COUNCIL OF DEFENSE AND SPACE INDUSTRY ASSOCIATIONS
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CODSIA Case 2017-001

February 2, 2017

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 (IR&D) Expenses

Dear Mr. Gomersall:

On behalf of CODSIA,[1] we offer the following comments on the subject DFARS Case, Independent Research and Development Expenses, published in the Federal Register on November 4, 2016.[2] The proposed rule follows the February 8, 2016 DFARS Advanced Notice of Proposed Rulemaking (ANPR), Independent Research and Development Expenses (same regulatory case number), and the March 8, 2016 public meeting to obtain comments.

CODSIA strongly opposes the proposed rule and recommends that it be withdrawn. We also recommend that a dialogue be established between the Department of Defense (DoD) and industry stakeholders to precisely identify DoD's concerns with current IR&D expense policy and to jointly develop fact-based and balanced solutions, where needed, to address the relevant policy issues.

The proposed rule would undo an IR&D framework that has been productive for a generation, yet it will not advance the interests of DoD or the industrial base in providing new technology for national security purposes. Its implementation will: create additional burdens for contractors; dissuade primarily commercial contractors from engaging with DoD (especially those whose R&D portfolios represent most of the value of the company); decelerate existing and future contractor IR&D investment in warfighting technology innovation; lead to more bid protests; and erect another unnecessary barrier to entry into the DoD market.

[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 seven associations – the Aerospace Industries Association, the American Council of Engineering Companies, the Associated General Contractors of America, 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. Together 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.

[2] CODSIA appreciates the December 22, 2016 extension of the due date for public comments until February 2, 2017.

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Introduction

The proposed rule is the latest iteration in a series of DoD policies on IR&D issued since 2011, including regulations and Better Buying Power (BBP) guidance, much of which overlaps. However, none of them have provided a cogent rationale on the need for the new policy.

In a public meeting on the ANPR hosted by DoD on March 8, 2016,[3] and then in CODSIA comments submitted on April 8, 2016 in response to the ANPR, we voiced strong opposition to the policy approach proposed in the ANPR and urged that it be withdrawn. We also recommended that any subsequent policy development be deferred until such time as DoD could articulate the problem it was trying to solve.[4] In lengthy written comments, CODSIA and others asserted that the approach envisioned in the ANPR violated the governing statute, deviated radically and unnecessarily from IR&D allowable cost laws and regulations, and contradicted the stated purpose of all of the BBP memos; namely, to encourage the defense industrial base to invest in and develop new technology. We make those same assertions with respect to this proposed rule.

To facilitate your review, our comments are organized as follows:

1. Rule & Executive Summary;
2. Policy and Cost Accounting Framework;
3. Specific Comments;
4. Regulatory & Administrative Requirements; and
5. Conclusion.

1. Rule & Executive Summary

As a threshold matter, we note that, on November 4, 2016, contemporaneously with this proposed rule, DoD promulgated a final rule in an IR&D sister case creating a new technical interchange process.[5] On November 15th, CODSIA wrote and requested that the technical interchange rules be suspended until DoD responded to an extensive slate of industry concerns that, we believe, were not addressed in the final rule. Our letter also requested that guidance to contracting officers (COs) be issued to clarify how industry and DoD personnel were to manage the technical interchange process or, in the alternative, to phase in the required compliance over a 6 to 12-month period to avoid the risk of costs being found unallowable by auditors in the future as a result of unnecessarily hasty implementation. We also posed a series of important questions, the answers to which would help guide our further comments on subsequent

[3] *See* NDIA and AIA presentations dated March 3, 2016.
[4] CODSIA letter, April 8, 2016, Subject: DFARS Case 2016-D017, Independent Research and Development (IR&D) Expenses.
[5] DFARS Case 2016-D002, Enhancing the Effectiveness of Independent Research and Development (IR&D) - Final Rules published in the *Federal Register*, Vol. 81, No. 214, November 4, 2016, at pages 78008-78011.

rulemaking.[6] While DoD has not responded to those questions as of the date of these comments, we appreciate that DoD issued a Class Deviation[7] on December 1, 2016. While the deviation did not suspend the rule, nor provide for permanent relief from a burdensome review process, it authorized COs to consider contractor fiscal year (FY) 2017 IR&D costs allowable if the technical interchange was conducted "sometime during" the contractor's FY 2017, rather than "before" contractor FY17 IR&D costs were generated.

