting and acquisition issues, proceed with the sole-source acquisition of the Boeing KC-767A Tanker Program for 100 or fewer aircraft.
2. Initiate a new major Defense acquisition program based on the results of an analysis of alternatives for military tanker aircraft.
3. Implement a mix of Option 1 for some of the tankers and Option 2 for subsequent tankers.

Our audit results showed that, contrary to the Air Force interpretation, the Boeing KC-767A Tanker Program did not meet the statutory definition of a commercial item. No commercial market for this tanker aircraft existed to establish reasonable prices by the forces of supply and demand. Consequently, the commercial item procurement strategy did not provide the Air Force with sufficient cost or pricing data to make multi-billion dollar decisions for the Boeing KC-767A Tanker Program and did not demonstrate the level of accountability needed to conclude that the prices negotiated represent a fair expenditure of DoD funds (Issue A). The Air Force used Section 8159 of the Department of Defense Appropriations Act for FY 2002 to justify its informal acquisition strategy with the primary goal to expeditiously lease 100 Boeing KC-767A Tanker aircraft to replace its aging KC-135E Tanker fleet. In doing so, the Air Force did not demonstrate best business practices and prudent acquisition procedures in developing this program and did not comply with statutory provisions for testing (Issue B).

[redacted]

Specific aspects of Issue A were:

- **Commercial Item Procurement Strategy.** The Air Force commercial item procurement strategy prevented any visibility into Boeing's costs and required the Air Force to use a fixed-price type contract. In a fixed-price type contract, the contractor retains all of the savings if the contractor's actual costs are lower than the estimates. Cost or fixed-price incentive type contracts are more appropriate for initial development, modifications, and logistics support. The strategy also exempted the sole-source provider from the requirement to submit cost or pricing data. The strategy places the Department at high risk for paying excessive prices and profits and precludes good fiduciary responsibility for DoD funds.

Using the commercial item procurement strategy, Air Force program officials:

- **Green (Commercial) Aircraft** [redacted] Waived obtaining cost or pricing data without obtaining data on prior Boeing commercial sales to establish price reasonableness, did not negotiate engine prices directly with engine manufacturers (a standard commercial practice), and relied on a questionable mix of Boeing 767 commercial aircraft models with a discounted Internet price to establish a fixed-price baseline of $7.9 billion for 100 "green aircraft" (basic Boeing 767 aircraft). The commercially available data and assumptions that the Air Force program officials relied on were not sufficient to support the fixed-price baseline price and could cause the price to be overstated from [redacted] to [redacted] based on an analysis performed by the Institute for Defense Analysis and our analysis of a higher discounted price appropriate for a significant competitive order.
- **Development** [redacted] Relied on data that Boeing provided to the Italian military for the Global Tanker Transport Aircraft (GTTA) with other assumptions for testing and certification and then added profit and financing costs to support the Air Force share of [redacted] for GTTA development. The Air Force negotiating team also used cost estimating relationships to other programs, Boeing engineering estimates, and other budget data to calculate Air Force-specific development costs of [redacted] The data used were not sufficient to establish a fixed-price baseline of [redacted] for development of the 100 tanker aircraft.
- **Modification** [redacted] Used questionable comparisons of modifications costs for other programs and Boeing engineering estimates and vendor quotes without determining the reliability of those estimates or quotes, and then applied a decrement factor to establish a fixed-price baseline of [redacted] for the modification of 100 "green aircraft." The data that Air Force program officials used were not sufficient to establish the modification baseline price, which could cause the modification price to be overstated by at least [redacted] based on an analysis performed by the Institute for Defense Analyses. The magnitude of the military modifications obliges the Air Force to request Congress to provide the statutory authority required by Department of Defense Appropriations Act for FY 2002 to modify leased general purpose Boeing 767 aircraft.

[redacted]

- **Limitation of Earnings and Termination Clauses.** Attempted to limit Boeing's earnings to [redacted] percent by including a limitation of earnings clause in the proposed contract. The clause was written to exclude any Government audit rights and to use Boeing's independent auditor to provide an attestation on profits earned. Only the Inspector General has the statutory authority to approve the use of non-Federal audit services. The Defense Contract Audit Agency (DCAA) is the appropriate audit entity and is in the best position to provide the requisite audit services. Further, the clause allowed Boeing to include questionable items in its costs and prevented the Government from any visibility of the costs with only a final accounting by Boeing's auditor after the last aircraft is delivered in FY 2015. The clause is highly detrimental to the fiduciary interests of DoD. The clause also appears to have created a statutorily prohibited cost-plus-a-percentage-of-cost system of contracting. Also, the termination for convenience clause in the proposed contract does not provide sufficient controls or audit rights to adequately determine the Government's termination liability and to prevent a possible Anti-Deficiency Act violation.
- **Logistics Support** [redacted] Used a mix of pricing data from brochures relating to other aircraft and escalated 1980s pricing data for support equipment costs that included a [redacted] error to justify a fixed-price fleet logistics support price of [redacted] for 12 years. The data used were not sufficient to support baseline fleet logistics support costs. Further, Air Force program officials set a 56 percent "performance aircraft availability" for Boeing to receive 100 percent of the annual contract price without benchmarking the availability rates of comparable aircraft systems. The 12-year sole-source contract is also premature because the Air Force should first comply with statutory requirements in the National Defense Authorization Act for FY 2004; Section 2464 of title 10, United States Code; and the Strom Thurmond National Defense Authorization Act for FY 1999 requiring analyses of the costs and benefits of organic or contractor support, core logistics, and contract length.
- **Lease** [redacted] Did not meet three of six criteria requirements for an operating lease as described in Office of Management and Budget Circular No. A-11, "Preparation, Submission, and Execution of the Budget (2003)." Meeting the Office of Management and Budget criteria for leases is a statutory requirement of Section 8159 of the Department of Defense Appropriations Act for FY 2002. Further, the lease for 20 tankers will increase Air Force costs by at least [redacted] more than purchasing the aircraft.

Specific aspects of Issue B were:

- **Acquisition Strategy.** The Office of the Assistant Secretary of the Air Force (Acquisition) did not establish an appropriate acquisition strategy for acquiring tanker aircraft to satisfy warfighter needs. Instead, the Air Force used Section 8159 of the Department of Defense Appropriations Act for FY 2002 to justify its informal acquisition strategy, the focus and goal of which was to expeditiously lease 100 Boeing 767A Tanker aircraft without regard to best business practices, prudent

[redacted]

acquisition procedures, and compliance with statutory provisions for testing. Without a disciplined acquisition strategy, the Air Force cannot ensure to the warfighter that the delivered KC-767A Tanker aircraft will satisfy operational requirements.

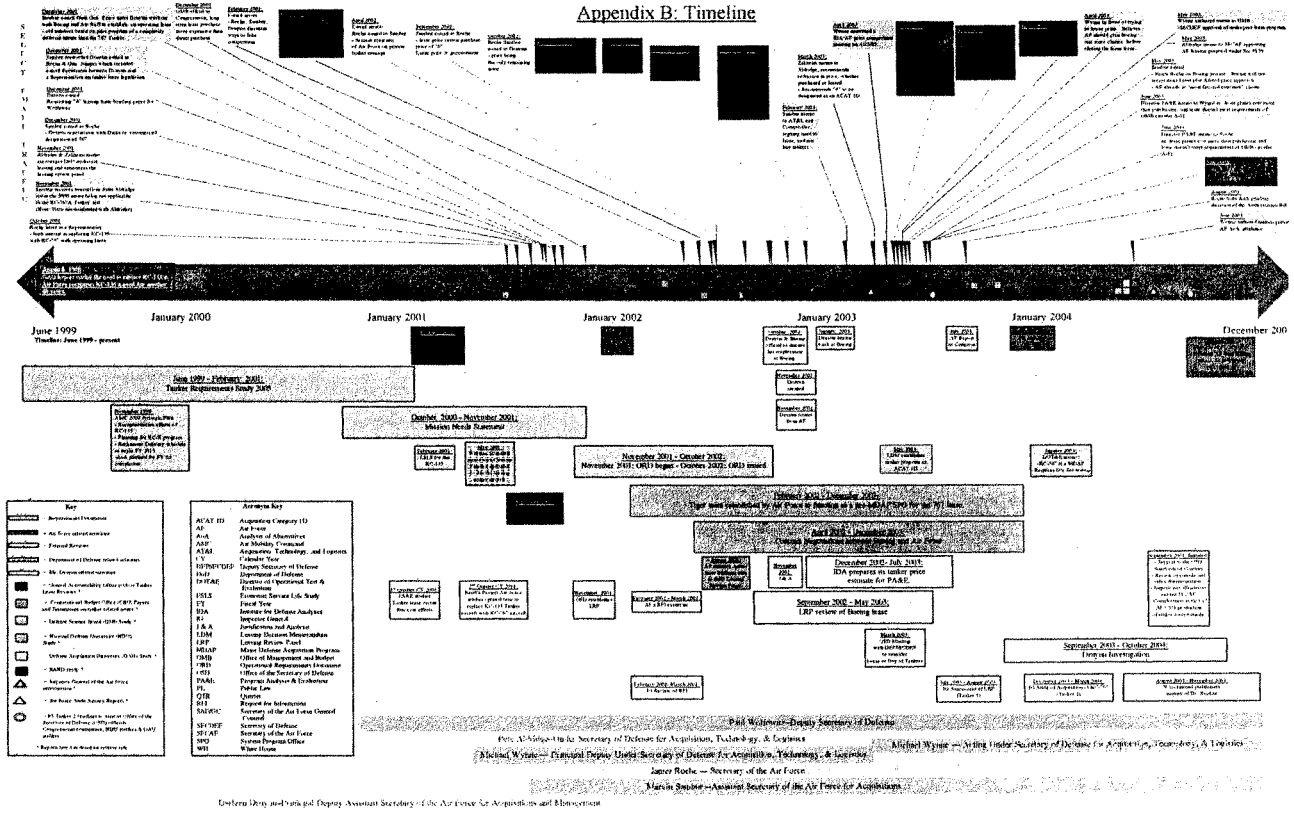
Using the legislation as the informal acquisition strategy, Air Force officials did not:

- **System Engineering Requirements.** Fully develop system engineering requirements to convert the commercial non-developmental aircraft into an integrated military configuration. Without fully developing system engineering requirements for aircraft conversion, the Boeing KC-767A Tanker aircraft may not meet the operational requirement for a 40-year service life as well as command, control, communications, computers, and intelligence (C4I) support plan requirements.
- **Operational Requirements Document.** Tailor the first spiral or increment of the operational requirements document to warfighter requirements in the mission needs statement for future air refueling aircraft but instead tailored it to correlate closely with the capabilities of the Boeing 767 tanker variant that Boeing was producing for the Italian government. As a result, the first 100 KC-767A Tankers will not meet the operational requirement for interoperability and will not meet the mission capabilities in the operational requirements document to conduct secondary missions, such as cargo/passenger and aeromedical evacuation missions.

Statutory Provisions for Testing. Comply with Sections 2366 and 2399 of title 10, United States Code for determining the operational effectiveness, suitability, and survivability of the Boeing 767A Tanker aircraft before proceeding beyond low-rate initial production and committing to the subsequent production of all 100 Boeing KC-767A Tanker aircraft. By not complying with the statutory provisions, the Boeing KC-767A Tanker aircraft delivered to the warfighter may not be operationally effective, suitable, and survivable.

[redacted]

Appendix B: Timeline



55

~~FOR OFFICIAL USE ONLY~~

Other Government Agency Reports on Tanker Related Issues:

General Accountability Office:

- GAO Report to Congressional Committees. US Combat Air Power, "Aging Refueling Aircraft Are Costly to Maintain and Operate. GAO/NSIAD-96-160," August 1996.
- GAO Briefing for the Senate Armed Services Committee, "Preliminary Information on Air Force Tanker Leasing Issues. GAO-02-724," May 2002.
- GAO Testimony Before the Subcommittee on Projection Forces, Committee on Armed Services, House of Representatives. Military Aircraft. "Information on Air Force Aerial Refueling Tankers, GAO-03-938T," June 24, 2003.
- GAO Testimony Before the Committee on Armed Services, House of Representatives. Military Aircraft, "Considerations in Reviewing the Air Force Proposal to Lease Aerial Refueling Aircraft, GAO-003-1048T," July 23, 2003.
- GAO Testimony Before the Committee on Commerce, Science, and Transportation, United States Senate, Military Aircraft," Observations on the Air Forces Plan to Lease Aerial Refueling Aircraft, GAO-03-1143T", September 3, 2003.
- GAO Testimony Before the Committee on Armed Services United States Senate, Military Aircraft, "Observations on the Proposed Lease of Aerial Refueling Aircraft by the Air Force, GAO-03-923T," September 4, 2003.
- GAO Letter, Committee on Armed Services, United States Senate, Subject: Military Aircraft. Institute for Defense Analyses Purchase Price Estimate for the Air Force's Aerial Refueling Aircraft Leasing Proposal, GAO-04-164R, October 14, 2003.
- GAO Letter, Committee on Armed Services, United States Senate, Subject: Military Aircraft: Observations on DoD's Aerial Refueling Aircraft Acquisition Options, GAO-04-169R, October 14, 2003.
- GAO Report to Congressional Requesters, Military Aircraft, "DoD Needs to Determine Its Aerial Refueling Aircraft Requirements, GAO-04-349," June 2004.

Congressional Budget Office:

- CBO Paper "The Effects of Aging on the Costs of Operating and Maintaining Military Equipment," August 2001.
- CBO letter to Congressman, regarding alternatives for modernizing the Air Force's fleet of tanker aircraft. May 7, 2002.
- CBO letter to Congressman regarding the report on leasing four Boeing 767 aircraft. July 23, 2002.
- CBO "Assessment of the Air Force's plan to Acquire 100 Boeing Tanker Aircraft," August 2003.
  - Given to Congressman in response to his request on August 26, 2003.
  - Briefed before the Committee on Commerce, Science, and Transportation United States Senate on September 3, 2003.
  - Briefed before the Committee on Armed Services United States Senate on September 4, 2003.
- CBO letter to Congressman regarding the cost of leasing 20 tanker aircraft and buying 80 under the negotiated financing arrangement or leasing 20 tanker aircraft and buying another 80 using separate new contracts. November 13, 2003.

Industrial College of the Armed Forces, National Defense University:

- Industrial College of the Armed Forces, National Defense University, "Tanker Lease Program: Acquisition 'Lessons Learned' or 'The Innovator's Dilemma'," April 20, 2004.

Defense Acquisition University:

- Defense Acquisition University, "Tanker Lease Program: Acquisitions 'Lessons Learned' or 'The Innovator's Dilemma?'," September 3, 2004.

Defense Science Board:

- Defense Science Board Task Force Report on Aerial Refueling Requirements, Ma 2004.

Inspector General of the Air Force:

- The Inspector General of the Air Force, "Report of Investigation (S6329P) MS. Darleen A. Druyun (SES) and [redacted]," August 2002.

Air Force Audit Agency:

- "KC-135 Aircraft Engine replacement Requirements F-2003-011-FC4000," April 21, 2003.
- "Program Office Preparation for the KC-767A Aerial Tanker Acquisition, F2004-0005-FC3000," August 2004.

RAND:

- RAND, "Investigating Optimal Replacement of Aging Air Force Systems," 2003.
- RAND, Project Air Force, "Common Replacement Asset (CRA) Study Results Briefing, DB-419-AF", 2003. [Restricted distribution not for public release]

Appendix C. Chronology of Events

The following is a not-all-encompassing chronology of events that correlate with the Timeline in Appendix B. The chronology of events provides an overview of what happened and who was accountable during the structuring and negotiating of the proposed lease contract for the Boeing KC-767A Tanker Program. The chronology of events is based on selected e-mails, memorandums, and excerpts from interviews that representatives from the Department of Defense Office of the Inspector General conducted of senior Office of the Secretary of Defense and Air Force officials associated with the Boeing KC-767A Tanker Program.

August 1996. In August 1996, the General Accounting Office (renamed the Government Accountability Office) issued a report, "Aging Refueling Aircraft are Costly to Maintain and Operate." The report stated that the KC-135 tanker aircraft were 30 to 40 years old and as a result were taking progressively more time and money to maintain and operate. However, the Air Force did not have immediate plans to replace the KC-135 aircraft because the Air Force considered the replacement of other aircraft (for example the C-5A and C-17 transport aircraft) a higher priority. At about the same time, the Air Force moved the date for beginning to replace the KC-135 tanker aircraft fleet from FY 2007 to FY 2013. Further, the General Accounting Office report stated that:

- In addition to refueling aircraft, the Air Force used the tanker fleet as cargo aircraft and suggested that the Air Force study replacing the KC-135s with dual-role aircraft for both the air refueling and airlift missions which might then enable the Air Force to begin recapitalizing the tanker fleet earlier than programmed.

- The Boeing Company projected that the KC-135 tanker aircraft could fly for many years beyond the turn of the century based on the average hours flown and a projected use of about 300 hours a year per aircraft. However, the report noted that the Boeing projection did not consider the effects of corrosion, widespread fatigue damage, and stress corrosion cracking on structural life, which could require major structural modifications and parts replacement.

- The Air Force extended depot maintenance time and cost growth and the deferral of some aircraft depot maintenance because actual maintenance costs were higher than budgeted amounts.

- Substantial projected costs were required to modify the KC-135 aircraft to improve reliability, maintainability, and capability, and to sustain the aircraft.

- Although aircraft replacement may be less than one-for-one, estimated cost to replace the KC-135 aircraft would be expensive. Preliminary cost estimates ranged from about $100 million to $150 million for each replacement aircraft and would compete with other acquisition programs.

[redacted]

- If a limited number of tanker replacement aircraft were acquired annually, most of the KC-135 aircraft would operate well past 2020.

Subsequently, the Air Force studied tanker requirements and KC-135 economic service life and concluded that the KC-135s were viable until 2040.

June 1999. In June 1999, the Air Force began the "Tanker Requirements Study (TRS-05)" and completed it in February 2001. The Tanker Requirements Study determined the number of tanker aircraft and aircrews required to meet air-refueling requirements for 2005 and identified significant shortfalls in air refueling aircraft needed to support national strategy.

August 1999. In August 1999, the Air Force began the "KC-135 Economic Service Life Study" and released it on February 9, 2001. The purpose of the Study was to provide the best possible information for senior leadership to make an informed decision on retirement or modernization of the KC-135 fleet. The Study did not make a specific recommendation on the retirement date, but provided the necessary source information to ensure a robust air refueling capability for the then next 40 years and beyond. The results of the KC-135 Economic Service Life Study and the Tanker Requirements Study (TRS-05) were to be the cornerstone of Air Mobility Command's Analysis of Alternatives for air refueling that was scheduled to begin in June 2001.

The KC-135 Economic Service Life Study focused on the cost of sustaining the KC-135 fleet through the year 2040 and related aircraft availability issues. The Study reflected forecast modification and operations and support costs without considering current and future budget constraints. The most likely aircraft availability projections were based on the assumption that suggested structural improvements and modifications were fully funded. Aircraft available would most likely improve from 292 aircraft in 2001 to a high of 342 aircraft in 2006 and then decrease to 290 aircraft in 2040.

The Study stated that depot level airframe and engine maintenance were the primary cost drivers to sustain the KC-135 fleet through 2040 and the airframe structural integrity of the KC-135 fleet remained strong. The Study estimated that the costs to maintain the aircraft structural integrity would increase from $321.0 million in 2001 to $1.1 billion annually in 2040. Further, the Study stated that aging-related structural repairs because of corrosion would continue to increase at a manageable rate. Repairs due to fatigue were insignificant and expected to remain so. In addition to routine depot repairs, fuel tank topcoat removal, the cost of overhauling the KC-135D/E model engine struts, plus three other notional major fleet wide repair programs had been identified and included. The Study stated that future engine costs would likely increase at a growth rate similar to their respective commercial equivalent engines.

October 2000. Air Force began preparing "Mission Need Statement (MNS) for the Future Air Refueling Aircraft AMC [Air Mobility Command] 004-01."

February 2001. During the first half of CY 2001, Program Analysis and Evaluation studied leasing verses buying capital assets and concluded that leasing was more expensive than purchasing capital assets. Also during the first half of

[redacted]

CY 2001, RAND Project Air Force,[4] investigated the optimal time to replace some Air Force systems, including the KC-135 tanker aircraft fleet and provided the Air Force their results as briefings. In October 2003, as a result of its studies, the RAND Corporation issued a report, "Common Replacement Asset (CRA) Study Results Briefing, DB-419-AF."[5]

On February 5, 2001, [redacted]

- [redacted]
- [redacted]
- [redacted]
- [redacted]
- [redacted]
- [redacted]

May 2001. On May 7, Mr. William Schneider, Jr., Chairman, Defense Science Board, at the suggestion of [redacted] Chairman, National Economic Council met with finance specialists at Citicorp (New York) to brief Citicorp on DoD interest in applying commercial financing techniques to selected DoD assets, including a replacement aerial tanker for the existing fleet of 500 KC-135 tanker aircraft, and to obtain Citicorp views on statutory and regulatory obstacles that prevent the use of commercial lease finance techniques to permit DoD to finance capital asset acquisitions and the sale-leaseback of DoD real property. Subsequently, the Secretary of Defense asked Dr. Dov Zakheim, Under Secretary of Defense (Comptroller) on May 11, 2001, to initiate a process to get commercial financing techniques moving and to coordinate with the appropriate people, including the DoD Office of General Counsel.

[4] Project Air Force (PAF), a division of RAND, is the U.S. Air Force's federally funded research and development center for studies and analyses. Project Air Force provides the Air Force with independent analyses of policy alternatives affecting the development, employment, combat readiness, and support of current and future aerospace forces.

[5] The study is subject to a restricted distribution, not for public release.

[redacted]

June 2001. On June 28, Brigadier General Daniel P. Leaf, Chairman, Air Force Requirements Oversight Council issued a memorandum, "Future Air Refueling Aircraft; AMC 004-01 (ACAT1)," in which he stated that the Air Force Requirements Oversight Council had reviewed the "Mission Need Statement (MNS) AMC 004-017 for AMC Future Air Refueling Aircraft" and concurred with the document as written. Further, the Chairman stated that the mission need had been defined through the Tanker Requirements Study – 05 and an Economic Service Life Study.

End of June 2001. An acquisition decision memorandum was signed for Milestone A, approval to enter technology development phase, that authorized the analysis of alternatives.

September 2001. Events of September 11, 2001, accelerated Air Force efforts to begin recapitalization of the aging KC-135 fleet.

On September 25, Boeing (Messrs [redacted] met with Ms. Darleen A. Druyun, Principal Deputy Assistant Secretary of the Air Force (Acquisition and Management) to discuss the revised Boeing KC-767A tanker aircraft proposal. Discussions involved the leasing of tanker aircraft, building 18 to 20 tanker aircraft per year, a 10-year lease, replacing 136 KC-135E models with 100 Boeing KC-767A aircraft, and working with Congress, including a Senator and a Representative. As a result of the meeting, [redacted] at Boeing was tasked to develop briefs on the tanker aircraft lease concept by September 26, 2001, for [redacted] and Ms. Druyun to take to Capital Hill.

On September 27 and 28, 2001, [redacted]

October 2001. On October 7, Ms. Druyun prepared a draft letter to a Representative concerning the "jump-starting" of a replacement program for the KC-135 tanker fleet. She forwarded the draft to Major General Essex, Director of Global Reach Programs, Office of the Assistant Secretary of the Air Force (Acquisition). On October 9, 2001, per the direction of Major General Essex, the draft was forwarded to the Office of the Secretary of the Air Force. On October 9, 2001, Dr. James G. Roche, Secretary of the Air Force sent a letter to a

[redacted]

Representative, which was basically the same as the draft prepared by Ms. Druyun. In the letter, the Secretary stated:

> Dear [Representative]:
>
> I appreciate your interest in jump-starting the replacement program for our venerable KC-135 tanker fleet. These critical aircraft, which are the backbone of our nation's Global Reach capability, have an average age of over 41 years and are becoming more and more expensive to maintain. Due to the effects of age, these aircraft are spending over 300 days on average in depot maintenance, which affects our ability to respond to the many global demands on our force.
>
> I strongly endorse beginning to upgrade this critical warfighting capability with new Boeing 767 aircraft. If Congress provides the needed supporting language, we could initiate this program through an operating lease with an option to purchase the aircraft in the future. This leasing approach will allow more rapid retirement and replacement of the KC-135Es. However, if the Congress determines this approach is not advisable, completing the upgrade through the purchase of new 767 airframes beginning in FY 02 will be in the best interest of the Air Force. To implement this transition, we intend to work with the USD(AT&L) and the OSD [Office of the Secretary of Defense] Comptroller to amend the FYO3 budget currently being vetted through the Department.
>
> From the warfighter's perspective, this initiative could provide the opportunity to expand our tanker vision from air refueling and limited airlift to include other key mission areas. We intend to consider elements of command and control, as well as intelligence, surveillance, and reconnaissance (ISR) for the KC-X-in other words, a smart tanker. This initiative will further enhance our efforts to expedite development and fielding of a Joint Stars Radar Technology Improvement Program on a 767 multi-mission command and control aircraft platform which we are hopeful the Congress will also expedite in the FY02 Appropriations Act.
>
> I very much appreciate your support in the FY02 Appropriations Act as we work to upgrade our overburdened tanker and ISR fleets. Your interest and support are crucial as we move forward with this critical recapitalization effort.

On October 12, 2001, [redacted]

[redacted]

[redacted]

On October 15, 2001, [redacted] at Boeing helped the Air Force prepare a draft legislation memorandum concerning the tankers. According to [redacted] Boeing representatives met with Ms. Druyun on October 16, 2001, to discuss revised language in the draft legislation. Ms. Druyun instructed Major General Essex to only send the draft legislation to a congressional staffer.

On October 17, 2001, the Joint Requirements Oversight Council approved the "Mission Need Statement (MNS) for Future Air Refueling Aircraft AMC 004-01." In a memorandum, "Future Air Refueling Aircraft Mission Need Statement (MNS)," to the Under Secretary of Defense for Acquisition, Technology, and Logistics, General Peter Pace, Vice Chairman of the Joint Chief of Staff stated that:

> The Joint Requirements Oversight Council (JROC) validated and approved the Future Air Refueling Aircraft MNS [Mission Need Statement] and has assigned a Joint Potential Designator of 'Joint Interest' to the program. The JROC designates the Air Force and Air Mobility Command as the lead component and command for this program. In addition, the JROC directs [that] the program return to brief the results of the Air Force's Tanker Support Requirements Study 2005 and Economic Service Life Study upon their approval, and the Future Air Refueling Aircraft Analysis of Alternatives upon its completion.

October 30, 2001, the Air Force formed a "High Power Team" in Washington, DC to prepare a draft operational requirements document. The team included Air Mobility Command, Air Logistics Center, and Aeronautical Systems Center experts. However, before preparing the operational requirements document, the Air Force did not conduct an analysis of alternatives to make an analytical comparison of the operational effectiveness, suitability, and life-cycle costs of alternatives to determine the optimum solution to satisfy the capability needs in the Mission Need Statement as required by the then current version of the Chairman of the Joint Chiefs of Staff Instruction 3170.01B, "Requirements Generation System," April 15, 2001.

[redacted]

November 2001. On November 1, Mr. Aldridge, Under Secretary of Defense for Acquisition, Technology, and Logistics, and Dr. Zakheim, Under Secretary of Defense (Comptroller) issued a memorandum, "Multiyear Leasing of Capital Assets," to the Secretaries of the Military Departments; the Commander in Chief, Special Operations Command; and the Directors of the Defense Agencies. In the memorandum, the Under Secretaries stated that "Leasing has several potential benefits to the Department and provides greater flexibility in dealing with changing requirements. The Department needs to use multiyear leases as a means of acquiring capital assets where it makes good business sense." Further, the Under Secretaries stated that they were jointly establishing a Leasing Review Panel and requested that the addressees identify candidate programs for acquisition by means of multiyear leases. The Under Secretaries also stated that the Panel would review all lease proposals projected to cost a total of $250 million or more over the life of the lease. After review of the proposals, the Panel would make recommendations to the Defense Acquisition Board or the DoD Chief Information Officer.

On November 1, 2001, General Charles T. Robertson, Junior, Commander, Air Mobility Command signed the "Mission Need Statement (MNS) for Future Air Refueling Aircraft AMC 004-01." The Mission Need Statement stated in part that:

> General Capabilities. The air refueling aircraft should have sufficient range and offload capability to support both inter- and intra-theater missions, be able to refuel the full range of receiver aircraft within a safe operating envelope, and be capable of carrying and off- loading a fuel type other than the primary fuel used by the new aircraft. The aircraft should be capable of refueling receptacle and probe-equipped receiver aircraft on the same mission, as well as refueling multiple aircraft simultaneously. The potential to maximize fuel off-load rates within receiver on-load capabilities is required *AFDD 2-6.2. Air Refueling Doctrine*, indicates a need for the air refueling aircraft to also be capable of on-loading fuel as a receiver from other air refueling aircraft. Additionally, the aircraft must have the capability to rapidly progress from a ground non-start condition to airborne condition in order to meet short-notice alert launch timing requirements. The air refueling aircraft should have increased fuel efficiency and be self sufficient, capable of deploying with its own support equipment and personnel. Using forward area refueling point (FARP) procedures, aircraft should be able to offload fuel on the ground to other aircraft or bladders at a forward location. The aircraft should also be capable of airlifting passengers and cargo while supporting/performing air refueling operations. Future fiscal constraints demand the most efficient use of air refueling assets and dictate that tomorrow's air refueling aircraft provide a more flexible, multi- mission service. An integral, multi-mission capability requirement exists to augment secondary combat mission support needs such as carrying bulk cargo, transporting troops, and supporting emergency aeromedical evacuation. Effective use of excess capacity within the aircraft during forward deployment and redeployment can reduce the use of other airlift assets. To maximize/optimize global commitments, the future tanker requires instantaneous, survivable, communications and a worldwide navigation capability.
>
> Risk/Shortfalls. Continued successful mission accomplishment of this crucial air refueling responsibility is at risk due to increasing demands and decreasing availability as a result of aircraft aging. This risk is

[redacted]

outlined in the Tanker Requirements Study 2005 (TRS-05) and the KC-135 Economic Service Life (ESL) Study.

ESL Study. Historically, availability has been decreasing due to maintenance and modification requirements of the aging fleet. The ESL Study indicates that the cost of continuing to operate the existing air refueling force is escalating. The average age of the KC-135 aircraft is 41 years. Corrosion, major structural repairs, and an increase in inspections are major drivers in increased cost and time spent in depot, which is leading to a decrease in operational aircraft availability. For example, an unscheduled aircraft inspection involving the stabilizer trim system recently resulted in a short-term, but significant, decrease in aircraft mission capable rates. Other age-related concerns are the increasing costs for engine overhauls and strut repairs, especially for the KC-135E model. *There is also concern for anti-corrosion* "topcoat" flaking from inside wing fuel tanks. Another issue of significance with the aging KC-135 aircraft is the decreasing availability of spare and replacement part suppliers. The existing KC-10 fleet is much younger, but the first aircraft will pass the 20-year milestone in 2001. As the KC-10 fleet continues to age, increases in maintenance and modification costs, with a decrease in availability can be expected.

Timing and Priority. Air Mobility Strategic Plan 2000 outlines timing and priority for the air refueling mission area. Initially, to meet the current airlift shortfall as identified in the Mobility Requirements Study 2005, Air Mobility Command's priority is to continue with C-17 acquisition and C-5 modernization in the near-term. As the airlift priority is met, AMC [Air Mobility Command] will begin to shift resources to address the next air refueling platform in the mid-to-long-term. Air Mobility Strategic Plan 2000 envisions KC-135 aircraft retirement beginning in 2013 with the concurrent fielding of a replacement air refueling platform. However, since TRS-05 shows an air *refueling shortfall now, definition of future air refueling mission needs* and examination of opportunities for technology enhancement must begin in the near-term.

Potential Materiel Alternatives. There are several potential materiel alternatives. Currently, there is a commercially contracted effort to provide probe/drogue air refueling. Additionally, several allied nations are planning to purchase/lease modified commercial derivatives. **At this time, there are no Commercial-Off-the-Shelf (COTS), or *Government-Off-the-Shelf* (GOTS) materiel alternatives readily available to meet the future air refueling mission need.** [Emphasis added.] However, there are several commercial concepts to modify commercial and military aircraft for an air refueling role. These concepts will be evaluated during the future air refueling Analysis of Alternatives (AoA). A service life extension program (SLEP) and new development effort using innovative concepts will also be evaluated during the AoA. Additionally, consideration will be given for the potential of an inter-command/service common replacement aircraft. Of primary concern affecting the designs and selection of an *air refueling capability is its* ability to reliably carry sufficient fuel for off-load to US military and allied/coalition air forces.

On November 7, 2001, [redacted] *Air Force Aeronautical Systems* Center, provides a draft of the KC-767 Operational Requirements Document, dated November 5, 2001, to [redacted] Boeing Military Aircraft, Derivative Airplane Programs.

On November 8, 2001, Dr. Marvin R. Sambur becomes the Assistant Secretary of the Air Force (Acquisition). In an interview with representatives of the

[redacted]

Department of Defense Office of the Inspector General, Dr. Sambur stated that, when he first assumed his new position as the Assistant Secretary of the Air Force (Acquisition), he spoke to Mr. Aldridge, Under Secretary of Defense for Acquisition, Technology, and Logistics, about the KC-767 tanker aircraft lease initiative and the DoD 5000 series of directives (the Defense Acquisition System). Dr. Sambur stated that Mr. Aldridge said, "well, this [the KC-767 tanker aircraft lease initiative] is obviously not a 5000 series initiative and we will convene a special OSD [Office of the Secretary of Defense] leasing panel that he would share with Dov Zakheim, who was OSDC [Under Secretary of Defense (Comptroller)]." Further, Dr. Sambur stated that "And at the end of nearly a year period of time in which we looked at almost every aspect of this [the KC-767 tanker lease initiative], the Under Secretary, Pete Aldridge, not the Air Force, made the decision to go forward, that this was something that he thought was appropriate. It was blessed by Dov Zakheim and blessed by OMB [Office of Management and Budget]."

On November 8, 2001, [redacted]

[redacted]

[redacted]

On Friday, November 9, 2001, [redacted]

On Friday, November 23, 2001, in an e-mail to Messrs. [redacted]

- [redacted]
- [redacted]
- [redacted]
- [redacted]
- [redacted]
- [redacted]
- [redacted]

[redacted]

On November 26, 2001, in response to

December 2001. On December 3,

[redacted]

On December 5, 2001, Ms. Druyun sent an e-mail to Dr. Roche; General John P. Jumper, Air Force Chief of Staff; General Robert H. Foglesong, Air Force Vice Chief of Staff; and Dr. Sambur with a cc: to Mr. Willard H. Mitchell, Deputy Under Secretary of the Air Force (International Affairs). In the e-mail, Ms. Druyun stated that:

> [A Representative] and [congressional staff] faxed me the new language on leasing last night that will go to conference. They have fixed some of the issues but as written it is still not executable. [The Representative] called me again this AM to get my sense of its executability and this is what I said to him:
>
> -the language requires the AF [Air Force] [to] lease green 767 aircraft but procure thru separate Auth/Approp [Authorization/Appropriation] the mod to make it a tanker. This means the aircraft cost is [redacted] which I then do my fair market value 90% assessment. For a ten year lease I bust the 90% figure...its approx 116% under OMB [Office of Management and Budget] Circular A-11.
>
> -I asked if they could describe the lease for a "commercial aircraft tanker" vs [versus] green 767 a/c [aircraft] My reasoning for this is that I

[redacted]

believe Boeing can market a commercial 767 tanker which hopefully can include a boom and comm [communications] equipment for US and FMS [Foreign Military Sales] sales. This would not require the USAF [U.S. Air Force] to come up with [redacted] a copy for each a/c [aircraft] which I told him would probably be impossible to do with our current top line Writing a lease for a commercial tanker largely solves this problem Also it puts the value I would do an OMB Circular A-11 calculation on close to [redacted] and if I do it on two 5 year leases I believe I can come within the 90% rule since each is a stand along calculation SAF/IA [Air Force Deputy Under Secretary (International Affairs)] is looking at whether Boeing can have as a description in their commercial tanker some variation or options such as radios and have two commercial tanker offerings: US and FMS and non FMS subject to ITAR [International Traffic in Arms Regulations]. I should hear back on that later today.

-[A Representative] asked that I call [a congressional staffer] and discuss the changes that I would want to see happen in Conference I am awaiting his call sometime today. [The Representative] and [the congressional staffer] told me that the prohibition to eventually buying these aircraft would be changed in the next couple of years Apparently they have some backroom agreement on this The lease would then be allowed to be scored annually per discussions they have had with CBO [Congressional Budget Office] and OMB if I can meet the A-11 requirements.

I will keep you posted. Boeing by next week can have a commercial tanker ready for marketing with a boom if I get a green light from IA [Air Force Deputy Under Secretary (International Affairs)] on my questions

On December 5, 2001, in response to Ms. Druyun's December 5, 2001, e-mail, Dr. Sambur sent an e-mail to Dr. Roche, Ms. Druyun, General Jumper, and General Foglesong with a cc: to Mr. Willard H. Mitchell, Deputy Under Secretary of the Air Force (International Affairs) in which he stated that, "Since this email, Darleen [Druyun] has done an excellent job on the Hill to modify the language so that it [is] approaching the doable range."

On December 12, 2001, [redacted]

On December 12, 2001, an Office of Management and Budget official sent a letter to a Representative in which he stated that "Thank you for your letter to [a White House official] requesting that the Administration's economic stimulus package include funding for the purchase or lease of Boeing 767 aircraft as the Air Force's next generation tanker. [The White House official] has asked me to respond on his behalf." Further, the Office of Management and Budget official discussed a

[redacted]

Representative's concern about the economic well-being of the Boeing Company and stated that:

> In your letter you ask that the economic stimulus package include money for the lease or purchase of new B-767 aircraft as tankers for the Air Force. We have grave reservations about leasing these aircraft. Our analysis shows that over the long-term a lease-purchase program would be much more expensive than direct purchase of the same aircraft. With regard to the possibility of procuring the aircraft, we have now begun the programmatic and budget reviews necessary for the preparation for the FY 2003 Budget submission. In this process programs are evaluated in terms of their cost and potential military benefit. Please be assured that we will consider your request carefully as we prepare the FY 2003 Budget request.

On December 12, 2001, [redacted] Office of the Air Force Director of Global Reach Programs, Office of the Assistant Secretary of the Air Force (Acquisition) sent an e-mail to Dr. Sambur; Ms. Druyun; Lieutenant General Stephen Plummer, Air Force Principal Deputy (Acquisition); and Major General Essex, Director of Global Reach Programs, Office of the Assistant Secretary of the Air Force (Acquisition) with a cc: to [redacted] Chief, Mobility Division, Office of the Air Force Director of Global Reach Programs; and [redacted] Office of the Air Force Director of Global Reach Programs. In the e-mail, [redacted] stated that:

* * * * *

On December 13, 2001, [redacted] at Boeing sent an e-mail to [redacted]

*Removed for reason stated in the initial asterisked footnote.

[redacted]

[redacted] with a cc: to [redacted] and [redacted] in which he stated that:

[redacted]

On December 17, 2001, under Dr. Sambur's e-mail account, Major General Essex appears to have sent an e-mail to Dr. Sambur; Ms. Druyun; Lieutenant General Stephen Plummer, Air Force Principal Deputy (Acquisition); Mr. Blaise J. Durante, Air Force Deputy Assistant Secretary (Management Policy and Program Integration); [redacted] Office of the Air Force Director of Global Reach Programs, Office of the Assistant Secretary of the Air Force (Acquisition); [redacted] Office of the Air Force Director of Global Reach Programs; [redacted] Office of the Air Force Director of Global Reach Programs; [redacted] Chief, Mobility Division, Office of the Air Force Director of Global Reach Programs; and himself. The e-mail stated that:

> Dr. Sambur
> Summary of actions taken:
>
> Mrs Druyun, Boeing, and Air Staff reps met end of last week to develop and examine set of options which meet the requirements for an operating lease. Over weekend further refined these options and began building briefing which lays out an Integrated Master Schedule combining all Boeing and Government actions required to obtain congressional approval and initiate the program. We will brief this to Mrs. Druyun Wednesday at 0700, along with the matrix of options which meet the operating lease gates. The variables in the matrix are: purchase price, lease term, interest rate, residual value, and lease payment . All the options presented will meet the OMB [Office of Management and Budget] gates.
>
> I recommend that we brief Dr. Roche on Wednesday after this meeting, at which time we can also show him what he just asked for.. how we got the old numbers and what are 'the real numbers.' I think it is important to remember that the old numbers were generated on a 'pilot program' which was really a capital lease by another name That is off the table , and we need to distance ourselves from them if we can.
>
> Mrs. Druyun and Gen [General] Plummer,
> This is what I sent to Dr. Sambur, at his request. He is going to call or e-mail SECAF [Secretary of the Air Force] about 767 numbers problem. As you can see, I am recommending we try to get SECAF to wait til[l] Wednesday to discuss the lease numbers. The previous lease numbers were for a pilot program which is completely different from what we're working toward now.

[redacted]

On December 18, 2001, Mr. Jaymie Durnan, The Special Assistant to the Secretary and the Deputy Secretary of Defense sent an e-mail to Dr. Roche with a cc: to Mr. Aldridge; Brigadier General Batiste, Senior Military Assistant to the Deputy Secretary of Defense; and [redacted] In the e-mail, Mr. Durnan stated that:

> Jim,
>
> DSD [Deputy Secretary of Defense] asks that you provide him with a briefing paper on the 767 leasing issues. He would like the paper to include how the decision was made, why the decision was made to lease versus buy, the costs involved, the scoring issues involved, the advantages and disadvantages of leasing versus buying, were there alternatives to the 767 and what were they, and other relevant issues you deem appropriate. It would be helpful to give him a scorecard of why [a Senator], et al. are so opposed to it.
>
> He asks if you can provide the paper by cob [close-of-business] today and, if necessary, would like to schedule a meeting with Pete [Aldridge] Dov [Zakheim] and you tomorrow to discuss the issue

January 2002. On January 8, Brigadier General (Select) Ted F. Bowlds, Program Executive Officer for Strategic Programs, Office of the Assistant Secretary of the Air Force (Acquisition) sent an e-mail to Dr. Sambur, Ms. Druyun, and Lieutenant General Stephen Plummer with a cc: to Major General Essex; [redacted] Office of Air Force Strategic Programs; [redacted] and [redacted] In the e-mail, he stated that:

> Sirs and Mrs. Druyun;
>
> A follow-up to our discussion at the staff meeting this morning The top-talent in AQQ [Office of the Director of Global Reach Programs] is way ahead of me and have a draft version of the ORD [operational requirements document] in hand There has been some preliminary work done on the effort required to go from the 'commercial' version of the tanker to the requirements in the ORD (I'm calling this a Delta Document for now). **This may be somewhat biased since it's a Boeing only look at this point**. [Emphasis added.]
>
> It seems the logical next step based on our discussion is once the initial SPO [system program office] cadre is identified, to have them complete the effort on this Delta Document and eliminate any biases Initial fact finding by another name
>
> My suggestion would be to have this cadre plus representatives from AMC [Air Mobility Command] come here to DC [District of Columbia] and work directly with Boeing to develop this document. Once Gen [General] Lyles [Commander, Air Force Materiel Command] identifies the people and the ORD is formally inside the beltway, this effort can start.
>
> I talked with AMC, the ORD started it's two-letter coordination today

On January 10, 2002, in Section 8159 of the Department of Defense Appropriations Act for FY 2002, Congress authorized the Air Force to make payments on a multiyear pilot program for leasing not more than 100 general purpose Boeing 767 aircraft for not more than 10 years per aircraft, inclusive of any options to renew or extend the initial lease term, and for not more than

[redacted]

90 percent of the fair market value of the aircraft obtained under the lease. Specifically:

SEC. 8159. MULTIYEAR AIRCRAFT LEASE PILOT PROGRAM

(a) The Secretary of the Air Force may, from funds provided in this Act or any future appropriations Act, establish and make payments on a multiyear pilot program for leasing general purpose Boeing 767 aircraft and Boeing 737 aircraft in commercial configuration.

(b) Sections 2401 and 2401a of title 10, United States Code, shall not apply to any aircraft lease authorized by this section.

(c) Under the aircraft lease Pilot Program authorized by this section:

(1) The Secretary may include terms and conditions in lease agreements that are customary in aircraft leases by a non-Government lessor to a non-Government lessee, but only those that are not inconsistent with any of the terms and conditions mandated herein.

(2) The term of any individual lease agreement into which the Secretary enters under this section shall not exceed 10 years, inclusive of any options to renew or extend the initial lease term.

(3) The Secretary may provide for special payments in a lessor if the Secretary terminates or cancels the lease prior to the expiration of its term. Such special payments shall not exceed an amount equal to the value of 1 year's lease payment under the lease.

(4) Subchapter IV of chapter 15 of title 31, United States Code shall apply to the lease transactions under this section, except that the limitation in section 1553(b)(2) shall not apply

(5) The Secretary shall lease aircraft under terms and conditions consistent with this section and consistent with the criteria for an operating lease as defined in OMB Circular A-11, as in effect at the time of the lease.

(6) Lease arrangements authorized by this section may not commence until:

(A) The Secretary submits a report to the congressional defense committees outlining the plans for implementing the Pilot Program. The report shall describe the terms and conditions of proposed contracts and describe the expected savings, if any, comparing total costs, including operation, support, acquisition, and financing, of the lease, including modification, with the outright purchase of the aircraft as modified.

(B) A period of not less than 30 calendar days has elapsed after submitting the report

(7) Not later than 1 year after the date on which the first aircraft is delivered under this Pilot Program, and yearly thereafter on the anniversary of the first delivery, the Secretary shall submit a report to the congressional defense committees describing the status of the Pilot Program. The Report will be based on at least 6 months of experience in operating the Pilot Program

(8) The Air Force shall accept delivery of the aircraft in a general purpose configuration.

(9) At the conclusion of the lease term, each aircraft obtained under that lease may be returned to the contractor in the same configuration in which the aircraft was delivered.

(10) The present value of the total payments over the duration of each lease entered into under this authority shall not exceed 90 percent of the fair market value of the aircraft obtained under that lease

(d) No lease entered into under this authority shall provide for—

(1) the modification of the general purpose aircraft from the commercial configuration, unless and until separate authority for such conversion is enacted and only to the extent budget authority is provided in advance in appropriations Acts for that purpose; or

[redacted]

(2) the purchase of the aircraft by, or the transfer of ownership to, the Air Force.
(e) The authority granted to the Secretary of the Air Force by this section is separate from and in addition to, and shall not be construed to impair or otherwise affect, the authority of the Secretary to procure transportation or enter into leases under a provision of law other than this section.
(f) The authority provided under this section may be used to lease not more than a total of 100 Boeing 767 aircraft and 4 Boeing 737 aircraft for the purposes specified herein.

February 2002. From February 5 through 8, operational requirements document meeting in Airlifter Hall at Air Mobility Command. Boeing had already received draft operational requirements document and was discussing how to meet Air Force requirements with a matrix.

On February 14, 2002, Ms. Druyun sent an e-mail to Dr. Roche, General Jumper, Dr. Sambur, and Major General Essex in which she stated that:

> Based on your hearing on Tuesday I am developing a draft CFI [contractor-furnished information] that would go to both Boeing and Airbus that lays out our requirements and asks that each contractor respond using a matrix we are developing that will identify and substantiate there ability to meet the requirements and begin delivery in FY05. The matrix will establish clear definitions to color code and identify the level of risk to satisfy the requirement. Data will be required to be submitted to substantiate any item that is color coded green or low risk. I plan showing this to you on Tuesday for your input and our plan to flush out the reality of a competition. In addition I have some data from the recent competition conducted by the Italians. We are also researching the requirements of the "Buy America"

On February 14, 2002, Dr. Roche responded to Ms. Druyun's e-mail and stated that:

> Darleen [Druyun], terrific. In the case of Airbus, we probably should note 'if you desire to do so,' or to ask them to request a CFI [contractor-furnished information]. Right? Or, unnecessary? Thanks much. We will need to do this as the prelude to a 'buy' if the lease can't easily be explained to [a Senator]. We will also have to vet the history of compliance with the FPCA. Finally, Speedy has a idea that is attractive: have the Germans and French agree to buy C-17's, and we give Airbus the chance to compete on blocks of tankers. Other than raising the hackles of certain Members, this could avoid the dependence on a single class of aircraft, and will avoid monopoly. Paul W [Wolfowitz] wants me to set up an Aldridge/Feith/Roche/DSD [Under Secretary of Defense for Acquisition, Technology, and Logistics/Under Secretary of Defense for Policy/Secretary of the Air Force/Deputy Secretary of Defense] discussion I'd appreciate your and Marv's [Dr. Sambur] thoughts on Tuesday

On February 14, 2002, Ms. Druyun responded to Dr. Roche's e-mail with an e-mail to Dr. Sambur; Mr. John P. Janecek, Air Force Deputy General Counsel (Acquisition); Ms. Mary L. Walker, Air Force General Counsel; and Major General Essex. In her response, Ms. Druyun stated that:

[redacted]

> You are right on about doing this as a prelude to a buy. I am hopeful we can smoke out the data we need to be able to look anyone in the eye and tell them why we are or are not conducting a competition. I am working with Jon Janecek....Speedy's idea is great or We will get on your calendar

On February 14, 2002, concerning Dr. Roche's response to Ms. Druyun's e-mail, Major General Essex sent an e-mail to Brigadier General Bowlds in which he stated that:

> Ted
> I think we should keep this close hold for now and just tell our AOs [action officers] the parts they need to know. The idea of a C-17 deal is appealing to some and appalling to others.
> Bill

On February 20, 2002, Brigadier General Darryl A. Scott, Deputy Assistant Secretary (Contracting), Office of the Assistant Secretary of the Air Force (Acquisition) signed out a request for information to The Boeing Company and Airbus North America, Inc. (European Aeronautic Defence and Space Company, Incorporated) to begin the Air Force's market research and assess market capabilities in the area of commercial aerial tankers.

On February 20, 2002, [redacted]

[redacted]

On February 26, 2002, [redacted] Aeronautical Systems Center sent an e-mail to [redacted] Mobility Division, Air Force Director of Global Reach Programs; [redacted] Air Force Strategic Programs, Office of the Assistant Secretary of the Air Force (Acquisition); and [redacted] Air Mobility Command with a cc: to [redacted] and [redacted] at the Aeronautical Systems Center. In his e-mail, [redacted] stated that:

> Given the competitive path we are now marching down, [I] request [and] direct [that] you terminate all contacts with Boeing, to include planned facility visits, until the competitive vs sole source decision is reached There is an RFI [request for information] briefing to Mrs. D [Druyun] on 18 March after which I am sure a decision will be made as to which direction we are marching. As the attached states, contact ASC/GRC [Aeronautical Systems Center] to discuss the issue or to seek further guidance Please pass this on to any other organizations/team members within your purvue [purview]

March 2002. On March 6, Air Force receives request for information responses from Boeing and Airbus.

On March 21, 2002, [redacted] Aerial Refueling Systems, Naval Air Systems Command, sent an e-mail to [redacted] Air Mobility Command with a cc: to [redacted] and [redacted] in which he stated:

> I've been in touch with [redacted] from RADM [Rear Admiral] Chanik's office (N780) following our phone conversation where you stated to me that the Navy's position with regard to the replacement tanker aircraft for the KC-135 was to have redundancy via a single centerline hose reel and a boom vice the capability to refuel two receiver aircraft simultaneously which also satisfies the redundancy issue. The enclosed table, which according to [redacted] was sent to your office in response to N780's first look at the ORD [operational requirements document], clearly states that 'The aircraft must have the capability to refuel two receivers simultaneously (THRESHOLD)' To date, the ORD still does not reflect our requirements.
>
> I am also in the process of gathering qualitative data supporting our position from carrier airwings returning from Afghanistan and Operation Southern Watch as well as our clearing house for airwing lessons learned, NSAWC [Naval Strike Air Warfare Center]
>
> Please call me if you would like to discuss this further.

On March 21, 2002, [redacted] Chief, Mobility Division, Office of the Air Force Director of Global Reach Programs sent an e-mail to Major General Essex, Director of Global Reach Programs, Office of the Assistant Secretary of the Air Force (Acquisition) with a cc: to [redacted] Office of the Air Force Director of Global Reach Programs; Lieutenant [redacted] Office of the Air Force Director of Global Reach Programs; [redacted] Office of the Air Force Director of Global Reach Programs; [redacted] Office of the Air Force Director of Global Reach Programs; [redacted] Office of the Air Force Director of Global Reach Programs; and [redacted] Office of the Air Force Director of Global Reach Programs. In his e-mail, [redacted] stated:

[redacted]

Sir,

At the AFROC [Air Force Requirements Oversight Council] I attended today, all of the mobility programs were approved. The AFROC approved the ORD [operational requirements document] for the Commercial Derivative Air Refueling Aircraft, as well as the VIPSAM Medium Lift Aircraft Replacement ORD (AMC [Air Mobility Command]), and Global Airlift and Mission Support ORD (ANG [Air National Guard]).

Maj [Major] Gen [General] Leaf was called away just prior to start of the AFROC, so [redacted] chaired the meeting, but he was obviously up to speed on all the issues. Regarding the Navy's concern about having the capability for simultaneous drogue refueling, a Navy rep was at the AFROC, and he nodded in agreement when AMC said they had resolved the issue with the Navy, and that the capability would not be included in the first spiral.

The AETC [Air Education & Training Command] representative presented a couple briefing slides on their concerns about the tanker program's training. AETC was not concerned about aircrew training, but they didn't want all the maintenance training to be done by a contractor. They were concerned, for example, about airmen going directly from BMT [basic military training] to contractor-conducted training and how they would miss the additional military training (or 'bluing') they would normally get at Sheppard After discussion, the AFROC consensus and decision was to approve the ORD as written-the final solution didn't need to be defined at this point, the ORD says, 'TSRA/BCA [Training System Requirements Analysis/Business Case Analysis] will be conducted to determine the most effective training system (contractor, organic, mix) '

Someone from the AFROC staff mentioned that recent AFMC e-mails raised some concerns about how the tanker ORD was written. AMC and the AFROC chair noted some room for improvement in how future ORDs are written, as well as the unique nature of the schedule/background surrounding this ORD. No further discussion or action ensued.

AMC is still working numerous minor comments from the Joint Staff 0-6 level review, but it's cleared by the Air Force to press on towards a JROC [Joint Requirements Oversight Council] in Jun[e] 02.

On March 25, 2002, in response to [redacted] e-mail, Major General Bill Essex sent an e-mail to [redacted] with a cc: to [redacted] and [redacted] in which he stated:

[redacted]

I need to know specifically, who from AMC [Air Mobility Command] talked to whom in the Navy and what was said and agreed upon.

On March 25, 2002, in response to Major General Bill Essex's e-mail, [redacted] sent an e-mail to [redacted] Chief, Systems Requirements Division, Directorate of Plans and Programs, Air Mobility Command with a cc: to [redacted] Air Mobility Command; [redacted] and [redacted] in which he stated:

[redacted]

[redacted]

My comment in the e-mail below about AMC [Air Mobility Command] reaching an agreement with the Navy, was based on remarks at the AFROC [Air Force Requirements Oversight Council] by you and/or [redacted] (at least as I recalled and understood what you said) Can you provide any more specifics?

On March 25, 2002, in response to [redacted] e-mail, [redacted] sent an e-mail to [redacted] with a cc: to [redacted] Air Mobility Command; Lieutenant [redacted] Air Mobility Command; [redacted] Air Mobility Command; and [redacted] in which he stated:

[redacted]

Here's some specifics regarding our resolution of the Navy's critical comment on simultaneous air refueling capability for the commercial derivative air refueling aircraft and Gen [Major General] Essex' query on 'who from AMC [Air Mobility Command] talked to whom in the Navy and what was said and agreed upon '

Background: The Navy, OPNAV N780, provided the following critical comment to the Commercial Derivative Air Refueling Aircraft ORD [operational requirements document]: Reference para 4.1.2.1.2, **Critical:** Change sentence to read: '*The aircraft must have the capability to refuel two receivers simultaneously* (THRESHOLD).' [redacted] N780G1, was identified in a letter signed by Rear Admiral Chanik as the POC [point of contract] for the Navy comments.

AMC [Air Mobility Command] resolution was: **Accepted:** Para 4 1 2 1 2 changed to include, 'The capability to refuel two receivers *simultaneously is required* (THRESHOLD). An analysis will be conducted to determine the proper number of aircraft required to have simultaneous refueling capability For aircraft not modified with simultaneous refueling capability, a second drogue system for redundancy is desired (OBJECTIVE).'

'Who from AMC talked to whom in the Navy and what was said and agreed upon?' [redacted] and [redacted] spoke to [redacted] on 12 Mar 02 and advised him of the exact changes (adding simultaneous air refueling as a THRESHOLD but not a KPP [key performance parameter]) that had been made to the ORD. *They pointed out that any simultaneous refueling capability* our new tanker would have adds to the existing capability in the KC-135/KC-10 fleet, as the KC-135Es that would be replaced by new aircraft do not have MPRS [multi-point refueling system]. We also pointed out that simultaneous refueling capability would be a spiral development, after an analysis was accomplished (IAW [in accordance with] the new ORD verbiage) to determine the proper number of aircraft required to have *simultaneous refueling capability. Verbal coordination* was provided by [redacted] on satisfactory resolution of the comment With regard to this issue, we have not received any additional comments on the joint 0-6 review and do not expect any.

