

# THE NASH & CIBINIC REPORT

government contract analysis and advice monthly from  
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## GUEST APPEARANCE

### ¶ 22 OTHER TRANSACTION AGREEMENTS: What Applies?

*A special column by Richard L. Dunn, retired General Counsel, Defense Advanced Research Projects Agency*

To practitioners schooled in the highly regulated Government purchasing system based on procurement statutes and the Federal Acquisition Regulation, Department of Defense other transactions (OTs) sometimes seem mysterious. See also *Other Transactions: A Preferred Technique?*, 32 NCRNL ¶ 8. This article outlines what laws and regulations apply to OTs as well as those that do not. While not comprehensive, it discusses many specific examples and provides general guidance for assessing the applicability of statutes to OT agreements. The key is to understand that within their domain (research and development, prototyping, and follow-on production) OTs are just contracts. Relatively few laws and regulations apply. They are more akin to common law or commercial contracts than to Government procurement contracts. Skills useful in that type contracting apply to OT contracting.

OTs exist within the construct of contract law. They are typically legally binding contracts with all their attributes but can take other forms such as agreements to agree. Their primary characteristic is freedom of contract: parties to an agreement create a regime between themselves that is legally enforceable. Freedom of contract is constrained by statutes of general applicability. Because the U.S. Government is party to OT agreements, laws specific to Government actions apply. The primary constraint in this regard is Government fiscal law.

In determining the applicability of federal statutes to OTs the first difficulty comes from the term “contract.” In some statutes, contract is intended to mean procurement contract. In other cases, it has a broader meaning. In the litany of terms *contract, grant, or cooperative agreement* appearing together, contract almost always means procurement contract. Procurement contracts are to be used for the principal purpose of acquiring property or services for the direct benefit or use of the Federal Government (31 USCA § 6303). The DOD’s primary procurement statute (Chapter 137, Title 10 U.S. Code) applies to the procurement of property or services paid with appropriated funds (10 USCA § 2303).

It helps in determining what does and does not apply to OTs to recognize that (1) R&D and (2) acquisition or procurement are not the same thing. R&D is not a subset of *procurement*. In the DOD, contracted R&D is almost always conducted for agency mission purposes and not for the primary purpose of providing financial assistance to a recipient. Cf. 31 USCA § § 6304, 6305. FAR 37.000 hints that R&D might be a specialized form of service contracting but defers to the R&D chapter (FAR Part 35), which states in FAR 35.002 that most R&D contracts are unlike contracts for supplies and services. In Title 10, U.S. Code, general procurement provisions (chapter 137) and R&D provisions (chapter 139) are contained in separate chapters. To better understand the role of OTs in R&D and prototyping, see generally, Dunn, *Feature Comment: Appropriate Contractual Instruments for R&D*, 59 GC ¶ 202 (July 12, 2017). Refer also to National Defense Authorization Act for Fiscal Year 2018, Pub. L. No. 115-91, § 862 (OTs added to 10 USCA § 2358) and § 867 (preference for OTs).

## What Applies—The OT Statutes

What do the statutes tell us about to what and how they apply? 10 USCA § 2371, applies to “basic, applied, and advanced research projects” (“research” or “science and technology (S&T)” OTs). The companion statute, 10 USCA § 2371b, which is executed “under the authority” of § 2371, applies to “prototype projects that are directly relevant to enhancing the mission effectiveness of military personnel,” their supporting systems, platforms, and so forth. Pursuant to 10 USCA § 2371b(f), a production effort may be awarded following a successful prototype project either as an OT, procurement contract, or pursuant to a contracting system to be established by the Secretary of Defense. The two statutes clearly overlap since research authorized by § 2371 may involve a prototype, and, a prototype project under § 2371b may involve research of the kinds authorized by 10 USCA § 2371.

Pursuant to 10 USCA § 2371(e), three conditions are prerequisite to award of an OT for basic, applied, or advanced research. They are (1) no duplication of effort with existing programs, essentially a throw-away provision; (2) to the extent practicable Government funds do not exceed funds provided by other parties; and (3) use of a standard contract, grant, or cooperative agreement is not feasible or appropriate. Subsection (2) reflects the statute’s primary emphasis on dual-use technologies but is not an absolute—*practicable*. The very first OT agreement with a venture capital supported firm did not involve any cost-sharing and was justified before Congress by the deputy secretary of defense. Subsection (3) provides no inhibition to the use of a § 2371 OT for DOD R&D. A standard contract means a procurement contract. Section 2371 OT’s are not used for the principal purpose of acquiring goods or services (incidental acquisition of hardware is permissible). They are used primarily for advancing scientific and technical knowledge and applying that knowledge to achieve agency and national goals.