Because DoD has published the proposed rule without addressing any of industry's prior comments, we continue to be concerned that DoD is changing the existing IR&D paradigm without substantive consultation with the industrial base. CODSIA thus opposes the subject proposed rule for the following reasons:

a. The proposed rule is contrary to Congressional intent and conflicts with the statutory and regulatory IR&D cost allowability framework.
b. The proposed rule will create unnecessary, complex and expensive pre-award process problems and post-award administrative and oversight burdens.
c. The proposed rule will discourage industry IR&D investment and derail the business models that have been erected to align with the existing IR&D policy.

a. Statutory Conflicts

CODSIA notes that the recent enactment of Section 824, *Treatment of Independent Research and Development Costs on Certain Contracts*, of the FY 2017 National Defense Authorization Act (NDAA) makes some changes to the existing IR&D and Bid & Proposal (B&P) Cost allowability frameworks and calls for new regulations to be prospectively applied after October 1, 2017. There is no way to accurately predict whether and how any new regulations to implement the changes will impact the existing IR&D regulations, so these comments will consider the regulatory structure as it currently exists, but will acknowledge, where necessary, any changes directed by Section 824 that would otherwise negate any of the points made in these comments.

Notwithstanding Section 824, the older version of the statute[8] unambiguously reflected the intent to align IR&D investments with DoD technology requirements, enumerated in subsection (g):

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[6] CODSIA Letter, Request to Suspend DFARS Case 2016-D002, Enhancing the Effectiveness of Independent Research and Development (IR&D), November 15, 2016. Those questions are repeated, infra, at 10-12.

[7] DPAP Class Deviation, DARS Tracking Number 2017-O0002, Enhancing the Effectiveness of IR&D, December 1, 2016, available at: http://www.acq.osd.mil/dpap/policy/policyvault/CD_2017_O0002_enhancing_effectiveness_of_IRAD-updated.pdf.

[8] Generally cited as 10 U.S.C. 2372, Independent research and Bid and Proposal Costs; payments to contractors.

> "…The regulations under subsection (a) shall encourage contractors to engage in research and development activities of potential interest to the Department of Defense, including activities intended to accomplish any of the following:
>
> **(1)** Enabling superior performance of future United States weapon systems and components.
> **(2)** Reducing acquisition costs and life-cycle costs of military systems.
> **(3)** Strengthening the defense industrial base and the technology base of the United States.
> **(4)** Enhancing the industrial competitiveness of the United States.
> **(5)** Promoting the development of technologies identified as critical under section 2506 of this title.
> **(6)** Increasing the development and promotion of efficient and effective applications of dual-use technologies.
> **(7)** Providing efficient and effective technologies for achieving such environmental benefits as improved environmental data gathering, environmental cleanup and restoration, pollution reduction in manufacturing, environmental conservation, and environmentally safe management of facilities."[9]

Section 824 no longer contains subsection (g), although CODSIA has no reason to believe that DoD has completely divorced themselves from such general intent language by enacting Section 824, nor is it clear that any new regulations might or might not include a restatement of DoD interests in encouraging contractor investments as a policy matter, as set forth in former subsection (g).

