M-100103

Congressional Research Service

Memorandum October 1, 2003

TO: Senate Commerce Committee
Attention: Pablo Carrillo

FROM: Christopher Bolkcom and Ronald O'Rourke
Specialists in National Defense
Foreign Affairs, Defense, & Trade Division

SUBJECT: Observations on DoD KC-767 Lease vs Buy Scenarios

This memo is in response to your September 25, 2003 request for an assessment of DoD's September 22, 2003 letter to Senators Warner and Levin regarding the proposed KC-767 lease. This memo addresses the acquisition options that DoD considered, an additional option that it did not consider, and DoD's response to Senator Warner's and Senator Levin's request for a "thorough assessment" of the KC-135 corrosion problems. Please contact us at 7-2577 (Christopher) or 7-7610 (Ron) if you have any questions or if we can be of additional assistance on this matter.

DoD Buy-Down Commitment

In its September 22, 2003 letter to the Senate Armed Services Committee, DoD compares the total costs, Future Year Defense Plan (FYDP) costs, and delivery schedule for six different options to acquire 100 Boeing KC-767 aircraft. In this comparison, DoD confirms the assessment of CRS and other agencies that leasing 100 KC-767s will likely cost approximately $5.5 billion more than a straight purchase.

In its September 22nd letter, DoD proposes to execute the lease contract now, but invest $2.4 billion in FY08-10 to purchase 26 KC-767s. This proposal elicits at least two observations. First, by expressing a desire to purchase 26 aircraft rather than lease all 100 aircraft, DoD appears to lend credence to the argument of lease critics that the original lease proposal was in fact a capital lease, or a "lease-purchase," and that purchasing these aircraft would be a more appropriate acquisition vehicle. Second, DoD's stated commitment to "buy down the outyear bow wave," may not be dependable. Neither DoD nor the Air Force has total control over their budgets. There is no guarantee that future Congresses will give DoD the funds to purchase these aircraft. Also, DoD's letter does not provide any information on how it would strive to make these funds available. Which Air Force programs would be canceled or curtailed to finance the $2.4 billion purchase? A detailed plan for making $2.4

billion available in the FY2008-FY2010 time frame would add additional clarity to DoD's stated commitment.

Incrementally Funded Multiyear Procurement Option

The September 22 DoD letter-report to Senators Warner and Levin does not address an alternative 767 acquisition strategy that is presented in the recent CRS Report (RL32056)[1] on the proposed 767 lease – the option of an incrementally funded multiyear procurement (MYP), perhaps with a delayed or eliminated economic order quantity (EOQ) purchase. This option is discussed on pages 38-44 of CRS report RL32056.

An incrementally funded MYP, perhaps with a delayed or eliminated EOQ purchase, represents a potential way to procure (rather than lease) the 767s while (1) delivering the 767s to the Air Force on the same schedule as the lease, (2) reducing the near-term funding requirements normally associated with a procurement and (3) capturing at least some of the savings (in constant dollars) normally associated with MYP.

MYP is a special contracting authority that Congress grants sparingly, to only a few DoD acquisition programs. Programs with MYP authority are permitted to make up-front EOQ purchases. Basic features of MYP, including EOQ purchases, are described in Appendix C (pages 78-82) of CRS Report RL30256. Compared to a regular procurement, using MYP can reduce a program's total procurement cost by 5%-10%. (The Air Force report to Congress assumes a 7.4% savings in the case of the 767 acquisition.) Using EOQ is one of the ways that MYP reduces total procurement costs. Delaying or eliminating the up-front EOQ purchase would reduce the savings achieved by MYP, perhaps by half, to 2.5%-5%.

Incremental funding is a potential alternative to full funding. Under full funding, the entire procurement cost of an item is provided up front, in the year the item is procured. Under incremental funding, the procurement cost of the item is provided in a series of annually approved increments that reflect the service's annual requirements for making progress payments to the contractor while the item is under construction. The full funding policy for DoD procurement, which Congress imposed on DoD in the 1950s, normally requires DoD procurement programs to use full funding rather than incremental funding. The full funding policy is discussed further in another CRS report.[2] Procuring the 767s with incremental funding would require more near-term funding than the proposed lease, but less near-term funding than a regular procurement.

An incrementally funded MYP would represent a departure from normal DoD procurement procedures in terms of both using incremental funding and applying MYP to a procurement program at the outset of the program. As discussed in CRS report RL32056, however, some recent DoD acquisition programs offer potential precedents for using incremental funding or for using MYP on the 767 acquisition. (Indeed, since September 2, 2003, when CRS report RL32056 was published, the House and Senate Appropriations

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[1] *The Air Force KC-767 Tanker Lease Proposal: Key Issues For Congress.* September 2, 2003. Christopher Bolkcom, Coordinator.

[2] CRS Report RL31404, *Defense Procurement: Full Funding Policy – Background, Issues, and Options for Congress*, by Ronald O'Rourke and Stephen Daggett. Washington, 2002. (Updated November 21, 2002) 41 p.

Committees have agreed to grant MYP authority to the Virginia-class submarine program, which is seen as strengthening the case for viewing the Virginia-class program as a precedent for using MYP on the 767 acquisition.)

An incrementally funded MYP, by combining precedents for both use of incremental funding and use of MYP at the start of a program, would arguably represent more of a departure from previous DoD acquisition practices than the other DoD programs mentioned in CRS Report RL30256. It could also be argued, however, that an incrementally funded MYP would represent no more of a departure, and perhaps less of a departure, from previous DoD acquisition practices than the proposed lease.[3]

The chart below summarizes how the option of an incrementally funded MYP (the shaded cells), would differ from other procurement approaches.

