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PRACTICAL TIGHT-KNIT BRIEFINGS INCLUDING ACTION GUIDELINES ON GOVERNMENT CONTRACT TOPICS

FAR 31.205-18, INDEPENDENT RESEARCH & DEVELOPMENT & BID & PROPOSAL COSTS

By Karen L. Manos

Undertaking independent research and development (IR&D) and seeking new work are necessary to sustain most businesses. A company that never developed a new product or service, or at least improved its existing products or services, would not long survive. Similarly, a company that never submitted a bid or proposal for new work could not hope to stay in business for long. Moreover, the Government plainly benefits from advances in technology and improvements in its contractors' products. One need look no further than the military victories in Afghanistan and Iraq to appreciate the value of IR&D. U.S. military forces enjoy a technological superiority unparalleled in the history of warfare. There have been tremendous technological gains since even the 1991 war against Iraq. Perhaps not surprisingly, these advances were made during a period that saw an increasing liberalization of the allowability rules for IR&D. Encouraging Government contractors to engage in IR&D enhances U.S. national security and strengthens the defense industrial and technology base, thereby increasing America's dominance in the global economy. If you are a contractor, the Government also benefits from your obtaining new business, whether Government or commercial, because it expands your allocation base and thereby reduces the Government's costs. Nevertheless, the cost principles governing the allowability of costs have not always allowed the full cost of contractors' IR&D and bid and proposal (B&P) efforts.

IN BRIEF

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This BRIEFING PAPER explains the operation of the Federal Acquisition Regulation "Independent research and development and bid and proposal costs" cost principle (FAR 31.205-18), describes the history of two of the cost principle's key provisions, and examines how the cost principle has been interpreted by the courts and agency boards of contract appeals.

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Operation Of The Cost Principle

The FAR 31.205-18 IR&D/B&P costs cost principle (see Figure 1 on pages 3–4) must be read in conjunction with Cost Accounting Standard 420, “Accounting for independent research and development costs and bid and proposal costs,”¹ which is incorporated in its entirety in the cost principle. Fully-CAS-covered contracts are subject to all of the requirements of CAS 420.² Modified CAS-covered and non-CAS-covered contracts are subject to all of the requirements of CAS 420 except CAS 420-50(e)(2) and (f)(2), unless at the time the contract is awarded, you have another contract subject to CAS 420, in which event all of the requirements of CAS 420 apply.³ For those contracts not subject to CAS 420-50(e)(2) and (f)(2), the cost principle requires that IR&D and B&P costs be allocated to final cost objectives in the same manner as general and administrative (G&A) expenses for that profit center are allocated unless it results in an inequitable allocation.⁴ If the IR&D or B&P costs benefit your other profit centers or the entire company, the costs must be allocated through your other profit centers’ G&A or corporate G&A, as appropriate.⁵

IR&D and B&P costs are generally allowable as indirect costs provided the costs are otherwise reasonable and allocable.⁶ The Armed Services Board of Contract Appeals has consistently rejected Government arguments that IR&D and B&P costs are not allocable when incurred in connection with the contractor’s commercial work.⁷

To qualify as *IR&D*, the effort must (a) fall within one of the following four categories:

(1) basic research, (2) applied research, (3) development, or (4) systems and other concept formulation studies; and (b) not be “sponsored by a grant or required in the performance of a contract.”⁸ Under the Defense FAR Supplement, there are additional limitations for “major contractors” that in the preceding fiscal year allocated more than \$11 million in IR&D/B&P costs to Department of Defense contracts or subcontracts in excess of the simplified acquisition threshold, excluding fixed-price contracts without cost incentives.⁹ If you are a “major contractor,” allowable IR&D/B&P costs are limited to projects determined by the cognizant Administrative Contracting Officer to be of “potential interest to DoD.”¹⁰ Projects of potential interest to the DOD include activities intended to accomplish any of the following:¹¹

- (1) Enable superior performance of future U.S. weapon system and components.
- (2) Reduce acquisition costs and life-cycle costs of military systems.
- (3) Strengthen the defense industrial and technology base of the United States.
- (4) Enhance the industrial competitiveness of the United States.
- (5) Promote the development of technologies identified as critical under 10 U.S.C.A. 2522.
- (6) Increase the development and promotion of efficient and effective applications of dual-use technologies.
- (7) Provide efficient and effective technologies for achieving such environmental benefits as: Improved environmental data gathering, environmental cleanup and restoration, pollution reduction in manufacturing, environmental conservation, and environmentally safe management of facilities.



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Figure 1

FAR 31.205-18 — Independent Research and Development and Bid and Proposal Costs

(a) *Definitions.* As used in this subsection—

“Applied research” means that effort which

- (1) normally follows basic research, but may not be severable from the related basic research,
- (2) attempts to determine and exploit the potential of scientific discoveries or improvements in technology, materials, processes, methods, devices, or techniques, and
- (3) attempts to advance the state of the art. Applied research does not include efforts whose principal aim is design, development, or test of specific items or services to be considered for sale; these efforts are within the definition of the term “development,” defined in this subsection.

“Basic research”(see 2.101).

“Bid and proposal (B&P) costs” means the costs incurred in preparing, submitting, and supporting bids and proposals (whether or not solicited) on potential Government or non-Government contracts. The term does not include the costs of effort sponsored by a grant or cooperative agreement, or required in the performance of a contract.

“Company” means all divisions, subsidiaries, and affiliates of the contractor under common control.

“Development” means the systematic use, under whatever name, of scientific and technical knowledge in the design, development, test, or evaluation of a potential new product or service (or of an improvement in an existing product or service) for the purpose of meeting specific performance requirements or objectives. Development includes the functions of design engineering, prototyping, and engineering testing. Development excludes—

- (1) Subcontracted technical effort which is for the sole purpose of developing an additional source for an existing product, or
- (2) Development effort for manufacturing or production materials, systems, processes, methods, equipment, tools, and techniques not intended for sale.

“Independent research and development (IR&D)” means a contractor’s IR&D cost that consists of projects falling within the four following areas:

- (1) basic research,
- (2) applied research,
- (3) development, and
- (4) systems and other concept formulation studies. The term does not include the costs of effort sponsored by a grant or required in the performance of a contract. IR&D effort shall not include technical effort expended in developing and preparing technical data specifically to support submitting a bid or proposal.

“Systems and other concept formulation studies” means analyses and study efforts either related to specific IR&D efforts or directed toward identifying desirable new systems, equipment or components, or modifications and improvements to existing systems, equipment, or components.

(b) *Composition and allocation of costs.* The requirements of 48 CFR 9904.420, Accounting for independent research and development costs and bid and proposal costs, are incorporated in their entirety and shall apply as follows—

(1) *Fully-CAS-covered contracts.* Contracts that are fully-CAS-covered shall be subject to all requirements of 48 CFR 9904.420.

(2) *Modified CAS-covered and non-CAS-covered contracts.* Contracts that are not CAS-covered or that contain terms or conditions requiring modified CAS coverage shall be subject to all requirements of 48 CFR 9904.420 *except* 48 CFR 9904.420-50(e)(2) and 48 CFR 9904.420-50(f)(2), which are not then applicable. However,

continued...