Most importantly, both the legacy version of the statute and the newly enacted version of the statute limit DoD intrusion into contractor decision-making on IR&D as follows:

> Regulations prescribed pursuant to subsection (c) may not include provisions that would infringe on the independence of a contractor to choose which technologies to pursue in its independent research and development program…."[10] (See also the extended statutory language directly below)

The recently enacted statute now additionally qualifies contractor independence as follows:

> "…if the chief executive officer of the contractor determines that expenditures will advance the needs of the Department of Defense for future technology and advanced capability as transmitted pursuant to subsection (c)(3)(A)."[11]

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[9] Formerly 10 U.S.C. 2372(g), Encouragement of Certain Contractor Activities
[10] Formerly 10 U.S.C. 2372(f), Independent research and Bid and Proposal Costs; payments to contractors, Limitations on regulations
[11] Revised as 10 U.S.C. 2372(d), Limitations on Regulations, by FY 2017 NDAA Section 824, Treatment of independent research and development costs on certain contracts, enacted December 23, 2016

While the statutory reference to subsection (c)(3)(A) on transmission methodology is confusing, we do not believe that the added contractor duty to make such determinations in any way changes the fundamental statutory limit on DoD regulation of contractor IR&D investments. We therefore view the proposed DFARS rule as an infringement on contractor independence and discretion on IR&D investment strategy in violation of the statute because it adds a step to the procurement process designed to penalize or limit industry from offering products or solutions which have IR&D expense in their genealogy.

b. Complex Procedures

For practical purposes, there is no way to implement a new price proposal evaluation factor in new solicitation requirements without adding confusion and procurement lead-time to the competitive source selection process. The new process also makes inevitable bid protests challenging the validity of a subjectively derived upward adjustment based on “future” IR&D investments. Significantly, DoD supported legislation to cure what it believed to be a growing ‘protest culture’ in DoD procurement; ironically, this rule will create completely new grounds for protests.

As set forth in the rule summary:

> “DoD is proposing to amend the Defense Federal Acquisition Regulation Supplement (DFARS) to ensure that substantial future independent research and development expenses, as a means to reduce evaluated bid prices in competitive source selections, are evaluated in a uniform way during competitive source selections.”

Furthermore, the Background statement accompanying the rule states:

> “As expressed in the ‘Implementation Directive for Better Buying Power 3.0—Achieving Dominant Capabilities through Technical Excellence and Innovation,’ dated April 9, 2015, the Under Secretary of Defense for Acquisition, Technology, and Logistics *noted a concern* (italics added) when ‘promised future IRAD [independent research and development] expenditures are used to substantially reduce the bid price on competitive procurements. In these cases, 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 rule posits that proposals for specific MDAPs and MAIS procurements for development efforts require a price evaluation adjustment factor be added to the vendor’s proposed cost/price to make up for an amount deemed by a DoD contracting officer to reflect future IR&D investments. DoD believes that the adjustment is necessary to offset artificial reductions to

industry cost/price proposals used to unfairly skew competitions and to also prevent what DoD perceives as industry 'double-dipping' on its IR&D allowable costs.

Among other things, the inference is that a competitor will have an unfair advantage by investing in IR&D that DoD may choose at some future time to develop further and which may (or may not) have application to efforts required in a specific procurement. However, it is just as likely in the MDAP and MAIS ecosystem that many offerors will have a broad spectrum of IR&D projects aimed at various commercial and defense needs, but whose further development is uncertain, and is therefore a risky venture for contractor IR&D investment. In cases where multiple offerors have many IR&D projects in their investment portfolios, and each has equal access to information, it is hard to discern any unfair competitive advantage.

Observers have also concluded from the Background statement that DoD believes that the ability of offerors to submit proposals that subsume or subtract cost elements of reimbursable IR&D from their offer in a competitive source selection (sometimes called concurrent IR&D) must be limited in order to (a) reduce unfair gaming of the proposal evaluation, and (b) allow contracting officers greater ability to "uniformly" evaluate competing price proposals. Yet the process set forth in the proposed rule is not "uniform;" but is actually arbitrary and random. It is fundamentally unclear why DoD would attempt to solve a cost accounting issue by creating new source selection processes.

c. Discouraging IR&D Investment

Among many other concerns, CODSIA contends that there are two main faults with accepting DoD's rationale for the rule. First, this rule rests on the vague proposition that leveraging IR&D-funded technology represents an unfair advantage to a contractor presenting an offer on a MDAP or MAIS development contract. As a policy matter, enticing contractors to invest in IR&D, but penalizing that investment by constraining their ability to provide competitive price proposals that take advantage of those investments, is both internally inconsistent, and contrary to the stated goal of using IR&D to fund technology innovation. It follows that, where IR&D investment by certain contractors reduces costs/prices for development efforts that ultimately lead to advances in warfighter capability in production programs, such investment is desirable. A contract for such a follow-on effort would, all things considered, arguably be an equitable and justifiable DoD incentive for such contractor IR&D investment, which values technical innovation and capability, risk reduction and risk mitigation, as well as cost/price, in its discretionary rubric.