On March 26, 2002, [redacted] forwarded [redacted] e-mail response on Major General Bill Essex with a cc: to [redacted] Global Mobility Division, Directorate of Operational Requirements, Office of the

[redacted]

Deputy Chief of Staff for Air and Space Operations; and [redacted] Director, Global Mobility Division, Directorate of Operational Requirements, Office of the Deputy Chief of Staff for Air and Space Operations. In his e-mail, [redacted] stated:

> Sir ..attached are specifics of AMC [Air Mobility Command] coord [coordination] with the Navy on simultaneous A/R [air refueling]. The current version of the ORD [operational requirements document] shows it as a threshold in spiral 2 And so far, there are no further comments from the Joint Staff.

On March 26, 2002, [redacted] Air Mobility Command sent an e-mail to [redacted] Aerial Refueling Systems, Naval Air Systems Command in response to his e-mail of March 21, 2002. In his e-mail, [redacted] stated:

> [redacted]
>
> The ORD [operational requirements document] I sent you last week might have incorrectly (typo) shown 'The capability to refuel two receivers simultaneously is required (THRESHOLD).' as spiral 1 instead of spiral 2. (see page 71 of ORD). I know I talked to you on the phone and mentioned this would be spiral 2 and we would do an analysis to determine the exact number of tankers needed to have this capability. Also, want to restate that any wing pods we would put on the CDARA [Commercial Derivative Air Refueling Aircraft] would be above and beyond what our current capability is as we are replacing the KC-135E fleet which does not have MPRS [multi-point refueling system].

On March 27, 2002, Brigadier General Bowlds requested $100 thousand for KC-767 System Program Office travel. Ms. Druyun and Major General Essex suggest using a portion of the funds for the tanker analysis of alternatives. Mr. Blaise J. Durante, Air Force Deputy Assistant Secretary (Management Policy and Program Integration) approved the use of the tanker analysis of alternatives funds for the KC-767 System Program Office travel as long as it tied to KC-767 work.

On March 28, 2002, in response to [redacted] e-mail, [redacted] sent an e-mail to [redacted] in which he stated:

> We're moving in the wrong direction again [redacted]!! Navair's position is that it needs to be spiral 1 like it says in the ORD [operational requirements document] you sent me dated 18 March I've got a call in with [redacted] to talk this over again. I think his position will be the same as ours. I'm going to Kirtland next week for the CDARA [Commercial Derivative Air Refueling Aircraft] core team meeting. You gonna [sic] be there?

On March 28, 2002, in response to [redacted] e-mail, [redacted] sent an e-mail to [redacted] with a cc: to [redacted] Air Mobility Command; [redacted] Air Mobility Command; [redacted] Office of the Air Force Director of Global Reach Programs; and [redacted] Global Mobility Division, Directorate of Operational Requirements, Office of the

[redacted]

Deputy Chief of Staff for Air and Space Operations. In his e-mail, [redacted] stated:

> [redacted]
>
> We'll have to work this out. The information we told CMD [redacted] was we will do a study to determine the number of acft [aircraft] needed with wing pods and modify those acft [aircraft] but don't need to do all 100. So there's no reason to mod the first acft [aircraft] off the line. We're checking on the Kirtland meeting It seems to be more testing focused and our guys from AMC/TE [Air Mobility Command/Test and Evaluation] will be there.

On March 28, 2002, [redacted] forwarded [redacted] e-mail to [redacted] with a cc: to [redacted] and [redacted] and stated:

> Sir,
>
> OK -maybe the Navy isn't happy with the pod solution. Email below from [redacted] says the pods must be Spiral '1,' not Spiral '2.'

On March 28, 2002, Dr. Sambur sent a letter to Mr. Aldridge in which he stated:

> [redacted]
>
> [redacted]

[redacted]

On March 29, 2002,

On March 29, 2002, Office of the Secretary of the Air Force sent an e-mail to Dr. Sambur and Ms. Druyun with a cc: to Major General Duncan J. McNabb, Office of the Air Force Deputy Chief of Staff for Plans and Programs; Office of the Air Force Deputy Chief of Staff for Air and Space Operations; Office of the

Assistant Secretary of the Air Force (Acquisition); [redacted] Executive Officer to the Air Force Chief of Staff; [redacted] Office of the Air Force Vice Chief of Staff; [redacted] Office of the Air Force Vice Chief of Staff; Mr. William C. Bodie, Special Assistant to the Secretary of the Air Force; Lieutenant General Stephen Plummer, Air Force Principal Deputy (Acquisition); Lieutenant General Charles Wald, Office of the Air Force Deputy Chief of Staff for Air and Space Operations; Lieutenant General Joseph H. Wehrle, Jr., Air Force Deputy Chief of Staff for Plans and Programs; Major General Dan Leaf, Director, Air Force Directorate of Operational Requirements; [redacted] contractor; [redacted] Confidential Assistant to the Secretary of the Air Force; [redacted] Office of the Assistant Secretary of the Air Force (Acquisition); and [redacted] Office of the Assistant Secretary of the Air Force (Acquisition). In the e-mail, [redacted] stated that:

> Sir/Ma'am
> SECAF [Secretary of the Air Force] just had a short discussion with DSD [Deputy Secretary of Defense] on our tanker deliberations. As follow-up to that discussion we need to get to DSD a short briefing to address the following:
> - Why do we need tanker modernization now
> - Why should we consider a lease
>
> While at least the first is a cross-cutting issue SECAF wants AQ [Office of the Assistant Secretary of the Air Force (Acquisition)] to pull together both and address both issues in the brief. SECAF called this 'Tanker 101.' SECAF would like to see this early the week after next, 8-12 April, and target it to DSD that same week. He also said that it be vetted with E Ring on the way to him

On March 29, 2002, as a result of [redacted] e-mail, [redacted] Office of the Assistant Secretary of the Air Force (Acquisition), on behalf of Dr. Sambur, sent an e-mail to Major General Essex and Brigadier General Bowlds with a cc: to [redacted] Office of the Air Force Director of Global Reach Programs, Office of the Assistant Secretary of the Air Force (Acquisition); [redacted] Office of the Program Executive Officer, Strategic Programs, Office of the Assistant Secretary of the Air Force (Acquisition); [redacted] Office of the Assistant Secretary of the Air Force (Acquisition); and [redacted] Office of the Assistant Secretary of the Air Force (Acquisition). In the e-mail, [redacted] stated that:

> MGen [Major General] Essex/BGen [Brigadier General] Bowlds,
> Dr Sambur requested that you and your staffs take the lead on this brief. Request that you work the brief through AQ [Office of the Assistant Secretary of the Air Force (Acquisition)] before going to the SECAF [Secretary of the Air Force] and DSD [Deputy Secretary of Defense] the week of 8th April.

April 2002. On April 1, [redacted]

[redacted]

[redacted]

83

[redacted]

[redacted]

On April 2, 2002, is the date of the final draft version of the operational requirements document, which is "locked" at this point to initiate final coordination and provide a "stabilized" position with which to negotiate with Boeing.

On April 8, 2002, negotiations with Boeing began. Air Force's position was to begin replacing the KC-135 fleet as soon as possible due to increasing challenges with maintaining a 40 plus-year old aircraft and the demands of the War on Terrorism.

On April 21, 2002, Major General Leroy Barnidge, Air Force Director of Legislative Liaison sent an e-mail to Dr. Roche; General Jumper; General Foglesong; Mr. Peter B. Teets, Under Secretary of the Air Force; Lieutenant General Joseph H. Wehrle, Jr., Air Force Assistant Vice Chief of Staff; and Ms. Druyun with a cc: to [redacted] Office of the Secretary of the Air Force; Mr. William C. Bodie, Special Assistant to the Secretary of the Air Force; [redacted] Executive Officer to the Air Force Chief of Staff; [redacted] Office of the Air Force Vice Chief of Staff; [redacted] Office of the Under Secretary of the Air Force; [redacted]

[redacted]

[redacted] Office of Legislative Liaison; [redacted] Office of Legislative Liaison; [redacted] Office of Legislative Liaison; [redacted] Office of Legislative Liaison; Major General Essex; [redacted] Office of Legislative Liaison; [redacted] Office of Legislative Liaison; and Brigadier General Thomas L. Carter, Military Assistant to the Director of Legislative Liaison. In his e-mail, Major General Barnidge discussed a meeting Ms. Druyun and Major General Essex had with congressional staff concerning the status of the KC-767 lease.

Subject: Back brief on Meeting with [a Congressional Staffer]

Escorted Ms. Druyun, Maj Gen [Major General] Essex and [redacted] over to see [a congressional staffer] today to discuss the AF [Air Force] evaluation of the responses to the tanker lease request for information (RFI). It was a very productive and worthwhile meeting on very many levels, due mainly to Mrs. Druyun's ability to speak authoritatively to all subjects She started by giving [the congressional staffer] background on how we got to where we are with respect to the RFI responses and then proceeded with the prepared briefing on the tanker lease RFI evaluation.

[The congressional staffer] seemed very interested in the process by which EADS [European Aeronautic Defence and Space Company] formulated their response to the RFI, i e., was the AF available to take their calls, did EADS believe their questions were answered timely and accurately etc. [The congressional staffer] was satisfied that EADS was provided all information requested from the AF for use in their RFI response, and that they had missed the mark. There was a short discussion on EADS's future viability and competitiveness.

[The congressional staffer] asked about the way ahead and when would the AF be able to come to the Hill with their findings.

Mrs. Druyun explained that we need to develop the classic business case along with a net present value workup IAW [in accordance with] OMB [Office of Management and Budget] Circular A-11, then present this to the OSD [Office of the Secretary of Defense] Leasing Panel after the leadership in the AF has all been briefed. She predicted this would be sometime in mid to late May.

[The congressional staffer] asked about the GAO [then General Accounting Office] process and expressed that he did not want that to slow this lease process down. He stated that the going forward with the lease satisfies the desires of Congress (mentioned the overwhelming majority of Congress wants this to go forward). He made the specific point that there is a law in the books today that tells the USAF [U S. Air Force] to go forward with a lease, so we need to go forward. Short of any change in the law we need to press forward with the lease.

[The congressional staffer] stated that [a Representative] and most Members believe the USAF needs these aircraft. He commented that the leasing approach may not be the best way to get it done but the bottom line is we need a platform and a lot of people (overwhelming majority) thought this legislation would move this process forward. [The congressional staffer] stated that if a small minority succeeds in stopping this current lease effort, we will be without a KC-135 replacement for a long time. There is a window of opportunity here that if it closes might not be available for some time. Certain Members and their staffs need to get over when they were notified-- first or last-- and get on with what is best for the country. Mrs. Druyun stated that the best she thought we

[redacted]

> would be able to negotiate is a six or seven-year lease. The driving factor for this is the market value of the aircraft at the end of the lease. **It will be very difficult to remarket 100 767 tankers.** [Emphasis added]
>
> [The congressional staffer] said several times how much he appreciated us coming. He said that there is a strong but silent majority who want this to go forward. He said he is satisfied we are moving along despite some of the official comments by the AF. He reiterated that if this falls through, re-engagement will be difficult.
>
> Several other topics were discussed:
>
> [The congressional staffer] asked about the status of the 737 lease. Mrs. Druyun stated that the business case will be tough to make. Mrs. Druyun said that she received the Boeing proposal and she did not like it. She has engaged Boeing senior management and she is working the issue to get the best deal available. [The congressional staffer] stated that the business case is not everything, that there are other factors involved. [The congressional staffer] stated there are a lot of people expecting to use of the two Ford Aerospace BBJs this July. Mrs. Druyun said she understands and will do her best. She said the results of the business case should be over to the Hill around the 20th of May.
>
> Another issue discussed pertained to the Berry Amendment (buy only American forged specialty metals), and how in this case it will significantly increase the costs of manufacture for both the 767 and 737 while allowing unfair advantages to foreign manufacturers like EADS. [The congressional staffer] was surprised by the implications and asked if relief could be provided through legislation.
>
> There were two taskers pertaining to requests from [the congressional staffer] for draft legislation:
>
> -Provide draft legislation which may provide relief/clarification on the Berry Amendment with respect to amending Section 8159 of the Approps Act.
>
> -Provide draft legislation WRT [with respect to] to Sect [Section] 8159 which provides for lease options such as lease to buy etc.

On April 22, 2002, Mr. Jaymie Durnan, The Special Assistant to the Secretary and the Deputy Secretary of Defense forwarded an e-mail from Mr. Thomas Christie, Office of the Director, Operational Test and Evaluation to Dr. Roche and Mr. William C. Bodie, Special Assistant to the Secretary of the Air Force. Mr. Christie's e-mail included a "Defense Week" article, "Private Aerial Tanker Earns Navy's Praise."

On April 22, 2002, Dr. Roche forwarded Mr. Durnan's e-mail with the "Defense Week" article, "Private Aerial Tanker Earns Navy's Praise," attached to Dr. Sambur and Ms. Druyun with a cc: to General John Handy, Air Mobility Command; General John Jumper, Air Force Chief of Staff; and Mr. William C. Bodie and stated:

> What do you all think? [A Senator] will beat us up on this, so let's do our homework. Note that Omega doesn't refuel N [Navy] aircraft near Afghanistan. There are war insurance issues, etc.

On April 22, 2002, Ms. Druyun forwarded Dr. Roche's e-mail with the "Defense Week" article, "Private Aerial Tanker Earns Navy's Praise," attached to Major

[redacted]

General Bill Essex, Director of Global Reach Programs, Office of the Assistant Secretary of the Air Force (Acquisition) and stated:

> See me on this so that we can get our ducks in order to shoot this down.

May 2002. On May 3, an Office of Management and Budget official sent a letter to a Senator in which he stated:

> Dear Senator:
>
> Thank you for your letter of April 17, 2002 in which you asked us for the preliminary results of our analysis of the following areas related to the Air Force's tanker fleet.
>
> Air Force tanker analysis related to KC-135E replacement and tanker requirements
>
> The Air Force has recently completed two studies of its tanker fleet and tanker requirements - the *KC-135 Economic Service Life Study (ESLS)* and the Tanker Requirements Study 05 (TRS-O5). The ESLS and TRS-05 were both large, detailed, computer-based analyses of the fleet and tanker requirements of which OMB [Office of Management and Budget] does not have intimate knowledge However, we are aware of the major conclusions of these studies
>
> The ESLS looked at the projected cost of maintaining the current fleet of KC-135 tankers (both the 'E' and the 'R' models) and at the availability of the aircraft as they age. The study concluded that maintenance costs would rise by $23 million/year over the next 40 years. In terms of aircraft availability, the ESLS concluded that there would be a gradual decline as the aircraft age However, study determined that only six aircraft would have to be retired before 2040 because they would exceed their airframe life. The TRS-05 examined force (in this case tanker) requirements in various strategic scenarios (the TRS-05 was based on the same scenarios and assumptions as DoD's Mobility Requirements Study 05). We understand that TRS-O5 identified tanker capacity shortfalls under some specific (classified) circumstances
>
> The Air Force proposes to replace the entire KC-135E fleet w1th 100 Boeing 767 tanker aircraft. Although the ESLS and TRS-05 did not examine the question of replacing aircraft in the existing fleet, they are pertinent to the issue since:
>
> - the current fleet consists of about 410 KC-135Rs and 126 KC-135Es in good condition, providing a total KC-135 tanker capacity of about 105 million pounds of fuel;
> - upgrading 126 KC-135Es to the 'R' model would result in a total capacity of over 106 million pounds of fuel – an increase of around 1.7 million pounds over existing capacity The estimated cost of converting the 126 'E' models to 'R' models to get this increase would be about $3.2 billion. However, the Air Force has chosen not to pursue this route; replacing 126 KC-135Es with 100 Boeing 767 tankers, while maintaining 410 KC-135Rs, would result in an overall tanker fleet capacity of about 103 million pounds of fuel – a decrease of almost 2 million pounds (because the larger capacity of a B-767 would not be enough to compensate for the less than 1:1 aircraft replacement rate). The estimated cost of the B-767s would be between $18 billion and $26 billion (the difference between direct purchase and leasing due to the cost of money).
>
> In other words, replacing the KC-135E fleet would not solve, and could exacerbate, the shortfalls identified in the TRS-05 It is quite possible

[redacted]

that greater operational availability of the new B-767 aircraft could mitigate the impact of such a reduction in total fleet capacity. We will continue to assess these issues as the Air Force develops its proposal

A cost comparison between possible alternatives for improving the tanker fleet

The Air Force's discussions with Boeing regarding leasing 100 B-767 tankers are still ongoing. We, therefore, have no basis to change our previous cost estimates for leasing or direct purchase of B-767 tanker aircraft. We believe, however, that there are four options for the tanker fleet:

- Do nothing. This is the path analyzed by the Air Force in its two studies. It results in increased long-term costs of $23 million/year paid out over 40 years, accepts the risk of shortfalls in certain scenarios, but avoids potentially large up-front costs of $3-26 billion, depending on the option
- Convert 126 KC-135'E' tanker models into KC-135'R' models. The AF [Air Force] has already conducted a re-engining and upgrade program for most of its KC-135s, to convert them to the 'R' model, which the Air Force plans to keep in service until perhaps 2030 or 2040 depending on usage. In all, the Air Force has already re-engined 410 aircraft, leaving only 126 'E' aircraft in the Air National Guard fleet with older engines that could also be converted into an 'R' model. Such an option could be achieved for an estimated cost of about $3.2 billion spread over a period of 6 years (about $525m/yr [$525 million/year]). The advantages of this option are that the fuel offload capacity of each aircraft would be increased and the total fleet capacity increased to solve some of the shortfalls identified in the TRS-05. Moreover, maintenance costs of the current aircraft would be reduced. In addition, this option would increase the capacity of the fleet sooner than other alternatives (all converted aircraft could be delivered by 2009).
- Direct purchase of 100 Boeing 767 tanker aircraft and retirement of the KC-135E fleet. Based on a price of $150 million per airplane, which we understand is a reasonable possibility, and including required military construction, this option would cost approximately $18 billion and would not be complete before 2011/12. The Air Force would have to fully fund these aircraft in its budget request. New B-767s would provide the Air Force with all the advantages of a modern aircraft with greater availability and a potential life longer than that of converted KC-135R aircraft. However, because 100 B-767 aircraft would replace 126 KC-135Es, the total tanker fleet capacity would be reduced and would not solve any of the shortfalls identified in TRS-05.
- Lease 100 Boeing 767 aircraft in accordance with section 8159 of the FY2002 Defense Appropriations Act. We understand section 8159 to mean that the lease would cover the aircraft in its basic, or transport, configuration, which the Air Force would then modify into a tanker configuration. At the end of the 10 year lease period the Air Force would de-modify the aircraft and return them to Boeing in their original transport configuration. In this way the Air Force could meet the criteria of an operating lease. The Air Force believes that the base aircraft cost is $90 million with tanker conversion and de-conversion costs adding $60 million to the price. As we indicated to you in our letter dated December 18, 2001, we believe that the total cost of this option would be $26 billion in then-year dollars. This option would provide aircraft on the same schedule and have the same tanking capacity as the direct purchase

[redacted]

option with lower near-term costs, but would require that the Air Force return the aircraft after 10 years, meaning that they would have to develop an alternative for the tanker fleet by that time.

We have no basis at this time to change our $26 billion estimate, since discussions between the Air Force and Boeing to determine the possible lease arrangements for such an aircraft are still ongoing. However, we understand that the Air Force interprets section 8159, together with a colloquy reported in the Congressional record on December 20, 2001, to mean that a B-767 tanker is a general purpose aircraft. In an exchange involving Senators, the Members stated they believed a converted 767 qualified 'as a general purpose aircraft.' This position presumes there is an active commercial market for tankers which would therefore relieve the Air Force of costs associated with conversions.

Clearly, this interpretation would make it financially easier for the Air Force to meet the conditions for an operating lease imposed by section 8159 because they could amortize the costs of tanker conversions over ten years instead of paying for conversions up front. While we are currently unaware of any commercial buyer or interest in purchasing 100 tankers, OMB will provide its views on the Air Force interpretation to you in the next few weeks.

The Air Force's tanker RFI [request for information] process

OMB did not conduct a detailed analyses or audits of the Air Force's RFI process for tanker aircraft. However, our overall impression of the Air Force's tanker RFI process is that it was done in a reasonable and fair manner. From what we know we have no reason to believe that the outcome would have been any different had another entity evaluated the two proposals, given the Air Force's requirements. Boeing simply appears to have more experience in air-to-air boom refueling than Airbus. Regarding other potential companies, we do not know of any other companies that were both capable of, and interested in, responding to the RFI.

Leasing policy

You asked us to examine the policy of leasing major defense programs and to evaluate the role of DoD's recently established Leasing Review Panel. When analyzing capital leases, we believe it is critically important to compare the full cost of the lease with other methods of acquiring the capital assets, including direct purchases. We also believe that [a White House official] and the Congress should consider the full cost of capital acquisitions when they make budget decisions to allocate resources to Federal agencies and programs. For that reason, we strongly support the budget scoring rules for leases, which were agreed to by the Congress and [the White House official] as part of the Budget Enforcement Act of 1990. The rules distinguish operating leases from capital leases and address the fact that some capital leases are virtually equivalent to the purchase of a capital asset, with most or all of the benefits and risks of ownership transferred to the government, while others are more like rentals. They require agencies to fund the full cost of purchases, lease purchases, and capital leases up-front in the first year of the transaction. In this way, the full cost is recognized at the time when decisions are made to incur that cost, regardless of the source and form of financing, so that Congress and [the White House official] have the incentive and the information necessary to make the most efficient use of taxpayers' money.

The Defense Department's Leasing Review Panel, of which OMB is a member, has not yet met because the Air Force has not yet completed its proposal to lease B-767s and B-737 executive jets.

[redacted]

Infrastructure costs

As we indicated in the attachment to our December 18, 2001 letter we believe the infrastructure costs associated with the purchase or lease of Boeing 767 aircraft to be approximately $1 billion

On May 30, 2002, [redacted]

[redacted]

June 2002. On June 4, Dr. Sambur, Assistant Secretary of the Air Force (Acquisition) sent a policy memorandum, "Reality-based Acquisition System Policy for all Programs," to Air Force Mission Area Directors, Functional Area Directors, Program Executive Officers, and Designated Acquisition Commanders. In the memorandum, Dr. Sambur stated that:

> Effective immediately, AFPD 63-1 [Air Force Policy Directive 63-1, 'Capability-Based Acquisition System'], dated 31 August 1993 is superceded by this policy memorandum Compliance with this memorandum is mandatory. This policy memorandum applies to Acquisition Category (ACAT) IC and IAC through ACAT III acquisition programs, including system modifications; it does not cover acquisition associated with non-ACAT programs. This policy implements guidance from the SECAF [Secretary of the Air Force] and CSAF [Chief of Staff Air Force], hereafter identified as the Commanders' Intent, and Department of Defense Directive (DoDD) 5000.1, The Defense Acquisition System, DoDD 5000.2, Operation of the Defense Acquisition System and DoDD 5000.2R, Mandatory Procedures for Major Defense Acquisition Programs (MDAPs) and Major Automated Information Systems (MAIS acquisition programs). This policy memorandum does not apply to Air Force Space programs, which are under the purview of the Under Secretary of the Air Force
>
> The two overarching objectives or this policy are: 1) shortening the acquisition cycle time and, 2) gaining credibility within and outside the acquisition community
>
> Every action and decision by individuals responsible for program execution must map directly to, and further these two primary objectives Members at all levels of the acquisition workforce are expected to seek innovative ways to achieve these objectives. This must be accomplished through teamwork, trust, common sense and agility. The intent is to give those accountable for program execution maximum flexibility.
>
> Unlike previous acquisition guidance, this policy is broad and non-prescriptive. Wherever possible, it uses terminology familiar to our customer, the warfighter
>
> **Commander's Intent:**
>
> The <u>primary mission</u> of our acquisition system is to <u>rapidly deliver</u> to the warfighters affordable, sustainable <u>capability that meets their expectations</u> All actions by any leader, staff or supporting organizations will support the Commander's Intent

[redacted]

Commander's Initial Guidance:

1) Program managers will ensure full compliance with the law; however, over restrictive implementation of the law that goes beyond what is required in statute must be challenged if the value added to the program does not equal or exceed the resources expended

2) Success in meeting our objective requires a shift from avoiding risk to managing it, and sometimes, simply accepting it. Taking risks will sometimes produce failure. That is acceptable as long as those in the execution chain understood the risks and we learn from the failure

3) Speed is important. In devising and implementing acquisition approaches, the concept of time or schedule as an independent variable is one that must override prior concepts of delivering the ultimate capability at whatever cost and schedule is necessary to do so. Every key decision must have an operational sense of urgency

4) Credibility is essential We must create and maintain realistic expectations. Program Managers (PMs) must continually manage expectations so that senior acquisition and warfighter leadership are never surprised by sudden cost growth, performance shortfalls or schedule slippages. Each program must have a clear, unambiguous set of priorities among cost, schedule, performance and supportability Normally, the senior leadership of the requiring MAJCOM [major command] should set these priorities as part of the initial requirement

5) Teaming among warfighters, developers/acquirers, technologists, testers, budgeters and sustainers must begin when the requirements are being defined, not after PMs through the MDA [milestone decision authority], are responsible for making decisions and leading implementation of programs, and are accountable for results The PM, as the accountable agent for executing the program, has a responsibility to seek resolution if asked to do something that goes counter with meeting the Commander's Intent. There are two avenues for appeal available to the PM: the Air Force Acquisition Center of Excellence (ACE) (located both at SAF/AQ [Assistant Secretary of the Air Force (Acquisition)] and HQ AFMC [Headquarters, Air Force Materiel Command]), and the MDA.

6) Solid systems engineering is required at the outset of a program to ensure a robust foundation and flexible architecture that can accommodate future requirements with minimal redesign.

7) Staffs at all level[s] exist to advise the MDA and PM and assist them with their responsibilities. Councils, committees, advisory groups, panels and staffs are advisers at the discretion of the PM, PEO [program executive officer] or DAC [Designated Acquisition Commander] or MDA. The MDA, PEO or DAC and PM are accountable for the overall program results. Those not accountable for program outcome are expected to provide objective inputs to the program decision process, but do not have decision-making authority.

Evolutionary Acquisition (EA) is the preferred acquisition strategy for achieving the Commander's Intent Spiral development is the preferred process to execute the EA strategy except in those exceptional cases where it is possible to field a full capability in 18 months or less

All programs start with a 'zero-based' perspective. All activities, reports, plans, coordination or reviews except those mandated by statute or previously approved by a person in the execution chain, must buy their way into the program by demonstrating that the benefit gained clearly equals or outweighs the resources expended

[redacted]

> The success of an acquisition program hinges on up-front, collaborative and concurrent planning by the MDA, technologists, developers/acquirers, sustainers, budgeters, warfighters, and testers The goal is to establish, at the outset of the program, mutual, realistic expectations for content delivered, schedule of delivery, and cost.
>
> Additional 'DRAFT' guidance on the concepts required by this policy memorandum is available on the SAF/AQ web site http://www.safaq.hq.af.mil under 'Acquisition Center of Excellence' or 'Policies –SAF/AQXA [Chief, Acquisition Management Policy Division, Office of the Assistant Secretary of the Air Force (Acquisition)].'

On June 17, 2002, [redacted]

On June 17, 2002, [redacted]

July 2002. On July 24, Major General Leroy Barnidge, Air Force Director of Legislative Liaison sent an e-mail to Dr. Roche with a cc: to [redacted] Chief, Senate Liaison Office, Office of Air Force Legislative Liaison in which he stated:

> Boss –
>
> [A congressional staffer] has been playing a pretty heavy game with us ref 'a personal copy of the DRAFT 737 contract (that we provided to the committee) for [a Senator].' You may recall, we had [congressional staffers] supporting us by saying that if the Senator wants a copy, then we (the committee) will give him one. Well, true to their word, they

[redacted]

> made the offer. [The congressional staffer], in the name of the Senator, said the Senator wants/deserves his own copy (addressed to him) from the AF [Air Force] and has made a formal request. I have been stalling since last evening on this. The 'emotionalism' associated with his demand has grown exponentially. HOWEVER, when I now balance the potential downsides of continued stalling (i.e., he can put a stop to the reprogramming authority for 737 which can really impact our program, and also may impact any number of other issues, including 767 if/when we hand them a pkg [package]), I just need to make sure I'm not getting ahead of my headlights in this 'game' with [the congressional staffer]
>
> Thus: I have stalled on giving [the congressional staffer] a copy of the 737 contract (for [a Senator]) for at least 24 hrs. Tomorrow, at 1400, we have AQ [Office of the Assistant Secretary of the Air Force (Acquisition)] lined up to provide [the congressional staffer] a brief on the 737 (as promised)..... We would have coord'd [coordinated] for you to attend if the Senator was actually in attendance. Before our briefer goes to see [the congressional staffer], I feel that we should decide whether we are in the business of providing members DRAFT copies of a contract (that we have already provided to the committee) or not. It IS precedent setting (in my opinion). However, in balance, given that we have given it to the committee, I feel that there is probably no reason not to answer an official request from any other committee member (because the 'potential costs' probably aren't worth it).
>
> But, sir, request your vectors ...

On July 24, 2002, in response to Major General Leroy Barnidge's e-mail, Dr. Roche sent an e-mail to Major General Leroy Barnidge with a cc: to [redacted] and Ms. Mary L. Walker, Air Force General Counsel in which he stated:

[redacted]

On July 24, 2002, in response to Dr. Roche's e-mail, Major General Leroy Barnidge sent an e-mail to Dr. Roche with a cc: to [redacted] and Ms. Mary L. Walker in which he stated:

> Thanks Boss. and, we've already coord'd with GC [General Counsel] and have a good cover letter to attach. We'll make it happen.

On July 30, 2002, General Peter Pace, Vice Chairman of the Joints Chief of Staff sent a memorandum, "Air Refueling Aircraft (ARA) Operational Requirements Document (ORD)," to the Under Secretary of Defense for Acquisition, Technology, and Logistics in which he stated that:

> The Joint Requirements Oversight Council (JROC) reviewed and approved the ARA ORD [Air Refueling Aircraft Operational Requirements Document] and validated the enclosed Key Performance Parameters (KPPs). The JROC considered the KPPs essential to meet the mission need. The JROC also recommends delegation of ORD approval authority to the Chief of Staff of the Air Force.

The key performance parameters included fuel offload versus range, tanker air refueling, boom air refueling, drogue air refueling, receiver air refueling,

[redacted]

worldwide airspace access (Global Air Traffic Management compliant), and interoperability. The following discusses those key performance parameters and associated thresholds and objectives:

- Fuel Offload Versus Range. To meet the threshold, "The aircraft shall be capable of a no-wind offload versus range as depicted in Chart 1." The chart showed that the fuel offload decreased as the radius distance increased. The objective was higher than the threshold.
- Tanker Air Refueling. To meet the threshold, "The aircraft must be able to use (non-simultaneously) both boom and drogue air refueling systems, day or night, on the same flight." The objective was the same as the threshold.
- Boom Air Refueling. To meet the threshold, "The aircraft must be capable of accomplishing boom air refueling of all boom-receptacle equipped receiver aircraft identified in AF [Air Force] technical orders 1-1C-1-3 and 1-1C-1-33, the F-22 and Joint Strike Fighter (JSF) using current procedures and refueling airspeeds with no modification to existing receiver air refueling equipment and no restrictions to the refueling envelope due to lighting/shadows." The objective was the same as the threshold
- Drogue Air Refueling. To meet the threshold, "The aircraft must be capable of accomplishing drogue air refueling of all drogue-refuelable receiver aircraft identified in AF [Air Force] technical orders 1-1C-1-3 and 1-1C-1-33 and the JSF [Joint Strike Fighter] using current procedures and refueling airspeeds with no modification to existing receiver air refueling equipment." The objective was the same as the threshold.
- Receiver Air Refueling. To meet the threshold, "The aircraft must be capable of operating in various inclement/adverse weather environments (IAW [in accordance with] KC-135/KC-10 aircraft directives) for day and night receiver air refueling to maximum fuel load from a KC-10, KC-135, or this aircraft using current air refueling procedures." The objective was the same as the threshold
- Worldwide Airspace Access. To meet the threshold, "The aircraft shall be capable of worldwide flight operations in all civil and military airspace including Reduced Vertical Separation Minima (RVSM) and Future Air Navigation System (FANS) 1/A airspace." The objective was the same as the threshold.
- Interoperability. To meet the threshold, "100% of top-level Information Exchange Requirements (IERs) designated critical will be satisfied." To meet the objective, "100% of top-level IERs will be satisfied."

August 2002. On August 7, [redacted] sent an e-mail to Dr. Roche in which she stated:

> Paris –European Aeronautic Defense & Space Co. NV (N EAD) said Wednesday that it has appointed [redacted] to head its North

Congressional Record

[redacted]

American operation. Until January, [redacted] was president of Northrop Grumman's Integrated Systems division, EADS [European Aeronautic Defence and Space Company] said in a statement.

'As our senior official in the U.S., [redacted] will oversee our efforts to expand our business, develop industrial partnerships, and ensure strong customer relationships in this critical market,' EADS said.

[redacted] will assume his position on Sept. 1. [redacted] EADS's current top representative in the U.S., will continue to work as a senior adviser, the company said.

Cordially,

[redacted]

Congressional Record

On August 7, 2002, Dr. Roche sent an e-mail to Mr. William C. Bodie, Special Assistant to the Secretary of the Air Force discussing the appointment of [redacted] at the European Aeronautic Defence and Space Company. In the e-mail, Dr. Roche stated:

Well, well. We will have fun with Airbus!
Jim

Congressional Record

On August 20, 2002, Mr. Wayne A. Schroeder, Deputy Under Secretary of Defense (Resource Planning/ Management), Office of the Under Secretary of Defense (Comptroller) sent an e-mail to Dr. Dov S. Zakheim, Under Secretary of Defense (Comptroller) with a cc: to Mr. Lawrence J. Lanzillotta, Principal Deputy and Deputy Under Secretary of Defense (Management Reform), Office of the Under Secretary of Defense (Comptroller). In the e-mail, Mr. Schroeder stated:

Dov,

Due to some schedule conflicts and absences, [redacted] requested that we reschedule the 767 tanker meeting with OMB [Office of Management and Budget] to later this week or next. But I did have a chance to speak with [redacted] about OMB's high profile. [redacted] said that OMB has been responding to letters from [a Senator] (they also just received a letter on the issue from [a Representative]). So part of their public profile has to do with responding to congressional requests for their position on the issue – [a Senator] wanted to get it 'on the record.' But [redacted] did say that the political leadership at OMB feels very strongly about the lease, and has decided to take a public posture knowing the effects this might have. He suggested you talk directly with Robin [Cleveland] if you want more information on the politics of the lease at OMB. He also gave me some insights into what OMB has learned about the lease from technical questions the Air Force has posed to them:

1. The deal is looking 'worse and worse.'
2. OMB is getting a lot of Air Force questions about A-94 and lease-purchase analysis.
3. Boeing will not finance this deal. It would be financed through an investment group or special purpose company partly owned by Boeing, the engine manufacturer and other investors. The Air Force would lease the tankers from this investment group, which would issue a set of bonds at different terms and interest rates.
4. The Air Force had questions for OMB about what interest rate they can use. Predicting interest rates is problematic, and could have a major impact on the analysis. OMB thinks the Air Force will want a very low interest rate and very high discount rate to make the lease-purchase analysis work.
5. The marketability of the aircraft is an issue. The Air Force will likely propose for purposes of calculating the residual value of the aircraft, that

[redacted]

> at the end of the lease they be sold as either freighters or tankers Not all 100 could be sold as tankers in the open market.
> 6. OMB thinks the Air Force could have gotten a much better deal on the purchase price than what they will show in the analysis.
> 7. To convince investors that this is not a risk, the Air Force will tell them that they will buy the aircraft at the end of the lease. This raises the question of why this will be structured as an operating lease, when the intent is clearly lease-to-buy. If this turns out to be the case, it will be an issue.
>
> As we get more details, I will pass more information on to you and Larry after we hold the meeting with OMB. [redacted] said he thought the Air Force and Boeing might finalize negotiations toward the end of next week

On August 20, 2002, in response to Mr. Wayne A. Schroeder's e-mail, Dr. Dov S. Zakheim sent an e-mail to Mr. Wayne A. Schroeder with a cc: to Mr. Lawrence J. Lanzillotta in which he stated that:

> [T]his does seem very troubling

On August 20, 2002, Mr. Lawrence J. Lanzillotta forwarded Mr. Wayne A. Schroeder's e-mail to Mr. John Roth, Deputy Comptroller (Program/Budget), Office of the Under Secretary of Defense (Comptroller); and Mr. Ronald G. Garant, Director, Investment, Office of the Under Secretary of Defense (Comptroller).

On August 21, 2002, in response to Mr. Wayne A. Schroeder's e-mail, Mr. Ronald G. Garant sent an e-mail to Mr. Lawrence J. Lanzillotta with a cc: to Mr. John Roth, and Mr. Wayne A. Schroeder in which he stated:

> I talked to [redacted] a month or so ago. He was the AF [Air Force] deputy comptroller The AF hired him to give their proposal the *grandmother test and as far as he was concerned it didn't pass.* He contends that the purchase price is probably over stated by 50% and he contends that the residual value is also very much overstated for a non-Air Force market. He was also concerned about the discount and interest rates used in the calculations.
>
> Since we all know that this is a bailout for Boeing why don't we just bite the bullet and do what we did when we were bailing Douglas out on the KC-10's. We didn't need those aircraft either, but we didn't screw the taxpayer in the process. The 767 is not the latest in technology. If we were going to get serious about buying the best I am sure that some rendition of the 777 would win out.
>
> I don't know of anyone who is dissatisfied with the outcome of the KC-10 deal. The Air Force should be made to come back with an analysis of why we couldn't do the same with the 767. **What we in effect would be buying is the tail end of the production line and should be getting the best price, not the inflated price that they want to put in the lease formula. The key of course is to include some competition into the purchase process.** [Emphasis added]

On August 28, 2002, [redacted] Office of the Air Force Director of Global Reach Programs, Office of the Assistant Secretary of the Air Force (Acquisition) sent an e-mail to Dr. Sambur with a cc: to Ms. Druyun, Major General Essex, and Brigadier General Bowlds in which he stated:

[redacted]

Sir,

Per your request:

Info we've made public:

Negotiations continue and are entering their final phase. We are cautiously optimistic that a lease deal that complies with the law and OMB [Office of Management and Budget] circulars can be reached. Once approved by SECAF [Secretary of the Air Force], we will present the business case to OMB and the OSD [Office of the Secretary of Defense] Leasing Panel, followed by a report to Congress A lease contract will not be signed without approval from all four defense committees and appropriate funding

Info not yet made public:

The preliminary lease arrangement passes the OMB business case analysis by a slim margin and will save money compared to buying We are currently running sensitivity analyses to prepare for – and ensure the deal can stand up to – criticism similar to that seen with the 737 deal We are actively engaging OMB to get their buy-in on the analysis – a critical ally needed to defend the lease I expect they will support the analysis, but will baulk at supporting our need to escape funding termination liability (peaks at [redacted] in FY07; will need Congressional language to overcome). OMB has also stated they believe a tanker is not a commercial product (a key test for an operating lease), but if the business case holds, I don't think OMB will make this issue a deal-killer.

On August 28, in response to [redacted] e-mail, Dr. Sambur sent an e-mail to [redacted] with a cc: to Ms. Druyun, Major General Essex, and Brigadier General Bowlds in which he stated:

Thanks
I assume you resolved the residual value issue from this update?
Should we pulse the SASC [Senate Armed Services Committee] staffers on the termination liability issue?

On August 28, in response to Dr. Sambur's e-mail, [redacted] sent an e-mail to Major General Essex in which he stated:

Sir,

Residual value issue of rebating resale profit to the gov't is still in OMB's [Office of Management and Budget] hands They've never seen anything like it before, and after 2 weeks of chewing on it, have not vetoed the concept However, when I spoke with [redacted] today, he cautioned me that 767 is so political that his input is only advice –

* * * * *

I defer to Mrs Druyun on the question of talking to SASC [Senate Armed Services Committee] staffers.

*Removed for reason stated in the initial asterisked footnote. (The reference is also on page 178.)

[redacted]

September 2002. On September 4, Mr. William C. Bodie, Special Assistant to the Secretary of the Air Force sent an e–mail to Dr. Roche discussing a *Defense Week Daily Update* "EADS [European Aeronautic Defence and Space Company]: Our Tanker Offer Cost Less Than Boeing's." In the e-mail, Mr. Bodie stated:

> We don't have to turn the other cheek, you know I'm ready to tell the truth about Airbus's boom, footprint, and financial shortcoming But maybe we should sleep on it

Congressional Record

On September 4, 2002, in response to Mr. William C. Bodie's e-mail, Dr. Roche sent an e-mail to Mr. William C. Bodie in which he stated:

> No, Sir, save it and blow him away. He admits that they were not technically qualified! And, we keep their record of bribes as our trump card! Jim

Congressional Record

On September 4, 2002, Mr. William C. Bodie sent an e-mail to Dr. Roche in which he stated:

> Hope [redacted] enjoyed it [Defense Week Daily Update: 'EADS: Our Tanker Offer Cost Less Than Boeing's']. I wonder if . . mind is supple enough to grasp what we're trying to do. I know Rumsfeld's isn't.

On September 4, 2002, in response to Mr. William C. Bodie's e-mail, Dr. Roche sent an e-mail to Mr. William C. Bodie in which he stated:

> Go to sleep! Tomorrow is another day in the minefield Jim

On September 5, 2002, Ms Druyun sent an e-mail to Dr. Roche in which she stated:

> I read with disgust the article on Airbus tankers from the new EADS [European Aeronautic Defence and Space Company] CEO [Chief Executive Officer] of North America. What BS [sic] ... should not have been surprised at the slime . . . his day of reckoning will come hopefully.

Congressional Record

On September 5, 2002, in response to Ms. Druyun's e-mail, Dr Roche sent an e-mail to Ms. Druyun in which he stated:

> Oy. I agree I had hoped you would have stayed and tortured him slowly over the next few years until EADS [European Aeronautic Defence and Space Company] got rid of him! Jim

Congressional Record

On September 11, 2002, Dr. Sambur sent an e-mail to Dr. Roche in which he stated:

> Boss
> I kicked off the effort to establish a 'need' justification for the tankers
> Hope to have a conceptual framework ready by the end of the week.
> Spoke to Robin [Cleveland] after the meeting to tell her that the economic justification is not a slam dunk for either position (purchase or lease). It is more a push and a slight change in the interest rates can flip the analysis. At the end of the day, we have to prove that there is a TRUE need and that there are other advantages to leasing (earlier.

[redacted]

> delivery, affordability, etc) that make it a good business deal. It is going to be a tough sell given the other factors such as liability and indemnification.
> Marv

On September 11, 2002, [redacted] Office of the Air Force Director of Global Reach Programs, Office of the Assistant Secretary of the Air Force (Acquisition) sent an e-mail to Major General Bill Essex with a cc: to [redacted] Chief, Mobility Division, Office of the Air Force Director of Global Reach Programs; [redacted] Office of the Air Force Director of Global Reach Programs, Office of the Assistant Secretary of the Air Force (Acquisition); [redacted] Mobility Division, Office of the Air Force Director of Global Reach Programs; and [redacted] Mobility Division, Office of the Air Force Director of Global Reach Programs. In the e-mail, [redacted] stated that:

> Sir,
> Proposed message is below. I think we are on the hook to contact AMC [Air Mobility Command], FM [Office of the Assistant Secretary (Financial Management and Comptroller)], AFSAA [Air Force Studies and Analysis Agency] and [redacted] at Rand [redacted]. [redacted] was to contact AFMC/CC [Air Force Materiel Command], Aging Aircraft SPO [System Program Office], 135 SPO, and Boeing authors of ESLS [Economic Service Life Study].
>
> Today the Office of Management and Budget met with the SECAF [Secretary of the Air Force], Dr. Sambur, and Lt Gen [Lieutenant General] Zettler [Deputy Chief of Staff for Installations and Logistics] regarding air refueling tanker recapitalization. OMB [Office of Management and Budget] presented their analysis of the KC-135 costs and service life projections concluding that there is no requirement to recapitalize now, or in the foreseeable future. OMB's principle source of data was the Feb 2001 KC-135 Economic Service Life Study (ESLS) for historical data/future projections and Air Force SORTS [Status of Resources and Training System] Database for mission capable rates
>
> SECAF has committed to work with OMB to identify a sensible replacement plan for the KC-135 aircraft. To accomplish this, the USAF [U.S. Air Force] must provide a compelling case to OMB for recapitalization. SECAF has committed to providing the case by next Thursday, 19 Sep [September] 02.
>
> Need your support to make this happen. SAF/AQ [Assistant Secretary of the Air Force (Acquisition)] and AF/LG are establishing an ad hoc team to support this quick turn effort, and will kick it off this Friday, 13 Sep 02 at 0800 in the 14th floor conference room (SAF/AQQ) 1500 Wilson Blvd, Arlington, VA 20330. We need you to send your top expert on KC-135 supportability and service life/recapitalization to this meeting with the intention that they will work non-stop through next Thursday the 19th.
>
> Specific task at hand is to explain why the USAF believes the ESLS was too optimistic and provide data to support this claim. Additionally, the team must explain and focus on what has changed in operations and maintenance since Feb 2001. All must be supported by cold hard facts
>
> Please assure your expert knows of and has immediate access to all of the documentary evidence the team must have to build the case SECAF has promised.

[redacted]

SAF/AQ POCs [points of contact] for this effort are [redacted] and [redacted] SAF/AQQM. They can be reached at DSN 425[redacted]

On September 18, 2002, [redacted]

On September 20, 2002, [redacted]

[redacted]

[redacted]

On September 20, 2002, Major General Leroy Barnidge, Air Force Director of Legislative Liaison sent an e-mail to Dr. Roche; General John Jumper, Air Force Chief of Staff; General Robert Foglesong, Air Force Vice Chief of Staff; and Lieutenant General Joseph H. Wehrle, Jr., Air Force Assistant Vice Chief of Staff with a cc: to Mr. William C. Bodie, Special Assistant to the Secretary of the Air Force; [redacted] Senior Military Assistant, Office of the Secretary of the Air Force; [redacted] Executive Officer to the Air Force Chief of Staff; [redacted] Office of the Air Force Chief of Staff; [redacted] Office of the Air Force Vice Chief

[redacted]

of Staff; [redacted] Office of the Air Force Vice Chief of Staff; [redacted] Office of the Air Force Assistant Secretary (Financial Management and Comptroller); [redacted] Confidential Assistant to the Secretary of the Air Force; [redacted] Secretary, Office of Air Force Legislative Liaison; [redacted] Chief, Program and Legislative Division, Office of Air Force Legislative Liaison; Brigadier General Thomas L. Carter, Military Assistant to the Director of Legislative Liaison; Brigadier General Scott B. Custer, Office of Air Force Legislative Liaison; [redacted] Office of Air Force Legislative Liaison. In his e-mail, Major General Leroy Barnidge stated:

> Sirs –
>
> Late yesterday, [a Representative] made a late notice visit to Andrews to see the new 737s. He was pleased with what he saw. Of note, however, he pulled [redacted] over (who had run to support [the Representative's] visit) and related that he, [the Representative] had talked with [* * * * * *] ref 767 lease. Said, '[* * * * * * * *] agreed that we need to make this work.' Also told [redacted] that he ([the Representative]) '... will work with SAC [Senate Appropriations Committee] leadership to ensure initiative comes together.'
>
> Additional data point: Proposed HASC [House Armed Services Committee] language is [s]till more restrictive:
>
> 'The Secretary of the AF [Air Force] shall not enter into any lease for tanker aircraft until the Secretary submits the report required by section 8159 (c) (6) of the Department of Defense Appropriations Act, 2002 and obtains authorization and appropriation of funds necessary to enter into a lease for such aircraft consistent with his publicly stated commitments to the Congress to do so.'
>
> Dr. Roche, we will rehighlight [the Representative's] position in your email prep [preparation] before your office call with [the Representative] next Wed, 25th, 1800

On September 22, 2002, in response to Lieutenant General Duncan McNabb's e-mail, General John Jumper sent an e-mail to Lieutenant General Duncan McNabb and Dr. Roche with a cc: to Mr. William C. Bodie; General Robert H. Foglesong; Ms. Druyun; Major General Bill Essex; Lieutenant General Joseph H. Wehrle, Jr.; and Major General Leroy Barnidge in which he stated:

> Tanker numbers much different than I expected. Good chart.

On September 23, 2002, in response to Lieutenant General Duncan McNabb's e-mail, Ms. Druyun sent an e-mail to General John Jumper, Lieutenant General Duncan McNabb, Dr. Roche, Major General Bill Essex, and Dr. Sambur with a cc: to Mr. William C. Bodie; General Robert H. Foglesong; Lieutenant General Joseph H. Wehrle, Jr.; and Major General Leroy Barnidge in which she stated:

> I do not agree with the AUPP [Average Unit Procurement Price] being used in the tanker chart. Our lease price we have negotiated I would characterize as a one time [g]ood deal. I expect it will be higher, closer

*Removed for reason stated in the initial asterisked footnote. (The reference is also on page 13.)

[redacted]

> to the price being paid by the Italians who are not getting digital cockpit etc vs. our configuration. I also know what the EADS [European Aeronautic Defence and Space Company] proposal was and Boeings was better for the Italians. I would add approximately $30M [million] to the AUPP for each aircraft. If the 767 line is shut down the number will be even higher.

On September 23, 2002, as an update to her earlier response to Lieutenant General Duncan McNabb's e-mail, Ms Druyun sent an e-mail to General John Jumper, Lieutenant General Duncan McNabb, Dr. Roche, Major General Bill Essex, and Dr. Sambur with a cc: to Mr. William C. Bodie; General Robert H. Foglesong; Lieutenant General Joseph H. Wehrle, Jr.; and Major General Leroy Barnidge in which she stated:

> Should have read 'one time good deal'. to early in the AM to type!. Bottom line is if we recalculate the numbers with a higher AUPP [Average Unit Procurement Price] you will have fewer tankers available. I have asked AQQ [Office of the Director of Global Reach Programs] to recalculate

On September 23, 2002, in response to Ms Druyun's e-mail, Lieutenant General Duncan McNabb sent an e-mail to her in which he stated:

> Darleen,
> We got the numbers from Bill and his folks—I'm not sure what the caveat needs to be—but just let us know.

On September 23, 2002, in response to Ms. Druyun's e-mail, Lieutenant General Duncan McNabb also sent an e-mail to Brigadier General Raymond Johns, Deputy Director of Programs, Office of the Air Force Deputy Chief of Staff for Plans and Programs; and Major General Bill Essex with a cc: to [redacted] Associate Director, Office of the Director of Programs, Office of the Air Force Deputy Chief of Staff for Plans and Programs; Major General Gary Heckman, Office of the Air Force Deputy Chief of Staff for Plans and Programs; Major General Kevin Chilton, Office of the Director of Programs, Office of the Air Force Deputy Chief of Staff for Plans and Programs; [redacted] Office of the Directorate of Strategic Planning, Office of the Air Force Deputy Chief of Staff for Plans and Programs; and Major General Ron Bath, Director, Directorate of Strategic Planning, Office of the Air Force Deputy Chief of Staff for Plans and Programs. In the e-mail, Lieutenant General McNabb stated:

> Ray/Bill,
> I'm not sure what the problem is here—thought it was a pretty straight forward question and we got the numbers from AQ [Office of the Assistant Secretary of the Air Force (Acquisition)]—what's up?

On September 23, 2002, in response to Ms. Druyun's e-mail, Dr. Roche sent an e-mail to Ms. Druyun, General John Jumper, Lieutenant General Duncan McNabb, Major General Bill Essex, and Dr. Sambur with a cc: to Mr. William C. Bodie; General Robert H. Foglesong; Lieutenant General Joseph H. Wehrle, Jr.; and Major General Leroy Barnidge in which he stated:

> Ok, Gang, let's resolve this and get the charts reissued. Thanks much

[redacted]

On September 23, 2002, in response to Ms. Druyun's e-mail, Dr. Sambur sent an e-mail to Dr. Roche, Ms. Druyun, General John Jumper, Lieutenant General Duncan McNabb, and Major General Bill Essex with a cc: to Mr. William C. Bodie; General Robert H. Foglesong; Lieutenant General Joseph H. Wehrle, Jr.; and Major General Leroy Barnidge in which he stated:

> Boss
> Darleen is correct that the purchase price will be higher and thus the number of tankers that can be purchased will be lower. However the *main thrust of the chart (that is independent of purchase price)* is that we will have only 1 plane delivered by 2009 (if we go according to the POM) and 67 planes delivered by 2009 (if we lease). Thus we get the planes significantly sooner and avoid the corresponding O&M [operation and maintenance] bills. On the 'significantly sooner issue' we have developed a new requirement chart in concert with Gen [General] Handy that reflects our tanker needs in line with the new homeland defense requirements. The analysis is secret but the data dramatically supports our lease argument!! We will show OMB [Office of Management and Budget] our new analysis and would like to show you and the Chief the presentation as well.

On September 23, 2002, Major General Essex forwarded Dr. Sambur's e-mail to [redacted] Office of the Air Force Director of Global Reach Programs, Office of the Assistant Secretary of the Air Force (Acquisition).

On September 23, 2002, in response to Lieutenant General Duncan McNabb's e-mail concerning Ms. Druyun's e-mail, Major General Kevin Chilton sent an e-mail to Lieutenant General Duncan McNabb, Brigadier General Raymond Johns, and Major General Bill Essex with a cc: to [redacted] Major General Gary Heckman, [redacted] and Major General Ron Bath in which he stated:

> Sir,
> Talked to Gen [General] Essex. The [redacted] per jet number they gave us had two reasonable assumptions in it. One, that the 767 production line would not be shut down in the interim and have to be re-started, and two, that the Air Force would be able to negotiate a multiyear purchase deal. Another mitigator is that if we secure a production deal near the end of Boeing's 767 production for airline customers, that we would be able to get some of the same benefits (reflected in a reduced price per jet) we derived from the KC-10 purchase. That said, Mrs Druyun feels the [redacted] number is [redacted] low. We will recompute the purchase #s using the [redacted] figure and include the [redacted] numbers on a separate line with an asterix [asterisk] that lists the assumptions I've discussed.

On September 23, 2002, Major General Bill Essex forwarded Major General Kevin Chilton's e-mail to [redacted] Office of the Air Force Director of Global Reach Programs, Office of the Assistant Secretary of the Air Force (Acquisition); [redacted] Mobility Division, Office of the Air Force Director of Global Reach Programs; [redacted] Chief, Mobility Division, Office of the Air Force Director of Global Reach Programs; [redacted] Mobility Division, Office of the Air Force Director of Global Reach Programs; and [redacted]

[redacted]

[redacted] Mobility Division, Office of the Air Force Director of Global Reach Programs.

On September 23, 2002, in response to Major General Bill Essex's e-mail forwarding Major General Kevin Chilton's e-mail, [redacted] Office of the Air Force Director of Global Reach Programs, Office of the Assistant Secretary of the Air Force (Acquisition) sent an e-mail to [redacted] and [redacted] with a cc: to Major General Bill Essex, [redacted] and [redacted] in which he stated:

> [redacted]
>
> I just got off the phone with [redacted] in Dr Sambur's office Dr. Sambur would like to include the costs on the tanker chart below for both lease and purchase (add two rows to the table). He would like it in a powerpoint slide. He only wants the tanker information in a powerpoint slide. Format of the table will now include the following rows:
>
> Lease Then Purchase
> Cost
> Blank
> 04 POM [Program Objectives Memorandum] Purchases
> Cost
> 04 POM Deliveries
>
> If possible, he needs this by COB [close of business] today, 23 Sep [September].

On September 23, 2002, in response to [redacted] e-mail, [redacted] sent an e-mail to [redacted] Air Force Program Executive Office for Strategic Programs; [redacted] at the Aeronautical Systems Center; [redacted] at the Aeronautical Systems Center with a cc: to [redacted] and [redacted] in which he stated:

> [redacted]
>
> How do you propose I answer this tasker from Dr Sambur [sic]
>
> We haven't seen any new budget numbers from the SPO [system program office] since early August.
>
> Will have to use the August numbers, but since this will be the first time the SAE [Service Acquisition Executive (Dr. Sambur)] sees costs associated with the lease, not to mention SECAF [Secretary of the Air Force] and the GOs [general officers] on the Staff, I want to make sure they are still roughly valid.

On September 23, 2002, in response to [redacted] e-mail, [redacted] sent an e-mail to [redacted] and [redacted] with a cc: to [redacted] and [redacted] in which he stated:

> SPO [system program office] has request per your email. A suggestion on the POM [Program Objectives Memorandum] price would be to not assume multiyear and use [redacted] negotiation spreadsheet to calculate a

[redacted]

> price based on not as big [of a] discount on Green [aircraft] and less learning on early mod [modification] installation.

