It May Be Time for Companies to Reconsider DOD Contracts

By **Eric Aaserud and Julia Fox** | July 6, 2018, 1:03 PM EDT

Eric Aaserud

Julia Fox

In the last decade or so, the U.S. Department of Defense has been, in the words of the Section 809 Panel, an "unattractive customer to large and small firms with innovative, state-of-the-art solutions."[1] Among other things, the department has imposed a growing list of new obligations on commercial item contractors and subcontractors; watched as large numbers of its acquisition personnel have left the workforce; taken longer and longer in its purchases of innovative technology; and sought greater intellectual property rights at the expense of government contractors.

There have been several recent developments, however, that may give rise to optimism among innovative, commercially oriented contractors that have been avoiding the DOD. In this article, we address a few of the more significant developments.

New DOD Rule Will Likely Broaden Use of Commercial Item Procedures

In recent years, the DOD has been requiring more and more contractor information to support commercial pricing, thereby lengthening the procurement process and narrowing the use of commercial item procedures.[2] A recent rule change signals a shift in the other direction.

On Jan. 31, 2018, the DOD published a final rule amending Defense Federal Acquisition Regulation Supplement commercial item purchasing requirements and implementing sections of the National Defense Authorization Acts for fiscal years 2013, 2016 and 2018. Among other things, the new rule does the following:

- Revises DFARS 212.102(a)(ii) to include a presumption that a prior commercial item determination made by a military department, defense agency or another DOD component shall serve as a determination for subsequent procurements of such item.
- Adds DFARS 212.209, which directs a contracting officer to consider market research in making price reasonableness determinations. If the CO determinates that information obtained through market research is insufficient to determine price reasonableness, the CO must consider recent purchase prices paid by both the government and commercial customers for the same or similar commercial items. In addition, the new rule establishes

a hierarchy that COs are to follow when determining what information is necessary to determine price reasonableness.

- Permits a CO to make a fair and reasonable price determination based upon "the minimum information necessary."

In addition, the new rule adds a clause advising offerors that the government may treat nontraditional defense contractor supplies and services as commercial items.[3] This approach "is intended to enhance defense innovation and investment, enable DoD to acquire items that otherwise might not have been available, and create incentives for nontraditional defense contractors to do business with DoD."

Government Must Meaningfully Consider Use of Commercial Item Procedures

Under 10 U.S.C. § 2377, a contracting agency must first assess whether commercial items are suitable to meet the agency's needs before resorting to the use of developmental items. The U.S. Court of Federal Claims recently affirmed and clarified this statutory obligation to consider use of commercial item acquisitions.

In Palantir USG Inc. v. United States,[4] Judge Marian Horn found that the Army acted arbitrarily and capriciously by failing to fully investigate commercial item alternatives to meet its requirements. Months later, in Analytical Graphics Inc. v. United States,[5] Judge Horn found that the Air Force properly rejected a commercial item acquisition following proper weighing and consideration. Judge Horn distinguished the decisions by noting that "the Palantir protest presented a much clearer picture of an agency trying to avoid a particular contractor and a commercial items approach to the procurement, as well as a failure on the part of the agency to do a proper investigation and review of available commercial alternatives. In the [Analytical Graphics] protest ... the Air Force was more deliberate and more candid about its commercial options."[6]

Perhaps the main point to glean from the two decisions is that contracting agencies must document their commercial item decisions. Indeed, according to Judge Horn, it "behooves any agency" to provide documentation of a commercial availability decision.[7]

The government has appealed Palantir. If the U.S. Court of Appeals for the Federal Circuit affirms and finds that agencies must (1) consider use of commercial items to the maximum extent practicable and (2) fully document their decisions, commercially oriented companies might enjoy richer opportunities in the federal marketplace.

Use of "Other Transaction" Agreements Is On the Rise

An "other transaction" agreement (OTA) is a special contracting vehicle that certain federal agencies can use to obtain research and development. OTAs typically do not include many of the

obligations and risks found in standard procurement contracts: DOD-approved accounting standards, small business subcontracting plans and onerous IP clauses, for example.

Only agencies that have been granted express authority may engage in these transactions. Congress first gave OTA authority to the National Aeronautics and Space Administration in the late 1950s when it passed the National Aeronautics and Space Act of 1958. In 1989, Congress enacted legislation to provide the Defense Advanced Research Projects Agency with authority to enter into cooperative agreements and "other transactions" for research work.[8]

After a protracted lull, the Pentagon in recent years has begun to embrace the use of OTAs in parallel with a renewed emphasis on speed and innovation in acquiring new technologies.

A change in the law has buoyed this shift. The FY 2016 NDAA added language to 10 U.S.C. § 2371b(f), which provides a more simplified way of transitioning from R&D to production. Follow-on production effort after a successful prototype effort can now be awarded as a noncompetitive procurement contract or executed as a production OTA. In the minds of many, the wide chasm between prototype and production (the "Valley of Death") has been bridged in a meaningful way.

Budget Increases

In addition to these law and policy changes, there has been an upsurge in DOD spending.

On March 23, 2018, President Donald Trump signed a $1.3 trillion spending bill that allocates $700 billion for the DOD in FY 2018, a sum that represents an eye-popping $61 billion increase from last year. Appearing with the president on the day he signed the spending bill, U.S. Secretary of Defense James Mattis lauded the move as "reversing many years of decline and unpredictable funding." Contractors can expect another significant increase in FY 2019.

All in all, these changes in procurement law and policy, along with recent budget increases, indicate that the DOD is developing into a more attractive customer for innovative, commercially oriented companies. For many of these companies, including those that have long been leery of federal contracting obligations and risk, now might be the time to take a new look at DOD.

Eric A. Aaserud is senior counsel and Julia M. Fox is an associate at Perkins Coie LLP.

[1] The 18-person panel was established per section 809 of the FY 2016 National Defense Authorization Act and amended by the NDAAs for FY 2017 and FY 2018. The panel is charged with finding ways to improve the defense acquisition process.

[2] Part 12 of the Federal Acquisition Regulation \implements the government's preference for the acquisition of commercial items. FAR Part 12 mandates more streamlined acquisition procedures and the use of fewer FAR and supplemental clauses in contracts.

[3] A nontraditional defense contractor is an entity that is not currently performing and has not performed for at least one year any contract or subcontract for DOD that is subject to full coverage under the cost accounting standards.

[4] Palantir USG Inc. v. United States, 129 Fed. Cl. 218 (2016)

[5] Analytical Graphics, Inc. v. United States, 135 Fed. Cl. 378 (2017)

[6] Id. at 433.

[7] Id. at 431, n.40.

[8] At DOD these transactions are now typically known as technology investment agreements.