Table 1. Procurement Options: Basic Features

Option	Contracting method		Funding method		Up-front EOQ purchase?	Reduces near-term funding requirement?	Average per-plane procurement cost (Constant $)
	Annual	Multiyear	Full funding	Incremental funding			
(1) Regular procurement	X		X		No – not allowed*	No	Baseline
(2) Multiyear procurement (MYP)		X	X		Yes	No	5%-10% less
(3) Incrementally funded procurement	X			X	No – not allowed*	Yes	Baseline
[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]

Table 1 prepared by CRS

* EOQ purchases allowed only under MYP.

** EOQ purchase permitted, but delayed or eliminated to further reduce near-term funding requirements.

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[3] The Air Force, in its FY2003 budget submission presented to Congress in February 2002, proposed a funding profile for the C-17 aircraft program (which had been granted MYP authority by Congress the previous year) that many observers viewed as a form of incremental funding. This funding profile, if approved, would have made the C-17 program, in the eyes of these observers, an incrementally funded MYP program. Congress, in acting on the FY2003 Air Force budget, did not approve the Air Force proposal and affirmed the requirement for using full funding on MYP programs. It could be argued, however, that Congress, by approving the legislation permitting the proposed 767 lease, signaled that in the case of the 767 acquisition, it is prepared to consider novel acquisition approaches.

Table 2 below shows the approximate comparative funding requirements, in current (i.e., then-year) dollars, of options (1) and (5) in the table above – the regular procurement option and an incrementally funded multiyear procurement without an up-front EOQ purchase. The figures shown in Table 2 are rough, notional estimates intended solely for illustrating broad changes in annual funding requirements for the two options.

Both estimates assume that the 100 planes are procured in annual quantities of 4, 16, 20, 20, 20, and 20, starting in FY2006 – a procurement profile that the Air Force says would deliver the planes to the Air Force on the same schedule as the proposed lease. Both estimates include a total of about $900 million in non-recurring engineering (NRE) costs in FY2006 and FY2007, divided somewhat equally between the two years.

For the regular procurement option, a 15/85 funding profile was used. That is, 15% of the procurement cost of each plane was provided as advance procurement (AP) funding in the year prior to the year of procurement, the remaining 85% was provided in the year of procurement, and no funding was required in any subsequent years. For the incrementally funded MYP option, a 15/30/30/25 funding profile was used. That is, 15% was provided as AP funding in the year prior to procurement, 30% was provided in the year of procurement, another 30% was provided the year after procurement, and the remaining 25% was provided the year after that.

The calculation assumed that applying MYP without use of an up-front EOQ purchase would reduce procurement costs by 3.7%, or half the 7.4% figure from the Air Force's July 11, 2003 report to Congress. For option (1), the average cost per plane was $141 million in constant FY2002 dollars. For option (5), it is 3.7% less, or $138.5 million in constant FY2002 dollars. (A 7.4% reduction would have resulted in a price of $130.6 million per plane in constant FY21002 dollars.) Both estimates used a 93.8% learning curve to achieve these average cost-per-plane figures. This is the same learning curve used in the Air Force model.

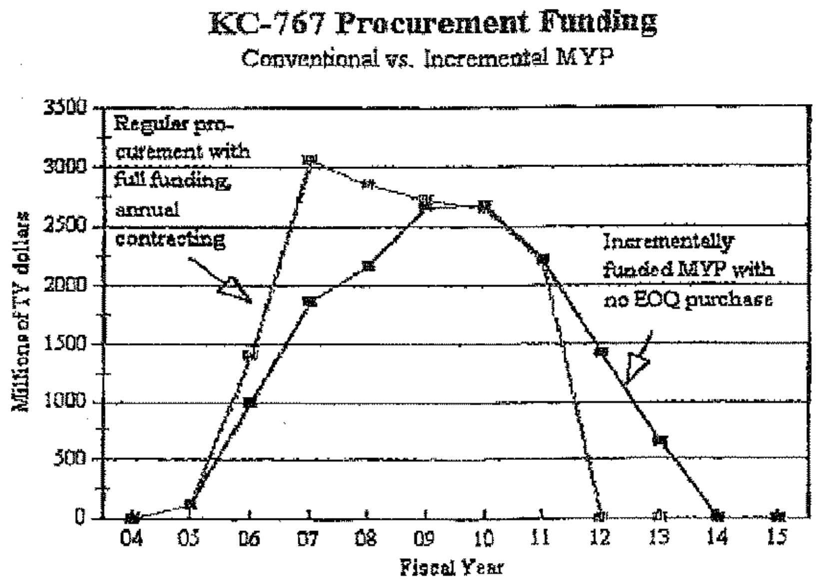
These estimated funding requirements are for illustrative purposes only and are not intended for direct comparison with cost estimates provided in the September 22 DoD letter-report or the recent CBO report on the proposed 767 lease. If desired, the Air Force, CBO, or perhaps CRS could develop more precise estimates of the annual funding requirements of these two options.

Table 2. Estimated Annual Funding Requirements
Regular procurement (fully funded, annually contracted)
vs. incrementally funded MYP with no up-front EOQ
(millions of then-year dollars, rounded to nearest million)

Fiscal Year	Options		Option (5) vs. Option (1)	
	(1) Regular procurement with full funding and annual contracting	(5) Incrementally funded MYP with no EOQ	Difference	Option (5) as % of Option (1)
04	0	0	0	n/a
05	115	113	(2)	98%
06	1,492	1,053	(439)	71%
07	3,304	2,020	(1,283)	61%
08	3,141	2,389	(752)	76%
09	3,056	2,983	(73)	98%
Subtotal FY04-09	*11,107*	*8,558*	*(2,549)*	*77%*
10	3,037	3,073	36	101%
11	2,592	2,609	16	101%
12	0	1,705	1,705	n/a
13	0	785	785	n/a
14	0	0	0	n/a
15	0	0	0	n/a
Subtotal FY10-15	*5,629*	*8,172*	*2,543*	*145%*
Total	16,736	16,730	(6)	100%

Source: CRS estimates based on U.S. Air Force data.

