October 27, 2004

VIA FACSIMILE and FIRST CLASS MAIL

Michael W. Wynne
Under Secretary of Defense
Acquisition, Technology and Logistics (acting)
3010 Defense Pentagon
Washington, D.C. 20301-3010

Re: Selection of Contractors for Subsystems and Components Memorandum for Secretaries of the Military Departments, Dated July 12, 2004

Dear Mr. Wynne:

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

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.

Background

On July 12, 2004, your office issued a memorandum for the secretaries of the military departments entitled Selection of Contractors for Subsystems and

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Components ("Memorandum"). Its purpose is to foster competition for major program subsystems and components. To achieve this purpose, the Memorandum mandates action by the government during the acquisition planning process and by industry when assembling a team to deliver the required capabilities.

The Memorandum notes that defense acquisition benefits from competition at both the prime contractor and subcontractor levels. Because of defense consolidation, however, large defense contractors more often must choose between an affiliate and an unrelated company for major program subsystems or components. The potential for bias favoring the affiliate is a stated reason for the government seeking greater insight into the prime contractor’s team selection process.

Comments

The Section understands and fully supports the government’s efforts to foster robust competition at both the prime contract and subcontract levels. In fact, the first principle in the Principles of Competition in Public Procurements adopted by the American Bar Association urges that public acquisition use full and open competition to the maximum extent practicable. The Section also strongly supports upholding the integrity of the acquisition process.

With these principles in mind, the Section's review of the Memorandum’s procedure to ensure competition for subsystems and components has resulted in the following four comments, which are offered for your consideration.

1. The effect of market forces.

The Memorandum’s procedures seek “insight into a prime contractor’s plan for assembling a team to deliver the required system capability, as well as to foster competition.” By definition, market forces exert power when there is a competitive procurement; but because some procurements must be conducted on a sole source basis, the Memorandum’s procedures might be improved by distinguishing between and addressing both competitive and sole source procurements.

The Section is informed that, typically, a contractor’s choice of team members, or its determination to perform the work itself or through an affiliate, results from numerous objective and subjective considerations, similar to a best-value determination. When this determination occurs in the context of competition, the competitive marketplace impacts the decision-making process and may punish wrong decisions. The competitive marketplace may also work to mitigate the concern over bias in favor of an affiliate. Competition for major programs today
usually is team versus team, and not simply company versus company. A company favoring an affiliate may have trouble attracting strong teammates if it is viewed as less competitive due to favoritism toward an affiliate, i.e., if the market views that affiliate as weak. In competitive prime contract awards, market forces may thus exert pressure on companies to select between affiliates and independent companies based on what will make their proposals the most competitive, so that the need for government involvement in the selection process is minimized.

On the other hand, in situations where the prime contract will be awarded on a sole source basis, government oversight may be an acceptable means of ensuring adequate and fair competition at the subsystem and component level. Such oversight might be used to compensate for the absence of competitive market forces. Government review of the prime contractor's subcontracting plan may provide insight into the adequacy of competition at the subsystem and component levels on a particular major program.

The Section supports the admonition contained in the Memorandum, cautioning that defense department officials who review competition at the subsystem and component levels should avoid acting as surrogate source selection officials. To do so could breach the wall between government and subcontractor, resulting in judicial determinations that privity of contract exists between a subcontractor and the government.

The integrity of the acquisition process requires that the determination of team members must reside with the prime contractor. The Section nevertheless supports the safety valve identified in the Memorandum -- the "last resort" of direct procurement of the subsystem or component and furnishing it as GFE. This "last resort" may avoid provoking a "forced marriage" between companies that would not have chosen to work together, or could not reach a satisfactory agreement.

As noted above, the Memorandum does not distinguish between competitive and sole source situations. A revision to the Memorandum or implementation guidance may be helpful on this point to address the fact that, in competitive situations, the marketplace exerts an incentive to assemble the most competitive team possible, subject to the restraints against anticompetitive behavior. It also tends to punish wrong decisions. The government long has sought to avoid unnecessary involvement in team assembly decisions, and has relied on the marketplace.

