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FEATURE COMMENT: Investing In Small Businesses—Navigating SBA's Affiliation Rules

Numerous Government contracts programs support small businesses. There are prime contracts set aside for various categories of small business entities. Agencies have small business contracting goals and take them very seriously. Prime contractors often are incentivized, through evaluation factors, to propose significant small business participation. They can also face liquidated damages for failing to make good faith efforts to comply with their small business subcontracting plans. These programs promote economic growth by incentivizing investment in small business entities.

The primary obstacle to investing in small businesses, from a Government contracts perspective, is that it is quite easy to lose small business size status as the result of a corporate transaction. The difficulty arises from the doctrine of "affiliation."

The Small Business Administration determines whether a contractor qualifies as a small business by examining whether its employees or gross receipts fall below a certain threshold, depending on the contractor's North American Industry Classification System (NAICS) code. The SBA considers the employees or gross receipts of both the contractor *and* its affiliates. In other words, the SBA treats the contractor and its affiliates as though they were a single entity by aggregating their employees or gross receipts when determining size status.

The SBA's definition of affiliation is extraordinarily broad. Two entities are affiliated if one controls, or has the power to control, the other, or if one or more third parties control, or have the power to control, both. The SBA considers factors including ownership, management, previous relationships with or ties to

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A ✦ has been added at the end of headlines in this section to indicate cases having an accompanying analytical note.

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another business, and contractual relationships in analyzing the issue of control.

Provided below are just a few examples of the circumstances under which the SBA will find affiliation between an investor and a small business:

- the investor owns more than 50 percent of the voting shares of the small business;
- the investor owns a block of voting stock that is large relative to the next largest block of voting stock (e.g., 25 percent vs. 15 percent) of the small business;
- the investor owns options that would allow it to acquire enough voting shares of the small business to meet either of the above conditions;
- the investor controls the board of directors or has the ability to block a quorum of directors of the small business;
- the investor has veto rights over any actions of the small business in the ordinary course (e.g., taking on debt, paying dividends, determining management compensation, etc.);
- the investor populates the small business with its management and/or key personnel; or
- the small business is dependent on the investor for contracts, funding or other support.

These are just a few examples intended to illustrate the breadth of the SBA's affiliation rules. There are many additional bases for affiliation. The bottom line is that acquiring any type of direct or indirect control over a small business will result in affiliation and, potentially, loss of that entity's small business size status and its associated benefits.

Following a transaction that results in a change in size status, a small business is required to notify the relevant contracting officers. Agencies are not required to terminate the contracts, but they can no longer count any funds spent on the contracts toward their small business goals. If an agency awarded a contract, in whole or in part, based on small business size status, there is a risk that it could terminate the contract for convenience or simply not exercise any future options under the contract.

Additionally, an entity that loses its small business size status as the result of a transaction is no longer eligible for small business set-aside contracts. This may not be a significant concern if the contractor operates in an industry where most contracts are not set aside for small businesses, if the contractor offers a unique product or service, and if the contractor has a record of competing successfully against large businesses. If, on the other hand, most of the contractor's awards are small business set-asides and the contractor operates in an industry in which most contracts are set aside for small businesses, then a loss of small business size status could significantly affect the buyer's valuation and, potentially, even the viability of the transaction.

The strategic implications of the SBA rules for Government contracts mergers and acquisitions are extraordinarily complex, but the key takeaways are relatively simple:

- *Large Businesses*: Acquiring a small business will likely result in the loss of small business size status, and you need to consider how the loss of small business size status will affect sales. Relevant diligence considerations include the percentage of contracts awarded to the target as small business set-asides; what percentage of the entity's business is attributable to subcontracts predicated on its small business status, thus contributing to its prime contractors' satisfaction of their small business subcontracting goals; the extent to which opportunities for large businesses exist in the target's industry; whether the target offers unique solutions that cannot be obtained from other contractors; and the target's record of success competing against large businesses.
- *Small Businesses*: Potential buyers will want to know how a loss of small business size status will affect your revenue. Position yourself to make a compelling argument that the impact will be minimal. Go outside your comfort zone. Compete with large businesses—and win. Articulate your value proposition independent of your size.
- *Private Equity Firms*: It is possible to invest in small businesses without jeopardizing their small business size status. But this is very complex and requires structuring the transaction with extreme care. If you want to keep the small business size status, you cannot have control. This necessitates an extraordinary level of trust in the controlling shareholder(s)—and a way to liquidate your investment if the relationship sours.

Small businesses will often appear at first glance to make attractive candidates for investment. However, the extent to which the entity's past and future success is dependent on its size status can mask significant downstream risk to the company's cash flow. Understanding the impact of the SBA's affiliation rules on a corporate transaction is essential to effective due diligence in this realm.

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This Feature Comment was written for The Government Contractor by* John Chierichella *and* Keith Szeliga*, partners in the Washington, D.C. office of global law firm Sheppard Mullin, and members of the firm's Government Contracts, Investigations and Internal Trade Practice Group. Mr. Szeliga is co-leader of the practice group, and Mr. Chierichella is co-leader of the firm's Aerospace and Defense Industry team. They can be reached at* jchierichella@sheppardmullin.com *and* kszeliga@sheppardmullin.com*.

Developments

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GAO Seeks Comments On Technology Maturity Assessment Guidance

The Government Accountability Office is seeking comments on an "exposure draft" of guidance on using technology readiness assessments (TRAs) to measure technology maturity in acquisition programs and projects.

In the draft guide, GAO noted, "Many of the government's most costly and complex acquisition efforts require the development of cutting-edge technologies and their integration into large and complex systems." GAO explained that a TRA is "a systematic, evidence-based process that evaluates the maturity of hardware and software technologies critical to the performance of a larger system or the fulfillment of the key objectives of an acquisition program." TRAs measure technology maturity to help reduce risks, illuminate concerns and inform decision-making.