Figure 1 continued—

non-CAS-covered or modified CAS-covered contracts awarded at a time the contractor has CAS-covered contracts requiring compliance with 48 CFR 9904.420, shall be subject to all the requirements of 48 CFR 9904.420. When the requirements of 48 CFR 9904.420-50(e)(2) and 48 CFR 9904.420-50(f)(2) are not applicable, the following apply:

(i) IR&D and B&P costs shall be allocated to final cost objectives on the same basis of allocation used for the G&A expense grouping of the profit center (see 31.001) in which the costs are incurred. However, when IR&D and B&P costs clearly benefit other profit centers or benefit the entire company, those costs shall be allocated through the G&A of the other profit centers or through the corporate G&A, as appropriate.

(ii) If allocations of IR&D or B&P through the G&A base do not provide equitable cost allocation, the contracting officer may approve use of a different base.

(c) *Allowability.* Except as provided in paragraphs (d) and (e) of this subsection, or as provided in agency regulations, costs for IR&D and B&P are allowable as indirect expenses on contracts to the extent that those costs are allocable and reasonable.

(d) *Deferred IR&D costs.*

(1) IR&D costs that were incurred in previous accounting periods are unallowable, except when a contractor has developed a specific product at its own risk in anticipation of recovering the development costs in the sale price of the product provided that—

(i) The total amount of IR&D costs applicable to the product can be identified;

(ii) The proration of such costs to sales of the product is reasonable;

(iii) The contractor had no Government business during the time that the costs were incurred or did not allocate IR&D costs to Government contracts except to prorate the cost of developing a specific product to the sales of that product; and

(iv) No costs of current IR&D programs are allocated to Government work except to prorate the costs of developing a specific product to the sales of that product.

(2) When deferred costs are recognized, the contract (except firm-fixed-price and fixed-price with economic price adjustment) will include a specific provision setting forth the amount of deferred IR&D costs that are allocable to the contract. The negotiation memorandum will state the circumstances pertaining to the case and the reason for accepting the deferred costs.

(e) *Cooperative arrangements.*

(1) IR&D costs may be incurred by contractors working jointly with one or more non-Federal entities pursuant to a cooperative arrangement (for example, joint ventures, limited partnerships, teaming arrangements, and collaboration and consortium arrangements). IR&D costs also may include costs contributed by contractors in performing cooperative research and development agreements, or similar arrangements, entered into under—

(i) Section 12 of the Stevenson-Wydler Technology Transfer Act of 1980 (15 U.S.C. 3710(a));

(ii) Sections 203(c)(5) and (6) of the National Aeronautics and Space Act of 1958, as amended (42 U.S.C. 2473(c)(5) and (6));

(iii) 10 U.S.C. 2371 for the Defense Advanced Research Projects Agency; or

(iv) Other equivalent authority.

(2) IR&D costs incurred by a contractor pursuant to these types of cooperative arrangements should be considered as allowable IR&D costs if the work performed would have been allowed as contractor IR&D had there been no cooperative arrangement.

(3) Costs incurred in preparing, submitting, and supporting offers on potential cooperative arrangements are allowable to the extent they are allocable, reasonable, and not otherwise unallowable.

This cost limitation does not apply to foreign military sales unless they are wholly paid for from funds made available to the foreign government on a nonrepayable basis.¹²

Deferred IR&D costs are generally unallowable unless that is the only way you are currently charging IR&D. For deferred IR&D to be allowable, the following conditions must be met: (1) you developed a specific project at your own risk in anticipation of recovering the development costs through future sales, (2) the total amount of IR&D costs applicable to that product can be identified, (3) your proration of IR&D costs is reasonable, (4) you either had no Government business during the time the costs were incurred or did not allocate IR&D costs to any Government contracts except to prorate the costs of deferred IR&D, and (5) no costs of current IR&D programs are allocated to your Government work except to prorate the costs of deferred IR&D.¹³

To qualify as *B&P* costs, the effort must not be “sponsored by a grant or cooperative agreement, or required in the performance of a contract.”¹⁴ By excluding costs of effort sponsored by a cooperative agreement, the FAR definition of B&P costs is more restrictive than the definition of IR&D costs and the CAS 420 definition of B&P costs. The CAS 420 definition of B&P costs mirrors the definition of IR&D costs: “*Bid and proposal (B&P) cost* means the cost incurred in preparing, submitting, and supporting any bid or proposal which effort is neither sponsored by a grant, nor required in the performance of a contract.”¹⁵ Paragraph (e) of the cost principle, which addresses cooperative agreements, also differentiates between IR&D costs and B&P costs. Whereas IR&D costs incurred pursuant to a cooperative arrangement are allowable, even if they include the contractor’s share of costs contributed to a cooperative research and development agreement, only B&P costs incurred in pursuit of *potential* cooperative arrangements are allowable.¹⁶

History Of The Cost Principle

Two aspects of the IR&D/B&P costs cost principle have proven particularly contro-

versial: (1) determining when an IR&D or B&P effort is “required in the performance of a contract” or “sponsored by a grant or cooperative agreement”; and (2) determining the allowability of B&P costs incurred in connection with contractor teaming arrangements.

■ “Independent” vs. “Sponsored” Or “Required” Effort

The revisions to the costs principle that took effect on January 1, 1972, changed the definition of what constitutes *independent* research and development. As initially promulgated in 1959, Armed Services Procurement Regulation 15-205.35 provided that IR&D “is that research and development which is not sponsored by a contract, grant, or other arrangement.”¹⁷ The ASPR Committee in 1968 proposed changing the “not sponsored by” language to “not sponsored by, or in support of, a contract or grant.”¹⁸ The Council of Defense and Space Industry Associations (CODSIA) expressed concern that the proposal would be a “source for future misinterpretation” because the phrase “in support of” could potentially be construed as including IR&D programs completely unrelated to a contractor’s Government contracts.¹⁹ The ASPR Committee agreed that this was a valid concern and issued a revised draft changing the definition to read: “A contractor’s independent research and development effort (IR&D) is that technical effort which is not sponsored by, or required in the performance of, a contract....”²⁰ CODSIA suggested that the limitation be further narrowed to “technical effort which is not sponsored by, or *specifically required* by contract provisions in performance of, a contract or grant.”²¹ CODSIA’s letter explained: “The additions of the word ‘specifically’ and words ‘by contract provisions’ are suggested because such language protects both of the contracting parties from misinterpreting this definition in cases where there may be some doubt as to whether certain work is required by the contract.”²² The ASPR Committee did not adopt CODSIA’s suggestion, and Defense Procurement Circular No. 90, published on September 1, 1971, amended the definition in ASPR

15-205.35 to state that IR&D “is that technical effort which is not sponsored by, or required in the performance of, a contract or grant.”²³

In a 1974 report, the General Accounting Office asserted that the ASPR’s revised definition of IR&D merely clarified the previous definition, and that it excluded from IR&D not only that technical effort explicitly required by the terms of a contract, but also the effort implicitly required to fulfill the contract’s objectives.²⁴ Among the military services, only the Navy agreed that the ASPR limitation included technical effort implicitly required by a contract, but only as a result of the 1972 amendment. However, in a subsequent report, the GAO noted:²⁵

In our draft of this report we pointed out that Navy contractors were unwilling to certify that their IR&D programs did not contain technical effort implicitly required by the terms of a contract. According to the Navy IR&D negotiator, contractors believe that “implicitly” covers such a broad spectrum that almost any effort could be considered unallowable as IR&D. We suggested that the Secretary of Defense initiate action to revise ASPR to specifically state that technical effort implicitly required to meet the purchaser’s requirements under the terms of a contract or production order is not allowable IR&D.