On September 23, 2002, in response to [redacted] e-mail, [redacted] sent an e-mail to [redacted] and [redacted] with a cc: to [redacted] and [redacted] in which he stated:

> Will use 180 for lots 1-4 per Mrs. Druyun. Will assume MYP [multiyear procurement] of 150 thereafter.

On September 23, 2002, [redacted] sent an e-mail to Major General Bill Essex and [redacted] with a cc: to [redacted] and [redacted] in which he stated:

> Sirs,
> [redacted] relayed the following three questions from [a Senator]. eeds answers by 1100 Recommended answers provided. Recommend approval for release
>
> **1) What is the effect on the lease proposal if the general provisions requested by the USAF [U.S. Air Force] are not included in the bill? [Emphasis added]**
>
> **A1) The provisions will allow the USAF to carry termination liability as a contingent liability and will not require the service to set aside the liability amount. The lease deal becomes unaffordable if the termination liability bills must be specifically budgeted. [Emphasis added]**
>
> 2) What is the annual bill for termination liability that must be budgeted for under OMB's [Office of Management and Budget] rules?
>
> A2) Starting in FY03 the following is the termination liability per year in [redacted]
>
> 3) What is the schedule for going on contract and what is the leased aircraft delivery schedule?
>
> A3) Boeing and USAF remain in negotiations The negotiating team projects a December Contract award, if AF [Air Force], OSD [Office of the Secretary of Defense], OMB [Office of Management and Budget], and Congress concur with the negotiated lease. Based on a December 2002 contract award, the delivery schedule is: starting in FY06 11/16/20/20/20/13 (last delivery is FY11)

On September 24, 2002, as a followup to his e-mail of September 20 to Dr. Roche, Lieutenant General Duncan McNabb sent an e-mail to Ms. Druyun, Major General Bill Essex, and Dr. Sambur with a cc: to Major General Kevin Chilton in which he stated:

> Marv/Darleen/Bill
> Here's the e'mail I'd like to send to the SECAF [Secretary of the Air Force] and CSAF [Chief of Staff Air Force] this morning. My folks say you are ok now with the profile (given that we have the flexibility in the MILCON [Military Construction (Appropriation)] to absorb the possible increase). I've highlighted the point you make about the real issue being the 67 vs 1 deliveries. With your coord [coordination], I'd like to get this out this morning

[redacted]

> Mr. Secretary/Chief,
> The KC-X POM [Program Objectives Memorandum] schedule I sent you on Friday is still correct. We have reconfirmed with AQ [Office of the Assistant Secretary of the Air Force (Acquisition)] that we have enough money laid in to purchase the 21 aircraft in the FYDP [Future Years Defense Program]—even if the price increases to [redacted] per aircraft that Darleen highlighted in her e'mail. If the price is higher, we plan to make an adjustment in how we lay in the MILCON, but we still have an executable plan (we have laid in over [redacted] in MILCON from 06-09 and could push some of it to FY10 and FY11).
> Both Dr Sambur and Darleen believe the most important point is that under the lease you will have 67 aircraft delivered by 09, while under the purchase approach in the 04 POM, we will only deliver 1 (given the two years from purchase to delivery)

On September 25, 2002, [redacted] Air Force Strategic Programs, Office of the Assistant Secretary of the Air Force (Acquisition) sent an e-mail to Brigadier General Ted F. Bowlds, Program Executive Officer for Strategic Programs, Office of the Assistant Secretary of the Air Force (Acquisition); [redacted] Program Executive Office for Strategic Programs; [redacted] at the Aeronautical Systems Center; and [redacted] at the Aeronautical Systems Center with a cc: to [redacted] Office of the Air Force Director of Global Reach Programs, Office of the Assistant Secretary of the Air Force (Acquisition); [redacted] Mobility Division, Office of the Air Force Director of Global Reach Programs; [redacted] Chief, Mobility Division, Office of the Air Force Director of Global Reach Programs; [redacted] Mobility Division, Office of the Air Force Director of Global Reach Programs; and [redacted] Mobility Division, Office of the Air Force Director of Global Reach Programs. In the e-mail, [redacted] provided notes on tanker meetings with the Chief of Staff of the Air Force and the Secretary of the Air Force:

> CSAF [Chief of Staff of the Air Force] Meeting
> -Focused on need, show availability in our year as 'fuzzy' 'unknown,' showing ESL [expected service life] projection is downward trend, with corrosion being one big unknown
> -Wanted to ensure SECAF [Secretary of the Air Force] knows POM [Program Objectives Memorandum] acceleration meant purchase 21 but only deliver 1 inside FYDP [Future Years Defense Program]
> -Recommended that we show cost avoidance of retiring 135Es to SECAF
> -Chief stated that 'you don't need to sell me' 'this made good sense from the start'
> -Chief stated he was optimistic
>
> SECAF Meeting
> -Termination liability addressed as issue needs to be fixed by Congress or not able to execute deal
> --Mrs Druyun mentioned that Congress allowed us to waive TL [termination liability] for the Gulfstream V contract
> 1Funding identified as issue; XP [Deputy Chief of Staff for Plans and Programs] pushed for strategy to approach how we get additional $2B [billion] for lease inside FYDP. XP addressed at end of meeting again mentioning that we could push for OSD [Office of the Secretary of Defense] to provide money much like we did a few years back with C-17 National Airlift Fund. SECAF acknowledged that TRANSCOM [U S Transportation Command] (working capital fund) is setup to breakeven and not pay for recapitalization costs.

[redacted]

-SECAF stated that we don't want to put another dime into these old 135Es
-SECAF summarized key points
1) Mission of tankers dramatically changed and we now refuel everybody
2) Estimates on maintenance costs increasing with rate of change growing at first derivative function
3) Lease 100 a/c at a time is good strategy. We learn, observe, retire old ones, return leased or keep, and figure out what right quantity and mix should be. Flexible strategy
-SECAF view is that lease is hedge or insurance policy for staying on 'blue line' (most likely availability). We have no experience with a/c this old.
-Asked about rebate. Explained if sold to another customer AF [Air Force] keeps anything received over loan balance.
-Dr. Sambur mentioned call from Boeing, [redacted] stating we are getting good opportunity/deal
-SECAF asked about cost of Trainers. Seemed high to him What did it include? Wanted to make sure Boeing wasn't padding the number. After some explanation that it covered more than 6 years and went out to FY 17, he felt more comfortable. Action item taken by Mrs. Druyun to provide more information on what was included in trainers cost/justification.
-Asked about fixed rate of bond not being variable after takeout, asking if shows up in price of bond. Yes sir, fixed rate bonds.
-Asked about commercial insurance ending if you buy. Yes
-Asked about word Smart Tanker on chart for recap options questioning whether cost for that Smart package included here or in another cost package. Answer was cost was in another package. Mrs. Druyun mentioned that the 767 had the growth laid into it for the Smart Tanker spiral
-SECAF questioned whether the NPV [net present value] had the cost avoidance included. Answer: no, just complied with A-94 which doesn't allow it.
-SECAF mentioned that the AF business case for POM [Program Objectives Memorandum] (purchase) would have to include big costs for AFMC [Air Force Materiel Command] 'monster program office'
-SECAF questioned assumption for last alternative of reengine, wait, then be forced into a developmental platform. Why not 777? Some explanation was provided that it was too big for need with not a lot of extra offload for size, but it was acknowledged that depending on strategy it could fulfill some of refueling requirement (like KC-10s).
-SECAF wanted to know average age of 135 in 2020; 60
-SECAF agrees with briefing We have a good deal to bring forward. WE have good deal for taxpayer and DOD.
-Next steps
—Brief Pete Aldridge before leasing panel
—Have Mr Aldridge send memo to Rumsfeld and Wolfowitz
—Go back to OMB [Office of Management and Budget], label it draft, ask if they have a problem if we discuss with Congress
—Get [a Representative] to look at it and get his read since he sided with [a Senator] before.
—Get with Lease Panel
—Caveat deal contingent with working out issues (such as TL [termination liability]) with OMB and Congress (need to see where we are with termination liability, Gulfstream may be precedent)
—Congress may decide not to return to session depending on what happens in elections.
—Gen [General] Zettler questioned if committees have to ok
—SECAF stated that if we still get report to staff in early Dec, and Congress (Senate Armed Services Committee) pushes for hearings then

[redacted]

we may be in the Spring. But we only need new TL language in this year's appropriation conference.
-[redacted] questioned lease policy if Navy trying to get out of lease and we are pursuing one.
--Navy did stupid lease.
--SECAF stated timing is different now. SECAF noted that people need somewhere to put money now since market is down. Bonds are good investment, the money is out there. This is good rate for people.
-General Baker, AMC [Air Mobility Command] vice, stated that although it was stated that this plane is a 1 for 1 R equivalent; it still brings other benefits/capabilities to warfighter including better availability
--SECAF noted that yes it also helps freighter position
-SECAF stated that we still needed to tell Gen [General] Myers that we need to keep some 135s until they reach age 80.

Dr. Sambur Follow-Up
-Need to add cost avoidance. Cautioned that since 767 has O&M [operation and maintenance (appropriation)] bill also, avoidance may not really be that great. Explained that its hard to get apples to apples CLS [contractor logistics support] vs organic. Mrs. Druyun stated that the 767 also has nonrecurring portions of costs built in. Dr. Sambur said its got to be less to maintain a new plane. Said if can't get exact apples to apples, still need applesauce.

October 2002. On October 7, Dr. Sambur sent an e-mail to Dr. Roche in which he stated:

* * * * *

OMB concerns are all answerable, but not irrefutably so. For example,
Requirements -- They view our requirements chart and maintain that the delta between need and availability is bogus given that we have been able to live with the deficit for so many years (and especially during the present conflict). Our answer is that we have been playing Russian roulette
Refund scheme. They view the scheme as very clever but violates the congressional rules and the operating lease requirements. Our answer is that we have no commitment to buy the tankers. Only an agreement to get a payback should they sell the tankers for more than [redacted]
Commercial lease. They view the market for tankers as only being military (which violates the operating lease rules). We assert that they may be correct but the residual value is based on the commercial use of the planes as commercial cargo transports and not as tankers. The residual value has the conversion to transport already baked into the price
Modification of the 767. They argue that we have violated the congressional language that requires a green plane. We answer by pointing to the congressional dialog that defines a green tanker.
You may have to have another high level meeting with (Robin [Cleveland]) to discuss these issues.
Marv

*Removed for reason stated in the initial asterisked footnote. (The first reference is also on page 14.)

[redacted]

On October 7, 2002, in response to Dr. Sambur's e-mail, Dr. Roche sent an e-mail to Dr. Sambur in which he stated:

> * * * * * But, if Robin's [Cleveland] folks persist, then we can gather to review
> Jim

On October 22, 2002, General John P. Jumper, Air Force Chief of Staff, approved the "Operational Requirements Document, AMC 004-01-B, Air Refueling Aircraft Program, ACAT [Acquisition Category] Level IC."

On October 22, 2002, Dr. Sambur sent an e-mail to Dr. Roche in which he stated:

> Boss
> Our problem is that we do not have a good answer to why we claim that we have a[n] urgent need for tankers BUT we are retiring 67 KC135E's in the FDYP [FYDP (Future Years Defense Program)] to save $1B [billion] BUT we need an additional $1.7B [billion] to lease the tankers
> Our other problem is that we have a parametric approach to deriving pricing that has black magic associated with the weighing function I tried to give an intuitive interpretation that went down better but our inability to explain in a concise manner the complicated weighing function is an issue I am working with our people to develop a more concise explanation.
> Marv

On October 28, 2002, Dr Roche sent an e-mail to Dr. Sambur with a cc: to Ms. Druyun in which he stated that:

> * * * * *

On October 28, 2002, in response to Dr. Roche's e-mail, Ms. Druyun sent an e-mail to Dr. Roche and Dr. Sambur in which she stated that:

> * * * * *

*Removed for reason stated in the initial asterisked footnote. (The second and third references are also on page 208.)

[redacted]

On October 28, 2002, in response to Ms. Druyun's e-mail, Dr. Roche sent an e-mail to Ms. Druyun and Dr. Sambur in which he stated:

> Darleen, I don't doubt you for a minute. My point was that, once OMB [Office of Management and Budget] and the WH [White House] take the lead, they own the responsibility! Let [a Representative] deal with them!

On October 29, 2002, in response to Dr. Roche's e-mail, Dr. Sambur sent an e-mail to Dr. Roche and Ms. Druyun in which he stated:

* * * * *

On October 29, 2002, in response to Dr. Sambur's e-mail, Dr. Roche sent an e-mail to Dr. Sambur in which he stated:

* * * * *

On October 29, 2002, [redacted]

[redacted]

*Removed for reason stated in the initial asterisked footnote.

[redacted]

On October 29, 2002, [redacted]

On October 29, 2002, [redacted]

November 2002. On November 5, Ms. Druyun submitted a letter to the Air Force ethics office, recusing herself from further negotiations with Boeing and retires mid-month.

[redacted]

On November 16, 2002, Dr. Roche sent an e-mail to [redacted] at Boeing in which he stated:

> [redacted] I think it's time to raise some eyebrows, if not an alarm, about the poor Hill and Administration support the Air Force is getting from Boeing. Specifically:
> 1. I am very unhappy with the bland support we received on the C-17 funding initiative. Of course, we will comply with the SAC/HAC [Senate Appropriations Committee/House Appropriations Committee] direction to fully fund the [C-]17 this year. But, any Boeing notion that we will rob others to make up for this problem would be arrogance of the first order. Believe me, Boeing will face at least it's fair share of this unexpected hit to our POM [Program Objectives Memorandum]. You all did little to help the Congress understand and accept our agreed to approach. It was our mutual responsibility to explain the approach. Our people felt very lonely.
> 2. [A Senator] has written the building asking about the supposed overrun on the F/A-22 EMD [engineering and manufacturing development] program. Hello? Why didn't the one third partner on the program take the time to help the staff of the senior Senator of the state in which its mil [military] sector is located? More Boeing arrogance? Or, are your people asleep? Do you not care about the [redacted] which you would lose if the [F/A-] 22 went down? Given your non-position on the 35 [F-35, Joint Strike Fighter], I'm stunned about the blasé approach you have taken re the 22.
> [redacted] both Johnny and I are seething over Boeing's behavior. Oh, if you all don't start talking up the [Boeing] 767 lease when you visit OSD [Office of the Secretary of Defense] colleagues, you will see that program go down (we understand that the staff is building up a head of steam to stop the lease). Gee, [redacted] when I knew you and [redacted], I had the sense you wanted to make money. Guess I was wrong. I'm off to PACAF [Pacific Air Forces], but Marv Sambur is here. Time for some senior mgt [management] attention, Old Friend.
> Be well. Jim

On November 19, 2002, Dr. Roche sent an e-mail to Mr. Aldridge with a cc: to General John Jumper, Air Force Chief of Staff; Dr. Sambur; and Mr. William C. Bodie, Special Assistant to the Secretary of the Air Force in which he stated:

> Pete, old Buddy, you have been our strongest supporter on the issue of the lease. I now hear that your staff is telling us that you are weakening. Please don't. Here is some food for thought:
> (1) Regardless of OMB [Office of Management and Budget], the deal is a good one for the taxpayer.
> (2) Every time we come forward with something good for the taxpayer, the bureaucrats (including yours) feel that they have to fight it (job security?)
> **(3) To delay for two years to do an AoA [analysis of alternatives] is simply silly. If just means two more years of wasted repair costs on the E models; a waste of taxpayers' money to some beltway bandit; more bureaucratic delay by PA&E [Program Analysis and Evaluation]; and an end which is predictable.** [Emphasis added.]
> (4) Since neither ships, trucks, or tiny planes can serve as tankers, we will be looking at big planes. Guess what? We're already there. We will waste money and have nothing to show for it.
> (5) Hey, we can extend the life of the E's and re-engine them! We'll that doesn't pass Grant's lieutenant's test: it means we will be flying 80 year old planes in a few years!!!! Average age is now between 42 and

Congressional Record

[redacted]

> 44 years. Re-engining won't solve the inherent catalytic corrosion problem. More waste of money
> (6) Gee why didn't we [go] for 50 or 60 or 70 year old Air Force ones? How many of our bureaucrats fly in such old planes? I'm getting used to some in their late 40s, but I'm not so picky! But, why don't we make the Navy sail 60 year old destroyers? Or submarines? Because it's dumb
> (7) If we wait, there may not be a 767 line! Hey, can we convert used ones? Here we go again. We can waste money with half measures that are penny wise and pound foolish. Why not do the same for ships? OK, so we'll be forced to buy French airplanes.
> (8) To kill this idea in OSD [Office of the Secretary of Defense] is proof that there may be words like "acquisition reform," but they are hollow The bureaucrats want to keep doing things the same old way, adding little value but lots of costs
> I can only keep my sanity by remembering . . . advice to me years ago: 'there are limits to the stupidity any one man can prevent." Off to Okinawa! Jim.

Congressional Record

On November 20, 2002, in response to Dr. Roche's e-mail to Mr. Aldridge, Mr. William C. Bodie sent an e-mail to Dr. Roche in which he stated:

> Good for you, boss. [Mr] Aldridge may deny he's been weakening, but the smoke signals are thick Aldridge interviewed with Anne Marie yesterday, and although he wouldn't comment on specifics of any deal and was keeping an open mind, he indicated that in general terms he would have concerns about leasing when/if buying was cheaper. That doesn't jibe with his previous support for the lease from a NPV [net present value]/cash flow management perspective. In addition, the spores seem to be pushing a 'what's the rush?' line: buying is cheaper (we 'exaggerate' the purchase cost of a green 767), therefore better; such a large expenditure requires more 'rigorous analysis' than the back-of-the-envelope assertions by the AF [Air Force], hence an AoA [analysis of alternatives]; the AF hasn't POM'ed [program objectives memorandum] for the lease, so how serious can we be? There is no 'urgent' need because the AF is starting to retire the E's next year even without an immediate replacement, so why can't we be more deliberative? Boeing will still be there, making airplanes, so what's the rush? Anyway, Airbus could make planes with enough American content if need be. I rebutted all these arguments with Jaymie [Durnan, The Special Assistant to the Secretary and the Deputy Secretary of Defense] (as you did with Pete [Aldridge]), but we might be in the 'power' phase with OSD [Office of the Secretary of Defense] on this issue. If anyone can talk sense to Aldridge, however, it's you

Congressional Record

On November 20, 2002, in response to Mr. William C. Bodie's e-mail, Dr. Roche sent an e-mail to Mr. William C. Bodie in which he stated:

> Right. I'm relaxed on this one. They have to take the bureaucratic position. Jim

Congressional Record

On November 22, 2002, [redacted]

[redacted]

[redacted]

On November 23, 2002, [redacted]

On November 25, 2002, [redacted]

[redacted]

[redacted]

December 2002. On December 17, [redacted]

[redacted]

[redacted]

[redacted]

On December 18, 2002, [redacted] Chief of Mobility and Special Operations Forces, Weapons Systems Liaison Division, Office of Air Force Legislative Liaison sent an e-mail to Major General Leroy Barnidge, Jr., Air Force Director of Legislative Liaison in which he stated:

> Maj Gen [Major General] Barnidge,
>
> As you know, there has been some conversation about a possible meeting with [a Representative's] office (generated from the [Representative's] office through Mr Powell Moore), OSD [Office of the Secretary of Defense] and one AF [Air Force] representative OSD/LA [Office of the Assistant Secretary of Defense (Legislative Affairs)] [redacted] called [a congressional staffer] this morning to determine the [Representative's] desire for the meeting
>
> [redacted] * * * * * * This eliminates the need for a meeting in which the AF, OSD, and the [Representative's] office were going to talk about the need for tankers right now, 767 ability to fill this need, and the 767 acquisition strategy.
>
> Way Forward: Where we are at right now is that OSD at the highest levels is getting together (DepSecDef, Mr Aldridge, Dr. Zakheim, Powell Moore [Assistant Secretary of Defense (Legislative Affairs)], etc) to decide the DoD way forward The decision will be to support the lease now or show why decision should wait until a later time. I am not sure when the meeting will occur, but waiting until March (the date previously given by OSD) is no longer an option. According to [redacted] this will be decided soon and it is more now an issue of OSD explaining why DoD shouldn't do the lease then [sic] it is the AF explaining why we should (a reversal of the normal process). I will keep you posted.

On December 19, 2002, [redacted]

[redacted]

*Removed for reason stated in the initial asterisked footnote (The reference is also on pages 16 and 185)

[redacted]

[redacted]

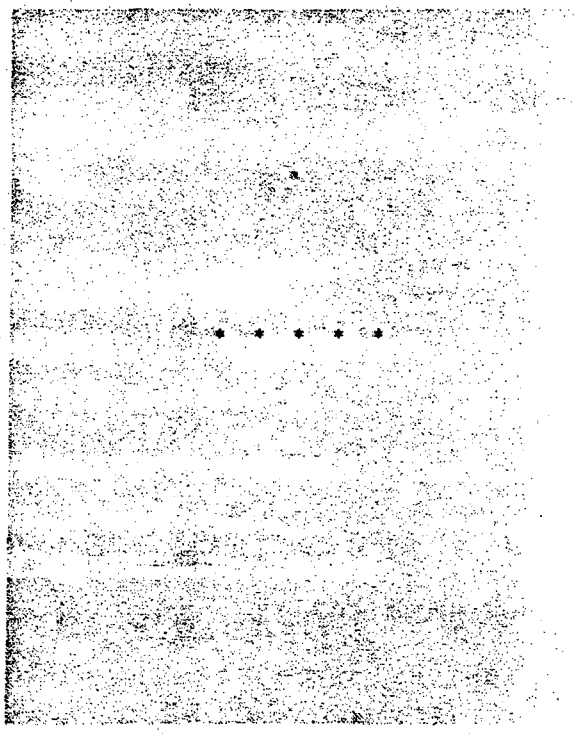
On December 19, [redacted]

[redacted]

January 2003. On January 23,

[redacted]

On January 30, 2003, General John Jumper, Air Force Chief of Staff sent an e-mail to Dr. Roche in which he stated:



* * * * *

*Removed for reason stated in the initial asterisked footnote. (The reference is also on pages 17, 188, and 210.)

[redacted]

On January 31, 2003, in response to General John Jumper's e-mail, Dr. Roche sent an e-mail to General Jumper in which he stated:

> And, I had at Himself on the deal in the morning, noting as I poin[t]ed to them that, unlike businessmen who would understand how good an opportunity this was, these Corporate Staff bureaucrats (Dov and Stevie) can't get it. Don asked if I was special pleading. I said 'yes.' And, further, would continue to do so. [Lawrence] DiRita [Principal Deputy Assistant Secretary of Defense (Public Affairs)] announced that my comments 'were brought to you by the Boeing Company.' I didn't rip his heart out. Don had been programmed by the Tall Spore and asked about 'opportunity costs', etc to which the Spores jumped. But, when asked what was in the budget, I had the chance to take a shot at the TS [Tall Spore] by telling Don that we wouldn't beartrap [sic] him by assuming that he approved the lease; thus, the budget had a buy. Pete then told him the 'when' of the buy, and Don said: 'Not soon enough!' Through the day, I have been asked by the Spores to consider a lease of 50 with an option for 50, and a 67/33 split. Each time I remind them that these hairbrained [sic] ideas would only be more expensive. Don asked that the decision be delayed until after he testified!!! Note: he doesn't want to touch it. But, there is no doubt that he understands our position. [redacted] Jim.

February 2003. On February 21, Dr. Sambur, Assistant Secretary of the Air Force (Acquisition) sent a memorandum, "KC-767 Lease Proposal," to Mr. Aldridge, Under Secretary of Defense for Acquisition, Technology, and Logistics; and Dr. Zakheim, Under Secretary of Defense (Comptroller) with a cc: to Dr. Spruill, Director, Acquisition Resource and Analysis, Office of the Under Secretary of Defense for Acquisition, Technology, and Logistics; and Dr. Schroeder, Deputy Under Secretary of Defense (Resource Planning/ Management), Office of the Under Secretary of Defense (Comptroller). In the memorandum, Dr. Sambur stated that:

> The Air Force's proposal to lease 100 KC-767s has truly been a 'learning journey' for all of us that have been working this new and innovative approach to acquiring needed capability for our warfighters. Throughout the review process, the OSD [Office of the Secretary of Defense] and OMB [Office of Management and Budget] staffs have challenged us with many thought-provoking questions, several of which have caused us to look deeper into the unique characteristics of leasing. One of these characteristics that seemed only secondary at first has now emerged as a significant, primary lease advantage: the multiyear nature of the contract itself.
>
> [redacted]

*Removed for reason stated in the initial asterisked footnote. (The reference is also on page 18.)

[redacted]

[redacted]

March 2003. On March 14, Dr. Dov S. Zakheim Under Secretary of Defense (Comptroller) sent a memorandum, "Air Force Boeing 767 Tanker Lease Decision Memorandum," to Mr. Aldridge, Under Secretary of Defense for Acquisition, Technology, and Logistics. In the memorandum, Dr. Zakheim stated that:

> I have reviewed the draft decision packages on the KC-767 program and the comments to the packages submitted by the Principal Deputy Director, Program Analysis and Evaluation (PA&E). I support a number of the recommended changes proposed by the Principal Deputy Director (PA&E), and offer the following comments
>
> - I strongly recommend that a new approach be considered by the Department in the negotiations with Boeing. The goal of these negotiations should be to reduce the price of the aircraft, regardless of the option selected-purchase or lease. No less important, I believe that you personally should lead the negotiations (my office and I will be happy to be of any assistance you deem to be useful).
> - The reference to waiving termination liability under the purchase option implies, but does not explicitly state, that the tanker acquisition will be incrementally funded, which also will require a waiver to the full funding policy. (If the procurement alternative is fully funded, the termination liability waiver would be unnecessary

[redacted]

because the only termination liability would be the small amount associated with the advance procurement.) Given the magnitude of this acquisition, the decision to waive both the full funding policy and the termination liability policy should be placed in a separate paragraph.

- In his comments, the Principal Deputy Director (PA&E) includes a statement in the purchase option that the procurement of the KC-767 should begin in FYO5. That statement is unnecessary, given PA&E's next statement which asserts that the KC-767 aircraft should be procured and delivered as quickly as possible using a multiyear procurement strategy.
- Regardless of the method of acquisition of the aircraft, I strongly believe that the KC-767 program should be designated as an ACAT [Acquisition Category] ID Major Defense Acquisition Program.

April 2003: On April 7, [redacted]

[redacted]

On April 10, 2003, [redacted]

On April 15, 2003, Mr. Michael W. Wynne, Principal Deputy Under Secretary of Defense for Acquisition, Technology, and Logistics sent an e-mail to Mr. Jaymie Durnan, The Special Assistant to the Secretary and the Deputy Secretary of Defense with a cc: to Dr. Dov S. Zakheim, Under Secretary of Defense (Comptroller); Mr. Pete Aldridge, Under Secretary of Defense for Acquisition, Technology, and Logistics; and Mr. Wayne A. Schroeder, Deputy Under Secretary of Defense (Resource Planning/Management), Office of the Under Secretary of Defense (Comptroller). In the e-mail, Mr. Wynne stated:

> As I mentioned this morning, I had shaped the program by working the configuration and the potential financing hard with the 100 airplane add-on. Pete Aldridge had asked the question as to where we were on the reconciliation to the IDA [Institute for Defense Analyses] values, and I received from the Air Force their assessment, but not from IDA.
>
> This afternoon, I took the reshaped program to OMB [Office of Management and Budget]; and they opined that this was a reduced price, but wondered why we had to change the configuration to achieve even remotely close to the IDA values [redacted], which were for the all up Tanker that the Air Force had sold them on earlier. They were not willing to compromise on that configuration.
>
> I probed about consequences to a broken negotiation regarding the lease, and got in return that if this went away, and was instead a multiyear in FY05 or FY06 they would be comfortable with that, and so would the White House. They also indicated that the IDA values should be reconciled to that business deal as well.
>
> That re-set the baseline, and so here is our current strategy:
> 1. Continue to reconcile to the IDA values, recognizing that for us they represent the top end of our negotiation.
> 2. Re-set the configuration baseline closer to or at the Air Force desired configuration.
> 3. Organize a trip to Boeing if there is any chance that they would agree to a simple price reduction, to illustrate:
> The Air Force Agreed Configuration reduction resulted in a price of [redacted] the IDA range for that configuration was [redacted]
> 4. We will require a minimum reduction of [redacted] or we have a broken negotiation.

[redacted]

> 5. Notify OMB and announce either way.
>
> This will not be easy, given the long history on this deal, and the consequences of a sudden change of heart. I would have expected that the concessions should have and could have come as a result of configuration changes which would have provided some cover for both teams. Recall, I gave them that opportunity over the past two weeks. In that absence...
>
> We should afford Boeing this last opportunity, and then call it a day for the lease.

On April 15, 2003, Mr. Michael W. Wynne forwarded his e-mail to Mr. Jaymie Durnan on to Dr. Sambur with a cc: to Dr. Nancy L. Spruill, Director, Acquisition Resource and Analysis, Office of the Under Secretary of Defense for Acquisition, Technology, and Logistics and stated:

> Marv; News, some good, some bad. The good news is that OMB [Office of Management and Budget] stood behind the configuration that you desired, or as close to it as we could get. The bad news is that they also stood behind the IDA [Institute for Defense Analyses] valuation, which was very close to their own, and will likely not get off that. They want a simple price concession from Boeing. Period. Look at the strategy below, and unless you want to go with me and give this a shot, I think this is over.

On April 15, 2003, Dr. Sambur forwarded Mr. Wynne's e-mail to [redacted] Senior Vice President for Boeing Defense Systems with no comments.

On April 23, 2003, Mr. Wynne met with the Office of the Secretary of Defense Leasing Review Panel for the lease of the Boeing KC-767A tanker aircraft as discussed in the following synopsis:

> Mr. Wynne did a nice job keeping the meeting non-confrontational, and exploring the factual bases for the differing Air Force and IDA [Institute for Defense Analyses] positions. Differences still exist in a number of areas, but no real mistakes are apparent, merely differences in professional judgments (e.g., Air Force uses commercial indexes, IDA uses DoD indexes). There seems to be only one area (cost of capital) that OSD [Office of the Secretary of Defense] will overrule IDA; this will move OSD roughly [redacted] closer to the Air Force position.
>
> Afterwards, Dr. Sambur advised the team that the Air Force is in trouble. It appears that a consensus now exists between OMB and the White House that the lease is only supportable at [redacted] per aircraft. Reportedly, Mr. Wynne has this information and shared it in confidence with Dr. Sambur.
>
> Bottom line: It appears the Air Force has to head back to the negotiation table with Boeing. My concern is that the SPO [system program office] has effectively lost credibility when IDA/OSD overruled the negotiated settlement they already reached. Unless someone from senior leadership gives the SPO top cover and authority, I doubt that Boeing will negotiate with them. The Boeing local office is already saying that they want to negotiate only with IDA.
>
> The saga continues...

[redacted]

On April 24, 2003, Dr. Sambur sent an e-mail to Mr. Wynne with a cc: to Dr. Roche and Mr. Aldridge in which he stated:

> Mike
> [redacted] [Boeing] visited me yesterday and asked about the status of the lease I told him that we were still debating the IDA [Institute for Defense Analyses] analysis. IDA based their analysis on third party estimates that assumed knowledge of [redacted] drawings (IP). He said that [redacted] never gives away its drawings and these 3rd party vendors do not have the ability to FAA [Federal Aviation Administration] certify their work. In addition, the SPE [Senior Procurement Executive] is taking the plane from [redacted] and unless the AF [Air Force] wants to certify the tanker and get [redacted] out of the loop, he does not see how the lease would work. He stated that there is tremendous risk in his FIXED PRICE number (note that IDA does not have fixed price bids) and if everything went PERFECTLY, he would make money He will not reduce his price to meet the IDA number and will recommend to the [redacted] Board in mid May that the effort stop. Marv

On April 24, 2003, in response to Dr. Sambur's e-mail, Dr. Roche sent an e-mail to Dr. Sambur and Mr. Wynne with a cc: to Mr. Aldridge in which he stated:

> And I don't blame him. This assumption that Boeing is cheating the American taxpayers is not helpful. I am struck that not a single critic has stepped forward to assume the program at a fixed price What a waste of effort! Pete, maybe it's time to just wrap up this initiative. Jim

On April 24, 2003, Dr. Sambur forwarded his e-mail with Dr. Roche's comments to [redacted] in which he stated:

> [redacted]
> Please treat as sensitive. I documented your visit (first email) to create a sense of urgency. Marv

On April 24, 2003, [redacted] forwarded Dr. Sambur's e-mail with Dr. Roche's comments to [redacted] in which he stated:

> [redacted]

May 2003. On May 3, [redacted] sent an e-mail to Dr. Sambur with a cc: to [redacted] in which he stated:

[redacted]

[redacted]

On May 3, 2003, Dr. Sambur forwarded [redacted] e-mail to Dr. Roche and Mr. Aldridge and stated:

> I have had discussions with [redacted] about the mixed cost plus and fixed price approach discussed on Friday. [redacted] will not go along with this approach for the following reasons: [redacted] can not give us a better price on the green A/C [aircraft] because we already have the 'most favored customer' clause. If they were to lower their price to us, it would mean that they would have to give a rebate to everyone else that has this clause. That is a non-starter for [redacted]. The cost plus aspect of the modifications is also a non-starter because the target price [redacted] - green A/C most favored price) has, by [redacted] calculation, negative margin. Thus, even with a cost plus contract they lose money. In addition, [redacted] believes that the cost plus contract is not permitted by the congressional language . . . . To resolve the underlying perception that [redacted] is 'ripping us off' and to live within the congressional language, they propose a fixed price contract of [redacted] that caps profit at [redacted] for the mods [modifications]. If at the end of the day, the true mod cost with [redacted] profit is less than [redacted] - most favored green A/C), they refund money to the AF [Air Force]. If the true mod cost plus [redacted] profit is more than [redacted] - most favored green A/C), [redacted] eats the difference. [redacted] will let us completely audit all costs associated with the mods (see attachment 2).
>
> I like this approach except for the 'give back' provision. This give back provision requires the AF to refund [redacted] if we do order a total of 200 tankers in the future. Without this provision the price is [redacted]. I think we can get a small reduction in this price [redacted] if we commit to go forward. I asked Jim to call you both on Monday to tell you that [redacted] will not accept the cost plus deal and to explain his offer. If you feel it is appropriate, you can ask about the [redacted] to [redacted] additional reduction especially if we can give him some assurance that we need to buy 200 tankers.

On May 3, 2003, [redacted] sent an e-mail to Dr. Roche in which he stated:

> [redacted]
>
> * * * * *

*Removed for reason stated in the initial asterisked footnote. (The reference is also on page 20.)

[redacted]

On May 7, 2003, [redacted]

On May 7, 2003, [redacted]

On May 7, 2003, [redacted] sent an e-mail to Dr. Roche in which he stated:

> MR. SECRETARY: [redacted] just called me and said that Marv Sambur was getting beat up by Mike Wynne[] again concerning the [redacted] dollar number per aircraft. [redacted] would like to know if he needs to do anything like calling in the big guns to help out. I told him I would query you to get your advice.
> God Bless,
> [redacted]

Congressional Record

[redacted]

On May 7, 2003, in response to [redacted] e-mail, Dr. Roche sent an e-mail to [redacted] in which he stated:

> It's time for the big guns to quash Wynne! Boeing won't accept such a dumb contract form and price, and Wynne needs to 'pay' the appropriate price! Jim.

On May 9, 2003, Dr. Roche sent an e-mail to Ms. Robin Cleveland, Office of Management and Budget, the subject of which was [redacted] resume and cover letter attached for export. In the e-mail, Dr. Roche stated:

> Be well. Smile. Give tankers now (Oops, did I say that? My new deal is terrific.) ☺
> Jim

On May 23, 2003, Mr. Aldridge, Under Secretary of Defense for Acquisition, Technology, and Logistics sent a memorandum, "Air Force Boeing 767 Tanker Lease Decision Memorandum," to the Secretary of the Air Force. In the memorandum, Mr. Aldridge stated that:

> After a comprehensive and deliberative review by the Leasing Review Panel, the Secretary of Defense has approved the Air Force's proposal to enter into a multiyear Pilot Program for leasing general purpose Boeing 767 aircraft under the authority in section 8159 of the Department of Defense Appropriations Act, 2002. While the currently approved plan will provide for delivery of a total of 100 KC-767 aircraft, approximately 67 of which will be delivered in the Future Years Defense Program (FYDP), it is the intent of the Department to go beyond the initial 100 aircraft as we begin the recapitalization of the airborne tanker fleet.
>
> The Leasing Review Panel compared the merits and shortcomings of both leasing and purchasing the aircraft, and the Secretary determined that the lease option best satisfied military needs and was preferable for two primary reasons. First, the lease will require a lesser initial outlay in the FYDP. Second, leasing accelerates the delivery of aircraft.
>
> The Secretary of Defense approved this lease proposal contingent upon securing a waiver of the requirement to fund termination liability and approval from the Office of Management and Budget. While the KC-767 program is in its initial stages, I am designating the program as an ACAT [Acquisition Category] ID Major Defense Acquisition Program. In the interests of the government and the taxpayer, I direct the Air Force to work with Boeing to negotiate the best possible total purchase price not to exceed $131 million per unit and lease unique costs, which the Special Purpose Entity will be responsible for paying to Boeing, and which will form the basis for government payments under the lease. The total purchase price shall include a firm, fixed-price for the 'green' aircraft (767-200C) and for modifications and additional tanker equipment on the green aircraft. The Return on Sales (ROS) shall not exceed [redacted] for the green aircraft or for the additional equipment; and the configuration shall meet the minimum set of requirements to satisfy the Air Force's mission. I further direct the Air Force to work with the Office of the Under Secretary of Defense (Comptroller) and the Office of the Director, Program Analysis & Evaluation, to finalize offsets in the FYDP to fully fund the lease plan.
>
> In addition, as mandated by the legislation, the Air Force shall submit a report to the Congressional Defense Committees before signing the lease

~~FOR OFFICIAL USE ONLY~~

> contract, and report back to Congress one year after the first delivery and annually thereafter.
>
> Finally, the Air Force shall develop a long-range recapitalization plan beyond the current lease proposal and present that plan to the Secretary of Defense by 1 November 2003.

On May 23, 2003, after about 2 years as the Under Secretary of Defense for Acquisition, Technology, and Logistics, Mr. Aldridge retired from the Government. Mr. Michael W. Wynne became the Acting Under Secretary Defense for Acquisition, Technology, and Logistics.

On May 28, 2003, Mr. Michael W. Wynne, Acting Under Secretary of Defense for Acquisition, Technology, and Logistics sent a memorandum, "Air Force Boeing 767 Tanker Lease Decision," to the Director, Office of Management and Budget. In the memorandum, Mr. Wynne stated that:

> After a comprehensive and deliberative review by the Leasing Review Panel, the Secretary of Defense has approved the Air Force's proposal to enter into a multiyear Pilot Program for leasing general purpose Boeing 767 aircraft under the authority in section 8159 of the Department of Defense Appropriations Act, 2002. The Secretary has approved the lease proposal contingent upon securing a waiver of the requirement to fund termination liability and approval from your office.
>
> There is consensus within the Department that we must start recapitalizing the airborne tanker fleet as soon as possible, and that re-engining the KC-135E aircraft will not extend their service life. The combined effects of aging, the surge in demand due to the Global War on Terrorism and recent conflicts have increased the need to replace the KC-135. The Leasing Review Panel compared the merits and shortcomings of both leasing and purchasing KC-767 aircraft, and the Secretary determined that the lease option best met the needs of the Air Force and was preferable for two primary reasons. First, leasing accelerates the delivery of aircraft, satisfying the recapitalization need. Second, leasing contributes to our goal of program stability by minimizing impact to on-going programs.
>
> The KC-767 program has been designated as an ACAT [Acquisition Category] ID Major Defense Acquisition Program. In the interests of the government and the taxpayer, the Air Force has been directed to work with Boeing to negotiate the best possible total purchase price not to exceed $131 million per unit and lease unique costs, which the Special Purpose Entity will be responsible for paying to Boeing, and which will form the basis for government payments under the lease. The total purchase price shall include a firm, fixed-price for the 'green' aircraft (767-200C) and for modifications and additional equipment on the green aircraft. The Return on Sales (ROS) shall not exceed [redacted] for the green aircraft or for the additional equipment; and the configuration shall meet the minimum set of requirements to satisfy the Air Force's mission.
>
> The Air Force has been directed to submit a report to the Congressional Defense Committees before signing the lease contract and report back to Congress one year after the first delivery and annually thereafter.
>
> While the currently approved plan will provide for delivery of a total of 100 KC-767 aircraft, approximately 67 of which will be delivered in the FYDP, it is the intent of the Department to go beyond the initial 100 aircraft as we begin the recapitalization of the airborne tanker fleet. The Air Force has been directed to develop a long-range recapitalization

> plan beyond the current lease proposal and to present that plan to the Secretary of Defense by 1 November 2003

June 2003. On June 20, Mr. Kenneth J. Krieg, Director, Program Analysis and Evaluation, sent a memorandum, "PA&E [Program Analysis and Evaluation] Analysis of KC-767A Lease Program," to the Mr. Wynne, Acting Under Secretary of Defense for Acquisition, Technology, and Logistics, and to Dr. Dov Zakheim, Under Secretary of Defense (Comptroller). In the memorandum, Mr. Krieg stated that:

> This memorandum provides a summary of the A-94 and A-11 analyses developed by PA&E [Program Analysis and Evaluation] in response to taskings from the leasing review panel and subsequent leasing working group meetings. The analyses are based on the latest version of the draft 767 leasing contract provided to my office on June 17, 2003.
>
> Our A-94 analysis indicates that the provisions of the draft KC-767A aircraft lease cost more than the equivalent purchase of tanker aircraft. Measured in then-year dollars, lease costs exceed purchase costs by $6.0B [billion]; by $5.1B [billion] if measured in constant FY02 dollars; or by $1 9B [billion] if measured in terms of net present value. Our A-94 analysis is based on the following key assumptions: 1) For the leasing scenario, that the Department purchases the KC-767A tanker aircraft at the end of the lease period; and 2) for the direct purchase scenario, that the Department seeks and receives Congressional approval for a multiyear procurement of 100 aircraft. We find that leasing provides no inherent economic efficiencies relative to direct purchase of tankers and is, therefore, more expensive in the long run.
>
> Our analysis also shows that the current draft lease fails to meet the requirement of OMB [Office of Management and Budget] Circular A-11 that the present value of the lease payments be less than 90 percent of the fair market value at lease inception. Our calculations show that lease payments are more than 93 percent of fair market value, exceeding the requirements for the definition of an operating lease. This analysis is based on a fair market value of $131 million (CY02$). In addition to OMB Circular A-11 requirements, Section 8159 of the FY02 appropriations act includes a requirement that the present value of the lease payments be less than 90 percent of the fair market value at lease inception.
>
> A more detailed supporting analysis will be provided under separate cover.

On June 20, 2003, Major General William Hodges, Director of Global Reach Programs, Office of the Assistant Secretary of the Air Force (Acquisition) sent an e-mail to Dr. Sambur with a cc: to Lieutenant General John Corley, Principal Deputy (Acquisition), Office of the Assistant Secretary of the Air Force (Acquisition); [redacted] Office of the Assistant Secretary of the Air Force (Acquisition); [redacted] Office of the Assistant Secretary of the Air Force (Acquisition); [redacted] Chief, Mobility Division, Office of the Air Force Director of Global Reach Programs; [redacted] Deputy Chief, Mobility Division, Office of the Air Force Director of Global Reach Programs; [redacted] Executive Officer, Office of the Air Force Director of Global Reach Programs; and [redacted] Office of the Air Force Director of Global Reach Programs in which he stated:

Congressional Record

[redacted]

> DR. SAMBUR: I received a call from [redacted] who works for Rick Burke in PA&E [Program Analysis and Evaluation]. HE stated he had just delivered a memo to Dr. Roche's office. I asked him if he could share what they had sent and he attached the memo in two files, below.
>
> This was a total surprise and not ever mentioned in any of our discussions with Dr. Spruill or Dr. Schroeder. It appears that they have simply listed all their positions on the report and none of the accommodations reach with the leasing working group. Apparently, they no longer want to be part of the process
>
> I propose that we provide you with an email containing our counterpoints on their assertions, followed by a proposed response from Dr Roche back to PA&E.

Congressional Record

On June 20, 2003, Dr. Sambur forwards Major General William Hodges' e-mail to Dr. Roche and stated:

> BOSS: This is getting ridiculous!!!!
> Marv.

Congressional Record

On June 22, 2003, in response to Dr. Sambur's e-mail, Dr. Roche forwards Major General William Hodges' e-mail to Mr. Wynne with a cc: to Dr. Sambur and stated:

> MIKE: Ever since Pete [Aldridge] left, the bureaucrats who opposed the 767 lease have come out of the woodwork to try to kill it-yet, once again Mike, I won't sign a letter that makes the case that we shouldn't lease the planes. Ken Krieg's memo attached is a cheap shot, and I'm sure has already been delivered to the enemies of the lease on the Hill. It was a process foul And Ken needs to be made aware of that BY YOU!
>
> I can't control the corporate staff on acquisition issues. Mike, this is their way of asserting dominance over you. I know this sounds wild, but animals are animals Pete [Aldridge] had beaten them down. Now, they are taking you on. I'm sorry. Expecting professional behavior from them is something I gave up on a while back. Among other things, they are about to cause us to embarrass SecDef [Secretary of Defense], who having approved the lease, will now have to explain why his staff is destroying the case for it I'll do whatever I can to help you, Mike, but it's your job to get the corporate staff under control. If not now, then they will overrun you whenever you 'don't behave' according to their desires. This is the same game they have played for years They and OMB [Office of Management and Budget] are trying to set the Air Force up to be destroyed by [a Senator] WITH OSD [Office of the Secretary of Defense] AND OMB ARGUMENTS. As you might imagine, I won't give them the chance, but I will make it clear who is responsible to Don [Rumsfeld]. I refuse to wear my flack jacket backwards!
>
> Sorry, Shipmate. Jim.

Congressional Record

On June 23, 2003, in response to Dr. Roche's e-mail, Mr. Wynne sent an e-mail to Dr. Roche with a cc: to Dr. Sambur in which he stated:

> JIM: Thanks for your note -- I see this as an OSD [Office of the Secretary of Defense] discipline problem myself. I will be taking it to the Secretary as well--better he hear it from two sources.
> Mike

Congressional Record

[redacted]

On June 23, 2003, Mr. Wynne sent an e-mail to Mr. Kenneth J. Krieg, Director, Program Analysis and Evaluation in which he stated:

> KEN: If the purpose of your note is to run acquisition from PA&E [Program Analysis and Evaluation], we have a problem that needs immediate resolution I have plenty of problems, but being 'fragged' didn't seem to be one of them, now I worry. If the SecDef [Secretary of Defense] wants to kill this he will, so far not--your note was not helpful to either one of us. I will continue to make decisions that have the potential for successful execution of the lease unless SecDef waves me off.
> Best Regards,
> Mike

Congressional Record

On June 23, 2003, in response to Mr. Wynne's e-mail, Mr. Krieg sent an e-mail to Mr. Wynne in which he stated:

> MIKE: That's not what I intended and I may have used the wrong instrument to communicate my concerns. I just want to get together with you and Jim to make sure you understand what we are worried about. That's why I asked for us to get together this afternoon.
> KJK

Congressional Record

On June 23, 2003, Mr. Krieg sent an e-mail to Dr. Roche in which he stated:

> JIM: Understand from Doc that you are as mad as Mike [Wynne]. I am not trying to walk back anything. I am trying to get the strategy to drive the deal; the deal and contract to set the numbers; the numbers to be reopened in the report without a lot of hype.
> Probably should have called you but I will explain later.
> Want to get together with you and Mike to clear air.
> KJK

Congressional Record

On June 23, 2003, in response to Mr. Krieg's e-mail, Dr. Roche sent an e-mail to Mr. Krieg in which he stated:

> Kenny, I love you, and you know that. I think you have been had by some members of the famous PA&E [Program Analysis and Evaluation] staff. You never should have put what you put in writing It will now be used against me and Don Rumsfeld
> Jim

Congressional Record

On June 23, 2003, [redacted]

[redacted]

[redacted]

July 2003. On July 8, Dr. Roche sent an e-mail to Mr. Jaymie Durnan, The Special Assistant to the Secretary and the Deputy Secretary of Defense with a cc: to Mr. William C. Bodie, Special Assistant to the Secretary of the Air Force in which he stated:

> *Jaymie, Mike Wynne has fallen for* [Robin] *Cleveland's line that our* letter must show the bogus calculation which is NPV [net present value] negative by $1.9 billion.
> Why bogus? If we had the budget, we wouldn't need to turn to a lease. But, we don't Thus, to assume that it exists (wrong premise), and then to assume the Congress passed legislation which it didn't, and then to condemn ourselves in writing by stating the calculation based on a fantasy simply is crazy It is a bureaucratic trick to make a fool out of Don [Rumsfeld] as well as the Air Force. All this was 'resolved' by Pete Aldridge before he left. To quote him: 'We need to go forward with DoD's position If OMB [Office of Management and Budget] wants to *comment, let them* '
> Point: we are running aground because PA&E [Program Analysis and Evaluation] and OMB want me to sign a suicide note, BUT I WILL NOT. This whole drill has gotten out of hand! Jim

Congressional Record

On July 10, 2003, Dr. Roche issued an update to Air Force Policy Directive 63-1, "Capability-Based Acquisition System," that had been previously superceded by a policy memorandum, "Reality-based Acquisition System Policy for all Programs," which Dr. Sambur issued on June 4, 2002. In the Directive, Dr. Roche stated that the Directive was substantially revised and must be completely reviewed. Further, he stated that:

> The update of AFPD [Air Force Policy Directive] 63-1 is a result of guidance from the SECAF [Secretary of the Air Force] and CSAF [Chief of Staff of the Air Force], identified as the Commanders' intent as well as *major revisions* to the DoD 5000 acquisition directive and instruction There are two overarching objectives of this policy: 1) shortening the acquisition cycle time and, 2) improving credibility within and outside the acquisition community. Emphasis is placed on the Commanders' intent and the primary mission to rapidly deliver affordable, sustainable capability that meets the warfighter's needs and expectations Based on

[redacted]

> the philosophy outlined in this policy, members at all levels of the acquisition workforce are expected to seek innovative ways to achieve there objectives through teamwork, trust, common sense, and agility. Unlike previous guidance this policy is broad and non-prescriptive. The objective is to give those accountable for program execution maximum flexibility in translating needs and technological opportunity into stable, affordable and well managed acquisition programs.

August 2003. On August 20, Major General William Hodges, Director of Global Reach Programs, Office of the Assistant Secretary of the Air Force (Acquisition) sent an e-mail to [redacted] RAND Corporation with a cc: to [redacted] Air Force Deputy Assistant Secretary (Management Policy and Program Integration); Dr. Sambur, Assistant Secretary of the Air Force (Acquisition); Major General Paul Essex, Headquarters, Air Mobility Command; Brigadier General Mark Volcheff, Headquarters, Air Mobility Command; [redacted] Office of the Assistant Secretary of the Air Force (Acquisition); Lieutenant General John Corley, Principal Deputy (Acquisition), Office of the Assistant Secretary of the Air Force (Acquisition); [redacted] Office of the Assistant Secretary of the Air Force (Acquisition); [redacted] Office of the Assistant Secretary of the Air Force (Acquisition). In the e-mail, Major General William Hodges stated that:

> [redacted]
>
> I believe you may have already got the word from Blaise Durante [Air Force Deputy Assistant Secretary (Management Policy and Program Integration)], but since you are still traveling I wanted to confirm that you have the latest direction from Dr. Roche [Secretary of the Air Force]. **He has asked us to halt our effort on conducting the AoA [analysis of alternatives] at this time, pending direction in the Authorization Bill to do so.** [Emphasis added.]
>
> The Secretary feels it would send the wrong signal to the members participating in the upcoming SASC [Senate Armed Services Committee] Hearing on 4 September and really convey the wrong message to the committees who have already supported the Lease Proposal and our New Start request
>
> I would like to discuss further at your convenience.

October 2003. In October 2003, the RAND Corporation issued a report, "Common Replacement Asset (CRA) Study Results Briefing, DB-419-AF," [redacted] which were before the outcomes of the Quadrennial Defense Review and the Tanker Requirements Study 2005. RAND conducted the study before September 11, 2001, to assist the Air Force in determining when it should replace KC-135s and 135/707 aircraft and what systems it should introduce to meet future force requirements and to minimize total long-run costs. The RAND results were for Boeing airliner derivatives. [redacted] Since the analysis was done before September 2001, the impact of the terrorist attacks on

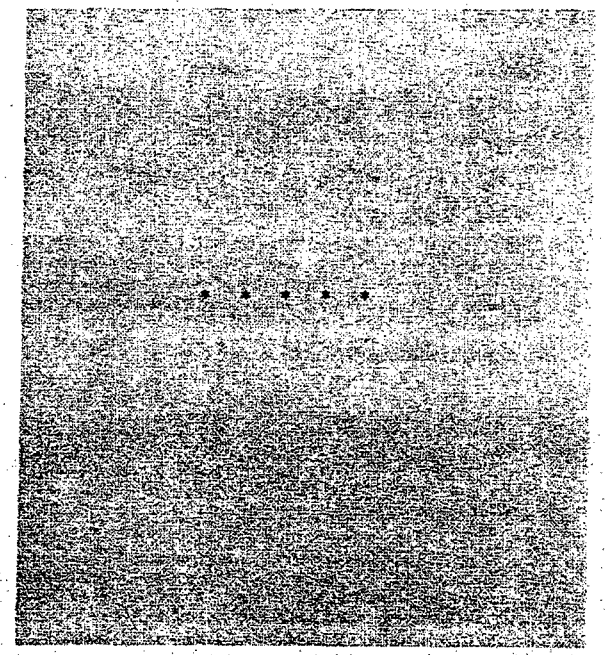
Restricted Distribution

[redacted]

the aircraft industry and, consequently, on the cost of acquiring commercial airliners was not included in the study.

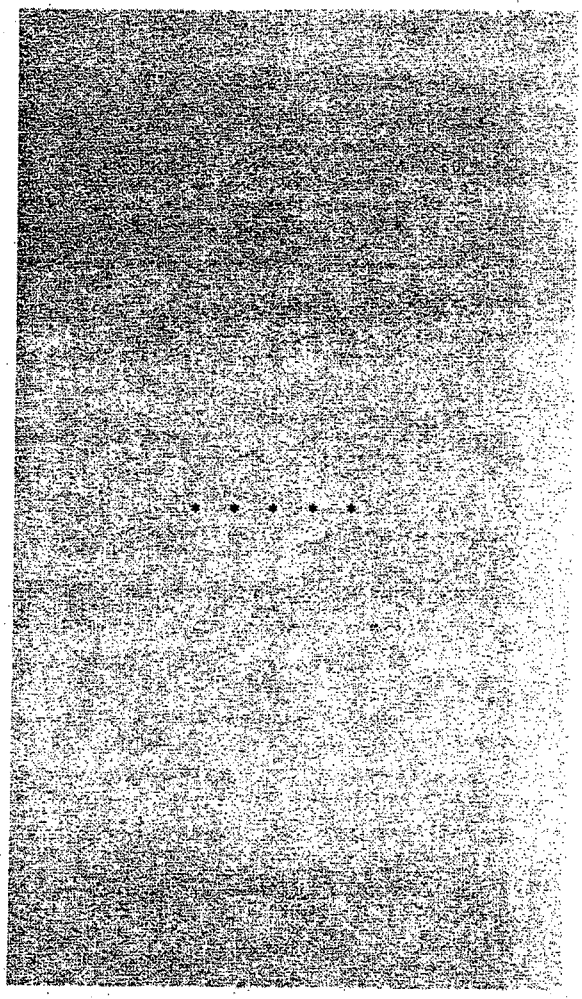
The study found that the optimal time to replace KC-135s depends on the growth rate of sustainment costs, and the size of the replacement fleet. According to RAND, sustainment growth rate and fleet size factors were uncertain. If KC-135 sustainment costs remain stable, then no economic reason existed for replacing the KC-135 fleet until the aircraft reach their structural flying limits. The report also stated that Project Air Force research suggests that sustainment costs may rise over time due to the increased maintenance requirements of aging aircraft and assuming that four KC-135s can be replaced with about three KC-767s or equivalent aircraft, RAND concluded that immediate replacement would make sense. However, RAND stated that quite plausible differences in future requirement assessments and in future cost-growth projection can make the answer vary from "now" to "decades from now."

November 2003. On November 1, Brigadier General Scott B. Custer, Office of Air Force Legislative Liaison sent an e-mail to Dr. Roche; General John Jumper, Air Force Chief of Staff; and Dr. Sambur in which he stated:



*Removed for reason stated in the initial asterisked footnote.

[redacted]



On November 24, 2003, in Section 135 of the National Defense Authorization Act for FY 2004, Congress limited the number of tanker aircraft that the Air Force could lease to 20 and authorizes procurement of up to 80 aircraft. In addition, Section 135 of the National Defense Authorization Act for FY 2004 required that

*Removed for reason stated in the initial asterisked footnote

the Secretary of Defense perform a study of long-term aircraft maintenance and requirements.