"The best practices presented in GAO's guide should help agencies better manage the critical technologies and related costs that often are a major source of risk in acquiring advanced systems and projects," said U.S. Comptroller General Gene Dodaro.

GAO intends the guidance to establish "a methodology based on best practices that can be used across the federal government for evaluating technology maturity, particularly as it relates to determining a program or project's readiness to move past key decision points that typically coincide with major commitments of resources."

GAO is seeking comments through Aug. 10, 2017, especially from the science and technology, systems engineering, and program management communities. Comments can be submitted at *tell.gao.gov/traguide*.

The Department of Defense and NASA have used TRAs since the early 2000s, GAO noted. GAO intends to establish general guidance for Government-wide use, but the guide "also provides information on where certain steps may be tailored for assessments for the narrower audience, referred [to] herein as knowledge building TRAs."

TRAs typically use a technology maturity scale with technology readiness levels (TRLs). GAO listed the nine TRL levels that DOD and NASA use. For example, the first TRL is "basic principles observed and reported," the third is "analytical and experimental critical function and/or characteristic proof of concept," and the ninth is "actual system proven through successful mission operations."

The first two chapters of GAO's draft focus on the definition of a TRA, why TRAs are important and their limitations. The next eight chapters detail best practices, including reliable processes for conducting credible TRAs, selecting and evaluating critical technologies, preparing technology maturation plans, and using TRAs to evaluate software systems and systems integration. Appendices include lists of key questions, case studies and various agencies' TRL descriptions.

Timothy Persons, GAO's chief scientist and one of the draft guide's architects, said that with the TRA guidance, "program managers and technology developers will be better equipped to evaluate technology maturity, gauge progress, and identify and manage risk in today's advanced systems acquisition and technology development environment." He added, "Government auditors will also be better

able to evaluate agencies' decisions about technology readiness."

The TRA guide is entitled *Technology Readiness Assessment Guide: Best Practices for Evaluating the Readiness of Technology for Use in Acquisition Programs and Projects* (GAO-16-410G). It is intended to be companion guidance to GAO's 2009 *Cost Estimating and Assessment Guide: Best Practices for Developing and Managing Capital Program Costs* (GAO-09-3SP) and its 2015 *Schedule Assessment Guide: Best Practices for Project Schedules* (GAO-16-89G). See 51 GC ¶ 83(d).

GAO's draft TRA guidance is available at *www.gao.gov/assets/680/679006.pdf*.

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DOE Has Not Developed Processes For Using Enhanced Procurement Authority

The Department of Energy has not developed specific processes for using an enhanced procurement authority that allows DOE to exclude a supplier that poses a supply chain risk from a contract or subcontract, according to a recent Government Accountability Office report. The authority, which has never been used, also allows DOE to make the exclusion without disclosing the reason to the supplier.

DOE through the National Nuclear Security Administration is responsible for the security of the U.S. nuclear weapons stockpile. According to NNSA, the Government is concerned about a trend towards a non-domestic supply chain for nuclear weapons components. Risks to the supply chain include the possibility that (1) a counterfeit or sabotaged component could cause a nuclear weapon to malfunction, (2) DOE classified information could be compromised, and (3) DOE program costs could increase.

The National Defense Authorization Act for Fiscal Year 2014 provided the secretary of energy enhanced procurement authority that, in the interest of national security, allowed DOE to withhold consent for a contractor to use a particular supplier or direct that the supplier be excluded. The authority applies specifically to components of nuclear weapons and nonproliferation and counterproliferation systems. The decision to exclude is not subject to review in federal court. GAO noted that DOE's enhanced procurement authority is similar to authorities used by the Department of Defense and the intelligence community.

As of May 2016, DOE had not used the enhanced procurement authority because it had not fully assessed the circumstances under which the authority might be useful. To use the authority, the energy secretary must be made aware of a supply chain risk by DOE or NNSA officials. Once that happens, the secretary must make a written determination that using the authority is necessary to protect national security and that less restrictive measures are not reasonably available to reduce the supply chain risk.

GAO reported that DOE has not developed specific processes to collect information to provide to the secretary for making the determination. DOE officials told GAO "they expect instances under which the authority would be useful to be infrequent." But DOE has not conducted an assessment to confirm that view, GAO said.

NNSA officials told GAO it is unlikely that the management and operating (M&O) contractors responsible for procuring nuclear weapons parts would need to request that the secretary use the authority. NNSA officials said "as nonfederal entities, M&O contractors are generally not required to disclose security-related reasons to explain why a particular supplier was not selected." Officials also noted that Federal Acquisition Regulation mechanisms exist that allow agencies to reject suppliers that pose a supply chain risk.

Despite DOE's and NNSA's position that the authority may be unnecessary, GAO concluded that management should review policies and related control activities for relevance. "Without assessing the circumstances under which the authority could be useful, DOE will have difficulty determining its relevance and, if necessary, developing processes for using it," GAO said. Without a review, DOE may miss opportunities to use the authority to manage supply chain risks, GAO added.

GAO also found that DOE has not examined whether adequate resources exist for using the enhanced procurement authority. DOE officials and M&O contractors expressed a range of opinions to GAO about whether the resources in place were adequate or consistent with federal standards. Some M&O contractors said they might need more trained personnel but could not assess the need without a requirement to do so in the contracts, and DOE had not established such requirements.

GAO recommended that DOE assess the circumstances that might warrant using the enhanced

procurement authority and take additional actions based on the results. GAO further recommended developing processes to use the authority and examining whether resources for doing so are adequate.