Neither the DOD nor industry agreed with the GAO’s position. In a letter commenting on the draft GAO report, including the GAO’s contention that the DOD should not subsidize the cost of contractors’ product support for commercial products, the Director of Defense Research and Engineering stated:²⁶

It has been the policy of the Department of Defense to allow recovery, as an overhead charge, of reasonable amounts of technical effort necessary to the operation of the business. This effort has been given the generic name of IR&D and includes, by definition, that post-production, technical assistance called product support that any manufacturer provides to his customers to assure the proper functioning of his products in the hands of those customers. Also by definition, product support is not effort required in the performance of a contract but rather, among other things, is that technical effort required to answer problems arising in operating the products in environments slightly different than originally intended or in providing technical

information useful to the smooth introduction of the products into the customers’ activities. The key question, therefore, concerning the allowability of product support as IR&D is the question of whether the effort was *specified as a deliverable requirement of an existing contract*.

Although the DOD expressed willingness to revise the IR&D cost principle “to include appropriate definitions of such terms as product support and product improvement,” it was not willing to adopt the GAO’s suggestion regarding work “implicitly required” by the terms of a contract.²⁷ The DOD’s letter stated: “The question of revising the ASPR to include the concept that all work implicitly required by a contract should not be allowed as IR&D leaves a great deal of impreciseness in the definition.”²⁸

The GAO report also attached a copy of a letter from General Electric Company, which similarly rejected GAO’s interpretation:²⁹

We are...aware of no legal support for the proposition expressed in the draft report that the ASPR definition of IR&D precludes the charging of costs which are “implicitly” related to a contract. Unless the contract provides funding for, or at least requires within its scope of work the technical effort under consideration, the costs of that technical effort is properly chargeable to IR&D. This is true even where the contract *assumes* that the fruits of the IR&D effort will be incorporated in the equipment delivered.

■ B&P Costs & Teaming Arrangements

Section 802 of the National Defense Authorization Act for Fiscal Years 1992 and 1993 eliminated the former requirement for negotiating an advance agreement regarding the allowability of IR&D and B&P costs and directed the DOD to prescribe regulations making IR&D/B&P costs allowable as indirect expenses to the extent the costs are allocable, reasonable, and not otherwise unallowable by law or the FAR cost principles.³⁰ Among other changes, the subsequent 1992 implementing revision to the IR&D/B&P costs cost principle modified the definition of IR&D to exclude “effort sponsored by a grant or required in the performance of a contract,” but there is no indication that this revision to the former exclusion from the definition of cost “sponsored

by, or required in the performance of, a contract or grant” was intended to make any substantive change in the cost principle.³¹ For many contractors, the new rules took effect immediately upon promulgation of the implementing revision to the cost principle. There was a three-year phase-in period for major contractors that received more than \$10 million in IR&D/B&P costs in the preceding fiscal year.³²

The legislative history of the Act makes clear that Congress wanted to enhance the DOD’s authority to pay both IR&D and B&P costs, including costs incurred through a contractor’s participation in consortia and cooperative agreements. As the Conference Report notes:³³

The conference agreement would eliminate both the advance agreement and formal technical review process. All independent research and development and bid and proposal costs would be reimbursed to the extent that they are reasonable, allocable, and not otherwise made unallowable by law or regulation.

The conferees note that in the past, questions have arisen as to whether such costs, when incurred by a contractor through participation in consortia or cooperative agreement, would be reimbursable. The conferees agree that such costs should be reimbursed. Under the conference agreement, such costs would be fully reimbursable to the extent that they are reasonable, allocable, and not otherwise disallowed under applicable laws or regulations.

Consistent with this congressional policy, in two memoranda dated April 22, 1993, Under Secretary of Defense John M. Deutch informed the secretaries of the military services, directors of the Defense Logistics Agency and the Defense Contract Audit Agency, and CODSIA of the need to “change the Department of Defense’s (DoD) fundamental approach to acquisition and research and development in order to keep pace with reduced defense budgets and other challenges of the Post-Cold War era.”³⁴ Therefore, he said, “DoD will increase its emphasis on the development of dual-use technologies, processes and products and on the integration of military and commercial manufacturing and business practices.”³⁵ Under Secretary Deutch further ex-

plained that the National Defense Authorization Act for FYs 1992 and 1993 made “significant changes” in the treatment of IR&D/B&P costs to provide an “incentive” for contractors to invest in dual-use technologies and to expand their businesses beyond traditional military procurement.³⁶ Under the Act and its implementing regulations, he wrote, IR&D/B&P has been expanded to cover contractors’ work in areas “that increase the development and promote efficient and effective applications of dual-use technologies, those that promote critical technologies, and those that enhance the industrial competitiveness of the United States.”³⁷

In enunciating the policy of encouraging contractors to invest in dual-use technologies, neither Congress nor Under Secretary Deutch drew any distinction between IR&D costs and B&P costs. To the contrary, they recognized that both IR&D and B&P costs are equally important to furthering the policy, and they treated the costs as interchangeable. However, in implementing this provision of the statute, the cost principle’s coverage was inexplicably limited to IR&D. By final rule effective September 24, 1992, the following new paragraph (e) was added to the cost principle:³⁸

Cooperative arrangements. IR&D effort may be performed by contractors working jointly with one or more non-Federal entities pursuant to a cooperative arrangement (for example, joint ventures, limited partnerships, teaming arrangements, and collaboration and consortium arrangements). IR&D effort may also be performed by contractors pursuant to cooperative research and development agreements, or similar arrangements, entered into under (1) section 12 of the Stevenson-Wydler Technology Transfer Act of 1980 (15 U.S.C. 3710(a)); (2) sections 203(c)(5) and (6) of the National Aeronautics and Space Act of 1958, as amended (42 U.S.C. 2473(c)(5) and (6)), when there is no transfer of Federal appropriated funds; (3) 10 U.S.C. 2327 for the Defense Advanced Research Projects Agency; or (4) other equivalent authority. IR&D costs incurred by a contractor pursuant to these types of cooperative arrangements should be considered as allowable IR&D costs if the work performed would have been allowed as contractor IR&D had there been no cooperative arrangement.

