June 8, 2001

Under Secretary of Defense
for Acquisition, Technology and Logistics
Attn: Ms. Teresa Brooks
USD(A&T)
3060 Defense Pentagon
Washington, DC 20301-3060

Re: Other Transactions Guide for Prototype Projects

Dear Ms. Brooks:

On behalf of the Section of Public Contract Law of the American Bar Association ("the Section"), I am submitting comments on the above-referenced Guide. The Section consists of attorneys and associated professionals in private practice, industry, and Government service. The Section’s governing Council and substantive committees contain members representing these three segments to ensure that all points of view are considered. In this manner, the Section seeks to improve the process of public contracting for needed supplies, services, and public works.

The Section is authorized to submit comments on acquisition regulations under special authority granted by the Association’s Board of Governors. The views expressed herein have not been approved by the House of Delegates or the Board of Governors of the American Bar Association and, therefore, should not be construed as representing the policy of the American Bar Association.¹

¹ Mary Ellen Coster Williams, an Officer of the Public Contract Law Section, did not participate in the Section’s consideration of these comments, and she abstained from voting to approve and send this letter.
The stated purpose of the Other Transactions ("OT") Guide is to provide a framework that Department of Defense ("DoD") Agreements Officers and Program Managers should consider when using OT authority for prototype projects directly relevant to weapons or weapon systems that the Department proposes to acquire or develop. DoD issued the OT Guide in January 2001 as a directive-type memorandum; we understand that the Department intends to issue an Instruction directing the acquisition workforce to use the OT Guide when considering the use of an OT for prototypes.

There was limited opportunity for comment on an October 1999 draft of the OT Guide. Those comments, as well as significant legislation and policy issues, resulted in substantial changes in the final OT Guide. The Section was informally requested to provide comments on the final OT Guide. Based largely on the experience that many of our Government, industry, and private bar members have in the negotiation and execution of OTs for prototypes, the Section offers the following comments and suggestions.

**The Definition of “Nontraditional Defense Contractor”**

The Section supports the Department’s goal of encouraging companies engaged in research and development, that do not traditionally do business with the federal government to participate in OTs. The OT Guide, however, defines these “nontraditional defense contractors” in a way that will inhibit the achievement of this goal, because the definition treats companies that receive an insignificant portion of their revenue from federal contracts as traditional defense contractors. The distinction between traditional and nontraditional defense contractors is significant, because the National Defense Authorization Act for Fiscal Year 2001 requires the private party to an OT for prototypes to provide a cost share of one-third the total cost unless a nontraditional defense contractor participates to a significant extent. Pub. L. No. 106-398, § 803(a).

The OT Guide paraphrases the statutory definition of nontraditional defense contractor as follows:

A nontraditional defense contractor is 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 prescribed pursuant to section 26 of the Office of Federal Procurement Policy Act
(41 U.S.C. 422) and the regulations implementing such section; 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. (emphasis added)

DL1.12. Significantly, the OT Guide uses the term “business unit” while the statute uses the term “business entity.” The term “business unit” and the related term “segment” have established meanings for cost accounting purposes. See CAS 9903.301. Business entity does not.

The above test can prevent business entities that have insignificant federal government business from qualifying as “nontraditional defense contractors.” For example, a company may have numerous research facilities, each conducting research and development in a completely different area of technology; the company may have all of these research facilities reporting directly to a home office, grouped as a single profit center, or within the same corporate structure. In such case, the research facilities together could constitute a “segment” or “business unit” as defined in the OT Guide. If only one of these research facilities receives a procurement contract in excess of $500,000 to carry out a prototype project or to perform basic, applied, or advanced research projects for a federal agency, that research facility, as well as all the other research facilities in that business unit or segment, would be considered traditional defense contractors.

This result appears inconsistent with the goal of attracting commercial business entities to participate in OTs. Although the Section understands that the statute currently relies upon a $500,000 threshold, this threshold, when applied to business units or segments as defined by the CAS regulations will prevent many commercial companies from qualifying to participate in fully funded OTs. For large research and development companies a $500,000 contract is not of sufficient value to impact its business processes. For example, commercial companies such as Motorola, Lucent Technologies, Kodak, IBM, and 3M each spend over $1 billion annually on internal research to develop new products.

The Section recommends that the OT Guide use the term “business entity” found in the statute instead of “business unit” or “segment” to achieve more flexibility. If the OT Guide defines a business entity as an established operation that was not otherwise subject to government cost accounting through either holding a cost reimbursement contract or application of CAS to its cost center, the flexibility needed to identify and attract commercial operations to DOD work might better be achieved.
Intellectual Property

Section C2.3 of the OT Guide covers intellectual property. It greatly expands the treatment of this topic as it appeared in the draft OT Guide. The introductory paragraph at C2.3.1 describes generally the significant flexibility available in OTs for prototypes; specifically, that the patent and technical data statutes do not apply to these instruments. This general section is consistent with the Draft Guide: Intellectual Property -- Navigating Through Commercial Waters (“IP Guide”), which your office is also preparing. The Section notes, however, that the specific discussion of Rights in Inventions and Patents in paragraph C2.3.2 and Rights in Technical Data and Computer Software in paragraph C2.3.3 include guidance that one could interpret to be more restrictive than, and inconsistent with, the principles stated in the introductory paragraph C2.3.1 and in the draft IP Guide. This is of concern because OTs should have even more flexibility than FAR-based contracts.

