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TABLE OF CONTENTS

- | | |
|--|----------------|
| 1. President's Column
<i>Elaine Eder</i> | Page 3 |
| 2. Editor's Column
<i>Clarence D. Long, III</i> | Page 4 |
| 3. Homeland Security
<i>David Bodenheimer</i> | Page 4 |
| 4. Judicial Enforceability of
Teaming Agreements: The
New Sheriff in Town
<i>David Metzger
John P. Rowley III,
Jennifer A. Short, and
Stuart Young</i> | Page 23 |
| 5. The IR&D Process
<i>Paul Pompeo</i> | Page 34 |

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Dec 25, 2003

After very useful and informative Annual Meeting presentations last October, we have been able to get off to a terrific start this service year! And for that, I thank many people in our organization. Our immediate past president, Dick Gallivan (Navy Litigation Office), did a tremendous amount of work on many issues, including enhanced web site features and practical guidance pertaining to e-filing. Dick took us significantly forward during his tenure over the past year, and his tact and steady leadership set us on a clear path to move successfully ahead.

As I extend thanks to Dick, I must also thank:

Jim Nagle (Oles, Morrison, Rinker & Baker) for chairing our 2003 annual meeting – with special gratitude to his panel chairs Liz Fleming (Trout & Richards), Jim McCullough (Fried Frank) and Hugh Long (USAF);

David Metzger (Holland & Knight) for his continuing work in chairing the highly regarded Executive Policy Forum;

David Fowler (Raytheon) for chairing the much appreciated Trial Practice Committee; the Board of Governors for their dedication and all their efforts on behalf of the BCABA; and

our Gold Medal firms for their strong and continuing support.

Finally, very special thanks are extended to two sustaining forces in the growth and evolution of the organization: Hugh Long and Peter McDonald (McGladrey & Pullen). Hugh serves our indefatigable editor of *The Clause*, and Pete has always shown unparalleled energy, enthusiasm and support for the organization and all its members.

All these contributions made it possible for me to propose at our first Board of Governor's meeting for this year that the BCABA develop and implement a long-range strategic planning process and plan. With those, we can be confident that our organization will continue to provide superb service and benefit for our members and the broad government contracting community into the future. Within the context of what BCAs are, what they do, and how they do it, we will emphasize responsive and proactive actions for the BCABA's purposes of promoting just, efficient, and effective practice of government contract law and BCA litigation. Pete McDonald, Dave Metzger, and Joe McDade (USAF OGC) are working as a core team to address this initiative.

In the meantime, I look forward to talking and meeting with many of you and to ensuring BCABA programs and activities serve our practice area well now and into the future.

Sincerely, Elaine A. Eder
President

EDITOR'S COLUMN

Let me thank every one for their help at the Annual Meeting. In this issue we have several fine articles by Dave Bodenheimer, David P. Metzger, John P. Rowley III, Jennifer A. Short, Stuart Young, and Paul Pompeo. These timely and informative articles on Homeland security, Teaming Agreements, and Independent Research and Development are of great value to our readers and to this magazine.

There was no time to get a Treasurer's Report, however, Alan Gourlay tells me we have plenty of money in the bank. MERRY CHRISTMAS, especially for our heroic and skilled soldiers in Central and South West Asia.

HOMELAND SECURITY NOW AND LATER: EMERGING ISSUES AND NEW PERILS IN CONTRACTING

David Z. Bodenheimer¹

"A new government department does not spring, like Athena from the brow of Zeus, full blown and ready for action." James Schlesinger, July 10, 2003.

Perhaps it would have been easier if the Homeland Security Department had been birthed from Zeus' brow amidst warring factions, arbitrary Greek gods, and tasks of Herculean proportions. The Department confronts essentially the same challenges, but must do so in its infancy: cleaning up inherited messes from predecessor agencies (the Augean stables), threading the needle between warring Congressional committees (Hera versus Zeus), and battling terrorism (the Hydra), but only if done in the "right" way.² Just as Hercules sought help in performing his twelve Labours, the Homeland Security Department depends heavily upon private industry for the technology, support, and

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² In assigning two additional "Labours" to Hercules, Eurystheus contended that improper shortcuts had been taken in killing the Hydra (calling for Iolaus' help) and cleaning the Augean stables (diverting the two rivers).

expertise to fulfill its many-headed missions. For this reason, the Department's problems will often become industry's problems.

During its inaugural year, the Homeland Security Department has hewed its way through a host of knotty issues, some of which arose out of the largest federal government reorganization in 50 years, while others sprang from the multiple – sometimes conflicting – missions of balancing anti-terrorism safeguards against budget constraints, individual rights, and efficient flow of trade. Despite progress, major issues remain. Both the Department and industry can expect to face emerging issues, opportunities, and pitfalls in the following areas:

- 1) Sharing Information
- 2) Moving Goods
- 3) Protecting Secrets
- 4) Spreading Technology
- 5) Forging Interoperability
- 6) Going Global
- 7) Funneling Funds to State & Local Governments
- 8) Tapping Private Funds
- 9) Avoiding Political Fallout
- 10) Finding the Right Person and Rule

Sharing Information

For the Homeland Security Department, few tasks have higher visibility or priority than receiving, coordinating, and sharing information.

The Mandate for Sharing Information

Since Pearl Harbor, the risks of not sharing information in a timely and effective manner have been well known. To this end, the Homeland Security Act of 2002 (Pub. L. No. 107-296, § 201(d)(1)) requires the Department to access, receive, analyze, and integrate “law enforcement information, intelligence information, and other information” from federal, state, and local governments and private sector entities. The General Accounting Office (GAO) recently summed up this core mission:

To accomplish this [anti-terrorism] mission, the act established specific homeland security responsibilities for the department and directed it to coordinate its efforts and share information within DHS and with other federal agencies, state and local governments, the private sector, and other entities. This information sharing is critical to successfully addressing increasing threats and fulfilling the mission of DHS.³

³ GAO, “Homeland Security: Information Sharing Responsibilities, Challenges, and Key Management Issues,” p. 12 (Sept. 17, 2003) (GAO-03-1165T) (www.gao.gov).

However, Congress recognized that unfettered information sharing posed other risks that the Department must weight in fulfilling its charter.

Privacy Issues in Information Sharing and Gathering

Balanced against this mandate for gathering and sharing information, the Homeland Security Act required the Department to “establish procedures” to “protect the constitutional and statutory rights of any individuals who are the subjects of such information” and to appoint a Privacy Officer responsible for “privacy policy” and protecting privacy rights. Pub. L. No. 107-296, §§ 221(3), 222. In the Homeland Security arena, both the Department and contractors may encounter privacy issues in a number of contexts.

Electronic Privacy

As illustrated by the Congressionally-mandated demise of the Total Information Awareness (TIA) program for collecting and analyzing public and private data,⁴ privacy has been a hot-button issue in the Homeland Security arena. Electronic data systems represent a linchpin for collecting, storing, and sharing data, but such systems may trigger Privacy Act coverage. 5 U.S.C. § 552a. Such privacy requirements may apply not only to government agencies, but also to the contractors operating such systems. *See* 5 U.S.C. § 552a(m)(1) (applicability to government contractors). Indeed, the Federal Acquisition Regulation (FAR) warns of the possibility of criminal penalties for Privacy Act violations:

An agency officer or employee may be criminally liable for violations of the Act. When the contract provides for operation of a system of records on individuals, contractors and their employees are considered employees of the agency for purposes of the criminal penalties of the Act.

As a result, both the Department and contractors must be attuned to privacy issues that may arise out of electronic systems that collect, store, or share personal information potentially subject to federal or state privacy restrictions.

Physical Privacy

With so much territory to cover, agencies are looking at remotely piloted vehicles and blimps for aerial surveillance. For example, Under Secretary Hutchinson testified before Congress about the Department’s specific interest in unmanned surveillance vehicles, or drones, as a potential technology for border security.⁵ Similarly, a sensor-

⁴ Fiscal Year 2004 Department of Defense Appropriations Act, Pub. L. No. 108-87, § 8131 (prohibiting funds for TIA except for foreign counterterrorism intelligence).

⁵ *Border Technology: Keeping Terrorists Out of the United States – 2003: Joint Hearings Before the Senate Subcomm. on Terrorism, Technology, and Homeland Security and Border Security, Immigration, and Citizenship, 108th Cong., 1st Sess. (Mar. 12, 2003) (statement of Under Sec. Hutchinson) (hereafter *Senate Border Technology Hearings*).*

packed blimp has recently floated over Manassas, Virginia to test aerial surveillance capabilities for Homeland Security missions.⁶ Such potential surveillance has not been without controversy: “Civil libertarians expressed concern that the blimps will be another government tool that infringes on privacy.”⁷ As a result, privacy issues will inevitably become tangled with Homeland Security programs involving such surveillance.

International Privacy

Some of the U.S. anti-terrorism requirements may collide head-long with international privacy laws: “The Europeans say the use of extensive information on passengers violates privacy laws.”⁸ The European Data Protection Directive has been a major factor in driving international privacy protection: “Existing privacy and data protection laws in many countries impose criminal sanctions, including unlimited fines and imprisonment, for non-compliance with elements of their legislation.”⁹ Given that Homeland Security cannot succeed without international cooperation, the Department and industry must navigate foreign privacy rules that may be compromised by certain data collection and sharing practices employed in the fight against terrorism.

Moving Goods

Controlling cargo has drawn increasing scrutiny among the many gargantuan tasks required for securing the border.

The Mandate For Securing The Border

As one of its primary missions, the Department has the responsibility for “Securing the borders, territorial waters, ports, terminals, waterways, and air, land, and sea transportation systems of the United States,” as well as “Preventing the entry of . . . instruments of terrorism into the United States.” Pub. L. No. 107-296, § 402. However, the task of stopping terrorism must not choke off trade, as the Department must balance the countervailing responsibility of “ensuring the speedy, orderly, and efficient flow of lawful traffic and commerce.” *Id.*

The Magnitude of the Task and the Risks

With 95,000 miles of shoreline and 7,500 miles of border circumscribing the U.S., the job of securing the border is daunting. Every day, 21,000 foreign containers enter the

⁶ Vogel, “Military Has High Hopes for New Eye in the Sky: Sensor-Equipped Blimps Could Aid Homeland Security,” *Washington Post*, p. B1 (Aug. 8, 2003).