As can be seen in the Table 2, compared to option (1), option (5) might reduce total funding requirements through FY2009 – the final year of the current (FY2004-FY2009) Future Years Defense Plan (FYDP) – by about \$2.5 billion, or about 23%. The relatively minor funding requirement for FY2005 would remain essentially unchanged, as would the substantial funding requirement for FY2009, while the funding requirements for FY2006, FY2007, and FY2008 would be reduced by about 29%, 39%, and 24%, respectively. Most of the additional funding required by option (1) during this period would be effectively deferred under option (5) until FY2012 and FY2013. Although the average cost per aircraft is 3.7% less in constant FY2002 dollars under option (5), the two options have essentially equal total then-year costs through FY2015 because of the inclusion of the NRE costs in both options and because option (5), by deferring funding requirements from earlier years to later years, is affected more by inflation in converting from constant dollars to then-year dollars. Figure 1 below shows the same data in graph form.



Prepared by CRS, September 2003, based on U.S. Air Force data.

Corrosion

In its September 22, 2003 letter, DoD does not provide the thorough corrosion analysis requested by the Senate Armed Services Committee. Instead, the letter reiterates the previously stated DoD position that corrosion is the KC-135s' life limiting factor, and that DoD fears an unpredictable fleet-wide grounding incident caused by corrosion. This unpredictability, the Air Force argues, makes the Air Force's need to replace the KC-135 urgent. Leasing the KC-767, the Air Force says, satisfies this urgent need better than does a purchase.

As noted in CRS report RL32056, other military services do not consider corrosion to be unpredictable. The Navy, for example, states that corrosion is a "known problem" that it takes "proactive steps" to mitigate. Internal Air Force documents suggest a level of competence in addressing corrosion that appears to be inconsistent with a statement in the September 22, 2003 DoD letter regarding the "unforeseeable effects of corrosion on the aircraft." Air Force Technical Manual 1-1500-344-23 *Aircraft Weapons Systems Cleaning and Corrosion Control* appears to be a comprehensive guide to addressing corrosion. This 400-page technical manual instructs Air Force maintenance personnel on preventative maintenance (cleaning, lubrication, preservation) corrosion inspection, corrosion removal and surface treatment, sealants, paint finishes and touch-up procedures, treatment of specific aircraft areas, and emergency procedures. A copy of the technical manual's table of contents is attached to this memo and an electronic copy can be provided to you if required.

It also appears that civil authorities find aircraft corrosion to be a known and treatable problem. The Federal Aviation Administration (FAA) publishes a 224-page advisory for commercial airlines (AC 43-4A) entitled *Corrosion Control for Aircraft*. This in-depth advisory addresses corrosion theory, the effects of corrosion, corrosion-prone areas, preventative maintenance, corrosion inspection requirements, and corrosion removal techniques. The FAA corrosion advisory states that corrosion can be prevented through "a constant cycle of cleaning, inspection, operational preservation, and lubrication" (p.1).

The September 22, 2003 letter to the Senate Armed Services Committee does not discuss recent advances in corrosion identification and prevention and the effect these advances could have on mitigating KC-135 corrosion. For example, new corrosion preventative coatings (*Dinol*) have been fielded on the Navy's P-3 Orion fleet. This coating is believed to prevent 50-80 percent of corrosion.[4] The Navy has also begun fielding "powder coating facilities" at its Naval air stations, which are expected to reduce the need for periodic corrosion treatment. Also, new corrosion sensor systems are being developed using bi-metallic thin film microsensor technology to collect and store corrosion information from inaccessible parts of an aircraft that can be retrieved on demand by transmitted radio signals.

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[4] Navy News Service. "P-3 cutting corrosion, saving millions with new coating by NAVAIRSYSCOM Aircraft Division Public Affairs. NNS4204

United States Senate

COMMITTEE ON ARMED SERVICES
WASHINGTON, DC 20510

For Immediate Release
September 5, 2003

Contact: John Ullyot
202-224-6290

CHAIRMAN WARNER, RANKING MEMBER LEVIN SEND LETTER TO PENTAGON ON TANKER LEASE ISSUE

Yesterday, the Chairman of the Senate Armed Services Committee, Sen. John Warner, R-Va., and the Committee's Ranking Member, Sen. Carl Levin, R-Mich., sent the following letter to Secretary of Defense Donald Rumsfeld concerning the Air Force tanker lease issue:

September 4, 2003

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

Dear Mr. Secretary:

As you know, the Senate Armed Services Committee held a hearing today on the Department's proposed lease of 100 KC-767A tanker aircraft. There was a large attendance of members and an extensive exchange of questions and views in this hearing that lasted over three hours.

During the course of the hearing, Chairman Warner raised the option of leasing a smaller number of tanker aircraft -- up to 25 -- to address the current, short-term need for additional tankers, to be followed by a traditional procurement, not a lease, of the remaining tankers, presumably under multi-year authority. Secretary Roche said that such an option had not been considered. We would like to draw your attention to section 367 of the Senate version of National Defense Authorization Act for Fiscal Year 2004, which requires the preparation of an analysis of alternatives for the Department's aerial refueling requirements. While this language is not directly targeted at the KC-767A lease proposal, it reflects the thinking of the Senate that other alternatives should have been considered.