Sec. 135. PROCUREMENT OF TANKER AIRCRAFT.
(a) LEASED AIRCRAFT – The Secretary of the Air Force may lease no more than 20 tanker aircraft under the multiyear aircraft lease pilot program referred to in subsection (d).
(b) MULTIYEAR PROCUREMENT AUTHORITY – (1) Beginning with the fiscal year 2004 program year, the Secretary of the Air Force may, in accordance with section 2306b of title 10, United States Code, enter into a multiyear contract for the purchase of tanker aircraft necessary to meet the requirements of the Air Force for which leasing of tanker aircraft is provided for under the multiyear aircraft lease pilot program but for which the number of tanker aircraft leased under the authority of subsection (a) is insufficient.
(2) The total number of tanker aircraft purchased through a multiyear contract under this subsection may not exceed 80.
(3) Notwithstanding subsection (k) of section 2306b of title 10, United States Code, a contract under this subsection may be for any period not in excess of 10 program years.
(4) A multiyear contract under this subsection may be initiated or continued for any fiscal year for which sufficient funds are available to pay the costs of such contract for that fiscal year, without regard to whether funds are available to pay the costs of such contract for any subsequent fiscal year. Such contract shall provide, however, that performance under the contract during the subsequent year or years of the contract is contingent upon the appropriation of funds and shall also provide for a cancellation payment to be made to the contractor if such appropriations are not made.
(c) STUDY OF LONG-TERM TANKER AIRCRAFT MAINTENANCE AND TRAINING REQUIREMENTS-(1)- The Secretary of Defense shall carry out a study to identify alternative means for meeting the long-term requirements of the Air Force for—
(A) the maintenance of tanker aircraft leased under the multiyear aircraft lease pilot program or purchased under subsection (b); and
(B) training in the operation of tanker aircraft leased under the multiyear aircraft lease pilot program or purchased under subsection (b).
(2) Not later than April 1, 2004, the Secretary of Defense shall submit a report on the results of the study to the congressional defense committees.
(d) MULTIYEAR AIRCRAFT LEASE PILOT PROGRAM DEFINED- In this section, the term 'multiyear aircraft lease pilot program' means the aerial refueling aircraft program authorized under section 8159 of the Department of Defense Appropriations Act, 2002 (division A of Public Law 107-117; 115 Stat. 2284).
(e) SENSE OF CONGRESS- It is the sense of Congress that, in budgeting for a program to acquire new tanker aircraft for the Air Force, the President should ensure that sufficient budgetary resources are provided to the Department of Defense to fully execute the program and to further ensure that all other critical defense programs are fully and properly funded.

On November 27, 2003, Mr. Peter Teets, Under Secretary of the Air Force sent an e-mail to Dr. Roche in which he stated:

Jim: I think it is important for you to know all I know about the situation surrounding the tankers. I sat in for you at the SecDef [Secretary of Defense] staff meeting last Tuesday As we went around the table, Joe

Congressional Record

[redacted]

Schmitz (IG) [Department of Defense Inspector General] mentioned the Boeing dismissal of Sears and Druyun. The SecDef then asked if in light of that should we take a second look at her involvement in any tanker lease related matters in order to deflect possible criticism from the SASC [Senate Armed Services Committee] and unfavorable publicity. I said I thought that was a good idea, and that we (the Air Force) would do so. No further discussion on the subject occurred at the staff meeting. After the staff meeting I scheduled short separate meetings with Marv Sambur and Mary Walker for Tuesday afternoon following my return from a meeting at CIA [Central Intelligence Agency]. When I returned, I learned that Marv could not meet with me at the scheduled time because he was in Mike Wynne's office discussing Darleen's involvement with tankers. I then met with Mary and asked her to think through the Darleen situation, plus another matter regarding proper packaging of material on the AFA [Air Force Academy] situation that Schmitz had said was required to be delivered to the SASC. Late Tuesday afternoon I then talked to Marv Sambur and got his assurance that a thorough review of the Darleen situation had been completed and that there was no way Darleen had any influence on our current plan for tankers. Furthermore, Marv said that a letter had been prepared for the DepSecDef [Deputy Secretary of Defense] to send over to the SASC indicating same, and notifying them of our intent to proceed. At that point, I thought the issue was resolved. On Wednesday morning I read the Wash [Washington] Post article quoting Sec [Secretary] Rumsfeld as saying he had asked his staff to do a review of the tanker deal. I sent Marv and [sic] e-mail offering any help I could provide, and he responded with thanks, but it was clear that this situation had once again gotten out of control. I am sorry to report the news to you, but felt you needed the whole story as it unfolded.
Best Regards,
Pete.

Congressional Record

December 2003. On December 1, 2003, the Deputy Secretary of Defense requested an audit by the Department of Defense Office of the Inspector General, stating that "In light of recent revelations by The Boeing Company concerning apparent improprieties by two of the company's executives, please determine whether there is any compelling reason why the Department of the Air Force should not proceed with its Tanker Lease Program. In particular, I would appreciate knowing whether any of these revelations affect any of your previous analysis of this program."

February 2004. On February 1, 2004, the Deputy Secretary of Defense requested that the Defense Science Board evaluate aerial refueling requirements. Specifically:

> I am requesting you form a Defense Science Board (DSB) Task Force to evaluate current aerial refueling capability and future Department of Defense (DoD) aerial refueling requirements. The Task Force's evaluation should include recommendations for meeting future aerial refueling requirements.
>
> Most legacy and projected DoD aircraft require aerial refueling to conduct operations across the entire spectrum of DoD missions. As the Department transforms itself to meet the challenges of the 21st century, existing aerial refueling capabilities may or may not meet future needs. New systems and capabilities are being developed (e.g. F/A-22, the Joint Strike Fighter, Small Diameter Bomb, unmanned aerial vehicles, proposed strategic strike capabilities, etc.) which may drastically alter future requirements for aerial refueling. Current long range air mobility

[redacted]

and strike aircraft represent a significant and pervasive demand on aerial refueling assets. In addition, it is quite possible that opponents have identified refueling assets as a necessary component of U.S. success and will target these assets in future conflicts, representing an attrition of aerial refueling capability that we have not experienced in the past.

The Task Force should assess current and future requirements with respect to both legacy systems and missions, and take into account proposed future systems and capabilities. The Task Force shall have access to the historic reviews of the Air Force, General Accounting Office, and other DoD departments, and request any data collection, or data development required to fill in analytical gaps. Using best estimates of requirements for 2010, 2020, and 2030, the Task Force should assess the following options with respect to DoD aerial refueling capability.

a. Retain the requisite number of assets to maintain current capability. The Task Force should identify any issues which may affect the ability of the current aerial refueling fleet to continue to operate, to include potential affects of corrosion, the estimated length of service existing for current assets, means to mitigate these issues, and estimated costs of maintaining these assets as the fleet ages.

b Perform a service life extension on the requisite number of existing aircraft. The Task Force should identify the expected lifetime of refurbished aircraft to bound the potential cost of this option.

c. Acquire new refueling capabilities As a minimum, the Task Force should assess the acquisition of new aircraft, modification of used aircraft to perform the aerial refueling mission, and development of unmanned aerial vehicles as an aerial refueling tanker. The Task Force should include an estimate of costs and quantify an acquisition rate for any new capabilities.

d. Evaluate other methods to address refueling needs. For example, there may be sufficient financial incentive to re-engine existing fleets of aircraft with more fuel efficient engines which would lower overall demand. Development of suitable doctrine to employ Small Diameter Bombs or other future precision weapons may reduce the number of required sorties and similarly lower future demand The Task Force should attempt to quantify these trends and estimate costs of these capabilities for comparison to the costs of other refueling options

In arriving at the conclusions, the Task Force should not be bound by any one option and may explore options not discussed above.

The Task Force should provide a final report by April 30, 2004. The Task Force should provide their report directly to the Secretary of Defense

Administrative support and funding will be provided by Mr Michael W. Wynne, Acting USD(AT&L) and Dr. Glenn Lamartin, Director, Defense Systems. Admiral Don Pilling, USN (Ret) and [redacted] will serve as Co-Chairmen of the Task Force. [redacted] Defense Systems (Air Warfare), will serve as Executive Secretary; and [redacted] USAF, will serve as the DSB [Defense Science Board] Secretariat Representative.

The Task Force shall have access to any classified information needed to develop its assessment and recommendations.

The Task Force will be operated in accordance with the provisions of P.L. 92-463, the 'Federal Advisory Committee Act,' and DoD Directive 5105.4, 'The DoD Federal Advisory Committee Management Program.' It is not anticipated that this Task Force will need to go into any 'particular matters' within the meaning of Section 208 of Title 18,

[redacted]

> U.S. Code, nor will it cause any member to be placed in the position of acting as a procurement official.

On February 1, 2004, the Deputy Secretary of Defense requested that the National Defense University conduct a comprehensive analysis of lessons learned for the Air Force Tanker Lease Program. Specifically:

> In our continuing effort to improve the Department of Defense acquisition processes, policies and procedures, I am requesting that National Defense University make available [redacted] and [redacted] from the Industrial College of the Armed Forces to conduct a thorough and comprehensive 'lessons learned' analysis of the U.S. Air Force Tanker Lease Program [redacted] and [redacted] will constitute a two person team with [redacted] as Chairman. [redacted] and [redacted] should plan to initiate their analysis on or about February 1, 2004 and brief results no later than April 30, 2004
>
> The lessons learned analysis should answer at a minimum, but not be limited to the following questions:
>
> a. What processes, policies and procedures apply to the Tanker Lease Program and the contractor selection?
>
> b. Was the established acquisition process followed in establishing the Tanker Lease Program as the solution to the DoD aerial refueling requirements, if not why not?
>
> c. Were established cost and pricing guidelines followed, if not why not?
>
> d. Were required congressional notifications made and made on time, if not why not?
>
> e. Was there a competitive process that determined the Tanker Lease Program contractor?
>
> f. What was the critical element in the acquisition needs statement that drove the requirement and therefore the replacement timing?
>
> I recognize that this request will place a burden on your faculty workload, but it is a crucially important assessment, and I am confident that the results of this analysis will be extremely valuable as we work to improve the DoD acquisition process
>
> Administrative support and funding will be provided by USD(AT&L). The Office of the Secretary of Defense point of contact is [redacted] (703) 695[redacted]

On February 24, 2004, Mr. Michael W. Wynne, Acting Under Secretary of Defense for Acquisition, Technology, and Logistics sent a memorandum, "Analysis of Alternatives (AoA) Guidance for KC-135 Recapitalization," to the Secretary of the Air Force. In the memorandum, Mr. Wynne stated:

> I direct you to conduct an AoA [analysis of alternatives] for analyzing potential courses of action for recapitalizing the KC-135 fleet, under the oversight of a Senior Steering Group (SSG). The attached guidance (Enclosure 1) is provided to assist you.
>
> I appoint the Director, Defense Systems [Dr Glenn F. Lamartin] as chair of the SSG, which will be comprised of representatives from offices that have equities in the future of the aerial refueling fleet to include the military services, Joint Staff, USTRANSCOM [U. S Transportation Command], and OSD/PA&E [Office of the Secretary of

[redacted]

Defense/Program Analysis and Evaluation] The SSG will guide and review the work of the AoA.

A study plan shall be submitted to the SSG for review and approval not later than two months from the date of this memorandum It should include the AoA team composition and should specify the federally funded research and development center or other independent agency being used for the study A final report—presenting details of the analysis, cost estimates, and the results—will be due within 18 months of the date of this memorandum.

My point of contact for this action is [redacted] at (703) 697-[redacted]

March 2004. On March 29, the Department of Defense Office of the Inspector General issued Report No. D-2004-064, "Acquisition of the Boeing KC-767A Tanker Aircraft," stating that the Air Force used an inappropriate procurement strategy and demonstrated neither best business practices nor prudent acquisition procedures to provide sufficient accountability for the expenditure of $23.5 billion for the KC-767A tanker program We identified five statutory provisions that have not yet been satisfied relating to: commercial items; testing (two statutes); cost-plus-a-percentage-of-cost system of contracting; and leases. Therefore, we recommended that DoD not proceed with the program until it resolves the issues pertaining to the procurement strategy, acquisition procedures, and statutory requirements.

Based on our findings, we also recommended that the Deputy Secretary consider the following options.

1. After implementation of audit recommendations to resolve contracting and acquisition issues, proceed with the sole-source acquisition of the Boeing KC-767A Tanker Program for 100 or fewer aircraft.
2. Initiate a new major Defense acquisition program based on the results of an analysis of alternatives for military tanker aircraft.
3. Implement a mix of Option 1 for some of the tankers and Option 2 for subsequent tankers.

Our audit results showed that, contrary to the Air Force interpretation, the Boeing KC-767A Tanker Program did not meet the statutory definition of a commercial item. No commercial market for this tanker aircraft existed to establish reasonable prices by the forces of supply and demand. Consequently, the commercial item procurement strategy did not provide the Air Force with sufficient cost or pricing data to make multi-billion dollar decisions for the Boeing KC-767A Tanker Program and did not demonstrate the level of accountability needed to conclude that the prices negotiated represent a fair expenditure of DoD funds. The Air Force used Section 8159 of the Department of Defense Appropriations Act for FY 2002 to justify its informal acquisition strategy with the primary goal to expeditiously lease 100 Boeing KC-767A Tanker aircraft to replace its aging KC-135E Tanker fleet. In doing so, the Air Force did not demonstrate best business practices and prudent acquisition procedures in developing this program and did not comply with statutory provisions for testing.

[redacted]

April 2004. On April 20, the National Defense University issued its report in response to the Deputy Secretary of Defense tasking on February 1, 2004. The National Defense University was tasked to answer six questions dealing with the tanker lease acquisition. Based on interviews and literature reviews, the National Defense University concluded that the Air Force and the Department of Defense bypassed many elements of the normal acquisition system and that the Office of the Secretary of Defense Leasing Review Panel was not a substitute for the Defense Acquisition Board review of the tanker lease acquisition. The National Defense University also concluded that the Air Force did not use a competitive process for the tanker lease acquisition although contractor selection was a foregone conclusion based on Section 8159. The National Defense University recommended that the Department of Defense:

- publish guidance on leasing in policy directives, the Federal Acquisition Regulation, and the Defense Federal Acquisition Regulation Supplement; and
- establish procedures to require both cost and pricing data on sole source or monopoly, commercial leases.

May 2004. The Defense Science Board issued its report in response to the Deputy Secretary of Defense tasking on February 1, 2004. The Aerial Refueling Defense Science Board Task Force reviewed the KC-135 program and concluded that, based on fatigue life, the KC-135 airframe would be capable to 2040 and that corrosion was manageable. With regard to KC-135 operation and support costs, the Defense Science Board concluded that cost growth is manageable. The Board also commented on tanker recapitalization noting that there is a need to embark on a major tanker recapitalization program, but because total tanker requirements were uncertain, the recapitalization program could be deferred until the completion of the analysis of alternatives and the Mobility Capabilities Study. The Defense Science Board did not endorse the KC-767A tanker aircraft as the prime or only Air Force near term solution to the tanker recapitalization problem. The Defense Science Board suggested several options for replacing the KC-135Es including:

- obtaining additional DC-10s that could be converted into tankers,
- retiring half of the KC-135Es under a hybrid recapitalization program and replacing them with commercial entities as commercial tankers for missions in the Continental United States,
- phasing out the other half of the KC-135E and replacing them with converted KC-10, and
- working with major airframe manufacturers to develop new tanker options with more modern airframes than the 20-year-old Boeing 767 design.

September 2004. On September 3, the President, Defense Acquisition University issued his report in response to tasking memorandum, "Lessons Learned from the Independent Assessments of Proposed 767 Tanker Lease Buy," that the Acting Under Secretary of Defense for Acquisition, Technology, and Logistics issued on May 25, 2004. The independent assessments referred to were the Aerial

[redacted]

Refueling Defense Science Board Task Force Study; the Analysis of Lessons Learned from the United States Air Force Tanker Lease Program (TLP) – Industrial College of the Armed Forces/National Defense University (ICAF/NDU); and the DoD Inspector General Audit Report "Acquisition of the Boeing KC-767A Tanker Aircraft."

The memorandum directed the President, Defense Acquisition University to "... chair a working group to formulate recommendations based on the results of these three studies that will result in changes to the DoD 5000 Series, Federal Acquisition Regulation (FAR)/Defense Federal Acquisition Regulation (DFAR), and other acquisition related documents." The Defense Acquisition University Working Group did not conduct its own independent review, but relied on the work previously accomplished by the Defense Science Board, the Industrial College of the Armed Forces, and the Department of Defense Office of the Inspector General. The Working Group reviewed all three reports to assess the policy implications, which were based on systemic and structural deficiencies, and to make appropriate policy recommendations.

The Working Group concluded that policy for commercial item acquisitions and the leasing process needed clarification. Specific recommendations included several proposed policy changes in the areas of Acquisition Management and Oversight, Commercial Item Policy and Leasing Policy. The Under Secretary of Defense for Acquisition, Technology, and Logistics adopted all of the proposed recommendations and is in the process of implementation. The most significant of the proposed recommendations were that the Under Secretary of Defense for Acquisition, Technology, and Logistics:

- Follow DoD Instruction 5000.2 oversight, review, and decision processes - Cancel Leasing Review Panel;
- Change the Federal Acquisition Regulation and the Defense Federal Acquisition Regulation Supplement to clarify the authority of the contracting officer to obtain all necessary cost information needed to determine prices are fair and reasonable in commercial item acquisitions;
- Develop specific guidance for analyzing whether a significant military unique modification effects a commercial item determination and for determining a fair and reasonable price for the modified item;
- Rewrite the Commercial Item Handbook to incorporate recent changes resulting from legislation and best practices; and
- Evolve DoD's existing body of knowledge in regard to management of major systems to include systems acquired using Federal Acquisition Regulation, Part 12 procedures (e.g. testing, modifications).

October 2004. On October 28, in Section 133 of the "Ronald W. Reagan National Defense Authorization Act for Fiscal Year 2005," Congress terminated the Secretary of the Air Force authority to lease tanker aircraft; however, it authorized the procurement of up to 100 tanker aircraft.

[redacted]

SEC 133. AERIAL REFUELING AIRCRAFT ACQUISITION PROGRAM

(a) TERMINATION OF LEASING AUTHORITY.—Subsection (a) of section 135 of the National Defense Authorization Act for Fiscal Year 2004 (Public Law 108–136; 117 Stat 1413; 10 U.S.C. 2401a note) is amended by striking "may lease no more than 20 tanker aircraft" and inserting "shall lease no tanker aircraft".

(b) MULTIYEAR PROCUREMENT AUTHORITY.—Subsection (b) of such section is amended—

(1) in paragraph (1)—

(A) by striking "Beginning with the fiscal year 2004 program year, the Secretary" and inserting "The Secretary"; and

(B) by striking "necessary to meet" and all that follows through "is insufficient";

(2) in paragraph (2), by striking "80" and inserting "100"; and

(3) by striking paragraph (4).

(c) STUDY.—Subsection (c)(1) of such section is amended by striking "leased under the multiyear aircraft lease pilot program or" in subparagraphs (A) and (B).

(d) RELATIONSHIP TO PREVIOUS LAW.—Such section is further amended by adding at the end the following new subsection:

"(f) RELATIONSHIP TO PREVIOUS LAW.—The multiyear procurement authority in subsection (b) may not be executed under section 8159 of the Department of Defense Appropriations Act, 2002 (division A of Public Law 107–117)".

December 2004. On December 9, Mr. Donald M. Horstman, Director, Investigations of Senior Officials, Department of Defense Office of the Inspector General sent a memorandum, "Accountability Assessment of Air Force Officials who Participated in the KC-767A Tanker Aircraft Program," to the Inspector General of the Air Force, Attention: [redacted]. In the memorandum, Mr. Horstman stated that:

> As discussed with [redacted] of your office on December 9, 2004, we have initiated a review to assess the accountability of Air Force officials who were involved in the KC-767A Tanker Aircraft Program. This review is separate and distinct from previous and ongoing audits/investigations into matters concerning the tanker program. The objective is to determine the extent to which individual Air Force officials bear responsibility for decisions that resulted, or had the potential to result, in the waste of Government resources, or that constituted an abuse of authority
>
> Our assessment will consider information collected during previous and ongoing activities concerning the KC- 767 tanker lease initiative, augmented by additional interviews and fact-finding We will begin the fieldwork portion of our assessment by interviewing knowledgeable witnesses at the Air Force Material Command (AFMC), Wright-Patterson Air Force Base Will coordinate our activities with the Inspector General, AFMC, and we request that you advise Air Force officials of the assessment as you deem appropriate
>
> Should you have any questions, please contact me or [redacted] at (703) 604[redacted]

January 2005. On January 19, in response to Mr. Donald M. Horstman's memorandum of December 9, 2004, Dr. Roche sent a letter to Mr. Joseph E. Schmitz, Department of Defense Inspector General with a cc: to the Secretary of Defense and the Deputy Secretary of Defense. In his letter, Dr. Roche stated:

[redacted]

Dear Mr. Schmitz:

I am in receipt of your 9 December 2004 memorandum forwarded to the Air Force Inspector General announcing another investigation of current Air Force officials by the DoD IG Directorate of Investigations of Senior Officials into matters related to the 767 tanker lease proposal

I am astounded that we are spending government resources chasing groundless allegations of malfeasance related to tanker recapitalization proposals. It should be abundantly clear to all objective observers that air refueling tanker recapitalization must be started soon, and that those finalizing the previous lease proposal did so consistent with legislation and with the intention of protecting taxpayer interests. As important, limiting any review to the Air Force, and not OSD [Office of the Secretary of Defense], only contributes to the myth that this was exclusively an Air Force proposal. It was not. It was a proposal of the Department of Defense and the Administration, and it consistently was supported by three of the four congressional defense committees. But do not misconstrue this point. I'm not calling for an investigation of DoD or Air Force personnel I see no basis to investigate anyone associated with the final lease proposal. But if you find yourself compelled to do so, then your agency should look at all aspects of the process leading to that proposal.

Many looking into the lease proposal seem to miss the starting point. The proposed lease responded to unambiguous congressional language Specifically, the 2002 National Defense Appropriations Act, passed by Congress and signed by the President, included the provision that allowed the Secretary of the Air Force to *establish and make payments on a lease pilot program for leasing general purpose Boeing 767 aircraft and Boeing 737 aircraft ...*.

Acting under this legislative direction, the Air Force negotiated a *proposed* pilot lease for 100 KC-767A tanker aircraft, regularly vetting details of the evolving proposal with the Department of Defense along the way. Not unlike the process followed for the successful 737 lease months earlier, about which there have been no complaints, we collaborated on an ongoing basis with the OSD Leasing Review Panel to formulate the details of the proposed lease agreement. The Leasing Review Panel, co-chaired by the Undersecretary of Defense, Acquisition Technology and Logistics, the Honorable Pete Aldridge; and the Undersecretary of Defense, Comptroller and Chief Financial Officer, the Honorable Dov Zakheim, was the final decision authority on whether and when to bring the final lease proposal forward.

This body, supported by a Working Group that included representatives from the Office of Management and Budget, scrutinized every aspect of the proposal for over a year. Ultimately, the Department of Defense, not the Air Force, approved the lease pilot program It was the Undersecretary of Defense (AT&L [Acquisition, Technology, and Logistics]) who took the lead, quite properly, in negotiating this matter with the Office of Management and Budget and with senior White House staff. Ultimately, the Department of Defense authorized the Air Force to submit the proposal to the congressional defense committees for their consideration and approval, as directed by law. While three of the four committees approved the new start request for the lease, the Senate Armed Services Committee (SASC) did not. Incidentally, it was I who originally championed obtaining the approval of all four committees before we proceeded. Without SASC approval, no contract was signed, no funds were expended, and, unlike the 737 lease, a Boeing 767 lease pilot program was not executed There is no improper contract to investigate, no waste of resources to pursue, and, a Defense Acquisition

[redacted]

University study determined that there were no violations of procurement policies.*

Unfortunately, the DoD IG inquiry to 'determine the extent to which individual Air Force officials bear responsibility,' as announced in your memorandum, appears to suggest that the Air Force is somehow solely responsible for all that transpired in negotiating the lease and presenting the proposal to Congress Again, let me be clear The Air Force and the Department of Defense responded to congressional direction and proposed a lease of Boeing 767 tanker aircraft in compliance with legislation. Decisions on the future of this program were made at every level throughout the Department of Defense. Indeed, it would be difficult to preserve the credibility of the inspector general process or the investigation results if the investigation is arbitrarily limited to Air Force personnel or Air Force processes, or even DoD personnel and processes, particularly given these basic facts:

a. In January 2003, the Undersecretary of Defense (AT&L), the Honorable Pete Aldridge, concluded that a lease of 100 tankers as called for in legislation was the right and fiscally prudent decision. He then took the lead in developing the Department's tanker proposal through the Leasing Review Panel

b. In the same month, [* * * * * *] told the Air Force Chief of Staff that, along with [a Representative], he supported the proposal for new tankers for the Air Force.

c Throughout the spring of 2003, [* * * * * *] took the lead for the White House in developing the Administration's tanker proposal, concentrating in particular on unit price.

d. In this period, the Boeing Company met with and discussed the tanker lease with [* * * * * *] on at least one occasion.

e. Mr. Aldridge and Deputy Secretary of Defense Wolfowitz negotiated the approval of the proposal with [* * * * *] based largely on what the Administration believed would be an acceptable price for the tankers

f. Near the end of May 2003, Mr. Aldridge recommended to the Deputy Secretary, and presumably the Secretary, that the Department go forward with the lease, given the dramatic price reduction obtained over the spring

g. With the approval of the White House and the Secretary of Defense, Mr. Aldridge announced the Department's position at a press conference in late May.

h. In July 2003, Secretary Rumsfeld called me in Newport, Rhode Island, to tell me that he did not want me to 'give anything away' during my visits with senators in conjunction with my nomination to be Secretary of the Army. He specifically stated that he did not want me to budge on the tanker lease proposal

i. In September 2003, OMB [Office of Management and Budget] and OSD joined the Air Force in supporting the Administration's tanker proposal before Congress Three of the four defense committees approved the proposal.

j. Throughout the period spent developing the tanker lease proposal, [a Representative] vigorously supported the proposal, and closely monitored the process, as did other members of Congress. The Chairmen

*Removed for reason stated in the initial asterisked footnote. (The second, third, and fourth references are also on page 213.)

of the Senate and House Defense Appropriations Subcommittees strongly supported the proposal, as did the Chairman of the House Armed Services Committee These three defense committees continue to this day to call for tanker recapitalization of one form or another.

Lastly, you indicate an intention to start this investigation at the field offices of 'Air Force Material (sic) Command.' The bulk of the activities related to this innovative effort to begin recapitalizing our tanker fleet occurred here in Washington. As indicated previously, offices within DoD were engaged at every stage in the development of this proposal. Moreover, members and committees of Congress, as well as the White House, the Office of Management and Budget in particular, were involved from the earliest days and frequently along the way. You simply cannot gain a proper perspective of how good and decent people tried to do the right thing by our warfighters and the American taxpayer without looking at every aspect of how this program developed and evolved. If you are going to undertake this investigation, then I believe you should in all fairness obtain the full cooperation of the Secretary of Defense, the White House and congressional leadership for your inquiry.

In conclusion, I'm not calling for a broad investigation into all these events, even though a comprehensive look across multiple agencies would be absolutely necessary should you wish to understand the process fully. The Air Force put forward a proposal done in conformance with the law and policies in place at the time The Air Force performed a due diligence look into potential alternatives, including open competition, even though the legislation specified the Boeing 767. We faced some criticism from certain members of Congress for taking this step. The proposal had built-in safeguards against any windfall profits for the supplier. It was debated, adjusted, renegotiated, and eventually approved by OSD and the Administration Not a dime was given to the Boeing Company at anytime, nor would any be given without full congressional approval.

No, I'm calling for you to do the courageous thing and not contribute to the further character assassination of those who tried to serve honorably in this matter. To continue down the current path will dramatically contribute to severe risk aversion on the part of senior and junior military leaders who should innovatively and efficiently field enhanced war-fighting capabilities to those Americans who must go into harm's way To put it bluntly, this investigation will further stifle innovative procurement for years to come.

Sincerely, James G. Roche, Secretary of the Air Force

On January 27, 2005, the Chairman, Committee on Commerce, Science, and Transportation sent a letter to the Secretary of the Defense, requesting that we determine who intentionally deleted information from placards that were displayed during a tour that members of the Senate Armed Services Committee staff participated in during Tinker Air Force Base visit in October 2003. Subsequent to the tour, the Committee staff asked for copies of the placards. Appendix G and supporting Appendices H, I, J, and K address the placards.

[redacted]

Appendix D. Members of the Office of the Secretary of Defense and the Air Force Who Were Interviewed

The following members of the Office of the Secretary of Defense and the Department of the Air Force, both military and civilian, including the then-Secretary of the Air Force and the then-Assistant Secretary of the Air Force (Acquisition), were interviewed to gain insight into what happened and who was accountable during the structuring and negotiating of the proposed lease contract for the Boeing KC-767A Tanker Program.

Office of the Secretary of Defense

Donald Rumsfeld, Secretary of Defense

Paul Wolfowitz, Deputy Secretary of Defense

Office of the Under Secretary of Defense for Acquisition, Technology, and Logistics

Mr. Michael Wynne, Acting Under Secretary of Defense for Acquisition, Technology, and Logistics[6] (formerly the Principal Deputy Under Secretary of Defense for Acquisition, Technology, and Logistics)

Dr. Nancy Spruill, Director, Acquisition Resource and Analysis

Ms. Deidre Lee, Director of Defense Procurement and Acquisition Policy

Office of the Under Secretary of Defense (Comptroller/Chief Financial Officer)

Dr. Dov Zakheim, Under Secretary of Defense (Comptroller)/Chief Financial Officer

Mr. Wayne Schroeder, Deputy Under Secretary of Defense (Resource Planning/ Management)

Office of the General Counsel

[redacted] Department of Defense Office of the General Counsel

[6]Became the Under Secretary of Defense for Acquisition, Technology, and Logistics on April 1, 2005

[redacted]

Mr. Douglas Larsen, Department of Defense Deputy General Counsel for Acquisition and Logistics

Office of Program Analysis and Evaluation

Mr. Kenneth Krieg, Director

Mr. Richard Burke, Deputy Director for Resource Analysis

Mr. David McNicol, Deputy Director for Resource Analysis (former)

[redacted] Analyst for the Economic and Manpower Analysis Division

Office of the Secretary of the Air Force

Dr. James G. Roche, Secretary of the Air Force

Office of the Assistant Secretary of the Air Force (Acquisition)

Dr. Marvin R. Sambur, Assistant Secretary of the Air Force (Acquisition)

Major General Paul Essex, Director of Global Reach Programs (former)

Major General Wayne Hodges, Director of Global Reach Programs

Major General Darryl A. Scott, Deputy Assistant Secretary (Contracting)

[redacted] Deputy Director of Global Reach Programs (retired)

[redacted] Deputy Director for Special Programs (retired)

[redacted] Chief, Mobility Division (retired)

[redacted] Mobility Division

[redacted] Mobility Division

[redacted] Support Contractor Analyst, Mobility Division

[redacted] Deputy Chief, Contracting Operations Division

Office of the Assistant Secretary of the Air Force (Financial Management and Comptroller)

Mr. Michael Montelongo, Assistant Secretary of the Air Force (Financial Management and Comptroller)

[redacted]

[redacted] Chief of the Economics Division

[redacted] Senior Financial Economist (former)

Office of the Air Force Chief of Staff

General John Jumper,

Office of the Air Force Deputy Chief of Staff for Air and Space Operations

Mr. Harry Disbrow, Assistant Director of Operational Capabilities Requirements

Office of the Air Force Deputy Chief of Staff for Installations and Logistics

[redacted] Action Officer for Weapon Systems Division, Aircraft Maintenance Directorate

[redacted] Action Officer for Weapons Systems Division, Aircraft Maintenance Directorate

Office of the Air Force General Counsel

Mr. James "Ty" Hughes, Office of the Deputy General Counsel (Acquisition)

Office of the Air Force Legislative Liaison

[redacted] Chief of Programs and Legislation (retired)

[redacted] Chief of the Force Structure Branch

[redacted] Legislative Liaison

Air Force Air Mobility Command

Lieutenant General Arthur Lichte, Director of Plans and Programs (former)

[redacted] Chief of Systems Requirements

[redacted] Chief of Tanker Requirements (former)

[redacted] Chief of Tanker Requirements (former)

[redacted]

[redacted] Chief of Tanker Requirements (former)

[redacted] Chief of Tanker Requirements

[redacted] Chief of Tanker Requirements (former)

[redacted] Air Refueling Program Manager for the Tanker Requirements Branch

[redacted] Senior Analyst Studies and Analysis Division

[redacted] Chief of Studies and Analysis Division

[redacted] Science Applications International Corporation KC-135 Tanker Requirement Manager

[redacted] Requirements and Planning Council Analyst

[redacted] Program Analyst for the Next Generation Tanker program

[redacted] Program Analyst for Tanker Requirements Branch

Air Force Program Executive Office, Aeronautical Systems Command, Air Force Materiel Command

Brigadier General Ted Bowlds, Program Executive Officer for Strategic Programs

[redacted] System Program Director, KC-767 System Program Office

[redacted] Deputy Director, KC-767 System Program Office

[redacted] Contracting Officer

[redacted] Office of the Staff Judge Advocate

[redacted] Contracting Officer

[redacted] Logistics Manager

[redacted] Contracting Officer

[redacted] Cost Price Analyst

[redacted] Chief of Air Force Vehicle Integrated Product Team

[redacted] Deputy Chief of Contracting

[redacted]

[redacted] Supervisory Cost Analyst

Oklahoma City Air Logistics Center, Air Force Materiel Command

Lieutenant General Charles Johnson, Commander

[redacted] Director of Maintenance (retired)

[redacted] Vice Commander

[redacted] Director of the KC-135 System Program Office

[redacted] Chief of Aircraft Maintenance

[redacted] Deputy Chief of Tanker Aircraft Maintenance Branch, Maintenance Division

[redacted] Executive Officer for the Director of Maintenance

[redacted] Executive Officer for the Director of Maintenance

[redacted] Deputy Director of Staff

Mr. Robert Conner, Executive Director

[redacted] Tanker Branch Planning Chief

[redacted] Chief Engineer of the KC-135 System Program Office

[redacted] KC-135 Weapons Systems Support Center Chief

[redacted] Director of Staff

[redacted] Director of Engineering

[redacted] Deputy Chief of Aircraft Maintenance

[redacted] KC-135 Industrial Engineering Technician

[redacted] Systems Engineering Division Chief for the KC-135 System Program Office

[redacted] Deputy Director of Maintenance

[redacted] Chief of Procedures and Analysis for the KC-135

[redacted] Sustainment Division Chief for the KC-135 System Program Office

[redacted]

[redacted] Deputy Director for the KC-135 System Program Office

[redacted] Structural Engineer for the KC-135 System Program Office

[redacted] Production Management Specialist for the Procedures and Analysis Branch

[redacted] Tanker Branch Chief, Aircraft Division

Defense Science Board

William Schneider, Jr., Chairman of the Defense Science Board

[redacted]

Appendix E. Operating Leases

The following discusses the use of commercial financing to recapitalize the Air Force KC-135 tanker aircraft fleet with Boeing KC-767A tanker aircraft; the concerns of the congressional budget committees, the Office of Management and Budget, and the Congressional Budget Office about various financing schemes involving lease-purchase arrangements; and the approval process for the Boeing KC-767A tanker aircraft operating lease.

Using Commercial Financing to Recapitalize the Air Force KC-135 Tanker Aircraft Fleet with Boeing KC-767A Tanker Aircraft

Senior members of the Administration, Congress, the Department of Defense, and the Air Force worked together in an effort to use commercial financing, an operating lease, to start recapitalizing the Air Force aerial tanker fleet with Boeing KC-767A tanker aircraft. The purpose of the operating lease was to preserve budget authority for other higher priority items because the Air Force did not have money in the budget to purchase tanker aircraft. The use of an operating lease to begin recapitalizing military assets is an issue that needs to be clearly addressed by the Administration, Congress, and DoD to prevent future problems.

Office of Management and Budget Circular Nos. A-11, "Preparation, Submission, and Execution of the Budget (2003)" and A-94, "Guidelines and Discount Rates for Benefit-Cost Analysis of Federal Programs," provide specific requirements that must be met to qualify for an operating lease. Senior members of the Office of the Assistant Secretary of the Air Force (Acquisition) consistently argued it was their opinion that the Boeing KC-767A Tanker Program met the Office of Management and Budget criteria for an operating lease; however, the Office of Management and Budget, the Congressional Budget Office, congressional staff, the Department of Defense Office of Program Analysis and Evaluation, the Department of Defense Office of the Inspector General, and other Air Force officials had different opinions. Subsequently, the Office of Management and Budget changed its A-11 criteria to where the tanker lease program would no longer qualify. Further, some of the actions taken to "make the lease fit" were highly questionable such as:

- paying 90 percent of the assets fair market value over 6 years for a 25 to 40-year asset;
- selling the tanker aircraft at fair market value and then receiving a refund for the difference between the fair market value and the remaining 10 percent value after 6 years;
- waiving termination liability for the lease peaking at over [redacted] and

[redacted]

- using a multiyear aircraft lease price and a non-multiyear buy price for the A-94 net present value analysis.

Congressional Budget Office Paper on the Use of Leases and the Relationship to the Budget

The congressional budget committees, the Office of Management and Budget, and the Congressional Budget Office have historically had concerns with various financing schemes involving lease-purchase arrangements because they understate the cost of capital acquisitions in the budget. When lease-purchases are not appropriately scored in the budget, managers may be encouraged to purchase assets that were lower priority and that could not otherwise compete in the budget process.

A Congressional Budget Office paper, "The Budgetary Treatment of Leases and Public/Private Ventures," examined agencies' use of leases and the relationship to the budget. The Congressional Budget Office paper showed that in the late 1980s, the congressional budget committees, the Office of Management and Budget, and the Congressional Budget Office have been concerned with the proliferation of lease-purchases. In October 1988, the Acting Director, Office of Management and Budget told the heads of the executive departments and agencies that, although "a number of agencies and committees of Congress have proposed financing schemes involving lease-purchase arrangement," those arrangements understated the cost of capital acquisitions in the budget and were opposed by the Administration. The Congressional Budget Office paper reported that the demand for budgetary treatment, which would consistently put the costs of lease-purchases up front in the budget, reflected three basic concerns:

- One was that the ability of agencies to rely on private borrowing, albeit private borrowing backed by future lease payments by the government, had the potential to seriously undermine fiscal discipline, rendering limits on deficits or caps on federal spending ineffective.

- Second was the concern that the ability of agencies to avoid the up-front costs of their decisions could make it more likely that they would undertake projects of lower priority, leading to an inefficient allocation of resources.

- The third concern was the incentive to use lease-purchases even though a lease-purchase was almost always more costly than direct purchase of the same asset.

The Congressional Budget Office paper also addressed other lease issues.

> Rapid growth in the use of lease-purchases in the 1980s highlighted the need for up-front scoring of those leases that amounted to asset purchases. In response to budgetary pressures, federal managers increasingly relied on such leases even though, viewed over the life of the asset, they were almost always more costly than outright purchases. In addition, the extensive use of leases threatened to undermine efforts to control total federal spending. The guidelines for the budgetary

[redacted]

treatment of leases that accompanied the Budget Enforcement Act [BEA] of 1990 were expected to curb the rapid growth of leasing, promote fiscal discipline, and encourage more cost-effective choices between leases and outright purchases.

Although the BEA guidelines for leases were adopted in response to the specific budgetary problems of the 1980s, they might be viewed as part of a gradual and sometimes erratic shift toward a budget process that provides greater visibility and control over federal spending Evidence of that shift is seen in the 1967 Commission on Budget Concepts, which set out the basic principles of federal budgeting, and late in the Congressional Budget and Impoundment Control Act of 1974, which gave the Congress the ability to set revenue and spending targets and monitor progress toward those targets. OMB's current guidelines for the full funding of investments—which initially applied only to the Department of Defense's acquisition of weapons systems but now are applied much more widely—are consistent with that trend

Under current budgetary guidelines, leases fall into three distinct categories: operating leases, lease-purchase, and capital leases. Operating leases are limited ones that are not considered the equivalent of an asset purchase. As defined in the current scorekeeping guidelines, operating leases satisfy six criteria. Those criteria include a limit on total amount spent on the lease (90 percent of the asset's fair market value) and a limit on the portion of the useful service life of the asset covered by the lease (75 percent). Because operating leases are not equivalent to an asset purchase, the budget authority for such leases is scored either for the full amount of future lease payments up front or, if the contract includes a cancellation clause, for the first year's payment plus any cancellation penalty, with future years' payments scored incrementally over the term of the lease

In contrast, the budget authority for a lease that fails to meet the criteria for an operating lease is scored up front for the full present discounted value of all future lease payments, regardless of any cancellation clause Scoring the budget authority up front in this way acknowledges that such leases are, in effect, a commitment to purchase an asset on the installment plan Such leases are either lease-purchases—leases in which the ownership of the asset transfers to the government at the end of the lease—or capital leases, a category that includes all leases that are neither operating leases nor lease-purchases

Before the implementation of the current lease-purchase guidelines in 1991, OMB's standard practice was to record the budget authority and outlays for lease-purchases that were specifically exempted from the Anti-Deficiency Act in their authorizing legislation incrementally, over the term of the lease. That approach made lease lease-purchases appear much less costly, in the near term, than direct purchases of assets. In some cases, that budgetary treatment encouraged managers to purchase assets that were lower priority and could not otherwise compete in the budget process. It also encouraged managers to use lease-purchases even if a direct purchase would have been more cost-effective

Summary of How the Operating Lease Was Approved

The following are selected e-mails, memorandums, and interviews that identify accountable officials associated with the operating lease for the Boeing KC-767A tanker aircraft and excerpts from interviews that representatives from the Department of Defense Office of the Inspector General conducted of senior

[redacted]

Office of the Secretary of Defense and Air Force officials associated with the operating lease.

Prior to 2001. A Senator and the Senate Appropriations Committee encouraged the Air Force to lease airplanes. Specifically, a Senator was pushing to lease airplanes for the Air Force from Boeing for the VCX program.[7] The Air Force entered negotiations, but never leased the planes because of problems involved in the lease process. The Air Force did lease 737s but it was a lot easier deal because Boeing financed them and they were not new airplanes. A Senator and the Senate Appropriations Committee have been trying to encourage the Air Force to lease airplanes.

Early 2001. A Senator called Ms. Druyun, Principal Deputy Assistant Secretary of the Air Force (Acquisition and Management) about acquiring airplanes from Boeing and using leasing because the Air Force did not have the money in the budget. Specifically, a Senator called Ms. Druyun indicating that he was again looking to acquire airplanes for the Air Force. The Senator was really pushing leasing. The Air Force needed to lease the aircraft because it did not have money in the budget to purchase them and was not willing to give up other programs for those aircraft. The Senator was thinking that Boeing would have excess capability after September 11, 2001, and as a result, the Air Force could get a good deal from Boeing. [redacted] Deputy Chief, Contracting Operations Division, Office of the Assistant Secretary of the Air Force (Acquisition) stated that the Senator thought that the DoD budgeting system did not work well and that DoD was going to need additional military capability. In addition, he stated that the Senator thought that the Defense budget was going to go up in the future and that leasing was a way to get programs going.

***May 2001.* On May 11, Secretary of Defense Donald Rumsfeld asked Dr. Dov Zakheim, Under Secretary of Defense (Comptroller) to look into commercial financing concepts relating to capital asset leasing and mentioned a Senator's strong interest in facilitating such financing. One of the potential capital asset lease concepts discussed was the replacement aerial tanker for the KC-135 tanker aircraft. The use of lease financing did not require additional budget authority.** Specifically, on May 11, 2001, Secretary of Defense Rumsfeld asked Dr. Dov Zakheim to "initiate the process to get this moving and coordinated" relating to a paper on commercial financing concepts of capital asset leasing. The paper was outlined in a May 8, 2001, memorandum that Mr. William Schneider, Jr., Chairman, Defense Science Board, prepared at the suggestion of [redacted] Chairman, National Economic Council, who met with finance specialists at Citicorp (New York) to:

- brief Citicorp on DoD interest in applying commercial financing techniques to selected DoD assets, including a replacement aerial tanker for the existing fleet of 500 KC-135 tanker aircraft, and

[7] The VCX program consisted of small and large aircraft. The small VCX (C-37A) was a long range executive passenger jet that would have provided worldwide air transportation for the Vice President, cabinet members, congressional delegations, Presidential emissaries and other high ranking dignitaries of the United States. The large VCX (C-32A) was a Boeing 757-200 passenger jet. The large VCX aircraft was to have been acquired under a lease with option to purchase contract.

[redacted]

- obtain Citicorp views on statutory and regulatory obstacles that prevent the use of commercial lease finance techniques in order to permit DoD to finance capital asset acquisitions and the sale-leaseback of DoD real property.

Mr. Schneider's memorandum stated that:

> Two potential capital asset lease concepts were discussed: (1) C-17 strategic airlift aircraft, and (2) a replacement aerial tanker for the existing fleet of – 500 KC-135 aircraft. The opportunity cost of tying up appropriated funds for decades on long-lived capital assets is an important incentive for the use of lease finance in the private sector. In view of the likelihood of tight topline budget constraints, preserving scarce Budget Authority for transformation and recovery of the capability of currently deployed forces is a high priority. The use of lease financing can contribute to these ends without a requirement for additional Budget Authority.

Mr. Schneider also stated that a Senator has a "strong interest in facilitating the use of such financing." A congressional staffer affirmed the Senator's intense interest in increasing the role of commercial financing in defense acquisition.

Subsequently, the Secretary of Defense asked Dr. Dov Zakheim, Under Secretary of Defense (Comptroller) on May 11, 2001, to initiate a process to get commercial financing techniques moving and to coordinate with the appropriate people, including the DoD Office of General Counsel.

September 2001. Ms. Druyun stated that the Air Force was leasing rather than purchasing the aircraft because funds were not in the budget to purchase tanker aircraft and that a lease deal was favorable to both a Senator and General John Jumper, Air Force Chief of Staff. Ms. Druyun was not sure who initially drafted the Department of Defense Appropriations Act for FY 2002 language; however, she stated that she, along with her staff, reviewed the language and might have made changes. Ms. Druyun also stated that Dr. James G. Roche, Secretary of the Air Force made the decision to use Federal Acquisition Regulation, Part 12 instead of Federal Acquisition Regulation, Part 15. In addition, Ms. Druyun stated that a Representative frequently called her requesting information about the tanker negotiations with Boeing.

On September 25, 2001, Ms. Druyun wanted to lease tanker aircraft that was also a "vision item" of Dr. Roche's. Boeing, a Senator, and the Air Force could work Capital Hill and the Office of Management and Budget on the tanker aircraft lease. Specifically, notes from a Boeing meeting on September 25, 2001, attended by Ms. Druyun and Messrs. [redacted] and [redacted] stated that:

- Ms. Druyun stated belief that Boeing was facing problems before September 11, 2001, and they need to share overhead impacts with DoD.
- Ms. Druyun had spoken with a Representative to purchase Boeing 767A tanker aircraft.

[redacted]

- Ms. Druyun wanted to lease tankers and this was a Secretary Roche vision item.
- Senate and House Appropriations Committees interested in increased capability.
- Major General Paul W. Essex, Director of Global Reach Programs, Office of the Assistant Secretary of the Air Force (Acquisition) stated that the tanker need was 500 to 600 aircraft.
- Ms. Druyun wanted to take charts to Capital Hill on concept.
- Boeing, a Senator, and the Air Force could work Capital Hill and the Office of Management and Budget on concept.
- Major General Paul W. Essex suggested converting 136 KC-135E tanker aircraft to 100 Boeing 767A tanker aircraft.
- As a result of the meeting, [redacted] at Boeing was tasked to develop briefs on the tanker aircraft lease concept by September 26, 2001, for [redacted] and Ms. Druyun to take to Capital Hill.

On September 30, 2001, [redacted]

October 2001. The Air Force did not plan to fund the Boeing KC-767A Tanker Program out of its budget. [redacted] Air Force Air Mobility Command, stated that the Air Force was not going to take the Boeing KC-767A Tanker Program out of hide and that because the Air Force was not going to get the money any other way, it would have to do something else.

The original lease language that Boeing was working did not provide for leasing custom built aircraft. [redacted] Office of the Air Force Director of Global Reach Programs, Office of the Assistant Secretary of the Air Force (Acquisition) stated that, with regards to the Department of Defense Appropriations Act for FY 2002 language, the Air Force provided input to the appropriations and authorizing committees. He recalled that one Air Force input was to go with an operating lease. In addition, [redacted] stated that the draft language was provided to Boeing, who edited it and provided their input to the language. The Air Force's first draft was made available to Boeing in October 2001. Because the Office of Management and Budget rules did not allow for leasing a custom built aircraft, the Air Force

[redacted]

determined that it would lease "green aircraft" (basic Boeing 767 aircraft) from a Special Purpose Entity and modify the aircraft into tankers

On October 7, 2001, Ms. Druyun prepared a letter for Dr. Roche to send to a Representative on the need to "jump-starting" a replacement program for the KC-135 tanker aircraft fleet. Specifically, on October 7, 2001, Ms. Druyun prepared a draft letter to a Representative concerning the "jump-starting" of a replacement program for the KC-135 tanker aircraft fleet She forwarded the draft to Major General Paul W. Essex, Director of Global Reach Programs, Office of the Assistant Secretary of the Air Force (Acquisition). On October 9, 2001, at the direction of Major General Essex, the draft was forwarded to the Office of the Secretary of the Air Force. On October 9, 2001, Dr. Roche sent a letter to the Representative, which was basically the same as the draft prepared by Ms. Druyun.

On October 12, 2001, [redacted]

- [redacted]
- [redacted]
- [redacted]
- [redacted]
- [redacted]
- [redacted]

November 2001. Lieutenant General Reynolds, Commander, Aeronautical Systems Center, Wright-Patterson Air Force Base chartered a "tiger" team to work a contract to lease KC-767 air refueling aircraft. The charter was to develop an implementation plan to lease aircraft.

On November 1, 2001, Mr. Edward C. "Pete" Aldridge, Jr., Under Secretary of Defense for Acquisition, Technology, and Logistics and Dr. Dov Zakheim, Under Secretary of Defense (Comptroller) issued a memorandum, stating that leasing had potential benefits and greater flexibility and that the Department should use multiyear leases as a means of acquiring capital

[redacted]

assets where it makes good business sense. Specifically, on November 1, Mr. Aldridge and Dr. Zakheim issued a memorandum, "Multiyear Leasing of Capital Assets," to the Secretaries of the Military Departments; the Commander in Chief, Special Operations Command; and the Directors of the Defense Agencies. In the memorandum, the Under Secretaries stated that "Leasing has several potential benefits to the Department and provides greater flexibility in dealing with changing requirements. The Department needs to use multiyear leases as a means of acquiring capital assets where it makes good business sense." Further, the Under Secretaries stated that they were jointly establishing a Leasing Review Panel and requested that the addressees identify candidate programs for acquisition by means of multiyear leases. The Under Secretaries also stated that the Panel would review all lease proposals projected to cost a total of $250 million or more over the life of the lease. After review of the proposals, the Panel would make recommendations to the Defense Acquisition Board or the DoD Chief Information Officer.

On November 8, 2001, the Congressional Budget Office explained that the only way to make the tanker aircraft program happen was to score it as a capital lease. Specifically, on November 8, 2001, according to [redacted] at Boeing, Major General Essex, Director of Global Reach Programs, Office of the Assistant Secretary of the Air Force (Acquisition) met with representatives from the Congressional Budget Office to receive an out-brief of the Office's recommended scoring position on the tanker lease program, which was as a capital lease. [redacted] noted that Major General Essex's meeting with the Congressional Budget Office had the same "flavor" as did Boeing's meeting.) Further, [redacted] stated that, upon arriving, it was clear that the Congressional Budget Office's intent was to question Major General Essex about the details of the tanker lease program. Specifically:

> CBO [Congressional Budget Office] had decided that the program could only be scored as a Capital Lease (Lease-to-Own). Most of their questions were intended to have the Air Force provide statements to bolster their position.
>
> - CBO asked if AF [Air Force] will have a requirement for Tankers at the end of the lease. Gen [Major General] Essex responded they would, but the 767 might not necessarily be the Tanker for the future – that the AF will have an Analysis of Alternatives in the FEY [sic] budget to look at Tanker recapitalization.
> - CBO asked about the type of modifications necessary to convert a 767 to a tanker. Gen Essex explained that Cargo door & Cargo floor mods [modifications] would convert the a/c [aircraft] to a Cargo aircraft (with commercial value) and the boom, and hose & drogue would have to be added to make it a tanker.
> - CBO asked, then was it AF intent to turn these back over to Boeing at the end of the lease. Gen Essex explained [that] the AF wanted flexibility through this pilot program to either end the lease, extend the lease, or purchase the aircraft at some point.
> - CBO asked if Boeing has estimated the de-modification costs for these aircraft? [T]ermination liability required? [C]ost to finance? Gen Essex explained these questions could best be answered by Boeing CBO asked the AF to get Boeing to provide this information.

[redacted]

> Bottom Line: CBO concluded saying they could not find any other way to make this lease program happen except [by] scoring this as a Capital Lease They are recommending to the Committees, as they did in our [Boeing's] meeting, that these aircraft could be procured using Advance Appropriations

[redacted] also stated that Major General Essex thanked Boeing representatives for the pre-brief before the Air Force's meeting with the Congressional Budget Office. As a result, they were better prepared for the meeting.

December 2001. [redacted] *Office of the Assistant Secretary of the Air Force (Financial Management and Comptroller)* stated that [redacted] Office of the Air Force Director of Global Reach Programs, Office of the Assistant Secretary of the Air Force (Acquisition) asked him to make certain assumptions that he though were a little unreasonable to make the lease look good. Further, he stated that [redacted] was basically delegated to run the show and his main function was to get the tanker aircraft operating lease on the ramps. From December 2001 to November 2002, [redacted] erson was a senior financial management economist assigned to review the Boeing KC-767A Tanker Program. [redacted] stated that he worked with other financial management people at Wright-Patterson Air Force Base: [redacted] and [redacted] In addition, he stated that [redacted] was basically delegated to run the show. [redacted] stated that, while he did not work with Major General Essex on a day-to-day basis, he worked the most with [redacted] and [redacted] Office of the Air Force Director of Global Reach Programs, Office of the Assistant Secretary of the Air Force (Acquisition). Further, he stated that, while his main concern was looking at the numbers, the main function of [redacted] was to get something on the ramps. In regard to the lease, [redacted] asked him to make certain assumptions that he thought were a little unreasonable to make the lease look more attractive. There were a number of things in the analysis where he thought assumptions were not really valid. [redacted] stated that he sent a number of e-mails questioning certain assumptions and their defensibility. [redacted] was the main face to DoD and outside organizations and not the financial management side of the house. In addition, he stated that numbers were contorted a lot of different ways to sell the program.

[redacted] Office of the Assistant Secretary of the Air Force (Financial Management and Comptroller) remembered receiving a call from [redacted] Office of the Air Force Director of Global Reach Programs, Office of the Assistant Secretary of the Air Force (Acquisition) asking if he was trying to torpedo the Air Force. In addition, [redacted] remembered Mr. Michael Montelongo, Assistant Secretary of the Air Force (Financial Management and Comptroller) coming to his office and saying "Hey, guys, we fought our fight, and, you know, this is the Air Force position. You know, it's time to get in line." He believed that Dr. Sambur knew the financial management position. [redacted] thought that financial management as an organization was fairly weak and did not think that Mr. Montelongo, as a personality, was as strong as Dr. Sambur. Further, [redacted] knew of an anonymous

[redacted]

e-mail to [redacted] stating that [redacted] had no integrity, et cetera, et cetera, a rather harsh and damning e-mail.

On December 3, 2001, Ms. Druyun recognized that the Congressional Budget Office position on scoring the lease as a capital lease was a problem and stated that the Senate Appropriation Committee and Boeing were working the issue. Specifically, on December 3, 2001, Ms. Druyun spoke to [redacted] at Boeing about the Congressional Budget Office tanker aircraft language. She expressed her view that the Congressional Budget Office construct was not viable. Subsequently, Ms. Druyun spoke to the Senate Appropriations Committee staff. After speaking with the Senate Appropriations Committee staff, Ms. Druyun called [redacted] back to report. She stated that she was frustrated with the Congressional Budget Office and that knew that the Senate Appropriations Committee and Boeing were trying to work the issue.

