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FEATURE COMMENT • DOD's Guide For Prototype Other Transactions—Walking The Line Between Flexibility And Accountability

The Department of Defense issued its first mandatory guidance governing acquisition strategy, award, and execution of Other Transactions for Prototype Projects on December 21, 2000, seven years after the Defense Advanced Research Projects Agency (DARPA) first was authorized to enter into such agreements. DOD's final guidance document is clearly a compromise drafted by a committee of persons with divergent interests. This FEATURE COMMENT discusses key issues likely to be encountered under the new guidance, DOD's responses to industry's comments on a draft of the guidance, and some new issues that arose in the final version of the "Other Transactions" (OT) Guide for Prototype Projects.

DARPA first had statutory authority to enter into Prototype Other Transactions in Fiscal Year 1994. By FY 1996, Congress had expanded the Prototype OT authority, essentially permitting all DOD components to enter into Other Transactions, described as instruments other than procurement contracts, grants, or cooperative agreements. National Defense Authorization Act for FY 1997, P.L. 104-201, § 804. DOD has temporary authority, until September 30, 2004, to execute Other Transactions for prototype projects that are directly relevant to weapons or weapon systems that DOD proposes to acquire or develop. National Defense Authorization Act for FY 2001, P.L. 106-259, § 803(b); National Defense Authorization Act for Fiscal Year 1994, P.L. 103-601, § 845(a).

A myriad of smaller Prototype OTs cover component or subsystem-level prototypes, but receiving the

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most attention are the larger and better known programs for which DOD has chosen to use the Prototype OT instrument rather than a standard procurement contract. These programs include:

- Evolved Expendable Launch Vehicle program.
- Global Hawk unmanned aerial vehicle.
- DarkStar unmanned aerial vehicle.
- Commercial information processing, storage, transmission, compression, and display technologies used for national security purposes.
- Common cockpit for the CH-60 and SH-60R helicopters.
- DD-21 Land Attack destroyer.
- Arsenal Ship.

As of October 1998, DOD had awarded 97 Prototype OTs worth \$2.6 billion. This amount is fairly small, however, when compared to the \$100 billion in research and development contracts DOD awarded during the same period. See *DOD's Guidance on Using Section 845 Agreements Could Be Improved* (NSIAD-00-33, Apr. 7, 2000) at 4 (GAO Report). See also 42 GC ¶ 149.

Prototype OTs are not subject to the Federal Acquisition Regulation or to many procurement statutes listed in Appendix 1 to the OT Guide, which include the Competition in Contracting Act, the Contract Disputes Act, and the Procurement Integrity Act. For that reason, many in DOD and industry supported Prototype OTs as a way to (1) develop cutting-edge R&D—"better, faster, cheaper"—and (2) acquire the R&D efforts of commercial companies that refuse to contract with the Federal Government because of unique requirements imposed by the FAR and various procurement statutes.

Background—Many in DOD and industry asserted that Prototype OTs should not be subject to written guidance, allowing maximum flexibility in negotiations and performance. For example, then-Under Secretary of Defense for Acquisition, Technology and Logistics Jacques S. Gansler criticized the DOD Office of Inspector General last year for demanding that DOD "issue rules that make OTs more like standard government contracts, thus removing the ability to create commercial-like business arrangements." 42 GC ¶ 35. The IG "suggested that the guidance define what constituted a prototype project or a commercial firm and clarify various administrative and financial management is-

suces (such as the role of the Defense Contract Audit Agency) and an appropriate access to records clause." GAO Report at 31. While Gansler pledged to respond to the IG's concerns regarding oversight and cost sharing, he expressed a clear preference for "encouraging" the "unprecedented flexibility and creativity" that OTs permit. *Id.*

As a result of these divergent views, the final OT Guide is a compromise document—a "directive-type memorandum." The Guide's cover memorandum states that it "is intended to provide a framework for the government team to consider and apply, as appropriate" but also says "there are some mandatory requirements...evident by the prescriptive language used." USD(AT&L) Gansler Mem., "Other Transaction Authority (OTA) for Prototype Projects" (Dec. 21, 2000) at 1. (The full text of the OT Guide and Gansler's transmittal memorandum are available at http://web1.deskbook.osd.mil/htmlfiles/DBY_dod_272-2.asp). Not surprisingly, reaction to the OT Guide has been mixed. Advocates of less regulation and more reform label the OT Guide as a step backwards, while others feel that lack of mandatory regulation can leave either party vulnerable.