⁷ Associated Press, “U.S. Navy May Use Blimps as Anti-Terror Tool” (Aug. 7, 2002) (www.foxnews.com).

⁸ Knight, “Some Air Carriers in Europe Skirt Antiterror Steps,” *The Wall Street Journal*, p. D10 (Sept. 24, 2003).

⁹ “The Need for Compliance,” *Expertise. Privacy & Data Protection* (www.crowell.com).

United States, but only 2 percent are inspected.¹⁰ The consequences of an undetected, bomb-laden container could be catastrophic:

For example, in May 2002, the Brookings Institution estimated that costs associated with U.S. port closures resulting from a detonated WMD [weapons of mass destruction] could amount to \$1 trillion. Estimating the cost of discovering an undetonated WMD at a U.S. seaport, Booz, Allen and Hamilton reported in October 2002 that a 12-day closure would cost approximately \$58 billion.¹¹

Single-handedly, Charles McKinley illustrated how porous and vulnerable the cargo chain is by packing himself inside a wooden crate and shipping himself as human cargo from Brooklyn, New York to Dallas, Texas to save airfare.¹²

At the same time, international trade continues as the economic lifeblood for the U.S. economy, with United States trade in 2000 with its Canadian and Mexican neighbors alone accounting for \$653 billion.¹³ By 2006, international trade volume with all countries will top \$2 trillion.¹⁴ As Secretary Ridge explained, the specter of terror must not stop the wheels of trade from rolling:

[W]e could pass regulations that would so tightly constrict legitimate trade and commerce that our economy would slow to a crawl. Yes, such rules might prevent a terrorist attack someday, but such rules would also cause economic dislocation and disruption every day, literally in every corner of the globe. To cripple our economy without firing a shot, that's not just counterproductive, that's a terrorist's dream, and that should be our nightmare.¹⁵

¹⁰ Hasson, "Despite Technology, Cargo Vulnerable," *Federal Computer Week* (Mar. 20, 2003); Lisagor, "Operation Safe Commerce Advancing," *Federal Computer Week*, at 2 (Apr. 16, 2003) (www.fcw.com/fcw/articles/2003).

¹¹ GAO, "Container Security: Expansion of Key Customs Programs Will Require Greater Attention to Critical Success Factors," p. 8 (July 2003) (GAO-03-777) (www.gao.gov/homelandsecurity).

¹² Power, "Bush Seeks Tougher Curbs on Airline Cargo," *Wall Street Journal*, p. A4 (Sept. 22, 2003).

¹³ GAO, "Border Security: Challenges in Implementing Border Technology," p. 9 (Mar. 12, 2003) (GAO-03-546T) (www.gao.gov/homelandsecurity).

¹⁴ GAO, "Homeland Security: Challenges Facing the Department of Homeland Security in Balancing its Border Security and Trade Facilitation Missions," p. 6 (June 16, 2003) (GAO-03-902T) (www.gao.gov/homelandsecurity).

¹⁵ Press Release, "Remarks by Secretary of Homeland Security Tom Ridge at the Custom and Border Protection Trade Symposium," p. 2 (Nov. 20, 2003) (www.dhs.gov/dhspublic/display?content=2324).

Moving the Cargo

The Homeland Security has initiated a number of programs to keep the terrorists out, but the cargo moving. Technology also promises to play a major role in maintaining cargo security through electronic seals, tamper-proof containers, GPS tracking systems, non-intrusive inspection devices, and biometric security controls.

Container Security Initiative

The Container Security Initiative (CSI) seeks to push out the borders by placing Customs staff at high-volume foreign ports to screen containers for WMD. Through use of the Automated Targeting System, the CSI team of United States and foreign inspectors screen container data and identify high-risk cargo to be subjected to inspection. At a minimum, such foreign ports must have the non-intrusive inspection equipment to perform such inspections. The CSI budget increases from \$4.3 million in 2002 to \$61.2 million in 2004.¹⁶

Customs-Trade Partnership Against Terrorism

The Customs-Trade Partnership Against Terrorism (C-TPAT) focuses upon improving the global supply chain through security in the private sector. By agreeing to certain security measures, companies may be able to expedite their cargo through the transportation system. The C-TPAT budget rises from \$8.3 million in 2002 to \$12.1 million in 2004.¹⁷

Automated Commercial Environment

The Automated Commercial Environment (ACE) will replace the existing Customs system for tracking, controlling, and processing all commercial goods imported into, or exported out of, the U.S. The system is expected to cost \$1.7 billion.¹⁸

Protecting Secrets

From intelligence data to SAFETY Act applications to critical infrastructure information, the Department will stand atop a treasure trove of trade secrets and national security intelligence.

¹⁶ GAO, "Container Security: Expansion of Key Customs Programs Will Require Greater Attention to Critical Success Factors," pp. 2, 9-10 (July 2003) (GAO-03-770) (www.gao.gov/homelandsecurity).

¹⁷ *Id.*, pp. 3, 14, 17.

¹⁸ GAO, "Homeland Security: Challenges Facing the Department of Homeland Security in Balancing its Border Security and Trade Facilitation Missions," p. 7 (June 16, 2003) (GAO-03-902T) (www.gao.gov/homelandsecurity).

The Mandate to Collect and Protect Data

In an effort to centralize data, the Homeland Security Act requires that the Department have access to “all information, including reports, assessments, analyses, and unevaluated intelligence relating to threats of terrorism against the United States” and “all information concerning infrastructure and other vulnerabilities.” Pub. L. No. 107-296, § 202(a). For SAFETY Act applications, the Act includes provisions for contractors’ submissions of “safety and hazard analyses” and other information relating to anti-terrorism technology. *Id.*, § 863(d).

In some instances, the Act includes express protections for such information. *Id.*, § 214(a) (protection for critical infrastructure information); § 892(e) (federal control of information shared with state and local governments). However, the Act does not carve out specific protection for many other types of information to be submitted, such as SAFETY Act applications.

Cyber Risks to Information

Breaches of cyber security, such as hacking, have skyrocketed in recent years, with an 800-percent increase in reported “computer security incidents” from 1999 to 2002, with further dramatic rises in the first two quarters of 2003.¹⁹ In one instance, a British computer administrator “used his home computer and automated software available on the Internet to scan tens of thousands of computers on U.S. military networks.”²⁰ Notwithstanding such risks, GAO found significant and “widespread” deficiencies in information security within federal agencies.²¹

Managing Cyber Risks

For contractors, cyber risks have at least two implications. First, the Department will necessarily need technology and support to protect and harden electronic data systems from cyber attacks. Second, contractors must weigh legal options in the event that trade secrets spill into the public domain.

Technology Solutions

As the pace and sophistication of cyber attacks increase, the technology for cyber security must rapidly and substantially improve. A host of technologies and standards have been funded and developed for this task:

The [cyber security] programs have been in three generations. The first generation is to prevent intrusions

¹⁹ GAO, “Homeland Security: Information Sharing Responsibilities, Challenges, and Key Management Issues,” p. 7 (Sept. 17, 2003) (GAO-03-1165T) (www.gao.gov/homelandsecurity).

²⁰ GAO, “Information Security: Further Efforts Needed to Fully Implement Statutory Requirements in DOD,” p. 7 (July 24, 2003) (GAO-03-1037T) (www.gao.gov/homelandsecurity).

²¹ *Id.*, p. 1.

and there have been a number of successes that have come out of this, including several sets of cryptographic tools, access control and multiple levels of security.

In the second generation, if intrusions happen, how does one detect them and how does one limit damage? Examples of successful products, which came out of this, are firewalls, boundary controllers, intrusion detection systems, virtual private networks and a public key infrastructure.

In the third generation, which we're now in the midst of, the goal is to operate through attacks and these goals are intrusion tolerance and graceful degradation. In my opinion, this is the space that we need to be in to able to have critical infrastructure systems that can weather attacks.²²

Cyber security research priorities include systems that can modify themselves “on-the-fly” and coordinate information with other networks while under attack. Similarly, high-bandwidth, secure, digital communications systems generate a host of cyber security challenges when multiple organizations at many tiers must be interconnected.²³

Legal Options

Outside of the cyber world, a contractor occasionally has advance notice of an impending release of its trade secrets into the public domain. In such cases, the contractor may have rights to seek injunctive relief or to pursue administrative remedies.²⁴ In contrast, such secrets can be thrust into the public domain in a nanosecond by a breach of cyber security. In the event that the Government fails to take proper steps to safeguard such trade secrets, the contractor may have a damages remedy against the Government.²⁵ However, these waters are largely uncharted, leaving both the Government and contractor exposed to potentially substantial risks involving improper releases of trade secrets.

Spreading Technology

²² *Cybersecurity: Getting It Right: Hearings Before the House Subcomm. on Cybersecurity, Science, Research and Development*, 108th Cong., 1st Sess. (July 22, 2003) (statement of Dr. Sastry).

²³ *Id.* (statement of Mr. Wolf, NSA Director of Information Assurance).

²⁴ *Megapulse, Inc. v. Lewis*, 672 F.2d 959 (D.C. Cir. 1982) (injunctive relief); FAR § 52.227-14(e) (administrative protection for technical data).

²⁵ *See, e.g., Ruckelshaus v. Monsanto*, 467 U.S. 986 (1984).