The original prototype statute (§ 845 of the National Defense Authorization Act for Fiscal Year 1994, Pub. L. No. 103-160) primarily applied to defense contractors (“directly relevant to weapons or weapons systems”). Although § 2371b is under the authority of § 2371, subsections (e)(2) and (3) of § 2371 do not apply to § 2371b. Section 2371b may be used without § 2371 cost-sharing and used for standard acquisition, financial assistance, or for other purposes. An amendment (see § 815 of the National Defense Authorization Act for Fiscal Year 2016, Pub. L. No. 114-92), subsection (d) of 2371b, requires either significant participation of a nontraditional defense contractor; one-third cost sharing; or that innovative business arrangements or contract structures justify a finding of “exceptional circumstances.” The legislative history indicates that the intent of the amendment was (1) to increase the participation of nontraditional contractors in defense projects, or, alternatively (2) to increase the efficiency of traditional defense contractors. An exceptional circumstances determination by the agency’s senior procurement executive has been seldom utilized despite exceptional circumstances findings being readily available. Many OT prototype projects incorporate a series of fixed payments based on achieving observable technical milestones. This is not a contract structure described in FAR Part 16 and would require a formal FAR deviation for a procurement contract. A structure requiring formal deviation should be viewed as “exceptional circumstances” within the meaning of the statute. There are many other initiatives that contractors could propose that would constitute exceptional circumstances, but an OT structured with fixed payable milestones should receive automatic approval.

## Other Statutes—What Does Not Apply?

Lists of various statutes that generally apply or do not apply to OTs have been issued by the DOD and by some other agencies that have OT authority. A detailed and thoughtful analysis of the subject is contained in *The Applicability of Certain Procurement-Related Statutes to DOD “Other Transactions”* by an ad hoc working group of the Section of Public Contract Law, American Bar Association. The ABA analysis reviewed the Under Secretary of Defense (AT&L) memorandum on the subject and in most cases was in agreement. The ABA group also analyzed other statutes that were not included in the DOD list. In the discussion below, I have generally relied on the ABA analysis, however, there have been changes in the OT statutes as well as amendments to some of statutes that were analyzed and that has been taken into consideration.

In general, statutes (and regulations based on statutes) that are specific to the procurement or financial assistance systems do not apply to OTs whether under 10 USCA § 2371 or § 2371b. The statutes specific to the procurement system include Chapters 137 (“Procurement Generally”) and 141 (“Miscellaneous Procurement Provisions”) of Title 10 U.S. Code; Title 41, U.S. Code (“Public Contracts”); Subchapter 5, Title 31 U.S. Code (“Procurement Protest System”). Refer to the index to those chapters in the U.S. Code to get a sense of specific provisions.

Listed here are some of the more well-known provisions of the procurement system that are not applicable: Competition in Contracting Act, Contract Disputes Act, Procurement Protest System, Kinds of Contracts, Examination of records of contractors, Rights in Technical Data, Truthfulness in Negotiations, Prohibition against doing business with certain officers (10 USCA § 2393), Major Weapons Systems: Contractor Guarantees, Prohibition on persons convicted of defense contract related felonies (10 USCA § 2408), Service Contract Act, Drug Free Workplace, and Buy American Act.

Another important statute that is not applicable is the Bayh-Dole Act, 35 USCA § § 200–212, governing patent rights in certain Government-funded inventions. This enables the parties to negotiate rights in these inventions that vary from the rights granted under the Bayh-Dole Act, particularly beneficial in attracting high technology, leading-edge commercial companies to perform OTs for the DOD.

A beneficial statute that does not apply is 10 USCA § 2354 concerning indemnification of certain R&D activities. Lack of this is substantially mitigated since the ABA analysis noted the applicability of another indemnification statute. (“Public Law 85-804 applies to both S&T and § 2371b OTs. Moreover, it is in the interests of both the Government and contractor to include both types of OTs within coverage of the statute.”)