Second, because the proposed rule deviates from the long-standing IR&D statutory balance, and conflicts with the policy considerations that frame contractor IR&D practices, it seeks to penalize offerors from benefiting from the fruits of their IR&D investment. Such a tactic will have the unintended consequence of discouraging contractors from strategically investing IR&D funds in innovative technology projects.

CODSIA believes that the current statutory and regulatory framework governing IR&D allowability encourages the defense industry to invest in new technology that brings substantial overall benefit to DoD.

2. Policy and Cost Accounting Framework

By law, regulation and DoD policy, contractor IR&D investments are indirect costs and they are allowable when they meet the requirements of FAR 31.205-18 and DFARS 231.205-18, *Independent Research and Development and Bid and Proposal Costs*. Instructively, the purpose of indirect costs is set forth in the Cost Accounting Standards (CAS)[12] as follows:

> The purpose of this standard is to require that each type of cost is allocated only once and on only one basis to any contract or other cost objective. The criteria for determining the allocation of costs to a product, contract, or other cost objective should be the same for all similar objectives. Adherence to these cost accounting concepts is necessary to guard against the overcharging of some cost objectives and to prevent double counting. Double counting occurs most commonly when cost items are allocated directly to a cost objective without eliminating like cost items from indirect cost pools which are allocated to that cost objective.[13]

Further, IR&D costs are defined as:

> *Independent research and development* means the cost of effort which is neither sponsored by a grant, nor required in the performance of a contract, and which falls within any of the following three areas: (i) Basic and applied research, (ii) Development, and (iii) Systems and other concept formulation studies.[14]

Based on the limits placed on DoD in 10 U.S.C. 2372(f) and as repeated in the August 2015 AT&L White Paper,[15] IR&D costs *are not directed by the government and are identified by individual companies and intended to advance a particular company's ability to develop and deliver superior and more competitive products to the warfighter.* (Emphasis added)

Many academic treatises and federal and private sector studies have articulated the history of IR&D policy.[16] It is reasonable to conclude from the history and wealth of documentary

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[12] Title 48, Chapter 99, Cost Accounting Standards
[13] 48 CFR 9904, 402-20, Purpose
[14] 48 CFR 9904.420-30, Definitions
[15] White Paper, SUBJECT: Enhancing the Effectiveness of Independent Research and Development, Frank Kendall, USD (AT&L), August 26, 2015.
[16] *See* Rand Corporation-NDRI Study, R-3649-ACQ, The Defense Department's Support of Industry's Independent Research and Development, 1989; Aerospace Industries Association, Maintaining Technological Leadership, The Critical role of IR&D/B&P, 1989; DoD Directive 2304.1 IR&D and B&P Program 2, May 10, 1999; McKenna/Dentons, IR&D, B&P, Selling and Related Costs under Federal Government Contracts – A Practical Guide, January 9, 2002, Authors: Lemmer, Meagher, Seckman.

evidence that supporting IR&D as a way to incentivize investment by contractors to develop and acquire improved warfighter capabilities has been embraced by the statutes and implemented by DoD regulation. This shared strategic investment policy has led to the most technically advanced military force the world has ever seen, and CODSIA believes it is vital to keeping the nation's technological advantage from waning.

To advance that policy, throughout the 1990s, Congress enacted multiple statutory provisions in Title 10 declaring that contractor IR&D activities were beneficial to the Government, and that DoD regulations implementing the provisions of 10 U.S.C. 2372 should, among other things, (1) encourage contractors to engage in R&D activities of potential interest to the DoD, (2) not infringe on the independence of contractors to choose which technologies to pursue in their IR&D activities, and (3) provide that IR&D costs are allowable as indirect expenses on covered contracts.