Nuclear Supply Chain: DOE Should Assess Circumstances for Using Enhanced Procurement Authority to Manage Risk (GAO-16-710) is available at *www.gao.gov/assets/680/678998.pdf.*

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OFPP Directs Agencies To Make Source Code Available To Other Agencies

When procuring custom-developed source code, agencies must secure appropriate Government data rights and make the source code broadly available for reuse by other agencies, Office of Federal Procurement Policy Administrator Anne Rung wrote in a recent memorandum with White House Chief Information Officer Tony Scott. Rung also announced a pilot program requiring agencies to release 20 percent of new source code as open-source software.

Rung noted that when agencies procure custom-developed source code, they do not consistently make it broadly available for Government-wide use, and sometimes agencies can have difficulty determining that the software was produced in the performance of a Government contract. "These challenges may result in duplicative acquisitions for substantially similar code and an inefficient use of taxpayer dollars," she said.

Rung set out a three-step analysis for agencies procuring software solutions: (1) conduct strategic analysis and analyze alternatives, (2) consider existing commercial solutions, and (3) consider custom development. When procuring custom-developed source code, agencies must ensure delivery of the source code and obtain appropriate Government data rights, including rights to Government-wide reuse and the right to modify the code. Rung also directed agencies to inventory all custom-developed code, make it available Government-wide and consider the publishing it as open-source software.

For the pilot program, agencies must release at least 20 percent of new custom-developed source code as open-source software, but Rung said agencies "are strongly encouraged to release as much custom-developed code as possible to further the Federal Government's commitment to transparency, participation, and collaboration." The pilot will last for three years.

Rung said agencies are not required to share custom-developed code where doing so is restricted by law or regulation, including intellectual property law, export regulations, the International Traffic in Arms Regulations, and rules on classified information. The policy also includes exceptions when sharing code with other agencies would pose a risk to national security, individual privacy, confidentiality of Government data, or an agency's personnel or mission, or when the agency CIO believes it is in the national interest. The policy also exempts source code developed for national-security systems under 40 USCA § 11103.

Rung said the new policy will reduce costs and help reduce federal "vendor lock-in"—when agencies must rely on a single supplier and cannot easily move to a competing vendor. She noted that within 90 days, OFPP will launch *Code.gov* with resources for agencies to implement the policy and pilot.

In June, Rung and Scott issued guidance on managing commercial and commercial off-the-shelf software licenses. See 58 GC ¶ 209. And in July, Rung and Digital Service Administrator Mikey Dickerson launched the TechFAR Hub, a website providing agencies with resources for digital service acquisitions. See 58 GC ¶ 278(c).

Rung's memo is available at *www.whitehouse.gov/sites/default/files/omb/memoranda/2016/m_16_21.pdf*.

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East Asia Remains Top Region For Foreign Targeting Of Classified U.S. Data

In fiscal year 2015, for the fourth consecutive year, East Asia and the Pacific was the region with the most reported attempts to access classified U.S. data or technologies, the Defense Security Service has reported. In FY 2015, the U.S. saw "a marked increase in industry reporting of foreign collection attempts to obtain sensitive or classified information and technology resident in cleared industry," with collection attempts rising 15 percent over FY 2014.

Collection attempts originating in East Asia accounted for 35 percent of reports. "Entities fre-

quently attempted to leverage joint ventures with cleared contractors," DSS noted. East Asia will "almost certainly" continue to be the region with the most reported attempts to target U.S. technologies, DSS said. The Near East had the next-most attempts with 21 percent, and South and Central Asia had 20 percent.

The top three targeted technology categories remained the same as in FY 2014: electronics; command, control, communication and computers, or "C4"; and aeronautic systems. But reported attempts to access energy systems rose by a third, moving from tenth to fourth most-targeted. Software was the fifth most-targeted, slipping from fourth in FY 2014.

The most common method of operation for targeting U.S. technology remained academic solicitation. Seeking employment increased significantly, moving from sixth most-common method in FY 2014 to second. Attempted acquisition of technology "remained in the top three, although it showed a slight decrease," DSS reported. Rounding out the top-five methods of targeting in FY 2015 were requests for information and suspicious network activity. DSS also cautioned that "commercial entities will likely continue using solicitation or marketing services as a way to begin a business relationship with cleared contactors, which opens a potential avenue to access sensitive information, technology, and manufacturing processes."

DSS highlighted academic solicitation as a mode of operation for targeting sensitive data in its FY 2015 report. "Foreign student academic requests represent an ongoing threat to cleared industry." Students typically request "information on post-graduate degree programs, research internships, thesis assistance, and review of technical publications—all under the guise of legitimate research," DSS cautioned.

The increase in foreign attempts to access sensitive U.S. technologies in FY 2015 continues a trend in recent years. See 55 GC ¶ 234; 56 GC ¶ 272(a); 57 GC ¶ 255(a).

The National Industrial Security Program (NISP) requires cleared contractors to report suspicious attempts to access sensitive data, DSS noted. DSS "supports national security and the warfighter, secures the nation's technological base, and oversees the protection of U.S. and foreign classified information in the hands of industry." In May, DSS added new insider-threat requirements to the NISP Operating Manual. See 58 GC ¶ 200(a).

DSS' FY 2015 analysis of cleared industry reporting is available at *www.dss.mil/documents/ci/16-08-15_Unclass_Trends_with_cover.pdf*.

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Developments In Brief ...

