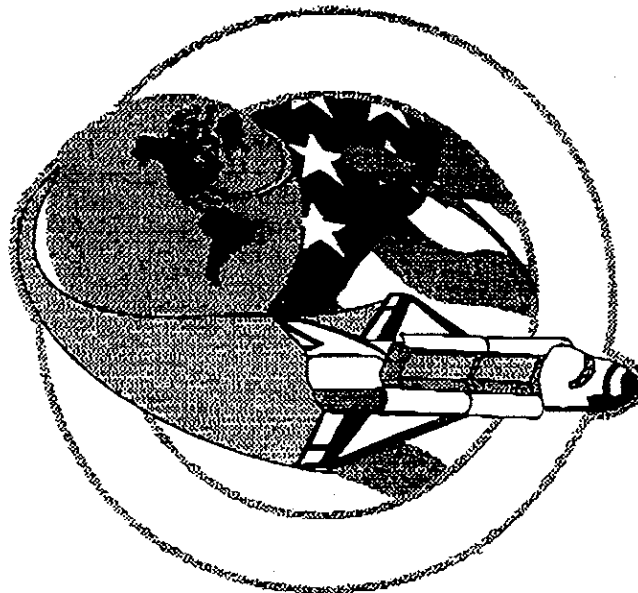


The Government Contracts Law Sections
of the
American Bar Association and the Federal Bar Association



Breakfast Panel Discussion--R & D Prototypes Usin "Other Transactions:" Kiss the FAR Goodbye?



speakers:

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Edward A. Frankle, NASA General Counsel
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Using "Other Transactions" in Cooperative Government-Industry Relationships to Support the Development and Application of Affordable Technology

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The technological superiority of United States military forces is the fulcrum of our national military strategy. The threat to our national security is diverse and requires a flexible and responsive approach to acquisition. The challenge is not only to develop technologically advanced military products and components but to provide superior systems that we can afford. This paper discusses legal authority that may help the Department of Defense meet the dual challenge of technological superiority and affordability.

INTRODUCTION

Despite the inherent contract authority of the Federal Government agencies first recognized by the Supreme Court in U.S. v. Tingey 30 U.S. 115 (1831) it is common for the organic or authorizing statutes of Federal agencies to contain a reference to the authority to contract. In some cases only "contracts" are mentioned. In other cases "grants" or "cooperative agreements" are also mentioned in some combination with "contracts." In a surprising number of instances those terms are juxtaposed with additional terms such as "other transactions," "other arrangements," "other similar arrangements," or "cooperative arrangements." The purpose of this article is to explore the background and implications of the authority of federal agencies to enter into "other transactions." The Advanced Research Projects Agency (ARPA) of the Department of Defense has had such authority since 1989. ARPA has entered into over fifty agreements using this authority. The Military Departments have had such authority since 1991 but have yet to make significant use of it.

Before going into this subject in detail, a brief word about ARPA (formerly DARPA) is in order. ARPA is the Defense Department's corporate research and development organization. It addresses issues that cut across Military Department responsibilities or that offer the possibility of revolutionary breakthroughs in military capabilities or affordability.

Beginning in the early 1960's ARPA began to support advances in computer technology on a broad front rather than focusing on military-specific or command, control and intelligence functions. This approach, which would today be called "dual-use", led to America's dominant global position in information processing systems for commercial and military uses ("America's computer strength came out of DARPA" John Deutch, 1989). There are many other examples. The military pioneered the use of semi-conductors but their cost dropped dramatically when they achieved widespread commercial applications. Advanced materials and microelectro-mechanical devices are others.

ARPA's mission is such that "gee whiz" technology alone is not of interest. Technology that actually gets into use to enhance national security is ARPA's aim. ARPA is not constrained in how this happens, thus dual-use strategies that field technology as commercial products which are available, or can be adapted, for military use are not only legitimate but often considered an optimum approach.

BACKGROUND

Modern Government contracting began at the start of the Cold War era with the enactment of the Armed Services Procurement Act (1947) and the Federal Property and Administrative Services Act (1949). By the early 1950's a separate and permanent defense industry began to emerge. This was caused in part by the needs of a large peacetime military force, and technologies applicable only to military products, but in no small measure it resulted from government contracting rules (such as accounting and audit rules and specifications that are military specific) that made a government contractor non-competitive outside the defense marketplace. See e.g., Integrating Civilian and Military Technologies: An Industry Survey (Center for Strategic and International Studies, 1993). "Government contractor" is a better term than defense contractor since the available market includes NASA, FAA, NOAA and other government agencies. Contractors dependent on these agencies may likewise find that business practices mandated by government rules are not optimal for commercial business. It is worth noting in passing that the real problem of "defense conversion" is not merely the shrinking government market but the Government contractor's limited ability to succeed in other markets.