The regulations and guidance implementing the statutes incrementally changed many of the rules on the treatment of IR&D and B&P costs in the FAR and DFARS. At the same time, DoD also addressed new data rights regulations (DFARS 252.227) to remove another obstacle to contractor IR&D investment stemming from contractors' concern that IR&D investment could become the basis for government claims to contractor data rights even where technology was developed at private expense. The principle repeatedly articulated by Congress and DoD throughout the '90s was that contractors should use IR&D to develop new military capabilities, invest in dual-use technologies, and expand their businesses beyond traditional military procurement, including investing in IR&D activities to lower the cost and time required for providing any new capabilities. For reasons that are unclear, DoD policy has evolved to view concurrent IR&D as either unfair in the source selection process and/or creating an incentive for industry to abandon existing development projects in favor of improving performance under other non-development contracts.

Aside from the clear intent of Congress and DoD to encourage IR&D, one remaining concern of DoD about the efficacy of IR&D costs, and ancillary to the "double-dipping" argument, was whether, in the context of a specific contract, the acquisition implicitly required costs be expended by contractors for R&D efforts to perform under that contract, and, if so, whether such costs would also be allowable under CAS as indirect IR&D costs. Further, it was unclear whether, if that principle were enforced under CAS, that interpretation would thwart Congressional intent to incentivize contractor use of IR&D and/or negate the DFARS and CAS regulatory frameworks. Early cases held that costs were not indirect IR&D if implicitly required,[17] but more recent holdings have settled the key issues by (1) rejecting the implicitly required theory of indirect costs,[18] and (2) ruling that using IR&D indirect costs as an element of an offeror's price proposal concurrent with its status as an indirect cost was not an unfair

[17] *United States v. Newport News Shipbuilding, Inc.*, 276 F. Supp. 2d 539 (E.D. Va. 2003)
[18] *ATK Thiokol, Inc. v. United States*, 598 F.3d 1329 (Fed. Cir. 2010)

advantage in the bidding process and is consistent with the government's intent to support contractor IR&D.[19]

Whether particular research and development costs qualify as indirect IR&D for purposes of government contract accounting is determined by several interrelated regulations. First, section 402 of the Cost Accounting Standards, 48 C.F.R. § 9904.402 ("CAS 402"), defines direct and indirect costs. Second, two parallel regulations determine whether certain costs qualify as IR&D. A provision of the Federal Acquisition Regulation, 48 C.F.R. § 31.205-18 ("FAR 31.205-18"), determines whether particular costs are allowable IR&D charges. A provision of the Cost Accounting Standards, 48 C.F.R. § 9904.420 ("CAS 420"), determines whether those costs are allocable to the particular contract in question. Both the FAR and the CAS define IR&D as excluding costs that are "required in the performance of a contract." FAR 31.205-18(a); CAS 420-30(a)(6).[20]

Ultimately, the Court's *ATK* decision held that "required in the performance of a contract" only meant direct costs and rejected the government's narrow policy arguments. Notably, in addition to the technical conclusion about CAS 420, the case cites several key policy arguments in support of their holding:

> First, the purpose of IR&D is to benefit both government contractors and their customer agencies by encouraging the contractors to engage in research that is likely to benefit multiple contracts, both governmental and commercial. Spreading IR&D costs across multiple contracts encourages general research that enables the contractor to innovate, to maintain a high level of technological sophistication, and ultimately to improve the products it offers the government. As the Department of Defense has explained, providing financial support for IR&D serves several Departmental goals, including creating "an environment that encourages DoD contractors to expand knowledge in mathematics and science, improve technology in areas of interest to the Department of Defense, and enrich and broaden the spectrum of technology available to the Department of Defense." Dep't of Def. Directive No. 3204.1, at 3 (May 10, 1999).
>
> Second, the result of requiring IR&D costs to be borne by a contract for which the research and development work in question is deemed necessary could have the perverse effect of charging all of the research and development costs for a proposed product line against the first contract for the products in that line, whether the contract is governmental or commercial. That approach would either disproportionately burden the contract that happened to be first in line or ensure that the first contract would be a losing one.[21]