(a) Contract Prisons Need More Oversight, DOJ IG Finds—Contract prisons incurred more safety and security incidents per capita than comparable Bureau of Prisons institutions, according to a recent report by the Department of Justice inspector general. Contract prisons are privately owned institutions. BOP began contracting with private prison facilities to alleviate over-crowding in federal facilities. The IG analyzed data from 14 contract prisons with inmate populations comparable to BOP institutions. BOP found that contract prisons confiscated eight times more contraband cell phones and had higher assault rates than BOP facilities. The IG found that BOP lacked sufficient oversight of contract prisons. Without proper oversight, BOP cannot ensure that federal inmates' rights and needs are not placed at risk when housed in contract prisons. The IG recommended that BOP (1) improve monitoring and oversight of its contract prisons, and (2) enhance its oversight checklist to ensure contract facilities provide appropriate health and correctional services to inmates. *Review of the Federal Bureau of Prisons' Monitoring of Contract Prisons* is available at *oig.justice.gov/reports/2016/e1606.pdf*.

(b) HHS IG Questions Medicare Contractors' Drug Coverage Determinations—According to a recent report by the Department of Health and Human Services inspector general, inconsistent drug coverage decisions by Medicare administrative contractors (MACs) could lead to variations in coverage across the country and spending on drug uses that are not medically accepted. MACs review Medicare Part B outpatient drug claims to ensure that Medicare-funded drugs meet coverage criteria, and have discretion to

make coverage decisions, including off-label use. Off-label use of drugs refers to uses other than those approved by the Food and Drug Administration, and may be covered under Part B "if the MAC determines that [such] use is medically accepted." MACs rely on a variety of information sources to help them make coverage decisions, particularly in approving off-label use, and have implemented varying payment controls to ensure that payments for drug claims complied with their coverage policies. However, some MACs were unable to provide the IG with the results of payment controls, making it difficult to accurately evaluate their effectiveness. Without effective payment controls, "Medicare may be vulnerable to improperly paying for non-covered drug uses," the IG cautioned. Moreover, most MACs reported additional challenges determining Part B coverage, including difficulties remaining up-to-date on covered uses and interpreting Centers for Medicare and Medicaid Services (CMS) policy manuals. The IG recommended that CMS (a) have a single entity assist MACs with coverage determinations, and (b) evaluate the cost-effectiveness of actions "designed to ensure appropriate payments for covered uses on Part B drug claims." In 2015, the IG questioned Federal Marketplace contract awards, oversight and spending by CMS. See 57 GC ¶ 28; 57 GC ¶ 284; 57 GC ¶ 291. *MACs Continue to Use Different Methods to Determine Drug Coverage* is available at *oig.hhs.gov/oei/reports/oei-03-13-00450.pdf*.

(c) IG Flags Oversight Problems on FWS Mapping Contracts—Fish and Wildlife Service contracting officials did not review contractor employee qualifications, resolve labor category redundancies or maintain permanent contract files for two Federal Supply Schedule time-and-materials contracts awarded in 2014 to Dewberry and Davis to update coastal maps, the Interior Department inspector general reported. The IG found that FWS did not adequately review Dewberry employees' qualifications to verify billed labor rates. FWS officials said they reviewed some qualifications during the solicitation but lacked resources to review every employee's qualifications. Federal Acquisition Regulation 13.601(c)(1) states that time-and-materials contracts provide "no positive profit incentive to the contractor for cost control or labor efficiency," and thus require "appropriate Government surveillance of contractor performance." FWS employees should have verified contractor employees' qualifications and experience equivalents—a task that was simplified by Dewberry's qualification summaries, the IG noted. The FSS contract contained two job categories with duplicate descriptions and overlapping experience requirements: a computer-aided design and drafting (CADD) operator is billed at $45.51 per hour, and a CADD system operator at $62.83. The IG identified four employees who were eligible to bill at the lower rate but billed at the higher. "This practice resulted in $25,825 in additional costs billed to the contracts that we regard as wasted funds." FWS officials should have substantiated invoices and verified billing rates and experience equivalents, the IG said. Finally, the IG found that FWS did not keep permanent contract files for the Dewberry contracts, as FAR 4.801 requires. The IG recommended that FWS (1) develop procedures for contract oversight, including verifying labor categories and employee qualifications, and (2) train employees on contract administration. The IG's report is available at *www.doioig.gov/sites/doioig.gov/files/2016CG031APublic.pdf*.

(d) KC-46A Refueling Tanker Gets Production Go-Ahead—Boeing Co.'s KC-46A refueling tanker has received Milestone C approval to begin production from Undersecretary of Defense for Acquisition, Technology and Logistics Frank Kendall. Within 30 days, the Air Force will award low-rate initial production contracts, worth a prenegotiated total of $2.8 billion, to Boeing for two lots of 19 aircraft and related spare parts, the Air Force said. Most of the tankers will be delivered by early fiscal year 2018. The KC-46A program will next undergo Federal Aviation Administration and military certification flight tests, including refueling test flights, the Air Force added. Air Force Secretary Deborah Lee James said the KC-46A "has made significant strides in moving the Air Force toward the modernization needed in our strategic tanker fleet." In April, the Government Accountability Office reported that KC-46A program costs dropped by seven percent,

but flight-testing challenges loomed. See 58 GC ¶ 132. In 2011, the KC-46A contract award led to a GAO bid protest and a World Trade Organization panel's review of U.S. and EU aerospace subsidies. See 53 GC ¶ 71; 53 GC ¶ 122; see also Edwards, Feature Comment, "Boeing Versus The Air Force—The KC-45 Tanker Protest And The Future Of Major System Source Selections," 50 GC ¶ 230; Green, Feature Comment, "Splitting The Baby—Why The Air Force Needs Two Tankers," 50 GC ¶ 353.

Regulations

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Proposed Rule Would Make Numerous DFARS Changes On Commercial Item Procurements

The Department of Defense proposed amending the Defense Federal Acquisition Regulation Supplement to implement sections of fiscal year 2013 and FY 2016 National Defense Authorization Acts (NDAA) on commercial item acquisitions, including definitions, use of nontraditional contractors, price reasonableness and responsibility determinations. The proposed rule "also provides guidance to contracting officers to promote consistency and uniformity in the acquisition process." See DFARS Case 2016-D006, 81 Fed. Reg. 53101 (Aug. 11, 2016). Comments are due October 11. In January, DOD withdrew a proposed DFARS rule, DFARS Case 2013-D034, which was merged into the current proposed rule. See 58 GC ¶ 6.