We request that the Department analyze the option of leasing up to 25 tanker aircraft, followed by a procurement of the remaining aircraft. Such an analysis should include an examination of the budgetary and cost implications of various options for an incremental lease-buy, including an accelerated exercise of the purchase option in the proposed lease.

Additionally, given the emphasis on an apparent corrosion problem in the existing KC-135 tanker fleet, we would appreciate your providing us with a thorough assessment of the extent of those corrosion problems and the expected cost of addressing those problems if tanker aircraft were purchased according to the previous Air Force plan instead of leased sooner as more recently proposed. Also, please provide us with a justification of the Department's decision to pay $10.3 million per aircraft more than the $120.7 million per aircraft as determined by the Institute for Defense Analysis to be a reasonable purchase price.

The Committee will await your reply prior to meeting to discuss the pending lease proposal.

With kind regards,

Sincerely,

Carl Levin
Ranking Member

John Warner
Chairman

THE DEPUTY SECRETARY OF DEFENSE

WASHINGTON, D.C. 20301

SEP 2 2 2003

The Honorable Carl Levin
Ranking Member
Senate Armed Services Committee
Washington, D.C. 20510

Dear Senator Levin:

Thank you and the Committee for your consideration of the Department of Defense's proposal to lease 100 KC-767A aircraft. We value the opportunity to analyze the merits of leasing 25 tankers and buying 75 – and to respond to a request from Senator Roberts that we consider alternatives under the existing lease proposal – as we attempt to meet the Department's critical need for air-refueling tankers. At your request, my staff has analyzed the option of leasing only the first 25 KC-767A tanker aircraft, and purchasing the remaining 75 aircraft through different mechanisms.

A summary of the new profiles, compared to the proposed 100-aircraft lease, is shown in the enclosed tables and charts. Each alternative creates different budgeting pressures that must be balanced against affordability in the near-term, the ultimate cost savings, and the timely delivery of tankers.

a. The purchase of one hundred tankers at the time of order, under the same multiyear conditions as the lease, requires an additional 13 billion dollars in the Future Years Defense Program (FYDP) but saves 5.5 billion dollars in total then-year dollars (TY$) versus the baseline lease of 100 tankers (Figure 1).

b. Alternatives that would entail the lease of 25 aircraft and then the purchase of 75 aircraft, using the proposed lease, with the purchase of 75 aircraft either at the time of the order or at the time of delivery of the aircraft, are shown in Figure 2. Purchase at the time of delivery requires a smaller increase in the FYDP, 4.6 billion dollars (TY$), but the savings versus the baseline lease are reduced to 3.5 billion dollars (TY$). Purchase before construction requires an increase in the FYDP of 11.1 billion dollars (TY$) but the savings versus the baseline lease are 4.1 billion dollars (TY$).

c. Finally, a lease of 25 tankers followed by a traditional multiyear procurement of 75 tankers requires an additional 10.5 billion dollars (TY$) in the FYDP but saves 2.7 billion dollars (TY$) versus the lease (Figure 3). The biggest drawback to this approach is the need to negotiate totally new contracts; we believe this will cause at least a one-year delay to initiate the multiyear program.

As negotiated, the proposed lease of 100 aircraft has the flexibility to be converted to a purchase, in whole or in part, at the discretion of Congress, subject to availability of funds and authorization for purchase. As mentioned above and shown in Figure 2, applying the 25/75 split profile under the proposed lease saves 3 - 4 billion dollars over the total program, but requires significant additional budget authority (4.6 - 11 billion dollars) in the FYDP.

We understand the Committee's concerns about the future affordability of the lease and, as stated in the Air Force's KC-767 report, the DoD intends to request congressional authority to buy down mid-year program expenses by identifying 2.4 billion dollars in FY08-10 (Figure 4). This would enable us to purchase 26 of the leased aircraft. While this adds expense in the FYDP, it drives down costs in FY11 through FY15 and saves approximately 1.2 billion dollars in total program costs. The alternatives are summarized in Figure 5. The optimum approach must balance the total cost of the program, the additional funds needed in the FYDP, and the delivery schedule for the new capability. We believe that to begin the lease with an agreed-upon goal of requesting funds and authority to buy leased aircraft, according to a planned schedule, would permit the Air Force to initiate tanker modernization immediately. It also would balance cost savings with the realities of funding availability.

The Department remains steadfast in its desire to begin recapitalization now. The Department proposed a KC-X procurement program in the FY04 President's Budget submission. Because of affordability constraints, the KC-X program was scheduled to begin in FY06 and would have provided for the delivery of one tanker to the warfighter in FY09; the 100[th] aircraft would have been delivered in FY16, five years after the 100[th] would be delivered under the proposed lease. The lease schedule, therefore, delivers needed capability much sooner and avoids significant costs associated with the aging KC-135E fleet.

With respect to your question concerning the corrosion of the KC-135, assessments of the aircraft's service life indicate that fatigue alone will not compel the Air Force to retire the aircraft; rather, degradation of the aircraft's structure due to corrosion is the life-limiting factor. One of our greatest concerns is a potential fleet-wide grounding event that could emerge with little or no warning because of the unforeseeable effects of corrosion on the aircraft. I believe that we cannot accept the risk of unknown systemic failures that could ground the tanker fleet and cripple the global reach of U.S. and coalition forces. With availability decreasing, and costs increasing, we see the need to recapitalize this aging system before the next unforeseeable event significantly affects the fleet.