[19] *Raytheon Co. v. United States*, 809 F.3d 590 (Fed. Cir. 2015)
[20] *ATK*, supra
[21] *ATK*, supra

The policy pronouncements in *ATK* are significant because they frame the issues for practical purposes: if contractors were not permitted to use IR&D to feed development across all contractor programs, and concurrently propose in new offers, the DoD would either have to fund all R&D themselves directly and by separate contracts over a long period of time, or in the alternative, pay all of the development costs for a specific program in the price of the first contract, which as the court notes, would likely be a losing proposition for any contractor pricing in that way, or completely unaffordable, thus defeating the purpose of IR&D cost policy.

The *Raytheon* holding then further confirmed that IR&D is:

> "[R]esearch conducted by the contractor but not specifically for a particular government project. … Although such work is contract-independent, its fruits can actually help the contractor deliver the goods or services promised in a particular contract. When that is so, the cost of work implicitly needed for a particular contract, which otherwise might have been built into the price for that contract, may instead be treated as an IR&D cost . . . . The result is a "cost reduction" for the particular contract without compromising the contractor's ability to fulfill its promises in that contract."[22] (Emphasis added)

The *Raytheon* holding reinforced that properly categorized IR&D effort does not alter the contractor's commitment to perform a contract even though an IR&D project is not required by a contract. The DoD concern that contract efforts will be performed on IR&D is misplaced because current cost accounting rules prohibit that and there is no evidence that such behavior is common in the defense industry. While contractors focus their IR&D spend on projects with near and long term returns on investment and to fit developing technology into new offers, it does not mean that contractors would either abandon their subsequent contract obligations or their IR&D projects.

By its nature, the proposed rule also appears to devalue IR&D investments that provide near term, incremental improvements in technology, especially where they support multiple short term business ventures that a contractor/offeror may be pursuing in favor of stand-alone technology leaps. As a practical matter, when IR&D projects near completion, a contractor/offeror will begin to include those innovations in their proposals, since they are intended as advancing the state of the art and providing improved products as fast as possible to the warfighter. This approach has significant benefits to DoD since the latest innovation is made available to DoD at an affordable price in lieu of paying the full price of the IR&D in a single contract or completely funding the technology development on their own, as mentioned above. If DoD artificially adjusts a specific offer to include all of the IR&D investment costs made by contractors (if this can even be done on a real time transactional basis), the inflated price is almost sure to make the technology unaffordable and the offer non-competitive, thereby depriving DoD of the best available technology.

[22] *Raytheon, supra*

IR&D expense policy has multiple and varied purposes, including those mentioned at length above. Its criticality to DoD technology innovation is obscured by arguments about whether DoD contractors invest in the right focus areas and, conversely, whether DoD, in the absence of providing accurate demand signals and/or of a secure and stable budget, has the authority to "direct" or "penalize" contractor IR&D investment through various procurement and oversight processes, and/or to force industry to invest in projects that they would not otherwise have done independent of those pressures because they would not have any application to their primary market.

The historical record, including legislative history and supporting case law through the current round of acquisition reform, leads to the conclusion that Congress and DoD have jointly chosen to encourage industry to invest IR&D spend in areas of interest to both industry and DoD, and to do so under the statutory parameters and constraints articulated in 10 U.S.C. 2372. There is nothing in the history of IR&D policy or law that could be construed as a demand that contractors should ever be directly or indirectly penalized in the competitive source selection process (such as envisioned in this rulemaking) for undertaking IR&D projects. Given that the policy has been highly successful since the creation of the CAS Board in 1970, it is unclear why the Department has chosen this moment in time to question its usefulness or legitimacy.

3. Specific Rule Comments

The April 2016 CODSIA response to the February 2016 ANPR asked many questions that have not been addressed, either separately or in the proposed rule. Those issues are repeated here, along with questions about the terms proposed to implement the clause and policy:

1. 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? The lack of the proper regulatory review handicaps industry attempts to understand the real scope of the problem.