Specifically, DOD is proposing to amend the DFARS to implement the requirements of §§ 851–853 and 855–857 of the FY 2016 NDAA, P.L. 114-92, and § 831 of the FY 2013 NDAA, P.L. 112-239, directing DOD to develop guidance and training on evaluating price reasonableness and to issue standards for determining when additional cost or pricing data are necessary to determine the reasonableness of commercial item prices.

The changes include adding (a) new definitions of "market prices," "market research," "nontraditional defense contractor," "relevant sales data," and "uncertified cost data"; (b) DFARS subpt. 212.72, Limitation on conversion of procurement from commercial acquisition procedures; (c) DFARS 212.209, Determination of price reasonableness, to provide a hierarchy of data for COs to consider when making price reasonableness determinations; (d) DFARS 252.215-70XX, Requirements for Certified Cost or Pricing Data and Data Other Than Certified Cost or Pricing Data; (e) DFARS 252.215-70YY, Requirements for Submission of Proposals to the Administrative Contracting Officer and Contract Auditor; and (f) DFARS 252.215-70ZZ, Requirements for Submission of Proposals via Electronic Media.

According to DOD, DFARS 252.215-70XX "allows for offerors to submit a written request for an exception from the requirement to submit certified cost or pricing data, by submitting specific information to support a commercial item exception or an exception based on prices set by law or regulation." The proposed DFARS 252.215-70YY and 252.215-70ZZ "specify when a proposal is required to be submitted to the administrative [CO] or cost auditor or if submission of the cost portion is required via certain electronic media." The provisions would implement § 831 of the FY 2013 NDAA and §§ 851 and 853 of the FY 2016 NDAA.

Because those provisions "were enacted to address requirements related to the treatment of commercial items and submission of uncertified cost or pricing data to support evaluations of price reasonableness for commercial items," DOD said it "intends to determine that it is in the best interest of the Federal Government to apply the rule to contracts for the acquisition of commercial items, including [commercial off-the-shelf] items." Making an exception for commercial items, including COTS items, "would exclude the contracts intended to be covered by the law," and run counter to its public policy goals, DOD said. However, DOD does not intend the requirements to apply to acquisitions below the simplified acquisition threshold.

The proposed rule also amends (1) DFARS 212.102, Applicability, to instruct COs on the treatment of prior commercial item determinations and nontraditional defense contractors; (2) DFARS 215.402, Pricing policy, to provide information on COs' responsibility for determining sufficiency of the information provided by an offeror to determine price reasonableness; (3) DFARS 215.403-1, Prohibition on obtaining certified cost or pricing data,

to add a reference to DFARS 212.102 regarding prior commercial item determinations; (4) DFARS 215.404-1, Proposal analysis techniques, to supplement the proposal analysis procedures identified in the FAR; (5) DFARS 234.7002, Policy, to incorporate the revisions in § 852 of the FY 2016 NDAA; and (6) DFARS 239.101, Policy, to incorporate the revisions in § 855 of the FY 2016 NDAA.

For more on the relevant sections of the FY 2016 NDAA, see Schaengold, Broitman and Prusock, Feature Comment, "The FY 2016 National Defense Authorization Act's Substantial Impact On Federal Procurement—Part I," 58 GC ¶ 20; Schaengold, Broitman and Prusock, Feature Comment, "The FY 2016 National Defense Authorization Act's Substantial Impact On Federal Procurement—Part II," 58 GC ¶ 28.

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IRS Issues Regulations On Foreign Procurement Tax

The Internal Revenue Service has published final regulations under § 5000C of the Internal Revenue Code relating to the two-percent tax on payments made by the Government to foreign persons pursuant to certain contracts. The regulations affect Government acquiring agencies and foreign persons providing certain goods or services to the Government pursuant to a contract. The August 18 *Federal Register* notice also contains final regulations about foreign persons claiming an exemption from the two-percent tax under an income tax treaty.

Effective August 18, the regulations also set forth a number of exemptions and provide procedures for collecting the tax. See 81 Fed. Reg. 55133 (Aug. 18, 2016).

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ABA Section Comments On DFARS Technical Data Rights For Advisory Panel

The American Bar Association's Section of Public Contract Law August 15 submitted numerous discussion points and recommendations in response to a request for comments from the Department of Defense's Government-Industry Advisory Panel. The panel will review statutory and Defense Federal Acquisition Regulation Supplement coverage of contractor rights in technical data and software.

In June, DOD sought comments to inform the work of the advisory panel's review of 10 USCA §§ 2320, 2321 on rights in technical data and proprietary data restrictions. See 58 GC ¶ 236. Although those provisions address only technical data, the panel has extended its scope to include software.

The ABA section noted that § 2320(a)(1) addresses patents and copyrights, but does not expressly address "trade secrets," which the Defend Trade Secrets Act of 2016 protects. Trade secrets are an important form of intellectual property affected by technical data rights, so the statute should be updated to address them, the section said.

Section 2320(a)(2)(E) lists factors for establishing negotiated rights with contractors. The ABA section suggested adding two factors to the list: the Government's interest in encouraging contractors to commercialize items and the relative monetary contributions of the Government and contractor to the development of an item.

The DFARS Small Business Innovation Research clause stipulates that SBIR data convert to unlimited rights data when the SBIR data period expires. "But converting the SBIR data instead to Government Purpose Rights would suffice to allow the Government to make use of the data while also allowing the SBIR participant to commercialize its technology," the ABA section said. In July, the section criticized a proposed time limit on SBIR software data rights. See 58 GC ¶ 252.