The drafters' comments explain that the term "arrangement" was used instead of "agreement" to "avoid confusion with the meaning of 'cooperative agreement' as it is used in the Federal Grant and Cooperative Agreement Act of 1977 (Pub. L. 95-224)."³⁹ No explanation was provided for limiting the coverage of paragraph (e) to IR&D costs.

On August 21, 1995, the FAR Councils published a proposed rule to revise the definition of B&P costs in FAR 31.205-18 "to clarify that B&P costs related to all types of funding instruments (e.g., contracts, grants, cooperative agreements, and other similar types of agreements) are allowable costs."⁴⁰ The comments accompanying the proposal stated:⁴¹

The definition currently does not address proposal costs associated with grants or cooperative agreements. This change was requested by the Director of Defense Procurement to address an issue which arose under a competition being conducted by the Advanced Research Projects Agency (ARPA) and to make the cost principle compatible with the definition of B&P costs in Cost Accounting Standard 420 (4 CFR 9904.420-30).

The FAR Councils withdrew the proposal the following year with this cryptic explanation: "As a result of the public comments received in response to the proposed rule, the Councils have determined that the existing FAR definition of B&P costs should not be changed to avoid potential conflicts with cost accounting standards; imposing unnecessary changes in certain contractor accounting practices; and possible misinterpretations of the proposed B&P cost definition."⁴²

The FAR Councils amended paragraph (e) of FAR 31.205-18 twice in 1997. The first revision eliminated the prohibition against treating contractor IR&D contributions under National Aeronautics and Space Administration cooperative arrangements as allowable indirect costs, thereby obviating the need for NASA's class deviation.⁴³ The second revision added coverage for B&P costs.⁴⁴ In commenting on the proposed rule for the second revision, both the National Security Industrial Association and

American Bar Association Section of Public Contract Law recommended that the Councils revise paragraph (e) to include "and B&P" after IR&D wherever it appears.⁴⁵ The ABA Section further encouraged the Councils "to bring the cost principle into line with Congressional intent and eliminate the disparate treatment of IR&D and B&P costs by deleting the words 'or cooperative agreement' from the definition of B&P costs."⁴⁶ The Councils' Cost Principles Committee rejected both suggestions:⁴⁷

The Committee does not agree that the term "or B&P" should be added after "IR&D" each time it appears in FAR 31.205-18(e), or that the definition of B&P should be revised as suggested. These two recommendations were previously made in response to the proposed rule issued under FAR Case 93-018. The Committee rejected both suggestions.

Based on public comments received under FAR Case 93-018, it was evident the existing FAR definition of B&P costs should not be changed because doing so could inadvertently require some contractors to change their existing cost accounting practices unnecessarily. In addition, adding the term "or B&P" after "IR&D" could mistakenly imply that B&P costs incurred pursuant to a requirement of a cooperative agreement should be charged indirect instead of direct, or that contractors should use B&P costs as part of their contributions under an arrangement.

Without explanation, the wording of the final rule was in one respect more limited than the proposed rule. Whereas the proposed rule stated that costs "incurred in pursuit of cooperative arrangements are allowable," the final rule stated that costs "incurred in preparing, submitting, and supporting offers on *potential* cooperative arrangements are allowable"⁴⁸ The final rule also revised the cost principle to remove the requirement to calculate or negotiate a ceiling on the allowability of IR&D/B&P costs.⁴⁹

Case Law Interpretation

Because there is considerable overlap between the terms defined in FAR 31.205-18 and other cost principles, as shown in the chart in Figure 2 on page 10, and because the definitions themselves are somewhat amorphous, it is often un-

clear whether the costs of a particular activity should properly be characterized as (1) B&P, (2) IR&D, (3) manufacturing and production engineering under FAR 31.205-25, (4) pre-contract costs under FAR 31.205-32, (5) selling costs under FAR 31.205-38, or (6) effort sponsored by a grant or cooperative agreement or required in the performance of a contract. The cost principle's definitional deficiencies have been widely criticized,⁵⁰ and the courts and boards have struggled in interpreting its terms.⁵¹ Nevertheless, the DOD has steadfastly resisted resolving these definitional problems. Consequently, the definitions will continue to evolve through case law, including, unfortunately, in the context of civil False Claims Act suits and criminal prosecutions for alleged mischarging. As recently as February 3, 2003, the Department of Justice announced that it had filed suit against a major defense contractor for allegedly mischarging as IR&D the costs of effort required in the performance of its commercial contracts.⁵²

The appropriate classification of an activity depends on the contractor's *primary* purpose for engaging in it.⁵³ It is an objective test in which the tribunal "must look to the contractual definitions, examine both the overt acts of the parties as well as *expressed* intent, and then determine from all of these how the work concerned and costs incurred should be categorized."⁵⁴

■ "Independent" vs. "Sponsored" Or "Required" Effort

In interpreting the term "sponsored" as used in the cost principle, the ASBCA has held that the costs of research projects in excess of contributions from outside sources are allowable as IR&D costs because, at least to that extent, the projects are not "sponsored" by the outside sources.⁵⁵ The ASBCA reasoned as follows:⁵⁶

At a minimum, the [cost principle language] was intended to insure that a contractor performing research and development work would not be paid twice for its effort, i.e., once under a contract covering the work directly, and a second time, in part at least, by an overhead markup resulting from research and development

costs applied to all of the Government contracts which the contractor had.

In the absence of any guidance as to interpretation, the ASBCA adopted the contractor's "common sense" argument that because there would be no question that the costs were allowable if the contractor had undertaken the research without any financial assistance from outside sources, it would be anomalous to penalize the contractor for having obtained private contributions that effectively reduced the Government's costs.⁵⁷

Cases construing the term "required by" are not entirely consistent. One case involved costs incurred under a cost-plus-fixed-fee incrementally funded subcontract.⁵⁸ After reaching the funds limitation amount, the contractor continued to work, charging some of the costs to its B&P account and some to its IR&D account. The Government argued that the effort was "required" by the terms of the subcontract, and therefore should have been treated as an unallowable cost overrun. The ASBCA disagreed, holding that the costs were properly chargeable to IR&D and B&P because the contractor was not contractually obligated to perform the work.⁵⁹

In another case, a federal district court in California held that the DCAA committed professional malpractice by challenging the allowability of costs incurred on a firm-fixed-price (best efforts) contract after funding for the contract expired.⁶⁰ That case involved a contract to develop two prototypes for the Divisional Air Defense System (DIVAD). The contract stipulated that the contractor, General Dynamics Corporation, was required only to provide its "best efforts" to meet the contract requirements and had no obligation to continue working after it had expended the contract funds.⁶¹ After the Army chose not to fund the contract's options, the contractor decided to continue work and informed the Army that it was charging its effort to its B&P and IR&D accounts.⁶² Apparently not understanding the difference between a firm-fixed-price contract and a firm-fixed-price (best efforts) contract, the DCAA erroneously determined that General