Nearly everyone agrees that technology is critical to the Homeland Security mission: “The old security paradigm in this country of guns, gates and guards is changing fast. And technology is going to replace it all.”²⁶

The Mandate to Develop and Deploy Technology

Technology represents a core asset that the Department must direct, fund, and conduct “national research, development, test and evaluation, and procurement of technology and systems” for fighting terrorism. Pub. L. No. 107-296, § 302. The Department has multiple arms to accomplish this mission:

- Federally Funded Research & Development Centers (§ 305)
- Homeland Security Advanced Research Projects Agency (§ 307)
- University Based Centers for Homeland Security (§ 308)
- Department of Energy National Laboratories (§ 309)
- Homeland Security Institute (§ 312)
- Technology Clearinghouse (§ 313)

Factors Driving Technology

For Fiscal Year 2004, the Information Analysis and Infrastructure Directorate receives \$893 million, while the Science and Technology Directorate operates on a budget of \$918 million, of which \$874 million is directed to research, development, and acquisition.²⁷ Some of the key factors driving how the Department will spend such money include: (1) off-the-shelf availability; (2) force-multiplier capability; and (3) statutory requirements.

Off-the-Shelf Availability

In testimony before Congress, Secretary Ridge has emphasized his interest in technologies “that have immediate application.”²⁸ Assistant Secretary McQueary recently stated that the Homeland Security Advanced Research Projects Agency (HSARPA) would give priority to existing technology:

Perhaps 90 percent of HSARPA’s efforts are focused on improving existing technologies that can be developed and deployed to the commercial sector quickly, while the

²⁶ *Fiscal Year 2004 Appropriations: Homeland Security: Hearings Before the House Subcomm. On Homeland Security of the Appropriations Comm.*, 108th Cong., 1st Sess. (March 20, 2003) (statement of Rep. Wamp).

²⁷ “Homeland Security Appropriations,” *Congressional Quarterly Action Report No. 108-6*, pp. 12-13 (Sept. 24, 2003).

²⁸ *Fiscal Year 2004 Appropriations: Homeland Security: Hearings Before the House Subcomm. on Homeland Security of the Appropriations Comm.*, 108th Cong., 1st Sess. (Mar. 20, 2003) (statement of Sec. Ridge).

remaining 10 percent address revolutionary long-range research for breakthrough technologies.²⁹

During his confirmation hearing for the position of Assistant Secretary (Plans, Programs and Budget) in the Science and Technology Directorate, Dr. Penrose Albright also underscored a preference that “we rapidly field available technology where it is cost effective to do so” and “provide upgrades using near-term technologies available from the labs and private sector.”³⁰ Accordingly, these public statements of senior Homeland Security officials leave little doubt that off-the-shelf technology will have an inside track for many of the Department’s purchases.

Force-Multiplier Capability

Doing more with less has been a theme during many Congressional hearings. With 95,000 miles of shoreline and 7,500 miles of land borders, the Department will never have enough people to guard every entry point without the help of technology.

[W]e’ll be getting a good firsthand look at the vastness of the land, the fact that people can’t possibly patrol the entire area. And therefore, we’re going to continue to enhance the application of technology, not just at the ports of entry, but also in those areas in between.³¹

For this reason, Congress focused upon “the force multiplying nature of technology.”³² Similarly, some components of the Department, such as TSA, are under Congressional pressure to reduce personnel, while upgrading technology. According to the chairman of the House Transportation and Infrastructure Subcommittee on Aviation, “TSA has spent too much money on salaries and personnel at the expense of technology.”³³ For these reasons, technology that increases productivity, while keeping trade moving, will be at a premium for the Homeland Security mission.

Legislative Requirements

Legislation drives some of the technology choices. For example, the Enhanced Border Security and Visa Entry Reform Act of 2002 (Pub. L. No. 107-173, § 302) establishes biometric requirements for screening foreign visitors. Similarly, the USA Patriot Act (Pub. L. No. 107-56, § 414) provides for the development of technical

²⁹ DHS Press Release, “Remarks by Dr. Charles McQueary Before the 7th Annual Executive Symposium on Emerging Business Opportunities in Photonics,” p. 2 (Nov. 13, 2003) (www.dhs.gov/dhspublic).

³⁰ *Homeland Security and OMB Nominations: Hearings Before the Senate Governmental Affairs Comm.*, 108th Cong., 1st Sess. (July 29, 2003) (statement of Dr. Albright).

³¹ *Senate Border Technology Hearings*, (Sen. Kyl).

³² *Id.*

³³ Strohm, “House chair urges TSA to spend less on people, more on technology,” *Government Executive Magazine*, (Nov. 24, 2003) (www.govexec.com).

standards for the entry and exit system. For information technology, the Homeland Security Act (Pub. L. No. 107-296, § 509) includes a preference for off-the-shelf equipment.

Intellectual Property Rights

In recent announcements, the Department has touted its Other Transactions authority (“to license intellectual property – but not own it”) and the Small Business Innovation Research (SBIR) program as being contractor-friendly means for protecting intellectual property rights.³⁴ Furthermore, to the extent that the Department proceeds with giving priority to buying off-the-shelf equipment, the FAR establishes a presumption that such commercial items have been developed exclusively at private expense, thus according substantial protection to the contractor’s technical data rights. See FAR § 12.211.

Forging Interoperability

Without interoperability, much of the technology and intelligence data may be wasted.

The Mandate for Interoperability

Bipartisan support exists for interoperability. For example, Senator Kennedy emphasized the importance not only for “getting the best technology,” but also “having it interoperable.”³⁵ Secretary Ridge described interoperability as one of the “highest priorities” of his department.³⁶ In addition, the Enhanced Border Security and Visa Entry Reform Act of 2002 specifies the development and implementation of an interoperable law enforcement and intelligence data system for visas, admissions and deportations. Pub. L. No. 107-173, § 202.

History supports the need for interoperability, as one of the firefighters testified before Congress:

After the 1993 attack on the World Trade Center, evaluations conducted by emergency planning organizations identified lack of communication between police helicopters and the incident commander as a significant impediment to effective response. Tragically,

³⁴ See DHS Press Releases, “Remarks of Dr. Charles McQueary Before the 7th Annual Executive Symposium on Emerging Business Opportunities in Photonics” (Nov. 13, 2003) and “HSARPA Issues Solicitation Seeking Research Proposals from Small Businesses” (Nov. 14, 2003) (www.dhs.gov).

³⁵ *Senate Border Technology Hearings*, (statement of Sen. Kennedy).

³⁶ *Investing in Homeland Security: Streamlining and Enhancing Homeland Security Grant Programs: Hearings Before the Senate Comm. on Governmental Affairs, 108th Cong., 1st Sess.* (May 1, 2003) (statement of Sec. Ridge) (hereinafter “*Senate Investing in Homeland Security Hearings*”).

this exact same lack of communication hindered our response on September 11th.³⁷

Given the legislative, management, and practical impetuses behind interoperability, both the Department and contractors face Herculean challenges in connecting divergent systems not only between federal agencies, but with state, local, and private entities as well.

Practical Challenges to Interoperability

As a practical matter, a considerable gulf separates the ideal and the actual implementation of interoperability. For example, if the schedule drags out while two federal agencies dicker over the details of interface requirements, how will the cost and risk be allocated under the contract for making two disparate systems interoperable? As the number of parties multiply, the challenge for interoperability will likely grow exponentially. For example, the Integrated Wireless Network “will create interoperability among local, State and Federal public safety agencies in 25 cities.”³⁸ Under these circumstances, the difference between a well-managed, on-time, successful project and a costly, endless disaster may well depend upon how well the parties nail down the interfaces and requirements in the beginning.

Going Global

Although Homeland Security is primarily a domestic mission, the border and transportation functions necessarily involve international matters.

International Cooperation

The US VISIT “program will use photographs and fingerprints to log entries and exits at major U.S. airports and seaports.”³⁹ A similar Canadian system will link Canada’s law enforcement system and its overseas ports, allowing users “to share information with the United States to protect the common border: “Officials from both nations now must ensure the systems are interoperable – a task complicated by the differing technical standards that the countries use.”⁴⁰ Thus, the need for foreign agreement and interoperability will raise the bar of difficulty for both the Department and contractors involved in such international ventures.

Pushing Out the Borders

³⁷ *Senate Investing in Homeland Security Hearings*, (statement of Capt. Bowers).

³⁸ *Strength Through Knowledge: Hearings Before the House Subcomm. on Cyber Security, Science and Research and Development*, 108th Cong., 1st Sess. (Oct. 30, 2003) (Dr. Ambrose)

³⁹ Eggen, “U.S. Set to Revise How It Tracks Some Visitors,” *Washington Post*, p. A1 (Nov. 21, 2003).

⁴⁰ Michael *et al.*, “Diplomacy spotlights border systems,” *Federal Computer Week*, pp. 1-2 (June 16, 2003) (www.fcw.com).

For companies with international partners and supply sources, obtaining parts “just in time” has become easier with e-commerce systems for managing inventory and transportation. However, heightened restrictions on moving cargo threaten to drive up costs, inventory levels, and transportation times. In an effort to speed up the flow of cargo, the Customs Office has struck bilateral agreements with 16 foreign governments covering 22 of the largest seaports to allow container inspections before high-risk cargo leaves foreign shores. However, Customs has yet to deploy inspection teams to many ports, due to lack of foreign-speaking inspectors, readiness of foreign ports, and other factors.⁴¹ As a result, international ventures and partnerships may suffer through this transition.

International Challenges

International cooperation and business alliances may trigger a host of issues, as the clamp down on terrorism affects how companies do business. Areas to watch include the following

- Export controls on technology and data
- European privacy restrictions
- Inconsistent international technical standards
- Facility and personnel security

Funneling Funds to State and Local Governments

Few aspects of the Homeland Security Act have generated more scrutiny and blown air than moving grants to the state and local level.

The Mission to Support State and Local Efforts

Section 801 of the Homeland Security Act establishes “within the Office of the Secretary the Office for State and Local Government Coordination, to oversee and coordinate departmental programs for and relationships with State and local governments.” Pub. L. No. 107-296, § 801(a). However, the political action swirls around the Office of Domestic Preparedness (ODP) that “shall have the primary responsibility within the executive branch of Government for the preparedness of the United States for acts of terrorism.” *Id.*, § 403(c). Aside from various tasks of “coordinating preparedness,” “consolidating communications,” and “providing agency-specific training,” ODP hands out the grant money.