Given the panel's extension of its scope to include software, the ABA section encouraged emphasis of "the difference between software (which is the item being purchased) and technical data (which pertain to items being purchased)." The section "encourages addressing the extent to which the technical-data scheme should be applied to software, particularly in light of the substantial amendments to 10 U.S.C. § 2320 by Section 815 of the 2012 [National Defense Authorization Act]."

The ABA section recommended refreshing DOD 5010.12-M, "Procedures for the Acquisition and Management of Technical Data," which it said has not been updated since 1993. The section also recommended adding or improving DFARS guidance on non-contractual data requirements, Government

rights to validate asserted restrictions, the process of "asserting" commerciality, and the use of priced options and licensing data.

The Government-Industry Advisory Panel was established under § 813 of the National Defense Authorization Act for Fiscal Year 2016. See Schaengold, Broitman and Prusock, Feature Comment, "The FY 2016 National Defense Authorization Act's Substantial Impact On Federal Procurement—Part I," 58 GC ¶ 20. Its work will cover 10 USCA §§ 2320 and 2321, the DFARS implementing regulations, DOD IP policy, DOD officials' capacity to administer the policies, coverage of computer software, applicability to commercial items, engagement of nontraditional contractors, and relation to open systems architecture and modular systems.

DOD has several open DFARS proposed rules related to contractor rights in technical data and the panel's work. See 58 GC ¶ 177; 58 GC ¶ 236.

The ABA section's comments are available at *www.americanbar.org/content/dam/aba/administrative/public_contract_law/comments/research_develop_intellectual_property_response_to_dod_giap_rfi_section_813_panel.authcheckdam.pdf*.

Decisions

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CO's Request For Information Was Not A Denial Of Contract Extension, Fed. Cir. Holds

Zafer Taahhut Insaat ve Ticaret A.S. v. U.S., 2016 WL 4375654 (Fed. Cir. Aug. 17, 2016)

Requests for information to allow the contracting officer to assess a request for an extension of time to complete the contract did not constitute a denial of the time extension, the U.S. Court of Appeals for the Federal Circuit has held in affirming a decision of the Court of Federal Claims granting summary judgment for the Government. The Federal Circuit also held that the closure of a shipping route in Pakistan did not constructively change the contract because the government of Pakistan closed the border. Moreover, any related U.S. Government actions were sovereign acts that do not subject the Government to contractual liability, the Federal Circuit said.

In May 2011, the Army Corps of Engineers (COE) entered into a firm-fixed-price contract with Zafer Taahhut Insaat ve Ticaret A.S. for construction work at Bagram Air Force Field in Afghanistan. Under the contract, Zafer was responsible for delivering construction materials to the project's site and assumed the risk "for all costs and resulting loss or profit." Federal Acquisition Regulation 16.202-1.

In June 2011, Zafer received notice to proceed. The COE later recognized that it could not make the project site available until June 2012, and the parties agreed to an increased contract price and a completion date in October 2013.

In November 2011, Pakistan closed its border from the city of Karachi along the routes into Afghanistan in response to a combat incident with the U.S. and NATO that allegedly killed 24 Pakistanis. The route was closed until July 2012.

Zafer told the COE that 19 of 24 shipments of material were at Karachi and could not be moved because of the route closure. Zafer asked for directions on how to proceed, including whether it should use another route with increased costs and shipping time.

The COE acknowledged the difficulties arising from the closure of the Karachi route and noted that the contract allows for a non-compensable time extension for unforeseeable delays. But it informed Zafer that the COE was not responsible for the closure, which was "purely the act of Pakistan governmental authorities." The COE said that Zafer was obligated to deliver the materials and supplies by "any means necessary" without additional compensation.

After the Karachi route reopened, Zafer requested additional time and reimbursement for costs caused by the closure. The COE adhered to its view that Zafer was responsible for delivering all materials "by whatever means necessary," and that the COE was not responsible for increased costs.

Zafer later submitted a claim for additional compensation, which the CO denied. Zafer appealed the CO's decision to the COFC, alleging that (1) the COE constructively accelerated the contract by ordering Zafer to perform despite the route-closure delays, and (2) the U.S. Government caused the route closure and ineffectively negotiated for reopening the route, which constructively changed the contract. The COFC granted summary judgment for

the Government, *Zafer Taahhut Insaat ve Ticaret A.S. v. U.S.*, 120 Fed. Cl. 604 (2015), and Zafer appealed to the Federal Circuit.

Constructive Acceleration—The Federal Circuit said that even without a formal order under the Changes clause, a CO may constructively change the contract, "either due to an informal order from, or through the fault of, the government." *NavCom Def. Elecs., Inc. v. England*, 53 F. App'x 897 (Fed. Cir. 2002).

An informal order to accelerate contract performance can constructively change the contract and require an equitable adjustment. *Fraser Constr. Co. v. U.S.*, 384 F.3d 1354 (Fed. Cir. 2004). Constructive acceleration often occurs when the Government demands compliance with an original contract deadline, despite excusable delay by the contractor. Under *Fraser*, to prove a constructive acceleration claim, a contractor must show all five of the following elements:

> (1) that the contractor encountered a delay that is excusable under the contract; (2) that the contractor made a timely and sufficient request for an extension of the contract schedule; (3) that the government denied the contractor's request for an extension or failed to act on it within a reasonable time; (4) that the government insisted on completion of the contract within a period shorter than the period to which the contractor would be entitled by taking into account the period of excusable delay, after which the contractor notified the government that it regarded the alleged order to accelerate as a constructive change in the contract; and (5) that the contractor was required to expend extra resources to compensate for the lost time and remain on schedule.