The OT Guide was not promulgated through the standard notice and comment procedures applicable to FAR and Defense FAR Supplement changes. In a September 13, 1999 letter, USD(A&T) Gansler asked the Council of Defense and Space Industry Associations (CODSIA) and the Integrated Dual-Use Commercial Companies (IDCC) to comment on a Draft Prototype OT Guide. Dr. Gansler explained that "[r]eferencing the Guide in [a] Directive rather than incorporating it, would retain the flexibility to modify the guide to accommodate changing circumstances without modifying the Directive itself." CODSIA's and the IDCC's comments addressed over 23 issues in detail. See CODSIA letter, "DOD Directive on the Use of Other Transactions for Prototype Projects," CODSIA Case No. 20-99P (Oct. 29, 1999); IDCC letter, "Proposed DOD Guide on Section 845/804 Other Transactions for Prototype Projects" (Oct. 29, 1999). For several reasons, including industry's comments, the final OT Guide was substantially restructured and rewritten. While the OT Guide now covers an extensive list of topics, essentially creating a "mini-FAR" for Prototype OTs, the following discussion focuses

on the topics expected to require the most attention by negotiators of Prototype OTs.

“Nontraditional Defense Contractors”—The FY 2001 Defense Authorization Act imposed a new requirement for Prototype OTs: either (a) at least one “nontraditional defense contractor” must participate to a “*significant extent*” in the prototype project, or (b) the private parties to the transaction must pay at least one-third of the total cost (absent exceptional circumstances). P.L. 104-201, § 804(a). The OT Guide incorporates the statute’s definition of a “nontraditional defense contractor”:

[A] *business unit* that has not, for a period of at least one year prior to the date of the OT agreement, entered into or performed on (1) any procurement contract that is subject to full coverage under the cost accounting standards...; or (2) any other procurement contract in excess of \$500,000 to carry out prototype projects or to perform basic, applied, or advanced research projects for a federal agency. OT Guide ¶ DL1.12 (emphasis added).

CODSIA had commented that the draft OT Guide addressed neither the important role of commercial sectors of traditional defense contractors or the varied operating procedures that can exist among different sectors of a single corporation. To make it clear that commercial sectors of traditional defense contractors would qualify as “nontraditional defense contractors” under the FY 2001 Defense Authorization Act, the OT Guide adopts the CAS definitions of “business unit” and “segment.” “Business unit” means “any segment of an organization, or an entire business organization which is not divided into segments.” OT Guide ¶ DL1.5; 48 CFR § 9904.410-30(a)(2). “Segment” means “one of two or more divisions, product departments, plants, or other subdivisions of an organization reporting directly to a home office, usually identified with responsibility for profit and/or producing a product or service.” OT Guide ¶ DL1.15; 48 CFR § 9904.410-30(a)(7). Examples of possible “significant contributions” by nontraditional defense contractors 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.” OT Guide ¶ C1.5.1.

Scope of Prototype OTs—In their comments on the draft Guide, CODSIA and IDCC observed that Agreements Officers have been reluctant to use the Prototype OT instrument where projects did not appear to be for an entire weapon system, so CODSIA requested clarification that a broader application was intended. The OT Guide expands the scope for Prototype OTs, stating that covered projects can include prototypes of weapon subsystems, components, or technology, as well as entire weapon systems. OT Guide ¶ C1.6. Moreover, a prototype can be “a physical or virtual model used to evaluate the technical or manufacturing feasibility or military utility of a particular technology or process, concept, end item, or system.” Id. Thus, the OT Guide makes clear that the Prototype OT instrument can be used for projects other than a prototype of an entire major weapon system, such as an aircraft or ship.