The parties negotiating intellectual property rights under OTs should use the IP Guide as a potential framework, but each OT transaction requires individual evaluation. Although we recognize that the OT Guide is explicitly premised on this proposition, one could construe the text of the OT Guide relating to intellectual property to be even more restrictive than the IP Guide now being prepared. For example, paragraph C2.3.3.4 suggests that all OTs presume that unless delivered data is marked precisely in accordance with the contract, protection is lost, that is the DFARS rule. Moreover, the problem remains even if the OT Guide was revised to refer readers to the IP Guide, because OTs are intended to have more flexibility, Agreements Officer may be reluctant to deviate from the examples found in the IP Guide.

To address this potential misinterpretation of the OT Guide, we suggest the following revisions:

(1) Paragraph C2.3.1.3 should be revised to place greater emphasis on the potentially unique nature of the OT and its commercial context:

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2 See DFARS 252.227-7013(f). First, substantial compliance should be all that is necessary. Second, an OT could switch the presumption and the parties agree that all data provided is presumed to be delivered to the Government with restricted rights. In commercial contracts, this is often the presumption.
C2.3.1.3. Where the government overestimates the intellectual property rights it will need, the government might pay for unused rights and dissuade new business entities from entering into an Agreement. The Agreements Officer should recognize that companies view their best research and development assets as investment resources. In other words, on successful projects they expect the investment to be returned many times over in the future through obtaining a better market position. Such positioning is one of the principal justifications for cost sharing. To the extent the OT arrangement precludes such future returns,* the incentive for companies to participate is diminished. Conversely, bearing this in mind, the Agreements Officer should carefully assess the intellectual property needs of the government. The Agreements Officer should assess the impact of intellectual property 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. In addition, insufficient intellectual property rights could hinder the government’s ability to adapt the developed technology for use outside the initial scope of the prototype project.

ftnt. * The Agreement Officer should also negotiate restrictions if any, on the contractor’s ability to compete for follow-on work as part of the OT due to any actual or perceived organizational conflict of interest.

(2) We suggest similar changes to paragraph C.2.3.1.4 by deleting the sentence restricting the incorporation of clauses by reference. The implication of that sentence is that the FAR or DFAR clauses would generally be appropriate; that may not be the case. A revised paragraph could state:

C.2.3.1.4. The negotiated intellectual property clauses should facilitate the acquisition strategy, including any likely production and follow-on support of the prototyped item, and balance the relative investments and risks borne by the parties both in past development of the technology
and in future development and maintenance of the technology. Also, the Agreements Officer should consider the effect of other forms of intellectual property (e.g., trademarks, registered vessel hulls, etc.), that may impact the acquisitions strategy for the technology. The Agreements Officer should negotiate rights of a scope appropriate to accomplish program objectives and foster government interests.

(3) The last sentence of paragraph C2.3.1.7 could be read to require paid up licenses for unlimited Government use or release of technology in OTs. This is not necessary, however, as long as the commercial market place is providing reasonable support for the technology. In fact, obtaining an unrestricted license will often encourage the commercial market to stop supporting the technology in favor of other technology in which private business can invest and protect. We therefore suggest revising the second sentence of Paragraph C2.3.1.7 as follows:

The OT agreement should provide contingent rights if the commercial market place stops reasonably supporting the technology. For example, it could provide that each contractor supporting the technology agrees that if the technology is no longer supported commercially (and the agreement should define what this means to the parties), then that contractor will provide the Government with rights sufficient to allow continued support, generally government purpose rights, or will license the technology and “know how” to other contractors who are willing to provide support.

(4) Paragraph C2.3.1.8 raises extremely complex issues involving a balance of the impacts of licensing on domestic markets. Given this complexity, the concern is that most contracting officers will simply forbid licensing or manufacturing outside the United States which will unduly limit commercial firms. Of course, export restrictions must be observed. This section should therefore be deleted or provide more guidance.

(5) Likewise, paragraph C2.3.1.9 follows the FAR/DFARS model in suggesting that after a set number of years the developer should lose all its rights. Commercial firms will find this directly contrary to commercial practices; traditional government contractors that must invest their own funds in OT projects will likewise
find such a preference troublesome. Similar changes would be appropriate throughout paragraphs C2.3.2 and C2.3.3.

The Section supports the efforts of the Department to provide mechanisms for nontraditional defense contractors to support its weapons systems needs. Recognizing the limitations inherent in existing legislation, the Department can still advance this objective by (1) revising the definition of “nontraditional defense contractors” to ensure commercial firms or commercial business entities of defense firms are not unnecessarily treated as traditional defense contractors, and (2) better reflect throughout the intellectual property sections of the OT Guide the flexibility needed to address the many longstanding, difficult issues acquisition of rights in intellectual property present.

The Section hopes these comments prove useful and is available to provide additional information or assistance as you may require.

Sincerely,

Gregory A. Smith
Chair, Section of Public Contract Law

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