Because Zafer failed to show that the COE denied a request for a time extension, Zafer failed to establish a constructive acceleration claim, the Federal Circuit said. After Zafer raised the route-closure issue, the COE said that Zafer could request a time extension. The COE asked Zafer to "fully explain why the delay was unforeseeable" and provide all "documentation of the date when the materials or equipment were shipped and when the delay began at the Pakistan border." Those demands are "entirely consistent" with the CO's duty to make specific factual determinations, such as whether a time extension is proper and how much time should be awarded. FAR 52.249-10(b)(1)–(2). "Indeed, though not required, contractors requesting a time extension for an excusable delay regularly ask for a specific time frame to ameliorate the harms of delay," the Federal Circuit said citing *Azure v. U.S.*, 129 F.3d 136 (Fed. Cir. 1997) (table); *Trepte Constr. Co., Inc.*, ASBCA 38555, 90-1 BCA ¶ 22,595.

In response to the COE's request, Zafer described the reasons for the delay, proclaimed its "entitlement to additional time," and asked for compensation for all "increased costs occasioned by the border closing." Zafer did not, however, ask for a specific amount of time.

The COE responded to these statements by again requesting "documentation of the date when the materials or equipment were shipped and when the delay began" so that it could assess the propriety of a time extension.

Zafer then repeated its request for additional payment, but still did not describe a time frame. At most, Zafer put the COE on notice of its entitlement to additional time generally, the Federal Circuit said.

The Court concluded that the COE did not deny a request for a time extension. To the extent that Zafer's repeated "notice of entitlement to additional time" amounts to a "timely and sufficient request for an extension" under *Fraser*, nothing indicates that the COE denied the request. The correspondence "simply reflects an ongoing conversation" aimed at resolving the issues related to the route closure. The communications do not show that the COE expressly or impliedly denied a request for a time extension. Instead, they show that Zafer repeatedly failed to comply with the CO's proper request for more information to allow the CO to assess the merits of a time extension, the Federal Circuit said in affirming the COFC.

Government Fault—The Federal Circuit acknowledged that a constructive change "may result through the fault of the government that warrants an equitable adjustment to the contract." Zafer argued that the Government was at fault for the delay because the U.S./NATO incident led to the route closure, and the Government prolonged the delay when it acted in its contractual capacity in negotiating with Pakistan to reopen the route.

The Federal Circuit rejected this argument. First, Pakistan alone closed the route, and the U.S. Government is not responsible for the sovereign acts of a foreign nation. Second, the Government is usually "not responsible for any 'obstruction to the

performance of the particular contract resulting from its public and general acts as a sovereign.' " See *Conner Bros. Constr. Co., Inc. v. Geren*, 550 F.3d 1368 (Fed. Cir. 2008); 51 GC ¶ 17.

Under an exception to the sovereign acts defense, the Government may be responsible for an act "specifically directed at nullifying contract rights." Id.; *U.S. v. Winstar Corp.*, 518 U.S. 839 (1996); 38 GC ¶ 322. Zafer did not allege any facts indicating that the Government took any action "specifically directed at nullifying contract rights." Instead, Zafer made broad and unsubstantiated allegations that the Government "contractually interfered, hindered, [and] delayed" resolution of the border closure issue, the Federal Circuit said.

Supplementation of the Record—Zafer challenged the COFC's refusal to supplement the record with newspaper articles and social media sources that Zafer offered to show that the contract contemplated only the Karachi route, and that the Government acted in its contractual capacity when it negotiated with Pakistan to reopen the route.

The Federal Circuit reviews COFC evidentiary determinations for an abuse of discretion. *Axiom Res. Mgmt., Inc. v. U.S.*, 564 F.3d 1374 (Fed. Cir. 2009); 51 GC ¶ 202. An abuse of discretion is found when (1) the court's decision is "clearly unreasonable, arbitrary, or fanciful," (2) the court's decision is "based on an erroneous conclusion of the law," (3) the court's findings are clearly erroneous, or (4) the record contains no evidence "upon which the [court] rationally could have based its decision." *Air Land Forwarders, Inc. v. U.S.*, 172 F.3d 1338 (Fed. Cir. 1999).

The Federal Circuit upheld the COFC's exclusion of the evidence on hearsay and parol evidence grounds. Zafer argued that the news articles and social media sources were self-authenticating under Fed. R. Evid. 902. But that argument does not account for the difference between authentication and the hearsay rule, the Federal Circuit said.

Zafer's challenge to the COFC's application of the parol evidence rule similarly failed. The parol evidence rule "renders inadmissible evidence introduced to modify, supplement, or interpret the terms" of a fully integrated, unambiguous agreement. See *Barron Bancshares, Inc. v. U.S.*, 366 F.3d 1360 (Fed. Cir. 2004). Zafer did not contend that its contract was ambiguous or not integrated. Instead, "Zafer assumes the conclusion and argues that the articles and sources highlight what the parties 'clearly' contemplated," the Federal Circuit said in rejecting this evidentiary challenge.

✦ **Note**—Longstanding authority holds that although a Contract Disputes Act claim need not be submitted in any particular form or use particular wording, it must contain "a clear and unequivocal statement that gives the contracting officer adequate notice of the basis and amount of the claim." *Contract Cleaning Maint., Inc. v. U.S.,* 811 F.2d 586 (Fed. Cir. 1987). In *M. Maropakis Carpentry, Inc. v. U.S.*, 609 F.3d 1323 (Fed. Cir. 2010); 52 GC ¶ 225, the Federal Circuit held that the contractor's letter to the CO did not meet this standard and thus did not constitute a claim for a contract extension. The Federal Circuit said that the

> letter did not state the total number of days requested in extension and did not request a final decision. In fact, the letter appears to promise a forthcoming written claim, which never materialized. A claim cannot be based merely on intent to assert a claim without any communication by the contractor of a desire for a contracting officer decision.