2. Are there examples where DoD evaluated IR&D in source selections? If yes, what was the result? Did IR&D investment have any impact on the source selection process, for good or bad, in the eyes of the evaluators?

3. Why does DoD believe that industry is not investing in innovation or is using IR&D investment in violation of the regulations?

4. DFARS 215.305, Proposal Evaluation:

   a. What is meant by "a price that is reduced due to reliance upon future Government-reimbursed IR&D projects"? How are future projects to be valued?

   b. How will a CO "adjust the total evaluated cost or price of the proposal to include the amount by which such investments reduce the price of the proposal"?

5. DFARS 252.215-70XX, Notification of Inclusion of Evaluation Criteria for Reliance Upon Future Government-reimbursed IR&D Investments:

    a. What is meant by "This solicitation includes price evaluation criteria that consider the Offeror's intended use of future Government reimbursed IR&D projects…"? How will these criteria manifest in a solicitation or in a proposal response? How does a contractor/offeror quantify the value of future Government reimbursed IR&D projects to address the criteria? Will there be some set of standard DoD price evaluation criteria for IR&D allocation purposes? How does a contractor/offeror determine the amount that the Government will reimburse as IR&D? Do these criteria differ from the amount CO's are required to reduce contractor/offerors proposals by in subsection (c)? How will PCO's be able to distinguish IR&D from other indirect costs closely corresponding to IR&D, such as B&P and selling costs?

    b. What is the purpose of an offeror/contractor identifying IR&D for use in the performance of any contract, and what documentation will suffice for such a purpose? How could an offeror/contractor know in advance whether IR&D will be used in performance of a contract beyond a short period?

    c. Is there some standard algorithm that a PCO would use to adjust an evaluated bid price to include future IR&D investment? Assuming offerors/contractors cannot pinpoint exact IR&D amounts for use in this process, will a PCO invent a numeric amount and/or how will this factor be calculated? How would such an amount withstand a sustainable protest? Will PCO's be trained in how to value future IR&D investments?

6. Will prime contractors be required to question subcontract IR&D indirect rates prior to submission of their proposal in order to align with the DoD approach here? How will PCO's value IR&D spend in an offer from a prime contractor with multiple sub-contractors? Will multiples of the price evaluation factor be added to the proposed prime contract cost/price to account for all IR&D in the supply chain?

7. Will IR&D used for "risk reduction" be treated differently in the source selection additive process? If DoD favors technology leaps, will risk reduction investment be dismissed or determined to be unallowable cost?

8. How will IR&D program value be allocated to multiple different proposals that may hinge on the use of the technology attributed to the IR&D spend? Will all proposals submitted in response to MDAP or MAIS solicitations be burdened by the additive price factors by a DoD PCO? How will a share of IR&D contractor investment used for non-federal contracts be taken into account? How will the necessary complex business models be constructed that will address this nuanced nature of IR&D to take into account impact over the life of the proposal being evaluated by the government?

9. Will this additive evaluation price factor be used in other than competitive solicitations or by PCO's trying to negotiate cost /price reductions in competitive source selections where effective competition does not occur?

10. Increased bid protest risk can be expected due to disputes over the price evaluation factor based on PCO estimates of future IR&D investment. 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 or arbitrarily derived models will not withstand a sustainable protest. This is because, like PCO projections about cost or price in those cases, the price evaluation factor envisioned here to value future IR&D investment will not be based on verifiable data.

4. Regulatory & Administrative Requirements

Applicability to SAT and COTS

CODSIA endorses the DoD position that the rules and clause should not apply at or below the Simplified Acquisition Threshold (SAT) nor to commercial or COTS items.

