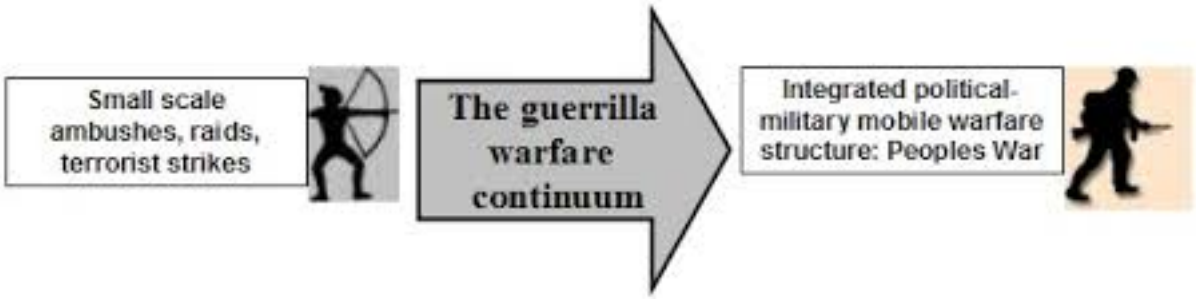

That's not our headline; it's the headline from a recent **client alert** issued by the esteemed law firm of Crowell & Moring. It's a pithy summary of our feelings on the matter, though, as exemplified by our most recent
article
on the topic. In that article we recounted some of the history of the various DoD-led attempts to micro-manage contractors' R&D spending, so as to "encourage effective use" of R&D dollars to meet Pentagon objectives.

"Micro-manage" is our term. Others might use terms such as "guide" or "control" or even "engage in centralized planning". Whatever term you prefer to use, the fact of the matter is that one of the defining characteristics of the Obama Defense Department is its focus on contractors' IR&D budgets. That focus, of course, in inimical to fostering the kind of innovation that the DoD also says it wants to achieve. On one hand, the Pentagon talks about losing its technological edge to adversaries and trying to leverage the "fail faster" agility of Silicon Valley; but on the other hand it talks about "sponsoring" IR&D projects and using the amount contractors spend on certain R&D projects as an adder to price evaluations, which effectively penalizes a contractor for engaging in research and development.

Dear Dr. Carter: You can't have it both ways. You have to choose between managing contractor R&D projects from a central Pentagon bureaucracy, or else getting that bureaucracy the hell away from contractors and let them go to town—just like they do it at Silicon Valley. Pick one, please.

A recent example of how Pentagon policies stifle innovation was reported by DefenseNews in
this story
, written by Laura Seligman. Ms. Seligman reported that—

Lockheed Martin has decided not to offer a clean-sheet design for the US Air Force's T-X

program, instead moving forward with the original plan to offer the T-50A to replace the service'sÂÂÂ aging T-38 trainer fleet. Lockheed had been toying with the idea of offering a clean-sheet design for the T-X competition for months, but ultimately concluded that option would pose too much risk to the program's cost and schedule …

… the [Lockheed Martin] team concluded that a brand-new blueprint would be about eight times more expensive than the modernized T-50A and would not meet the Air Force's new target date of 2024 for initial operational capability … [and] would add significant risk to the program.

Thus, instead of getting a "clean-sheet design" that maximizes innovation, the Air Force gets the same trainer aircraft it has been using for more than 50 years. Of course, Lockheed touted the "block changes" it will make to the existing aircraft if it wins the competition. (You can read about those changes in the DefenseNews story.) But none of those changes represent fundamental, innovative, advances on the original nearly 60 year-old design.

Lockheed Martin chose a path that minimizes risk but sacrifices innovation. In the current acquisition environment—one rife with Lowest-Price Technically Acceptable contract awards and management reviews of any price "premiums" paid in best value trade-off analyses—it's probably the smart way to go.

And yet, once again the Pentagon isn't getting what it says it wants. Why? The culprit may be the acquisition folks and the recent "Better Buying Power 3.0" initiative. Let's look at that initiative (once again).