On December 5, 2001, Ms. Druyun notified a Representative and a congressional staffer that the language on leasing tankers was not executable. The language required the lease of "green aircraft" (basic Boeing 767 aircraft) and then modification through a separate appropriation. She wanted the congressional language to describe the lease for a "commercial aircraft tanker" versus a green 767 aircraft because the Air Force did not have the money for the modification and would not meet the 90 percent fair market value rule. (In July 2003, the Office of Management and Budget changed the Office of Management and Budget Circular No. A-11 criteria to require Government unique features or enhancement to be financed up front and separate from the lease.) On December 5, 2001, Ms. Druyun sent this information in an e-mail to Dr. Roche; General John P. Jumper, Air Force Chief of Staff; General Robert H. Foglesong, Air Force Vice Chief of Staff; and Dr. Sambur. In the e-mail, Ms. Druyun stated that:

> [A Representative] and [a congressional staffer] faxed me the new language on leasing last night that will go to conference. They have fixed some of the issues but as written it is still not executable. [The Representative] called me again this AM to get my sense of its executability and this is what I said to him:
>
> - the language requires the AF [Air Force] [to] lease green 767 aircraft but procure thru separate Auth/Approp [Authorization/Appropriation] the mod to make it a tanker. This means the aircraft cost is [redacted] which I then do my fair market value 90% assessment. For a ten year lease I bust the 90% figure...its approx 116% under OMB [Office of Management and Budget] Circular A-11.
> - *I asked if they could describe the lease for a "commercial aircraft tanker" vs [versus] green 767 a/c. My reasoning for this is that I* believe Boeing can market a commercial 767 tanker which hopefully can include a boom and comm [communications] equipment for US and FMS [Foreign Military Sales] sales. This would not require the USAF [U.S. Air Force] to come up with [redacted] a copy for each a/c [aircraft] which I told him would probably be impossible to do with our current top line. Writing a lease for a commercial tanker largely solves this problem. Also it puts the value I would do an OMB Circular A-11 calculation on close to [redacted] and if I do it on two 5 year leases I believe I can come within the 90% rule since each is a stand alone calculation. SAF/IA [Air Force Deputy Under Secretary (International Affairs)] is looking at whether [redacted] can have as a

[redacted]

description in their commercial tanker some variation or options such as radios and have two commercial-tanker offerings: US and FMS and non FMS subject to ITAR [International Traffic in Arms Regulations]. I should hear back on that later today.

- [The Representative] asked that I call [a congressional staffer] and discuss the changes that I would want to see happen in Conference. I am awaiting his call sometime today. [The Representative] and [the congressional staffer] told me that the prohibition to eventually buying these aircraft would be changed in the next couple of years. Apparently they have some backroom agreement on this. The lease would then be allowed to be scored annually per discussions they have had with CBO [Congressional Budget Office] and OMB if I can meet the A-11 requirements.

I will keep you posted. Boeing by next week can have a commercial tanker ready for marketing with a boom if I get a green light from IA [Air Force Deputy Under Secretary (International Affairs)] on my questions.

On December 5, 2001, Dr. Sambur touted that Ms. Druyun was doing an excellent job on Capital Hill to modify language on the tanker aircraft lease and that it was "approaching the doable range." Specifically, on December 5, 2001, in response to Ms. Druyun's December 5, 2001, e-mail, Dr. Sambur sent an e-mail to Dr. Roche, Ms. Druyun, General Jumper, and General Foglesong with a cc: to Mr. Willard H. Mitchell, Deputy Under Secretary of the Air Force (International Affairs) in which he stated that, "Since this email, Darleen [Druyun] has done an excellent job on the Hill to modify the language so that it [is] approaching the doable range."

On December 12, 2001, an Office of Management and Budget official sent a letter to a Representative expressing grave reservations about leasing tanker aircraft as part of an economic stimulus package. Specifically, on December 12, 2001, an Office of Management and Budget official sent a letter to a Representative in which he stated that "Thank you for your letter to [a White House official] requesting that the Administration's economic stimulus package include funding for the purchase or lease of Boeing 767 aircraft as the Air Force's next generation tanker. The [White House official] has asked me to respond on his behalf." Further, the Office of Management and Budget official discussed the Representative's concern about the economic well-being of the Boeing Company and stated that:

> In your letter you ask that the economic stimulus package include money for the lease or purchase of new B-767 aircraft as tankers for the Air Force. We have grave reservations about leasing these aircraft. Our analysis shows that over the long-term a lease-purchase program would be much more expensive than direct purchase of the same aircraft. With regard to the possibility of procuring the aircraft, we have now begun the programmatic and budget reviews necessary for the preparation for the FY 2003 Budget submission. In this process programs are evaluated in terms of their cost and potential military benefit. Please be assured that we will consider your request carefully as we prepare the FY 2003 Budget request.

On December 13, 2001, [redacted]

[redacted]

[redacted]

[redacted]

On December 17, 2001, Major General Paul W. Essex e-mailed Dr. Sambur that Ms. Druyun, Boeing, and Air Staff representatives had developed options that met the requirements for an operating lease. On that date, Major General Paul W. Essex, Director of Global Reach Programs, Office of the Assistant Secretary of the Air Force (Acquisition) sent an e–mail to Dr. Sambur; Ms. Druyun; Lieutenant General Stephen Plummer, Air Force Principal Deputy (Acquisition); Mr. Blaise J. Durante, Air Force Deputy Assistant Secretary (Management Policy and Program Integration); [redacted] Office of the Air Force Director of Global Reach Programs, Office of the Assistant Secretary of the Air Force (Acquisition); [redacted] Office of the Air Force Director of Global Reach Programs; [redacted] Office of the Air Force Director of Global Reach Programs; and [redacted] Chief, Mobility Division, Office of the Air Force Director of Global Reach Programs. In the e-mail, Major General Essex stated:

> Dr. Sambur
>
> Summary of actions taken:
>
> Mrs. Druyun, Boeing, and Air Staff reps met end of last week to develop and examine set of options which meet the requirements for an operating lease. Over weekend further refined these options and began building briefing which lays out an Integrated Master Schedule combining all Boeing and Government actions required to obtain congressional approval and initiate the program. We will brief this to Mrs. Druyun Wednesday at 0700, along with the matrix of options which meet the operating lease gates. The variables in the matrix are: purchase price, lease term, interest rate, residual value, and lease payment. All the options presented will meet the OMB [Office of Management and Budget] gates.
>
> I recommend that we brief Dr. Roche on Wednesday after this meeting, at which time we can also show him what he just asked for...how we got the old numbers and what are 'the real numbers.' I think it is important to remember that the old numbers were generated on a 'pilot program' which was really a capital lease by another name. That is off the table and we need to distance ourselves from them if we can.
>
> Mrs. Druyun and Gen [General] Plummer,

[redacted]

> This is what I sent to Dr. Sambur, at his request. He is going to call or e-mail SECAF [Secretary of the Air Force] about 767 numbers problem. As you can see, I am recommending we try to get SECAF to wait til[l] Wednesday to discuss the lease numbers The previous lease numbers were for a pilot program which is completely different from what we're working toward now.

On December 18, 2001, Mr. Paul D. Wolfowitz, Deputy Secretary of Defense wanted a briefing paper on Boeing 767 leasing issues, including why the decision was made to lease versus buy, costs, scoring issues, and advantages and disadvantages. Specifically, on December 18, 2001, Mr. Jaymie Durnan, The Special Assistant to the Secretary and the Deputy Secretary of Defense sent an e-mail to Dr. Roche with a cc: to Mr. Aldridge; Brigadier General Batiste, Senior Military Assistant to the Deputy Secretary of Defense; and [redacted] In the e-mail, Mr. Durnan stated:

> Jim,
>
> DSD [Deputy Secretary of Defense] asks that you provide him with a briefing paper on the 767 leasing issues. He would like the paper to include how the decision was made, why the decision was made to lease versus buy, the costs involved, the scoring issues involved, the advantages and disadvantages of leasing versus buying, were there alternatives to the 767 and what were they, and other relevant issues you deem appropriate. It would be helpful to give him a scorecard of why [a Senator], et al are so opposed to it.
>
> He asks if you can provide the paper by cob [close-of-business] today and, if necessary, would like to schedule a meeting with Pete [Aldridge] Dov [Zakheim] and you tomorrow to discuss the issue.

On December 25, 2001, Dr. Roche, Dr. Sambur, and most senior Air Force officials discussed whether the Air Force could live with the tanker aircraft lease language in the law. Specifically, on December 25, 2001, [redacted] stated that Dr. Roche called together people from the Offices of the Air Force General Counsel, the Assistant Secretary of the Air Force (Financial Management and Comptroller), the Deputy Assistant Secretary of the Air Force for Contracting, and the Deputy Chief of Staff for Air and Space Operations to analyze the tanker aircraft lease language in the law, to determine what they understood Boeing's process to be, and to determine whether they could go forward with the Air Force budget. [redacted] recalled that they met over Christmas and everyone agreed it would be difficult. Almost all "two-letter" directorates at the Air Force Staff agreed to go forward. It was then that Dr. Sambur tasked [redacted] System Program Director, KC-767 System Program Office to press forward.

January 2002. The Air Force Integrated Process Team looked into the feasibility of leasing the aircraft called for in the congressional language. The Air Force Integrated Process Team was formed to look into the feasibility of leasing tanker aircraft as mentioned in Section 159 of the Department of Defense Appropriations Act for FY 2002. Team members were: [redacted] Cost Analyst; [redacted] Integrated Process Team lead, who was later replaced by [redacted] System Program Director for the KC-767 System Program Office; [redacted] Program Manager; [redacted]

[redacted]

contracts; [redacted] configuration; [redacted] former contracting officer, and others.

The KC-767 System Program Office was tasked to get on contract the lease called for in the congressional language. [redacted] Deputy Chief of Contracting, Air Force Materiel Command recalled attending a meeting directing the Aeronautical Systems Command, Wright-Patterson Air Force Base to get on contract the tanker aircraft lease called for in Section 8159 of the Department of Defense Appropriations Act for FY 2002. He stated that Lieutenant General Reynolds, Commander, Aeronautical Systems Command directed that the KC-767 System Program Office be set-up.

The Air Force contracting officer stated that he was marching to the congressional language to lease tanker aircraft. [redacted] Contracting Officer, Aeronautical Systems Command, Wright-Patterson Air Force Base stated that he was involved on the initial team that started work on the Commercial Derivative Air Refueling Aircraft, later changed to the KC-767 System Program Office. He stated that the Aeronautical Systems Command received short notice to get on contract the lease called for in Section 8159 of the Department of Defense Appropriations Act for FY 2002. In addition, [redacted] stated that Lieutenant General Reynolds, Commander, Aeronautical Systems Command directed that the KC-767 System Program Office be set up to handle the tanker lease program. He further stated that Lieutenant General Reynolds may have received this direction from Headquarters, Air Force.

The Air Force Deputy Chief of Contracting stated that the KC-767 System Program Office was on the ragged edge trying to make the tanker aircraft operating lease fit. [redacted] stated that, in regard to the lease, "we pushed the edge of the envelope. There's no question that there were a couple of issues with regard to the operating lease [for the Boeing KC-767A tanker aircraft]. It was on the ragged edge. There's no question that it was on the edge and that we were really reaching to try and make it [the operating lease] fit."

February 2002. The KC-767 System Program Office at the Aeronautical Systems Command, Wright-Patterson Air Force Base was formed to support the Office of the Assistant Secretary of the Air Force (Acquisition). [redacted] Deputy Director, KC-767 System Program Office stated that the KC-767 System Program Office team was formed to support the Office of the Assistant Secretary of the Air Force (Acquisition).

Lieutenant General Reynolds, Commander, Aeronautical Systems Command assigned [redacted] **to the KC-767 System Program Office team as the System Program Director to support the Office of the Assistant Secretary of the Air Force (Acquisition).** At the time, [redacted] was working the KC-135 tanker aircraft replacement program. [redacted] stated that he reported to Brigadier General Ted F. Bowlds, Program Executive Officer for Strategic Programs, Office of the Assistant Secretary of the Air Force (Acquisition).

Brigadier General Ted F. Bowlds, Program Executive Officer for Strategic Programs, Office of the Assistant Secretary of the Air Force (Acquisition) stated that Ms. Druyun was running the program and that he was just an

[redacted]

action officer, not a decision maker. [redacted] Office of the Air Force Director of Global Reach Programs, Office of the Assistant Secretary of the Air Force (Acquisition) was Ms. Druyun's inside person and Brigadier General Bowlds was concerned about what [redacted] was reporting back to Capital Hill. Brigadier General Bowlds stated that "she [Ms. Druyun] is very hands-on, and you were kind of like an action officer as opposed to a decision maker. You're just the implementer." Ms. Druyun would also pick a person to be her inside man or woman, that person was [redacted] In addition, Brigadier General Bowlds stated that, "So you basically, I got somebody out here running a program that is answerable not to me, not necessarily to his boss, Major General Essex at the time, and answers directly to [Ms.] Druyun." Brigadier General Bowlds further stated that:

> Because there was questions that were going back to the Hill, and it was, you know, two pages deep worth of the truth, but when it got to [redacted] it was, well, we can't tell that whole story, da da da da, we're only going to give them a paragraph and that's what we're going to send forward

Brigadier General Bowlds stated that he mentioned to Major General Essex problems about being left out of a meeting. Specifically, at a meeting in Saint Louis, Missouri, Ms. Druyun pulled Brigadier General Bowlds; [redacted] System Program Director, KC-767 System Program Office; [redacted] and [redacted] Cost Price Analyst, Aeronautical Systems Command, Wright-Patterson Air Force Base aside and told the team that you are trying to drive the price too low and for [redacted] to work with the team to bring the price back up.

On February 12, 2002, a Representative and a Senator worked on congressional language to help the Air Force achieve tanker recapitalization goals.

On February 20, 2002, Brigadier General Darryl A. Scott, Deputy Assistant Secretary (Contracting), Office of the Assistant Secretary of the Air Force (Acquisition) signed out a request for information to The Boeing Company and Airbus North America, Inc. (European Aeronautic Defence and Space Company, Incorporated) to begin the Air Force's market research and assess market capabilities in the area of commercial aerial tankers.

On February 26, 2002, a congressional staffer asked why an request for information was sent to Airbus North America, Inc. (European Aeronautic Defence and Space Company, Incorporated) when the Senate had already decided that Boeing would supply the tankers. Specifically, on February 26, 2002, a congressional staffer asked why the Air Force had asked Airbus to provide information in response to a request for information before notifying a Senator. The congressional staffer noted that the issue regarding Boeing supplying the tankers had been decided by an overwhelming vote of the Senate (98 to 2). In response, Brigadier General Darryl A. Scott explained that the request for information did not commit the Air Force to competition. The congressional staffer's final words were "It is important to pick and choose your friends very carefully. It is clear that you have chosen, and the Committee has noted it."

[redacted]

April 2002. [redacted] Cost Price Analyst, Aeronautical Systems Command, Wright-Patterson Air Force Base stated that the guidance from Ms. Druyun and Congress was to get an operating lease on contract, do it commercially, and get it from Boeing. [redacted] was involved in attempting to get the lease of 100 Boeing KC-767A tanker aircraft on contract. He stated that, basically, the team was formed to support the Office of the Assistant Secretary of the Air Force (Acquisition), which at the time was working the KC-135 replacement program. In addition, [redacted] stated that, around April 1, 2002, the team received instructions to start work with Boeing to finalize a contract. Specifically, he stated that the guidance from Ms. Druyun and Congress was to get an operating lease on contract, do it commercially, and get it from Boeing. [redacted] was told by Solomon Smith Barney that classic modeling of an operating lease would not work because of the lenders. Trying to do a reasonable residual value under the lease would not work because the lenders would not buy-in because of the loan to value ratio. When the Air Force turns the tanker aircraft back in, the marketplace would be saturated sometime after 20 planes were turned in and the last 30 or 40 planes may be sold as scrap. Further, [redacted] stated that, because the Air Force could not use any language stating that they intended to buy the Boeing KC-767A tanker aircraft, Dr. Roche and Ms. Druyun would offer "letters of comfort" when the time came. He also stated that [redacted] Office of the Air Force Director of Global Reach Programs, Office of the Assistant Secretary of the Air Force (Acquisition) devised contract clause C102 to address the issue of residual value of only 10 percent after 6 years. The clause states that the planes have to be purchased at fair market value; however, if the fair market value is higher than the residual value, Boeing must give the Air Force a rebate. In addition, [redacted] stated that the Boeing and Air Force Integrated Product Team provided joint presentations and status reports to Ms. Druyun and [redacted] at Boeing. After Ms. Druyun and [redacted] retired, Brigadier General Bowlds and [redacted] at Boeing received the briefings.

On April 8, 2002, at the DoD Press Briefing of Secretary Rumsfeld and General Richard B. Myers, Chairman, Joint Chiefs of Staff; General Myers stated that "Now, what we are talking about, leasing, this is an Air Force issue. The Air Force is looking at that, and they have not brought that to me, or to the Secretary."

On April 16, 2002, Senate Armed Services Committee professional staff informed Major General Essex; [redacted] Office of the Air Force Director of Global Reach Programs, Office of the Assistant Secretary of the Air Force (Acquisition); and [redacted] Chief of Mobility and Special Operations Forces, Weapons Systems Liaison Division, Office of Air Force Legislative Liaison that leasing was perfectly acceptable if you get what you pay for. However, if you pay 90 percent of the assets value, you should obtain 90 percent of the assets life in return. A six-year lease for 90 percent of the cost of the aircraft is not a good deal. Those comments resulted from a discussion reported in an April 16, 2002, Tanker Lease Congressional Contact Report. Present at the discussion were four members of the Senate Armed Services Committee professional staff and three Air Force officials: Major General Essex, [redacted] and [redacted]

[redacted]

On April 25, 2002, the Air Force did not answer questions from a reporter about whether the tanker aircraft lease purchase plan began when a Senator called the Air Force and requested that it use "creative funding" to buy Boeing KC-767A tanker aircraft. Specifically, on April 25, 2002, [redacted] "U.S. News and World Report," submitted questions to Dr. Sambur. Question: I am told by two sources that the tanker lease purchase plan began when a Senator called the Air Force and requested that the service use "creative funding" to buy 767 tankers. I am further told the Senator said creative funding meant a lease. I understand it was this call that helped move the proposal to the top of the agenda. Is that true? When was the call? Who did the Senator speak with? Whose idea was the lease? Whose idea was it to buy 767s? Is the lease cost more than a purchase, will that limit the number of new tankers the Air Force can have long term? Answers were not provided to these questions.

May 2002. On May 3, in a letter to a Senator, the Office of Management and Budget stated that it interpreted the congressional language on the tanker aircraft to mean that the Air Force could lease basic aircraft and then modify the aircraft; however, the Air Force interpreted the language to mean that it could lease the converted aircraft because the aircraft qualified as "general purpose aircraft." The Air Force interpretation presumed that an active commercial market existed for the tanker aircraft. Specifically, on May 3, 2002, an Office of Management and Budget official sent a letter to a Senator in which he stated:

> Dear Senator:
>
> Thank you for your letter of April 17, 2002 in which you asked us for the preliminary results of our analysis of the following areas related to the Air Force's tanker fleet.
>
> The Air Force's discussions with Boeing regarding leasing 100 B-767 tankers are still ongoing. We, therefore, have no basis to change our previous cost estimates for leasing or direct purchase of B-767 tanker aircraft We believe, however, that there are four options for the tanker fleet:
>
> Do nothing. This is the path analyzed by the Air Force in its two studies It results in increased long-term costs of [redacted] paid out over 40 years, accepts the risk of shortfalls in certain scenarios, but avoids potentially large up-front costs of $3-26 billion, depending on the option
>
> Convert 126 KC-135'E' tanker models into KC-135'R' models. The AF [Air Force] has already conducted a re-engining and upgrade program for most of its KC-135s, to convert them to the 'R' model, which the Air Force plans to keep in service until perhaps 2030 or 2040 depending on usage. In all, the Air Force has already re-engined 410 aircraft, leaving only 126 'E' aircraft in the Air National Guard fleet with older engines that could also be converted into an 'R' model. Such an option could be achieved for an estimated cost of about [redacted] spread over a period of 6 years (about [redacted] The advantages of this option are that the fuel offload capacity of each aircraft would be increased and the total fleet capacity increased to solve some of the shortfalls identified in the TRS-05. Moreover, maintenance costs of the current aircraft would be reduced. In addition, this option would increase the capacity of the fleet sooner than other alternatives (all converted aircraft could be delivered by 2009)

[redacted]

Direct purchase of 100 Boeing 767 tanker aircraft and retirement of the KC-135E fleet Based on a price of [redacted] per airplane, which we understand is a reasonable possibility, and including required military construction, this option would cost approximately [redacted] and would not be complete before 2011/12. The Air Force would have to fully fund these aircraft in its budget request. New B-767s would provide the Air Force with all the advantages of a modern aircraft with greater availability and a potential life longer than that of converted KC-135R aircraft. However, because 100 B-767 aircraft would replace 126 KC-135Es, the total tanker fleet capacity would be reduced and would not solve any of the shortfalls identified in *TRS-05*.

Lease 100 Boeing 767 aircraft in accordance with section 8159 of the FY2002 Defense Appropriations Act We understand section 8159 to mean that the lease would cover the aircraft in its basic, or transport, configuration, which the Air Force would then modify into a tanker configuration. At the end of the 10 year lease period the Air Force would de-modify the aircraft and return them to Boeing in their original transport configuration. In this way the Air Force could meet the criteria of an operating lease. The Air Force believes that the base aircraft cost is [redacted] with tanker conversion and de-conversion costs adding [redacted] to the price. As we indicated to you in our letter dated December 18, 2001, we believe that the total cost of this option would be [redacted] in then-year dollars. This option would provide aircraft on the same schedule and have the same tanking capacity as the direct purchase option with lower near-term costs, but would require that the Air Force return the aircraft after 10 years, meaning that they would have to develop an alternative for the tanker fleet by that time.

We have no basis at this time to change our [redacted] estimate, since discussions between the Air Force and Boeing to determine the possible lease arrangements for such an aircraft are still ongoing. However, we understand that the Air Force interprets section 8159, together with a colloquy reported in the Congressional record on December 20, 2001, to mean that a B-767 tanker is a general purpose aircraft In an exchange involving Senators, the Members stated they believed a converted 767 qualified 'as a general purpose aircraft' This position presumes there is an active commercial market for tankers which would therefore relieve the Air Force of costs associated with conversions.

Clearly, this interpretation would make it financially easier for the Air Force to meet the conditions for an operating lease imposed by section 8159 because they could amortize the costs of tanker conversions over ten years instead of paying for conversions up front. While we are currently unaware of any commercial buyer or interest in purchasing 100 tankers, OMB will provide its views on the Air Force interpretation to you in the next few weeks.

Leasing policy

You asked us to examine the policy of leasing major defense programs and to evaluate the role of DoD's recently established Leasing Review Panel. When analyzing capital leases, we believe it is critically important to compare the full cost of the lease with other methods of acquiring the capital assets, including direct purchases. We also believe that [a White House official] and the Congress should consider the full cost of capital acquisitions when they make budget decisions to allocate resources to Federal agencies and programs For that reason, we strongly support the budget scoring rules for leases, which were agreed to by the Congress and [the White House official] as part of the Budget Enforcement Act of 1990 The rules distinguish operating leases from capital leases and address the fact that some capital leases are virtually equivalent to the purchase of a capital asset, with most or all of the benefits and risks of

[redacted]

> ownership transferred to the government, while others are more like rentals. They require agencies to fund the full cost of purchases, lease purchases, and capital leases up-front in the first year of the transaction. In this way, the full cost is recognized at the time when decisions are made to incur that cost, regardless of the source and form of financing, so that Congress and [the White House official] have the incentive and the information necessary to make the most efficient use of taxpayers' money.
>
> The Defense Department's Leasing Review Panel, of which OMB is a member, has not yet met because the Air Force has not yet completed its proposal to lease B-767s and B-737 executive jets.

On May 7, 2002, the Congressional Budget Office expressed to a Senator its concerns about why leasing tankers will cost more than the direct purchase and estimated that, in net present value terms, the lease would cost about $4 billion more than the purchase option. Factors that make leasing tankers more costly included the additional cost of financing, risk associated with a limited market, increased administrative costs, and long-term requirement for assets. Specifically, on May 7, 2002, the Congressional Budget Office sent a letter to a Senator that addressed its analysis of the tanker lease. The Congressional Budget Office analysis showed:

> Factors that tend to make the lease of such assets by the government more costly than a direct purchase include the lessor's cost of financing (which is higher than the cost of Treasury borrowing), the need to set lease payments high enough to compensate the lessor for the risk he incurs by producing an asset for which there is a limited market, and any increased administrative costs associated with a lease rather than an outright purchase. Further, in this case, the need for tanker capability will presumably not expire with the lease term – something must be purchased or leased to replace it. Therefore, we have included an estimate of the cost to purchase these tankers at the end of the lease term – the most likely option to preserve tanker capability.
>
> Leases have a greater potential to be cost-effective if the government does not have a long-term requirement for the asset. That does not appear to be the case here. Cost-effective leases also require the existence of a substantial market (by scoring rules, a private market) into which to sell assets at the end of the lease. While there is no private market for tankers, even the public, government market is not likely to absorb more that a few of the 100 tankers.

The Congressional Budget Office estimated that the purchase option would cost about [redacted] in current dollars over the period from 2003 to 2020 and [redacted] in net present value while the lease option would cost about [redacted] over the same period and [redacted] in net present value.

On May 22, 2002, [redacted]

[redacted]

[redacted]

On May 30, 2002, Boeing and [redacted] **are trying to make the business case work.** On that date, [redacted] sent an e-mail to [redacted] at Boeing and to [redacted] System Program Director, KC-767 System Program Office that provided news on the Boeing 767 Business Case Analysis. [redacted] stated that news from a meeting with the Office of Management and Budget was that Air Force would be allowed to build the purchase alternative funding profile for years in which funds would be expended. Specifically, commercial payment practices, such as 35 percent with order, 35 percent mid-payment, and 30 percent on delivery could be used. [redacted]

July 2002. On July 10, the Air Force was having problems with the business case analysis. On that date, [redacted] stated that a problem existed with the Boeing commercial airplane analysis. In addition, he stated that he had a question regarding the Boeing commercial airplane purchase price:

> Would we be allow 15% advance payment in the first year of a 100 a/c [aircraft] commercial buy, even though they're segregated into several lots, and would anyone actually give us the budget to do it? If unrealistic, we'll be roasted for manipulating the analysis, even if legal A better approach would be that, given we would NOT do a 15% adv [advance] payment, the unit would go up – THAT's the price you put *into the BCA [business case analysis] with a "normal" payment schedule.* We can justify an adv payment on the lease, because we get a lower cost. Surely, the same can be said of a hypothetical purchase price

August 2002. [redacted] **Supervisory Cost Analyst, Aeronautical Systems Command, Wright-Patterson Air Force Base, expressed concerns about the operating lease, but his concerns only got as far as the KC-767 System Program Office.** He stated that he had many concerns about the operating lease; however, [redacted] had received Air Force approval to go forward with the operating lease. He elevated his concerns to

[redacted]

Mr. Michael Montelongo, Assistant Secretary of the Air Force (Financial Management and Comptroller) and showed him that, when realistic assumptions were used, the tanker aircraft purchase alternative was at least $2.1 billion less than the lease alternative. After the issue was raised, Ms. Druyun called General Lyles, Commander, Air Force Materiel Command, and told him she no longer needed the financial management team at the Aeronautical Systems Command on the project.

In addition, [redacted] stated that under the guise of transformation, the normal acquisition process was not followed. Supposedly, [redacted] and company up to the Office of the Secretary of the Air Force (Acquisition) had received approval for the tanker aircraft lease to be an operating lease. [redacted] also stated that the goal was to get a contract at any cost and that the lease had lots of issues, such as how to determine fair market value. Further, he stated that his boss, [redacted] elevated the lease issues to Lieutenant General Reynolds, Commander, Aeronautical Systems Center, Wright-Patterson Air Force Base, who contacted General Lyles, Commander, Air Force Materiel Command, in July 2002, about the issues.

Further, [redacted] stated that in early August 2002, the Office of the Deputy Assistant Secretary of the Air Force (Cost and Economics) briefed Mr. Michael Montelongo, Assistant Secretary of the Air Force (Financial Management and Comptroller) on the Commercial Derivative Air Refueling Aircraft lease program. The brief concluded that, when realistic assumptions were used, the purchase alternative was at least $2.1 billion less than the lease alternative and recommended that that the business case analysis for the program should not be coordinated unless more realistic assumptions were used. The briefing showed that the Office of the Director of Global Reach Programs, Office of the Assistant Secretary of the Air Force (Acquisition) would not use the most probable interest rates for business case analysis inputs to budget estimates and that finance interest rates in the business case analysis were unrealistic, too low, and not fixed. Further, [redacted] stated that, because of the issues being raised, Ms. Druyun basically fired [redacted] and her team by calling General Lyles and telling him that she no longer needed [redacted] and her team on the project. As a result of the firing, Brigadier General Bowlds requested that anyone, who had a problem with the tanker aircraft lease, should be in his office on Monday to discuss the problem. In the meantime, [redacted] got a call from Lieutenant General Reynolds who had gotten a call from General Lyles in which he stated that he wanted a group to go to Washington, DC the next week to present their concerns. (See the following August 27, 2002, discussion.)

On August 1, 2002, an Office of Management and Budget official sent a letter to a Senator in which he stated that all current discussions between the Office of Management and Budget and the Air Force on the Boeing 767s indicate that it was unlikely that a proposal could be crafted that complied with the lease requirements. Further, the Office of Management and Budget official stated that Office of Management and Budget discussions with the Air Force suggest that the cost of an operational lease of Boeing 767s would substantially exceed the purchase price of Boeing 767s and that any reconfigured Boeing 767s as tanker aircraft would be designed for unique government purposes and would not be commercially viable. (Department of Defense Office of the

[redacted]

Inspector General Audit Report No. D-2004-064, "Acquisition of the Boeing KC-767A Tanker Aircraft," March 29, 2004, also reported that the Boeing KC-767A tanker aircraft lease did not meet Office of Management and Budget Circular No. A-11 criteria requiring that the asset be a general purpose asset and not be built for unique Government purposes) The Office of Management and Budget official also stated that to support any lease proposal that would cost tax payers more than direct purchase would be inconsistent with Office of Management and Budget circulars and irresponsible.

On August 2, 2002, [redacted] sent an e-mail to Major General Essex in which he identified potential Office of Management and Budget problems with the Boeing KC-767A tanker aircraft lease. Specifically, he stated that an Office of Management and Budget official believed that:

- a 767 proposal that complies with Office of Management and Budget circulars and policy is unlikely;
- the cost of a lease will "substantially exceed" a purchase price;
- a tanker is a unique government asset (thus failing one of the tests for an operating lease); and
- termination liability must be funded or Office of Management and Budget will not consider a lease.

[redacted] suggested a plan to eliminate the Office of Management and Budget concerns. He suggested:

- maximum interaction with Office of Management and Budget personnel;
- let Office of Management and Budget Circular No. A-94 analysis stand on its own;
- agree on tanker market but suggested that aircraft will be sold as freighters; and
- termination liability is an already know problem.

In addition, [redacted] stated that Congress would need to provide legislative relief.

On August 2, 2002, [redacted]

[redacted]

[redacted]

On August 27, 2002, Brigadier General Ted F. Bowlds had [redacted] brief Ms. Druyun, Major General Paul W. Essex, [redacted] the Boeing team, and the [redacted] team on tanker program concerns, not just the operating lease. The briefing showed that the operating lease was about $1.658 billion more than purchasing the tanker aircraft. Ms. Druyun halted the briefing after about five charts were shown and stated that she did not want to see numbers like that again where leasing cost more than purchasing the tanker aircraft. Brigadier General Bowlds stated that he wanted [redacted] to attend an Office of Management and Budget meeting with [redacted] however, Ms. Druyun countermanded the suggestion. [redacted] stated that very few people in the briefing really knew the implications of the price, construction financing, the lease financing, and what the Air Force was actually going to pay at the end of the day. [redacted] also stated that the [redacted] representatives were sensitive to the Enron scandal and were up front, stating that, you know, the lease was going to cost more than the purchase. [redacted] stated that another problem with the lease was that a commercial market did not exist for the Boeing KC-767A tanker aircraft. In addition, he stated that, in another meeting, a Boeing Representative stated that maybe the whole process was being looked at incorrectly and that we should go back to stating that the lease would cost more than the purchase. However, Ms. Druyun and Major General Essex did not agree with that line of thought and shut it down real quick.

On August 27, 2002, in regard to a briefing on that date about the lease analysis, [redacted] Cost Price Analyst, Aeronautical Systems Command, Wright-Patterson Air Force Base stated that [redacted] got to about his second chart and Ms. Druyun basically "gunned him down." She told him to "sit down and shut up, basically." [redacted] didn't say boo to defend her person and "it was pretty intimidating." When [redacted] went down in "flames" the conversation turned to "well, what should we use."

On August 28, 2002, [redacted] sent an e-mail to Dr. Sambur, Ms. Druyun, Major General Essex, and Brigadier General Bowlds stating that the preliminary lease arrangement passed the Office of Management and Budget business case analysis by a slim margin and would save money compared to buying. Further, he stated:

[redacted]

Sir,

Per your request:

Info we've made public:

Negotiations continue and are entering their final phase. We are cautiously optimistic that a lease deal that complies with the law and OMB [Office of Management and Budget] circulars can be reached. Once approved by SECAF [Secretary of the Air Force], we will present the business case to OMB and the OSD [Office of the Secretary of Defense] Leasing Panel, followed by a report to Congress. A lease contract will not be signed without approval from all four defense committees and appropriate funding

Info not yet made public:

The preliminary lease arrangement passes the OMB business case analysis by a slim margin and will save money compared to buying. We are currently running sensitivity analyses to prepare for – and ensure the deal can stand up to – criticism similar to that seen with the 737 deal. We are actively engaging OMB to get their buy-in on the analysis – a critical ally needed to defend the lease. I expect they will support the analysis, but will baulk at supporting our need to escape funding termination liability (peaks at [redacted] in FY07; will need Congressional language to overcome) OMB has also stated they believe a tanker is not a commercial product (a key test for an operating lease), but if the business case holds, I don't think OMB will make this issue a deal-killer

On August 28, 2002, Dr. Sambur asks [redacted] whether they should pulse the Senate Armed Services Committee on the termination liability issue. Specifically, on August 28, 2002, in response to [redacted] e-mail, Dr. Sambur sent an e-mail to [redacted] with a cc: to Ms. Druyun, Major General Essex, and Brigadier General Bowlds in which he stated:

Thanks

I assume you resolved the residual value issue from this update?

Should we pulse the SASC [Senate Armed Services Committee] staffers on the termination liability issue?

On August 28, 2002, in response to Dr. Sambur's e-mail [redacted] stated:

Sir,

Residual value issue of rebating resale profit to the gov't is still in OMB's [Office of Management and Budget] hands They've never seen anything like it before, and after 2 weeks of chewing on it, have not vetoed the concept. However, when I spoke with [redacted] today, he cautioned me that 767 is so political that his input is only advice – [redacted]

*Removed for reason stated in the initial asterisked footnote. (The reference is also on page 97.)

[redacted]

> I defer to Mrs Druyun on the question of talking to SASC [Senate Armed Services Committee] staffers.

September 2002. On September 11, Dr. Sambur sent an e-mail to Dr. Roche in which he stated that the economic justification for the tanker is not a slam dunk for either position (purchase or lease). Specifically, he stated:

> Boss
>
> I kicked off the effort to establish 'need' justification for the tankers Hope to have conceptual frame ready by the end of the week.
>
> Spoke to Robin [Cleveland] after meeting to tell her that the economic justification is not a slam dunk for either position (purchase or lease). It is more a push and a slight change in the interest rates can flip the analysis. At the end of the day, we have to prove that there is a TRUE need and that there are other advantages to leasing (earlier deliver, affordability, etc) that make it a good business deal. It is going to be a tough sell given the other factors such as liability and indemnification.
>
> Marv

On September 20, 2002, [redacted]

[redacted]

[redacted]

On September 23, 2002, a Senator wanted to know what the effect on the lease proposal was if the Air Force provisions on termination liability were not included in the bill. The provision allowed the Air Force to carry termination liability as a contingent liability and would not require the Air Force to set aside the liability amount. The lease deal became unaffordable if the termination liability bills must be specifically budgeted (peaks at [redacted] in FY 2007). On September 23, 2002, [redacted] Office of the Air Force Director of Global Reach Programs, Office of the Assistant Secretary of the Air Force (Acquisition) sent an e-mail to Major General Essex and [redacted] in which he stated:

> Sirs,
>
> [redacted] relayed the following three questions from [a Senator] Needs answers by 1100. Recommended answers provided. Recommend approval for release.
>
> 1) What is the effect on the lease proposal if the general provisions requested by the USAF [U.S. Air Force] are not included in the bill?
>
> A1) The provisions will allow the USAF to carry termination liability as a contingent liability and will not require the service to set aside the liability amount. The lease deal becomes unaffordable if the termination liability bills must be specifically budgeted
>
> 2) What is the annual bill for termination liability that must be budgeted for under OMB's [Office of Management and Budget] rules?
>
> A2) Starting in FY03 the following is the termination liability per year in [redacted]
>
> 3) What is the schedule for going on contract and what is the leased aircraft delivery schedule?
>
> A3) Boeing and USAF remain in negotiations. The negotiating team projects a December Contract award, if AF [Air Force], OSD [Office of the Secretary of Defense], OMB [Office of Management and Budget], and Congress concur with the negotiated lease. Based on a December 2002 contract award, the delivery schedule is: starting in FY06 11/16/20/20/20/13 (last delivery is FY11).

[redacted]

In October 2002, Mr. Richard P. Burke, Deputy Director for Resource Analysis, Office of Program Analysis and Evaluation stated that, in general, leasing a long-term asset was a dumb idea and that the tanker lease was clearly a lease/buy proposal. Further, he stated that Office of Management and Budget regulations prohibit lease/buy provisions when awarding contracts for operating leases. Mr. Burke also stated that the Air Force saw the lease as a way to keep the tanker off budget in the near term, and then, you know, it would be put on their budget in the long term. He did not believe that the appropriators took kindly to that kind of thing and that was the reason for Office of Management and Budget Circular No. A-11. Lease/buy provisions in contracts tend to lead to no requirement for funding up front and obligating the Government and future Congresses to things that are not apparent in the early start of the programs.

In addition, Mr. Burke stated that he and [redacted] Department of Defense Office of the General Counsel chaired a meeting between the Institute for Defense Analyses and Boeing on the analysis by the Institute for Defense Analyses. He further stated that the Boeing representatives were "sweating profusely during that entire meeting." Mr. Burke recalled a call from Dr. Sambur's office in which the caller wanted to know how much work the Air Force did with the Institute for Defense Analyses. He interpreted that question as a "thinly veiled threat" in that the Air Force was going to pull work and would strongly complain to his boss Mr. Kenneth J. Krieg, Director, Program Analysis and Evaluation. Mr. Burke also stated that "Leasing things long-term like this [tanker aircraft] is just a bad idea economically. You can go to any economics course and get taught this over and over again. There's no way you can meet the conditions the Department has on borrowing funds from the Treasury." Further, he stated that, from the start, the Office of Program Analysis and Evaluation questioned how can you [the Air Force] do this? How can you violate Office of Management and Budget Circular No. A-11, which was set up specifically to preclude this kind of transaction? Mr. Burke also did not know why the Office of Management and Budget did not declare this [a violation] earlier.

On October 1, 2002, an Office of Management and Budget representative told [redacted] that the Boeing KC-767A tanker lease could never pass the requirements of Office of Management and Budget Circular No. A-94, so if the KC-767 did pass today, he would change the rules until it could not pass. In an e-mail from [redacted] to Ms. Druyun with a cc: to Major General Essex, he stated that:

> As expected, we only heard one real objection – our choice of discount rate. We did it the way the circular told us to do it, but as the [Office of Management and Budget Circular No.] A-94 author said in the meeting, he wrote it and he can always change it. He stated that OMB's [Office of Management and Budget's] philosophy is you can never pass A-94, so if KC-767 did pass today, he'd change the rules until we couldn't. He threw out several ideas on how he thought he might stop us (all of them arbitrary and capricious), thus providing free intel on how to counter (we'd already thought them through, but this confirmed our suspicions). An interesting fellow – I bet he's a terrible poker player

[redacted]

On October 11, 2002, [redacted] Office of the Air Force Director of Global Reach Programs sent an e-mail to Major General Essex, [redacted] and [redacted] Chief, Mobility Division, Office of the Air Force Director of Global Reach Programs in which he stated that a Representative advised that the Air Force should meet critics of the tanker initiative head-on and elevate the discussion to the real decision makers: the Secretary of Defense and a [redacted].

On October 21, 2002, Dr. Sambur sent an e-mail to Dr. Roche in which he stated that he briefed Ms. Robin Cleveland, Office of Management and Budget, on why the proposal met the requirements for an operating lease. At the briefing, the Office of Management and Budget official was quite upset that Boeing representatives were there to answer questions. Dr. Sambur briefed Ms. Cleveland on the requirements justification, price of the "green aircraft" (basic Boeing 767 aircraft), why the proposal met the requirements of an operating lease, and the legal ramifications of a Special Purpose Entity. [redacted]

On October 23, 2002, [redacted] sent a e-mail to [redacted] Air Force Strategic Programs, Office of the Assistant Secretary of the Air Force (Acquisition) in which he stated that, based on different discount rates (15-year and 6-year), the net present value analysis favored lease by [redacted] using a 15-year rate at 5.275 percent and favored purchase by [redacted] using a 6-year rate at 4.65 percent.

On October 28, 2002, Dr. Roche and members of the Office of the Assistant Secretary of the Air Force (Acquisition) briefed a [redacted]

On October 29, 2002, [redacted]

On October 29, 2002, [redacted]

November 2002. On November 12, [redacted] Office of the Air Force Director of Global Reach Programs sent a copy of the November 7, 2002, KC-135 Tanker Modernization Action Group "Questions

*Removed for reason stated in the initial asterisked footnote

[redacted]

and Answers" to senior Air Force officials on why the Air Force was leasing Boeing KC-767A tanker aircraft rather than buying them. The questions and answers relating to the lease proposal are:

> Q5 Why does the Air Force want to lease 767 tankers rather than buy them? Why the Urgency?
>
> A5. Soundbite Leasing fills a combat need for the USAF [U.S Air Force] and takes advantage of the current low interest rates, slow economic conditions, and creates jobs throughout the country
>
> A 5. The Air Force does not have enough money to buy new tankers today. Leasing is the only affordable solution at this time. Leasing requires less money upfront and allows the Air Force to spread the acquisition cost over the life of the lease. That means the Air Force can begin replacing the KC-135E three years earlier than if they had to wait until they could afford to buy the 767. Waiting to begin replacement will result in higher unit costs and a slower "ramp-up" of much needed new aircraft.

On November 20, 2002, Major General Essex sent an e-mail to Air Force senior staff in which he responded to discussions about postponing the Boeing KC-767A tanker aircraft lease and provided information on the consequences of that choice. He stated:

> Sirs
>
> I understand that within the Air Force senior staff, there is now serious discussion about postponing the 767 lease program. I am therefore providing some information on the consequences of that choice.
>
> The impact of waiting to execute the lease program until 2005 could be substantial in terms of both cost and schedule Specifically,
>
> The current economic conditions of low interest rates and depressed aircraft prices are predicted to turn around by the end of 2005. This will seriously degrade the negotiation leverage we've taken advantage of today
>
> If the 2005 negotiation results in a real price increase of just 5%, we will have to drop one aircraft per year to live within our budget. This will add further cost and stretch-out the KC-135 recapitalization effort two more years in addition to the two-year late start.
>
> A 5 percent price increase due to loss of negotiation leverage will add more than $700M [million] to the cost of the first 100 KC-767s.
>
> A delay of 2 years could kill the lease by cutting in half the "jump-start" advantage over the POM [Program Objectives Memorandum] buy profile (some may see this as a good thing!) In addition, the momentum we've built today to gain lease approval will be lost, including, perhaps, Congressional support
>
> Also, it should be noted that the political heat from several congressional members will be significant and retaliations will likely be threatened Couple this with the fact that the SecAF [Secretary of the Air Force] has spent a tremendous amount of political capital on the need to do this deal now, and I urge caution in suggesting the AF [Air Force] back away from this deal. (and the answer to the obvious question is . . . no, I still don't know how to pay for this)

On November 22, 2002, [redacted]

[redacted]

[redacted]

184

[redacted]

On November 23, 2002, Major General Essex recommended that [redacted] be at the Office of the Secretary of Defense Leasing Review Panel meeting "which could easily turn into an ambush" because "he has answers to every question they could throw at us." Major General Essex's e-mail to Dr. Sambur regarding the Leasing Review Panel stated:

> Dr. Sambur
>
> This could easily turn into an ambush. Maybe or maybe not. In any case, I strongly advise that [redacted] should be there because he has answers to every question they could throw at us. If need be, he could go in my place. I will be just returning from TDY anyway and we could easily say he is representing me. I am not trying to avoid this meeting, but I am honest enough to admit that [redacted] is our best on this topic.
>
> Vr
>
> Bill

On November 29, 2002, Dr. Sambur sent an e-mail to Dr. Roche about the Office of the Secretary of Defense Leasing Panel meeting with Mr. Aldridge. He stated that "The reality of the situation is that everyone is looking for a sign from the White House. If the White House wants to lease the tankers, OMB's [Office of Management and Budget's] objections will suddenly go away and their worse case views will be replaced with our more likely analysis. The delay gives the WH [White House] time to sense the political winds."

December 2002. On December 18, [redacted] Chief of Mobility and Special Operations Forces, Weapons Systems Liaison Division, Office of Air Force Legislative Liaison reported that a need no longer exists to meet with a Representative because [redacted] * * * * * * [redacted] sent an e-mail to Major General Leroy Barnidge, Jr., Air Force Director of Legislative Liaison in which he stated:

> As you know, there has been some conversation about a possible meeting with [a Representative's] office (generated from the [Representative's] office through Mr Powell Moore), OSD [Office of the Secretary of Defense] and one AF [Air Force] representative. OSD/LA [Office of the Assistant Secretary of Defense (Legislative Affairs)] [redacted] called [a congressional staffer] this morning to determine the [Representative's] desire for the meeting.
>
> * * * * * * This eliminates the need for a meeting in which the AF, OSD, and the [Representative's] office were going to talk about the need for tankers right now, 767 ability to fill this need, and the 767 acquisition strategy.
>
> Way Forward: Where we are at right now is that OSD at the highest levels is getting together (DepSecDef [Deputy Secretary of Defense], Mr. Aldridge, Dr. Zakheim, Powell Moore [Assistant Secretary of

*Removed for reason stated in the initial asterisked footnote. (The references are also on pages 16 and 117.)

[redacted]

> Defense (Legislative Affairs)], etc) to decide the DoD way forward. The decision will be to support the lease now or show why decision should wait until a later time. I am not sure when the meeting will occur, but waiting until March (the date previously given by OSD) is no longer an option. According to [redacted] this will be decided soon and it is more now an issue of OSD explaining why DoD shouldn't do the lease then [sic] it is the AF explaining why we should (a reversal of the normal process). I will keep you posted.

On December 18, 2002, Dr. Roche stated in an e-mail that everyone knows where he and General Jumper stand on the tanker aircraft lease and that they "can look angelic" and people will "learn some civics." Specifically, Dr. Roche's e-mail to General Jumper stated that:

> The fun is to let them dangle on the hook Pete [Aldridge] is fine, but [redacted] will learn some civics. We should be cool and let power play out. Everyone knows that you and I supported. And, Marv [Sambur] has done a super job answer PA&E's [Program Analysis and Evaluation's] petty questions one by one. [A Representative] has the con You and I can look angelic. ☺ Jim

On December 19, 2002, [redacted]

[redacted]

[redacted]

On December 19, 2002, [redacted]

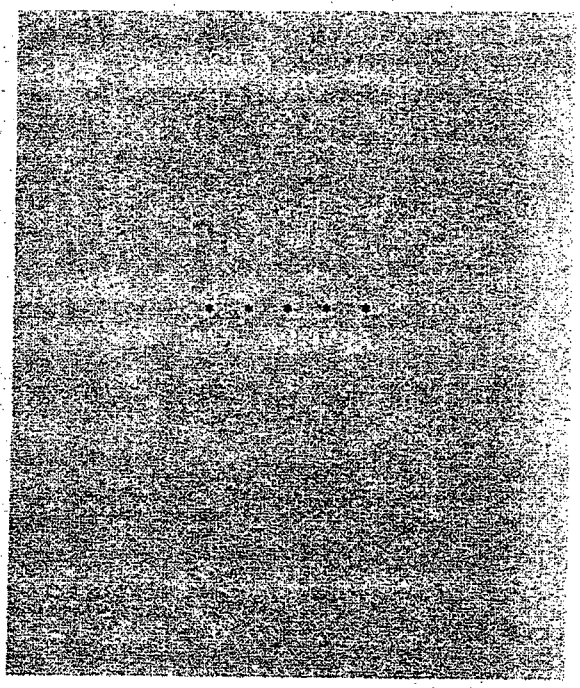
[redacted]

January 2003. On January 30, Mr. Michael Montelongo, Assistant Secretary of the Air Force (Financial Management and Comptroller) sent an e-mail to

[redacted]

Dr. Roche in which he stated that the Office of the Secretary of Defense Leasing Review Panel decided that it was not ready to make a recommendation to the Secretary of Defense about the tanker aircraft lease proposal. In addition, he stated that the Office of Management and Budget, the Office of the Under Secretary of Defense (Comptroller), the Office of Program Analysis and Evaluation, and the Department of Defense Office of the General Counsel all lined up to give their "anti-lease" pitches, thereby leaving [redacted] only 5 minutes to offer counterpoints and make the Air Force case. He also stated that "Truly these people have not been helpful throughout the process. They've been secretive, uncooperative, obstructionist, condescending, and dismissive." Further, Mr. Montelongo stated that one issue to resonate with Mr. Aldridge was that the Air Force would not be able to get the 100-tanker aircraft lease price under a traditional procurement scenario.

On January 30, 2003, General Jumper sent an e-mail to Dr. Roche in which he discussed * * * * * interest in the tanker aircraft lease. Specifically, in the e-mail to Dr. Roche, General Jumper stated:



*Removed for reason stated in the initial asterisked footnote. (The reference is also on pages 17, 120, and 210.)

[redacted]

On January 31, 2003, Lieutenant General Joseph H. Wehrle, Jr., Air Force Assistant Vice Chief of Staff reported that Mr. Aldridge, after a bit more analysis (cost of buying tankers at the same rate versus leasing them), is going to support the lease. He plans to send the recommended approval to Office of Management and Budget and, if they disagree, have them argue with the White House. In an e-mail to Dr. Roche; General Jumper; and General Robert Foglesong, Air Force Vice Chief of Staff; Lieutenant General Wehrle stated:

> Sirs: At a formal function last evening honoring Sec [Secretary] Aldridge, he told me that after a bit more analysis (cost of buying tankers at the same rate vs. leasing them), he is going to support the lease. He mentioned [redacted] to by vs. 1 purchased tanker at the end of the FYDP [Future Years Defense Program]. His plan is to send the recommended approval to OMB [Office of Management and Budget] and if they disagree, have them argue with the WH [White House]. This involvement corresponds with interest from new WHMO [White House Military Office] chief (RADM [Rear Admiral] Miller) who asked me how the lease was coming. I passed this info to Marv [Sambur] who was at the ceremony. . . his folks are engaged with AT&L [Office of the Under Secretary of Defense for Acquisition, Technology, and Logistics] already.
>
> VR Joe

On January 31, 2003, Dr. Roche commented that he thinks that he finally got to Mr. Aldridge by focusing on the unique opportunity Congress has given the Air Force concerning the tanker aircraft lease. In an e-mail to General Jumper, General Foglesong, Lieutenant General Wehrle, Dr. Roche stated:

> Joe, good for you. I think I finally got to Pete [Aldridge] yesterday pm by focusing on this unique opportunity Congress has given us (with Marv's [Sambur] point that no one is giving us the top line money to by [sic] all 100 [tanker aircraft] at one shot). I also reviewed the lease deal with [a Senator], who, as with Gen [General] Jumper, continues to wonder why the Administration doesn't understand the goodness of this situation. JGR

February 2003. On February 11, [redacted] Office of Management and Budget told Mr. Michael W. Wynne, Principal Deputy Under Secretary of Defense for Acquisition, Technology, and Logistics that he believed that some of the arguments surrounding the tanker lease have been mischaracterized. In an e-mail to Mr. Wynne, [redacted] stated:

> This is in reply to your e-mail which, in our view, mischaracterized some of the arguments surrounding the tanker lease
>
> Aircraft Quantity: The Air Force can obtain the same quantity (number) of aircraft within the FYDP [Future Years Defense Program] for a lease as it can with a direct purchase. It is merely a question of willingness to

*Removed for reason stated in the initial asterisked footnote. (The reference is also on pages 17, 120, and 210.)

[redacted]

> put funding resources behind the program (something the Air Force chose not to do in its POM [Program Objectives Memorandum] or budget for FY 2004), which is usually a good indicator of a Services' priority for a program. If, however, by "quantity" you mean tanking capacity over the FYDP, this capacity will actually be decreased under the Air Force's plan.
>
> Lease Costs: Although leasing tankers may not require as much up front funding, and therefore requires less over the FYDP, leasing is more expensive than direct purchase. That is, in the end, the government will pay more for these tankers through a lease than a direct purchase. Both OMB [Office of Management and Budget] and PA&E [Program Analysis and Evaluation] analyses show this. All leasing does is phase the dollars differently.

On February 21, 2003, Dr. Sambur reported to senior Defense officials that the tanker aircraft lease would place the entire cost performance burden on the contractor while delivering the savings of a multiyear contract to the Government from day one. However, he did not mention that the Air Force needed to obtain a waiver for lease termination liability that would peak at about [redacted] in FY 2007 and that the lease would be for only 6 years over which time the Air Force would be required to pay 90 percent of the fair market value of aircraft. In a memorandum, "KC-767 Lease Proposal," February 21, 2003, to Mr. Aldridge and Dr. Zakheim, Under Secretary of Defense (Comptroller) with a cc: to Dr. Spruill, Director, Acquisition Resource and Analysis, Office of the Under Secretary of Defense for Acquisition, Technology, and Logistics; and Dr. Schroeder, Deputy Under Secretary of Defense (Resource Planning/ Management), Dr. Sambur stated that:

> The Air Force's proposal to lease 100 KC-767s has truly been a 'learning journey' for all of us that have been working this new and innovative approach to acquiring needed capability for our warfighters. Throughout the review process, the OSD [Office of the Secretary of Defense] and OMB [Office of Management and Budget] staffs have challenged us with many thought-provoking questions, several of which have caused us to look deeper into the unique characteristics of leasing. One of these characteristics that seemed only secondary at first has now emerged as a significant, primary lease advantage: the multiyear nature of the contract itself.
>
> [redacted]

[redacted]

[redacted]

On February 23, 2003, [redacted] sent an e-mail to Major General Essex in which he stated that, if the KC-767A tanker aircraft goes into production via the lease, it will continue to get funding as long as there are no serious technical problems and many decision makers will probably consider it a continuous "must pay" bill. The e-mail stated:

> Sir,
>
> The following is my look at this issue through a "political framework:"
>
> The decision to end a production line has as much to do with maintaining the defense industrial base (a DoD concern) and jobs (a Congressional concern) as it does with force structure needs (a concern of both).
>
> Once an acquisition program goes into production, it is very hard to terminate early—not because of sunk costs (a popular myth), but rather because it has then become part of the industrial base and jobs infrastructure.
>
> Even as an acquisition program reaches its pre-planned ending point, it can be difficult to actually shut down. Decisionmakers know it is generally impractical to re-open a closed production line; therefore, a decision to stop production is very final – you cannot change your mind in a year or two if the world changes. Unless a replacement is in the wings (signaling an industrial base/jobs/force structure shift, but not a net loss), or the program is unpopular (technical difficulties, high expense, etc), the ending point may turn into a gradual decline in production rates rather that a "cold turkey" shut off.
>
> Conclusions:
>
> As long as C-17 continues to be considered a high-value asset, has no replacement identified, and continues to reduce costs, it will likely continue to get funding up to the point where the operational need has unquestionably been met.

[redacted]

> If KC-767 goes into production via the lease, it will also continue to get funding as long as it does not exhibit serious technical problems when first fielded. Once KC-135 recapitalization starts, many decisionmakers will probably consider it a continuous "must pay" bill.
>
> Therefore, with both of these high-value programs in simultaneous production, funded by a MAJCOM [major command] that may not be able to fund them both after 2009, there is just as much likelihood that AMC [Air Mobility Command] will see a TOA [Total Obligation Authority] increase as the alternative decision to close C-17 or KC-767. Put another way, the C-17 decision will not necessarily be a function of KC-767. If it were, KC-767 recapitalization would be delayed not just a few years – it would be delayed indefinitely.

On February 28, 2003, Dr. Sambur sent an e-mail to Dr. Roche and General Jumper in which he stated that the Office of the Secretary of Defense Leasing Panel was converging toward supporting the Air Force position on the tanker aircraft lease. Specifically, the e-mail stated:

> Boss, Chief The Leasing panel is converging towards supporting the AF [Air Force] position. We have no debate on whether we have a need and consensus that re-engining is NOT the way to go. There is a recognition that leasing gets us the tankers soonest given budget realities and that the AF can afford the lease in the FYDP [Future Years Defense Program]. There is still a debate on the OMB [Office of Management and Budget] issues, but Dov [Zakheim] is now coming around to kicking the can to OMB [Mr] Aldridge is already there.