Although the estimate of price prepared by the Institute of Defense Analyses (IDA) does not have the fidelity of a negotiated position in a commercial market, it was an important tool that we employed during final negotiations. IDA's estimate provided critical leverage to drive the final negotiated price down significantly. In addition, we included two contract provisions, the "Return-On-Sales" cap and "Most-Favored-Customer" clause, which call for third-party audits of Boeing's books every year. Should IDA's estimate prove to be correct and Boeing's profit exceed the cap, Boeing would be obligated to refund the difference to the Government. We also have guarantees from Boeing that it has never sold the 767-200ER or 767-200C (the underlying aircraft) for a lower price, and will not do so during the term of the lease. Thus, these two auditable contract provisions protect the taxpayers and ensure that we will spend their money in a responsible manner.

Executing the negotiated lease contract now enables us to begin the recapitalization of our oldest aircraft fleet immediately. The lease proposal balances the urgent needs of the warfighter with the demands of our other vital programs, while staying within our budget. It also provides the Department and Congress the flexibility to shape future budgets, as needed, through various combinations of lease and purchase, should resources be made available. We propose to execute the lease contract now and to invest 2.4 billion dollars in FY 08-10 to buy down the outyear "bow wave," as shown in the enclosed charts. This would result in the purchase of 8 aircraft in FY08, 8 in FY09, 6 in FY10, and 4 in FY11. We also commit to address the Department's investment in tankers as we formulate the President's FY05 and beyond budgets, to determine whether we can further buy down the "bow wave." Under this approach, we are committed to purchase more than 26 KC-767 tanker aircraft, as the budget permits and in close coordination with the congressional defense committees. This strategy would save the time to renegotiate the lease and to establish a second contract, and would allow the Air Force to place the full one hundred aircraft on order.

We trust that this information, along with the discussions we have had with your professional staff members over the past week, provides the information needed to consider in detail our request for a "New Start." Again, we appreciate the support that you and the Committee have provided to ensure that we make the best investment in capability for our Nation. A similar letter has been sent to Chairman Warner.

Sincerely,

Paul Wolfowitz

Enclosure:
As stated

THE DEPUTY SECRETARY OF DEFENSE

WASHINGTON, D.C. 20301

SEP 22 2003

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A summary of the new profiles, compared to the proposed 100-aircraft lease, is shown in the enclosed tables and charts. Each alternative creates different budgeting pressures that must be balanced against affordability in the near-term, the ultimate cost savings, and the timely delivery of tankers.

a. The purchase of one hundred tankers at the time of order, under the same multiyear conditions as the lease, requires an additional 13 billion dollars in the Future Years Defense Program (FYDP) but saves 5.5 billion dollars in total then-year dollars (TY$) versus the baseline lease of 100 tankers (Figure 1). FYDP > 13 Savs 5.5

b. Alternatives that would entail the lease of 25 aircraft and then the purchase of 75 aircraft, using the proposed lease, with the purchase of 75 aircraft either at the time of the order or at the time of delivery of the aircraft, are shown in Figure 2. Purchase at the time of delivery requires a smaller increase in the FYDP, 4.6 billion dollars (TY$), but the savings versus the baseline lease are reduced to 3.5 billion dollars (TY$). Purchase before construction requires an increase in the FYDP of 11.1 billion dollars (TY$) but the savings versus the baseline lease are 4.1 billion dollars (TY$). FYDP > 4.6 Savs 3.5

c. Finally, a lease of 25 tankers followed by a traditional multiyear procurement of 75 tankers requires an additional 10.5 billion dollars (TY$) in the FYDP but saves 2.7 billion dollars (TY$) versus the lease (Figure 3). The biggest FYDP > 10.5 Savs . 2.7

drawback to this approach is the need to negotiate totally new contracts; we believe this will cause at least a one-year delay to initiate the multiyear program.

As negotiated, the proposed lease of 100 aircraft has the flexibility to be converted to a purchase, in whole or in part, at the discretion of Congress, subject to availability of funds and authorization for purchase. As mentioned above and shown in Figure 2, applying the 25-75 split profile under the proposed lease saves 3 - 4 billion dollars over the total program, but requires significant additional budget authority (4.6 - 11 billion dollars) in the FYDP.

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Preferred Option?

The Department remains steadfast in its desire to begin recapitalization now. The Department proposed a KC-X procurement program in the FY04 President's Budget submission. Because of affordability constraints, the KC-X program was scheduled to begin in FY06 and would have provided for the delivery of one tanker to the warfighter in FY09; the 100th aircraft would have been delivered in FY16, five years after the 100th would be delivered under the proposed lease. The lease schedule, therefore, delivers needed capability much sooner and avoids significant costs associated with the aging KC-135E fleet.

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This is it? No New analysis. Just repeat of past statement