Finally, there appears to be a tension between this Memorandum's emphasis on the potential desirability of teaming with independent companies and other guidance that discourages the use of such companies. The Federal Trade
Commission ("FTC") and the U.S. Department of Justice have noted that in order to compete in today’s marketplace, companies who are competitors might need to collaborate as teammates.\(^1\) The FTC and Justice Department have also found that such teams may be procompetitive; “[n]evertheless a perception that antitrust laws are skeptical about agreements among actual or potential competitors may deter the development of procompetitive collaborations.”\(^2\) A number of draft rules have been issued on this subject of anticompetitive teaming, and the Section is informed that these draft rules may have caused some contractors to consider greater use of in-house sources to avoid teaming with competitors in order not to run afoul of anticompetitive concerns.\(^3\) These policies focused on exclusive team arrangements.\(^4\) In contrast to the potentially anticompetitive exclusive teaming concern, which may have constrained contractor use of non-affiliated contractors, the Memorandum on subsystems and components provides a reason to look outward and add non-affiliated teammates. These may be mixed messages on the subject of collaboration.

2. Subjective factors.

The Section is informed that companies employ many factors in determining team composition, and the determination is in effect a best value determination. Included are subjective factors such as the ability to work with a certain company, and the existence of trust between the companies as a result of previous working relationships. The Section believes that these subjective factors benefit the government as well as its contractors, by helping to ensure a better, more cohesive team and thus better value to the government. The Memorandum’s procedures focus on objective factors, which are similar to those found in the


2 *Id.* at 1.

3 For example, then under secretary of defense for acquisition and technology, Jacques S. Gansler, issued on January 5, 1999, a policy to ensure that team assembly was not anticompetitive. This policy was in response to industry consolidation, and mandated heightened scrutiny of teaming arrangements. The policy was followed on March 30, 1999, with a Defense Contract Audit Agency memorandum on the same issue, which noted that auditors might encounter information raising suspicion of an exclusive teaming arrangement. On November 18, 1999, a proposed DFARS rule was published for comments. It proposed amendments stating that certain exclusive teaming arrangements may evidence violations of antitrust laws. After receipt of comments, which addressed the benefits of team assembly and its pro-competitive aspects, as well as the fact that existing anticompetitive rules addressed the point, the proposed rule was withdrawn.

4 Another, more recent example is the NRO issuance of N52.215-020 “Exclusive Teaming Prohibition” (May 2004), which prohibits offerors on NRO solicitations from entering into any exclusive teaming arrangements. This rule was not published for comment.
Federal Acquisition Regulation ("FAR") coverage of make-or-buy programs, and consent to subcontracts. These factors do not expressly mention the subjective factors that may be used by contractors in determining whether to team with a particular company or to have an affiliate do the work. The Section believes that these subjective factors should be a valid consideration in the team assembly process.

Guidance on this subject may prove beneficial to program managers and contracting officers charged with implementing the Memorandum's objectives. Specifically, the Section recommends that guidance on this subject be provided to those charged with the implementation of this Memorandum, and that a FAR change be considered in order to avoid confusion. The selection of significant team members is not unlike the government's best value selection of a contractor for a significant program. The FAR underwent a change to provide guidance on the use of best value tradeoffs. Similarly, the current subcontracting provisions in the FAR may required modification to facilitate understanding of subjective subcontractor selection factors.

3. Fitting into the existing FAR framework.

The Memorandum lists five items that should be addressed in a contractor's plan to ensure a fair competition when another division of the contractor might be a competitor for a subsystem. The Memorandum notes that a similar review after contract award exists pursuant to the FAR subpart entitled "Consent to Subcontract." This part of the Memorandum is unclear, however, because it discusses both a preaward review of plans and a post award review "that can be accomplished pursuant to the Federal Acquisition Regulation (FAR) subpart 44.2." Implementing personnel are not told whether to favor a preaward or a post award approach and when one or the other should be utilized. If the FAR adequately addresses the post-award concern covered in the Memorandum, a FAR (or Defense Federal Acquisition Regulation Supplement) change might be considered in order to address the government's preaward consideration of competition.

This part of the Memorandum may cause confusion in one other way. Since the "Consent to Subcontract" process already exists in the FAR, an unanswered question is whether greater use is intended for the post award consent

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6 FAR 44.202-2, 48 C.F.R. § 44.202-2.
8 FAR Subpart 44.2, 48 C.F.R. Subpart 44.2.
right? One reading of the Memorandum might be that the goal is to consider during the preaward stage the offeror’s plan to ensure adequate subcontractor competition, and not to rely upon the consent to subcontracts right in FAR subpart 44.2. But another reading may be that the existing post award right to consent is adequate for significant contracts. Clarification is advisable.