Figure 2
Overlapping Definitions

<p>B&P: “costs incurred in preparing, submitting, and supporting bids and proposals (whether or not solicited) on potential Government or non-Government contracts,” <i>but not including</i> “the costs of effort sponsored by a grant or cooperative agreement, or required in the performance of a contract.” FAR 31.205-18(a).</p>	<p>Direct Selling: “those acts or actions to induce particular customers to purchase particular products or services of the contractor.” FAR 31.205-38(c)(1).</p>	<p>Precontract Costs: “costs incurred before the effective date of the contract directly pursuant to the negotiation and in anticipation of the contract award when such incurrence is necessary to comply with the proposed contract delivery schedule.” FAR 31.205-32.</p>
<p>IR&D: <i>Basic research</i>—“that research directed toward increasing knowledge in science,” with the “primary aim of...a fuller knowledge or understanding of the subject under study, rather than any practical application of that knowledge.” FAR 2.101.</p> <p><i>Applied research</i>—“that effort which (1) normally follows basic research, but may not be severable from the related basic research, (2) attempts to determine and exploit the potential of scientific discoveries or improvements in technology, materials, processes, methods, devices, or techniques, and (3) attempts to advance the state of the art,” <i>but not including</i> “efforts whose principal aim is design, development, or test of specific items or service to be considered for sale; these efforts are within the definition of the term ‘development,’ defined in this subsection.” FAR 31.205-18(a).</p> <p><i>Development</i>—“the systematic use, under whatever name, of scientific and technical knowledge in the design, development, test, or evaluation of a potential new product or service (or of an improvement in an existing product or service) for the purpose of meeting specific performance requirements or objectives,” including “the functions of design engineering, prototyping, and engineering testing,” <i>but not including</i> “(1) Subcontracted technical effort which is for the sole purpose of developing an additional source for an existing product,...(2) Development effort for manufacturing or production materials, systems, processes, methods, equipment, tools, and techniques not intended for sale,” (3) “costs of effort sponsored by a grant or required in the performance of a contract,” or (4) “technical effort expended in developing and preparing technical data specifically to support submitting a bid or proposal.” FAR 31.205-18(a).</p>	<p>Manufacturing and Production Engineering: “(1) Developing and deploying new or improved materials, systems, processes, methods, equipment, tools and techniques that are or are expected to be used in producing products or services; (2) Developing and deploying pilot production lines; (3) Improving current production functions, such as plant layout, production scheduling and control, methods and job analysis, equipment capabilities and capacities, inspection techniques, and tooling analysis (including tooling design and application improvements); and (4) Material and manufacturing producibility analysis for production suitability and to optimize manufacturing processes, methods, and techniques,” <i>but not including</i> “(1) Basic and applied research effort...related to new technology, materials, systems, processes, methods, equipment tools and techniques” or “(2) “Development effort for manufacturing or production materials, systems, processes, methods, equipment, tools, and techniques that are not intended for sale....” FAR 31.205-25.</p>	<p>Precontract Costs: “costs incurred before the effective date of the contract directly pursuant to the negotiation and in anticipation of the contract award when such incurrence is necessary to comply with the proposed contract delivery schedule.” FAR 31.205-32.</p>

Dynamics had mischarged over \$8 million of DIVAD contract costs and reported it as suspected fraud to the Naval Investigative Service and the DOJ. The DOJ, in turn, launched a three-and-a-half year criminal investigation, subpoenaing millions of documents, interviewing numerous witnesses, and obtaining a grand jury indictment against the contractor and four of its employees. After belatedly determining the significance of the fact that the contract was a fixed-price (best efforts) contract and not a firm-fixed-price contract, the DOJ voluntarily dismissed the case.⁶³

In the ensuing Federal Tort Claims Act suit for costs that the contractor incurred as a result of the DCAA's malpractice, the district court rejected the Government's argument that, even if the work were not required, the costs had to be charged directly to the DIVAD contract because the work could be specifically identified with that contract and, therefore, could not be treated as IR&D or B&P. The district court stated:⁶⁴

[T]he IR&D and B&P regulations themselves state that work *required* in the performance of a contract cannot be charged to IR&D and B&P. (32 C.F.R. §§ 15-205.35, 15-205.3 (1977) (emphasis added). The IR&D and B&P regulations never use the term "specifically identifiable," nor do they in any way suggest that the term has significance with respect to what is and what is not IR&D and B&P. Indeed,...the government's IR&D and B&P expert, testified that in order to determine whether something was more appropriately charged to the DIVAD contract or, rather, to IR&D or B&P, the proper inquiry was to determine what was required under the contract's statement of work.

The district court awarded General Dynamics nearly \$26 million in damages.⁶⁵ The United States Court of Appeals for the Ninth Circuit reversed, holding that because the harm was caused by the prosecutor's exercise of discretion, not the DCAA's negligent audit report, the suit was barred by the discretionary function exception to the Federal Tort Claims Act.⁶⁶

Consistently, the U.S. Court of Appeals for the Federal Circuit has rejected the Government's argument that all costs "related

to" or "caused or generated" by a contract must be charged directly to that contract instead of as B&P and has held that only the costs of proposals "specifically required" by the terms of the contract must be charged directly to that contract.⁶⁷ In that case, the contractor was awarded a Phase I contract that required submission of a proposal for Phase 2.⁶⁸ The contractor charged to B&P all of its costs of preparing to win the Phase II contract, except for the costs incurred from the time it received the request for proposals for the Phase II proposal until it submitted the Phase II proposal.⁶⁹ The Federal Circuit concluded that the contractor's allocation was proper:⁷⁰

As a result of the government's Phase I contract acceptance, only the Phase 2 proposal costs delineated in [the contractor's] best and final offer—those incurred between Phase 2 [RFP] receipt and Phase 2 proposal submission—were *specifically required* by an existing contract. [The contractor] allocated those B&P costs directly to the contract because they were incurred in different circumstances from [the contractor's] overall B&P efforts. Although other Phase 2 B&P costs may have been generated by the Phase 1 contract, no *contractual obligation* existed which would differentiate these costs from other B&P costs. Thus, these costs were properly allocated as indirect B&P costs.

United States ex rel. Mayman v. Martin Marietta Corp. was a False Claims Act case involving allegations that Martin Marietta defrauded the Government by intentionally underbidding a contract to design and build a Supersonic Low Altitude Target (SLAT) with the intent of recovering the excess costs through IR&D.⁷¹ Martin Marietta moved to dismiss, arguing, among other things, "that the IR&D work, while in support of the SLAT contract, had potential applicability to other future contracts."⁷² The district court acknowledged but expressly left open the issue whether the term "required" includes work "implicitly required" by the contract.⁷³

It may be that there are some grey areas in the relevant regulations which result in confusion and honest mistakes on the part of some government contractors. For example, there is considerable debate over whether a particular task is "required" by a contract and therefore cannot be billed to IR&D. One view is that contractor can bill to IR&D any work

not explicitly called for in the contract. An alternative view is that a contract includes everything implicitly necessary to carry it out. In any case, the story depicted by the Government, and accepted as true for the purposes of this Motion, does not fall into any grey area.