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Sincerely,

Paul Wolfowitz

Enclosure:
As stated

Budget Authority Requirements

Total Program

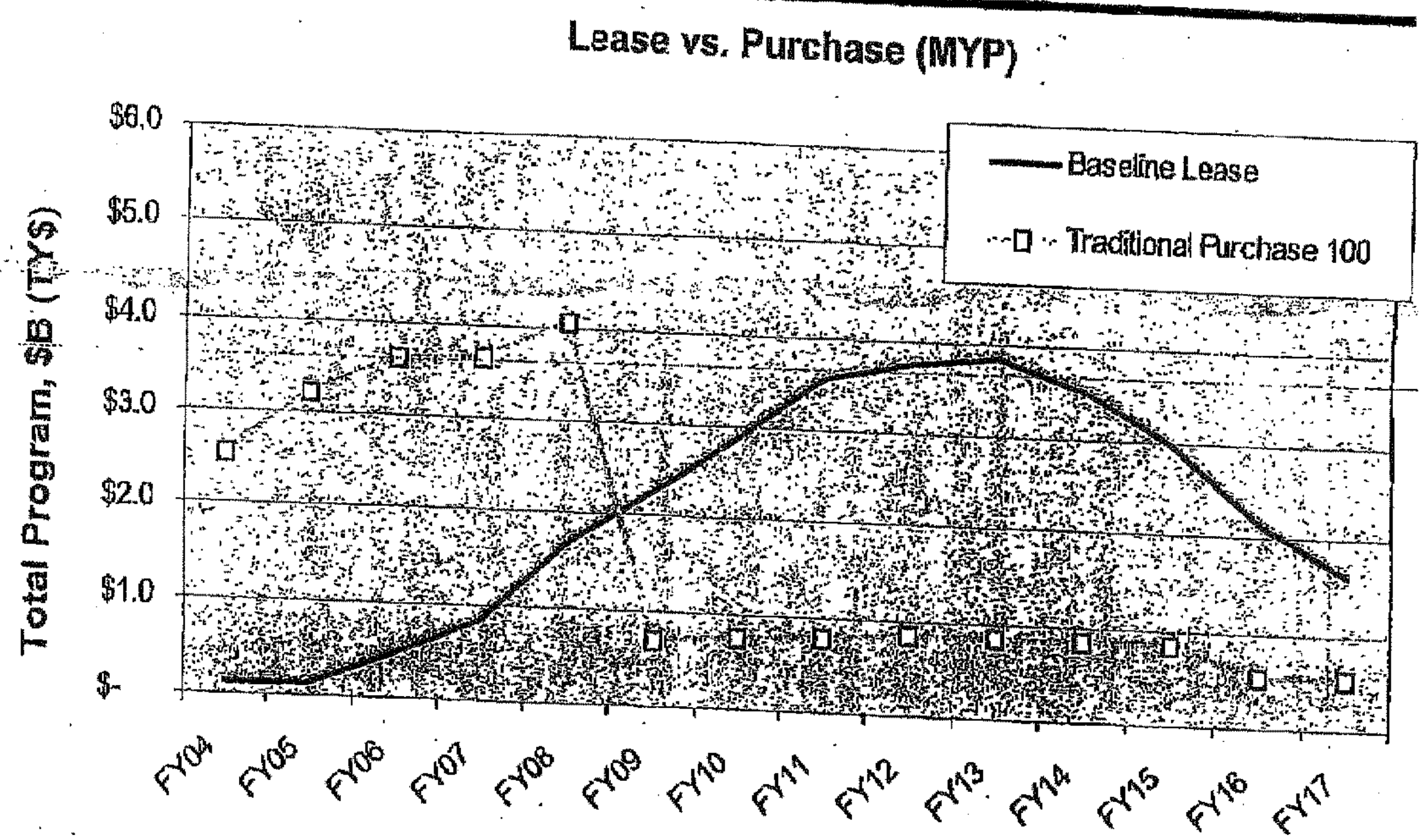
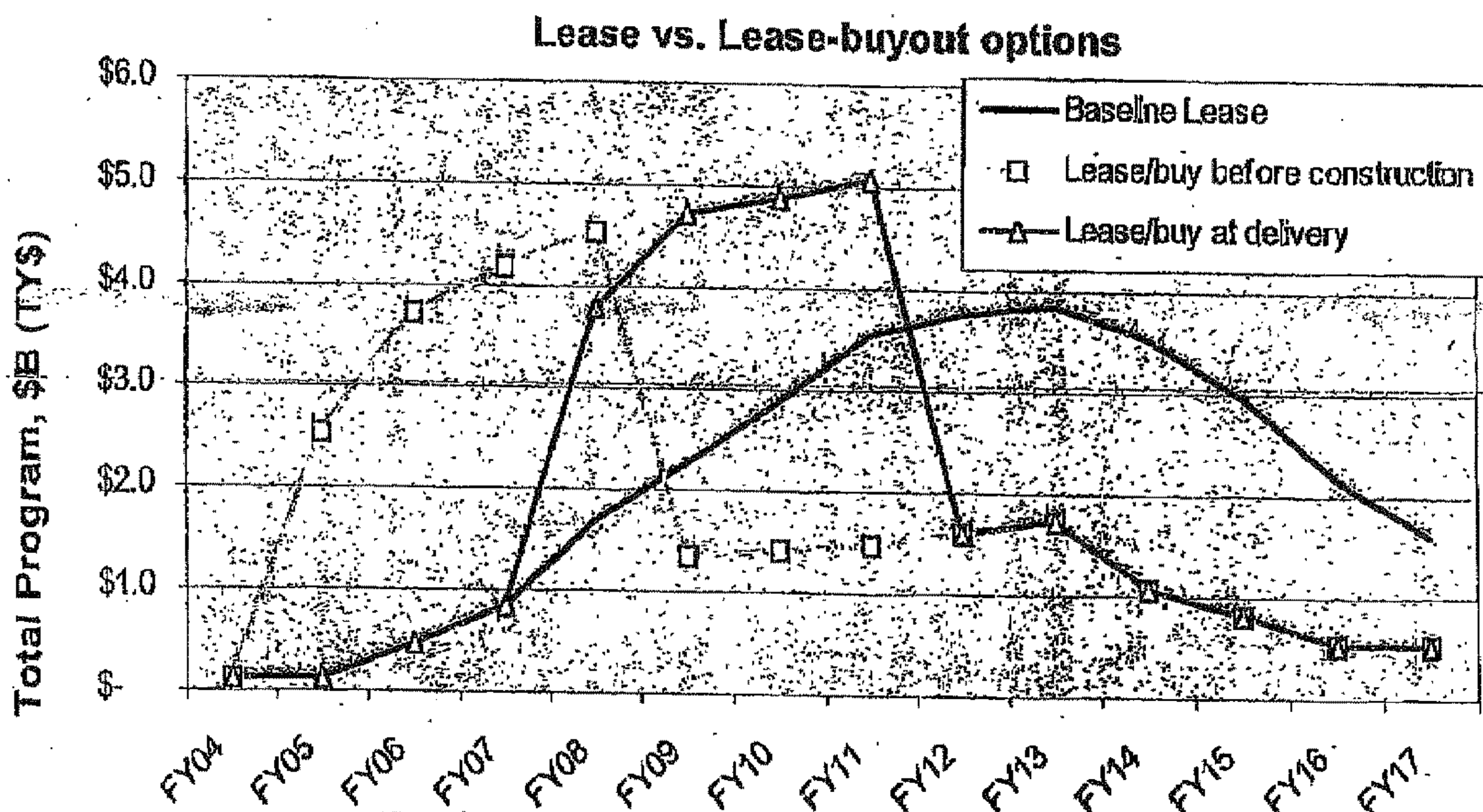