Accordingly, the Court affirmed the COFC's dismissal of the time-extension claim for lack of jurisdiction.

Similarly, in *K-Con Bldg. Sys., Inc. v. U.S.*, 778 F.3d 1000 (Fed. Cir. 2015); 57 GC ¶ 64, the Federal Circuit held that the COFC lacked jurisdiction over a contractor's time-extension claim because the contractor's letter to the CO failed to allege enough detail to provide adequate notice of the basis for a time extension.

¶ 300

COFC Denies Transfer Of Case To ASBCA Where It Would Be Time-Barred

Nova Grp./Tutor-Saliba v. U.S., 2016 WL 4009886 (Fed. Cl. July 22, 2016)

The U.S. Court of Federal Claims denied a contractor's motion to transfer an action to the Armed Services Board of Contract Appeals for consolidation with another action. If filed at the ASBCA, the COFC suit would have been untimely under the Contract Disputes Act, and the Court of Appeals for the Federal Circuit has reserved ruling on whether the CDA filing deadlines are jurisdictional. The

COFC instead granted the contractor's alternative motion for transfer of the Board case to the COFC.

In 2008, the Navy awarded a contract for design and construction of a repair wharf to Nova Group/Tutor-Saliba (NTS). The Navy initially approved NTS' design. The Navy construction manager later questioned it, and NTS stopped work to reevaluate its design. NTS' architect-engineer hired a third-party designer, who found that the design complied with requirements. NTS then resumed construction, accelerating the work.

NTS submitted requests for equitable adjustment (REAs), including REA 9 for pile driving due to differing site conditions and REA 14 for the work stoppage, delay and work acceleration. The contracting officer denied both REAs. In August 2015, NTS appealed the denial of REA 14 to the COFC, and in November 2015, it appealed REA 9's denial to the ASBCA. In May 2016, NTS filed an unopposed motion to transfer the COFC case to the ASBCA or, in the alternative, to transfer the Board suit to the COFC.

Under the CDA, appeals to the ASBCA must be filed within 90 days of a CO's final decision. See 41 USCA § 7104(a). The appeal of the COFC case on REA 14 would not have been timely at the ASBCA, and the Board would lack jurisdiction. NTS argued, however, that the Court could confer "derivative jurisdiction" on the ASBCA under § 7107(d) of the CDA, which states that if two or more suits are filed at the COFC and BCAs, "for the convenience of the parties or witnesses or in the interest of justice, the [COFC] may order the consolidation of the actions in that court or transfer any actions to or among the agency boards involved."

NTS cited *Glenn v. U.S.*, 858 F.2d 1577 (Fed. Cir. 1988). In *Glenn*, a contractor appealed a CO's decision on liability to the ASBCA. The CO then issued a second decision on quantum, which the contractor appealed to the U.S. Claims Court, having missed the 90-day period for appeal to the ASBCA. The contractor moved to transfer from the Claims Court to the Board. The trial court denied the transfer, but the Federal Circuit vacated, finding that the quantum decision "supplemented" the liability decision. Thus, the Board had jurisdiction over both appeals.

The COFC noted the narrowness of the ruling in *Glenn*. The Federal Circuit emphasized "the unique circumstances of this case," and said the appeals should be consolidated "in this particular and unusual case" to "avoid the necessity of two tribunals concurrently deciding appeals on interrelated issues and the possibility of inconsistent decisions." The CO's decisions involved the same facts, and the quantum decision was a continuation of the liability decision.

In contrast, the COFC noted that the decisions on NTS' differing site conditions and work stoppage claims involved "wholly separate factual and legal issues," and there was no risk that two tribunals could issue inconsistent decisions on them.

Furthermore, transfer of a time-barred action to the ASBCA would presume that the 90-day CDA time limit to file at the Board is not jurisdictional, the COFC said. But the Federal Circuit "has expressly reserved ruling on whether or not the filing deadline in the CDA is jurisdictional." See *Guardian Angels Med. Serv. Dogs, Inc. v. U.S.*, 809 F.3d 1244 (Fed. Cir. 2016); 58 GC ¶ 27. If the CDA time limit is eventually held to be jurisdictional, transferring the suit to the ASBCA could have "a deleterious effect" because "its decision would be a nullity," the COFC found, citing *Cosmic Constr. Co. v. U.S.*, 697 F.2d 1389 (Fed. Cir. 1982); 25 GC ¶ 67.

NTS also cited *Sw. Marine, Inc. ex rel. Universal Painting & Sandblasting Corp. v. U.S.*, 680 F. Supp. 327 (N.D. Cal. 1988). In that case, the district court permitted transfer of a time-barred case to the ASBCA, and noted that neither party cited a case on whether the Board could accept transfer of a time-barred case. The COFC noted, however, that *Universal Painting* was decided nine months before *Glenn* and is not binding on the Court. It thus "declines to adopt its rationale in light of *Guardian Angels Medical Service Dogs, Inc.*, *Cosmic Construction*, and its progeny, and the uncertainty surrounding whether the CDA's 90-day and 12-month filing deadlines are jurisdictional."

The Court also questioned NTS' argument for transfer to the ASBCA. NTS argued that the Board case "has progressed further." The COFC said this was "wholly due" to NTS' request to stay COFC proceedings while it considered whether to seek transfer to the Board. The Court said that procedural matters at such an early stage should not allow circumvention of a filing deadline that may be jurisdictional, and the alternative relief would allow NTS to resolve the disputes in a single forum.

The COFC thus denied NTS' motion to transfer the action to the Board, and granted its alternative motion to transfer the ASBCA appeal to the COFC and consolidate the cases.

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