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April 6, 2016

Defense Acquisition Regulations 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 more than 1,600 member companies and the nearly 90,000 individual members that comprise the National Defense Industrial Association (NDIA), I offer the following comments on the subject advance notice of proposed rulemaking (ANPRM). Based in part on comments from Department of Defense (DoD) representatives at the March 3, 2016 public meeting, I offer the following concerns regarding the intent and proposed approach of the ANPRM.

Introduction:

Notice: On February 8, 2016, the Defense Acquisition Regulatory System (DARS) published an ANPRM, entitled "Independent Research and Development Expenses." The initiation of this process came at the direction of Under Secretary of Defense, Acquisition, Technology, and Logistics, Frank Kendall in the "Implementation Directive for Better Buying Power 3.0." The purpose of this effort is to "ensure that substantial future independent research and development (IRAD) expenses as a means to reduce evaluated bid prices in competitive source selections are evaluated in a uniform way during competitive source selections." Mr. Kendall expressed concern that "development price proposals are reduced by using a separate source of government funding (allowable IRAD overhead expenses spread across the total business) to gain a price advantage in a specific competitive bid. This is not the intended purpose of making IRAD an allowable cost." The approach taken to remedy this perceived problem with IRAD in the ANPRM is to require offerors to detail the "nature and value" of prospective IRAD projects that the offeror would rely on in the performance of the resultant contract and then adjust an offeror's total evaluated price "to include the value of related future IRAD projects."

Public Meeting: As part of the ANPRM, a public meeting was held on March 3rd, with representatives from Defense Procurement and Acquisition Policy (DPAP), and the Office of the Assistant Secretary of Defense, Research and Engineering (ASD [R&E]). The following conclusions were drawn from the meeting:

1. DPAP/DARS are unfamiliar with the specifics of the IRAD data referenced by Under Secretary Kendall in Better Buying Power 3.0.
2. The Department does not believe that enough IRAD is spent on intermediate-to-long range research and development projects. Thus, the ultimate goal of the eventual proposed rule will be to incentivize contractors to adopt their (the DoD) desired IRAD “portfolio mix.”
3. The Department’s justification for this effort is fairness: (1) between competitors on competitive source selections and, (2) between traditional defense contractors with IRAD programs and nontraditional contractors without IRAD programs.

To properly frame our comments, I would first like to describe what NDIA’s vision is for the IRAD program.

NDIA’s Vision for IRAD

NDIA’s vision for the IRAD program is simple and driven by our core belief that government will not regulate its way to innovation and technological superiority¹. Instead, DoD should rely on incentives, a far more efficient means to achieve their desired outcomes. If government customers make their preference for innovation clear through source selections, demonstrating that innovation will be rewarded, industry will invest in IRAD accordingly.

If DoD intends to follow through with the changes affecting the IRAD program as indicated in the ANPRM, it should provide broader strategic guidance on its vision and goals for the IRAD program, and how the intended changes to IRAD align with the Department’s approach to maintain technological superiority through the “Third Offset Strategy” and outreach in Silicon Valley. The brief commentary provided in the Better Buying Power 3.0 is insufficient to this end.

Comments

The proposed approach should not be implemented through a change to the Defense Federal Acquisition Regulations Supplement (DFARS). Instead, the Department of Defense should amend existing policy guidance to effect any changes to the source selection procedures. On March 4, 2011, the Director, Defense Pricing issued the “Department of Defense Source Selection Procedures.”² The stated purpose of this document is to provide “a common set of principles and procedures for conducting” competitively negotiated source selections across the Department of Defense. See paragraph 1.1. Given that stated purpose, the Source Selection Procedures would be the more appropriate place to direct procedural changes regarding how bid price is evaluated in negotiated source selections.

The proposed approach will lead to practical difficulties as well as potentially costly mistakes and disagreements. Adjusting an offeror’s total evaluated bid price in a negotiated source selection to accurately include the “value of related future IRAD projects” requires good judgment and skill. The Department will have to invest considerable time and resources to

¹ See Page 10 of NDIA’s “Top Issues 2016,” which can be accessed electronically at: http://www.ndia.org/Policy/policyweeklydigest/Documents/NDIA_TopIssues_2016.pdf

² See <http://www.acq.osd.mil/dpap/policy/policyvault/USA007183-10-DPAP.pdf>

adequately train the acquisition workforce to make these critical determinations. Even with the best training, the proposed approach relies upon the subjective judgment of the contracting officer and other source selection officials. How will the Department ensure that costly mistakes are not made in this process? Mistakes made in adjusting the evaluated bid price will likely lead to more bid protests with lengthy delays and increased costs for the taxpayer, since the proposed adjustments appear directly inconsistent with the proper treatment and evaluation of IRAD expenses under CAS 402, 420 and FAR 31.205-18, as interpreted by the United States Court of Appeals for the Federal Circuit in *ATK Thiokol v. United States*, 598 F.3d. 1329 (2010).

The proposed approach is not consistent with 10 U.S.C. §2372(f). The statute 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.” See 10 U.S.C. §2372(f). The Department’s proposed approach disfavors IRAD investments that provide near term, incremental improvements in technology. These improvements may support several current business captures that a contractor may be pursuing through competitive source selections. 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.

The proposed approach does not sufficiently state how “related future IRAD projects” will be determined. The approach in the ANPRM states that the total evaluated bid price will be adjusted to include the value of “related future IRAD projects.” The term “related future IRAD projects” is not further defined in the ANPRM. Many IRAD projects are “continuing.” In other words, an IRAD 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 IRAD projects as “related future IRAD projects” for purposes of adjusting the bid price in negotiated source selections? If so, how would the Department minimize the chilling effect on continuing IRAD investment that such treatment would cause?

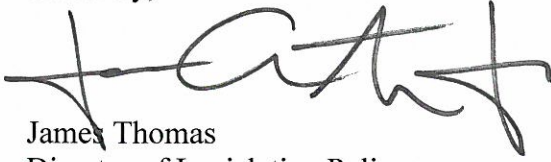
An individual IRAD project may also have applicability across more than one DoD program. How would the government determine which program the IRAD project was “related to” for purposes of adjusting the evaluated bid price? Would the government adjust the offeror’s bid price by the full value of the IRAD project in each bid? For example, if an offeror had an IRAD 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 bid price by the full value of the IRAD project in each instance? Or would the value of that IRAD project be allocated between the offeror’s two bids (e.g. 50-50 split)?

Concluding Thoughts

I hope that these comments are helpful to you as you refine your thinking on this proposed approach. As my association colleagues and I expressed at the public meeting on March 3rd, industry could have offered more constructive feedback had the Department provided a more robust statement of the problem, as the Department sees it, and a range of acceptable means to address that problem beyond altering the source selection procedures. I urge you to amend the ANPRM to provide such a problem statement, including real world examples or case studies

illustrating the Department's view, and to host another public meeting to continue the dialog about possible solutions. Feel free to contact me at jthomas@ndia.org or (703) 247-2598 if you have any questions.

Sincerely,

A handwritten signature in black ink, appearing to read 'J. Thomas', with a stylized, cursive script.

James Thomas
Director of Legislative Policy