The constraints of the contracting statutes and their implementing regulations (originally DoD's Armed Services Procurement Regulation, later the Defense Acquisition Regulation and Federal Acquisition Regulation) led some agencies to issue "grants" to support university research. Grants were simple instruments not subject to procurement rules. Other agencies,

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viewing a grant to be a form of contract, believed that the procurement rules applied to grants. Yet other agencies viewed grants as gifts and doubted their authority to give gifts in the absence of express statutory authority. Congress remedied the confusion by enacting the Grant Statute in 1958. This authorized agencies to award grants to universities and non-profit research organizations to conduct basic and applied research. Under the authority of the Grant Statute or other statutory authority some agencies began to award "cooperative agreements" characterized by more active Government involvement than was traditional with grants.

The Federal Grant and Cooperative Agreement Act (1978) was enacted to remedy the substantial inconsistency being practiced by federal agencies in using the various award instruments. Unlike the Grant Statute, which it repealed, the new statute was not limited to research but could also apply to other activities. By repealing the Grant Statute, it repealed that statute's limitations on recipients (university and non-profits) and type of research (basic and applied).

The Office of Management and Budget (OMB), which oversees the Federal Grant and Cooperative Agreement Act, characterized the statute as establishing two categories of transactions -- procurement and assistance, the former being the domain of procurement contracts and the latter authorizing the use of a grant or cooperative agreement. The distinction between a grant and a cooperative agreement is the level of anticipated government involvement. Procurement contracts are to be used when "the principal purpose of the instrument is to acquire ... property or services for the direct benefit or use of the United States Government... ." Assistance instruments are used when "the principal purpose of the relationship is to transfer a thing of value ... to carry out a public purpose of support or stimulation... ."

In the research and development context this statutory policy has been implemented in the following language:

Contracts shall be used only when the principal purpose is the acquisition of supplies or services for the direct benefit of the Federal Government. Grants or cooperative agreements should be used when the principal purpose of the transaction is to stimulate or support research and development for another public purpose. Federal Acquisition Regulation (FAR) 35.003 (a).

Despite the repeal of the Grant Statute the Department of Defense, by policy, until very recently continued to limit grant recipients to universities and non-profit organizations performing basic research. Government-wide regulations governed grants and

agreements with universities and non-profits (OMB Circular A-110) but not profit-making companies. Some agencies, such as the Department of Energy, have awarded assistance instruments to profit-making companies, but by regulation applied key provisions of the procurement system such as procurement cost principles and auditing.

There is a general misunderstanding that procurement and assistance (contracts, grants, and cooperative agreements) cover the field of all possible research and development contractual instruments. The following excerpt is from correspondence between OMB Director McIntyre and the Administrator of the National Aeronautics and Space Administration (NASA):

On the related question of transactions not covered by the Act, based on earlier comments of NASA and other agencies, a statement has been included in the OMB guidance that transactions such as patent licenses, out-bailments, etc. are not covered by the Act. It would help us in our study if your staff would provide a brief list and description of such transactions... (OMB letter, Oct. 11, 1978).

Over the years NASA has entered into a wide variety of contractual arrangements which it considers outside the procurement and assistance categories. See generally, Dunn, Contractual Mechanisms in Support of Commercial Space Activities (The Air and Space Lawyer, 1984). Among these is a "funded Space Act Agreement" under NASA's authority "to enter into and perform such contracts, leases, cooperative agreements or other transactions as may be necessary in the conduct of its work..." under section 203(c) (5) of the National Aeronautics and Space Act.

The Comptroller General has held that "authority 'to enter into contracts, grants or other arrangements'... particularly the language 'or other arrangements' is sufficiently broad to encompass transfer of Commission funds so long as the transfer is to an entity carrying out a function set forth" in the agency's statute (B-217093, January 1985).

In 1989 Congress enacted section 251 of public law 101-189 which was codified at 10 U.S.C. 2371. Section (a) stated:

The Secretary of Defense, in carrying out advanced research projects through the Defense Advanced Research Projects Agency, may enter into cooperative agreements and other transactions with any person, any agency or instrumentality of the United States, any unit of state or local government, any educational institution, and any other entity.

