

COUNCIL OF DEFENSE AND SPACE INDUSTRY ASSOCIATIONS
4401 Wilson Boulevard, Suite 1110
Arlington, Virginia 22209
codsia@codsia.org

April 8, 2016

Defense Acquisition Regulation System
Attn: Mr. Mark Gomersall
OUSD (AT&L) DPAP/DARS
Room 3B941
3060 Defense Pentagon
Washington, DC 20301-3060

Subject: DFARS Case 2016-D017, Independent Research and Development Expenses

Dear Mr. Gomersall:

On behalf of the undersigned members of the Council of Defense and Space Industry Associations (CODSIA),¹ we offer the following comments to the DFARS Advanced notice of proposed rulemaking (ANPR), Independent Research and Development (IR&D) Expenses, published in the *Federal Register* on February 8, 2016. Industry appreciates the opportunity to submit comments early in the rule development cycle prior to DoD creating proposed new rules.

Introduction and Executive Summary

The ANPR seeks comments from industry in an effort to create new source selection standards for DoD contracting officials in evaluating offeror application of IR&D expenses in proposals submitted in competitive acquisitions. DoD appears to have concluded that the ability of offerors to submit proposals containing elements of concurrent IR&D within a competitive source selection must be limited in order to (a) reduce unfair gamesmanship of the proposal and evaluation processes and (b) allow CO's greater ability to consistently evaluate competing price proposals. As set forth below, CODSIA associations disagree with this conclusion and believe the current statutory and regulatory framework governing IR&D allowability properly incentivizes the defense industry to invest in projects designed to enable warfighters to gain access to the most modern military capabilities at a cost that takes advantage of corporate investments in new technology development that results in substantial benefit overall for the Department of Defense.

The ANPR aspires to implement the guidance in Better Buying Power 3.0 which stated in part its intention to: "[E]nsure that substantial future independent research and development (IR&D) expenses as a means to reduce evaluated bid prices are evaluated in a uniform way during competitive source selections." Under this ANPR, the eventual regulatory approach being

¹ At the suggestion of the Department of Defense, CODSIA was formed in 1964 by industry associations with common interests in federal procurement policy issues. CODSIA consists of six associations – the Aerospace Industries Association, the American Council of Engineering Companies, the Information Technology Alliance for Public Sector, the National Defense Industrial Association, the Professional Services Council, and the U.S. Chamber of Commerce. CODSIA acts as an institutional focal point for coordination of its members' positions regarding policies, regulations, directives, and procedures that affect them. Combined these associations represent thousands of government contractors and subcontractors. A decision by any member association to abstain from participation in a particular case is not necessarily an indication of dissent.

considered would affect solicitations by requiring offerors to detail the nature and value of prospective IR&D projects the offeror would rely on to perform the resultant contract. DoD would then evaluate proposals in a manner that would adjust the offeror's total evaluated price to include the "value of related future IR&D projects."

As described in our comments that follow, CODSIA has a number of concerns with the proposed rule. As presently written, the proposed rule presents a myriad of interpretation challenges and significant complexities associated with the implementation that would follow if the proposed rule were adopted. In short, the proposed rule is a step back from the overarching strategic vision of BBP 3.0 in that it neither streamlines the IR&D/B&P process, nor does it encourage investment and hence increase the likelihood of innovation by either traditional or non-traditional defense contractors. Given the complexities and lack of clarity with much of the rule, our response to what's been proposed can only be made at this time through a series of questions that depict both the shortcomings of the proposed rule and the difficulties in carrying the ANPR forward without making numerous changes.

Moreover, any attempt to over-manage contractor IR&D costs by creating a one size fits all source selection construct has a high risk for unintended consequences for the cost allowability rules and may run afoul of current case law on the cost allowability of IR&D. To the extent that industry generally considers both the cost allowability and source selection rules to be uniformly applied and interpreted by DoD buying activities and oversight agents, and consistent with the long standing statutory objective to encourage industry investment and reimburse those investment costs in exchange for the best possible warfighter solutions, industry perceives no need for DoD to build this additional administrative process into their acquisition infrastructure. While DoD may be able to cite unique examples where they believe some type of inappropriate offeror behavior or inexperienced CO source selection decision related to concurrent IR&D has occurred, it is irrational to exchange an IR&D process with a long historical success record for one that has high potential to disrupt industry IR&D efforts and dis-incentivize contractors from entering or engaging in the DoD market.

As such, CODSIA opposes the proposed DoD IR&D evaluation approach proffered in the ANPR. We recommend that the proposed ANPR be withdrawn and that DoD both reevaluate the costs and benefits of such an approach and engage in further dialogue with industry to identify the exact nature of their concern prior to any further regulatory initiative. Conducting further dialogue with industry would be consistent with implementing BBP 3.0 and the White Paper on Enhancing Effectiveness of IR&D outlines issued by Under Secretary Frank Kendall in August of 2015 and would offer industry greater clarity into the true nature of DoD concerns.

