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Other Transactions

DOD Issues Guidance on 'Other Transactions' for Prototypes

For the first time, Defense Department officials have prepared guidance on the use of so-called ''other transactions'' authority (OTA) for prototype projects relevant to weapon systems.

The 60-page guidance was issued Dec. 21 by then-Under Secretary of Defense for Acquisition, Technology, and Logistics Jacques S. Gansler before he left DOD to take a position at the University of Maryland.

Gansler encouraged agreements officers and project managers to pursue ''competitively awarded prototype projects that can be adequately defined to establish a fixed-price type of agreement and attract nontraditional defense contractors to participating to a significant extent.''

OTs—which are authorized by 10 U.S.C. § 2371—are not contracts, grants, or cooperative agreements and generally are not subject to the federal laws and regulations that apply to contracts, and thus provide ''tremendous flexibility,'' Gansler observed. An appendix to the guidance lists the statutes that are not applicable to OTs.

Nontraditional Defense Contractor Participation. Section 803 of the fiscal 2001 defense authorization act extended the § 2371 authority through Sept. 30, 2004, but also directed that DOD not use an OT unless:

- at least one nontraditional defense contractor is participating to a ''significant extent'' in the prototype project; or
- no nontraditional defense contractor is participating to a significant extent, but either: (1) at least one-third of the cost of the project is to be paid by the other party to the transaction; or (2) the senior procurement executive determines that exceptional circumstances justify the use of OT arrangements that would not be ''feasible or appropriate'' under a contract.

The guidance makes clear that a ''nontraditional defense contractor'' can be ''at the prime level, team members, subcontractors, lower tier vendors, or 'intra-company' business units.''

''Significant contributions'' to the prototype project may include ''supplying new key technology or products accomplishing a significant amount of the effort, or in some other way causing a material reduction in the cost or schedule or increase in the performance.''

As to using an OT when a nontraditional defense contractor is not participating to a significant extent, the guidance advises that:

- while cost sharing may justify use of an OT, because the government generally should not mandate cost sharing for defense-unique items, use of OT authority that involves cost sharing should be limited to situations where there are commercial or other benefits to the awardee; and
- any justification for the use of OTA based on exceptional circumstances must be approved by the agency's senior procurement executive and ''fully describe'' the innovative business arrangements, the associated benefits, and why they would not be feasible or appropriate under a contract.

''In general, Research, Development, Test, & Evaluation (RDT&E) appropriations will be appropriate for OT prototype projects. Low Rate Initial Production quantities are not authorized to be acquired under prototype authority.''

OT Is 'Acquisition Instrument.' The guidance also says that because OT prototype authority is limited to projects that are directly relevant to weapon systems, ''any resultant OT awards are acquisition instruments since the government is acquiring something for its direct benefit.''

''Terms such as 'support' or ''stimulate' are assistance terms and are not appropriate in OT agreements for prototype projects,'' according to the guidance.

The quantity developed under an OT should be limited to that needed to prove technical or manufacturing feasibility or to evaluate military utility, the guidance says. ''In general, Research, Development, Test, & Evaluation (RDT&E) appropriations will be appropriate

for OT prototype projects. Low Rate Initial Production quantities are not authorized to be acquired under prototype authority.''

Risk May Require Accounting Systems, Audits. The terms and conditions of the OT agreement should be negotiated based on the technical, cost and schedule risk of the prototype project, the guidance says.

When a prototype project is competitively awarded and the risk permits adequate definition and a fixed-price agreement, there typically is no need to invoke the Cost Accounting Standards or an audit, the guidance says.

However, this is not true if an agreement, although identifying the government funding as fixed, only provides for best efforts or potential adjustment of payable milestones based on amounts generated from financial or cost records. If the prototype effort is too risky to enter into a definitive, fixed-price type of agreement or the agreement requires at least one-third of the total costs to be provided by non-federal parties under a statute, ''then accounting systems become more important and audits may be necessary.''

In such cases, the government ''should make every attempt to allow an entity to use its existing accounting system, provided it adequately maintains records to account for federal funds received and cost sharing, if any.''

Critical Role of Intellectual Property. While some of the intellectual property (IP) requirements normally imposed by statute do not apply to OTs, due to the critical role of intellectual property created under prototype projects, agreements officers should contact intellectual property counsel for assistance as early as possible in the acquisition process, the guidance says.

The agreements officer should:

- assess the impact of IP rights on the government's total life-cycle cost of the technology, both in costs attributable to royalties from required licenses and in costs associated with the inability to obtain competition for the future production, maintenance, upgrade, and modification of prototype technology;
- generally seek to obtain IP rights consistent with the Bayh-Dole Act for patents and 10 U.S.C. § § 2310-21 for technical data, while balancing the relative investments and risks borne by the parties both in past development of the technology and its future development and maintenance;
- ensure that the disputes clause of the OT agreement can accommodate IP disputes;
- consider restricting awardees from licensing technology developed under the agreement to domestic or foreign firms under circumstances that would hinder potential domestic manufacture or use of the technology; and
- consider including in the IP clauses any additional rights available to the government in the case of inability or refusal of the other party to perform.