The statute provided for equal cost sharing "to the extent ... practicable ..." and avoidance of duplication of effort "to the maximum extent practicable ..." Advance payments could be made. Recoupment or other payments to the government were authorized. The authority was to be used only "when the use of standard contracts or grants is not feasible or appropriate ..."

In 1989 "standard" DoD grants were grants to universities and non-profit research organizations for the conduct of basic research. Standard contracts were described in Part 16 of the FAR and involved the principal purpose of acquiring goods or services for the direct benefit or use of the Federal Government. Much of ARPA's work involves other activities such as advancing the state of the art, demonstrating technology, establishing industrial capabilities, and transitioning technology into actual use.

Another characteristic of "standard" DoD instruments in 1989 when the statute was originally enacted is that they were entered into with single parties. The trend toward research joint ventures was in its infancy in the 1980's. The passage of the National Cooperative Research Act of 1984 accelerated the process. In 1987, when fourteen companies sought government support for a collaborative effort to regain world market share in semi-conductors they formed a non-profit research corporation (SEMATECH) to receive a government grant and a special statute was enacted to govern the relationship. The statute included special provisions related to intellectual property. Contrary to the SEMATECH model, ARPA's experience has been that industry prefers not to create a new legal entity in order to conduct joint research.

ARPA has repeatedly reported to Congress on its use of "other transactions" authority. Congress has re-enacted the statute three times (1991, 1993 and 1994) making minor changes without changing the substance of the authority. In 1990 (section 244, Public Law 101-510) Congress authorized a \$50 million appropriation for ARPA to fund consortia to support dual-use technologies utilizing the authority of 10 U.S.C. 2371. The following year \$60 million was authorized. Each year ARPA used these funds to enter into several "other transactions" which were duly reported to Congress. In 1992 Congress appropriated nearly one-half billion dollars for a series of programs that became known as the Technology Reinvestment Project (TRP). Although many TRP efforts were executed by other agencies cooperating with ARPA, all of ARPA's TRP efforts were executed as "other transactions." Total TRP appropriations have now exceeded one billion dollars. By these actions of re-enacting 10 U.S.C. 2371 and appropriating millions of dollars year after year in the knowledge of ARPA's use and interpretation of 10 U.S.C. 2371 Congress may be viewed as having ratified ARPA's interpretation of its authority. See, e.g., TVA v. Kinzer 142 F. 2d 833, 837 and U.S. v. Two Tracts of

Land, 456 F. 2d 264, cert. den. 409 U.S. 887 (1972). Congress recently authorized ARPA to use the authority of 10 U.S.C. 2371 on an experimental basis without cost sharing for strictly military prototype projects (sec. 845, Public Law 103-160).

IMPLICATIONS

ARPA has interpreted 10 U.S.C. 2371 to mean that "other transactions" are a class of transactions outside the procurement and assistance categories as they were implemented by DoD in 1989 at the time of the statute's original enactment. "Other transactions" are not subject to the Armed Services Procurement Act, Federal Acquisition Regulation, Defense Federal Acquisitions Regulation Supplement or other laws and regulations specific to the procurement system, including most of the statutes codified in title 41, U.S. Code. Likewise laws and regulations governing assistance relationships or specific to grants and cooperative agreements are not applicable. Statutes of general applicability such as title VI of the Civil Rights Act of 1964 and statutes applicable to "every...agreement...of the United States" (e.g., 41 U.S.C. 22) are applicable.

ARPA has entered into a number of "other transactions" with single commercial firms such as agreements with Gazelle Microcircuits, Cray Research, Intel Corporation, and Boeing. ARPA has entered into unfunded agreements with Rockwell Corporation, Boeing and Northrop. The majority of ARPA's several dozen other transactions have been multi-party agreements, most with multiple signatures and others with one company as an agent signing for all members of a consortium. The agreements are styled in various ways - Coordinated Research Agreement, Technology Reinvestment Project Agreement, Technology Development Agreement, or other appropriate designation. The legal authority for the agreement is always expressly stated. Agreements range in total funding from less than \$1 million to \$370 million. Government funding is almost always less than half and in some cases a small fraction of the total.

TYPES OF RELATIONSHIPS

In its initial report to congress ARPA described the first agreement executed under the authority of 10 U.S.C. 2371. This was an agreement with Gazelle Microcircuits, Inc., a small venture capital supported firm that had never had a government procurement contract. The agreement would accelerate the development of a new class of high speed gallium arsenide communication components. ARPA had previously helped establish the U.S. manufacturing capability for digital gallium arsenide products. The purpose of ARPA's technical and funding support under the agreement was to

participating in the TRP and the non-DoD agencies cooperating in the TRP to review their policies on intellectual property rights. (House Report 103-499, p. 285)

Seldom does ARPA abandon the general scheme of the Bayh-Dole Act. ARPA requires its industrial partners to make the case that the standard patent clause is inconsistent with the goal of a particular project. Typical ARPA concessions are to delay the effective date of the government purpose license for a period of years and to specifically define what are reasonable efforts toward practical application that will preclude exercise of the government's march-in rights. Through such measures ARPA can reduce the actual and perceived risk to the partnership during the initial phase of a project.