On February 28, 2003, the Office of the Director of Global Reach Programs, Office of the Assistant Secretary of the Air Force (Acquisition) provided a briefing on the KC-767A lease proposal to the Office of the Secretary of Defense Leasing Review Panel. They briefed that the lease purchase analysis showed that the net present value favoring the lease over the purchase by $863.8 million using various assumptions and a non-multi year purchase adjustment to meet Office of Management and Budget Circular No. A-94 requirements.

March 2003. On March 6, the Office of the Secretary of Defense Leasing Review Panel issued a memorandum that addressed:

- **Institute for Defense Analyses Report.** The study showed a conservative estimate of [redacted] (FY 2002 dollars) per aircraft for 100 aircraft [redacted] for green aircraft, [redacted] for modification, and [redacted] for recurring costs). The aggressive estimate was [redacted] The Air Force agreed to work with the Institute for Defense Analyses to address differences.

- **Department of Defense Office of the General Counsel Report.** The Department of Defense Office of the General Counsel indicated that parties could resolve legal issues but additional risk would shift to the Government.

- **Office of Management and Budget Report.** The Office of Management and Budget reported that the tanker aircraft lease was the largest and most complex in the history of the Office of Management

[redacted]

> and Budget Circular No. A-94 and had the potential to set future precedence. At that time, no Circular precedence existed for leasing when purchasing was less expensive. The Office of Management and Budget stated that, if a termination liability waiver was not obtained, the lease was not affordable. In addition, the Office of Management and Budget reported another precedent setting issue relating to using a rolling discount rate for the Circular analysis. The Air Force agreed to work the issues with the Office of Management and Budget and the Department of Defense Office of the General Counsel.

On March 7, 2003, [redacted] provided an update on the Boeing KC-767A tanker aircraft lease decision to Dr. Sambur, Major General William Hodges, Director of Global Reach Programs, Office of the Assistant Secretary of the Air Force (Acquisition) in which he stated that "IDA [Institute for Defense Analyses], Boeing, and the Air Force met this morning to discuss cost estimate differences. Boeing's bases of estimate were very strong in face of IDA's relatively weak rationale."

May 2003. On May 2, [redacted] sent an e-mail to Dr. Sambur in which he stated that he met with Mr. Aldridge; Vice Admiral Stanley Szemborski, Principal Deputy Director, Program Analysis and Evaluation; and their staff on the Boeing KC-767 tanker aircraft lease. The outcome was that Mr. Aldridge would sign out a decision that authorized the Air Force to proceed with a lease program and that asked the Office of Management and Budget to waive the termination liability for the tanker aircraft lease. Specifically, [redacted] stated in the e-mail that:

> I met this afternoon with Pete Aldridge, VAdm [Vice Admiral] Szemborski and their staffs concerning KC-767 lease. The outcome was a decision to be signed out by Pete (as an Acquisition Decision Memo) authorizing the AF [Air Force] to proceed with a lease program and asking OMB [Office of Management and Budget] to waive termination liability. He will also direct a unit price of about [redacted] below our current position), but will allow us to craft a cost-plus arrangement for the tanker modification. We believe this is do-able within a lease contract and, though out of the box, should be acceptable to Boeing
>
> This will allow us to proceed without cutting content and at a price that matches the OMB/IDA [Office of Management and Budget/Institute for Defense Analyses] estimate, but only if we can shift cost risk for that estimate to the government. In essence, if OSD [Office of the Secretary of Defense] believe the IDA estimate and isn't willing to pay Boeing to assume the risk of a fixed-price contract, then OSD should be willing to assume it through a cost-plus contract I think we'll have full support of AT&L [Acquisition, Technology, and Logistics], PA&E [Program Analysis and Evaluation] and Comptroller for this course of action (they predicted OMB support as well)
>
> There are going to be plenty of details to work out in the coming weeks, but this looks like a win-win decision to me.

On May 12, 2003, financial advisors provided an analysis showing that the financing subsidy for the tanker aircraft lease was worth from [redacted] to [redacted] per plane depending on market rate assumptions. On that date,

[redacted]

[redacted] sent an e-mail to [redacted] System Program Director, KC-767 System Program Office that was later forwarded to Major General William Hodges and [redacted] In the e-mail, [redacted] stated:

> [redacted] I have attached a short analysis of the per plane value of the B Note (G+100) subsidy at various interest rates. We spoke with [redacted] today and they indicated that they have not updated their estimate of the market interest rate for this tranche for several months. Consequently, we have used the old range of assumed rates of 10%, 12.5%, and 15% for this analysis. We have asked [redacted] to provide us with an updated view on the market rate for this tranche as soon as possible. This analysis shows that the subsidy is worth from [redacted] to [redacted] per plane depending upon these assumed market rate assumptions.
>
> As you and I have discussed, while this Boeing plane may be the ideal plane for the USAF [U.S. Air Force] tanker needs, it may not have the same utility/value for commercial use. The new and used market for commercial aircraft, both passenger and freighter, in the world is perhaps at an all-time low. This combined with the fact that the B767 is about to go out of production means that potential B note investors may not get much comfort in the collateral value of the asset that they are being asked to finance. I also doubt that it will be possible to convince them that a sizeable "used" tanker market exists for this plane, particularly in the circumstances where the USAF is rejecting the plane. In our opinion, these are good reasons to have interest rate insurance policy that the subsidy provides.
>
> We recognize that there is an active effort underway to close the gap on the price for these planes, and perhaps a desire to obtain the lowest price possible from Boeing — even if that means eliminating the B note subsidy. Our recommendation is to keep that subsidy as part of the deal, or at least to give the Air Force the option to take it and pay Boeing a higher price for the planes (offer an extra [redacted] per plane). Even if a monocline wrap is ultimately utilized, the current business deal is that the financial terms of that new monocline financing must be at least as good for the Air Force as the current financing structure, which includes the subsidized B note rates.
>
> Three years from now when the first of these planes is ready to go in service and the permanent financing is being solicited, I doubt that anyone will remember if the acquisition price in 2002 dollars was, to use an example [redacted] or [redacted] However, if the market rate on the B note gets priced at rates above 10% and the least term is shortened to 5 years, people will take notice.

On May 14, 2003, [redacted] Program Budget and Congressional Division, Office of the Director of Global Reach Programs, Office of the Assistant Secretary of the Air Force (Acquisition) sent an e-mail to the Office of the Director of Global Reach Programs staff in which he stated that a Senator was questioning the Secretary of Defense on the tanker aircraft lease issue and that a Senator repeated that a further delay was unconscionable. In the e-mail, [redacted] discussed a Senate Appropriations Committee hearing with the Secretary of Defense on May 14, 2003, and stated:

> Of direct interest to AQQ [Office of the Director of Global Reach Programs] was the question/answer session between [a Senator] and SECDEF [Secretary of Defense] on the tanker lease issue. [The

[redacted]

Senator's] question centered around the delay in reaching a decision on the KC-767 lease vs buy issue. He framed his question in a strongly worded statement that addressed the age of the KC-135 tankers, the decay and corrosion, that after a year of repair the aircraft were still unfit to fly and the danger to the airmen flying them. He invited the SECDEF, his advisors and outside experts to Tinker AFB [Air Force] to see for themselves the condition of the aircraft He closed by saying "They are old and need to be replaced. Further delay is unconscionable."

SECDEF responded by saying that DoD was breaking new ground here in looking at a leasing deal of this size. He described the lease proposal as 125 pages long with at least 80 clauses. He wanted a through outside look He said we were still trying to negotiate a proper price.

[The Senator] repeated, again, further delay was unconscionable

On May 16, 2003, [redacted] reported in an e-mail to Major General William Hodges that the KC-767 System Program Office continues to pursue the Boeing KC-767A tanker aircraft lease deal with zero risk-tolerance even though the Office of the Secretary of Defense is saying otherwise. "The key here (and apparently missed by the SPO [System Program Office]) is that OSD [Office of the Secretary of Defense] wants to lower the price and assume more risk and that's what removing the subsidy does." In the e-mail, [redacted] stated:

Sir,

I had [redacted] assessment along with Dr M's before I made my own [redacted] didn't say the rate would be 10-15%, they just said what the impact would be if it got that high and factors that might cause it to be that high.

Three questions you might ask the [redacted] [System Program Office/ [redacted] (for which I've given you my own opinion already):

1) "Can you give me examples of 6-yr bonds that are trading today at 10-15% interest rate and an assessment of how their risk is comparable to ours?"

2) "Since the perceived risk is tied so closely to the chance of AF [Air Force] returning the aircraft at the end of the lease, how would the AF's purchase of some of the KC-767s prior to delivery (as early as the first lot) affect the B-tranche interest rate?"

3) " Do you think the rate will go down or up as deliveries progress – i.e., is your prediction of 10-15% a peak or average rate?"

The SPO continues to pursue this deal with zero risk-tolerance even though OSD is saying otherwise Much like our cost estimates, the B-tranche interest rate estimate is just a prediction The higher the estimated rate you use, the lower the risk you'll be surprised in the future – that's why the SPO wants a high number. That's also why they want to assume a higher-than-official inflation rate (3.3% instead of 1.8%) and a large budget for [redacted] But it's up to the executive decisionmakers to decide what they want for a unit price (a question of contractual risk) and how much to put in the budget (a question of budget risk) It looks like the SPO would like these to be the same, but they don't have to be (Mr. Aldridge so told Dr. Sambur and I two weeks ago) The SPO's attempt to push the price (rather than the budget) back up to lessen the risk could be very counterproductive to getting approval for the deal in the first place.

[redacted]

The key here (and apparently missed by the SPO) is that OSD [Office of the Secretary of Defense] wants to lower the price and assume more risk and that's what removing the subsidy does.

V/R,

[redacted]

On May 19, 2003, [redacted]

On May 22, 2003, [redacted]

On May 23, 2003, Mr. Michael Wynne, Principal Deputy Under Secretary of Defense for Acquisition, Technology, and Logistics recalled that Mr. Aldridge announced at a press conference that the Government was going forward with the lease for 100 Boeing KC-767A tanker aircraft.

June 2003. On June 10, Dr. Sambur sent an e-mail to Dr. Roche in which he stated that Ms. Robin Cleveland wanted all the operating lease issues "pristine" and if not, the Air Force had to get a waiver from Congress. Specifically, Dr. Sambur stated:

Boss

We had the meeting and Robin had 2 points:

- She wanted to make sure that we were "pristine" with All (operating lease) issues and if not we had to go to Congress for a waiver

- She wanted the $2B [billion] that [Mr.] Aldridge promised to pay down the lease

I countered that we showed that we passed [Office of Management and Budget Circular] A-11 and that if we had to go for a waiver, the lease would be killed. * * * * * *

[Mr.] Wynne, to his credit, said that the $2B [billion] was a separate issue from the lease. [Ms.] Robin [Cleveland] pushed back but Wynne held firm

*Removed for reason stated in the initial asterisked footnote.

[redacted]

> I have my PEO [Program Executive Officer] and DAC [Designated Acquisition Commander] reviews this morning and afternoon. Gen [General] Hodges will be attending.
>
> Marv

On June 20, 2003, Mr. Kenneth J. Krieg, Director, Program Analysis and Evaluation sent a memorandum to Mr. Wynne, Acting Under Secretary of Defense for Acquisition, Technology, and Logistics and Dr. Zakheim in which he stated in part that:

> Our A-94 analysis indicates that the provisions of the draft KC-767A aircraft lease cost more than the equivalent purchase of tanker aircraft. Measured in then-year dollars, lease costs exceed purchase costs by $6.0B [billion]; by $5.1B [billion] if measured in constant FY02 dollars; or by $1.9B [billion] if measured in terms of net present value. Our A-94 analysis is based on the following key assumptions: 1) For the leasing scenario, that the Department purchases the KC-767A tanker aircraft at the end of the lease period; and 2) for the direct purchase scenario, that the Department seeks and receives Congressional approval for a multiyear procurement of 100 aircraft. We find that leasing provides no inherent economic efficiencies relative to direct purchase of tankers and is, therefore, more expensive in the long run.
>
> Our analysis also shows that the current draft lease fails to meet the requirement of OMB [Office of Management and Budget] Circular A-11 that the present value of the lease payments be less than 90 percent of the fair market value at lease inception. Our calculations show that lease payments are more than 93 percent of fair market value, exceeding the requirements for the definition of an operating lease. This analysis is based on a fair market value of $131 million (CY02$). In addition to OMB Circular A-11 requirements, Section 8159 of the FY02 appropriations act includes a requirement that the present value of the lease payments be less than 90 percent of the fair market value at lease inception.

On June 23, 2003, [redacted]

July 2003. On July 3, Dr. Sambur stated in an e-mail to Dr. Roche that the tanker aircraft lease report to Congress has left the building for final approval by the Office of Management and Budget and assurance of a waiver of the termination liability. Further, he stated that the Office of Management and Budget and the Office of Program Analysis and Evaluation were not happy with a comparison between a lease and a traditional buy. Instead, if the Air Force use a multiyear procurement for comparison, it would heavily favor a buy. Specifically, Dr. Sambur stated:

> Boss
> It left the building (after an agreed version between OSD [Office of the Secretary of Defense] and the AF [Air force]) for OMB's [Office of Management and Budget's] final blessing and assurance of a waiver of termination. They (OMB and PA&E [Program Analysis and Evaluation]) are now OK with my A-11 interpretation (the [redacted] [million] is not the price at time of delivery) but PA&E and OMB (Robin [Cleveland]) are unhappy with the use of a lease comparison

[redacted]

with a traditional buy (which is a wash). If we use MYP [multiyear procurement] purchase for comparison, it is heavily favored towards a buy. AT&L [Office of the Under Secretary of Defense for Acquisition, Technology, and Logistics] and OSDC [Office of the Under Secretary of Defense (Comptroller)] have come over to our side. If all goes well you sign and we deliver to Congress. Have a Happy 4th!
Marv

October 2003. On October 9, Dr. Sambur stated in an e-mail to [redacted] Office of Management and Budget that he was concerned about changes to Office of Management and Budget Circular No. A-11 that clarified the criteria for qualifying for an operation lease and the inference that the tanker aircraft lease squeezed by on a "loophole." Specifically, Dr. Sambur stated:

[redacted]

I am worried about the answer in which it is stated that

- In July 2003, as part of our annual revision to Circular A-11, OMB [Office of Management and Budget] prospectively tightened and clarified the criteria for qualifying as an "operating lease." This change should help to ensure that long-term leases of capital equipment remain the exception rather than the rule.

Does this statement not beg the question as to whether you changed the circular because the tanker lease squeezed by on a "loophole" in the old circular and would not pass the new circular? Is this not a bad inference for the lease?

Marv Sambur

November 2003. On November 24, in Section 135 of the National Defense Authorization Act for FY 2004, Congress limited the number of tanker aircraft that the Air Force could lease to 20 and authorized the procurement of up to 80 tanker aircraft. In addition, Section 135 required the Secretary of Defense to perform a study of long-term aircraft maintenance and requirements. Specifically, Section 135 stated:

Sec. 135. PROCUREMENT OF TANKER AIRCRAFT.

(a) LEASED AIRCRAFT – The Secretary of the Air Force may lease no more than 20 tanker aircraft under the multiyear aircraft lease pilot program referred to in subsection (d).

(b) MULTIYEAR PROCUREMENT AUTHORITY – (1) Beginning with the fiscal year 2004 program year, the Secretary of the Air Force may, in accordance with section 2306b of title 10, United States Code, enter into a multiyear contract for the purchase of tanker aircraft necessary to meet the requirements of the Air Force for which leasing of tanker aircraft is provided for under the multiyear aircraft lease pilot program but for which the number of tanker aircraft leased under the authority of subsection (a) is insufficient.

(2) The total number of tanker aircraft purchased through a multiyear contract under this subsection may not exceed 80.

(3) Notwithstanding subsection (k) of section 2306b of title 10, United States Code, a contract under this subsection may be for any period not in excess of 10 program years.

[redacted]

(4) A multiyear contract under this subsection may be initiated or continued for any fiscal year for which sufficient funds are available to pay the costs of such contract for that fiscal year, without regard to whether funds are available to pay the costs of such contract for any subsequent fiscal year. Such contract shall provide, however, that performance under the contract during the subsequent year or years of the contract is contingent upon the appropriation of funds and shall also provide for a cancellation payment to be made to the contractor if such appropriations are not made

(c) STUDY OF LONG-TERM TANKER AIRCRAFT MAINTENANCE AND TRAINING REQUIREMENTS-(1)- The Secretary of Defense shall carry out a study to identify alternative means for meeting the long-term requirements of the Air Force for—

(A) the maintenance of tanker aircraft leased under the multiyear aircraft lease pilot program or purchased under subsection (b); and

(B) training in the operation of tanker aircraft leased under the multiyear aircraft lease pilot program or purchased under subsection (b).

(2) Not later than April 1, 2004, the Secretary of Defense shall submit a report on the results of the study to the congressional defense committees.

(d) MULTIYEAR AIRCRAFT LEASE PILOT PROGRAM DEFINED- In this section, the term 'multiyear aircraft lease pilot program' means the aerial refueling aircraft program authorized under section 8159 of the Department of Defense Appropriations Act, 2002 (division A of Public Law 107-117; 115 Stat. 2284).

(e) SENSE OF CONGRESS- It is the sense of Congress that, in budgeting for a program to acquire new tanker aircraft for the Air Force, the President should ensure that sufficient budgetary resources are provided to the Department of Defense to fully execute the program and to further ensure that all other critical defense programs are fully and properly funded

March 2004. On March 29, the Department of Defense Office of the Inspector General issued Report No. D-2004-064, "Acquisition of the Boeing KC-767A Tanker Aircraft," stating that:

> The contract lease for 20 Boeing 767A tanker aircraft did not meet three of six criteria requirements for an operating lease as described in OMB [Office of Management and Budget] Circular No A-11. Meeting the OMB criteria for leases is a statutory requirement of Section 8159 of the Department of Defense Appropriations Act for FY 2002. Further, the Air Force long-term lease is contrary to the actual intended use of operating leases, which may be cost effective when the Government has only a temporary need for the asset. Accordingly, the lease for the Boeing KC-767A Tanker Program was incorrectly classified as an operating lease.

The three criteria not met were:

- the asset is a general-purpose asset rather than being for a special purpose of the government and is not built to the unique specification of the government as lessee;

[redacted]

- there is a private-sector market for the asset; and
- the lease does not contain a bargain-price purchase option.

October 2004. On October 28, in Section 133 of the "Ronald W. Reagan National Defense Authorization Act for Fiscal Year 2005," Congress terminated the Secretary of the Air Force authority to lease tanker aircraft; however, it authorized the procurement of up to 100 tanker aircraft. Specifically, Section 133 stated:

> SEC. 133. AERIAL REFUELING AIRCRAFT ACQUISITION PROGRAM.
>
> (a) TERMINATION OF LEASING AUTHORITY.—Subsection (a) of section 135 of the National Defense Authorization Act for Fiscal Year 2004 (Public Law 108–136; 117 Stat. 1413; 10 U.S.C. 2401a note) is amended by striking "may lease no more than 20 tanker aircraft" and inserting "shall lease no tanker aircraft".
>
> (b) MULTIYEAR PROCUREMENT AUTHORITY.—Subsection (b) of such section is amended—
>
> (1) in paragraph (1)—
>
> (A) by striking "Beginning with the fiscal year 2004 program year, the Secretary" and inserting "The Secretary"; and
>
> (B) by striking "necessary to meet" and all that follows through "is insufficient";
>
> (2) in paragraph (2), by striking "80" and inserting "100"; and
>
> (3) by striking paragraph (4)
>
> (c) STUDY.—Subsection (c)(1) of such section is amended by striking "leased under the multiyear aircraft lease pilot program or" in subparagraphs (A) and (B).
>
> (d) RELATIONSHIP TO PREVIOUS LAW.—Such section is further amended by adding at the end the following new subsection:
>
> "(f) RELATIONSHIP TO PREVIOUS LAW.—The multiyear procurement authority in subsection (b) may not be executed under section 8159 of the Department of Defense Appropriations Act, 2002 (division A of Public Law 107–117) ".

[redacted]

Appendix F. Commercial Item Procurement Strategy – Pricing Issues

The following discusses the commercial item procurement strategy and pricing issues associated with the Boeing KC-767A Tanker Program, the obtaining of a fair and reasonable price for the Boeing KC-767A tanker aircraft, and a summary of how the Air Force arrived at the Boeing KC-767A tanker aircraft price.

Commercial Item Procurement Strategy – Pricing Issues Related to the Boeing KC-767A Tanker Program

In order to use an operating lease to recapitalize the Air Force KC-135 tanker aircraft fleet, the Boeing KC-767A tanker aircraft had to be a commercial item. Department of Defense Office of the Inspector General Report No. D-2004-064 stated that "contrary to the Air Force interpretation, the military tanker aircraft is not a commercial item as defined in Section 403 of title 41, United States Code. Further, there is no commercial market to establish reasonable prices by the forces of supply and demand."

Throughout the negotiation process, Boeing maintained a hard line commercial pricing strategy and provided virtually no transparency into the costs of the basic Boeing 767 aircraft, tanker development and modification costs, and logistics support costs totaling almost [redacted] for the first 100 aircraft. Boeing also failed to provide any information on prices at which the same or similar items (Boeing 767 aircraft) had been sold in the commercial market and refused to accept any type of cost reimbursable contract for the tanker development and modification costs. This lack of insight into commercial prices for Boeing 767 aircraft and cost data to support development, modification, and contract logistics support costs plagued the negotiation process and placed the Air Force at a disadvantage during the negotiation process. Again, similar to the operating lease analysis, senior members of the Office of the Assistant Secretary of the Air Force (Acquisition) consistently reported that the Air Force was getting a fair and reasonable price for the Boeing KC-767A tanker aircraft; however, the Office of Management and Budget, the Institute for Defense Analyses, and the Department of Defense Office of the Inspector General did not agree.

Obtaining a Fair and Reasonable Price for the Boeing KC-767A Tanker Aircraft

Several of the most serious issues identified with obtaining a fair and reasonable price include:

- Improper influence by Ms. Darleen A. Druyun, former Principal Deputy Assistant Secretary of the Air Force (Acquisition and Management) to increase tanker modifications prices and the failure by other senior Air Force officials to support the Air Force

[redacted]

negotiator/cost price analyst on June 17, 2002;

- Incorrect statements made by senior Air Force officials (originating from Ms. Druyun on October 26, 2002) relating to the discount on the "green aircraft" (basic Boeing 767 aircraft) made to the Office of the Secretary of Defense Leasing Review Panel, the Office of Management and Budget, and [* * * * * *] about the Air Force receiving a [redacted] better discount than a preferred airline customer;
- Questionable statements from Boeing on whether the Air Force was getting a better or equal deal than a major airline; and
- Continuous "battle of BOE's [basis of estimate]" among the Air Force, the Office of the Secretary of Defense, the Office of Management and Budget, and the White House as a result of the commercial pricing strategy.

Summary of How the Air Force Arrived at the Boeing KC-767A Tanker Aircraft Price

The following are selected e-mails and memorandums that identify accountable officials associated with the pricing of the Boeing KC-767A tanker aircraft and excerpts from interviews conducted of senior Office of the Secretary of Defense and Air Force officials associated with how the Air Force arrived at the Boeing KC-767A tanker aircraft price.

February 2001. On February 5, [redacted]

October 2001. [redacted] **Air Force Air Mobility Command stated that early figures on airplane costs from the internet for Boeing 767-200 and Boeing 767-400 aircraft ranged from [redacted] to [redacted] while Boeing was offering between [redacted] and [redacted] Boeing asked where the figures came from and when informed they came from the internet, the figures were removed from the internet less than a week later.** [redacted] also stated that the Air Force was not going to take the tanker aircraft program out of hide because it could not get the money any other way; therefore, it would have to do something else.

December 2001 to November 2002. [redacted] Office of the Assistant Secretary of the Air Force (Financial Management and Comptroller) commented that [redacted] Office of the Air Force Director of Global Reach Programs, Office of the Assistant Secretary of the Air Force (Acquisition) was basically delegated to run the show and his main concern was getting something on the ramps. He said he went to a number of investment

*Removed for reason stated in the initial asterisked footnote. (The reference is also on page 31.)

[redacted]

places on Wall Street to find out what a commercial Boeing 767 aircraft should cost and came back with a price of about [redacted] (maybe as low as [redacted] for the "green aircraft." He said that the Boeing internet price for the "green aircraft" was about [redacted] said he thought Ms. Druyun was trying to increase the Air Force price for the aircraft and to get [redacted] Cost Price Analyst, Aeronautical Systems Command, Wright-Patterson Air Force Base to justify a higher price for the aircraft. He said that he felt sorry for [redacted] because he was under a lot of pressure to increase the aircraft price. He also stated that the Air Force was complaining about increases in maintenance costs for the KC-135 tanker aircraft even though it was negotiating a maintenance contract for Boeing KC-767A tanker aircraft that was higher than what they were paying for the KC-135 tanker aircraft. He said that he felt sorry for [redacted] because of the pressure he was under to increase the aircraft price and because he, as [redacted] was alone and did not have anyone from the KC-767 System Program Office defending him.

January 2002. [redacted] **Contracting Officer, Aeronautical Systems Command, Wright-Patterson Air Force Base stated that his task was to get on contract the lease called for in Section 8159 of the Department of Defense Appropriations Act for FY 2002.** Further, he stated that he was involved on the initial team that started work on the Commercial Derivative Air Refueling Aircraft, later changed to the KC-767 System Program Office [redacted] also stated that Lieutenant General Reynolds, Commander, Aeronautical Systems Center, Wright-Patterson Air Force Base directed that the KC-767 System Program Office be established to handle the tanker aircraft lease program.

On January 18, 2002, [redacted] Deputy Chief of Contracting, Air Force Materiel Command recalled attending a meeting in response to a short notice that the Aeronautical Systems Command received to put the tanker aircraft lease on contract as called for in Section 8159 of the Department of Defense Appropriations Act for FY 2002.

February 2002. [redacted] System Program Director, KC-767 System Program Office, who was assigned to KC-767 team by Lieutenant General Reynolds to support the Office of the Assistant Secretary of the Air Force (Acquisition). Before the assignment, he was working on the KC-135 tanker aircraft replacement program.

At a meeting in Saint Louis, Missouri, Ms. Druyun pulled Brigadier General Ted F. Bowlds, Program Executive Officer for Strategic Programs, Office of the Assistant Secretary of the Air Force (Acquisition); [redacted] **and** [redacted] **aside and told the team that you are trying to drive the price too low and for** [redacted] **to work with the team to bring the price back up.** [Emphasis added.]

On February 26, 2002, a congressional staffer asked why the Air Force had asked Airbus North America, Inc. (European Aeronautic Defence and Space Company, Incorporated) to provide information in response to a request for information before notifying a Senator. The congressional staffer noted that the issue regarding Boeing supplying the tankers had been decided by an overwhelming

[redacted]

vote of the Senate (98 to 2). In response, Brigadier General Darryl A. Scott explained that the request for information did not commit the Air Force to competition. The congressional staffer's final words were "It is important to pick and choose your friends very carefully. It is clear that you have chosen, and the Committee has noted it."

April 2002. On April 1, [redacted]

On April 5, [redacted] **Ms. Druyun commented that the Air Force pre-negotiation prices appeared low in comparison to Boeing's. Specifically, for the "green aircraft," the Air Force price ranged from** [redacted] **to** [redacted] **to** [redacted] **discount) with Boeing at** [redacted] **and for the tanker aircraft, the Air Force ranged from** [redacted] **to** [redacted] **with Boeing at** [redacted] **In addition, she stated that the Air Force contractor logistics support costs range from** [redacted] **to** [redacted] **per aircraft per year with Boeing at** [redacted]

May 2002. On May 13, Brigadier General Bowlds sent an e-mail to Dr. Sambur with a cc: to Ms. Druyun; Major General Essex, Director of Global Reach Programs, Office of the Assistant Secretary of the Air Force (Acquisition); and [redacted] **in which he provided the tanker aircraft lease negotiations status: "Air Force** [redacted] **(FY02$) Boeing-** [redacted] **(FY01$) and CLS [contract logistics support] Boeing** [redacted] **per aircraft per year Air Force** [redacted] **per aircraft per year."**

On May 18, 2002, [redacted] **sent an e-mail to Major General Essex and** [redacted] **Office of the Air Force Director of Global Reach Programs, Office of the Assistant Secretary of the Air Force (Acquisition) in which he provided the tanker aircraft lease negotiations status: "Air Force** [redacted] **[million] Boeing-** [redacted] **"**

On May 21, 2002, in an e-mail from [redacted] **to Ms. Druyun and Major General Essex he stated that Ms. Druyun believed that** [redacted] **was the right number, a discount from the list price of about** [redacted] **She compared that number with a** [redacted] **discount for C-32 aircraft,** [redacted] **on a major airline's buy, and** [redacted] **on another major airline's buy. Further, he stated that Boeing was at** [redacted] **and the KC-767 System Program Office was at** [redacted] **but seems willing to go to** [redacted]

On May 22, 2002, [redacted]

[redacted]

[redacted]

On May 22, 2002, in response to questions from the Office of Management and Budget about the Air Force negotiating team being led by a GS-13, Ms. Druyun commented that the staff of the Office of the Assistant Secretary of the Air Force (Acquisition) is deeply involved, including Major General Essex; Brigadier General Darryl A. Scott, Deputy Assistant Secretary (Contracting), Office of the Assistant Secretary of the Air Force (Acquisition); and [redacted]

June 2002. On June 17, the Air Force and Boeing negotiating teams met in Long Beach, California. [redacted] Cost Price Analyst, Aeronautical Systems Command, Wright-Patterson Air Force Base described the meeting in Long Beach as the "Long Beach Massacre." [redacted] stated that Ms. Druyun pretty much by herself pushed the Air Force team to the high end of the price reasonableness range. He asked Brigadier General Scott to jump in any time with support. [redacted] also talked about what he called the [redacted] provision. This provision provided that, because the Air Force was going to fill up the Boeing pipeline and other buyers might start buying Boeing 767s, Boeing would reap the benefit of any quantity efficiencies and the Air Force wanted a share. [redacted] agreed but Ms. Druyun later took the provision off the table. [redacted] believed that Major General Essex, Brigadier General Bowlds, and Brigadier General Scott were all at the Long Beach meeting. [redacted] identified 26 data points relating to learning curve for the modifications costs ranging from about 57 percent to about 83 percent. Each of the data points was weighted based on reliability of data. Ms. Druyun went through each data point until only 4 were left, and the 4 that were left were the high ones that favored Boeing. Further, he stated that the Price Negotiation Memorandum stated that the learning curve was [redacted] because "Air Force leadership based on their expertise said it was so." However, the data suggested that the highest end of the learning curve ought to be [redacted] and one would expect it to be better than that.

[redacted]

On June 17, 2002, [redacted]

[redacted]

Further, in regard to the June 17, 2002 meeting, [redacted] **Contracting Officer(GS-12), Aeronautical Systems Command stated in his interview that he was present at the pricing meeting in Long Beach, California, and that Ms. Druyun made most of the decisions on the numbers. Further, he stated that Brigadier General Bowlds, Brigadier General Scott, and** [redacted] **were at the meeting.**

[redacted] **stated in his interview that, as far as he could tell regarding the June 17, 2002 meeting, Ms. Druyun was never in negotiations for the Boeing 767A tanker aircraft and that he had no recollection of the meeting in Long Beach, California.**

Major General Scott stated in his interview that he did not remember the June 17, 2002, meeting in Long Beach, California. However, he followed-up his interview with an e-mail in which he stated that he was at the meeting but did not recall any discussions with the Air Force Materiel Command pricer. Further, Major General Scott stated that his contracting authority flowed through Ms. Druyun and that she basically oversaw his work but that he reported to Dr. Sambur, the Senior Acquisition Executive. He also stated that the tanker aircraft was not a commercial item, but that the Boeing 767 aircraft was a commercial item.

August 2002. On August 1, [redacted] **sent an e-mail to Major General Essex in which he stated that preliminary KC-767 agreement had been reached: purchase price was** [redacted] **and the lease price was** [redacted] Later, Major General Essex forwarded the e-mail to Dr. Sambur, Ms. Druyun, and Lieutenant General Stephen Plummer, Air Force Principal Deputy (Acquisition)

September 2002. On September 20, [redacted]

October 2002. On October 22, [redacted] **sent an e-mail to Ms. Druyun with a cc: to Major General Essex in which he stated that "[a major airline's] buy of [Boeing] 767-200ERs and engines is pretty complicated. Bottom line: [the major airline] is the only one who knows exactly what the full-up aircraft cost (I'm checking with** [redacted] **to see if he got any insight into [the major airline's] engine discount)."**

[redacted]

On October 24, 2002, Ms. Druyun sent an e-mail to Dr. Sambur stating:

> [A major airline] has agreed to talk to me and I expect to sign a nondisclosure statement. It is my understanding that I will also get the data in writing. I may fly out to Seattle early next week with [redacted] to look at other sales of [Boeing] 767's to airlines to see their discounts as well. Will keep you posted.

On October 25, 2002, Ms. Druyun sent an e-mail to Dr. Sambur stating:

> Had two more discussions with the guys from [a major airline] including their chief negotiator. His bottom line is that we negotiated a very good deal. In fact our discount off of the published catalog price is higher than that given to Boeings most favored customer. We also got some other things thrown into the green aircraft which they would have paid for. He is now working a letter. I asked him to state "very good deal." He said the company lawyers would have to pass on what they put in writing. In any event I can characterized our discussion. I also verified that the so called market price of [redacted] thrown about is fictitious. They have NEVER bought an aircraft at that price and he doesn't know anyone in industry who has.

On October 25, 2002, in response to Ms. Druyun, Dr. Sambur e-mailed:

> Darleen
> Good work. We need to be careful with characterizing verbal discussion because [an Office of Management and Budget official] tends to think we exaggerate.
> Marv

On October 25, 2002, Ms. Druyun sent an e-mail to [redacted] at General Electric stating:

> Need your help for a quick answer to help us in our OMB [Office of Management and Budget] discussion. I assuming for the GE engines you sold to [a major airline] for its [Boeing] 767-200ER purchase with deliveries in 2001 that your ship set engine price was in the range of [redacted] and that they probably got a discount of [redacted] because of the high utilization rate of 3000 hours a year. For the same type of engine for the AF [Air Force] (yes I know we are using a larger one for MTOW [maximum takeoff weight]) but with a utilization rate of 750 hours a year that our discount would be in the [redacted] range. Need an answer ASAP [as soon as possible]. Call me at home if you need to discuss.

On October 26, 2002, [redacted]

[redacted]

[redacted]

On October 27, 2002, Ms. Druyun sent an e-mail to Dr. Sambur stating:

[redacted]

* * * * *

On October 28, 2002, Dr. Roche sent an e-mail to Dr. Sambur and Ms. Druyun stating:

* * * * *

On October 28, 2002, Ms. Druyun sent an e-mail to Dr. Roche in which she stated that:

* * * * *

On October 28, 2002, [redacted] Cost Price Analyst, Aeronautical Systems Command, Wright-Patterson Air Force Base informed [redacted] that the appraiser valuations for the "green aircraft" obtained in May 2002 showed the aircraft price at [redacted] for a 50/50 split of Boeing 200 and Boeing 400 aircraft, same as shown in the BCA [Benefit/Cost Analysis].

On October 30, 2002, Dr. Roche sent a letter to Ms. Robin Cleveland, Office of Management and Budget, in which he stated that:

> You also questioned whether or not we thought a lower price was achievable in the current economic environment. In fact, we believe the

*Removed for reason stated in the initial asterisked footnote. (The second and third references are also on page 110.)

[redacted]

current climate of low interest rates and few commercial aircraft orders was the reason we were able to negotiate a deal superior to that of Airlines with multiyear exclusivity contracts. It is a tribute to the government's tough stand that these negotiations took three months longer than planned and resulted in a total price [redacted] less than expected by one of these Airline customers-prompting their Senior Vice President of Finance to call ours a "great deal." In short, we believe we're already bringing in the price cut you suggested.

November 2002. On November 5, Major General Essex sent an e-mail to [redacted], Office of Program Analysis and Evaluation, stating:

> [redacted]
>
> Gen [Lieutenant General] McNabb told me that you had mentioned OMB's [Office of Management and Budget's] concern that the negotiated price for the airplane was too high and that it appears we did not get a good deal
>
> * * * * * *
>
> We actually have an excellent price with a better discount than the best airline company customers can get We have gone back to get documentation to back this up and I am very confident of it . . .

On November 7, 2002. Dr. Roche and members of the Office of the Assistant Secretary of the Air Force (Acquisition) presented to the Office of Secretary of Defense Leasing Review Panel a briefing that contained the following pricing information;

- The Air Force has more funding flexibility outside the Future Years Defense Program.
- The Air Force negotiated a good price--[redacted]
  - Boeing 767 discounted [redacted] from list price.
  - [redacted] better than discounts given to 20-year exclusive, "preferred" airline customer. (DoD OIG audit shows no support for this statement.)
- If the Air Force only negotiated to same discount as this "preferred airline," it would have added [redacted] per aircraft. This is a very good deal --[redacted] better than the "pros."

December 2002. On December 20, [redacted]

January 2003. Dr. Roche stated that General Jumper has a note from a * * * * * * **. Further, he stated that he got thrown out of a Senator's office because he wanted competition**

*Removed for reason stated in the initial asterisked footnote.

[redacted]

and a Representative crowned him the "most politically tone deaf political appointee" he had ever met in his life because he wanted competition. Dr. Roche also stated that Mr. Aldridge, who ran this thing for the Department not him, decided in January that this thing was a good thing. In addition, he stated that the Chief Executive Officer of Boeing did not want to talk to him because he was talking to a [* * * * * *]. So at that point, the only thing we were debating was what was the right price for something for which there was no known market price. Dr. Roche also stated that, "If you can make it a military line you can build on all of the mods as you're going and you could probably save [redacted] more per plane," versus modifying planes you just built.

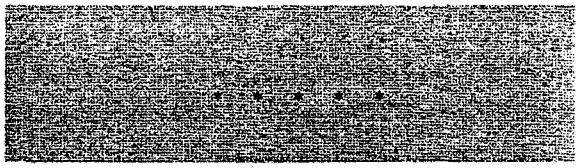
On January 23, 2003, [redacted]

On January 30, 2003, General Jumper sent an e-mail to Dr. Roche in which he discussed a * * * * * interest in the tanker aircraft lease. Specifically, he stated:

* * * * *

*Removed for reason stated in the initial asterisked footnote. (The second and third references are also on pages 17, 120, and 188.)

[redacted]



February 2003. On February 7, Mr. Michael Wynne, Principal Deputy Under Secretary of Defense for Acquisition, Technology, and Logistics sent to [redacted] Office of Management and Budget a comparison of prices developed by the Office of Management and Budget (low estimate of $100 million per aircraft and high estimate of $125 million per aircraft) and the Air Force [redacted] per tanker aircraft). Mr. Wynne believed that the Office of Management and Budget estimates had potential errors relating to the Boeing 767 200/400 modification work and that the learning curve on the tanker modification.

On February 11, 2003, [redacted] Office of Management and Budget responded to Mr. Wynne:

> KC-767-200 Modifications: The extent of the needed modification to the green aircraft are somewhat unclear. Note, however, that the Air Force's price of a [redacted] 767-400/-200 aircraft was not based on a content analysis, but on a melding of the list prices for these two aircraft types provided by Boeing. We understand that the green aircraft will fly out of Seattle to Wichita certified as a B767-200 by the FAA [Federal Aviation Administration]. In order to be certified as a B767-200 it cannot have major structural changes to the airframe (wings, tanks, tails etc. that have sometimes been mentioned by the Air Force). Our approach to pricing, which is to determine the basic market price of a B767-200 and then add the recurring cost of a digital cockpit and its associated electrics is the most sensible given how the basic aircraft will be built. The tanker manager for Boeing indicated to us at a meeting that the recurring cost of such changes was not large. Our $5M [million] and $10M numbers cover what we believe the Air Force wants done on a recurring basis and could be low or high, but is likely in the ball park.
>
> The Air Force change to the heading of its modification chart after months of briefings simply will not suffice as an explanation for the Air Force's tanker modification cost. Once the Air Force Alerted us to the "typo", we asked for details of the learning curve that the Air Force applied and for the T1 cost, but have not received an answer from the Air Force. We would think that upon noticing its "typo" in the chart, the Air Force would have been prepared to provide us (and PA&E [Program Analysis and Evaluation]) with the supporting details which are critical to the price analysis; they did not do so. Moreover, if this is a legitimate typo, it raises the question as to why the initial cost of the tanker modifications is greater than the cost of the basic aircraft. In this situation, I expect that you would want to call for an independent cost estimator to go over every CLIN [contract line item number] in the proposed work to understand how costs are derived.

*Removed for reason stated in the initial asterisked footnote. (The reference is also on pages 17, 120, 188, and 210.)

[redacted]

March 2003. On March 6, the Office of the Secretary of Defense Leasing Review Panel issued a memorandum that addressed:

- **Institute for Defense Analyses Report.** The study showed a conservative estimate of [redacted] (FY 2002 dollars) per aircraft for 100 aircraft [redacted] for green aircraft, [redacted] for modification, and [redacted] for recurring costs). The aggressive estimate was [redacted] The Air Force agreed to work with the Institute for Defense Analyses to address differences.

- **Department of Defense Office of the General Counsel Report.** The Department of Defense Office of the General Counsel indicated that parties could resolve legal issues but additional risk would shift to the Government.

- **Office of Management and Budget Report.** The Office of Management and Budget reported that the tanker aircraft lease was the largest and most complex in the history of the Office of Management and Budget Circular No. A-94 and had the potential to set future precedence. At that time, no A-94 precedence existed for leasing when purchasing was less expensive. The Office of Management and Budget stated that, if a termination liability waiver was not obtained, the lease was not affordable. In addition, the Office of Management and Budget reported another precedent setting issue relating to using a rolling discount rate for the A-94 analysis. The Air Force agreed to work the issues with the Office of Management and Budget and the Department of Defense Office of the General Counsel.

On March 7, 2003, [redacted] sent an e-mail to Dr. Sambur and Major General William Hodges, Director of Global Reach Programs, Office of the Assistant Secretary of the Air Force (Acquisition) in which he stated that "IDA [Institute for Defense Analyses], Boeing, and the Air Force met this morning to discuss cost estimate differences. Boeing's bases of estimate were very strong in face of IDA's relatively weak rationale."

In Mid-March, 2003, according to Mr. Richard P. Burke, Deputy Director for Resource Analysis, Office of Program Analysis and Evaluation, a representative from the Office of the Assistant Secretary of the Air Force (Acquisition) called and asked exactly how much money did the Institute for Defense Analyses receives annually from the Air Force.

On March 20, 2003, Dr. Nancy Spruill, Director, Acquisition Resource and Analysis, Office of the Under Secretary of Defense for Acquisition, Technology, and Logistics provided Dr. Sambur information on funding for the Institute for Defense Analyses.

On March 27, 2003, the Office of the Assistant Secretary of the Air Force (Acquisition) provided an overview of the Boeing KC-767 tanker aircraft lease pricing and negotiation issues that stated:

[redacted]

- Federal Acquisition Regulation Part 12 Commercial Contract Negotiations
  - Negotiating team had to use price-based techniques, rather than FAR Part 15's normal cost-based methods.
  - Proposal evaluation switches from scrubbing predicted man-hours to finding analogous systems with known cost data.
- Lacking a detailed cost-based proposal, price-based negotiations become a "battle of BOEs [Basis of Estimate]."
  - One's negotiating position is only as good as one's basis of estimate.
- Impact of competing cost [price] estimates
  - If based on a superior basis of estimate, negotiate to get lower price.
  - If based on an inferior basis of estimate, disregard/explain/discredit/...

April 2003. Mr. Wynne became heavily involved in tanker aircraft lease program. He stated that he called Boeing concerning a most favored customer clause and told them they were going to have to allow audit and asked that they cap the maximum earnings at [redacted] percent. Mr. Wynne also asked that the Institute for Defense Analyses do a price analysis of the tanker aircraft lease proposal.

Dr. Roche stated that in April 2003, a [redacted] took the lead for the White House in developing the Administration's tanker proposal, concentrating in particular on unit price. Further, he stated that Boeing met with the [redacted] on at least one occasion to discuss the tanker lease. Dr. Roche also stated that Messrs. Wolfowitz and Aldridge negotiated the approval of the proposal with the [redacted] based largely on what the Administration believed would be an acceptable price for tanker aircraft. In addition, he stated that near the end of May 2003, Mr. Aldridge recommended to Mr. Wolfowitz and presumably the Secretary of Defense, that the Department go forward with the lease, given the dramatic price reduction obtained over the spring. Dr. Roche stated that, with the approval of the White House and the Secretary of Defense, Mr. Aldridge announced the Department's position to go forward with the tanker aircraft lease at a press conference.

On April 7, 2003, [redacted]

*Removed for reason stated in the initial asterisked footnote. (The references are also on page 147.)

[redacted]

- [redacted]
- [redacted]
- [redacted]
- [redacted]

On April 10, 2003, [redacted]

On April 15, 2003, [redacted]

On April 15, 2003, Dr. Sambur sent to Dr. Roche and General Jumper a tanker aircraft chart that showed the cost savings by removing capability.

Proposal to Remove Capability to Lower Price		
[redacted]		
[redacted]		
[redacted]		
[redacted]		
[redacted]		
[redacted]		
[redacted]		
[redacted]		
[redacted]		
[redacted]		
[redacted]		
[redacted]		

[redacted]

[redacted]

On April 23, 2003, [redacted]

On April 28, 2003, Ms. Robin Cleveland, Office of Management and Budget, sent Dr. Roche an e-mail stating:

> I stand by my view; * * * * * * I am not sure what else OMB [Office of Management and Budget] could have done. Since [redacted] and others value this plane around [redacted] green, and Boeing still believes they should get [redacted] I guess you are right, the price issue has lost it bearings. Cost over-runs are only the most recent justification as to why we must pay [redacted] the explanation has varied literally by the week. By the way, if the F-22 is the model on cost over run commitments, this proposal may be worse than we could imagine.
>
> It has become clear to me that Boeing was persuaded that eventually we would agree to their entering price position notwithstanding budget priorities and market facts. * * * * * * Even with rotating senior level involvement from AT&L [Under Secretary of Defense for Acquisition, Technology, and Logistics], AF [Air Force], and the Comptroller, it looks like we are off track and unable to produce an agreement. What a shame.

May 2003. On May 2, [redacted] reported in an e-mail to Dr. Sambur that he met with Mr. Aldridge; Vice Admiral Stanley Szemborski, Principal Deputy Director, Program Analysis and Evaluation; and their staff on the Boeing KC-767 tanker aircraft lease. The outcome was that Mr. Aldridge would sign out a decision that authorized the Air Force to proceed with a lease program and that asked the Office of Management and Budget to waive the termination liability for the tanker aircraft lease. Specifically, [redacted] stated:

> I met this afternoon with Pete Aldridge, VAdm [Vice Admiral] Szemborski and their staffs concerning KC-767 lease. The outcome was a decision to be signed out by Pete (as an Acquisition Decision Memo) authorizing the AF [Air Force] to proceed with a lease program and asking OMB [Office of Management and Budget] to waive termination liability. He will also direct a unit price of about [redacted] below our current position), but will allow us to craft a cost-plus arrangement for the tanker modification. We believe this is do-able

*Removed for reason stated in the initial asterisked footnote.

[redacted]

within a lease contract and, though out of the box, should be acceptable to Boeing.

This will allow us to proceed without cutting content and at a price that matches the OMB/IDA [Office of Management and Budget/Institute for Defense Analyses] estimate, but only if we can shift cost risk for that estimate to the government. In essence, if OSD [Office of the Secretary of Defense] believe the IDA estimate and isn't willing to pay Boeing to assume the risk of a fixed-price contract, then OSD should be willing to assume it through a cost-plus contract. I think we'll have full support of AT&L [Acquisition, Technology, and Logistics], PA&E [Program Analysis and Evaluation] and Comptroller for this course of action (they predicted OMB support as well).

There are going to be plenty of details to work out in the coming weeks, but this looks like a win-win decision to me.

On May 3, 2003, [redacted]

On May 3, 2003, [redacted]

On May 3, 2003, Dr. Sambur sent an e-mail to Dr. Roche and Mr. Aldridge in which he stated that Boeing would not go along with a mixed fixed price and cost plus approach. In regard to the "most favored customer" clause, Dr. Sambur stated that "If they were to lower their price to us, it would mean that they would have to give a rebate to everyone else that has this clause." He also stated that the cost plus modification at [redacted] has a negative margin for Boeing. He mentions that the cap on profit at [redacted] and stated that, "If the true mod cost plus [redacted] profit is more than [redacted] most favored green A/C

[redacted]

[aircraft]), Boeing eats the difference. Boeing will let us completely audit all costs associated with the mods . . . ." Dr. Sambur liked the approach except for the "give back" provision that requires the Air Force to refund [redacted] for each aircraft if the Air Force did not order 200 tanker aircraft.

On May 3, 2003, [redacted]

On May 4, 2003, [redacted] sent an e-mail to Major General Hodges, Director of Global Reach Programs, stating:

> According to [redacted] Dr Sambur and Boeing have decided to hold firm on the following:
>
> - Cost-plus is unacceptable to Boeing
> - Boeing has countered with a Fixed-Price [redacted] convertible freighter, but no combi, with a profit cap of [redacted] (i.e., if they make more than [redacted] Return of Sales, they'll reimburse the gov't [Government])
> - This will prevent any windfall profits (gouging)
>
> [redacted] said Dr Sambur claims SECAF [Secretary of the Air Force] supports this approach. Apparently, they all feel that if SECDEF [Secretary of Defense] disapproves the program on price ground, Boeing will take it to WH [White House] and/or Congress and win.
>
> Recommendation: No email to Dr S [Sambur]. Based on the political poker game now being played, I suggest AQQ [Office of the Director of Global Reach Programs] do nothing until we see who has the upper hand. We have a fallback position if we absolutely must have a [redacted] contract, but in the meantime, the AF [Air Force] position today looks to be "call OSD's [Office of the Secretary of Defense] bluff and see what [redacted] and Congress say.

On May 5, 2003, [redacted]

[redacted]

[redacted]

*Removed for reason stated in the initial asterisked footnote.

[redacted]

On May 5, 2003, Dr. Sambur sent an e-mail to at Boeing:

> I am willing to agree that we received most favored price for green aircraft, [Boeing] 200 ER. The issue of contention is that of the mods. We need to have an agreement that has a NTE [not-to-exceed] on the mods of per cent. That will remove the perception issue of Boeing ripping us off.
>
> We give you the price on the 200 ER an we monitor the mod to ensure the profit is NTE per cent.

On May 7, 2003,

On May 7, 2003,

On May 12, 2003,

On May 12, 2003, Mr. Aldridge sent an e-mail to Drs. Roche and Sambur that discussed a meeting on the tanker price. Specifically, Mr. Aldridge stated that:

* * * * *

On May 12, 2003, Dr. Sambur sent an e-mail to Dr. Roche and Mr. Aldridge on why Boeing cannot give the Air Force a better price. Specifically, Dr. Sambur stated:

> Pete, Jim
>
> I spoke to on the issue of ROS [return on sales]. Before speaking to him, I researched the Boeing financials and found that the commercial sector operating margin on AVERAGE was less than and the [Boeing] 767 is doing worse than average because its base is shrinking . . . . I told these facts and he promised to get me the AVERAGE ROS (again the 767 will be less than the average.
>
> * * * * *
>
> Also, Boeing can not give away its commercial 767 cost structure because it would hurt them in the arena. is having a conference call with and and will get back to me this afternoon

*Removed for reason stated in the initial asterisked footnote.

On May 13, 2003, Dr. Roche sent [redacted] at Boeing an e-mail in which he stated:

> [redacted] I need to have you set up a meeting here in my office with OMB [Office of Management and Budget] (or the [redacted]). I need for you, [redacted] and possibly [redacted] to come here for a meeting with me and Robin Cleveland. I cannot get OMB comfortable with the price, no matter what I argue. So, the last chance is for you all to listen to the basic question about why is the price this high [redacted] If we can't get anywhere, then, [redacted] it's all over because we will never get there. Pls contact me soonest

On May 14, 2003, Mr. James "Ty" Hughes, Office of the Air Force General Counsel, sent an e-mail to Dr. Sambur expressing concerns about contract clauses that Dr. Sambur forwarded to [redacted] at Boeing. Concerns relating to pricing were:

[redacted]

On May 14, 2003, Dr. Roche sent an e-mail to Ms. Robin Cleveland, Office of Management and Budget, about an upcoming meeting with [redacted] and [redacted] at Boeing. Specifically, Dr. Roche stated:

> ... I will try to summarize where we stand, and ask for discussion among us about how to grapple with the issue of price; the possibility of transferring the [Boeing] 767 from a commercial product to a military one (thus, breaking it out from the pack and permitting cost discussions, audits, etc.); some history of other DoD purchases of commercial planes (737's, Air Force One and Two); and, how can we come to grips with this issue since it will plague us for future aircraft. I will be teamed with you, and not put you in a corner. Chime in whenever.

On May 16, 2003, [redacted]

*Removed for reason stated in the initial asterisked footnote.

[redacted]

[redacted]

[redacted]

On May 16, 2003, [redacted]

[redacted]

[redacted]

[redacted]

On May 19, 2003, [redacted]

On May 19, 2003, [redacted]

On May 22, 2003, [redacted]

On May 23, 2003, Mr. Aldridge signed the "Air Force Boeing 767 Tanker Lease Decision Memorandum." He directed the Air Force "to work with Boeing to negotiate the best possible total purchase price not to exceed $131 million per unit and lease unique costs." Specifically, the memorandum stated:

> After a comprehensive and deliberative review by the Leasing Review Panel, the Secretary of Defense has approved the Air Force's proposal to enter into a multiyear Pilot Program for leasing general purpose Boeing 767 aircraft under the authority in section 8159 of the Department of Defense Appropriations Act, 2002. While the currently approved plan will provide for delivery of a total of 100 KC-767 aircraft, approximately 67 of which will be delivered in the Future Years Defense Program (FYDP), it is the intent of the Department to go beyond the initial 100 aircraft as we begin the recapitalization of the airborne tanker fleet

[redacted]

The Leasing Review Panel compared the merits and shortcomings of both leasing and purchasing the aircraft, and the Secretary determined that the lease option best satisfied military needs and was preferable for two primary reasons. First, the lease will require a lesser initial outlay in the FYDP. Second, leasing accelerates the delivery of aircraft

The Secretary of Defense approved this lease proposal contingent upon securing a waiver of the requirement to fund termination liability and approval from the Office of Management and Budget While the KC-767 program is in its initial stages, I am designating the program as an ACAT [Acquisition Category] ID Major Defense Acquisition Program. In the interests of the government and the taxpayer, I direct the Air Force to work with Boeing to negotiate the best possible total purchase price not to exceed $131 million per unit and lease unique costs, which the Special Purpose Entity will be responsible for paying to Boeing, and which will form the basis for government payments under the lease The total purchase price shall include a firm, fixed-price for the 'green' aircraft (767-200C) and for modifications and additional tanker equipment on the green aircraft The Return on Sales (ROS) shall not exceed [redacted]% for the green aircraft or for the additional equipment; and the configuration shall meet the minimum set of requirements to satisfy the Air Force's mission I further direct the Air Force to work with the Office of the Under Secretary of Defense (Comptroller) and the Office of the Director, Program Analysis & Evaluation, to finalize offsets in the FYDP to fully fund the lease plan

In addition, as mandated by the legislation, the Air Force shall submit a report to the Congressional Defense Committees before signing the lease contract, and report back to Congress one year after the first delivery and annually thereafter.

Finally, the Air Force shall develop a long-range recapitalization plan beyond the current lease proposal and present that plan to the Secretary of Defense by 1 November 2003

June 2003. On June 13, [redacted]

On June 27, 2003, [redacted]

[redacted]

[redacted]

[redacted]

September 2003. On September 1, Mr. James "Ty" Hughes, Office of the Air Force General Counsel, sent an e-mail to Dr. Sambur in which he stated:

[redacted]

On September 1, 2003, in response, Dr. Sambur sent an e-mail to Mr. Hughes in which he stated:

> Ty
>
> I will NOT let the contract to Boeing unless it is an audit opinion AND we get a yearly audit. You can tell them that they may win the SASC [Senate Armed Services Committee] hearing but they will not get a contract!!! Marv

[redacted]

Appendix G. Placard Paradox

Appendix G responds to a January 27, 2005, letter from the Chairman, Committee on Commerce, Science, and Transportation to the Secretary of the Defense, requesting that we determine who intentionally deleted information from placards that were displayed during a tour that members of the Senate Armed Services Committee staff participated in during Tinker Air Force Base visit in October 2003. Subsequent to the tour, the Committee staff asked for copies of the placards.

We interviewed 30 individuals associated with the placards to determine who changed the original placards submitted to the Senate Armed Services Committee staffers and why the placards were changed. Exhibit 1 shows an abbreviated organization chart of the Air Logistics Center as of October 2003 and identifies the key divisions and branches that the Senate Armed Services Committee staff visited relating to the KC-135 production line. Appendix H provides a listing of the key players involved in the placard paradox.