Industry Concerns:

The following sections of this letter detail our questions and comments with the proposed rule. As mentioned above, the rule presents an apparent dichotomy between the concepts of "innovation", "outreach" and "streamlining" used in all three iterations of BBP, in the recent FY 2016 National Defense Authorization Act (NDAA) and the additional evaluation process requirements and unnecessary paperwork burden contemplated in this ANPR.

Questions Unanswered by the ANPR:

- What is the underlying problem being addressed?
- How widespread is the use of IR&D to reduce the bid price on competitive proposals? What data exists that depicts the magnitude of the problem?
- Are there examples where DoD improperly evaluated IR&D in source selections? If yes, why did this occur and with what result?
- Are there examples where current process/rules would prohibit a source selection team from considering future IR&D as part of its technical evaluation? If yes, this is not apparent to CODSIA and should be considered prior to publishing an additional rule(s).

How will “related future IR&D projects” be determined?

- The ANPR states that the total evaluated proposal price will be adjusted to include the value of “related future IR&D projects.” The term “related future IR&D projects” is not further defined in the ANPR and it is not clear how the future value of IR&D efforts can be estimated with any certainty by offerors or CO’s in a competitive source selection? Even where such estimates of future IR&D value might notionally be offered as cost or price data for proposal evaluation purposes, such information could never be certified as current, accurate or complete under TINA or be sufficiently precise for a CO to rely upon for contracting purposes, without creating potentially high risk of liability for defective pricing or False Claims Act litigation.
- Additionally, the ANPR asserts that offerors may be required to provide detailed future value estimates, so is not inconceivable that CO’s will default to asking offerors for detailed cost or pricing data to feed into their “future value” model.
- Many IR&D projects are “continuing.” In other words, an IR&D project may be initiated in one year and have research or development activity occur over several subsequent years after project initiation.
 - Would the Department treat continuing IR&D projects as “related future IR&D projects” for purposes of adjusting the offeror’s price in negotiated source selections?
 - If so, what effect does the Department believe this treatment will have on continuing IR&D investment?
 - An individual IR&D project may also have applicability across more than one DoD program. How would the Department determine which program the IR&D project was “related to” for purposes of adjusting the evaluated offeror price? Would the Department adjust the offeror’s price by the full value of the IR&D project in each bid?

- For example, if an offeror had an IR&D project that applied to two DoD programs and the offeror submitted bids during competitive negotiated source selections on both DoD programs, would the government adjust the evaluated proposed price by the full value of the IR&D project in each instance?
 - Or would the value of that IR&D project be allocated between the offeror's two proposals (e.g. 50-50 split)?
- Since no “bright line” exists for determining an explicit benefit to specific proposals, industry and Department will need to invest resources to make these subjective determinations.

Will IR&D used for “risk reduction” be treated differently?

- Proving out a new material or manufacturing process for instance.
- How would the risk associated with the project be evaluated and priced? If at all? Are there examples of this that presently exist?

How will these changes be implemented?

- Adjusting an offeror's total evaluated price in a negotiated source selection to accurately include the “value of related future IR&D projects” requires a level of judgment, skill and expertise currently not resident in DoD.
- How will the Department train the acquisition workforce to make these critical determinations?
- How will the Department ensure that costly mistakes are not made in this process? This could lead to an increase in bid protests as contractors dispute assessments of future IR&D under the source selection process contemplated in this ANPR. It is reasonable to conclude from the body of bid protest “realism” case law that source selections based on highly subjective thinking by CO's about future value involving rough estimates of cost or price in support of the evaluation process would not be able to withstand a sustainable protest.

Additional areas of concern with the ANPR:

- How will subcontractor flow downs be addressed? Subcontractor IR&D evaluations? Who will perform evaluations for supply chain impact? Given that most of the cost of today's defense programs flow through the supply chain, the requirements for implementation of this rule will be immense and impractical for both government and industry.
- Will there be a consistently used, publicly available evaluation criteria or formula used in all proposals?

- How to distinguish/evaluate IR&D that is being used for multiple programs? What level of detail will it be necessary to provide?
- When does the “clock” start? While IR&D projects are proposed on an annual basis for allowability purposes, most IR&D projects are really part of a continuum of investment, sometimes over many years. And (hopefully) all IR&D is aimed at eventually culminating in an RFP that benefits from our results. This just adds to the complexity of the guidance that would need to be established to carry out this proposed rule.
- What about leveraging of prior IR&D, particularly commercial R&D? Will this create an advantage for companies that develop and sell products principally in the commercial marketplace over those that do so principally in the defense marketplace?
- Will the ANPR be applicable to all contracts or will there be a threshold? Will there be exceptions such as for fixed price contractors on contracts for commercial items and services?
- Will the ANPR prohibit adjusting the total evaluated price from “non-reimbursed IR&D” and technology developed outside of U.S. Government participation?
- The Cost Accounting Standards and existing case law require R&D that is an “explicit” requirement of a contract to be charged to that contract, subject to the offeror’s CAS disclosure statement. But R&D not specifically required in the performance of a contract essentially constitutes IR&D. Thus, the courts have rejected the idea of “implicitly” required R&D as obviating or negating a contractor’s IR&D costs.
 - Will the application of this ANPR run contrary to these existing rules? How is this concern being addressed?