4. Recognizing the timing issue.

There is an important timing issue with use of the post award consent right for significant subcontracts. The Section is informed that, typically, companies combine complementary capabilities in order to address and fulfill contract requirements, to be competitive, and to meet the source selection criteria. As a result, teams are formed very early in the procurement process, often before the final solicitation is released. All members of the team then work together in proposal preparation in order to win the contract. The team members share the bid and proposal expense, and prepare a proposal highlighting the relevant past performance and experience of the entire team. Whether application of the consent right for subcontracts found in FAR subpart 44.2 should be updated to address teaming issues is a separate question from those directly raised in the July 12, 2004 Memorandum. Nevertheless, because the Memorandum raises the issue of consenting to subcontracts arising out of teaming arrangements, that issue is addressed here.

The effect on teaming arrangements of the government’s post-award refusal to consent to a subcontract should be considered and addressed in guidance to this policy. Although the Memorandum focuses on the potential for bias toward affiliates in decisions on subsystems and components, greater use of the post-award consent right could impede the formation of strong team relationships because any commitment to provide a subcontract necessarily would be conditional for what the Memorandum describes as “significant subcontracts,” a term left undefined. The Section is informed that most standard teaming agreements condition the prime contractor’s obligation to award a subcontract on obtaining any necessary government consent, but that this rarely becomes an issue. In reality, it appears that deference is given to companies brought early into the proposal process by the potential prime contractor to assist as teammates in the pursuit of a contract. These teammates typically participate in the proposal preparation, and provide past performance and capabilities required to meet the solicitation’s requirements. This applies whether the teammate is a separate entity or is affiliated with the prime through common ownership.
The FAR itself states that the integrity of teaming arrangements should be upheld. The “Policy” section of FAR subpart 9.6 states that the integrity and validity of contractor team arrangements will be recognized, and that the Government will not normally require or encourage the dissolution of contractor team arrangements.” The Section believes that this is a sound policy, and the consent right should not be utilized to dissolve such arrangements absent extraordinary circumstances. In addition, relevant case law indicates that formation of a teaming arrangement may be more than simply a commitment that a team member later can compete for a subcontract. Unless guidance is issued in connection with this Memorandum acknowledging the importance of teaming agreements – consistent with existing FAR policy -- and addressing the potential adverse effect that a refusal to consent to a subcontract might have on such agreements, the benefits the department has obtained through teaming may be eroded.

Likewise, the evaluation criteria and the government’s source selection decision in competitive procurements frequently are based in part on the offeror teams’ composition, their collective past performance, and the each team’s collective experience. Thus a post-award change in team composition resulting from the consent right could undermine not only the obligations of the parties, but also the integrity of the procurement process, raising questions about the validity of the source selection decision. The Section therefore recommends that guidance should be given in this area so that procurement personnel understand the relevant considerations in light of existing FAR policy to recognize the integrity and validity of teaming arrangements.

**Conclusion**

The Memorandum issued by your office on subcontractor selection for major program subsystems and components addresses favoritism toward an affiliate, and seeks to promote competition for such subsystems and components. This is a valid concern. The Section strongly supports efforts to promote robust competition, and to protect the integrity of the government acquisition process.

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10 Id.
12 Indeed, the Air Force recently issued guidance following up on the July 12 memorandum that instructs personnel to require offerors to explain how “the offeror would compete major items.”
The Memorandum does not appear to recognize that the competitive marketplace at the prime contractor level exerts considerable power over such decisions. Therefore, the Section recommends that this Memorandum be followed by guidance that addresses, among other issues, reliance on the competitive marketplace at the prime level, and distinguishes prime level competitive situations from sole source situations, where greater insight may be required. A FAR change to address these issues should be considered.

Another area in which implementing guidance may be useful is the use by prime contractors of subjective factors in determining the team members providing overall best value to the team. Factors such as the ability to work together in a cooperative environment, and a willingness to share bid and proposal expenses, for example, are typically used in the team assembly process and should be acknowledged. Again, guidance is suggested, and a FAR change should be considered.

Finally, the Memorandum raises the question of the proper use of the existing provisions in the FAR. The FAR addresses subcontract competition in its make-or-buy process, and in the reservation of the government’s post-award right to consent to subcontracts. The Memorandum’s procedures should reference and make use of the existing FAR guidance to the maximum extent possible. An important timing issue exists with the use of the FAR consent right for “significant subcontracts.” Team members must be chosen early in the pursuit of a competitive government contract. To restructure teams after award could impact the integrity of the competitive selection process and its consideration of subcontractors.

The Section appreciates the opportunity to provide these comments and is available to provide additional information or assistance as you may require.

Sincerely,

Patricia H. Wittie
Chair, Section of Public Contract Law