Because it was undisputed, at least for purposes of deciding the motion to dismiss, that the work was required by the SLAT contract, the district court held that the costs could not properly be charged to IR&D.⁷⁴

United States v. Newport News Shipbuilding, Inc., another False Claims Act case, was the first case to squarely address the issue whether work *implicitly* required by a contract qualifies as IR&D.⁷⁵ The contractor, relying on the advice of its in-house counsel and a partner at a major accounting firm, charged to IR&D what it characterized as “generic” design work for double-hulled commercial tankers and charged to the commercial tanker contracts only the design work explicitly required by those contracts. The district court rejected the contractor’s interpretation of FAR 31.205-18 and held, based on the “FAR’s plain language,” as follows:⁷⁶

First, the exclusion from IR&D of the cost of efforts “required in the performance of a contract” must be read to include efforts which are not explicitly stated in the contract, but are nonetheless required by it. This follows from the plain language of the regulation itself. This language does not exclude from IR&D those efforts “required by” a contract, a phrase that might be read to refer only to efforts explicitly called for in the contract. Instead, the regulatory language excludes from IR&D all efforts “required *in the performance of a contract*.” This locution plainly focuses the inquiry on all efforts required in *performing* the contract, not simply on efforts explicitly called for by the contract, whether designated in the contract’s statement of work or required as an explicit deliverable. Although the regulation might have been more explicit in its intent to reach implicit requirements, the plain meaning of “required in the performance of a contract” includes those efforts that are implicitly required to perform the work as well as those efforts explicitly called for in the contract.

Second, it is clear that the plain language of the regulation does not allow charging of research and design efforts as I&RD simply because they are a benefit to more than one existing contract.

The court observed that the dividing line between IR&D and work required in the performance of a contract is not whether the work is explicitly or implicitly required, but rather, whether the work is performed before or after the contract is signed. The court stated:⁷⁷

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 of 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 the performance of that contract may no longer be charged as I&RD. Thus, for example, a shipbuilding contractor may engage in independent research and development to design a new radio antenna for a ship class and, provided other requirements are met, may charge that effort to IR&D. However, once a contract for such a ship is signed, any further radio antenna design effort that is incorporated into that ship may no longer be charged as IR&D, even if that further design effort benefits the entire ship class. And this is so whether or not the contract explicitly requires the shipbuilder to design the new radio antenna and whether or not the contract explicitly names the new radio antenna design as a “deliverable” of the contract.

The court denied the parties’ cross-motions for summary judgment on whether the contractor had “knowingly” violated the False Claims Act, finding that there were material facts in dispute. The parties settled the case six days after the court’s decision was filed.⁷⁸

The rules regarding allocability of B&P costs may have been muddled as an unintended consequence of the Federal Circuit’s decision in a case involving the recovery of proposal preparation costs in the context of a bid protest.⁷⁹ In that case, the Government allowed the contractor’s proposal preparation costs incurred before submission of the proposal, but denied the contractor’s post-submission costs, including the costs of developing a prototype.⁸⁰ The Federal Circuit began its analysis by determining that the definition of B&P under the applicable pre-

FAR Federal Procurement Regulation 1-15.205-3 was broad enough to encompass a prototype because the definition included “the development of engineering data and cost data necessary to support the contractor’s bids or proposals,” and a prototype generates engineering data.⁸¹ The court then reasoned that postsubmission costs are allowable in a negotiated procurement provided the costs are incurred in support of the negotiations and not for the purpose of getting an early start on contract performance.⁸² The court concluded by holding that if the contractor built the prototype “pursuant to ongoing negotiations,” the cost of building the prototype was allocable and that “the cost of building the prototype here clearly was incurred specifically for the contract.”⁸³ If the cost of building the prototype was in fact incurred specifically for the contract, it probably would not meet the definition of B&P.

Another bid protest cost case, *TRW, Inc. v. United States*, does a better job of explaining why proposal preparation costs are recoverable without confusing the normal rules of allocability.⁸⁴ In that case, the agency moved for partial summary judgment, arguing that (1) the contractor had already been paid \$2.1 million of the \$2.9 million it sought in proposal preparation costs through its B&P advance agreement, and (2) it would be inconsistent with CAS 402, “Consistency in allocating costs incurred for the same purpose,”⁸⁵ for the contractor to charge the proposal preparation costs directly when all of its other B&P costs were charged indirectly.⁸⁶ The Court of Federal Claims rejected both arguments. With regard to the first argument, the court found that the contractor’s total uncompensated B&P costs (i.e., the B&P costs it incurred in excess of the negotiated ceiling) exceeded the amount claimed in connection with the IRS solicitation.⁸⁷ With regard to the second argument, and more pertinent for the purposes of this discussion, the court held that the contractor was not changing its accounting practices, it was merely seeking to recover damages.⁸⁸ The court stated:⁸⁹

[E]ven assuming for purposes of argument that the costs were incurred in similar or like circumstances, this does not mean that it would be inconsistent with accounting standards for the court to permit plaintiff to recover the...B&P costs in a [bid protest]. If the court concludes that defendant breached its implied agreement and orders defendant to pay damages in the amount of plaintiff’s B&P costs, then pursuant to [FAR] § 31.201-5, plaintiff is obliged to credit the government in the form of a cost reduction for the amount of the recovery.

■ Independent Development vs. Manufacturing & Production Engineering

The 1972 revision to the IR&D/BP cost principle that added the phrase “required in the performance of a contract” to the definition of “independent” also changed the definition of “development.” As initially promulgated, the definition of “development” contained an exclusion for “manufacturing and production engineering.”⁹⁰ Although the cost principle for manufacturing and production engineering did not change, the 1972 revision eliminated the manufacturing and production engineering exclusion from the definition of development.⁹¹ The ASBCA held that notwithstanding the elimination of the manufacturing and production engineering exclusion, because the cost principle for manufacturing and production engineering “remained unchanged, and since tool design and improvement was specifically allowable therein, it would not also be allowable as independent research and development.”⁹² On that basis, the board upheld a contractor’s capitalization of the costs of developing a software tool for internal use.⁹³

In *Aydin Corp. (West)*, the contractor had a commercial contract to develop a prototype of a three-dimensional radar.⁹⁴ The contract funds expired before the contractor completed the prototype, and the contractor continued the development using its own funds. Having already exceeded its IR&D ceiling, the contractor capitalized the costs of the prototype and included the depreciation costs in its G&A expense pool, claiming that the radar had become a depreciable capital asset. The board rejected the contractor’s argument, holding

that the work, in addition to being specifically required by the terms of the commercial contract, “fell within the FAR 31.205-18(a) definition of ‘development’ which included ‘the function of design engineering, prototyping, and engineering testing,’” and should therefore have been charged as IR&D in the years incurred.⁹⁵ The Federal Circuit affirmed this aspect of the board’s holding, but on the ground that the development of the radar was an IR&D expense under generally accepted accounting principles and therefore could not be depreciated.⁹⁶

United States ex rel. Bagley v. TRW, Inc. involved a similar issue.⁹⁷ The contractor, TRW, over the objection of its then director of financial control (and future qui tam relator), Richard D. Bagley, capitalized some of the costs of developing a prototype solar array wing.⁹⁸ (A second mischarging allegation in this case—that the costs of TRW’s Odyssey communications system proposal should not have been charged as B&P, is discussed below.) Because TRW had exceeded its negotiated IR&D ceiling for the years in which the solar array costs were incurred, if the costs had not been capitalized, they would have been unallowable.⁹⁹ TRW funded the solar array project with a combination of IR&D and capital funds, a fact that was fully disclosed to the Government in TRW’s technical plans submitted as part of the IR&D advance agreement negotiations.¹⁰⁰ Based in large part on TRW’s internal documents approving funding, the district court concluded that the primary objective of the project was to demonstrate and qualify a prototype solar array wing for the purpose of future sales, and that this objective did not change over the life of the project.¹⁰¹ Therefore, the court concluded, the costs met the definition of “development” and should have been charged as IR&D.