Risk Allocation—The draft OT Guide did not limit the nature of agreements (e.g., cost-reimbursement, fixed-price, or hybrid) deemed appropriate for Prototype OTs. Based on experience with past Prototype OTs, CODSIA made two key points about agreement type and corresponding cost, schedule, and technical risk. CODSIA contended that (1) fixed-price agreements should only be awarded when the project risk has been sufficiently reduced to allow the awardee to price the work realistically, and (2) award of a fixed-price agreement would be improper for any Prototype OT that incorporates production options that must be priced before the awardee has performed the development phases. The final OT Guide recognizes that a prototype effort may be “too risky to enter into a definitive, fixed-price type of agreement,” but does not preclude pricing production options in a prototype agreement. OT Guide ¶ C2.1.1.5. The Agreements Officer is only given general guidance to address follow-on activities in developing the acquisition strategy. OT Guide ¶ C2.1.3.1.9.

Cost Sharing—Cost sharing by the private party is required by statute for several types of R&D agreements, including cooperative agreements and Science and Technology OTs. Prototype OTs, however, are not required to include cost sharing as a matter of law. Nevertheless, several prior DOD solicitations for Prototype OTs have suggested that the private party “demonstrate its commitment” by

cost sharing. Moreover, private parties often offer to contribute funds to remain competitive.

While the draft OT Guide stated that "cost sharing is not required," it also indicated that cost sharing might be appropriate if an agreement is expected to result in commercial or other benefits to the contractor. Draft OT Guide at 8. CODSIA recommended that the OT Guide expressly state that cost sharing is discouraged when the prototype project is for purely military purposes and has no commercial application. The final OT Guide adopted this recommendation, advising Agreements Officers that they "should not generally mandate cost-sharing requirements for defense unique items." OT Guide ¶ C2.16.1.

CODSIA also urged that the Government not have the unilateral right to change the OT agreement where the awardee provides cost sharing; rather, changes should be mutually agreed upon. While making no such express statement, the final OT Guide leaves a great deal of flexibility for the Agreements Officer to omit a unilateral right to make changes. The OT Guide states, "[t]he government may need the right to make a unilateral change to the agreement to ensure that critical requirements are met. If a significant cost contribution is *not* expected from the OT awardee, then the government should normally retain its right to make a unilateral change." OT Guide ¶ C2.19.2 (emphasis added).

When the awardee is cost sharing, a unilateral termination for convenience by the Government likewise is inappropriate, according to CODSIA, since the awardee would be unlikely to recover its initial investment in this situation. While retaining the Government's right to a unilateral termination for convenience, the final Guide states that it would be appropriate to allow the awardee a termination right as well, "where there is an apportionment of risk allocation and cost shares." OT Guide ¶ C2.21.1. The right to terminate an agreement could occur in "instances in which 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." *Id.* Under these circumstances, the Government is more willing to give the private party equal rights to terminate rather than give up its own right to terminate for convenience.

CODSIA also stated that in Prototype OTs involving cost sharing, the Government should re-

ceive no more than "Government Purpose" or "limited foreground" rights in intellectual property (IP) or technical data, explaining that retention of IP rights is key to commercializing the results of any Prototype OT. A major problem, discussed below, is that the final OT Guide does not recognize different levels of IP or technical data rights depending on whether the awardee is cost sharing.

Intellectual Property—The OT Guide frequently references DOD's need to acquire IP rights to support the operation and maintenance of prototype technology. See OT Guide ¶¶ C2.3.1.3, C2.3.1.4, C2.3.1.7. This need exists, for example, when DOD plans follow-on procurements of production models. In the context of the Prototype OT agreement itself, however, this is confusing because Prototype OTs are intended to demonstrate technology, not to develop physical prototypes of new weapon systems or their component parts. Even when a physical prototype is developed, it typically is not delivered to the Government. The OT Guide confirms this concept when it states, "[t]he government is not required to, and generally should not, take title to property acquired or produced by a private party signatory to an OT except property the agreement identifies as deliverable property." OT Guide ¶ C2.18.1. DOD has not, in practice, taken title to physical prototypes under several past large Prototype OT agreements.