The OT agreement must clearly address the government's rights to use, modify, reproduce, release, and disclose the relevant technical data and computer software, the guidance says.

''The government should receive rights in all technical data and computer software that is developed under the agreement, regardless of whether it is delivered, and should receive rights in all delivered technical data and computer software, regardless of whether it was developed under the agreement.''

The agreement should also account for commercial technical data and computer software incorporated into the prototype, the guidance advises. While the government typically does not require as extensive rights in such data, depending on the acquisition strategy, the government may need to negotiate for greater rights in order to use the developed technology.

Specific Provisions. The guidance also addresses:

- **Recovery of funds.** The agreements officer should consider whether expected applications of the prototype beyond the government make it appropriate to include a clause for recovery of funds.
- **Protests.** General Accounting Office bid protest rules do not apply to OTs for prototype projects. Solicitations that envision the use of an OT should stipulate the offerors' rights and procedures for filing a protest

Observer Calls OT Guidance 'A Huge Step Backwards'

One corporate attorney who has followed OT matters closely believes the new DOD guidance on other transactions for prototypes is ''a huge step backward for commercial companies and defense contractors.''

The new guidance is ''very restrictive'' on changes, terminations, use of commercial accounting practices versus FAR cost principles, intellectual property rights, and other areas, the observer told FCR.

Flexibility 'Taken Away.' Saying that ''the very flexibility inherent in OTs for prototypes has been largely taken away,'' the observer warned that if the new guidance is strictly observed, OTs for prototypes will look like traditional Federal Acquisition Regulation contracts.

For example, fixed-price best efforts OTs, OTs that require cost sharing, and OTs with fixed amount payable milestones that can be adjusted based on costs incurred are all to be treated essentially as cost-reimbursable.

Most payable milestones OTs clearly state that they are for ''best efforts'' because there can be no guarantee that the research will be successful, the observer noted.

IP Draft Ignored. Regarding intellectual property, the observer said the OT guide and the second draft of DOD's IP training guidance (see story in this issue) are ''going in opposite directions.''

The OT guide's IP section is ''the old DOD approach,'' which, if followed, will turn away many commercial companies, the observer predicted.

However, the second draft of the IP guide is very good, the observer said.

with the agency, using either the established agency-level protest procedure or an OT-specific procedure.

■ **Price reasonableness.** The agreements officer may require the awardees to provide whatever data are needed to establish price reasonableness, including commercial pricing data, market data, or cost information. However, the agreements officer should attempt to establish price reasonableness through other means before requesting cost information.

■ **Allowable costs.** The OT agreement should stipulate that federal funds, and the awardee's cost-sharing funds, if any, may be used only for costs that a reasonable and prudent person would incur in carrying out the prototype project.

■ **Accounting systems.** The guidance on accounting systems applies only when the OT agreement uses amounts generated from the awardee's financial or cost records as the basis for payment, or requires at least one third of the total costs to be provided by non-federal parties. The agreements officer should not enter into such an agreement unless the awardee has an accounting system capable of identifying the amount/costs to individual agreements/contracts and providing for equitable allocation of indirect costs. Provisions address the circumstances in which the Federal Acquisition Regulation cost principles and the Cost Accounting Standards are appropriately avoided or incorporated.

■ **Audits.** Draft audit policy—which permits audits by outside independent public accountants in certain circumstances, and specifies the government's rights in the event an audit is not performed—will be published in the *Federal Register* for public comment. The policy applies only when the OT agreement uses amounts generated from the awardee's financial or cost records as a basis for payment, or requires at least one third of the total costs to be provided by non-federal parties.

Section 801 of the FY 2000 defense authorization act requires GAO access to records for a prototype project that provides for payments exceeding $5 million. That requirement is implemented by a rule that became effective last July (73 FCR 632).

■ **Cost sharing.** Cost sharing should generally consist of labor, materials, equipment, and facilities costs (including allocable indirect costs). Costs incurred by the non-federal party after the beginning of negotiations but prior to the effective date of the OT agreement may be counted for purposes of cost sharing.

Awardees that have cost-based contracts may treat their cost share as a direct effort or as independent research and development. IR&D is acceptable as cost sharing, even though it may be reimbursed by the government through other awards. The awardee may have contracts subject to the CAS that could be affected by an awardee's inconsistent accounting treatment of prototype cost share costs.

Profit or fee is permitted for awardees of prototype projects, but generally should not be permitted on projects that are cost-shared.

■ **Changes.** The OT agreement should address how changes will be handled. The fact that unilateral changes may lead to disputes and claims, particularly in agreements with fixed-price characteristics, should be considered.

■ **Disputes.** OTs are not subject to the Contract Disputes Act, but may be the subject of a claim in the Court of Federal Claims. Agreements officers should seek to negotiate disputes clauses which maximize the use of alternative dispute resolution.

■ **Termination.** A unilateral government termination right is appropriate, and in cases where there is an apportionment of risk allocation and cost shares, it could be appropriate to allow an awardee a termination right as well. Such a termination could occur when an awardee discovers that the expected commercial value of the prototype technology does not justify continued investment, or the government fails to provide funding in accordance with the agreement.

By Martha A. Matthews