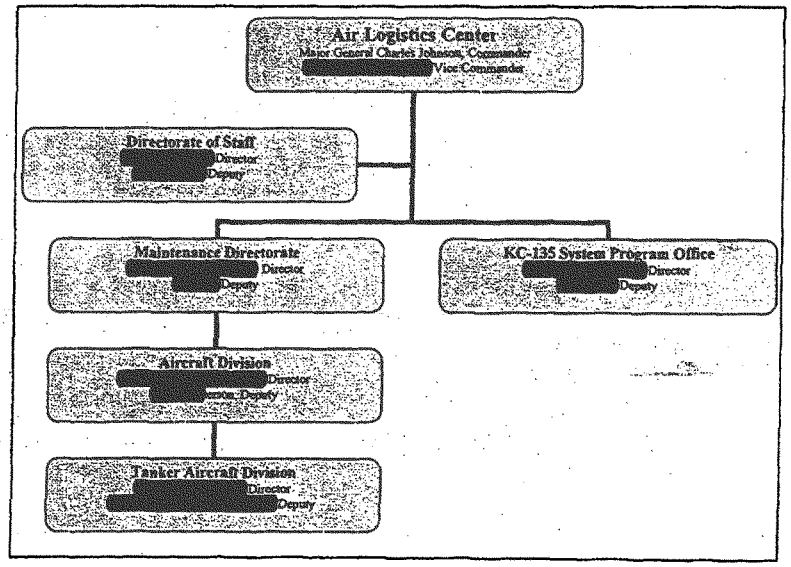


Exhibit 1. Excerpt from the Air Logistics Center, Tinker Air Force Base, Oklahoma Organization Chart (October 2003)

[redacted]

We concluded that Air Force officials intentionally deleted and modified information contained on placards displayed during the Senate Armed Services Committee tour. However, we determined that these actions were taken to portray the most current and accurate maintenance status of the aircraft. We did not find evidence to indicate that the placard information was changed to misrepresent the health of the KC-135 fleet.

- **Initial Submission.** With respect to the initial submission of placards to the Committee staff on October 22, 2003, we concluded that actions taken by members of the Air Logistics Center staff and the Department of the Air Force were not meant to misrepresent maintenance information related to corrosion on the KC-135. Personnel at Tinker Air Force Base indicated that collaborative discussions occurred between members of the Maintenance Division staff who wanted to ensure that they updated the placards to show the most current and accurate information associated with the Tinker-only fleet.

- **Final Submission.** With respect to the second and final submission of placards to the Committee staff, we determined that Air Logistics Center command officials and Deputy Chief of Staff Air Force, Installations and Logistics officials became involved once concerns were raised about the initial submission of placards. We found that during the staffing of the placards, Deputy Chief of Staff Air Force, Installations and Logistics, determined that the Air Force would supplement the maintenance information on the original placards to represent the health of the entire KC-135 fleet. We determined that the corrosion information contained on the placards was current, accurate, and not misrepresented for the entire KC-135 fleet.

Background

On October 10, 2003, staffers from the Senate Armed Services Committee participated in a tour of the Air Logistics Center at Tinker Air Force Base, Oklahoma. Several representatives from the Air Logistics Center accompanied the staffers. [redacted] Legislative Liaison for the Office of Legislative Liaison, Secretary of the Air Force, coordinated the visit and accompanied the staffers to Tinker Air Force Base and throughout the tour. Exhibit 2 depicts the staging of the KC-135 maintenance production line tour. The photographs contained in this appendix were obtained during a re-creation of the October 2003 tour provided to investigative team members, Office of the Inspector General Department of Defense on February 8, 2005.

[redacted]

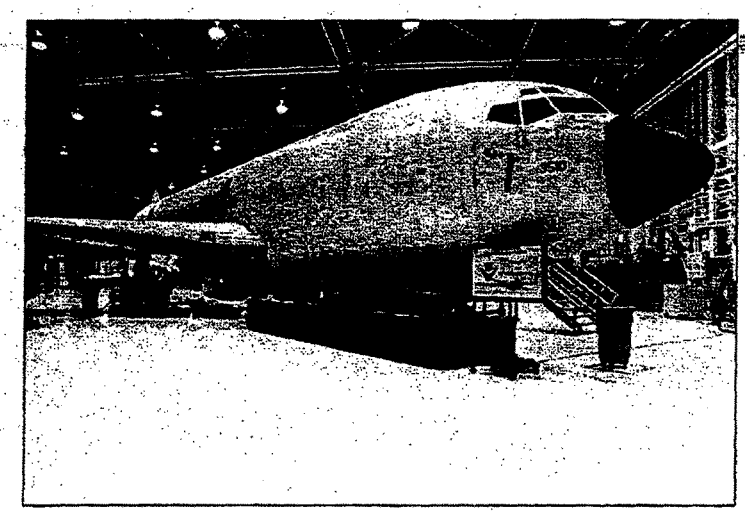


Exhibit 2. Staging of the KC-135 maintenance production line tour

The KC-135 production line tour segment included a plasma screen briefing followed by a guided walking tour around the aircraft. During the walking tour, briefers identified examples of major structural repairs[8] that may have been performed on KC-135 aircraft during depot maintenance. At each major structural repair exhibit, a placard was displayed.

What were the placards? The placard slides were small story boards commonly used during tours of the KC-135 aircraft maintenance line. The placards were placed at each major structural repair exhibit and identified resource requirements needed to repair or replace the major structural item. Exhibit 3 illustrates how the placards were displayed around the aircraft during the tour.

[8]Major structural repairs are repairs or replacements of core aircraft components. Major structural repairs typically caused by corrosion or stress corrosion are not part of the planned or scheduled maintenance of the aircraft.

[redacted]

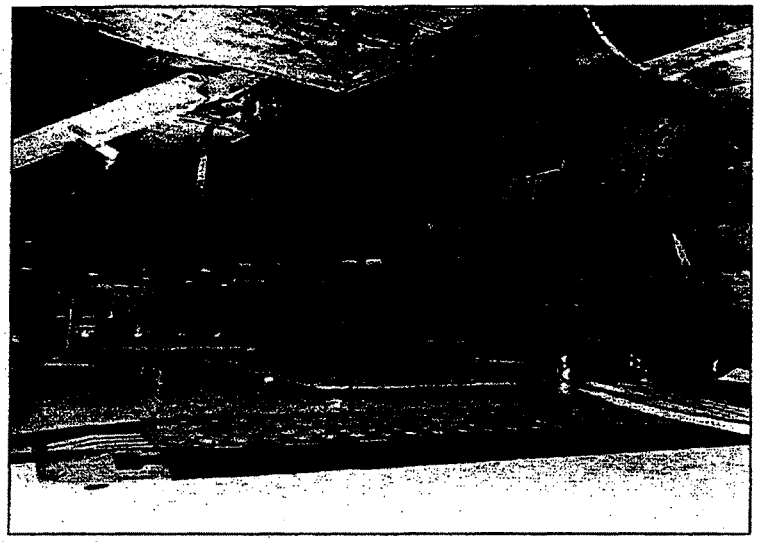


Exhibit 3. Example of the placards displayed around the aircraft during the KC-135 maintenance production line tour

The resource requirement information included on the placards addressed labor hours, labor rate, fitting cost, total cost, and occurrence factor.[9] Information on the placards pertained to the Tinker KC-135 fleet and did not include information related to the remainder of the KC-135 aircraft fleet. The original placards displayed during the tour are located in Appendix I.

Findings of Fact

Placard Request and Coordination. A congressional staffer first requested a copy of the original placards made on October 10, 2003. The request was made to [redacted] Chief of Tanker Maintenance. Normally, data requests are initiated through [redacted] Legislative Liaison. However, the [redacted] did not become aware of the placard request until Friday, October 17, 2003.

[redacted] delegated the Senate Armed Services Committee request to [redacted] Chief Analyst, Procedures and Analysis Division who normally was not involved in the tours. The following week, [redacted] requested that the placards be updated with current 2003 data. Although [redacted] recalls [redacted] tasking, he did not recall who asked him to update the placard information. The updated charts included the current information on 66 KC-135

[9]Occurrence factor indicates the number of times a core aircraft component was replaced or repaired over a set series of KC-135 aircraft at Air Logistics Center, Tinker Air Force Base

[redacted]

aircrafts repaired at the Air Logistics Center between fiscal year 2002 and 2003. The placards still depicted labor hours, labor rate, total cost, and occurrence factors. However, a material cost figure was added and the fitting cost was removed. Because the request for the placards was provided only to the Tanker Maintenance Branch, the placards were not forwarded up through the Air Logistics Center Command at that time. On Tuesday, October 21, 2003, [redacted], Executive Officer to [redacted] Director of Maintenance, sent a copy of the placards to [redacted] Deputy Director of Staff, Oklahoma City Air Logistics Center, Air Force Materiel Command. The initial placard submission is located at Appendix J. The placards sent to [redacted] contained the updated 2003 data,[10] minus the fitting cost, hourly rate and occurrence factor. On Wednesday, October 22, 2003, [redacted] forwarded the same copy to [redacted] who forwarded the charts to the Senate Armed Services Committee staffers.

The Senate Armed Services Committee staffers realized that the information contained on the placards provided was different from what they had recalled was displayed and contacted [redacted]. The staffers indicated that their request was for the "exact" placards shown to them during their visit. On October 28, 2003, [redacted] provided the information in the original placards to Senate Armed Services Committee staffers. This submission contained the original placard information with added header and footer information, a point paper explaining the placards, and excerpts from the Corrosion Service Life Report for the KC-135. The final submission is located at Appendix K. The Corrosion Service Life Report for the KC-135 was released in its entirety on October 24, 2003.

Who Changed the Placards and Why? We were unable to determine the identity of the individual that made key stroke changes to the placards regarding the first submission of the placards. However, we did determine that the decision to modify the initial set of charts was a collaborative decision between at least two individuals. [redacted] Chief of Aircraft Maintenance and [redacted] Director of Maintenance. The request for the placards generated intense discussion over what information should be provided.

October 13 though October 17, 2003. The week following the tour (October 13 though October 17, 2003), [redacted] requested that [redacted] KC-135 Industrial Engineering Technician, update the placards to current 2003 data. [redacted] did not recall who asked him to update the placard information. The updated charts included the current information on 66 KC-135 aircrafts repaired at the Air Logistics Center between 2002 and October 2003. The placards still showed labor hours, labor rate, total cost, and occurrence factor; however a material cost figure was added and fitting cost was removed. We found that during this week the placards remained within the Tanker Maintenance Branch.

October 20 though October 24, 2003. During the second week following the tour (October 20 though October 24, 2003), [redacted] and [redacted]

[10] We were unable to fully verify the placards with the 2003 data because Air Logistics Center updated their maintenance system in 2004 and were unable to determine what aircraft supported the 66 aircraft identified in the updated placards

[redacted]

[redacted] raised concerns about the data contained in the placards and how the Senate Armed Services Committee staffers would interpret the information. The original placards contained Tinker Air Force Base-only data and did not address maintenance data from the other two centers that maintained the fleet of KC-135's. We found that:

- On Monday, October 20, 2003, [redacted] requested an electronic copy of the original placards and the updated 2003 placards from [redacted] through [redacted] deputy, [redacted] Deputy of the Tanker Aircraft Branch.

- On Tuesday, October 21, 2003, [redacted] production management specialist, provided the original placards and updated 2003 placards for the Aircraft Maintenance Branch. We were not able to determine how or who coordinated the information, but suspect the information was emailed through [redacted] to [redacted] to [redacted] Witnesses recalled discussions among [redacted] and [redacted] regarding the placards but were not able to determine specific conversations or times of these discussions. [redacted] recalled a discussion about the placard charts with [redacted] during this timeframe and remembered that they only contained Tinker-only data. Subsequently, [redacted] executive Officer to [redacted] provided an electronic version of the placards to [redacted] These placards constituted the initial submission of the placards to the Senate Armed Services Committee staffers (placards included the 2003 data less occurrence factors, fitting costs, and labor rates). [redacted] did not recall who provided the placards to him; however, under normal protocol, witnesses advised that coordination would come from [redacted] or [redacted] We determined that during this timeframe [redacted] was on travel. [redacted] stated that he would have coordinated the charts with [redacted] before submitting them to [redacted] However, he does not specifically recall the coordination with either [redacted] or [redacted]

- On Wednesday, October 22, 2003, [redacted] provided the initial submission of the placards to [redacted] and a courtesy copy to [redacted] Director of Staff, Air Logistics Center, Tinker Air Force Base by email. (Appendix J) [redacted] stated that he coordinated the placards with Mr. Conner, Deputy Commander, Air Logistics Center. However, Mr. Conner told us that he did not recall the coordination, but would not deny that the coordination transpired. [redacted] submitted the placards to the Senate Armed Services Committee staffers later that day. Upon review, the Senate Armed Services Committee staffers realized that the placards were not the same placards as those displayed around the KC-135 maintenance production line tour. The staffers contacted [redacted] and again, requested a copy of the placards, but this time asked for the "exact" placards displayed around the KC-135 aircraft. [redacted] responded by contacting [redacted] Director of

[redacted]

Staff, and indicated a sense of urgency to provide the original placards to the Senate Armed Services Committee staffers.

- On Thursday October 23, 2004, [redacted] again contacted [redacted] to obtain an update on the status of the placards. We found that senior members of the command were now involved in the placard request. [redacted] Vice Commander, became involved in coordinating the placard request. Because the original placards contained outdated Tinker-only depot maintenance data, [redacted] wanted to ensure that the information was understood. [redacted] held several meetings to better understand the information contained on the placards and tasked the KC-135 System Program Office to prepare a point paper explaining the distinction between Tinker-only data and fleet wide data. We confirmed that several individuals were involved in one or all of these discussions including Major General Johnson, Commander Air Logistics Center, [redacted] Vice Commander Air Logistics Center, [redacted] Deputy Director Maintenance Division, [redacted] and [redacted] structural engineer. We found that [redacted] and [redacted] were on travel during this period.

- On Friday October 24, 2003, [redacted] submitted the placard charts to [redacted] The submission included the original placards with the footer reference, an explanative point paper, and an excerpt from the Corrosion Service Life Report for the KC-135. The office of the Deputy Chief of Staff Air Force, Installations and Logistics contacted [redacted] and requested that the placards be coordinated prior to submission to the staffers.

October 27 though October 28, 2003. During the third week following the tour, (October 27 though October 28, 2003), we found that the placards were reviewed by individuals at the Air Staff level. At this point the placards still contained Tinker-only data.

- On Monday October 27, 2003, [redacted] provided the placard package from [redacted] to the [redacted] Deputy Chief of Staff Air Force, Installations and Logistics coordinated the package with Lieutenant General Zettler, Deputy Chief of Staff Air Force, Installations and Logistics. [redacted] was on leave and [redacted] added the header information to the placard charts per Lieutenant General Zettler's request.

- On Tuesday October 28, 2003, [redacted] received the coordinated package from the Office of the Deputy Chief of Staff Air Force, Installations and Logistics and submitted the placards to the Committee staffers.

[redacted]

Appendix H. Key Air Force Players in the Placard Paradox

The following Air Force representatives were key players in executing the Senate Armed Services Committee staffers tour at Tinker Air Force Base on October 10, 2003, or were involved in providing the KC-135 placards to the Senate Armed Services Committee staffers.

Air Logistics Command, Tinker Air Force Base, Oklahoma

Major General Charles Johnson. Major General Charles Johnson, Commander Air Logistics Center, was not involved during the tour; however he did meet the staffers following the tour's conclusion. Major General Johnson was involved with providing the final submission of the placards to the Senate Armed Services Committee staffers

[redacted] Vice Commander, Air Logistics Center, was not involved during the tour; however, [redacted] did coordinate the final submission of the placards and the point paper explaining the placards information.

Mr. Robert Connor. Mr. Robert Connor, Executive Director, reportedly coordinated the initial submission of the placards before it left Tinker Air Force Base.

[redacted] Director of Staff, escorted Senate Armed Services Committee staffers during base tour, and was involved with providing the placards to the Senate Armed Services Committee staffers

[redacted] Deputy Director of Staff, was not present during the tour but was tasked with coordinating the placard submissions to the Senate Armed Services Committee staffers.

Maintenance Division, Air Logistics Command, Tinker Air Force Base, Oklahoma

[redacted] Director of Maintenance, Air Logistics Command, Tinker Air Force Base, Oklahoma, escorted the Senate Armed Services Committee staffers on the tour and presented the lean engineering briefing. [redacted] was involved in discussions about the content of the placards and his executive Officer processed the initial placard submission.

[redacted] was one of [redacted] executive Officers. [redacted] was not involved with the Senate Armed

[redacted]

Services Committee Staffer tour, but was involved in the coordination of the initial submission of the placards to the staffers.

[redacted] Deputy Director of Maintenance, assisted in the preparation of the point paper with [redacted] and [redacted] that accompanied the final placard submission.

Aircraft Branch, Maintenance Division, Air Logistics Command, Tinker Air Force Base, Oklahoma

[redacted] Chief Aircraft Division, was not present during the tour, but was involved with providing the placards to the Senate Armed Services Committee staffers.

Tanker Aircraft Branch, Maintenance Division, Air Logistics Command, Tinker Air Force Base, Oklahoma

[redacted] KC-135 Production Chief, Tanker Aircraft Branch, Maintenance Division, was involved during the tour; however, he had limited involvement with providing the placards to the staffers. [redacted] recalls the Senate Armed Services Committee staffers placard request.

[redacted] Deputy Chief of Tanker Aircraft Maintenance Branch, was not present during the tour however was involved with coordinating the initial placard submission to the Senate Armed Services Committee staffers.

[redacted] Analyst Chief, stated that he help set up for the tour on the morning of October 10, 2003. He also asked [redacted] to update the placards, although he did not recall who ask him to update the placard information.

[redacted] KC-135 Industrial Engineering Technician, updated the original placards to 2003 Tinker Air Force Base data. The data used to update the placards was obtained from the Program Depot Maintenance Support System database.

[redacted] Production Management Specialist, transmitted the updated placards with 2003 Tinker data to the Aircraft Maintenance branch.

KC-135 System Program Office

[redacted] Director of the KC-135 System Program Office did not attend the tour and was on travel around key placard submission dates.

[redacted]

[redacted] Deputy Director of the KC-135 System Program Office did not attend the tour and was on travel around key placard submission dates.

[redacted] structural engineer, prepared the point paper dated October 24, 2003, on the information contained on the original placards and explained why the transmission of the actual placards as delayed. He also prepared point paper with the assistance of [redacted] and [redacted].

Deputy Chief of Staff Air Force, Installations and Logistics

Lieutenant General Michael Zettler. Lieutenant General Michael Zettler, Deputy Chief of Staff Air Force, Installations and Logistics, coordinated the final placard submission and directed that the header information was added to the original placards before submission.

[redacted] action officer for the KC-135 desk, Office of the Deputy Chief of Staff Air Force, Installations and Logistics, received the placards for coordination. However, he went on leave the following the coordination and [redacted] assisted with the coordination.

[redacted] co-worker of [redacted] Deputy Chief of Staff Air Force, Installations and Logistics and assisted the coordination of the final placard submission while [redacted] was on leave. [redacted] added the header information to the original placards prior to the final submission per Lieutenant General Zettler's Request.

Department of the Air Force, Office of Legislative Liaison

[redacted] legislative liaison action officer coordinated the Senate Armed Services Committee staffer visit to Tinker Air Force Base. [redacted] also accompanied Committee staffers to Tinker Air Force Base and submitted both versions of the placards to the Senate Armed Services Committee staffers.

[redacted]

Appendix I. Original Placards Displayed

Aft Terminal Fitting: [redacted]
(Body Station 820)

- (Due to extensive disassembly both fitting are changed , "R" model only)
- Man hours for installation (both sides [redacted]
- Prepare 820 fittings
- Jacking
- Total Labor [redacted]
- Fitting Cost [redacted]
- History of 82 A/C: 0 Occurrences

Main Landing Gear Trunnion: [redacted]

- Man hours per installation: [redacted]
- Beavertail rework :
- Jacking :
- Total Labor ([redacted] :
- Fitting Cost ([redacted]
- History of 82 A/C: 1 Occurrence
  - 1.2% Occurrence Factor

[redacted]

Bulkhead Fitting: [redacted]
(Body Station 960)

- Man hours per installation [redacted]
- Jacking
- Total Labor [redacted]
- Fitting Cost [redacted]
- History of 82 A/C: 4 Occurrences
  - 5% Occurrence Factor

Bulkhead Fitting: [redacted]
(Body Station 820)

- Man hours per installation: [redacted]
- Jacking
- Total Labor [redacted]
- Fitting Cost [redacted]
- History of 82 A/C: 4 Occurrences
  - 5% Occurrence Factor

[redacted]

Forward Terminal fitting: [redacted]
(Body Station 620)

- Man hours per installation [redacted]
- Jacking
- Total Labor [redacted]
- Fitting Cost [redacted]
- History of 82 A/C: 1 Occurrence
  - 1.2% Occurrence Factor

Right Fuselage Skin Body: [redacted]
(Station 360-620)

- Man hours per installation: [redacted]
- Jacking
- Total Labor ([redacted]
- Fitting Cost ([redacted]
- History of 82 A/C: 18 Occurrences
  - 22% Occurrence Factor

[redacted]

R/H 880 Beam Replacement: [redacted]
(must remove L/H to replace R/H)

- Man hours per installation: [redacted]
- Jacking & Jig :
- 10.9 Pressure check :
- Total Labor [redacted] :
- Fitting Cost [redacted]
- History of 82 A/C: 1 Occurrence
  - 1.2% Occurrence Factor

R/H 890 Beam Replacement: [redacted]

- Man hours per installation: [redacted]
- Jacking & Jig :
- 10.9 Pressure check :
- Total Labor [redacted] :
- Fitting Cost [redacted]
- History of 82 A/C: 0 Occurrences

[redacted]

Boom Shock Absorber receptacle: [redacted]

- Man hours per installation [redacted]
- No jacking required
- Total Labor ([redacted]
- Fitting Cost ([redacted]
- History of 82 A/C: 1 Occurrences
  - 1.2% Occurrence Factor

[redacted]

Appendix J. Initial Placard Submission

Aft Terminal Fitting (Body Station 820)

- (Due to extensive disassembly both fittings are changed, "R" model only)
- Man hours for installation (both sides) : [redacted]
- Prepare 820 fittings
- Jacking
- Total Labor (Hrs)
- Material Cost ([redacted])

* Bench Stock Not Included

1

Main Landing Gear Trunnion Fitting

- Man hours for installation : [redacted]
- Beavertail Rework :
- Jacking :
- Total Labor (Hrs) :
- Material Cos[redacted]

* Bench Stock Not Included

2

[redacted]

Bulkhead Fitting (Body Station 960)

- Man hours for installation : [redacted]
- Jacking :
- Total Labor (Hrs) :
- Material Cost [redacted]

* Bench Stock Not Included

3

Bulkhead Fitting (Body Station 820)

- Man hours for installation [redacted]
- Jacking
- Total Labor (Hrs)
- Material Cost [redacted]

* Bench Stock Not Included

4

[redacted]

Forward Terminal Fitting (Body Station 620)

- Man hours for installation : [redacted]
- Jacking :
- Total Labor (Hrs) :
- Material Cost [redacted]

* Bench Stock Not Included

5

Right Fuselage Skin Body (Station 360-620)

- Man hours for installation : [redacted]
- Jacking :
- Total Labor (Hrs) :
- Material Cost [redacted]

* Bench Stock Not Included

6

[redacted]

R/H 880 Beam Replacement (must remove L/H to replace R/H)

- Man hours for installation : [redacted]
- Jacking & Jig :
- 10.9 Pressure Check :
- Total Labor (Hrs) :
- Material Cost ([redacted]

* Bench Stock Not Included

7

R/H 890 Beam Replacement

- Man hours for installation : [redacted]
- Jacking & Jig :
- 10.9 Pressure Check :
- Total Labor (Hrs) :
- Material Cost ([redacted])

* Bench Stock Not Included

8

[redacted]

Boom Shock Absorber Receptacle

- Man hours for installation : [redacted]
- No Jacking Required : [redacted]
- Total Labor (Hrs) : [redacted]
- Material Cost ([redacted]

* Bench Stock Not Included

9

[redacted]

Appendix K. Final Placard Submission

[redacted]

Bulkhead Fitting: [redacted]
(Body Station 820)

- Man hours per installation: [redacted]
- Jacking :
- Total Labor ([redacted]) : [redacted]
- Fitting Cost ([redacted]
- History of 82 A/C: 4 Occurrences
  - 5% Occurrence Factor

[redacted]

[redacted]

Bulkhead Fitting: [redacted]
(Body Station 960)

- Man hours per installation: [redacted]
- Jacking :
- Total Labor ([redacted]) : [redacted]
- Fitting Cost ([redacted]
- History of 82 A/C: 4 Occurrences
  - 5% Occurrence Factor

[redacted]

[redacted]

[redacted]

R/H 880 Beam Replacement: [redacted]
(must remove L/H to replace R/H)

- Man hours per installation: [redacted]
- Jacking & Jig :
- 10.9 Pressure check :
- Total Labor (: [redacted]
- Fitting Cost ([redacted]
- History of 82 A/C: 1 Occurrence
  - 1.2% Occurrence Factor

[redacted]

[redacted]

R/H 890 Beam Replacement: [redacted]

- Man hours per installation: [redacted]
- Jacking & Jig :
- 10.9 Pressure check :
- Total Labor (: [redacted]
- Fitting Cost ([redacted]
- History of 82 A/C: 0 Occurrences

[redacted]

[redacted]

[redacted]

Right Fuselage Skin Body [redacted]
(Station 360-620)

- Man hours per installation: [redacted]
- Jacking
- Total Labor [redacted]
- Fitting Cost [redacted]
- History of 82 A/C: 18 Occurrences
  - 22% Occurrence Factor

[redacted]

[redacted]

Forward Terminal fitting: [redacted]
(Body Station 620)

- Man hours per installation: [redacted]
- Jacking
- Total Labor [redacted]
- Fitting Cost [redacted]
- History of 82 A/C: 1 Occurrence
  - 1.2% Occurrence Factor

[redacted]

[redacted]

[redacted]

Aft Terminal Fitting: [redacted]
(Body Station 820)

- (Due to extensive disassembly both fitting are changed , "R" model only)
- Man hours for installation (both sides): [redacted]
- Prepare 820 fittings :
- Jacking :
- Total Labor (:
- Fitting Cost ([redacted]
- History of 82 A/C: 0 Occurrences

[redacted]

[redacted]

Main Landing Gear Trunnion: [redacted]

- Man hours per installation: [redacted]
- Beavertail rework :
- Jacking :
- Total Labor :
- Fitting Cost [redacted]
- History of 82 A/C: 1 Occurrence
  - 1.2% Occurrence Factor

[redacted]

[redacted]

[redacted]

Boom Shock Absorber receptacle [redacted]

- Man hours per installation: [redacted]
- No jacking required : [redacted]
- Total Labor [redacted] : [redacted]
- Fitting Cost [redacted]
- History of 82 A/C: 1 Occurrences
  - 1.2% Occurrence Factor

[redacted]

[redacted]

POINT PAPER

ON

C/KC-135 AGING AIRCRAFT PDM TOUR

- Purpose
  - Provide C/KC-135 corrosion/service life history and explain placard data provided to * * * * * Professional Staff Members of the Senate Armed Services Committee (SASC), 10 Oct 03 Tinker AFB tour
    - Professional staffers were provided an overview of the -135 depot maintenance process and capabilities at Tinker
      - Nine placards (attachment 1) were displayed under an aircraft to show examples of repairs accomplished during the depot maintenance processes

- Background
  - The -135 aircraft fleet is composed of 581 aircraft with an average age of 42 years and are repaired at four Programmed Depot Maintenance (PDM) repair sites:
    - OC-ALC/MAB Tinker AFB, OK
    - Boeing Aerospace Services Center (BASC) San Antonio, TX
    - PEMCO Aeroplex Birmingham, AL
    - L-3 Communications Greenville, TX
  - Aging A/C issues – Complex corrosion/cracking repairs are unpredictable and random; results in growth of structural repairs, PDM hours and repair costs
  - The repairs briefed at dockside on 10 Oct were a small portion of the [redacted] hours contained in the PDM work package

- Discussion
  - Placards displayed dockside were for parts identification/general information
    - Not a representative sample of the major structural repairs (MSRs) being accomplished at <u>all four PDM repair sites</u>
    - OC-ALC placard MSR data reflected only Tinker occurrences from FY00 to mid-FY02
  - C/KC-135 corrosion history including MSR and rewire data for the fleet is documented in the *KC-135 Corrosion and Service Life Report* dated Oct 2003 (attachment 3)
    - Information contained in the Oct 03 was assembled by the AF/ILM staff with information/analysis provided by the -135 SystemProgram Office

-1-

* Names of Professional Staff Members removed

[redacted]

- The OC-ALC MSR placard data displayed dockside was a subset of the data displayed on page 48 of the Oct 03 report
  - *Attachment 2 is page 48 of the Oct 03 report displaying the percent of fleet-wide MSRs from FY95 – FY03*
  - OC-ALC placards discussed during the 10 Oct visit are cross-referenced on the left side of the chart
  - For example, the body station 820 bulkhead fitting
    - Tinker occurrence factor from FY00 thru mid FY02 averaged 5% (attachment 1/placard 1)
    - In comparison, fleet-wide (all four FDM sites) occurrence factors vary from FY00 thru FY02 (19%, 4%, 10%) (attachment 2, pg 48 of Oct 03 report)
    - Note the erratic/unpredictable nature of MSR repairs since FY95
  - OC-ALC placards #2-9 can be cross-referenced to the Oct 03 report and occurrence factors also vary from year to year

- **Summary/Recommendation**
  - For a comprehensive understanding of corrosion and service life issues on the C/KC-135 fleet, please review the *KC-135 Corrosion and Service Life Report*, attachment 3

-2-

[redacted]

PERCENT OF FLEET-WIDE MAJOR STRUCTURAL REPAIRS
(FY95 - FY03)

Fleet-WidePercent Aircraft Major Structural Repairs (MSR) (all MDS)

OCALC Report Chart No.		FY95	FY96	FY97	FY98	FY99	FY00	FY01	FY02	FY03
	AVG MSR PER AIRCRAFT	3	3	3	3	2	2	3	2	2*
	BULKHEADS									
#1	820 Bulkhead	13%	16%	17%	8%	19%	19%	14%	10%	3%
	620 Bulkhead	3%	9%	5%	6%	5%	3%	1%	2%	7%
#2	960 Bulkhead	2%	4%	10%	10%	5%	7%	10%	11%	17%
	FLOOR BEAMS									
#3	880 Beam	8%	7%	5%	4%	6%	6%	5%	4%	2%
#4	559 Beam	19%	27%	32%	3%	5%	1%	4%	1%	2%
	BODY SKINS									
#5	RH Belly Skin	5%	17%	22%	22%	9%	14%	8%	32%	17%
	LH Belly Skin	16%	35%	58%	66%	23%	60%	43%	56%	40%
	Other Body Skins	2%	1%	22%	4%	2%	18%	0%	2%	5%
	BOTTLE PIN FITTINGS									
#6	Front Spar Terminal Fitting	0%	1%	2%	5%	2%	1%	1%	2%	0%
#7	Rear Spar Terminal Fitting	2%	1%	3%	0%	1%	0%	0%	0%	0%
	WING									
	Production Break (any)	150%	24%	46%	38%	12%	53%	42%	51%	36%
	Wing Skin	4%	21%	7%	10%	3%	3%	5%	6%	15%
	Spar Repair/Replace	1%	4%	9%	9%	17%	8%	17%	13%	7%
	Reverstail	0%	3%	25%	13%	13%	10%	2%	12%	5%
#8	MLG Trunnion Rib	9%	9%	8%	9%	5%	2%	9%	3%	8%
	OTHER									
	Uplock Fitting	0%	0%	0%	3%	7%	2%	3%	2%	1%
	Window Frame	0%	1%	0%	6%	1%	6%	1%	1%	0%
	820 Tension Strap	0%	1%	7%	3%	0%	1%	0%	0%	0%
	Nose Wheel Well Skin	0%	0%	2%	19%	9%	11%	12%	15%	23%
#9	Other Major Actions	-	-	-	-	-	2%	5%	0%	0%
	Other Bulkheads	-	-	-	-	-	2%	0%	0%	0%

* FY03 data is based on the first 60 inputs

EXHIBIT FROM OCT 03 REPORT
(PAGE 40)

[redacted]

Under Secretary of Defense for Acquisition, Technology, and Logistics Comments

THE UNDER SECRETARY OF DEFENSE
3010 DEFENSE PENTAGON
WASHINGTON DC 20301-3010

ACQUISITION, TECHNOLOGY AND LOGISTICS

APR 27 2005

MEMORANDUM FOR INSPECTOR GENERAL OF THE DEPARTMENT OF DEFENSE

SUBJECT: Draft Report on Tanker Accountability

I have reviewed your draft report on tanker accountability and find it troubling in a number of areas.

As we all know, the Department must shorten acquisition time in order to get the right equipment to the warfighter more quickly. Meeting this demand requires innovation and the improvement of business practices. Flexibility is absolutely necessary if we are ever to be capable of responding appropriately to an immediate requirement for a major end item.

The draft report, however, seems to ignore this imperative, by not acknowledging the expressed congressional approval for the Secretary of the Air Force to consider the lease of commercially configured tanker aircraft. By seeking to identify those officials responsible for "proposing" to lease the aircraft, the draft report implies that the mere consideration of an alternative to standard major systems acquisition practices is somehow wrongful – even if congressionally permitted. That is not the right conclusion, and I worry about the apparent suggestion that the acquisition community should not seek to innovate, improve and change.

In an environment where acquisition innovation is consistently demanded, we must be willing to consider bold alternatives, even if they are ultimately rejected. The robust debate about the lease of these aircraft, for example, ultimately resulted in the rejection of this particular alternative without obligating a single dollar on the lease. While the debate may have been painful, it was also instructive and has probably affected business approaches for years to come. Your devotion to returning to standard practices ignores the fact that even in the midst of the debate, Congress again authorized leasing the aircraft in a 20-80 lease-purchase split. Debate, scrutiny and criticism may well be the price of trying to improve, but that is preferable to the categorical resistance to innovation reflected in the draft report. One possible lesson from this experience, that the draft report ignores completely, is that critics and supporters of leasing never saw the

[redacted]

same risks and benefits to the Air Force. A more constructive recommendation for the future might be that the Department devote more effort in the early stages of an innovative acquisition to ensuring a common appreciation of the transaction.

Finally, as you note in your draft report, I did not become the Acting Under Secretary until after the decision to lease was taken and announced as approved by the Secretary of Defense and the Office of Management and Budget. My role before becoming Acting Under Secretary was limited - I was not, for example, a member of the Leasing Review Panel - and focused principally on efforts to reduce the price that had been negotiated by the Air Force, a fact you correctly report based on the email traffic criticizing those efforts. When I assumed my current position, I sought to foster debate regarding the merits of the proposal, rather than to foreclose a productive exchange of views or attempt to persuade the Secretary to reverse his decision.

The Department would be better served if you were to help us find new approaches to doing business. I trust you will consider these views in finalizing your report.

Michael W. Wynne

[redacted]

Department of the Air Force Comments

SECRETARY OF THE AIR FORCE
WASHINGTON

28 APR 2005

MEMORANDUM FOR OFFICE OF THE INSPECTOR GENERAL, DEPT OF DEFENSE

SUBJECT: DoD IG Draft Report, "Management Accountability Review of the Boeing KC-767A Tanker Program," Project Number D2005AE-0092

Thank you for providing the Air Force with the opportunity to review and comment on the draft report, *Management Accountability Review of the Boeing KC-767A Tanker Program*. With one exception, I concur with the recommendations contained in Part III of your report. That exception concerns the recommendation to legislate a requirement to conduct an Analysis of Alternatives. This regulatory requirement is already contained in the Department of Defense 5000 series directives. A statutory requirement would remove the agility the Defense Acquisition System requires in cases where a time imperative exists and the materiel solution is clear.

Your report correctly notes that the pilot tanker lease program did not follow the traditional approach for the acquisition of major systems contained in the Department of Defense 5000 series directives. That was a deliberate decision by the Under Secretary of Defense for Acquisition, Technology and Logistics—encouraged aggressively and supported by key leaders of the US Air Force and the Congress. Those leaders believed the innovative pilot tanker lease program provided an opportunity to accelerate replacement of a critical military capability increasingly in demand for the Global War on Terror. The actions that drew criticism (that no Analysis of Alternatives was conducted, that traditional acquisition practices were not followed, the subsequent disagreements over pricing, etc.) flowed from that first-order decision by the individual charged by law and policy with responsibility for making it.

Your report does not distinguish between the roles of those within the Air Force who identified requirements and those who implemented acquisition strategies. These are important distinctions. Most of the concerns expressed have focused on the acquisition strategy. Members of our "requirements community," such as the Air Force Chief of Staff, have neither responsibility for, nor authority over, acquisition strategy decisions.

Your report notes accurately that the basis for the selected acquisition strategy (a commercial item procurement via lease) rested, in part, on the *urgency* for tanker recapitalization. The Air Force did not successfully make the case for urgency, but those who attempted to do so should not be found at fault for the attempt. It is important to remember that, throughout this period, we were sustaining a continuous global air bridge, refueling countless hundreds of combat sorties in the Central Command Area of Operations, and sustaining Air Sovereignty Alert over the 50 States in our union. Operational leaders were—and are—legitimately concerned about the future viability of the entire KC-135 fleet, and understandably

[redacted]

anxious about a number of age-related problems It is their job to raise the alarm, and, under different circumstances, one could imagine finding fault with them for NOT raising the alarm

We have learned much already from this experience. Your report makes a valuable contribution to the body of knowledge we have amassed and will aid us substantially in improving our acquisition policy and practice, as well as the important culture that is our foundation. Please express my sincere appreciation to your staff. Their diligence and professionalism are evident in the completeness and thoroughness of the report.

Michael L. Dominguez
Acting Secretary of the Air Force

[redacted]

Team Members

The Acquisition and Technology Management Directorate and the Contract Management Directorate, Office of the Deputy Inspector General for Auditing of the Department of Defense contributed to the preparation of this report. Personnel of the Office of the Inspector General of the Department of Defense who contributed to the report are listed below.

Thomas F. Gimble
Mary L. Ugone
Henry F. Kleinknecht
John E. Meling
Jack D. Snider
Suellen R. Brittingham
Joseph P. Bucsko
Neal J. Gause
Kelly B. Klakamp
Joyce Tseng

[redacted]

Mr. SCHMITZ. This morning I would like to introduce the report's primary author, to my left, Deputy Inspector General Thomas Gimble; and I would like to very briefly review the report's genesis, its scope and methodology, and its bottom-line results. Of course, Mr. Gimble and I are prepared to answer your questions.

On December 2, 2003, as you said, Mr. Chairman, you sent a letter to the Deputy Secretary of Defense in which you suggested that I conduct an independent assessment that would "examine the actions of all members of the DOD and the Department of the Air Force, both military and civilian, top to bottom, who participated in structuring and negotiating the proposed tanker lease contract."

Subsequently, on November 19, 2004, you and two other members of the committee, Senator Levin and Senator McCain, sent another letter, as you said, this time addressed to Secretary of Defense Donald Rumsfeld, reiterating that I should conduct an assessment of accountability along the same lines of your prior letter, and requesting that my assessment determine "what happened, who is accountable, and what actions must be taken to prevent this situation from happening again."

To accomplish this objective, our independent review team analyzed selected e-mails and memoranda from the DOD, the Air Force, and the Boeing Company, and interviewed 88 individuals from the Departments of Defense and Air Force who had been involved in the Boeing KC–767A Tanker Program to determine what happened and who was accountable during the structuring and negotiating of the proposed lease contract.

Our review team did not interview White House officials, Members of Congress, or officials of the Boeing Company because the objective of the review focused on the accountability of members of the Office of the Secretary of Defense and of the Air Force who were involved in the Boeing Tanker Program.

What happened? Although Boeing had submitted a proposal in February 2001 to the Chief of Staff of the Air Force to convert 36 Boeing 767 commercial aircraft into tanker aircraft, it was not until after September 11, 2001, that Air Force officials began meeting with Boeing Company executives to enter into an agreement to lease 100 Boeing KC–767A tanker aircraft. The proposed lease agreement generally had support of White House officials, Members of Congress, senior officials of both the DOD and Air Force, and of the Boeing Company. At that time, that is before and immediately after September 11, 2001, the Air Force had neither identified nor funded an urgent requirement for the replacement of its existing fleet of tankers.

The Department of Defense Appropriations Act for Fiscal Year 2002, enacted in January 2002, included section 8159, titled "Multi-Year Aircraft Lease Pilot Program," which section authorized the Air Force to make payments on a multi-year pilot program "to lease not more than a total of 100 Boeing 767 aircraft." That section also provided that the term of any individual lease agreement shall not exceed 10 years.

Without conducting an analysis of alternatives, the Air Force used the provisions of section 8159 to justify an informal acquisition strategy, the focus and goal of which was expeditiously to lease 100 KC–767A tanker aircraft from Boeing through a business

trust. By not following established acquisition procedures contained in DOD directives, the DOD and Air Force officials identified in our report neither applied best business practices nor adhered to prudent acquisition procedures, and failed to comply with five statutory provisions relating to commercial items, testing, cost-plus-a-percentage-of-cost system of contracting, and leases to satisfy the warfighter needs.

Who was accountable? Our report identifies the DOD and Air Force officials who were responsible for failing to ensure the prescribed acquisition rules and procedures were followed. In summary, a number of senior DOD and Air Force officials acted as if section 8159 of the Fiscal Year 2002 Appropriations Act had waived various legal requirements, statutory checks and balances, that that section had not waived.

Moreover, as our executive summary concludes, the system of management internal controls within the Air Force and the Office of Secretary of Defense was either not in place or not effective, because the existing acquisitions procedures were not followed in the proposed lease of the Boeing KC–767A tanker aircraft.

What actions must be taken to prevent this situation from happening again? We have four recommendations in our report. Briefly summarizing them: The Department must change the cultural environment in its acquisition community to ensure that the proper internal control environment is reestablished and followed for major weapon system acquisitions.

Number two, the Secretary of Defense should reemphasize the need to conduct an analysis of alternatives for all major systems before major milestone decision points.

Number three, DOD 5000 series guidance should emphasize that leasing is merely a method for financing the acquisition of a program and that lease programs should be treated the same as any other acquisition programs of like cost.

Finally, DOD 5000 series guidance should require, at a minimum, that the decision to enter into a contract to lease a major system must be subject to the results of a Defense Acquisition Board or a System Acquisition Review Council review as applicable.

This concludes my oral statement. Mr. Gimble and I would be happy to answer any questions you have.

Chairman WARNER. I judge Mr. Gimble at this time will not make an independent opening statement; is that correct?

Mr. GIMBLE. No, sir.

Chairman WARNER. Thank you.

Mr. Secretary.

STATEMENT OF HON. GORDON R. ENGLAND, ACTING DEPUTY SECRETARY OF DEFENSE

Mr. ENGLAND. Mr. Chairman, Senator Levin, members of the committee: It is always a pleasure to be with you. I do appreciate the great work you do to provide for our men and women in uniform, to get them the equipment they need to protect our Nation. It is your oversight role, however, that is especially critical in ensuring the continued confidence of the American people, and I thank you.

During my last appearance before this committee when seeking confirmation as the Deputy Secretary of Defense, I commented then that ethical leadership is especially critical in the DOD because trust and confidence define the strength of the link between a Nation and her citizens and her military. While legal adherence is always necessary, ethical behavior is absolutely essential, and actions by the DOD must always be above reproach. As this committee has properly emphasized, when individuals do not meet the standards expected by the American people they need to be held accountable.

It is vitally important that the Department have in place the effective processes with appropriate checks and balances to ensure that America's warfighters receive the equipment they need and when they need it, while at all times providing transparency and the greatest value possible for every single taxpayer dollar spent. We owe that to our troops who serve us so bravely and we owe it to the American people who support us so generously.

Regarding the Inspector General's accountability review of the Boeing Tanker Program, many recommendations for corrective action and for better checks and balances in acquisition have been assembled and proposed, instigated by this committee's review. Multiple organizations and interested groups, many external to the DOD, have applied their expertise, talents, and energies in evaluating the tanker recapitalization issue. As a result of these recommendations, many acquisition changes have already been instituted within the DOD.

We have initiated a three-pronged approach: first, restoring primacy of the acquisition process through cancellation of the leasing panel, conformance to the Defense Federal Acquisition Regulation Supplement (DFARS) and 5000 series, and implementation of the Defense Acquisition Guidebook; second, restraint and internal controls to ensure conformity to process and integrity; and most importantly, restoring primacy of integrity in acquisition.

Specifically, we have changed DOD Instruction 5000.2 and the Defense Acquisition Guidebook, we have changed the FARS and DFARS to clarify the contracting officer authority, we have restructured the Defense Acquisition University curriculum, we have rewritten the Commercial Item Handbook, and many, many other changes have already been incorporated.

I commend the efforts of everyone who has been involved in this endeavor. In my judgment, all these changes and proposals will be helpful as we go forward.

Now, that said, on the other hand, and as we discussed during my confirmation hearing, the entire acquisition structure within the DOD needs to be reexamined and in great detail. As highlighted by Senator Lieberman during that hearing, there is a growing and deep concern about the acquisition process within the DOD here in this committee and I share that concern with you.

While we have recently incorporated many individual corrective actions in our acquisition processes, as I have noted, the final answer to past problems may lie in a complete restructuring of the way the Department accomplishes acquisition for all of its goods and services. Senator McCain at our earlier hearing stated that we need a comprehensive study even going back and looking at the

premises of Goldwater-Nichols, and we will do that and we have started that effort. I agree with that recommendation.

I want to assure this committee that we in DOD value our relationship with Congress and with this committee and we will consult with you and we will seek your advice and counsel, including enabling legislation as appropriate, as we go forward. This committee and the DOD share a common goal and that is to maintain the trust and the confidence of our citizens while protecting and defending this great Nation. Know that you have my personal commitment to manage the Department ethically and above reproach, to be forthright, honest, and direct with everyone and in every circumstance, and to expect the same from every DOD employee.

I will work closely with each of you to restore and retain confidence, effectiveness, and efficiency in the DOD acquisition process, and I thank you for your continued support.

[The prepared statement of Mr. England follows:]

PREPARED STATEMENT BY HON. GORDON R. ENGLAND

Chairman Warner, Senator Levin, members of the committee, thank you for the opportunity to appear before you today. This is a committee that I greatly admire, with members whom I have come to know and to greatly respect after 4 years in Washington. I also thank the committee for helping to provide our magnificent men and women in uniform with the equipment they need to protect and defend our great Nation. It is your oversight role that is critical in ensuring the continued confidence of the American people.

During my last appearance before this committee, when seeking confirmation as the Deputy Secretary of Defense, I commented that ethical leadership is especially critical in the DOD because trust and confidence define the strength of the link between a nation and her citizens and her military. While legal adherence is always necessary, ethical behavior is absolutely essential. Actions by the DOD must always be above reproach and, as this committee has properly emphasized, when individuals do not meet the standards expected by the American people, they need to be held accountable.

It is vitally important that the Department have in place the effective processes with appropriate checks and balances to ensure that America's war fighters receive the equipment they need, when they need it, while at all times providing transparency and the greatest value possible for every single taxpayer dollar spent. We owe that to our troops who serve us so bravely, and we owe it to the American people who have entrusted us with this important task and who support us so generously.

Regarding the Inspector General's Accountability Review of the Boeing Tanker Program, many recommendations for corrective action and for better checks and balances in acquisition have been assembled and proposed. Multiple organizations and interested groups including the Inspector General, the Defense Science Board, the Defense Acquisition University, the Industrial College of the Armed Forces, the Government Accountability Office, studies internal to the Department of Defense and others have applied their expertise, talents and energies in evaluating the Tanker Recapitalization issue.

As a result of these recommendations, many changes have already been instituted within the Department of Defense. We have initiated a three-pronged approach:

- Restore primacy of the acquisition process through cancellation of the Leasing Panel, mandate conformance to the Defense Federal Acquisition Regulation (DFAR) and 5000 Series and implementation of the Defense Acquisition Guidebook;
- Strengthen internal controls to assure conformity to the approved process;
- Finally, and most importantly, restore primacy of Integrity in Acquisition.

Specifically, the Department of Defense has changed DOD Instruction 5000.2 and the Defense Acquisition Guidebook, changed Federal Acquisition Regulations (FARs) and DFARS to clarify the contracting officer authority, restructured the Defense Acquisition University curriculum, and has rewritten the Commercial Item Handbook and many others.

I commend the efforts of everyone involved in this endeavor. In my judgment, all of these changes and proposals will be helpful as we go forward.

On the other hand, as we discussed during my confirmation hearing, the entire acquisition structure within the Department of Defense needs to be re-examined in great detail. As highlighted by Senator Lieberman during that hearing, there is a clearly growing and deep concern about the acquisition process within the Department of Defense in this committee, and I share that concern. In my judgment, no single proposal that I am aware of—no "tweak," no "silver bullet"—should substitute for a comprehensive, end-to-end review and analysis of this extremely complex acquisition system. In order to meet our dual responsibilities of providing our fighting men and women with the very best they require and satisfying our charge as trusted stewards of the taxpayer, we can do no less.

While we have recently incorporated many individual corrective actions in our acquisition processes, the final answer to past problems may lie in a complete restructuring of the way the Department accomplishes acquisition for all of its goods and services. Senator McCain earlier stated this needs to be a comprehensive study, even going back and looking at the premises of Goldwater-Nichols. We will do that. We have started this effort.

I want to assure this committee that we in DOD value our relationship with Congress and with this committee, and we will consult with you and will seek your advice and counsel, including enabling legislation, as we go forward. This committee and the Department of Defense share a common goal, and that is to maintain the confidence and trust of our citizens while protecting and defending this great Nation.

Know that you have my personal commitment to manage the Department ethically and above reproach, to be forthright, honest and direct with everyone and in every circumstance and to expect the same from every DOD employee. I will work closely with you to restore and retain confidence, effectiveness and efficiency in the DOD acquisition process. Thank you for your support.

Chairman WARNER. Thank you, Mr. Secretary.

The Acting Secretary of the Air Force, Mr. Dominguez.

STATEMENT OF HON. MICHAEL L. DOMINGUEZ, ACTING SECRETARY OF THE AIR FORCE

Mr. DOMINGUEZ. Thank you, Mr. Chairman. I want to take this opportunity, on behalf of the men and women of the United States Air Force, to apologize to the committee and in particular to Senator McCain for the unprofessional nature of many of our e-mails that are published in the DOD Inspector General's report. The tone in those e-mails was certainly unwarranted by the motivation of Senator McCain and his staff and certainly unwarranted by virtue of his long service to this Nation. So, I am deeply sorry for that violation of the standards of conduct and professionalism that we owe to this committee. It will not happen again, sir.

Chairman WARNER. Do you have any further comment on behalf of the Department? Now, I recognize that you were not, I guess, in the direct chain of these issues that are before us today; would that be correct, in your responsibilities?

Mr. DOMINGUEZ. Excuse me, sir? I did not hear the question.

Chairman WARNER. Well, you do not wish to add any further comments with regard to the report at this time?

Mr. DOMINGUEZ. No, sir. I will stand by for your questions, sir.

Chairman WARNER. General Jumper.

STATEMENT OF GEN. JOHN P. JUMPER, USAF, CHIEF OF STAFF, UNITED STATES AIR FORCE

General JUMPER. Sir, let me echo the statement of the Secretary of the Air Force in offering my apology to the members of the committee and especially to Senator McCain, especially for the tone of

some of the e-mails that were reported in the DOD Inspector General's report. These comments were unprofessional and not worthy of a great Air Force that has members out there performing, and I require a higher standard of them every day than we demonstrated ourselves in that report. So, I apologize, sir, and I look forward to your questions.

Chairman WARNER. Well, let us turn to questions at this time. We will go a 6-minute round and we will take as many rounds as required.

Secretary England, you have had an opportunity to review the report of Mr. Schmitz and his colleagues. Do you agree that there were violations of law performed by members of the DOD?

Mr. ENGLAND. Certainly, Senator, there were violations of law by Darlene Druyun. There is no question about that, and of course she has already had her case held. Beyond that, there are certainly cases of what would appear to be very poor judgment. I certainly cannot say there has been anyone breaking the law. I mean, there have certainly been some judgments that can be questioned along the way, Senator, but I certainly cannot speak in terms of people breaking the law other than Darlene Druyun herself and obviously some people with the Boeing Corporation.

Chairman WARNER. Mr. Schmitz, do you feel that there were any in the Department that violated the law, other than Ms. Druyun. You will need that microphone.

Mr. SCHMITZ. Mr. Chairman, that is a very good question. Mr. Chairman, it is important to note that we conducted an audit before the lease was signed, in which we identified five specific statutes that would be violated were the contract to be signed. But, thanks in part, major part, to this committee, the contract was never signed. So, the major legal violations that we identified in our earlier audit and repeated in this report today, those violations did not occur.

Chairman WARNER. Excuse me? Did not occur?

Mr. SCHMITZ. They did not occur because the contract was never signed. Our recommendation back in our earlier audit was before signing any contract that the Department comply with these five legal requirements.

Now, we have I believe 13 other contracts that we are now looking at—we are conducting preliminary reviews—that were associated with Darleen Druyun. Secretary Wynne referred, I believe, eight of those to us and we have identified another five. We are looking at those to answer your question, sir.

So, in fine Naval Academy tradition, I will tell you, "I'll find out, sir." We are still looking and we will report back if we find violations of law.

[The information referred to follows:]

We are still reviewing procurement actions and will report back to the committee if any violations of the law are found.

Chairman WARNER. Let me return to you, Secretary England. Given what Mr. Schmitz said, that there was a progression of actions which, had the signatures been affixed, would then have consummated a violation of law——

Mr. ENGLAND. I am sorry, sir?

Chairman WARNER. If I understand the Inspector General, there were a progression of actions taken by various officials other than Ms. Druyun that, had a signature been affixed to contract, would have then constituted a violation of law. Do you concur in that observation?

Mr. ENGLAND. Senator, my feeling is if this had proceeded there still would have been checks and balances in the system. This would not have gone strictly to a contract. There are still systems in the DOD before contracts are signed. So I would not, frankly, leap to the conclusion that it would have just stayed on its current path. There is still a leap before contracts are signed and other people would have been involved at that point.

I do not know if you can make that leap. Perhaps that would have happened. My own feeling is you would have had other people involved before contracts were actually signed, Senator.

Chairman WARNER. Well, I will return to that at another time.

Given that there was at least in one instance, as you say, a violation of law, what is it that you and Secretary Rumsfeld are going to take by way of steps to impress upon all employees of the DOD to adhere carefully to the law of the land?

Mr. ENGLAND. Well, as I commented, Mr. Chairman, in my opening statement, obviously ethical behavior is very important to the DOD. You know my own personal standards in that regard and I expect that everyone in the DOD will act not only legally but ethically in every single action that they deal with. So, we will set very high standards. We do have very high standards in the DOD, but we will continuously emphasize that.

It is critically important. As I commented before, this is question of faith between the American people and her military, and it is very important that we not weaken those bonds. Everything we do in the DOD needs to be completely above reproach. It needs to be very transparent.

My comment to you, to be forthright, honest, and direct with everyone in every circumstance, is the way, frankly, I have conducted myself for 4 years and I expect everyone in the DOD will conduct themselves that way. This is a question about ethical behavior and you have my full commitment that that is the way we will proceed going forward, sir.

Chairman WARNER. What are the procedures by which you and the Secretary will address the issue of accountability regarding those persons who have departed the DOD who are implicated in this matter?

Mr. ENGLAND. Senator, I have to tell you I am not that familiar with all the events that transpired in this regard. During most of this period I was in the Department of Homeland Security. I have read the Inspector General's report, but I also know that there are lots of things that do not show up in the Inspector General's report in conversations and rationales, and I believe in most cases people try to do what is right and best for America and they may exercise bad judgment. It is going to be very difficult, frankly, for me to go back and try to understand this in great detail.

Frankly, my emphasis will be to go forward, to make sure that we run this Department effectively and efficiently and above re-

proach. I am frankly going to emphasize on the future and not the past.

Chairman WARNER. Well, I fully appreciate that there have been gaps in your distinguished career. We are fortunate you offered to return now. Therefore, I presume it would largely be left to Secretary Rumsfeld; and have you had an opportunity to consult with him with regard to this Inspector General's report and what actions and procedures he may wish to take?

Mr. ENGLAND. No, sir, I have not had those conversations.

Chairman WARNER. Now, Mr. Schmitz, we will go into executive session, but I think it is important here in open session to explore the scope and depth of your investigation and in the course of which, were there facts which gave rise in any way to a decision by you or others in the Department that perhaps some of the actions taken by individuals should be examined by the United States Attorney because they give rise to possible criminal violations?

We need not mention names at this point, but I just want to know, in the course of the investigation did facts come to your attention which constituted a basis for this matter to be referred to the United States Attorney?

Mr. SCHMITZ. Aside from Darleen Druyun, of course?

Chairman WARNER. That is correct.

Mr. SCHMITZ. There is at least one matter, and you and Senator Levin referred it to me, which we are looking at which may in fact lead to that. But, it is an active matter and I should not go into it any further here at this point.

Chairman WARNER. Thank you.

My time is up. Senator Levin.