The OT Guide's section on IP is greatly expanded over the draft Guide's five bullet points. The Guide divides IP into two sections—Patents and Technical Data (copyrights and trade secrets are only briefly mentioned, as is common under Government contract guidance and regulations).

Agreements Officers are told to weigh: (a) the cost of buying IP rights now, perhaps incurring costs unnecessarily, against (b) the possibility the Government will not have the rights it needs later. OT Guide ¶ C2.3.1.3. It is disappointing that the OT Guide does not address a more practical alternative—the purchase now of deliverable drawings, specifications, and reports, while delaying purchase of IP rights until the Government has more clearly identified its needs. The OT Guide also fails to address the common commercial practice of placing the IP in escrow, ensuring its future availability.

Prototype programs may fail or the technology may not be further developed. Even if a de-

development program ensues, many such programs are cancelled or the purchase quantities are greatly reduced from original expectations. In all of these instances, the Government benefits little from IP rights purchased in the prototype phase.

Patents: The OT Guide's discussion of IP begins with the recognition that the Bayh-Dole Act, 35 USC §§ 202–204, does not apply to OTs. OT Guide ¶ C2.3.1.1 and App. 1. The Bayh-Dole Act permits the awardee to retain ownership of an invention, but requires the Government to receive a nonexclusive, nontransferable, irrevocable, paid-up license to practice or have practiced, worldwide, on behalf of the United States, inventions conceived or first actually reduced to practice under a Government contract. 35 USC §§ 202–204. While the OT Guide's general approach to IP rights recognizes the interests of both the Government and the private party, specific sections of the Guide miss the opportunity to provide detailed negotiation alternatives.

For example, the Guide's patent section states that the Agreements Officer "should consider allowing the participant to retain ownership of the subject invention," while reserving for the Government Bayh-Dole patent rights. OT Guide ¶ C2.3.2.2.2. Agreements Officers likely will interpret this statement to mean that the Government should obtain *at least* Bayh-Dole rights, when according to Appendix 1 of the OT Guide, the Bayh-Dole Act does not even apply to Prototype OTs. It would have been helpful to Agreements Officers had the OT Guide described when the Bayh-Dole approach may be inappropriate, such as when the awardee provides a significant cost share or provides "Background Intellectual Property" (IP developed by the awardee with private funding before or outside of the Prototype OT).

The OT Guide does, however, provide flexibility in the filing of patent applications. For example, Agreements Officers may extend the time period within which an awardee must patent an invention, permitting the awardee to keep the technology a trade secret for a period of time instead of filing a patent application immediately upon discovery. OT Guide ¶¶ C2.3.2.2.5, C2.3.2.2.2. The Agreements Officer also may consider whether the Government must obtain the standard patent "march-in" rights. *Id.* See generally FAR 52.227-12(j); FAR 27.304-1(g) (outlining scope of and procedures for Government "march-in" rights).

DOD hopes to lure nontraditional defense contractors into Prototype OTs to leverage those companies' *privately developed* IP (i.e., Background IP). The OT Guide unfortunately does not provide Agreements Officers with much advice on Background IP, merely observing that it "may...affect the government's life cycle cost." OT Guide ¶ C2.3.2.2.2. Nor does the OT Guide communicate to Agreements Officers that the ability to negotiate specific and limited rights for DOD in Background IP may be the most important business point for nontraditional defense contractors. It is important that Agreements Officers understand that IP rights can be limited in many ways depending on the parties' needs, including restricting the persons/organizations permitted the rights as well as imposing geographic limitations on use and limitations on quantities and scope (e.g., make and/or use and/or sell and/or distribute). Unfortunately, the OT Guide offers no examples of alternative restrictions.