ODP Grants: The Money Train

Everyone wants to take credit for loading up funds for state and local Homeland Security grants. For example, the Whitehouse website included the bolded news that

⁴¹ GAO, “Container Security: Expansion of Key Customs Programs Will Require Greater Attention to Critical Success Factors,” pp. 18-20 (July 2003) (GAO-03-770).

“DHS Announces \$2.2 Billion for Our Nation’s First Responders,” bringing the two-year total to \$6 billion:

Since March 1, DHS will have allocated or awarded over \$6 billion dollars in grant funding for first responders from the FY '03 Budget, the FY '03 Supplemental and the FY '04 Budget to help first responders across the country enhance their capabilities and provide additional resources for state and local governments to protect their citizens and critical infrastructure.⁴²

The House Select Committee on Homeland Security included an even more eye-catching statement: “Funding for first responders has *increased* over 1,000 percent since FY 2001.”⁴³ The Homeland Security Department also highlighted “an additional \$725 million dollars from the FY '04 Budget for the Urban Area Security Initiative (UASI), for grants to urban areas.”⁴⁴ Thus, the grant train is being fueled with billions of dollars to bring Homeland Security to state and local entities.

Fixing the Procedures: Show Me the Money

Despite the funds already appropriated, the demand for more continues: “if anything has drowned out [Secretary] Ridge’s avuncular assurances over the past year, it is the incessant cries of state and local authorities for more money to make their hometowns secure.”⁴⁵

One-Stop Shopping

Fragmentation of federal grant process, including the requirement for filling out multiple grant applications, represented one of the major criticisms of the federal programs. The Department has responded by announcing “one-stop shopping”:

For the first time, states can apply for their allocated grants using one form that will serve as a ‘one-stop-shop’ application for three different programs that benefit first responders and will provide additional resources to state and local government counterterrorism efforts.⁴⁶

⁴² “DHS Announces \$2.2 Billion for Our Nation’s First Responders,” (Nov. 3, 2003) (www.whitehouse.gov/news/releases/2003/11/20031103-5.html).

⁴³ House Select Committee on Homeland Security website (www.hsc.house.gov/firstresponders.cfm).

⁴⁴ DHS Press Release, “Securing the Homeland: Helping Our State and Local First Responders and First Preventers,” (Nov. 13, 2003) (www.dhs.gov/dhspublic).

⁴⁵ “CQ Outlook: Is Homeland Security Keeping America Safe?” *Congressional Quarterly Weekly* (June 13, 2003).

⁴⁶ DHS Press Release (Nov. 3, 2003) (www.whitehouse.gov/news/releases/2003/11/20031103-5).

Stopped Up Pipeline

Slow distribution of grant funding has been another significant criticism: "Funding for first responders is getting trapped in the pipeline, and the funding is not getting to the right places."⁴⁷ The money in the pipeline has been substantial.

\$2 billion	FY 2002
\$3.5 billion	FY 2003
\$2 billion	FY 2003 Supplemental
\$4 billion	FY 2004

With "one-stop shopping" and other efforts to streamline the process, the Department has sought to quell this criticism and get the money flowing faster.

Misdirected Funding

Congress and the Homeland Security Department have wrestled over the formulas for distributing grant money, with some advocating allocation of funds by state, while others push for directing such funds to high-threat areas. Such wrangling will likely continue, as well as anecdotes about Homeland Security funding going where it is unneeded:

According to a news article published last summer, in Massachusetts, the Steamship Authority, which runs ferries to the resort island of Martha's Vineyard, and one of the Vineyard's harbors were awarded \$900,000 to upgrade port security. Oak Bluff's harbormaster told Vineyard Gazette newspaper: "Quite honestly, I don't know what we're going to do, but you don't turn down grant money."⁴⁸

To address such concerns about misdirected funds, a House Homeland Security Subcommittee recently passed a bill (H.R. 3266) to create a program "to distribute money solely on the terrorist threat an area faces."⁴⁹ However, this fight over how to allocate the money is far from over. Both Congress and the Homeland Security Department will continue to wrestle over how to spread the funding.

⁴⁷ "Cox Stands With First Responders and Calls for Improvements to Their Current Grant Funding Process," (Oct. 16, 2003) (http://hsc.house.gov/text_release.cfm?id=97).

⁴⁸ House Select Committee on Homeland Security, Press Release (Oct. 16, 2003). (http://hsc.house.gov/text_release.cfm?id=97).

⁴⁹ Kady, "Panel's New 'First Responder' Funding Formula Would Be Based on Terrorism Threat," *Congressional Quarterly Daily Monitor*, (Nov. 20, 2003).

Tapping Private Funds

Much of the brunt of the anti-terrorism efforts will fall upon private and quasi-private entities.

Looking Beyond State & Local Governments

Private Entities

The private sector will have to foot much of the security bill: "In place of these top-down approaches, the administration has largely relied on the private sector, which owns an estimated 87 percent of the nation's factories, rail lines, power plants and computer networks, to come up with its own strategies to defend against terrorist attacks."⁵⁰

Quasi-Private Entities

The term "local government" is broadly defined to include not only the traditional entities, but also "regional or interstate government entity," "an Indian tribe," or "other public entity." Pub. L. No. 107-296, § 2. Thus, Homeland Security buyers may include a number of non-traditional sources:

- Port authorities
- Regional compacts
- Indian tribes

Implications for Contractors

The fact that private industry will foot the bill for much of the Homeland Security tab has a number of profound implications for contractors. First, the contractor may need to look no further than itself for a customer. In short, the buyer and seller of Homeland Security products and services may be one and the same. Second, federal contractors accustomed to locating business opportunities on a handful of federal websites may find the Homeland Security marketplace to be surprisingly diffuse, with customers scattered among state, local, and private entities. The Homeland Security Department's Technology Clearinghouse may offer a partial answer when it receives a critical mass of available technology, as well as sufficient publicity that buyers will turn to it for information about products and services. Pub. L. No. 107-296, § 313. Third, the emphasis upon private funding increases the likelihood that more products and services will qualify for "commercial item" status, thus reducing the pain of selling to federal agencies.

⁵⁰ "CQ Outlook: Is Homeland Security Keeping America Safe?" *Congressional Quarterly Weekly* (June 13, 2003).

Avoiding the Political Fallout

From the beginning, everything about the Homeland Security Department has been highly politicized.

Congressional Oversight

Eighty-eight Congressional committees assert oversight for Homeland Security activities.

In the case of the Department of Homeland Security, there are all too many platforms for such criticism. At last count, there were 26 full committees with jurisdiction – and a total of 88 committees including subcommittees.⁵¹

These committees have not shied away from sharp critiques of how the Department conducts its business. Not surprisingly, many of the fights have broke out over money: “congressional staffers complain frequently that the Department of Homeland Security is in a state of bureaucratic and budgetary confusion, constantly moving money from one program to another.”⁵² As a result, Congressional pressure has been building to subject the Department to the Chief Financial Officer (CFO) Act:

Subjecting the Department to the CFO Act will ensure that the CFO reports directly to the Secretary, is a Senate-confirmed presidential appointee, and that the CFO is a member of the statutorily created CFO Council.⁵³

These multi-headed committees have leveled a barrage of criticisms against the Department:

- Inadequate budget documentation
- Excessively cumbersome grants application process
- Exceeding TSA personnel ceilings
- Failing to oversee contractor performance

Inspector General Oversight

The Homeland Security Inspector General not been shy about criticizing the Department. A sample of such critiques include the following:

⁵¹ *Hearings Before the House Select Committee on Homeland Security*, 108th Cong., 1st Sess. (July 10, 2003) (statement of James Schlesinger).

⁵² Phillips, “Hazardous Cargo: Adding Protection Without Disruption,” *Washington Post*, p. E4 (Sept. 9, 2003).

⁵³ House Press Release, “Committee Passes Financial Accountability Act,” (Oct. 31, 2003) (<http://hsc.house.gov>).

- “We believe emphatically that financial accountability for DHS should not be postponed.” (p. 6)
- “DHS inherited a total of 18 material weaknesses identified in prior year financial statement audits at the legacy agencies.” (p.2)
- “Overall, DHS reports over 80 financial management systems, few of which are integrated.” (p. 3)⁵⁴

When faced with such criticisms from within, the Department can expect even harsher treatment from its external critics in the coming year.

Putting the Spotlight on Contractors

A number of contractors have been targeted in Congressional hearings over such issues as failing to screen out criminals hired by TSA and overcharging the Department for contract services. The Homeland Security Inspector General has focused the hot light on contractors and grantees as well.

- Ineffective performance and financial oversight “enabled grant recipients and subgrantees to misuse millions of dollars in federal funds.” (p. 3)
- “A review by TSA of one subcontractor involved with hiring airport screeners found that, out of \$18 million in expenses, between \$6 million and \$9 million appeared to be attributed to wasteful and abusive spending practices.” (p. 4)⁵⁵

In the coming year, both the Department and its contractors should anticipate that the light will only shine hotter and brighter upon programs that have fallen behind schedule and gone over budget.

Finding the Right Person and Rule

Flux continues to be the order of the day, so finding the right person, rule, or procedure within the Department can be a challenge.

Changing Faces

At the management level, the Homeland Security Department is still gelling. The General Counsel (Joe Whitley) and the Assistant Secretary for Plans, Programs, and

⁵⁴ *Hearings Before the House Select Comm. on Homeland Security, 108th Cong., 1st Sess. (Oct. 8, 2003) (statement of Asst. Inspector General Berman).*

⁵⁵ *Id.*, (statement of Asst. Inspector General Berman).

Budget (Penrose Albright) just had Senate confirmation hearings on July 29, 2003. The Deputy Secretary (Gordon England) has already left to return to the Navy. As Chief of Staff, Duncan Campbell has just replaced Gen. Bruce Lawlor.