Executive Orders 12866, Regulatory Planning and Review, and 13563, Improving Regulation and Regulatory Review

CODSIA strongly disagrees that this proposed rule is not a significant regulatory action and recommends that DoD submit the proposed rule to the Office of Information and Regulatory Affairs (OIRA) in the Office of Management & Budget (OMB) for review of, and compliance with, the requirements for a "significant regulatory action." Those are defined in Executive Order (E.O.) 12866 as likely to result in a rule that may:

1. Have an annual effect on the economy of $100 million or more or adversely affect in a material way the economy, a sector of the economy, productivity, competition, jobs, the environment, public health or safety, or State, local, or tribal governments or communities;
2. Create a serious inconsistency or otherwise interfere with an action taken or planned by another agency;
3. Materially alter the budgetary impact of entitlements, grants, user fees, or loan programs or the rights and obligations of recipients thereof; or
4. Raise novel legal or policy issues arising out of legal mandates, the President's priorities, or the principles set forth in this Executive Order.

The proposed rule meets the criteria for review. If implemented in its current form, the proposed rule would certainly impact contractor IR&D investment in DoD technology innovation and future warfighting; the ten largest DoD prime contractors alone have IR&D investments well over the $100 million threshold, and likely significantly higher. Those investments would

materially affect the general economy, as well as the aerospace and defense sectors specifically, including impacts to the nation's workforce. The proposed rule is also inconsistent with the existing statutes governing the use of IR&D expenses and will lead to inconsistent regulatory approaches to IR&D in the FAR and DFARS.

E.O. 13563 amplifies the review principles in E.O. 12866 by encouraging agencies to coordinate their regulatory activities, and to consider regulatory approaches that reduce the burden of regulation while maintaining flexibility and freedom of choice for the public. E.O. 13563 requires agencies to quantify anticipated benefits and costs of proposed rulemaking as accurately as possible using the best available techniques, and to ensure that any scientific and technological information or processes used to support their regulatory actions are objective.

Considering the proposed rule meets the standard for review by OIRA, and that no cost/benefit analysis was conducted per E.O. 13563 because DoD classified the proposed rule as not significant, DoD should submit the decisional documents for review to OIRA and OMB prior to issuing any final rules. Ideally these actions should be performed long before any rule is published in the *Federal Register*.

Regulatory Flexibility Act (RFA)

It is unclear whether the analysis required under the RFA is needed. However, it is not true that the rule will not have a significant economic impact on a substantial number of small entities. On the contrary, as described above, contractor IR&D investment is large. In addition, these contractors utilize or subcontract with many smaller entities to perform innovative work and also have both corporate and federal obligations to engage and subcontract with small and diverse businesses at every tier of their commercial and federal supply chains. In addition, companies are often required to contract or subcontract with small entities at levels of between 25% and 50% of corporate or federal contract spend. The statement that presumptively dismisses a need for the analysis "…because the cost, magnitude, and production requirements of such programs (MDAP/MAIS) are generally beyond the capability or capacity of small entities..." is patently incorrect. CODSIA recommends that the proposed rule should be reviewed further by both DoD and the SBA Chief Counsel for Advocacy to determine whether an RFA analysis is warranted.

5. Conclusion

CODSIA sees this rulemaking as having significantly broader implications about IR&D cost allowability and allocation, research and development contracting, source selection, competition policy, and other acquisition issues than DoD has expressed in the rulemaking process. For a rule that could have a substantial impact on IR&D investment decisions, it is disappointing that DoD has not presented any data whatsoever that demonstrates the depth and breadth of the problem they are trying to resolve that made this rulemaking necessary in the first place. Most importantly, the rule results in the effective directing by DoD of IR&D investment decisions of contractors in violation of existing statutes.

Given the importance of IR&D investment for both DoD and the defense industrial base, CODSIA strongly opposes the proposed rule and recommends that it be withdrawn. We also call for further industry engagement with DoD on their and our broader concerns, including, if appropriate, holding another public meeting.

Thank you for your attention to these comments. If you have any questions or need any additional information, please contact Ryan Ouimette, our project officer for this case, at (703) 247-9463 or at rouimette@ndia.org.

Sincerely,

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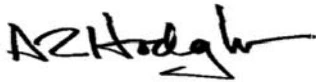

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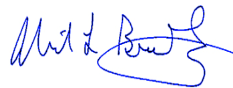

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