Technical Data and Computer Software: The first statement in the Guide's general discussion of IP recognizes that 10 USC § 2320, "Rights in Technical Data," and 10 USC § 2021, "Validation of Proprietary Data Restrictions," do not apply to Prototype OTs. OT Guide ¶ C2.3.1.1 and App. 1. The section covering technical data and computer software, however, is inconsistent with those statutory exemptions. While the patents section permits the Government to negotiate less than the standard FAR and DFARS patent rights, the technical data and computer software section imposes requirements that exceed those in the FAR and DFARS. Most telling is the Guide's discussion of the "allocation of rights":

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. OT Guide ¶ C2.3.3.2 (emphasis added).

First, whether the Government has rights in technical data and computer software that are not required to be delivered under Government contracts remains an open legal question. Second, instead of indicating that the terms are negotiable (i.e., "the Agreements Office should *consider*" re-

ceiving) the quoted language is more proscriptive ("the government *should* receive"), leaving Agreements Officers with the impression that acquisition of expansive rights in deliverable and nondeliverable technical data and computer software is mandatory under a Prototype OT. Finally, as discussed for patents above, the OT Guide misses the opportunity to provide examples of the technical data and computer software "rights" the Government should receive amongst myriad variations. Even the options available under the DFARS "Technical Data" clauses—e.g., unlimited rights, Government purpose rights, limited/restricted rights, or specifically negotiated rights—are not discussed. Compare DFARS 252.227-7013, "Rights in Technical Data—Noncommercial Items," DFARS 252.227-7014, "Rights in Noncommercial Computer Software and Noncommercial Computer Software Documentation." Most importantly, the awardee's rights in Background IP are not treated with deference, which is likely to continue to deter nontraditional defense contractors from doing business with DOD.

DOD's policy under the DFARS is to obtain rights in *commercial* technical data and *commercial* computer software only to the extent customarily provided to the public, with limited exceptions. See DFARS 227.7102-1, DFARS 227.7202-1. The OT Guide, by contrast, describes the potential need for the Government to obtain *additional* rights in commercial technical data or commercial computer software that is incorporated into a prototype:

As compared to non-commercial technical data and computer software, the government typically does not require as extensive rights in commercial technical data and software. However, *depending on the acquisition strategy, the government may need to negotiate for greater rights in order to utilize the developed technology.* OT Guide ¶ C2.3.3.3.6 (emphasis added).

In the end, despite the fact that the technical data statutes do not apply to Prototype OTs, the OT Guide leaves the Agreements Officer with less flexibility in negotiating rights in data and computer software than offered for FAR- and DFARS-covered procurement contracts.

The technical data portion of the OT Guide also contrasts starkly with the recent guidance in two memoranda and the draft Intellectual Property

Guide (IP Guide), also issued by the Office of the Under Secretary of Defense for Acquisition, Technology and Logistics. See USD(AT&L) Gansler Mem., "Training on Intellectual Property" (Sept. 5, 2000); Acting USD(AT&L) Oliver Mem., "Reform of Intellectual Property Rights of Contractors" (Jan. 5, 2001), 43 GC ¶ 44; USD(AT&L), "Second Draft, Intellectual Property: Navigating Through Commercial Waters" (Jan. 8, 2001). Attracting nontraditional defense contractors to perform DOD R&D contracts is a primary purpose of both the IP and OT Guides. To do so, the IP Guide, which applies to FAR-based procurement contracts, encourages the following four practices:

- (1) Emphasize the use of specifically negotiated license rights.
- (2) Exercise flexibility when negotiating patent rights.
- (3) Use performance-based acquisition strategies that may obviate the need for data and/or rights.
- (4) Acquire only data and/or rights to data truly needed for a given acquisition. IP Guide (Second Draft) at 2; USD(AT&L) Oliver Mem. at 1.

The inconsistencies between the OT Guide and the IP Guide, particularly in addressing rights in technical data and computer software, send an unfortunate mixed message to the very nontraditional defense contractors that DOD hopes to attract. As IDCC observed, "Agreements Officers are usually very reluctant to negotiate non-standard intellectual property rights and this has been a major problem in negotiating Prototype OTs." Absent the addition of clearer negotiating guidance, the perceived inability to treat IP rights under OTs differently than such rights are treated under traditional procurement contracts and cooperative agreements likely will remain a barrier to nontraditional defense firms' performance of Government-funded R&D.