At the staff level, the Department has been plagued by a combination of turnover and vacancies. For example, "26 percent of the INS inspections workforce was hired in FY 2002 showing a lot of twist and change."⁵⁶ Similarly, vacancies have been a problem: "TSA had not hired sufficient accounting personnel for the Financial Reporting office. At the end of fieldwork, the vacancy rate in the CFO's financial management structure was 50 percent."⁵⁷ As a result, the Department will struggle to perform its demanding mission while filling these positions and training the new personnel. At the same time, both the public and contractors may encounter challenges in trying to find the right person to handle an inquiry or resolve a problem.

Unsettled Rules and Processes

With the largest federal reorganization in 50 years bringing together 22 separate agencies, no one can be surprised that the Department is still trying to develop a unifying set of rules and processes. Some of these changes are necessary to fix past problems: "Previous FEMA and DOJ Office of Inspector General (OIG) reports identified significant shortcomings in the pre-award process, cash management, monitoring, and grant closeout processes."⁵⁸ Other changes will be required simply to avoid contractors being forced to deal with 22 different sets of procurement rules: "DHS also absorbed billions of dollars in contracts from the component agencies that were awarded under differing procedures and circumstances."⁵⁹ While hardly anyone would dispute the need for improved processes and uniform procedures, the mountain of competing departmental priorities will probably push such changes back, leaving Department personnel and contractors to struggle in the interim.

Conclusion

During the first year of its odyssey, the Department of Homeland Security has been confronted with hard choices not unlike Odysseus' passage between Charybdis and Scylla, buffeted by the political winds, and expected to solve the riddles of balancing anti-terrorism initiatives with other economic and democratic interests. We can all be heartened by the Department's progress during its first year. However, the burdens and challenges of the first year forewarn the tasks and risks ahead and both the Department and its contractors must prepare accordingly.

⁵⁶ *Border Technology: Keeping Terrorists Out of the United States – 2003: Hearings Before the Senate Subcomm. on Technology, Terrorism and Government Information of the Judiciary Comm., 108th Cong., 1st Sess. (Mar. 5, 2003) (statement of Sen. Leahy).*

⁵⁷ *Hearings Before the House Select Comm. on Homeland Security, 108th Cong., 1st Sess. (Oct. 8, 2003) (statement of Asst. Inspector General Berman).*

⁵⁸ *Id.*

⁵⁹ *Id.*

Judicial Enforceability of Teaming Agreements: The New Sheriff in Town⁶⁰

by

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In a groundbreaking but little-noticed decision issued last December, a Fairfax County, Va., trial court ordered a federal prime contractor to honor its teaming agreement and continue working with its partner and subcontractor. The decision and order in *EG&G Technical Services Inc. v. The Cube Corp.*⁶¹ affects government contractors that enter into teaming agreements in Virginia and potentially elsewhere. At its essence, the decision stands for the proposition that “you get what you bargain for” in a teaming agreement. The case is notable for the following reasons:

- The court distinguished a prior decision in which the Supreme Court of Virginia declared that a teaming agreement was a “mere agreement to agree”⁶² and could not be enforced because the terms were sufficiently uncertain; and
- The court granted EG&G specific performance of its agreements by ordering Cube to keep EG&G as its subcontractor, possibly until the year 2011.⁶³ This appears to be the first case in the country granting the equitable remedy of specific performance for breach of a government contracts teaming agreement.

This article reviews the facts and circumstances of the EG&G case, analyzes the court’s reasoning, discusses the implications of the decision for government prime and

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⁶¹ Dec. 23, 2002 Letter Opinion (unpublished) of Judge R. Terrence Ney in *EG&G Technical Services Inc. v. The Cube Corp.*, Chancery No. 178996 (Fairfax Cir. Ct.) (“*Letter Opinion*”), and Jan. 13, 2003 Modified Final Order (“*Final Order*”). See Christopher J. Adams, “Court Enforces EG&G Teaming Agreement, Orders Specific Performance on Subcontract,” 79 Fed. Cont. Rep. (BNA) 1, at 20 (Jan. 7, 2003); 2002 WL 31950215.

⁶² *W.J. Shafer Associates v. Cordant Inc.*, 254 Va. 514, 493 S.E.2d 512 (1997).

⁶³ *Final Order* at 2 (ordering performance of the teaming agreement for the entire term of the contract, which could last until 2011).

subcontractors, and suggests provisions that parties should consider incorporating into their teaming agreements.

The Parties to the Agreement

EG&G has extensive experience in providing management, scientific, technical, engineering, and logistics services. The vast majority of its business involves federal government contracts. During its 50-year history, EG&G has worked with the National Aeronautics and Space Administration (“NASA”); the departments of Defense, Navy, Justice, Transportation, and Energy; the Customs Service; and other agencies.⁶⁴

Cube was founded in 1994 and, like EG&G, much of its business involves federal government contracts to provide management, operations, and maintenance support services. In 1999, Cube was a small, minority owned business. As such, Cube was eligible to bid for contracts that were reserved (“set aside”) for just such businesses.⁶⁵

In late 1999, the Navy and NASA announced that several contracts being performed at the Wallops Institutional Flight Facility on Wallops Island, Va., were to be combined into a single contract, and that a request for proposals (“RFP”) would issue shortly. The Wallops Institutional Consolidated Contract (“WICC”) was to be a cost-plus-incentive-fee/award term contract, with an initial term of four years and the potential for an award of up to six additional years, depending on performance and whether cost estimates were met. The functions that the government anticipated combining in the WICC were described in general terms, without specific detail.⁶⁶

The Teaming Agreement

Cube was eligible to bid on the contract, although it lacked experience in certain areas that were to be included in the WICC—primarily in emergency services, environmental management, and telecommunications.⁶⁷ EG&G, on the other hand, had extensive experience in these areas, but as a large business, was not eligible to bid.⁶⁸ Anticipating an RFP from the Navy and NASA, EG&G and Cube met to discuss working together on preparing a bid for the WICC.⁶⁹ Shortly thereafter, EG&G and Cube entered into the teaming agreement (“Teaming Agreement”).

⁶⁴ *Letter Opinion* at 1.

⁶⁵ *Id.* at 2 (citing 15 U.S.C. § 631 et seq. (1994)).

⁶⁶ *Id.*

⁶⁷ *Id.*

⁶⁸ *Id.*

⁶⁹ *Id.* at 3.

The Teaming Agreement expressed a two-part bargain. First, EG&G agreed to work with Cube to prepare a response to the anticipated RFP on the WICC. In exchange, Cube agreed that, “if the contract [WICC] is awarded to The Cube Corporation, EG&G *will be* performing certain functional areas as a subcontractor to The Cube . . . with the functions to be determined, once the RFP is released,” and that EG&G would perform up to “49% of the contract dollar value.”⁷⁰ In addition, the Teaming Agreement separately noted that the parties would agree “at the time of proposal submission on a fully loaded fee structure,” and that if the WICC were awarded to Cube, the parties would “enter into a prime/subcontract agreement for the sole purpose of performing the contract [WICC] requirements.”⁷¹

Preparation of the WICC Proposal

As the Teaming Agreement had proposed, EG&G and Cube worked together throughout 2000 to prepare an initial proposal (“Initial Proposal”). They used the twelve specific functions set forth in the statement of work (“SOW”) in the WICC RFP to divide up their respective areas of responsibility, according to each company’s abilities and areas of expertise.⁷² Throughout the bid proposal process, Cube touted EG&G as its “principal subcontractor,” a key part of the “Cube Team,” and relied upon EG&G’s reputation and expertise in submitting its proposals to the government.⁷³

To avoid disclosure of confidential and proprietary pricing information between the two companies (which were potential competitors for other work), EG&G and Cube submitted separate detailed cost proposals to the government. EG&G sent Cube a summary of the fully loaded costs that EG&G anticipated incurring under its cost-reimbursement subcontract so that Cube could make its cost proposal as the prime contractor. EG&G followed that procedure twice—once for the Initial Proposal and again for the revised proposal (“Final Proposal”).⁷⁴

In both the Initial Proposal and Final Proposal, Cube offered to cap its G&A expenses, unbeknown to EG&G.⁷⁵ In the Final Proposal, Cube’s cost proposal offered to limit G&A to 3.9 percent of the total contract costs. EG&G, on the other hand, submitted its estimate of all actual G&A expenses *without* a cap.⁷⁶

⁷⁰ *Id.* (quoting the Teaming Agreement) (emphasis added).

⁷¹ *Id.* In a footnote, the court explained that a “fully loaded fee structure” includes general and administrative (“G&A”) expenses, overhead, and profit. *Id.* at 3 n.8.

⁷² *Id.* at 4.

⁷³ *Id.* at 5.

⁷⁴ *Id.* at 4–5.

⁷⁵ *Id.* at 6.

⁷⁶ *Id.*

Letter Subcontract

NASA awarded the WICC to Cube in July 2001, and the contract took effect in September 2001. EG&G worked with Cube during the transition period in August prior to commencing performance of its subcontract functions. EG&G took responsibility for the SOW areas it adopted in its subcontract proposal and for which the initial and final proposals gave it responsibility. These functions included running the chemical and biological lab at the government site, providing environmental management support services, handling the logistics functions (*e.g.*, supply and warehousing) at the facility, and operating the emergency services department (*e.g.*, fire and rescue operations).⁷⁷ EG&G hired personnel to staff these areas, brought in a project manager to supervise the EG&G employees, and established policies and procedures. Although the Teaming Agreement provided that EG&G would perform “up to 49% of the WICC,”⁷⁸ EG&G’s portion of performance at the outset would have been substantially less. To increase EG&G’s share of the work up to approximately 41 percent in the first year, the parties assigned EG&G the materials purchasing and handling function.