BBP 3.0 is the poster child for the Pentagon double-speak. On one hand, the goal of BBP 3.0 is to "increase the productivity, efficiency, and effectiveness" in the areas of acquisition, technology and logistics. On the other hand, page 11 of the implementing memo declared open war on contractors' R&D spending, stating –

Reviews of IRAD spending indicate that a high fraction of IRAD is being spent on near-term competitive opportunities and on de minimis investments primarily intended to create intellectual property. A problematic form of this use of IRAD is in cases where promised future IRAD 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 intent of the actions below is to ensure that IRAD meets the complementary goals of providing defense companies an opportunity to exercise independent judgement [*sic*] on investments in promising technologies that will provide a competitive advantage, including the creation of intellectual property, while at the same time pursuing technologies that may improve the military capability of the United States. The laissez faire approach of the last few decades has allowed defense companies to emphasize the former much more than the later [*sic*]. The goal of this initiative is to restore the balance between these goals.

To achieve the stated objective of "improve communication between DoD and industry and restore a higher degree of government oversight of this technology investment," the BBP 3.0 memo identified three initiatives that were to be undertaken by various Pentagon entities. The three initiatives were as follows (and we quote):

1.

ASD(R&E), beginning in 2015, will organize and initiate the execution of a continuing series of annual joint Technology Interchange Meetings (TIMs) with industry, organized by the existing S&T CoIs. Through virtual exchange of data and in person reviews, the S&T CoIs will provide industry with more detailed information about future program plans and gain enhanced DoD understanding and visibility into relevant IRAD.

1.

Director DPAP, with ASD(R&E), will recommend to USD(AT&L) new guidelines for allowable [*sic*] of IRAD expenses by May 2015. The new guidelines will include: identification and endorsement of an appropriate technical DoD sponsor from the DoD acquisition and technology community prior to project initiation; and provision of a written report of results obtained following the completion of the project, or annually if the project spans multiple years. Following USD(AT&L)'s approval, the new guidelines will be implemented through a standard rule making notice and comment process.

1.

Director DPAP, with ASD(A), will develop a proposed regulatory or statutory change that would preclude use of substantial future IRAD expenses as a means to reduce evaluated bid prices in competitive source selections and provide it to USD(AT&L) by July 2015.

As far as we know, the first initiative is going on. The second initiative was started but then stalled (publicly, at least). And we recently commented on the third initiative, which includes an Advance Notice of Proposed Rulemaking (ANPRM), an opportunity for the public to comment on the ANPRM, and a public meeting to air grievances and concerns with the ANPRM.

We've noted this apparent war on contractors' IR&D several times on this blog. We've railed against it. We've used intemperate language, and even implied that the kind of centralized planning and control the Pentagon said it wanted to impose was hard to differentiate from Soviet-era centralized planning and control. But it hasn't just been us! Others, including the President of Textron Systems, called on the Pentagon to walk away from its efforts to "micro-manage" IR&D. (That was her word, not ours.) At the time of the initial controversy, **an article** on the National Defense Industrial Association (NDIA) blog carried the following quote—

"The point of IRAD is to have government reimbursed R&D that isn't government directed, in order to see what the best minds in industry can do to solve the government's tough problems," said a defense industry representative who asked to not be quoted by name. *"Having the government dictate exactly what it wants kind of takes the 'I' out of IRAD."*

(Emphasis added.)

Having recited some of the history of this issue, we come at last to the final question: *why?*

Why do Defense leaders and policy-makers engage in double-speak on this topic? Why do so many Pentagon bureaucrats believe the best way to encourage innovation is to control it? Why

are they looking to penalize contractors for engaging in unauthorized R&D projects?

In more than five years of thinking and writing about this particular topic, it is the "why?" that has always eluded us. Why would something so obviously counter-productive be perceived to be in the Pentagon's best interests? We've never gotten it, and our lack of understanding has bothered us.

And now we think we've figured it out, thanks to Sam. Sam is a smart friend and we thank Sam for explaining it all to us.

The answer is right there in the last sentence of the quote above, the one we italicized. *The unspoken objective is to take the "I" out of IRAD.*

Why would that be important?

If the IRAD projects were not "independent" then the Pentagon would have access to the intellectual property developed by those projects.