Disputes—The draft OT Guide merely stated that the Contract Disputes Act does not apply to Prototype OTs and described an agency-level alternative dispute resolution ("ADR") process. Draft OT Guide at 10. CODSIA commented that the OT Guide should recognize the jurisdiction of the U.S. Court of Federal Claims and advocated a stated preference for a neutral, commercial-type ADR process. The final OT Guide generally adopts these suggestions by recognizing the jurisdiction

of the COFC over OT claims, but merely encourages the use of non-specific ADR clauses in Prototype OTs "when possible and appropriate." OT Guide ¶ C2.20.

Roles of DCMA and DCAA—Many of the objections expressed by nontraditional defense firms to contracting with the Government center on the broad audit and records inspection rights under standard procurement contracts. Because their projected revenue from Federal Government contracts is relatively insignificant, commercial companies refuse to invest in special processes or accounting systems merely to satisfy Government inspectors and auditors. For that reason, the anticipated roles of the Defense Contract Management Agency (DCMA) and Defense Contract Audit Agency (DCAA) under a Prototype OT are important.

The draft OT Guide advised that Agreements Officers should "provide for [an] authorized representative to have access to financial records for a specified period of time (normally three years) after payment of the final invoice," implying that DCAA would play the same role in Prototype OTs that it does in procurement contracts. Draft OT Guide at 8. Beyond that, the draft OT Guide merely encouraged the Agreements Officer to determine the respective roles of DCMA and DCAA. *Id.* at 6.

The final OT Guide notes that specific DCMA field offices have been designated to administer OTs, but does not discuss the delegation of administrative responsibilities to those DCMA offices. OT Guide ¶ C1.7.2. Thus, DCMA's role remains clear.

Just as DCMA has trained specific field offices to handle OTs, DCAA has assigned liaison auditors to those DCMA offices. OT Guide ¶ C1.7.2. However, the final OT Guide says that "DCAA acts in an advisory capacity only," indicating that the Agreements Officer continues to have significant discretion in deciding whether to request financial advisory services from DCAA. *Id.*

Conclusion—Confronted with political tensions and IG criticisms over program accountability and oversight, DOD has begun to rein in its Prototype OT authority. While the final OT Guide continues to allow Agreements Officers a great deal of flexibility in acquisition strategy and offers some exceptions from Government-unique requirements, DOD inexplicably has reduced flexibility for negotiating technical data and computer software rights. Reporting requirements for

Agreements Officers have increased dramatically as well. Moreover, demanding either participation of nontraditional defense contractors or the imposition of a mandatory cost share may deter DOD components and private parties from entering into Prototype OTs.

The Prototype OT is now a mature instrument and, like grants, cooperative agreements, and Cooperative Research and Development Agreements (CRADAs) before it, this instrument's initial freedom and flexibility are gradually succumbing to bureaucracy. Under the right circumstances, however, the Prototype OT remains an attractive alternative for achieving DOD's goals of acquiring technology "better, faster, cheaper" from nontraditional defense contractors.



This FEATURE COMMENT was written by Holly Emrick Svetz, an associate at Piper Marbury Rudnick & Wolfe LLP. Formerly an Air Force officer, engineer, and acquisition program manager, Ms. Svetz is Co-chair of the Research & Development & Intellectual Property Committee of the ABA Section of Public Contract Law and focuses her practice on counseling and litigation of technology issues in Government and commercial contracts.

Developments

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Comp. Gen. Sustains Protest Based On Subcontractor's Organizational Conflicts Of Interest

Johnson Controls World Servs., Inc., Comp. Gen. Dec. B-286714.2, 2001 CPD ¶ 20

In a rare decision sustaining a protest grounded on alleged organizational conflicts of interest, the U.S. Comptroller General ruled that the awardee's teaming arrangement with a subcontractor resulted in an unfair competitive advantage under an Army solicitation for installation logistics support services. The subcontractor's work under another