While *Bagley* was pending, the contractor filed and eventually appealed to the ASBCA two “no cost” claims seeking a determination that the IR&D and B&P costs (discussed below) were allowable. The ASBCA determined that the district court’s decisions in

favor of the Government did not preclude the contractor from continuing to pursue its appeals before the board.¹⁰² The ASBCA subsequently denied the contractor’s motions for summary judgment in both appeals, concluding that the contractor had not shown that it was entitled to judgment as a matter of law.¹⁰³ In the interim, TRW was acquired by Northrop Grumman Corporation, and on June 9, 2003, Northrop announced that it had agreed to pay \$111.2 million to settle the *Bagley* case.¹⁰⁴

■ B&P vs. Selling

The issue whether costs were properly classified as B&P or “direct selling” arose after the GAO sustained a protest that an agency’s decision to proceed in procuring on a sole-source basis was unwarranted because the agency had improperly concluded that the protester was not a viable source.¹⁰⁵ In the subsequent bid protest proposal preparation costs decision, the GAO ruled that the protester could not recover costs incurred in providing information to the agency during its market research to determine whether to proceed on a sole-source or competitive basis.¹⁰⁶ The GAO determined that the activity was more properly classified as “direct selling” than B&P because the agency never requested proposals or otherwise indicated that the briefings and informal meetings would result in a contract, and neither the agency nor the protester viewed the activities as proposal-related.¹⁰⁷

■ Teaming Agreements

The district court’s decision in *United States ex rel. Bagley v. TRW Inc.* regarding proposal costs incurred pursuant to a teaming agreement¹⁰⁸ and the subsequent ASBCA decision denying TRW’s motion for summary judgment on the same issue¹⁰⁹ point up a significant problem with the cost principle’s disparate treatment of IR&D and B&P costs and call into question a commonly followed accounting practice. That aspect of the *Bagley* case involved TRW’s Odyssey communications system, a network of medium-earth-orbit sat-

ellite and ground stations intended to permit worldwide telephone communications, including in regions without land-line or cellular telephone service. In 1994, TRW and Teleglobe Telecommunications Inc. signed a Memorandum of Agreement (MOA) to work together to finance and commercialize the Odyssey system.¹¹⁰ The MOA provided that (1) TRW and Teleglobe would form a limited partnership joint venture, (2) TRW would prepare a firm fixed-price proposal to build and sell the Odyssey system to the limited partnership, and (3) the cost of TRW's proposal activity would be included in the definitive commercial agreement between TRW and the limited partnership for procurement of the Odyssey system.¹¹¹ TRW and Teleglobe formed the limited partnership, and TRW submitted the proposal, but the parties abandoned the project before consummating a definitive commercial agreement.¹¹² TRW treated the costs of its proposal activity as B&P. Mr. Bagley, by then a former employee, brought a *qui tam* suit under the False Claims Act, alleging that the proposal costs should have been charged directly to the Odyssey project.

The Government acknowledged "that the Odyssey proposal costs would have been recoverable if TRW had undertaken that work independently and apart from any arrangements with any other entity, instead of pursuant to the MOA."¹¹³ However, the court held that because the costs incurred in preparing the Odyssey proposal were "costs of effort... required in the performance of a contract," they were "excluded from the definition of 'B&P' under FAR 31.205-18(a)."¹¹⁴ Moreover, the court held, FAR 31.205-18(e)(3) relates only to "*potential* cooperative arrangements," and since the teaming agreement was an *actual* cooperative arrangement, the costs were unallowable under that paragraph of the cost principle as well.¹¹⁵

Just as with IR&D effort, contractors often work jointly with other entities pursuant to cooperative arrangements to prepare, submit, and support bids and proposals on potential work.¹¹⁶ Although the costs of an IR&D

effort incurred pursuant to a teaming agreement are plainly allowable under paragraph (e) of the cost principle, *Bagley* holds that B&P costs incurred in precisely the same circumstances are unallowable. It is difficult to fault the district court's reading of the cost principle. The real problem is the cost principle itself. To illustrate the point, assume that the Air Force is soliciting proposals for a new generation fighter. If Contractor A, working independently, submits a proposal, the costs that it incurs are plainly recoverable as B&P costs. If Contractor A and Contractor B agree that they will form a joint venture to act as a potential prime contractor, or agree that if A wins the competition, A will award B a subcontract, the costs they incur in preparing and submitting a proposal are still recoverable as B&P costs so long as their agreement does not *require* either of them to prepare or submit a proposal. But, if A and B's agreement *requires* one or both of them to prepare a proposal, the costs they incur are unallowable. As a matter of policy, if not logic, that makes absolutely no sense. The FAR recognizes that contractor teaming arrangements benefit both the Government and contractors:¹¹⁷

(a) Contractor team arrangements may be desirable from both a Government and industry standpoint in order to enable the companies involved to—

(1) Complement each other's unique capabilities; and

(2) Offer the Government the best combination of performance, cost, and delivery for the system or product being acquired.

(b) Contractor team arrangements may be particularly appropriate in complex research and development acquisitions, but may be used in other appropriate acquisitions, including production.

(c) The companies involved normally form a contractor team arrangement before submitting an offer. However, they may enter into an arrangement later in the acquisition process, including after contract award.

Given the significant cost and effort involved in competing for large acquisitions, companies are generally reluctant to form a teaming arrangement in the absence of a binding agree-

ment.¹¹⁸ By disallowing what would otherwise be allowable B&P costs simply because the contractors have a binding agreement to submit a proposal, the cost principle effectively discourages such teaming arrangements. A potential solution to the problem—besides the obvious and easier solution of just correcting the cost principle—would be for Contractor A to award a subcontract to Contractor B, separate and apart from the teaming agreement, requiring Contractor B to prepare the team's proposal. The amount paid by A to B would be recoverable as B&P costs for A since nothing in the cost principle requires that the contractor prepare

its own proposals. The disadvantage of this proposed approach is that if the entire cost of the proposal effort were borne by A (i.e., if A fully reimbursed B's costs), then A's B&P costs would be twice as high as they otherwise would, and the resultant increase in A's G&A rates may put A at a competitive disadvantage. However, if this proposed approach were to be adopted throughout the industry, presumably the costs would even out because a contractor would presumably sometimes act as the prime contractor (incurring all of the B&P costs) and sometimes act as the subcontractor (incurring none of the B&P costs).