The Cube/EG&G team was in place at the end of the contract transition period, but the parties had not hammered out a final, “definitized” subcontract. Cube sent EG&G a temporary letter subcontract (“Letter Subcontract”) that permitted expenditures for a limited term during negotiation of a definitized subcontract.⁷⁹ EG&G edited the Letter Subcontract to clarify EG&G’s understanding that its role as subcontractor was to be coextensive with Cube’s role as the prime contractor. Both parties executed the Letter Subcontract after this change.⁸⁰

The parties made little, if any, progress towards definitizing the final subcontract at the Letter Subcontract’s expiration. They thereafter entered into a series of Letter Subcontract renewals between August 2001 and June 2002, until a dispute over the terms of the definitized subcontract landed them in court.⁸¹ During this 10-month period, EG&G continued to perform its assigned functions on the WICC, and submitted invoices to Cube for costs incurred, along with a percentage of costs attributable against the ultimate incentive fee for the first year of performance. Cube paid these invoices with no hesitation.⁸²

‘Definitized’ Subcontract Negotiations

Cube and EG&G worked on development of a “definitized” subcontract in the months following startup. Cube first circulated a draft subcontract in late October

⁷⁷ *Id.* at 5, 7.

⁷⁸ *Id.* at 6.

⁷⁹ *Id.* at 7.

⁸⁰ *Id.*

⁸¹ *Id.* at 7–8.

⁸² *Id.* at 8.

2001.⁸³ The parties discussed that draft, and reached a tentative agreement in early January 2002. Among other things, the agreement moved the fee share for EG&G closer to 49 percent by transferring the purchasing function to Cube with no loss of fee to EG&G.⁸⁴ However, Cube rescinded that agreement, insisted that the overall fee split relate to the proportion of costs incurred by each party, and reopened negotiations.⁸⁵ In April 2002, Cube forwarded a new draft subcontract for EG&G's review.

The revised draft subcontract was substantially different than the parties' earlier understanding and in at least two respects, differed from EG&G's understanding of its Teaming Agreement and the subcontract that it had been promised. First, Cube proposed that EG&G cap its G&A at the level Cube had adopted, without EG&G's knowledge, in the Initial and Final Proposals. Second, Cube wanted an unmodified Federal Acquisition Regulation ("FAR") "termination for convenience" clause (52.249-6) to flow down from the prime contract that would have allowed it to terminate EG&G's subcontract for any reason or for no reason whatsoever.⁸⁶ The proposed G&A cap would have imposed an unanticipated limit on EG&G's ability to recover its actual costs. Moreover, the termination clause demanded by Cube was contrary to the parties' original agreement that EG&G's subcontract would be in place for as long as Cube was the prime contractor on the WICC. The parties' negotiations centered around these two provisions from that point on.⁸⁷

Throughout the spring and early summer of 2002, EG&G and Cube were unable to agree on these two provisions. EG&G offered to cap its rates, but above the level capped by Cube, and also offered to accept a termination clause tied to its performance of cost objectives.⁸⁸ Cube rejected the offers to compromise.⁸⁹ The parties were never able to agree on the G&A expense issue, or flow-down of the unmodified termination for convenience provision. With respect to the latter, EG&G suspected that an unmodified termination for convenience clause would provide Cube the "out" it sought to terminate the entire relationship at any time and for any reason.

Impasse, Temporary Injunction, and Trial

On June 25, 2002, Cube sent EG&G a letter declaring an impasse and stating that the Letter Subcontract then in effect would expire and would not be renewed.⁹⁰ It gave

⁸³ *Id.* at 8 n.32.

⁸⁴ *Id.* at 9.

⁸⁵ *Id.*

⁸⁶ *Id.* at 9-10 (allowing Cube to terminate EG&G if any contractor on the WICC failed to meet its performance and cost goals, even if EG&G was not responsible for the failure).

⁸⁷ *Id.* at 9.

⁸⁸ *Id.* at 10.

⁸⁹ *Id.*

⁹⁰ *Id.*

EG&G less than a week to vacate its employees from Wallops Island. In response, EG&G filed a complaint and application for a temporary injunction in the Chancery Division of Fairfax County Circuit Court, requesting that Cube be enjoined from terminating EG&G as a subcontractor and seeking specific performance of the contractual relationship it had formed with Cube for the Wallops Island work. In requesting specific performance—an equitable remedy—EG&G argued that its business reputation, for both government and commercial business, would be irreparably harmed if Cube was allowed to terminate it as a subcontractor.⁹¹ The Fairfax County Circuit Court, sitting in Chancery, enjoined Cube from terminating the subcontract relationship for 90 days and set trial for Sept. 11, 2002.

At trial, EG&G argued that specific performance of a contract was appropriate when all the essential terms had been established in the Teaming Agreement.⁹² EG&G pointed to the Teaming Agreement, the Initial and Final Proposals, the Letter Subcontract, and the parties' conduct on the WICC, for over a one-year period, as evidence they intended to enter into a contract under Virginia law.⁹³ Cube countered that the Teaming Agreement was not a contract, but merely an unenforceable "agreement to agree."⁹⁴ Cube also argued that the parties' agreements, and their conduct, showed they intended to be bound only by a formal, "definitized" subcontract.⁹⁵

Final Decision and Order

The Fairfax Circuit Court considered extensive testimony and documentary evidence during a three-day hearing.⁹⁶ Judge Ney issued the Letter Opinion and Order on Dec. 23, 2002.⁹⁷

The 25-page opinion contains 84 footnotes and is a scholarly examination of the concept of teaming agreements, their role in federal contracting, the "agreement to agree" defense in light of the facts of the case, and the remedy of specific performance. Faced with this comprehensive analysis, Cube chose not to appeal the decision.

⁹¹ *Id.* at 11.

⁹² *Id.*

⁹³ *Id.*; see also *High Knob Inc. v. Allen*, 205 Va. 503, 507, 138 S.E.2d 49, 53 (1964) (refusing to release a party from responsibility where obligations can be understood with certainty by way of evaluating partial performance).

⁹⁴ *Id.*

⁹⁵ *Id.*; see also *Letter Opinion* at 11 n.45 and accompanying text.

⁹⁶ The parties submitted extensive oral and deposition testimony, Findings of Fact, Conclusions of Law, and exhibits, and did not file post-trial briefs.

⁹⁷ The Order was modified on Jan. 13, 2003, within the 21-day rule in Fairfax County Circuit Court permitting such modifications by the Court. This accounts for the difference in dates between the Final Decision and Order.

The Court's Reasoning in *EG&G v. Cube*

At the inception of his opinion, Judge Ney cited the FAR acknowledgment that teaming agreements are generally valid.⁹⁸ He noted that many federal agencies routinely consider subcontractors when evaluating proposals.⁹⁹ The Court went on to distinguish two distinct contract negotiations:

(1) the unenforceable “agreement to agree” to a contract some time in the future; and

(2) the enforceable mutual assent by the parties to award a subcontract to the subcontractor if the prime contract is awarded.¹⁰⁰

The court's opinion examines the record to determine into which category the parties' various agreements and conduct fell.

Judge Ney first distinguished, on the facts of the case, two leading precedents: *Shafer and Dual Inc. v. Symvionics Inc.*¹⁰¹ *Shafer* was Supreme Court of Virginia precedent that weighed heavily in the decision by EG&G's General Counsel initially to resort to the courts in the first place. The Supreme Court of Virginia had determined that the teaming agreement in *Shafer* amounted only to an “agreement to agree.”¹⁰² The court found no mutual commitment by the parties to produce and deliver digitizers, no obligation on the part of the defendant to sell them, no commitment by the plaintiff to purchase them, no agreed upon purchase price, and no assurance that the digitizers would even be available when required because they needed to be developed first (the subcontractor defendant intended to use a lower tier subcontractor).¹⁰³ The court accordingly held the teaming agreement unenforceable. Furthermore, in *Shafer*, the prime contractor committed to “negotiate in good faith” a subcontract if the prime contract was awarded.¹⁰⁴ Judge Ney distinguished *Shafer* from EG&G's situation, finding in the latter instance that there was a mutual commitment by the parties regarding EG&G's level of involvement in the contract, the nature of the work to be performed (as further evidenced by their post-award conduct), and an obligation to subcontract the work to EG&G.¹⁰⁵

⁹⁸ *Id.* at 12.

⁹⁹ *Id.*; see *id.* at 12 n.51 (citing *John Carlo Inc. v. Corps of Engineers of the United States Army*, 539 F. Supp. 1075, 1077 (N.D. Tex. 1982)).

¹⁰⁰ *Id.* at 13.

¹⁰¹ 1997 U.S. App. LEXIS 23959 (4th Cir. 1997).

¹⁰² *W.J. Shafer Associates*, 254 Va. at 520, 493 S.E.2d at 515.

¹⁰³ 493 S.E.2d. at 518.

¹⁰⁴ *Id.* at 517.

¹⁰⁵ *Letter Opinion* at 15. The Teaming Agreement stated that “. . . Cube will subcontract to EG&G. . . .”

Judge Ney also distinguished *Dual Inc. v. Symvionics Inc.* He noted that in *Dual* it was a substantial increase in the *subcontractor's* costs—not the prime contractor's—that was at issue, noting also that there had been a finding in that case of bad faith on the part of the subcontractor.¹⁰⁶ By contrast, there was not “a scintilla of bad faith on the part of EG&G,” nor had Cube presented any evidence of breach of any prior agreement between the parties.¹⁰⁷

Judge Ney concluded that the parties had anticipated that EG&G would be Cube's subcontract partner for the entire period of the WICC. He cited the specific language in the Teaming Agreement that “if Cube were awarded the WICC as prime, EG&G *would* be a subcontractor on the WICC and perform a substantial amount of the work—up to 49 percent—under the government contact.”¹⁰⁸ The wording of the Teaming Agreement, as well as the proposals submitted and the Letter Subcontracts, contributed to this finding.¹⁰⁹ Judge Ney specifically noted that the Teaming Agreement did not say EG&G “might” be a contractor if Cube was awarded the prime contract—it stated that EG&G *would* be.¹¹⁰ He also found that the parties' performance on the contract helped to establish the contract terms and dispelled any notion that the parties were confused about the scope of their agreement.¹¹¹

Cube vigorously argued that the parties' failure to agree to two terms it described as “material”—the G&A and termination clause issues—prevented a finding that a contract had been formed.¹¹² Disagreeing, Judge Ney noted that in Virginia, a contract is formed if the parties agree to:

- (1) the scope of work;
- (2) the compensation to be paid; and
- (3) the duration of the contract.