Figure 1

Budget Authority Requirements

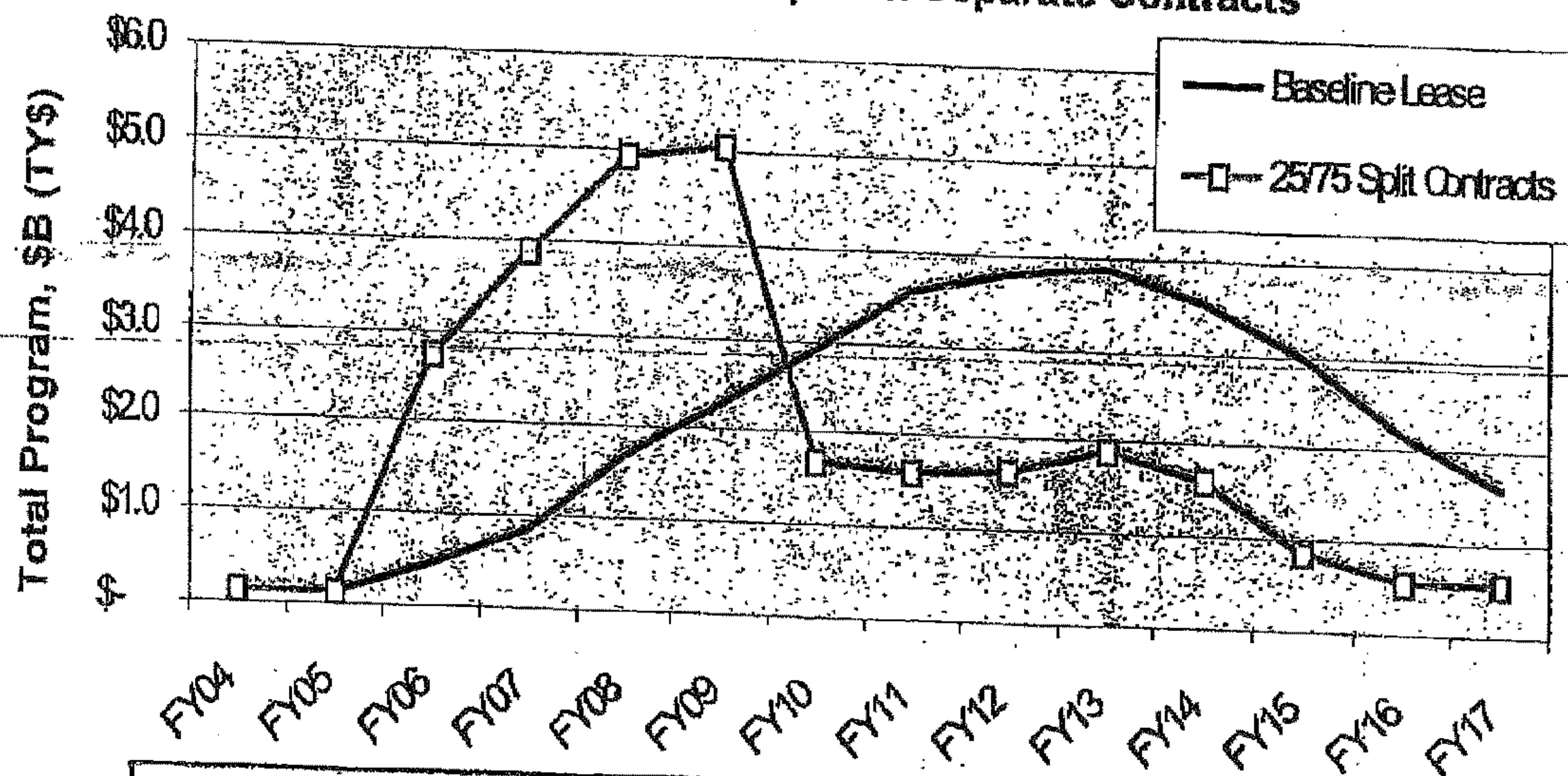


- Execute current lease contract
- Lease first 25 -- Buy remaining 75
- Maintains lease delivery schedule