The statutes governing the Cost Accounting Standards and Cost Principles do not apply to OTs. However, OTs are mentioned in one of the cost principles in FAR. The ABA analysis concluded the Anti-Kickback statute does not apply to § 2371 OTs but may apply to prototype OTs. While the full GAO protest system does not apply to OTs, the GAO will review an OT protest on the threshold question of whether an OT was properly used or a procurement contract was required.

### Statutes That Apply

Once again we begin with a review of the OT statutes themselves. In early lists the Procurement Integrity Act (41 USCA § § 2101–2107) was considered inapplicable but Congress has made it applicable to prototype OTs in 10 USCA § 2371b(h). Various statutes governing access to records do not apply to OTs but Congress has provided a provision for Comptroller General audits under certain circumstances in § 2371b(c). Records related to OTs are generally subject to the Freedom of Information Act (5 USCA § 552) but Congress has provided a statutory exception, 10 USCA § 2371(i), that applies to both S&T and prototype OTs.

Beyond the statutes themselves a number of statutory provisions apply that are not always obvious. Title VI of the Civil Rights Act, Non-Discrimination in Federal Programs (42 USCA § 2000d et seq.) applies in contrast to socioeconomic preference programs specific to the procurement system. The Trade Secrets Act (18 USCA § 1905) applies and is particularly important in dealing with commercial firms. The Tucker Act (28 USCA § 1491(a)) providing for federal court jurisdiction over certain contract claims applies. The old Wunderlich Act (disputes clause with an agency unilateral decision) allows court review of findings of law.

Other statutes might arguably be applicable but their potential application is based on either a misunderstanding of the proper use of OTs in R&D and prototyping or a presumed misuse of OTs. Statutes in this category include the Walsh-Healey Public Contracts Act (41 USCA § § 6501–6511) and the Fair Labor Standards Act (29 USCA § 201 et seq.). That discussion seems too arcane for this article. It should be noted, however, that production OTs may trigger the applicability of some statutes not applicable to S&T or prototype OTs.

### Fiscal Law And OTs

Some fiscal laws apply only to specific types of funding instruments or categories of transactions. Many fiscal laws, however, apply generally to obligations, expenditures, or contracting in whatever form they may take. The ABA study concluded that the Anti-Deficiency Act (31 USCA § 1341) applies to OTs but limitations on use of appropriated funds to influence certain contracting and financial transactions (Byrd Amendment, 31 USCA § 1352) do not. Title 31 provisions on judgments and compromise settlements (31 USCA § 1304) apply as do provisions on administrative remedies and false claims (31 USCA § 3801).

The most common interface between OTs and fiscal law is with authorization and appropriation acts. The annual National Defense Authorization Acts have been the primary vehicle for enacting and amending OT legislation and providing guidance on OT use through legislative provisions and report language. Appropriations Acts provide binding guidance on how much money an agency can spend, on what objects it can be spent, and for how long it is available for obligation. One of the myths about OTs is that they can only be funded by research, development, test, and evaluation (RDT&E) appropriations. A normal fiscal law analysis is used. For what objects or purposes are the appropriations available? What is the purpose of the OT? If the purposes match, the appropriation can be used. In addition to RDT&E appropriations, funds provided pursuant to Defense Production Act Title III and Operations and Maintenance (O&M) appropriations have been used to fund OTs. In the future, other appropriations, including procurement appropriations, may be used.

## Regulations And Guidance

The regulations relating to OTs unfortunately demonstrate the lack of leadership and bureaucratic stove piping that has characterized some career senior leaders' attitudes toward OTs until recently. The recent reorganization of the DOD decentralized acquisition and R&D, which some consider problematic. Sadly, a bureaucratic split (stove pipes) between acquisition and R&D offices has long characterized the DOD's approach to flexible contracting generally and OTs and other innovative contracting authorities (10 USCA § 2373, § 2374a) in particular. A new organizational model can hardly be worse.

- *Prototype OT regulations.* Regulations governing prototype OTs are found at 32 CFR Part 3. Interestingly, the definition of agreements officer (32 CFR § 3.4) does not require the agreements officer to be a warranted Contracting Officer. These regulations are based on § 845, are out of date, and have been generally ignored since they were promulgated.