The allocation of intellectual property rights also involves a balancing of the relative needs and prior investments of the parties. If industry has advanced the state of the art through the expenditure of large sums of capital over many years with little or no government support, the government should be more open to industry's request to maintain a proprietary position especially if the Government's interests are primarily served by having a product available in the marketplace.

The goals of the particular project often define the optimum allocation of rights. For example, ARPA has entered into agreements where one result of the effort is for the partnership to develop a proprietary version of the first generation of a new product while also developing the industry standards or reference architecture for future generations. The standards are delivered with unlimited rights since their very purpose is to be publically available.

In the area of sensitive business and technical data, ARPA typically minimizes the actual delivery to the government. Data which become an "agency record" for purposes of the Freedom of Information Act run the risk of being disclosed to a competitor or, at the minimum, requires a commercial firm to spend time and expense convincing the Government that the record should not be disclosed to a requestor. In lieu of delivery of sensitive data, alternative methods of keeping the ARPA program manager and agreement administrator informed are used such as meetings, briefings and delivery of summary reports.

OTHER OBSERVATIONS

Although most of ARPA's other transactions have been multi-party arrangements, this is clearly not the only, or in some cases even an optimum, way to do business. While consortia offer many

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advantages such as pooling talent, leveraging investments and developing strategic relationships, not every project or technology development can be accomplished collaboratively. ARPA's experience has been that working out the proper roles and relationships among the industry partners is often more difficult and time consuming than working out the Government-industry relationship. Without the flexibility of "other transactions" it would probably be impossible to reach agreement in many cases.

Foreign participation in ARPA sponsored efforts presents challenges and opportunities. The best technology is often not available domestically. Refusing to work with foreign companies would be a case of shooting one's own foot. On the other hand in this post-Cold War era domestic economic development must be carefully considered in government mission-oriented research and development. ARPA has developed a "Foreign Access to Technology" clause which it includes in its agreements. Companies with plans for strictly domestic production generally have no problems with the clause. In the case of multi-national companies and partnerships involving foreign firms, the clause generates elucidating discussions which help ARPA to understand where the economic benefit of the project is likely to go. ARPA tries to accommodate industry's needs so long as the end result is substantial benefit flowing to the U.S economy.

Cost-shared partnerships provide a real opportunity for developing new, less adversarial government-industry relationships. In the case of the TRP each project is dual-use in nature and industry has a strong incentive to push the project to a successful conclusion. It is industry self-interest, rather than government oversight, that becomes the dominant feature in maintaining the public trust. Each participant has a strong interest in performing as effectively as possible. Additional pressure comes from the industry partners who are typically dependent on the success of every other participant.

Use of fixed price payments triggered by the accomplishment of technical milestones reduces the need for extensive financial reporting and audit. This also avoids imposition of government cost principles and accounting systems which are anathema to many commercial firms.

Operating in a partnership environment is not natural for government or industry. Many traditional attitudes do not work well. In fact the stock in trade of the legal profession - focusing on avoiding failure and leaving nothing to trust - is particularly ill-suited to developing fruitful partnership relations. Few rules are applicable to "other transactions." This makes many people in both government and industry uncomfortable.

For those willing to accept the challenge, however, working in such

an environment is particularly rewarding.

CONCLUSION

At a time when government is trying to reinvent itself and Government's role in research and development is being re-examined in light of the end of the Cold War, the authority to enter into "other transactions" provides government agencies an unparalleled opportunity to experiment with new ways of doing business. "Other transactions" permit the deregulation of government supported research and development. Government is able to enter into "partnership" with industry and leverage not only the resources but also the genius and leadership of industry to the mutual advantage of both Government and industry. Government is no longer the market for high technology. Government technology developments must not only meet mission needs but must do so affordably. The dual-use strategy is premised on the view that integration of the Government market into the broader commercial market place is an important facet in assuring the affordability of high technology products for the military. "Other transactions" that are extremely flexible and permit the adoption of commercial practices can be an important tool in reaching the goal of affordable military superiority for the United States.