Senator LEVIN. Thank you, Mr. Chairman.

The report states that the DOD and the Air Force failed to follow applicable acquisition procedures. Clearly, I agree with that conclusion. I think we all would. It then goes on to name a number of officials who are determined to be responsible for the failure. I do have some questions about why some of those are named.

For instance, one of the officials is Mike Wynne, who was then the acting Under Secretary of Defense for Acquisition, Technology, and Logistics. This is what the report says with regard to Mr. Wynne: "Michael Wynne, Acting Under Secretary of Defense for Acquisition, was accountable for tacitly accepting Mr. Aldridge's decision to go forward with the Boeing KC tanker aircraft lease by sending a memorandum discussing the decision to an OMB official on May 28, 2003. In the memorandum, Mr. Wynne stated that, 'After a comprehensive and deliberative review by the Leasing Review Panel, the Secretary of Defense has approved the Air Force's proposal to enter into a multi-year pilot program for leasing general purpose Boeing 767 aircraft.' The memorandum was seeking approval of the proposed lease from the Office of Management and Budget (OMB)."

Now, Mr. Schmitz, this is my question. How do you hold Mr. Wynne responsible for misconduct on the basis of a memorandum in which he simply transmits to the OMB a determination by the Secretary of Defense?

Mr. SCHMITZ. Senator, we have identified Secretary Wynne as one of those individuals in the chain of events that we describe in our report in depth. In our executive summary we have also separated Secretary Wynne out from some of the other actors because, frankly, his role was less direct. I would say, in summary, Mr. Wynne came in after his predecessor. He could have reversed decisions of his predecessor. He could have, as you say, not passed on others' decisions to OMB. But he did, and we think that ultimately his accountability should be judged on the facts and circumstances of what he did, when he did it.

Senator LEVIN. Well, is not the issue here the decision of the Secretary, which he just simply forwarded to OMB?

Mr. SCHMITZ. It was also the decision of his predecessor, Secretary Aldridge.

Senator LEVIN. Was he not also, though, following a decision of the Secretary of Defense? How can you assess responsibility without seeing whether or not the person that you are saying is responsible is simply executing the order of a superior? How do you make that judgment?

Mr. SCHMITZ. Let me defer to my deputy——

Senator LEVIN. I do not have time for a long reference. Just, can you not answer that question?

Mr. SCHMITZ. Generally speaking, Senator, I think what you are getting into is the distinction between accountability and culpability. My report is a factual report and I give that to the Secretary of Defense and he puts my factual findings in context of all the other things that he is aware of, including the circumstances you are describing now, and then it is up to him to determine who is culpable and how to act on it.

Senator LEVIN. On page 147 of your report you have a letter from the Secretary of the Air Force, Jim Roche, describing events leading up to the Secretary of Defense's May 2003 approval of the lease. It is redacted. Much of it is redacted. Much key material is redacted. In subsection C on page 147: "Throughout the spring of 2003, BLANK took the lead for the White House in developing the administration's tanker proposal." "The administration's tanker proposal," "BLANK took the lead."

Subsection D: "In this period, the Boeing Company met with and discussed the tanker lease with BLANK on at least one occasion."

Subsection E: "Mr. Aldridge and Deputy Secretary of Defense Wolfowitz negotiated the approval of the proposal with BLANK based largely on what the administration believed would be an acceptable price for the tankers."

First of all, are there any inaccuracies in those descriptions that I just read? Did you find any of those inaccurate?

Mr. SCHMITZ. In Secretary Roche's letter?

Senator LEVIN. In C, D, and E.

Mr. SCHMITZ. Sir, I am not in a position to assess the accuracy of Secretary Roche's letter. I am repeating it verbatim here.

Senator LEVIN. So, you have not reached a conclusion as to whether or not in the spring of 2003 someone, "BLANK," took the lead for the White House in developing the administration's tanker proposal? You have not reached a conclusion as to whether that is accurate or not?

Mr. SCHMITZ. Sir, that was not within the scope of what you requested in your letter, nor is it within the scope of the Inspector General Act.

Senator LEVIN. When you hold people responsible for implementing decisions, you ought to know whether in fact they are implementing other decisions or their own.

Mr. SCHMITZ. Of course, of course.

Senator LEVIN. You did not do that. You did not do that. You do not know whether they were implementing their own decisions or other decisions. Is that correct?

Mr. SCHMITZ. Sir, we have reported factually what we are aware of based on all the data we have, and the questions you are asking are legitimate questions that I think the Secretary should ask himself when he is making an ultimate determination on our factual findings.

Senator LEVIN. Do you think it makes a difference as to whether decisions which are being implemented are the decisions of the people that you hold responsible or their superiors' decisions? Do you think that is relevant?

Mr. SCHMITZ. Of course, sir, and that is what I was explaining. That is why we set Secretary Wynne off from the rest, because he was essentially implementing decisions that had been made by his predecessor. That is precisely the point we—

Senator LEVIN. Did his predecessor implement the decision of the Secretary of Defense?

Mr. SCHMITZ. In that case it was Secretary Aldridge that was the decisionmaker.

Senator LEVIN. So, he was not implementing the decision of the Secretary of Defense? You did make that conclusion? You did reach that conclusion?

Mr. SCHMITZ. I think we are talking about two decisions now, sir.

Senator LEVIN. That is correct. Aldridge's decision was his own, not the Secretary of Defense's?

Mr. SCHMITZ. Yes, sir.

Senator LEVIN. You reached that conclusion?

Mr. SCHMITZ. Yes, sir.

Senator LEVIN. But, you did not reach the conclusion as to whether Wynne was implementing his own decision or the Secretary of Defense's. Why would you conclude that Aldridge had implemented his own, but when it came to Wynne you did not look at whether it was the Secretary of Defense's decision or the administration's decision or Wynne's decision? Why would you not make the same—

Mr. SCHMITZ. I believe we did look at that, sir, and we interviewed Secretary Rumsfeld and Secretary Wolfowitz.

Senator LEVIN. You did?

Mr. SCHMITZ. Yes, sir.

Senator LEVIN. On the Wynne decision?

Mr. SCHMITZ. I do not know. I have to check the transcript, sir. I have to get back to you if you would like to know that, sir.

Senator LEVIN. It was my understanding you did not talk to Wolfowitz or Rumsfeld.

Mr. SCHMITZ. No, sir, we interviewed both, sir.

Senator LEVIN. So, on all these matters you have talked to the Secretary of Defense?

Mr. SCHMITZ. Yes, sir.

Senator LEVIN. But, you did not reach any conclusion as to whether they were responsible for making decisions which were either in violation of regulations or——

Mr. SCHMITZ. I will find out, sir.

Senator LEVIN. Pardon?

Mr. SCHMITZ. I will find out. I do not recall the specific answer to your question. I will find out, sir.

Senator LEVIN. Mr. Chairman, thank you.

Chairman WARNER. That is a very important question. It requires careful review on your part. But, for the record this morning, you interviewed both the Deputy Secretary and the Secretary regarding the full breadth of the issues of the scope of your examination?

Mr. SCHMITZ. Yes, sir.

Chairman WARNER. You will then go back and re-examine the transcript and other statements to determine the responses to Senator Levin's questions and you will provide that for the record?

Mr. SCHMITZ. Yes, sir. Let me just clarify. When you say I interviewed, my staff interviewed 88 witnesses. Included among those 88 were the Secretary and the Deputy Secretary.

[The information referred to follows:]

Based on a re-examination of the transcripts of interviews, both the Secretary of Defense and the Deputy Secretary of Defense were aware of the leasing decision by Pete Aldridge and generally supported it.

Senator LEVIN. You interviewed them, but you did not report in your report what they told you or what their position was; is that correct?

Mr. SCHMITZ. Generally speaking, we interviewed them and we did not find anything relevant to report to tell the story about the Boeing 767 tanker aircraft. What we reported was, our independent judgment on that which was relevant.

Senator LEVIN. You found nothing in your interviews with the Secretary of Defense and the Deputy Secretary of Defense that was relevant to this report?

Mr. SCHMITZ. Sir, I told you I would go back to the transcript, I would look at it and would get back to you, but I recall speaking to our interviewers that spoke with both of them and asked what material came out of it, and I was told, in both cases, there was not much.

Chairman WARNER. I must say I am somewhat perplexed that you personally did not conduct or participate in those interviews, given that they were your superiors. Is that the routine?

Mr. SCHMITZ. Absolutely, sir. I have been the IG for 3 years now. I have not participated in a single interview. I review the transcripts, but I have professional investigators, inspectors, and auditors and they are paid to do these, and in this case I sent my best senior official investigator over to interview both Deputy Secretary Wolfowitz and Secretary Rumsfeld.

Senator LEVIN. If I could just conclude on that line then, you do have the responsibility of reading those transcripts?

Mr. SCHMITZ. Yes, sir.

Senator LEVIN. Did you read the transcripts?

Mr. SCHMITZ. I reviewed both transcripts, yes, sir.

Senator LEVIN. Was there anything relevant in those transcripts to the issues in your report?

Mr. SCHMITZ. Sir, I do not recall the specifics you are asking about. I will get back to you if you would like to know. I just——

Chairman WARNER. We will move on at this time. You will get back one way or another in response to those questions. Thank you.

Mr. SCHMITZ. Yes, sir.

Chairman WARNER. Senator McCain.

Senator MCCAIN. Thank you very much, and I would like to thank General Jumper and Secretary Dominguez for their remarks and I appreciate it. As I said earlier, I think following the conclusion of this hearing and this issue we should move forward. However, I also think we should make sure that responsibility is apportioned where it belongs.

Mr. Schmitz, after it became known that Ms. Druyun had committed a crime, for which she was later convicted, the line out of the Secretary of the Air Force and the Pentagon was that this was an isolated incident, that only Ms. Druyun was responsible for all this, and there was no other responsibility to be apportioned to any individuals or organization. Do you accept that statement?

Mr. SCHMITZ. No, sir. There are actually two components of my objection to that approach. One was, if you recall, "the line" was also that up until that point Ms. Druyun had a stellar, pristine record. In fact, there were at least five prior investigations and she had, in fact, been held accountable by my predecessor to acquisition irregularities back in the early 1990s and a recommendation of my office to hold her accountable had been overruled by the Deputy Secretary of Defense at the time. Instead of holding her accountable, she was actually promoted into the position where she then exercised all of the prerogatives she did, which led ultimately to her criminal conviction.

The other issue is, I would just say generally speaking, she did not operate in a vacuum. She had a powerful persona, there is no dispute about that. But, there were people both above, below, and aside of her that allowed her to continue operating without checks and balances that should have been in place.

Senator MCCAIN. Mr. Aldridge did not submit himself to an interview by your staff, is that true?

Mr. SCHMITZ. That is true, sir.

Senator MCCAIN. Did he say why not?

Mr. SCHMITZ. My staff could not reach him, sir.

Senator MCCAIN. Could not reach Mr. Aldridge, who is I believe now a member of the board of Lockheed Martin; is that right? Do you know that?

Mr. SCHMITZ. I have heard that. I believe that, sir, is right.

Senator MCCAIN. You could not get a hold of him through Lockheed Martin?

Mr. SCHMITZ. I do not recall. I recall my staff coming to me and saying that they had made repeated attempts to reach him and——

Senator MCCAIN. Since he made a crucial decision, I believe the day he left the Pentagon, about the leasing, signing off on the Air

Force leasing proposal, do you not think it would have been important to have his testimony?

Mr. SCHMITZ. We would have preferred to have his testimony, yes, sir.

Senator MCCAIN. Well, Mr. Chairman, since Mr. Aldridge has refused to cooperate with Mr. Schmitz, I might suggest that we subpoena him before this committee. He obviously signed off the day he left the Pentagon. He stated that the comprehensive and deliberative review by the Leasing Review Panel in support of his decision to approve the lease, but the panel never provided a recommendation and a co-chairman of the panel's working group recommended against the lease. Therefore, Mr. Aldridge's reliance on the panel's work in support of approving the decision is in fact misleading, is it not, Mr. Schmitz?

Mr. SCHMITZ. Can you repeat the last part of your question, sir?

Senator MCCAIN. One of the rationales given by Mr. Aldridge approving the leasing deal was that the Leasing Review Panel was in support of the Boeing 767 lease, and in fact the panel did not approve of it; is that not true?

Mr. SCHMITZ. That is true, sir.

Senator MCCAIN. So, Mr. Aldridge basically lied. Mr. Aldridge, we do not know why he made the statement, do we?

Mr. SCHMITZ. No, sir. Well, we know generally that he was, as I said in my opening statement, that he and others within the Air Force and OSD were trying to treat the appropriations language as if it had waived a whole bunch of legal requirements and were just trying to get to the result of leasing 100 aircraft.

Senator MCCAIN. Well, Mr. Chairman, I recommend we subpoena Mr. Aldridge to get his testimony, because key decisions were made by him and obviously made his statement of approval of the lease on false information. I think we might be able to get a hold of him through his board membership of one of the major defense contractors.

Chairman WARNER. I should say at this juncture that I have given some thought to that. I think we should first accord him the opportunity to appear voluntarily.

Senator MCCAIN. That would be fine.

Chairman WARNER. If he does not, then we will as a committee consider the use of the subpoena. But, I think at this point, to protect Mr. Aldridge to the extent we should, give us some detail as to the efforts you went to find him. I mean, he is an American citizen residing in this country. I do not think it is a mystery. If in fact he is on the board of a major defense contractor, it seems to me he is locatable. Can you give us some amplified data on what efforts you took to find him?

Mr. GIMBLE. Senator, we sent registered letters——

Chairman WARNER. I beg your pardon?

Mr. GIMBLE. We sent registered letters. We also left a number of voice-mails on his personal home voice-mail. We tried to obtain his number through the folks at the Pentagon, and we simply just were not able to make arrangements to interview him.

Chairman WARNER. Did the Department of the Air Force offer to help at all? I mean, he had some affiliations with them in years past and so forth.

Mr. GIMBLE. We exhausted all the avenues we thought were available. We just were not successful.

Chairman WARNER. All right.

Senator LEVIN. Would the chairman just yield very quickly on that point, though? Or would Senator McCain yield?

Chairman WARNER. I will increase your time.

Senator MCCAIN. Please.

Senator LEVIN. It will be on my next round. Just a 10-second question. Did you subpoena him?

Mr. GIMBLE. We did not subpoena him.

Senator LEVIN. Why not?

Mr. SCHMITZ. Sir, the——

Senator LEVIN. I will save that for my second round. I have taken too much time.

Chairman WARNER. That is all right. It is important that this juncture of the record be completed.

Mr. SCHMITZ. We do not normally exercise our subpoena power in a civil matter. We can in a very extraordinary circumstance exercise our subpoena authority, but usually it comes up in the context of an active criminal investigation. So, the normal procedures are not there. We would have truly had to exercise an extraordinary measure in that case to subpoena documents from Mr. Aldridge.

Frankly, we interviewed everybody around Secretary Aldridge, so the facts of what happened—we were able to tell the story to this committee and in our report, I think, in a full, objective, independent manner without Secretary Aldridge's——

Chairman WARNER. I would take a difference of opinion with you on that. I think this is an extraordinary case. It has enormous ramifications throughout the whole procurement process, impact on the military, and I think you should have utilized the subpoena. I will just tell you that.

[The information referred to follows:]

Inspector General Subpoena Authority

The DoD IG subpoena power does not include authority to compel personal testimony. IG subpoena power extends only to documents and Records. Section 6(a)(4) of the Inspector General Act of 1978, as amended, provides that each Inspector General is authorized "to require by subpena [sic] the production of all information, documents, reports, answers, records, accounts, papers, and other data and documentary evidence necessary in the performance of the functions assigned by this Act."

Subsequent to the Senate Armed Forces Committee hearing, Mr. Aldridge agreed voluntarily to be interviewed on June 21, 2005. After reviewing the transcript of Mr. Aldridge's interview, I stand by the findings and conclusions in my report. Specifically, in response to questions that dealt "with Mr. Rumsfeld and Mr. Wolfowitz providing any guidance or instruction regarding the 767 Tanker lease and the extent of their involvement," Mr. Aldridge answered, "I don't recall their involvement being very active at all. It was more -- we informed them what was going on, we informed them that the process was working. I informed that I thought this was a good deal for the country the way it was set up for, again military value. And he and Wolfowitz both I think were somewhat inactive in the process . . . . Aware but not engaged."

In a follow-on interview conducted on June 28, 2005, when asked if he had been "influenced or under any pressure by the Secretary or the Deputy Secretary of Defense to sign the Acquisition Decision Memorandum. And my recollection is, you told us no," Mr. Aldridge responded, "That's correct." Additionally, Mr. Aldridge stated the he had presented the recommendation of the leasing panel to proceed with the lease and that "when I presented that to the Secretary, it's my recollection he said, he agreed." Mr. Aldridge noted that the decision maker was "ultimately the Secretary of Defense," explaining that "the project would have stopped" if the Secretary had disagreed. This is consistent with the conclusion in our May 13, 2005, report that: "Mr. Edward C. Aldridge, Jr., Under Secretary of Defense for Acquisition, Technology, and Logistics; Dr. James G. Roche, Secretary of the Air Force; Dr. Marvin R. Sambur, Assistant Secretary of the Air Force (Acquisition); and Ms. Darleen A. Druyun, Principal Deputy Assistant Secretary of the Air Force (Acquisition and Management) were the primary decision makers within the Department of Defense and the Air Force who allowed the Boeing KC-767A tanker aircraft lease to continue moving forward."

INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
400 ARMY NAVY DRIVE
ARLINGTON, VIRGINIA 22202-4704

The Honorable John Warner
Chairman
Committee on Armed Services
United States Senate
Washington, DC 20510-6050

JUN 24 2005

Dear Mr. Chairman:

I am writing in further regard to the June 7, 2005, "Hearing to Receive Testimony on the Department of Defense Inspector General's Management Accountability Review of the Boeing KC-767A tanker Program." In response to your request during that hearing, on June 9, 2005, I sent to you an insert for the hearing record containing the answers I had previously provided to another Senator relating to White House protocols. The purpose of this letter is to provide to you an insert for the record regarding the subpoena power of Inspectors General.

During the hearing, I was asked why Pete Aldridge, the former Under Secretary of Defense for Acquisition, Technology and Logistics, had not been interviewed and whether my office had subpoenaed him. As a point of information, DoD IG subpoena power does not include authority to compel personal testimony. IG subpoena power extends only to "the production of all information, documents, reports, answers, records, accounts, papers, and other data and documentary evidence necessary in the performance of the functions assigned by this Act."

Subsequent to the Senate Armed Forces Committee hearing, Mr. Aldridge agreed voluntarily to be interviewed on June 21, 2005. After reviewing the transcript of Mr. Aldridge's interview, I stand by the findings and conclusions in my report. Specifically, in response to questions that dealt "with Mr. Rumsfeld and Mr. Wolfowitz providing any guidance or instruction regarding the 767 Tanker lease and the extent of their involvement," Mr. Aldridge answered, "I don't recall their involvement being very active at all. It was more -- we informed them what was going on, we informed them that the process was working. I informed that I thought this was a good deal for the country the way it was set up for, again military value. And he and Wolfowitz both I think were somewhat inactive in the process . . . . Aware but not engaged." A copy of the enclosed insert for the record will also be included along with the hearing transcript.

If you have any questions regarding this matter, please contact me or Mr. John R. Crane, Assistant Inspector General for Communications and Congressional Liaison at (703) 604-8324.

Sincerely,

Joseph E. Schmitz

Enclosure

cc: The Honorable Carl Levin
Ranking Minority Member
The Honorable John McCain

Chairman WARNER. Now we want to return and let you finish your questioning period.

Senator MCCAIN. Thank you.

Mr. Schmitz, just to complete the circle here, Mr. Aldridge stated in his decision, which I believe was the day he left office—is that correct?

Mr. SCHMITZ. I believe that is correct.

Senator MCCAIN. The day he left office, his decision was, he said, a comprehensive and deliberative review by the Leasing Review Panel in support of the decision to approve the lease, was part of his rationale, right?

Mr. SCHMITZ. I believe that is correct, sir.

Senator MCCAIN. That was false? The Leasing Review Panel did not recommend it, is that not true? Mr. Gimble?

Mr. SCHMITZ. I would like to doublecheck with my Deputy on that.

Mr. GIMBLE. The actual work of the leasing panel was not complete. There was a program analysis and evaluation (PA&E) memorandum, Mr. Kreig, a month later, which was a tasker of the leasing panel. So the leasing panel was not complete, the work was not.

Senator MCCAIN. Thank you. I would be interested to know what pressures Mr. Aldridge felt that he would make that decision on the day that he left office.

Mr. Schmitz, on January 19, 2005, former Secretary Roche sent you a lengthy letter. Near the end of the letter Mr. Roche writes, and I quote: "The Air Force put forward a proposal done in conformance with the law and policies in place at the time. The Air Force performed a due diligence look into potential alternatives, including open competition, even though the legislation specified the Boeing 767."

Is that statement true, Mr. Schmitz?

Mr. SCHMITZ. I disagree with those conclusions, sir.

Senator MCCAIN. Thank you.

At the end of the letter Mr. Roche wrote: "I am calling"—why do you disagree with that?

Mr. SCHMITZ. I do not think in a real sense there was free and open competition. I think that this was simply a result-oriented effort to lease 100 of the Boeing tankers as quickly as they could, as was authorized, but not required, in the Appropriations Act for fiscal year 2002.

Senator MCCAIN. Did Mr. Roche at one point call you into his office along with General Jumper and tell you you ought to back off this investigation?

Mr. SCHMITZ. He did not say, "back off the investigation," sir. But, he was critical of the way that I had criticized Darleen Druyun's integrity.

Senator MCCAIN. Did he ask you, do you know that maybe you could be liable for slander?

Mr. SCHMITZ. In fact he did say that.

Senator MCCAIN. You might be slandering Ms. Druyun?

Mr. SCHMITZ. That was not even an implication. That was the direct statement.

Senator MCCAIN. At the end of that letter, Mr. Roche wrote: "I am calling for you to do the courageous thing, not contribute to further character assassination of those who tried to serve honorably. To continue down the current path will dramatically contribute to severe risk aversion on the part of senior and junior military leaders. To those Americans who must go into harm's way, to put it bluntly, this investigation will further stifle innovative procurement for years to come. This amounts to coercion in my book."

Mr. Schmitz, do you think this was proper? Let me ask, General Jumper, do you think that is an accurate depiction of the situation that Secretary Roche wrote in his letter, that if we continue the in-

vestigation that, to put it bluntly, this investigation will further stifle innovative procurement for years to come?

General JUMPER. Sir, I believe the Secretary believed that when he wrote it.

Senator MCCAIN. Do you believe it?

General JUMPER. No, sir.

Senator MCCAIN. Do you believe it, Secretary England?

Mr. ENGLAND. No, sir, I do not.

Senator MCCAIN. Mr. Chairman, I have additional questions.

Chairman WARNER. We will have another round.

Senator MCCAIN. Again, I want to thank the witnesses.

Thank you, Mr. Chairman.

Chairman WARNER. Senator Nelson.

Senator BILL NELSON. Thank you, Mr. Chairman.

Mr. Gimble, did you read the transcripts of the Secretary and the Deputy Secretary?

Mr. GIMBLE. Yes, sir, I did.

Senator BILL NELSON. You said you did not?

Mr. GIMBLE. I did.

Senator BILL NELSON. You did read them?

Mr. GIMBLE. I did, yes.

Senator BILL NELSON. From what you read in the transcripts, do you have a conclusion about the Secretary or the Deputy Secretary of how they would have influenced the decision?

Mr. GIMBLE. Let me clarify. The decision that we are talking about was a decision of the senior acquisition executive, in this case Mr. Aldridge. What was quoted in that was that he had the support of the Secretary and the Deputy Secretary. We believe that that was the case.

Now, in the interviews with the Secretary and the Deputy Secretary they both indicated that they had delegated that to their acquisition people who were making acquisition decisions, and it seemed like, based on what they knew, it was a proper decision.

Senator BILL NELSON. So what—if I understand what you just said, that you do not have a conclusion that they actually influenced the decision?

Mr. GIMBLE. I do not believe that they influenced it from the standpoint that they said, move forward with it. Also, I do not believe they influenced it from the standpoint that they said, do not move forward with it. It was just an indication that they supported it and they were not stopping it, is the way I interpreted it.

Senator BILL NELSON. Mr. Schmitz, is that your conclusion?

Mr. SCHMITZ. Yes, I agree with that and I would also just elaborate that it was a decision of, I believe the Deputy Secretary to put a halt on it, and I know that the Secretary fully supported us when we stopped the process and put a freeze on the project going forward. They certainly played an active role in that.

Senator BILL NELSON. Secretary England, the House of Representatives has just passed the Defense Authorization Act and they have included a provision there that in effect would cut out any competition for the awarding of this contract for a tanker in the future for any firm that was not an American firm. What do you know about that provision?

Mr. ENGLAND. I am not familiar at all with the provision, but if that is a provision, it is not a provision I would agree with, frankly, Senator. I do believe we need to have free and open competition, frankly, for many of our goods and services. There are exceptions because there are items I think that are uniquely important to our military. But, as a matter of policy, frankly, we have limited competition in many of our acquisitions and, frankly, I think it would be healthy for America and healthy for our industrial base to have more competition, even international.

I would not support that amendment, but I am not familiar with it and I have not had discussions with members of the House.

Chairman WARNER. Senator, I thank you for bringing that up. Of course, that is directed against the Airbus possibility of working with U.S. firms to participate in that. But, we are going to probe that further. It will be a subject of the conference once our body acts on our bill, and we will solicit views from the Secretary and Deputy Secretary on that question. I thank you for bringing it up.

Senator BILL NELSON. Thank you, Mr. Chairman.

Mr. England. The Washington Post has reported that 45 sections were deleted by the White House's counsel's office—and I am quoting—"to obscure what several sources described as references to White House involvement in the lease negotiations and its interaction with Boeing." Can you tell the committee what you know about these deletions in the IG report?

Mr. ENGLAND. Senator, I actually cannot comment. I do not know what has been deleted. I just do not have the background in this. Again, this is recent in my background. I just have to defer to the IG in terms of what has been redacted in their report.

Senator BILL NELSON. Okay. Mr. IG?

Mr. SCHMITZ. It is generally an accurate statement about the number of redactions, and this goes back to the protocol that was mentioned earlier by Senator Levin and which we—I made an independent decision to respect.

Senator BILL NELSON. Do you think these deletions were proper?

Mr. SCHMITZ. Were they proper?

Senator BILL NELSON. Yes.

Mr. SCHMITZ. Of course. I did them.

Senator BILL NELSON. You did them at the request of whom?

Mr. SCHMITZ. No, I made an independent decision to delete them.

Senator BILL NELSON. So, this is not a correct statement in the Washington Post?

Mr. SCHMITZ. What I said was correct was that the number of redactions is correct.

Senator BILL NELSON. Well, the Washington Post says that they were deleted by White House counsel's office.

Mr. SCHMITZ. That is not correct.

Senator BILL NELSON. That is not correct?

Mr. SCHMITZ. We deleted them. My staff deleted them.

Senator BILL NELSON. There were 45, and the 45, were they—the redactions were the 45 in reference to White House involvement in the lease negotiations and interaction with Boeing?

Mr. SCHMITZ. There were redactions for White House names, Members of Congress, staff of Congress, and then there were also

redactions for company proprietary and "For Official Use Only" material in the report.

Senator BILL NELSON. Since you made the redactions—and thank you for clarifying that—why is the withholding of that information beneficial so that this committee or the public cannot understand the IG report in its full context?

Mr. SCHMITZ. Well, the leadership of this committee entered an agreement with White House Counsel to allow White House Counsel to withhold certain information, and I made an independent determination that I did not need to include that information in my report to give the full story, and so that is why the redactions are there. In fact, some of these issues were raised by Senator Grassley already and I have already answered them in writing, and I would be glad to answer—I would be glad to submit my answers to the committee for the record.

Chairman WARNER. We would like to have them. Without objection, they will be part of this record today.

[The information referred to follows:]

INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
400 ARMY NAVY DRIVE
ARLINGTON, VIRGINIA 22202-4704

JUN 0 9 2005

The Honorable John Warner
Chairman
Committee on Armed Services
United States Senate
Washington, D.C. 20510-6050

Dear Chairman Warner:

On June 7, 2005, in testimony before your Committee, I offered to submit to you my response to questions concerning White House protocols raised in letters of May 17 and May 27, 2005, from Chairman Grassley. Enclosed are the answers that I provided Chairman Grassley to his questions relating to the use of White House protocols.

If you have any questions regarding this matter, please contact me or Mr. John R. Crane, Assistant Inspector General, Communications and Congressional Liaison, at (703) 604-8324.

Sincerely,

Joseph E. Schmitz

Enclosures:
As stated

Do the "protocols" apply only to the source documents or also to the report itself?

The protocols apply to source documents, many of which are quoted verbatim in the report.

As IG, were you obligated to comply with the protocols?

The Inspector General, after confirming the existence of and the general terms of the protocols between Members of the Senate and the White House Counsel, made an independent decision to honor -- and, whenever possible, to comply with -- the protocols.

Do the Protocols supersede the IG Act?

Although the Inspector General is not aware of any legal authority for the protocols superseding the IG Act, the latter neither proscribes compliance with nor confers upon the Inspector General any authority either to abrogate directly -- or to circumvent -- protocols between Members of the Senate and the White House Counsel.

If the names of the White House Officials were in fact removed from your draft report, was it done "to ensure that the report was factually accurate?"

Taking into consideration the aforementioned protocols, the Inspector General made an independent decision to delete names of White House officials, Senators, Representatives, and congressional staff personnel. This decision was not part of the staffing effort to ensure factual accuracy of the report. The DoD IG's authority and the report's purpose was limited to assessing accountability for those DoD and Air Force officials that were in decision making positions or contributed to the decisions. It is not within the IG's authority to assess accountability of White House or Congressional officials.

Has anyone in the White House or the DoD ever asked you or directed you to submit a draft report for review? If so, please provide the details and documentation on each case?

No.

Did your submission to the White House on April 29, 2005 comply in every respect with the audit standards on the staffing of "discussion drafts"?

As previously stated, the Boeing Tanker Management Accountability Review was not an audit, but generally followed the audit standards. The auditing standard from the GAO "Yellow Book" in Paragraph 8.32 states, "Auditors should normally request that the responsible officials submit in writing their views on reported findings, conclusions and recommendations, as well as

management's planned corrective actions. Oral comments are acceptable as well and, in some cases, may be the only or more expeditious way to obtain comments." The DoD IG Audit Manual identifies processes to implement the Yellow Book standards.

The predecisional draft that was sent to the eight offices in the Pentagon and to the White House Counsel did include a draft transmittal letter and executive summary; however, they were clearly marked "predecisional draft" and could not have been confused with the final report.

Did your office receive and/or incorporate any external comments that are not summarized and referenced in the final report as required by standard audit procedures?

No. The predecisional draft was sent for comment and two DoD organizations provided comments which were included in the final report. The standard procedure for handling management comments was followed for this report.

Were the auditors involved given the option to accept or reject White House changes as specified in the audit manual?

Management comments were received only from two DoD entities. Paragraph 8.34 of the Yellow Book states, "When the audited entity's comments oppose the report's findings, conclusions, or recommendations, and are not, in the auditors' opinion, valid . . . , the auditors should state their reasons for disagreeing with the comments . . . in a fair and objective manner. Conversely, the auditors should modify their report if they find the comments valid."

The Review Team members were given the chance to accept or reject the management comments. The comments received were incorporated into the report, but did not change the conclusions. Our responses to the management comments are reflected in the Section titled "Management Comments and Audit Response" at page v of the Executive Summary to the report. We reemphasized our position on the need for Analysis of Alternatives ("AOA") and the need to follow the prescribed acquisitions procedures.

June 9, 2005

EXTERNAL AFFAIRS

Media Inquiry: On Thursday, June 9, 2005, Air Force Times reporter Laura Colarusso called to ask about the Boeing KC-767A Management Accountability Report and Dr. Marvin Sambur's involvement in that issue. She was told that our response to any questions involving those issues would be limited to what was in the Management Accountability Report and the DoD IG's statement at the SASC hearing.

Media Inquiry: On Wednesday, June 8, 2005, media calls regarding the Boeing KC-767A Management Accountability Report were received from the following, who were told that the report and the IG's testimony speak for themselves:

- St. Petersburg Times reporter Tim Nickens
- Washington Post Editorial Page Editor Ruth Marcus (Ms. Marcus requested an interview with the IG. After consulting OASD-PA, the request was declined.)
- Space News reporter Colin Clark
- Sacramento Bee reporter Dale Kasler
- USA Today reporter Dave Moniz
- Bloomberg reporter Tony Capaccio

Media Inquiry: On Tuesday, June 7, 2005, Federal News Radio reporter Austin O'Neil requested an on-air interview with the DoD IG or another senior officials on the Boeing KC-767A Management Accountability Report. The request was denied.

WEB Issues:

- On Wednesday, June 8, 2005, Web Team Leader Andy Kim and Audit Web Developer Andrew Filer corrected a security flaw in the pdf file of the redacted version of the Boeing KC-767A Management Accountability Report that was posted on the OIG internet. While doing a general word search for "White House," Mr. Filer came up with "hits" in areas of the report that had been deleted by gray blocks per an agreement between the White House and SASC. Further inspection showed that while no names or significant information were retrievable, minor notational descriptions made by redacting officials were. Although the notational descriptions did not compromise the information in the deleted areas, a system was devised to ensure that no "hits" came up in the deleted areas. The pdf file with original deletions was re-copied as a pdf file by Mr. Kim, who then tested each page of the second-generation pdf file. The second generation file was found to be secure and was posted.
- Mr. Kim continues to work with Mr. Tim Wimette in Audit on the new management survey project.
- Ms. Nancy West, OCCL Digital Media specialist, had eye surgery to repair a detached retina and will be out for approximately four weeks.

Information Release: "Manufacturer Charged With Providing Non-Conforming Parts for Military Aircraft," June 7, 2005

Senator BILL NELSON. Mr. Chairman, then am I given to believe, since we have had a clarification as to what was written in the Washington Post——

Chairman WARNER. I beg your pardon. Yes, go right ahead.

Senator BILL NELSON. Mr. Chairman, am I given to understand then that, since we have now clarified that it was not the White House Counsel that caused these deletions, it was the IG, is the full IG report available to the members of this committee without the deletions?

Chairman WARNER. There is an unredacted version of the report in our secure area. It has been available to all members of the committee.

I think some clarification at this point is proper by the chairman. I did meet with the senior leadership of the Senate. I think you were present. We made the decision, in order to facilitate the conveyance from the White House, which was supervising the material that Senator McCain and I requested, that we would allow certain redaction of names in order to get that material.

There is no reason why we cannot go back in executive session with this committee and fully advise all members of the committee on that transaction. Is that your recollection of it, Senator McCain?

Senator MCCAIN. Yes, Mr. Chairman. But, unfortunately, the DOD General Counsel abused and misinterpreted the agreement that we had. He basically is sending over entire volumes of pieces of paper that are totally redacted. It was supposed to be completed by the middle of February and we still have not received all of them, even though we reduced the number of e-mails requested.

DOD General Counsel and the White House have obfuscated and delayed in a very frustrating manner. I am not in sympathy, frankly, with their redacting this information. They have been less than forthcoming.

Chairman WARNER. We had the issue of executive privilege, which is a doctrine that has existed from the beginning of times here in this Republic. Senator McCain and I and others tried our very best to get the maximum amount of information that we felt was important for this committee to receive, but at the same time we had to respect the doctrine of executive privilege.

Senator LEVIN. Mr. Chairman, if I could just further add on this.

Inspector General, first of all, there are 45 White House redactions, as I understand it, which are still redacted; is that correct?

Mr. SCHMITZ. That is correct.

Senator LEVIN. That is different from what you suggested.

Mr. SCHMITZ. When you said "White House redactions"——

Senator LEVIN. Yes.

Mr. SCHMITZ.—redactions of White House names.

Senator LEVIN. Which the White House redacted.

Mr. SCHMITZ. Everything in this report was redacted by my staff.

Senator LEVIN. Well, according to this footnote here on page 13, "The report does not include full verbatim text of this e-mail because staff of the White House Counsel has indicated its intent to invoke an agreement between members of Congress and the White House covering the production of tanker-related e-mails." "Its intent." So it is not your redaction. "Its intent to invoke an agree-

ment," which is a totally separate deal which had to do with documents which this committee recommended and does not apply to your responsibility under law. I made that clear in my opening statement and I am going to stand by it.

But, whether that is correct or not, let us be real clear, the White House, according to this footnote 13 in your report, it is the White House counsel indicated an intent to invoke an agreement; is that correct? Is your footnote correct?

Mr. SCHMITZ. Of course, yes, sir.

Senator LEVIN. Well, do not say "of course." It is a real question about that.

Mr. SCHMITZ. That is my footnote. It is correct, yes, sir.

Senator LEVIN. All right. So, it is not just your decision to redact; it is the White House's intent to use an agreement which had to do with documents which this committee requested.

Why did you not request unredacted—I am sorry, this is not my time. I just have one other question.

There is also a suggestion—Mr. Chairman, this is for the clarification of the committee. What is in a classified version or an uncleared version are still redactions; is that correct?

Mr. SCHMITZ. Yes, sir.

Senator LEVIN. So, we do not have unredacted memos, is that correct, anywhere?

Mr. SCHMITZ. That is correct, sir.

Senator LEVIN. Thank you.

Senator BILL NELSON. Well then, Mr. Chairman, that is opposite of what you were given to believe.

Senator LEVIN. It is wrong. This committee has—it seems to me you have an obligation to give us your judgment and your judgment should be based on unredacted documents unless executive privilege is invoked. But, that is not what has been invoked here.

They have not invoked executive privilege, have they?

Mr. SCHMITZ. They have not formally invoked executive privilege, that is right.

Chairman WARNER. We will look into this matter further. I think you raise a very valid point.

Senator Talent.

Senator TALENT. Thank you, Mr. Chairman.

Mr. Schmitz and Mr. Gimble, let me just boil this down to you and ask you a question that is the most important for me here. Let me give you two scenarios and then you give me your opinion about which more closely reflects reality as you understand it after having conducted this investigation. Did the responsible officials really believe, based on their experience and understanding of the national military strategy, that we needed a new platform to meet our tanker needs and that the lease of these aircraft was the most economical and efficient way of achieving that, and then they just went on and were terribly impatient with all the rules and the requirements and so they cut corners in order to get this done, to meet what they really believed we needed? That is scenario one.

Scenario two is they did not think we needed a new platform, but in order to do a favor for somebody put this—were determined to put this lease through and cut all the corners to keep Congress and the country from finding out that we did not really have the need?

Which scenario in your view more accurately reflects the mind set of the people who were making the decisions?

Mr. SCHMITZ. Well, I think with regard to Darleen Druyun clearly the second scenario. With regard to the myriad of other senior officials that we have identified in our report, it depends upon case-by-case which scenario they fit into.

Senator TALENT. Some did and some did not?

Mr. SCHMITZ. I think there is a spectrum. I think it is actually a nice spectrum you have laid out with the two scenarios, and I think that at one end you have Darleen Druyun and at the other end I am sure you have honorable people that fully believed that we needed a new platform and this was the best way to do it. Then in between you have a whole smattering of others.

Senator TALENT. General Jumper, you want to comment on that for me?

General JUMPER. Sir, I am responsible for the requirement part of the Air Force. As the Chief of Staff of the Air Force, I came into this job on September 6, 2001. After September 11, I saw an instant surge in tanker utilization and I looked at a fleet that was more than 40 years old, and if we began recapitalizing immediately we would be flying these airplanes when they were 70 years old. I honestly thought it was time to get on with the recapitalization.

I was indifferent to how that recapitalization might take place. But, I believed, and I still believe that we do need to get on with recapitalizing the fleet.

Senator TALENT. Because this seems to me to be very important. The first scenario reflects one level of culpability as far as I am concerned. The second, to knowingly try and push through a program that would cost the government $23.5 billion that you did not think we needed to spend, given the other needs that are being unmet, that to me indicates a whole different level of culpability.

Thank you, Mr. Chairman.

Chairman WARNER. Thank you, Senator.

Senator Talent, I want to pursue your line of questions. I had intended to do it in my second round, to General Jumper. General, we have known each other quite well for a number of years and you have had a very long and distinguished career serving this Nation as a uniformed officer and you go out, whenever that retirement comes, holding your head high. But, I think here at this point we should have an amplification of your own analysis of the tanker fleet, and what were the options or what options exist today? I am not suggesting you outline the future of how you think a contract could be drawn, but just generally what is the condition?

You said 70 years old for some of the tankers. That would be of what class of tankers and so forth? Some facts should be put into this record at this time, and I give you that full opportunity to do so.

General JUMPER. Thank you, Mr. Chairman. First, I want to open my remarks by saying that I agree with Senator McCain on the course that we are taking now, and that is we are on a course to an analysis of alternatives, acquisition documents that are in full compliance with the oversight that this committee and Senator McCain has highlighted, and that we are proceeding down a path

to replace and recapitalize tankers in manner that is suitable to this committee.

My view when I came on board was that we were looking at a tanker fleet—and I was focused at that time from a requirements point of view on the oldest KC–135Es, which at the time were some 43 years old, and the need to begin recapitalization on that oldest tanker fleet. We were looking at increased costs of maintenance man-hours per flying hour and, as I said, a great surge in activity, and a strategy that was a part of the DOD's strategy—that was a new global strategy—that would put great demands on these tankers.

As a matter of fact, within a month of my taking office after 9–11 we were at war in Afghanistan, where everything that went into that country had to go in by air. Every fighter that flew off of an aircraft carrier deck refueled off an Air Force tanker on the way in and on the way out.

Chairman WARNER. Sometimes three and four times.

General JUMPER. Yes, sir.

From Diego Garcia, bombers even today continue to fly missions, and the demands on the tanker fleet have been enormous, a some 33-percent increase in that fleet.

So what we saw at the time was, in October, I visited Tinker Air Force Base just to confirm what I had been told at my own inquiry about the aging of the tanker fleet. What I saw there was, quite frankly, of concern to me. There were aging aircraft problems that I thought needed to be addressed.

Chairman WARNER. Some of them 70 years old?

General JUMPER. Well, sir, they are 40 years old now, but if we begin recapitalizing at what was a reasonable rate—and I used the C–17 as an example. We buy about 15 of those a year. If we begin recapitalizing this tanker fleet, which is more than 400 aircraft, at 15 a year, we are going to be flying some of these KC–135s when they are 70 years old.

Chairman WARNER. That clarifies. Nothing today is 70 years old.

General JUMPER. Nothing today is 70, 45 years old is the average of the KC–135Es today.

My judgment was and my recommendation was at the time that we begin recapitalizing as quickly as we can. I had no method in mind when the lease proposal was advanced. As a matter of fact, I think I am even on record in the IG report as saying that this method may not be acceptable and if it is not we still need to get on with a recapitalization effort, especially with the oldest tankers.

I am in the position now, Mr. Chairman, as we look forward—and this is again at the suggestion of Senator McCain—that we not look at just the oldest KC–135 fleet now, the E fleet, the oldest ones, but the entire fleet and, with the global demands that we will face in the future, we take a look at replacing the entire fleet, and how to recapitalize the large airplanes, the KC–10s, as well as the KC–135Rs and the KC–135Es, and determine the best way to go forward.

I think the analysis of alternatives, which comes out in August, will give us some insight as to how we might go about that.

That was my thought process at the time, sir. I never had it in mind to do anything that was not beneficial to this Nation, to the taxpayer, to the United States Air Force.

Chairman WARNER. Knowing you as I do, I am confident of that case. But, we should close out your testimony here this morning with reference to the men and women who fly these aircraft and the crews who service them. There is an inherent risk, as you know far better than I, in getting into a cockpit, whether it is a brand new airplane or one that has some 40 years of service. But do you feel today that any of the men and women involved in the tanker segment of your Department of the Air Force are taking an undue risk, personal risk, as a consequence of flying some of these aircraft?

General JUMPER. Mr. Chairman, I will tell you, as has been pointed out, that the maintainers we have in the Air Force are the Nation's finest maintenance personnel, and they do a magnificent job keeping these old airplanes flying as they do. But, I must tell you that if I lose sleep over anything, it is the condition of our aging fleet in general and of the KC–135Es in particular. That does worry me. I do not think that we are in any catastrophic risk at this point, but we have a situation now where 29 of our oldest KC–135Es are not flying because of problems, which we need to address. Senator McCain has pointed this out. We are finding ways to address this problem.

I would not let any of them fly, sir, if I thought they were at any catastrophic risk.

Chairman WARNER. That is fine.

General JUMPER. But, I am worried.

Chairman WARNER. I am glad to get that reassurance.

Secretary Wynne, we would like to give you this opportunity, now that you have heard a good deal of testimony, to perhaps make some opening observations yourself, and then I have a question for you.

STATEMENT OF HON. MICHAEL W. WYNNE, UNDER SECRETARY OF DEFENSE FOR ACQUISITION, TECHNOLOGY, AND LOGISTICS

Mr. WYNNE. Thank you very much, Senator Warner, and thank you very much, Senator Levin and Senator McCain, for the opportunity to appear before you.

I would like to start, frankly, by thanking Senator McCain for his persistence, because the exposure of wrongdoing inside of an acquisition system that is respected by all of us, was shocking. We thought we had an employment situation. In fact, we were all generating as much as we can for educating our people about employment, ethics in employment searching. Then suddenly we had yet another issue of wrongdoing, and this was so stunning that I partnered with the Inspector General and the GAO to try to resolve the issues, and have sent letters on ethics to all of the commanders of acquisition personnel to restore, as Secretary England said, the acquisition professionalism.

I would tell you that without the persistence and doggedness of the investigation Senator McCain put forward I just do not think

that this would have been discovered. I think in that regard we owe him a debt of gratitude.

Second, it has been indicated that I in fact allowed continued debate on the subject of the tankers, and I stand ready to accept that as a responsibility. I think the debate that has gone on has been painful but healthy. The fact is that in the July hearing in front of the House Armed Services Committee the GAO in fact stood by their 1996 report that said that we needed to address the tanker issue as soon as possible. Therefore, I felt like the debate on this particular approach to it should continue and should in fact resolve.

I was fully led to believe and passed on to the OMB my belief that the Secretary in fact had made the decision. In fact, as I think Senator Levin read in the letter——

Chairman WARNER. You are referring to the "Secretary." Do you mean the Secretary of the Air Force or the Secretary of Defense?

Mr. WYNNE. Secretary of Defense. When I said the Secretary of Defense had made the decision, I guess I was given that aura by Secretary Aldridge or I would not have put it in a letter like that. I am pretty careful about stuff like that.

So, I would tell you that the process, if you will, that has gone on, though painful, has in fact altered, I would tell you, the culture. We have made very significant changes in all three services to try to restore cross-checks that I think are valuable. I have strengthened internal controls to make sure of those cross-checks, and I have gone a long way, I think, to restoring the acquisition with integrity that is and has been my number one goal.

I do believe, as General Jumper said, that at some point we have to in fact recapitalize this tanker fleet. I also will tell you that I commissioned investigation after investigation to try to surface the actual fleet condition, and I could not get a response from anyone until approximately April 2004, which was a Defense Science Board report on the tanker condition. Then August 2004 came the Center for Naval Analyses report on corrosion, which gave me, if you will, the opportunity to speak out about the fact that the conditions for urgency were perhaps not as present as they were thought to be and that we could go into a full-blown analysis of alternatives and attempt to have free and open competition, to include, frankly, commercial providers and to include the opportunity for redoing.

I also reviewed the Tinker data, spoke personally to the Tinker commander, and frankly the Tinker maintenance people had turned a corner in late 2002 and were in fact performing magnificently to restore these tankers to a much shorter, if you will, expected life—or a much longer expected life than I had been previously led to believe.

So all of those features would tell you that it is the old story of, had I known now what I knew then, I might have been a little bit more responsive, if you will, to the IGs.

The other thing that I would like to say to you, sir, is that I partnered with the IG early on and in each case had tried to get their investigators to help me to understand the content and the efficacy of the lease itself. As Secretary England pointed out, we were using the Inspector General at each step of the way to make sure that we stayed very much within the laws of the United

States of America, which we are all beholden to. In fact, we are all beholden to you all for the oversight that you have provided.

That, sir, concludes my comment.

Chairman WARNER. One final question, then I yield to my colleagues here. You said you tried and tried to get a better analysis of the aging problems to corroborate the need to move forward with this rather dramatic concept as it was in its early stages. Did you not ever go in to the Secretary of Defense and say, hey, boss, look, I am not getting cooperation down here; give me a little leverage?

That is the way we used to work it when I was there. I always had access to the Secretary and the Deputy Secretary and I would go down and push other people around and get a job done. Why did you not do that?

Mr. WYNNE. It was the quality of the data that was collected. In fact, what I tried to do was to institute methods of data collection that would give me access to critical componentry, because the fear at least that was promulgated to me was that the corrosion was not just surface corrosion, but in fact depth corrosion. So, I asked and I did not get, if you will——

Chairman WARNER. Who were you asking? Who were you asking for the information? Department of the Air Force?

Mr. WYNNE. Department of the Air Force, and ultimately I asked the Tinker commander.

Chairman WARNER. All right. Well, let us let the record stand.

But let me ask you this, then. You were Mr. Aldridge's deputy and you raised concerns about the price of the lease and the need to conduct an analysis of the alternatives. However, the IG then stated you were accountable because you did not overturn your former boss's decision and make the Air Force comply with the DOD acquisition directives once you became Acting Under Secretary. Do you accept that finding?

Mr. WYNNE. What I would accept is that I chose not to overturn the Secretary of Defense's decision, which I was led to believe was his decision to make.

Chairman WARNER. Aldridge led you to believe that?

Mr. WYNNE. Yes, sir. That is the way that it was written out.

I would say that the debate was just starting. I was in fact convinceable that there was an urgent need. I was just not happy with the settlement that had occurred and the price. It is quite on the record that I would have preferred a much lower valuation. In fact, I was the one who commissioned the Institute for Defense Analysis price evaluation to begin with. I naturally would stand behind their evaluation.

That having been said, at the same House Armed Services Committee hearing that I was at there was somebody from the used airplane business and he said that you can never rely on the pricing unless you are intending to buy an airplane. This gave me pause as to what I knew or what I should have known. But I pushed and prodded for a different configuration. I wanted to replace the tanker capability, but the Air Force actually wanted to have a multi-mission airplane, which I have some respect for that. So, all my attempts at essentially changing the configuration to result in a lower price were not accepted.

Chairman WARNER. I thank the colleagues for the indulgence. I felt this witness is entitled to an opportunity to state his case.

Senator Levin.

Senator LEVIN. Thank you, Mr. Chairman.

You wrote the Director of OMB on May 28, 2003, that the Secretary of Defense had approved the Air Force's proposal to enter into the lease and that the Secretary had approved the lease proposal contingent on securing a waiver of the requirement to fund termination liability and approval from your office.

Mr. WYNNE. Yes, sir.

Senator LEVIN. That is correct, so that was your understanding?

Mr. WYNNE. Yes, sir.

Senator LEVIN. And still is your understanding?

Mr. WYNNE. Yes, sir.

Senator LEVIN. I want to go back, Mr. Schmitz, now to the report. You list General Jumper as being accountable for something here and I want to read your report and then I want to ask you, General. "DOD and Air Force acquisition officials determined that an urgent and compelling need existed to accelerate the recapitalization." Then you write: "Independent reviews and other testimony on the tanker aircraft fleet, such as the Defense Science Board, did not support the need to accelerate the recapitalization of the tanker fleet. General Jumper, Chief of Staff of the Air Force, was accountable for supporting the Air Force sense of urgency to initiate the lease."

Now, I do not know why we should hold General Jumper accountable for disagreeing or reaching a different conclusion than the Defense Science Board on the urgency of a tanker lease program, unless you believe he did not hold that in good faith. Senior military officials like the Air Force Chief of Staff are expected to offer their best military judgment on issues of this, regardless of what others may think, and that was and is an honestly held statement. I think all of us know General Jumper and that was his honestly held belief.

You think he should not pursue his honestly held belief because the Defense Science Board reaches a different conclusion on the urgency?

Mr. SCHMITZ. No, sir.

Chairman WARNER. Your response was not recorded.

Mr. SCHMITZ. No, sir.

Senator LEVIN. Now, if you'll take a look at page 188 of the report. There is a January 30, 2003, e-mail from General Jumper to Dr. Roche in which he—in which, according to the IG report, "General Jumper discussed"—redacted, somebody's—"interest in the tanker aircraft lease."

The Inspector General has redacted the text of that e-mail, so we do not know who that official was in the White House, whether the official directed, approved, condoned, supported, or whatever the actions which the report suggests that the Office of the Secretary of Defense and Air Force officials should be held responsible.

As I have expressed before, it seems to me obvious that the actions and directions of senior officials have a direct bearing on the responsibility of their subordinates for actions that they have taken. Do you disagree with that, Mr. Schmitz?

Mr. SCHMITZ. I agree with that, sir.

Senator LEVIN. Now, General Jumper, would you describe for us what is totally redacted on that page? Apparently still is redacted; is that correct? It still is redacted. We still do not have that in the back room or anywhere else. So what was in that e-mail?

General JUMPER. Senator Levin, sir, I am not aware of the status of redacted material and how I am able to respond to material that has been redacted. I have to ask the IG.

Chairman WARNER. These are matters I think we should exercise an abundance of care, and so that perhaps we could reserve that question for the executive session.

Senator LEVIN. I am going to follow the chairman's lead, obviously. I do think at a minimum we should get this document. Like all the other White House redactions, we have got to have that document unless they exercise executive privilege, Mr. Chairman, and they have not done that.

Chairman WARNER. Understood very clearly.

Senator LEVIN. Mr. Schmitz, since you agree with me that whether or not superior, people who are in superior positions decisions on matters should be taken into consideration when looking at the judgment of people who execute those decisions, did you interview White House and OMB officials about the role that they played in the tanker lease program?

Mr. SCHMITZ. We did not interview OMB and White House officials. I think I mentioned that in my opening statement.

Senator LEVIN. You did.

Just one other question, Mr. Schmitz. I believe in response to the chairman's question, but in any event in response to a question here this morning, you indicated that there is a pending review of a possible criminal matter and that you did not want to refer to that; is that correct?

Mr. SCHMITZ. Yes. You sent it to me, sir.

Senator LEVIN. Was that my question?

Chairman WARNER. It was my question.

Mr. SCHMITZ. The chairman's question.

Chairman WARNER. We will have clarification in the executive session.

Senator LEVIN. No, that is understood. I want to set that aside. That is not what I am referring to in my next question.

My next question is whether or not, Mr. Schmitz, you have ever declined a recommendation by your senior staff to initiate a criminal investigation of DOD officials relative to the tanker lease matter other than the one matter you referred to in response to the chairman's question?

Mr. SCHMITZ. I do not recall ever declining a recommendation of my staff in the tanker matter to investigate anybody.

Senator LEVIN. So, Mr. Gimble, do you have a different recollection of that?

Mr. GIMBLE. I do not have a different recollection to that.

Senator LEVIN. We are talking here now about whether or not there was a recommendation by senior staff to initiate a criminal investigation of DOD officials; is that correct? That is what you are responding to?

Mr. SCHMITZ. Yes, sir, in the tanker matter.

Senator LEVIN. Yes, relative to the tanker lease.

That is what you are responding to, Mr. Gimble?

Mr. GIMBLE. Yes, sir.

Senator LEVIN. Thank you.

Thank you, Mr. Chairman.

Chairman WARNER. Senator McCain.

Senator MCCAIN. Secretary Wynne, I would like to thank you for your remarks and your assumption of responsibilities. I have dealt with you for many years and I have found you to be a hardworking, honest, American citizen who has done a fine job, and I thank you for your comments.

Mr. Chairman, I do not want to prolong this part of the hearing. I just briefly would like to say, in response to Senator Talent's question, I do not think it is black and white. I think, as Mr. Schmitz said, there was some obvious wrongdoing, as evidenced by Ms. Druyun's conviction. I also believe that there was other mistakes made in the zeal to acquire this new tanker, which I think all of us agree is necessary, which led to a violation of standard practices which have been in place for good reasons, such as analysis of alternatives. The operational readiness document (ORD) was corrupted by removing the requirement for capability, at least in the initial phase, for refueling of Navy and Marine Corps aircraft. The GAO and Congressional Budget Office estimates that it would cost as much as $6 to $7 billion more to lease rather than to buy were ignored.

There was active lobbying here before this committee. A general volunteered before this committee without being asked his personal opinion about how badly tanker aircraft were needed. Documents from Tinker Air Force Base were tailored to present different statistics concerning maintenance of the KC–135.

The list goes on and on, and it became cumulative into a very regrettable experience. I am glad that Secretary England and the other witnesses have committed to changing the culture. Our job I think is to make sure that that happens. I take them at their word. These are honorable citizens who are making this commitment, and I look forward to moving forward.

Thank you, Mr. Chairman.

Chairman WARNER. Thank you, Senator.

Senator Levin, do you have any more?

Senator LEVIN. No.

Chairman WARNER. I think at this point, given the lateness of the hour, that we will terminate this open session, and hopefully by 11:45 we can resume in room 222 in executive session.

[Whereupon, at 11:30 a.m., the committee adjourned.]

○