He found the failure to agree to the G&A and termination provisions was irrelevant when the parties' intent was clear regarding the other terms necessary to form a contract in Virginia.¹¹³ The proposals and Letter Subcontracts had fully described the

¹⁰⁶ *Id.* In EG&G, Cube's costs were increasing and it was seeking to lower the costs it would have to pay EG&G to offset its own losses.

¹⁰⁷ *Id.*

¹⁰⁸ *Id.*

¹⁰⁹ *Id.*; see also *Letter Opinion* at 16 n.64

¹¹⁰ *Id.* at 17.

¹¹¹ *Id.* at 18.

¹¹² *Id.*

¹¹³ *Id.* at 19.

work EG&G would perform. The parties had agreed to EG&G's labor rates, other direct costs, G&A, and overhead. The division of the fee pool earned was to be determined by the proportion of costs EG&G performed. Judge Ney found that the failure to agree on the G&A expense and termination provisions "were problems that Cube created in an attempt to renegotiate—or, in the case of the termination for convenience clause, newly negotiate—essential terms of the parties' already established agreement."¹¹⁴

Judge Ney ordered that Cube specifically perform its contract, and prohibited Cube from terminating EG&G as its subcontractor on the WICC, except for good cause. Whether cause exists is to be determined from the facts of the situation, the Teaming Agreement, and Letter Subcontracts, together with the parties' conduct and Virginia and federal case law.¹¹⁵ The court further ordered Cube to pay EG&G's actually incurred, allowable, allocable, and reasonable costs, including G&A expenses on the WICC.¹¹⁶

Implications of the Case

Because of the comprehensive nature of the Final Opinion, the EG&G decision is likely to be followed in Virginia and perhaps other jurisdictions as well. The case fashions analytically brighter lines for enforcement of teaming agreements. It is now clear that if a subcontractor bargains for a subcontract in the teaming agreement, and not just for a period of good faith negotiations, it has a good chance of enforcing the agreement to enter into a subcontract. Several things can be done to enhance enforceability of the bargain expressed in a teaming agreement:

- Expressly state in the teaming agreement that the proposed subcontractor will receive a subcontract if the prime contract is awarded, and minimize the exceptions to that commitment;
- Specifically set out the scope of work in the teaming agreement, and incorporate the initial and final proposal in the description as well, expressing it as a not-to-exceed percentage of the work awarded, specific tasks or functions to be performed, or both;
- Set forth the subcontractor's compensation, including labor rates, other direct costs, overhead, G&A, and fee/profit in the teaming agreement for cost-reimbursement contracts, and firm-fixed prices and any adjustment mechanism for fixed price contracts, incorporating the cost/price proposals submitted by the proposed subcontractor into the teaming agreement's description; and

¹¹⁴ *Id.* at 20–21. Judge Ney found that Cube's attempts to alter the terms under which the parties had been working constituted bad faith, and in the case of altered provisions of the Letter Subcontracts, slipped in drafts without notice to EG&G, disingenuous, and possibly even fraudulent.

¹¹⁵ *Final Order* at 2.

¹¹⁶ *Id.*

- Clearly describe the duration of the anticipated subcontract, preferably tying its duration to the prime contract, including exercise of any options, amendments, or other extensions.

The prime contractor's interests often may lie in the opposite direction. Because enforceability of the teaming agreement rests on specifically expressing the above criteria, the proposed prime contractor may desire to weaken or exclude each of the above terms, and possibly others. For instance, the prime contractor typically prefers to express its commitment to negotiate in good faith with the proposed subcontractor for a period of time, in the event a prime contract is awarded, to leave the scope of work "to be determined," to be as vague as possible about compensation (possibly avoiding entirely a discussion of fee or profit), and to omit mention of the duration of the eventual subcontract. Any of these would erode the chances for enforcement of the subcontract under the EG&G precedent.

The *EG&G* case also demonstrates the importance of addressing cost and other adjustments that may need to occur during administration of the prime contract. These issues should be addressed, if foreseeable, at the time of the teaming agreement, so that provisions can be made for them in the eventual subcontract. There are many other considerations involved in executing and administering teaming agreements—exclusivity, communication with the customer, data protection, intellectual property ownership and allocation, non-solicitation of employees, classified data handling, public releases, assignment, dispute resolution, and indemnification among them. Those discussed above, however, are critical to the lowest level threshold for enforceability of a teaming agreement.

One of the most intriguing issues raised by the *EG&G* case is the termination for convenience clause proposed for in the eventual "definitized" subcontract. While the termination for convenience clause is mandatory in a prime contract, it is not a required flow down clause. Therefore, at its option, a prime contractor may include the termination for convenience clause in a subcontract. From the subcontractor's standpoint, the termination for convenience clause should not be accepted into the definitized subcontract *without modification*. In fact, to do so works an impractical result. Under the FAR clause at 52.249-6, the prime contractor is granted one year to submit its termination settlement proposal to the government.¹¹⁷ If the subcontractor also has one year, it would work a hardship for the prime contractor because it could receive the subcontractor's settlement proposal on the same day its own is due. Some modification is required to allow sequencing of the review and inclusion of subcontractors' settlement proposals into the prime contract. The subcontractor will desire further modification to the termination for convenience clause and limit the termination for convenience right to the single situation in which the government terminates the prime contract. The subcontractor can hardly expect the prime to continue its subcontract in that event, but such a modification would prevent the request made of EG&G—to agree to a clause which would have allowed the prime to terminate the subcontract as soon as the ink was dry on the executed definitized subcontract.

¹¹⁷ The same is true under FAR clause 52.249-2 for fixed-price contracts.

Conclusion

EG&G v. Cube changes the enforceability rules for teaming agreements. No longer will prime contractors automatically be able to view such agreements as mere “agreements to agree” and, therefore, inherently unenforceable. At least in Virginia, and possibly elsewhere, Judge Ney’s analysis of the dispute between these two companies may well become the new “sheriff” in deciding enforceability of the teaming agreement in the next shoot-out between a prime and subcontractor.

Has Independent Research and Development Lost its Independence?

Paul E. Pompeo¹¹⁸

For years contractors and the government have struggled with the definition of independent research and development (IR&D). The Federal Acquisition Regulation (FAR), like its predecessors the Defense Acquisition Regulation (DAR) and the Federal Procurement Regulation (FPR), specifically excludes from the definition of IR&D "effort sponsored by a grant or *required in the performance of a contract.*"¹¹⁹ It is determining what is required in the performance of a contract that has been troublesome.

On the one hand, contractors have looked to strict construction of the contract terms and statement of work; thus, efforts that are generic in nature and that would apply to both existing contracts and potential future products would remain IR&D. On the other hand, the government has construed the exclusion more broadly by including efforts that may be related to the performance of a contract even if the contract does not expressly call for them. The ramifications of the definition can be far reaching, particularly for those contractors who perform commercial contracts as well as government contracts, as the definition implicates the ability of contractors to recover significant and necessary IR&D costs.

The Federal District Court for the Eastern District of Virginia recently heated this debate in its August 14, 2003 decision in *United States v. Newport News Shipbuilding, Inc.* It concluded that the exclusion from IR&D in FAR 31.205-18 extends to efforts both explicitly and implicitly required for the performance of a contract.¹²⁰ The debate continues, however, in a pending case before the Court of Federal Claims.¹²¹

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¹¹⁹ FAR 31.205-18(a) (emphasis added); *see also*, Bedingfield and Rosen, Government Contract Accounting at 10-2 to 10-9 (1985) (providing historical background on the FAR, DAR and FPR cost principle for IR&D); Thomas P. Barletta & Gerard E. Wimberly, Jr., *Allowability of Independent Research and Development Costs Under FAR 31.205-18: A Proposal for Regulatory Reform*, 29 Pub. Cont. L.J. 113, 115-118 (1999) (discussing regulatory history and inclusion of "required in performance of a contract" language in 1971).

¹²⁰ *United States v. Newport News Shipbuilding, Inc.*, 276 F. Supp.2d 539 (E.D.Va 2003).

¹²¹ *Alliant Techsystems, Inc. v. United States*, 99-440C (Braden) (Ct. of Fed. Cl.) (originally styled *Thiokol Propulsion v. United States*).

The Newport News Decision

The government filed a False Claims Act¹²² case against Newport News, alleging that the company had knowingly charged approximately \$74 million in connection with design and construction of tankers for commercial customers as indirect IR&D costs. The government asserted that, once Newport News entered into the commercial contracts, the efforts were no longer IR&D. Indeed, the government argued that Newport News' execution of a Letter of Intent should be used as the cut off for distinguishing between IR&D and direct costs. According to the government, all of the engineering efforts were in support of the various commercial contracts. Because 85 percent to 99 percent of Newport News' revenues arose from government contracts, principally flexibly priced, the effect of charging these costs to IR&D was that the government bore the substantial burden of these costs.

Newport News argued that three factors are relevant to the determination of whether costs should remain IR&D or be reclassified as a direct cost of contract performance. These factors include: "(i) whether the effort was found in the contract's statement of work, (ii) whether the effort was included in the price of the contract, and (iii) whether the effort was a deliverable of the contracts."¹²³ Consequently, Newport News reasoned that any development or design work that is "generic in nature and applicable to the product as it will be offered to other potential customers is allowable as IR&D."¹²⁴

Rejecting Newport News' argument, the court held that costs both explicitly and implicitly required in the performance of a contract can no longer be classified as IR&D, regardless of whether they would benefit multiple or future contracts. After a thorough analysis of the regulatory history, the plain meaning of the language, and the sparse case law addressing the issue,¹²⁵ the court created a "bright line" test, holding that the execution of a contract is the point at which efforts will convert from IR&D to contract costs.