Sam pointed out that the FY 2011 National Defense Authorization Act (NDAA), at Section 824, eviscerated the long-standing "follow-the-funds" test to determine who owned intellectual property rights. Under that test, whichever entity paid for the research or development efforts owned the rights. For example, ideas discovered by people who were directly charging their time to a government contract were owned by the government; whereas ideas discovered by people who were charging to IR&D or other contractor-funded projects were owned by the contractor. But that was changed by the FY 2011 NDAA. Statutory language seemed to require that B&P and IR&D efforts be treated as "government expense"—since the government reimbursed the contractor for such efforts through indirect rates. As Louis Victorino of Shepherd Mullin **wrote** at the time—

As enacted, the Act seems to require, at least to some extent, that Independent Research and Development ('IRAD') costs and Bid and Proposal ('B&P') costs be treated as 'government expense' in applying the data rights follow-the-funds test. As such, the government would be

allocated, at a minimum, a Government Purpose Rights License in data related to an item or process developed under an IRAD or B&P project or, more likely, an Unlimited Rights License in those data. This, obviously, would be a marked departure from established principles that define IRAD and B&P costs as 'private expense.' Indeed, the treatment of IRAD and B&P costs as 'private expense' has its roots in the earliest interpretations of the rights in data provisions set forth in the Armed Services Procurement Regulation of the late 1950s and 1960s. This historic treatment of IRAD and B&P costs even avoided the assault on the Defense Federal Acquisition Regulation Supplement ('DFARS') data rights provisions adopted in the late 1987-88 time period (only to be reversed in the 1995 revisions).

The FY 2012 NDAA contained similar challenges to contractors' rights to their own intellectual property. In a February, 2012, Law360 article **pulled** from the Crowell & Moring website, Ralph Nash (esteemed *èminence grise* of all things government contracting) was quoted as saying that he —

sees the [FY 2012 NDAA] provisions as part of the 'steady erosion of contractors' ability to protect his data in the first case.' The government cannot force a contractor to give up data rights, but by using data rights as part of its evaluation of competing contract bids, it can leverage its buying power to get more and more data, he said. 'You could always buy data rights, but you had to buy them as a separate procurement,' Nash said. '[Government agencies] have been, in the last five years, busily finding ways to use that competition to get data rights by treating it as something they're going to evaluate in selecting the winner of the competition.'

Government agencies looking for ways to obtain data rights by making the issue a part of competitive evaluations? *Where, oh where, have we heard that before?*

A January, 2014, National Defense magazine article by Sanda Irwin **discussed** the "tension" between the Pentagon and its suppliers over rights to data and other intellectual property. The article (which we recommend you read in full) includes the following discussion points—

The origins of the conflict can be traced back to the mid-1990s, when the Defense Department saw its R&D budgets collapse and decided it should tap into the commercial market for innovation. The thinking was that the government would save money and benefit from industry's investment. … What sowed the seeds of the current discontent were contracts agreed upon years ago in which data requirements were not well defined. … The Pentagon is

now searching for less expensive options to maintain its aging equipment and finds that, in some cases, it cannot compete the work because the original manufacturer owns the IP ….

The cards are being stacked against contractors, as the Pentagon has Congress' full backing on this issue. … DoD and Congress believe this flexibility is needed to ensure market competition …. The law would permit the government to give a company's data to other contractors, which is a nightmare scenario for most manufacturers. …

As IP disputes become more frequent, contractors confront a dilemma. They can agree to their customers' demands or take them to court. … Attorneys suggest that, to get beyond this impasse, the government should consider licensing agreements so companies are compensated for their IP.

There is no easy solution, said Louis D. Victorino, an attorney at Sheppard, Mullin, Richter & Hampton LLP. 'Free and open competition is a fundamental tenet of procurement policy,' he said. 'But unless the government chooses to fund all R&D costs, it needs manufacturers' data rights.' If the government wants rights, he said, it should pay for the R&D. Unless the Defense Department can find a way to satisfy industry's concerns, he said, it soon will find that companies are not going to be willing to invest upfront R&D money.

The debate is unfolding as contractors are being asked by a cash-strapped Pentagon to invest in technology. As one executive noted, industry CEOs will have to ask themselves before they compete for Pentagon work: Do I want to risk losing control of my intellectual property?

To sum up this rather long-winded article, we think our friend Sam has nailed it. This is not about leveling the playing field by reducing "games" that some contractors can play—tactics that are perfectly permissible under the Federal Circuit's interpretation of CAS 402 and 420 in the *ATK Thiokol* decision. No. Instead, this is about obtaining contractors' intellectual property rights via subterfuge, in the guise of adjusting price evaluations. It's about taking away the "independent" in IRAD and thereby weakening contractor protections of their IP rights. As we think we've shown, the Pentagon has a long history of trying to obtain those IP rights, and the latest DFARS ANPRM fits perfectly into those historical efforts.

In that context, the attorneys at Crowell & Moring are absolutely correct to call the ongoing Pentagon snatch-and-grab efforts "guerrilla warfare".