Figure 2

Budget Authority Requirements

Lease vs. 25/75 Split on Separate Contracts

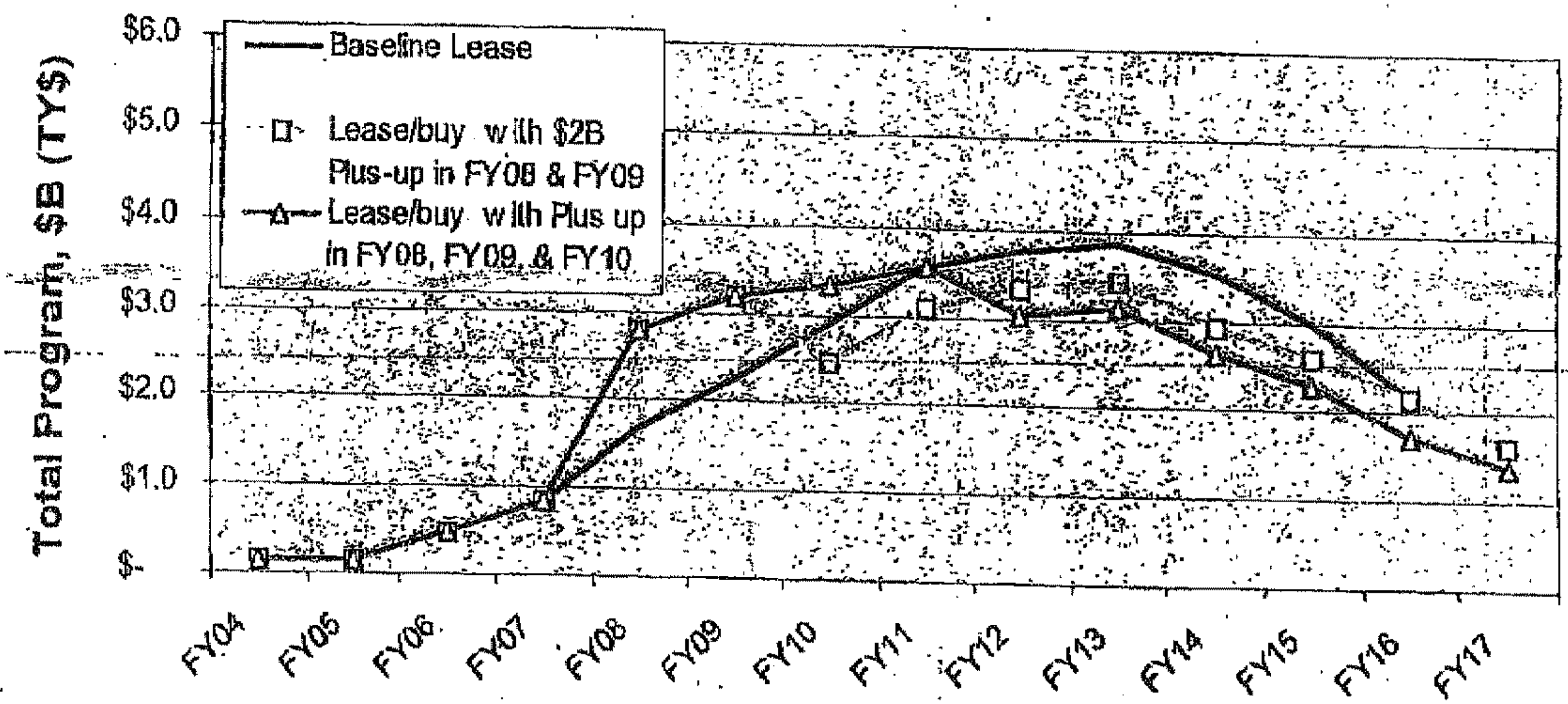


- Lease 25 on contract similar to current -- higher unit cost
- Buy 75 on traditional MYP contract
- Will delay initial program start by 10 months -- requires negotiation start for 2 new contracts

Figure 3

Budget Authority Requirements

Total Program



- Current lease contract with $1.1B add in FY08, $0.9B in FY09, $0.4B in FY10
- Match FY11 funding, and realize savings in FY12
- Buys 8 in FY08, 8 in FY09, 6 in FY10, and 4 in FY11
- Saves $1.2B (TY$) over the baseline lease total program

- Current lease contract with $1.1B add in FY08, $0.9B in FY09
- Begin to realize savings in FY10
- Buys 6 in FY08 and 8 in FY09
- Saves $0.8B (TY$) over the baseline lease total program

Figure 4

Alternate Profiles

Alternative Description	FYDP $ TY $B	Total $ TY $B	Delivered in FYDP	Comments
Lease 100	$5.5B	$29.6B	60	Execute lease for 100 planes according to current terms and conditions
Lease 25/Buy 75 Budget for Purchase @ Order	$16.6B	$25.6B	60	Assumes same unit price; requires Congressional approval to lease and purchase
Lease 25/Buy 75 Budget for Purchase @ delivery	$10.1B	$26.3B	60	Assumes same unit price; requires Congressional approval for lease of 100 planes now with future approval to purchase
Lease with $2B Plus-up	$7.5B	$29.0B	60	Assumes same unit price; requires Congressional approval to lease and purchase; adds $1.1B in FY08 and $0.9B in FY09; realizes savings starting in FY10; buys aircraft in FY08 (8) and FY09(8)
Lease with $2.4B Plus-up	$7.5B	$28.6B	60	Assumes same unit price; requires Congressional approval to lease and purchase; adds $1.1B in FY08, $0.9B in FY09, & $0.4B in FY10; realizes savings starting in FY12; buys aircraft in FY08 (8), FY09(8), FY10 (6), and FY11 (4)
Purchase 100	$18.4B	$24.3B	80	Requires most additional $ in FYDP and Congressional approval to purchase
Separate Contracts - Lease 25, Followed by "traditional" procurement of 75	$16.0B	$27.1B	40	Initial delay to renegotiate price and two new contracts; capital markets may not support lease—potentially unexecutable

Figure 5