- *Technology Investment Agreement (TIA) regulations.* These regulations found at 32 CFR Part 37 implement a provision of 10 USCA § 2371 requiring regulations. The purpose of these regulations is mainly to reconcile OTs with the DOD's use of financial assistance instruments generally (non-R&D specific) as part of the DOD Grants and Agreements Regulatory System. They are lengthy and complex, like a mini-FAR. They limit the "freedom of contract" attribute of OTs. They relate only to a minuscule fraction of potential § 2371 OT agreements—namely those used for financial assistance that incorporate a variation of the Bayh-Dole patent clause. Considering that § 2371 is essentially a dual-use, outward-looking statute, these regulations are strangely inward looking, a "how to" for Government insiders. Even in that role, they fail and many of their provisions are garbled and make little sense. Unfortunately, these regulations are often wrongly thought to apply to all § 2371 agreements; this played a significant role in the decline of S&T OTs.

- *DPAP Guidance for Prototype OTs.* While containing a few useful points, the DPAP Guidance is fundamentally flawed. The first thing to note is that it was issued by the director of the Office of the Secretary of Defense Office of Procurement and Acquisition Policy, an official who has no authority to direct the secretaries of the military departments on how to use or delegate the OT authority vested in them by statute. It merely constitutes the opinion of DPAP on how prototype OT authority should be used. The guide contains many provisions that indicate DPAP had a very limited understanding of the OT statutes or how they have been used. The Guide's few useful insights were contained in a draft document presented to DPAP. The final document issued by DPAP failed to fully incorporate the draft and reverted to outdated and erroneous concepts. The Guide wrongly asserts there is a hard divide between § 2371 and § 2371b OTs, failing to see substantial overlap between the two statutes. The Guide limits prototype OTs only to acquisition, which keeps prototype OTs in the DPAP stove pipe but fails to recognize non-acquisition prototype OTs including unfunded OTs.

- *Other regulations.* Caution should be used in applying regulations not specific to OTs to OT agreements. Certain terms used in the DOD Financial Management Regulation, 7000.14-R, are similar to terms in the OT statutes. The OT statutes are to be interpreted based on their plain meaning and legislative history independent of guidance contained in sources such as the FMR. Having said that, the regulation can provide useful insights. The FMR points out that O&M funds should be used for certain R&D activities namely those related to the enhancement or upgrade of an existing system or platform. While not specific to OTs this guidance covers use of O&M funds when OTs are used for that purpose.

As stated above the OT statute is mentioned in a Cost Principle. FAR 31.205-18(e) permits a contractor to use independent research and development funds in connection with project under 10 USCA § 2371 or equivalent authority. OT projects can be structured under IR&D rules with Government funds offsetting balances that otherwise would be allocated to the contractor's IR&D pool. Only overruns, if the contractor chooses to incur them, would be allocated to the IR&D pool.

Guidance and limitations on the use of OTs may also be found in delegations of authority related to OTs. For example, the Army OT delegation unwisely directs organizations receiving delegated authority to follow the flawed DPAP Guide on prototype OTs.

### Filling The Void

Some of the large number of procurement laws and regulations that do not apply address important issues. CICA does not apply. Prototype OTs are to be awarded using competitive procedures to the maximum extent practicable but those competitive procedures are not stated. This requires OT practitioners to think. What makes sense for the project? What is the best method of publicity and outreach? How does the industry segment in question normally handle similar requirements? Something similar to a broad agency announcement might make sense or perhaps an entirely different approach should be taken. The key is to be thoughtful.

Statutes governing patent rights and rights in technical data do not apply to OTs. How should these issues be addressed? Think and listen. These are matters for negotiation. Practitioners need to understand the needs of both Government and industry partners. This is different from plugging in the contract clause that the FAR requires. The skills required in this type of setting are common in the commercial world. Unfortunately, these are not skills that Government procurement practitioners normally acquire.

Issues illustrated above are just two examples that come up in OT contracting. In a freedom of contract environment new skills and approaches are needed especially by personnel steeped in the FAR regulatory system. Education and training are essential for personnel who will become OT practitioners. This has been recognized in § 863 of the FY 2018 NDAA (education on innovative contracting required). *Richard L. Dunn*