The practical effect of this reading of the "required in the performance of a contract" exclusion is to create a temporal dividing line between IR&D and direct work that must be billed to a contract at the point the contract requiring the effort is signed. Prior to such a contract, the research and design effort is independent, and is eligible to be charged as IR&D, provided it otherwise fits the IR&D definition. Once a contract is signed, however, research and design efforts that are explicitly or implicitly required in

¹²² 31 U.S.C. § 3729(a); that it is a False Claims Act case explains why the case was before a Federal district court rather than the Court of Federal Claims or a Board of Contract Appeals, which normally have jurisdiction over a government contract matter.

¹²³ *Newport News* at 548 (relying on the analysis of an outside government contracts consultant).

¹²⁴ *Id.*

¹²⁵ The court reviewed *United States ex re. Mayman v. Martin Marietta*, 894 F. Supp. 218 (D. Md. 1995), which case addresses the definition of IR&D, but did not reach the issue of whether implicit efforts are included within the definition of IR&D.

the performance of that contract may no longer be charged as IR&D . . . even if it also stands to benefit other existing contracts, potential future contracts, or a class design.¹²⁶

The court, however, rejected the government's argument that the Letter of Intent was the contractual vehicle that would serve as the dividing line between IR&D and contract costs, because, under Virginia law, a Letter of Intent is not an enforceable contract.¹²⁷ The answer could be different under the law of another state, where a Letter of Intent or Memorandum of Agreement typically predating the actual contract by months or a year could stop the clock on IR&D.

Policy considerations such as avoiding government subsidies where costs would otherwise be covered directly by a contract were a significant factor in the court's decision. Thus, where "a contractor has already found a commercial customer who will pay for the particular research and design work, or signed a specific contract with the government to perform that work, there is no apparent purpose in providing further payment for that work in the form of IR&D reimbursements from the government."¹²⁸ Further, the court held that applying only the "explicit" standard would allow a contractor to manipulate the statement of work on commercial contracts such that the contract would not expressly call for certain design work, thus permitting the contractor to continue charging design costs to IR&D even though the efforts would be necessary to performance of the contract.

Ultimately, the parties settled. The court had sent a clear message to Newport News that it could not classify its costs as IR&D and in a latter part of the decision signaled the government that it would not be able to prove the knowledge element of a False Claims Act case. Accordingly, the case will not be subject to appeal and stands as the only case law on this issue.

Implications for Government Contractors

Newport News has significant ramifications for government contractors who also perform commercial work, but it has equal implications for those who perform only government work. Although the decision is thorough and logical, it fails to consider its pragmatic effects. The government may also come to regret the pursuit of this case; \$74 million saved today may implicate the future benefit of billions of dollars in design and advancement in the future. Following are some of the many issues that the decision engenders.

A broader class of costs is now no longer recoverable as IR&D. The practical effect is that these costs may not be recoverable at all. Is it likely that a commercial client will accept the IR&D as a direct cost? Not if, as in the case of Newport News, the IR&D effort is nearly twice the cost of the production contract. Similarly, government clients will be reluctant to accept as a direct cost what otherwise might have been spread

¹²⁶ *Newport News*, at 555.

¹²⁷ *Id.* at 559 n.25.

¹²⁸ *Id.* at 557.

over IR&D. The consequence is that the contractor itself will bear the burden. The alternative is that the decision will have a chilling effect on IR&D. Engineers typically consider possible advancements well into the future; they envision a new world. Those processes may be stifled by the cost implications. Moreover, where a design effort has been characterized as a direct cost, that design might not serve as a springboard for future developments. The court has effectively ruled against the ability to recharacterize a cost as IR&D. The court described as "anomalous" a result where the "signing of the first contract requiring the effort would render the effort no longer chargeable as IR&D, but the signing of a subsequent, additional contract would render the effort again chargeable as IR&D, perhaps even retroactively."¹²⁹

The case provides no guidance as to what efforts will be considered "implicit." This will continue to be an area of debate between contractors and the government. Tedious advance agreements may need to be negotiated to identify the distinction.

The court's bright line test has a certain appeal, but it may cause contractors to jockey concurrent negotiations of contracts that would benefit from the same development efforts. Because the existence of multiple contracts benefiting from a design cannot drive the characterization of a cost as IR&D, the consequence of the court's analysis is that the first contract executed that requires the effort will cause a conversion of the costs from IR&D to a direct cost of *that contract*. Thus, a subsequent contract that might benefit from the same design efforts, even if entered into shortly after the first, will not bear the cost of the effort – it will get a free ride. Accordingly, contractors will be motivated to assure that a contract with a customer willing to bear that cost is the first contract executed.

In executing a contract, the contractor also must beware of the law of the governing state. Execution of preliminary agreements such as a Letter of Intent or Memorandum of Agreement may be sufficient in some jurisdictions to affect the bright line test under *Newport News*. Accordingly, a contractor might inadvertently convert costs from IR&D to a direct contract cost by executing such a document.

The case may both inhibit future design, and stifle competition. Contractors may face difficulties in pricing the design element of their contract proposals, which could be particularly devastating for firm fixed price work. Experienced contractors generally do not face great difficulty in pricing the express design elements, but they may encounter difficulties in pricing the implicit design work, thereby pricing themselves out of competition, or proposing costs that are so low that true costs will not be recovered. Similarly, contractors seeking to enter an existing marketplace may be precluded from competition by the inability to recover necessary design costs. Accordingly, while the court has sought to resolve a 32-year-old debate, it has opened the door to a host of new issues.

¹²⁹

Id. at 554.

Alliant Techsystems, a Light on the Horizon

Like the questions surrounding the *Bicoastal* case out of a Florida bankruptcy court that addressed Cost Accounting Standard 413, many wonder about the impact of the *Newport News* decision from the Eastern District of Virginia, which is not a typical venue for government contract cases. The answer may rest in a case pending before the Court of Federal Claims: *Alliant Techsystems*.

The parties in *Alliant Techsystems* face the same issue as in *Newport News*: the meaning of "required in the performance of a contract" under FAR 31.205-18.¹³⁰ In *Alliant* the government disallowed approximately \$8 million in costs that Alliant's predecessor-in-interest, Thiokol, had charged as indirect IR&D or B&P¹³¹ costs rather than direct costs. The actual case is a test case for only about \$700,000 of the \$8 million, and involves a contract with Mitsubishi Heavy Industries. The efforts, however, involved upgrades to a solid rocket booster for which several commercial contractors as well as the United States Air Force had expressed an interest.

Relying heavily on the *Newport News* decision, the government asserts that the development efforts were expressly required under the Mitsubishi contract and should be direct costs.¹³²

Alliant raises arguments that go to the heart of *Newport News*. Alliant's pleadings focus on efforts that were specifically excluded from the Mitsubishi contract. Much like *Newport News*, Alliant looks to the terms of the statement of work and that were specifically included in the pricing and proposal to determine whether the effort was required in the performance of the contract. In its negotiations, Alliant tried to ensure that certain efforts involving the solid rocket booster were not made part of the contract so as not to be sponsored by the Mitsubishi contract.¹³³ The court in *Newport News*, however, envisioned such a prospect and ruled against it.

For example, parties might draft commercial contracts that designated certain "deliverables," but remained silent on the research and development efforts necessary to produce those deliverables, thereby potentially rendering all such research and design efforts chargeable to the government as IR&D notwithstanding the fact that those efforts were necessary to build the ship.¹³⁴

¹³⁰ The government also questioned certain depreciation costs, asserting that they are direct costs of the Mitsubishi contract under FAR 31.205-40 rather than indirect costs.

¹³¹ The B&P cost principle is the same as that for IR&D, FAR 31.205-18, and contains the same "required in the performance of a contract" language in its definition.

¹³² *Alliant Techsystems*, Defendant's Motion for Summary Judgment or in the Alternative, for Summary Judgment Upon Counts I and II and to Dismiss Count III (Sept. 3, 2003).

¹³³ *Alliant Techsystems*, Complaint (Jul. 2, 1999)

¹³⁴ *Newport News* at 557.

The issue of explicit versus implicit costs, therefore, stands at the forefront of this case. To date, the case has not been decided.¹³⁵

Unique to Alliant, however, is the potential argument of "retroactive disallowance" or estoppel. Alliant explains in its pleadings that it had a long-standing practice of charging such costs as indirect and that the government had reviewed and not objected to those practices. Even more compelling, Alliant had proposed an advance agreement to the government for the treatment of the development costs as indirect in anticipation of submitting proposals to potential customers. The government was aware of the proposed agreement but did not issue a Notice of Intent to Disallow costs until a full two years after Alliant had suggested the advance agreement.

Another fact that addresses an open question in *Newport News* is the existence of a proposed Memorandum of Agreement. Here, Alliant had proposed, but never executed, a Memorandum of Agreement with Mitsubishi. If the Court of Federal Claims adopts the bright line test set out in *Newport News*, could the Memorandum of Agreement serve as the temporal dividing line?

Contractors can anticipate a statement from the Court of Federal Claims on whether both explicit and implicit efforts are excluded from the definition of IR&D. If the Court of Federal Claims elects to follow the *Newport News* decision, it will be in a position to provide further guidance about implicit efforts, and may even speak to the advance agreement that Alliant had proposed as a mechanism to address open issues. Further, because the facts in Alliant implicate both commercial and government contracts, as the Air Force had expressed interest in the developments of the rocket boosters, the court may also provide guidance on whether the costs may be spread to subsequent contracts benefiting from the development efforts, or whether, as the *Newport News* court held, the first contract to so benefit will bear the burden of the costs.

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¹³⁵

As of this publication, the case is pending on a Motion for Summary Judgment; Alliant's response is due on December 19, 2003.