Second Order Effects and Unintended Consequences:

- As an IR&D project approaches fruition, a contractor would begin to include these innovations in their bids, offering cutting edge technology. If the contractor anticipates more than the initial contract on which he is bidding will benefit from this innovation, existing regulations allow him to allocate the IR&D costs across his business rather than just the initial contract to benefit from the innovation. This cost approach has practical benefits. Not only is the latest innovation available to DoD early but at an affordable price immediately as well. If, however, DoD artificially adjusts the initial bid to include all of the IR&D cost, the inflated price is almost sure to make it unaffordable and uncompetitive with lesser offerings, thereby depriving DoD of the latest technology and instead requiring DoD to wait until the IR&D project has concluded and the innovation in the bid no longer merits an “IR&D surcharge”. It is unclear why DoD would create a process that self-imposes an inability to access cutting edge technology as early as possible.

- How does DoD justify treating all IR&D as direct to a single contract through this proposal assessment process, despite the existing requirements of the Cost Accounting Standards which allow the IR&D with broader benefits to be allocated indirectly across multiple contracts?
- Will less assurance of business brought about by this rule result in a more conservative business base forecast by contractors that would increase rates across all programs?
- How much will be required to be spent in evaluating sub-tier IR&D? And will the addition of another rule on IR&D, and associated IP and other pricing requirements, affect outreach and efforts to increase supply chain participants in DoD? How far down the supply chain will this go?
- All IR&D can eventually be traced to programs. Where do you draw the line without driving out the incentive to invest at all?

Lastly, are these proposed changes consistent with 10 U.S.C. §2372(f)?

- 10 U.S.C. §2372(f) prohibits the Secretary of Defense from issuing regulations that “would infringe on the independence of a contractor to choose which technologies to pursue in its independent research and development program.”
- The Department’s proposed approach appears to disfavor IR&D investments that provide near term, incremental improvements in technology, which may support several current business captures that a contractor may be pursuing through competitive source selections. Overall, use of IR&D for feeding into proposals reduces contract costs and provides broader technology benefits beyond a single contract.
- The DoD fear that contract efforts will be performed on IR&D appear overblown because current cost accounting rules prohibit that and there is no evidence that such behavior is common in the defense industry. It is also germane that contractors currently focus their IR&D spend on projects with both near and long term returns on investment and to fit developing technology into a new offer to create a competitive advantage, but such application does not mean that contractors would either abandon their subsequent contract obligations or their IR&D projects.
- This approach appears to be an indirect attempt by the Department to drive contractor investment in technology and infringe on the independence protected in Title 10.
- When trying to create a complex source selection process for artificially valuing IR&D, CO’s will have to be able to distinguish IR&D from other indirect costs closely corresponding to IR&D, such as B&P and selling costs.

Conclusion

In our view, the ANPR creates significant uncertainty and confusion for industry and government alike. Therefore, we re-emphasize our opposition to the approach being suggested in the ANPR and the importance of withdrawing the ANPR and re-engaging with industry on the root cause of the problem.

Having said that, there are areas that were addressed toward the end of the public meeting that provide a possible basis for increased dialogue in this area: The first is the comment addressed by OSD panelist Dr. Flagg when she indicated the goal is to “incentivize industry to have a greater balance among its short, medium and long-range investment portfolio”. The second was the notion addressed by a number of attendees that it will be important to encourage greater participation of the military services as a participant in this continuing dialogue.

CODSIA considers both of these observations to be focused on areas ripe for engagement with all the stakeholders in the near term, prior to any further consideration of additional rulemaking and would welcome the opportunity to host future fact-finding sessions with DoD and industry cost accounting and R&D experts to work through alternatives that retain the current balance between allowable cost of IR&D and its application for use in competitive source selections.

CODSIA looks forward to working with you to help maintain and sustain a robust, innovative and incentivized industrial base and thanks you for your consideration of these comments. Should you have any questions, or need further information, please contact Ron Youngs at the Aerospace Industries Association AIA, the CODSIA case manager, at 703-358-1045 or via email at ronald.youngs@aia-aerospace.org.

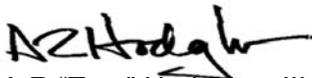
Sincerely,



John Luddy
Vice President National Security &
Acquisition Policy
Aerospace Industries Association



Jessica Salmoiraghi
Senior Policy Director
American Council of Engineering Companies



A.R. “Trey” Hodgkins, III, CAE
Senior Vice President, Public Sector
Information Technology Alliance for the
Public Sector



James Thomas
Director, Legislative Policy
National Defense Industry Association



Alan Chvotkin
Executive Vice President and Counsel
Professional Services Council



R. Bruce Josten
Executive Vice President *for Government Affairs*
U.S. Chamber of Commerce