GUIDELINES

These *Guidelines* are designed to assist you in ensuring the allowability of your IR&D/B&P costs. They are not, however, a substitute for professional representation in any specific situation.

1. Ensure that your employees understand the importance of *appropriately characterizing* and *charging* IR&D and B&P efforts.

2. Before undertaking an *IR&D* project, determine—and *document* your determination—that the effort is *not* required in the performance of a contract, sponsored by a grant, or part of the development of technical data to support submitting a bid or proposal.

3. Before undertaking a *B&P* effort, determine—and *document* your determination—that the effort is *not* required in the performance of a contract or sponsored by a grant or cooperative agreement.

4. When in doubt about the appropriate characterization of certain efforts, consider making a *written disclosure* of your plan to the cognizant Administrative Contracting Officer or auditor and, if possible, seek an *advance agreement*.

5. When performing IR&D projects, ensure that there is a mechanism in place for determining whether (and when) you are awarded a *contract* that requires the *same effort*.

★ REFERENCES ★

1/ 48 C.F.R. § 9904.420.

2/ FAR 31.205-18(b)(1).

3/ FAR 31.205-18(b)(2).

4/ FAR 31.205-18(b)(2). See also Stanley Aviation Corp., ASBCA No. 12292, 68-2 BCA ¶ 7081, at 32,783, 10 GC ¶ 424 (holding that "ASPR Section XV requires that allowable IR&D expense be allocated on such a basis as to be charged pro rata to all of appellant's contracts and products, which means as a practical matter that it should be included in the G&A pool for allocation on a total cost input basis").

5/ FAR 31.205-18(b)(2)(i).

6/ FAR 31.205-18(c).

7/ See Data-Design Labs., ASBCA No. 27535, 85-3 BCA ¶ 18,400, at 92,302-04 (holding that costs of IR&D project with commercial as well as Government sales potential was allocable to contractor's Government contracts); General Dynamics Corp., Elec. Boat Div., ASBCA No. 18503, 75-2 BCA ¶ 11,521, at 54,974 (upholding allocability of IR&D and B&P costs for commercial work and stating, "Although these costs were not an absolute necessity in the sense that absent their incurrence appellant would have had to close its doors, they were basic to appellant's viability as a commercial enterprise. Without new business a contractor cannot survive."), *aff'd* on recons., 76-1 BCA ¶ 11,743, 18 GC ¶ 195.

- 8/ FAR 31.205-18(a).
- 9/ DFARS 231.205-18(a).
- 10/ DFARS 231.205-18(c).
- 11/ DFARS 231.205-18(c)(iii)(B).
- 12/ DFARS 225.7303-2(c).
- 13/ FAR 31.205-18(d)(1).
- 14/ FAR 31.205-18(a).
- 15/ 48 C.F.R. § 9904.420-30 (a)(2); see also 48 C.F.R. § 9904.420-30 (a)(6).
- 16/ FAR 31.205-18(e).
- 17/ ASPR 15-205.35(c) (1955 ed. rev. 50).
- 18/ See Enclosure to Memorandum from Reagan A. Scurlock, Chairman, ASPR Committee (Jan. 29, 1968) (on file with author).
- 19/ See Letter from CODSIA to ASPR Committee 5A (Apr. 25, 1968) (on file with author).
- 20/ See Enclosure 1 to Memorandum for the Chairman, ASPR Committee, "ASPR Case No. 68-14" (Jan 9, 1969) (on file with author).
- 21/ See Letter from CODSIA to ASPR Committee (Jul. 26, 1971) (on file with author).
- 22/ Id.
- 23/ ASPR 15-205.35(a) (1974 ed.).
- 24/ See GAO, Independent Research and Development Allocations Should Not Absorb Costs of Commercial Development Work 9-10 (GAO/PSAD-75-5, Dec. 10, 1974).
- 25/ See GAO, Need To Prevent Department of Defense from Paying Some Costs for Aircraft Engines That Contractors Should Pay 14 (GAO/PSAD-77-57, Feb. 28, 1977).
- 26/ Id. app. I, at 1 (Letter from Malcolm R. Currie, Director of Defense Research and Engineering, to R.W. Gutman, Director, Procurement and Systems Acquisition Division, GAO 1 (Aug. 13, 1976)) (emphasis added).
- 27/ Id. app I, at 2.
- 28/ Id.
- 29/ Id. app. III, at 30 (Letter from Edward Woll, General Electric Co., to GAO (Jul. 23, 1976)).
- 30/ Pub. L. No. 102-190, § 802, 105 Stat. 1290 (Dec. 5, 1991) (amending 10 U.S.C. § 2372).
- 31/ FAC 90-13, 57 Fed. Reg. 44,264 (Sept. 24, 1992) (amending FAR 31.205-18).
- 32/ See 57 Fed. Reg. 44,264.
- 33/ H.R. Conf. Rep. No. 102-311 (to accompany H.R. 2100) at 568 (1991).
- 34/ Memorandum from John M. Deutch, Under Secretary of Defense, "Broadened Use of Funds for Independent Research and Development" 1 (Apr. 22, 1993); Letter from John M. Deutch, Under Secretary of Defense to C. Stanley Dees, Chairman, CODSIA 1 (Apr. 22, 1993) (both on file with author).
- 35/ Memorandum from John M. Deutch, supra note 34; Letter from John M. Deutch, supra note 34.
- 36/ Memorandum from John M. Deutch, supra note 34; Letter from John M. Deutch, supra note 34.
- 37/ Memorandum from John M. Deutch, supra note 34, at 1-2; Letter from John M. Deutch, supra note 34, at 1-2.
- 38/ FAC 90-13, 57 Fed. Reg. 44,264 (Sept. 24, 1992) (amending FAR 31.205-18). See generally John H. Russell, "'Cooperative Arrangements' Under the 'IR&D' Cost Principle (FAR 31.205-18(e))," 94-10 Costs, Pricing & Acct. Rep. 3 (Oct. 1994).
- 39/ 57 Fed. Reg. at 44,265.
- 40/ 60 Fed. Reg. 43,508 (Aug. 21, 1995).
- 41/ 60 Fed. Reg. 43,508.
- 42/ 61 Fed. Reg. 50,114 (Sept. 24, 1996).
- 43/ FAC 90-46, 62 Fed. Reg. 12,704 (Mar. 17, 1997). NASA's class deviation was published at 59 Fed. Reg. 46,359 (Sept. 8, 1994).
- 44/ FAC 97-03, 62 Fed. Reg. 64,931 (Dec. 9, 1997).
- 45/ See Letter from Erwin H. Schiff, National Security Industrial Association, to Clarence Belton, Department of the Navy, "FAR Case 95-032" (Jan. 6, 1997) (on file with author); Letter from John T. Kuelbs, Chair, Section of Public Contract Law, ABA, to FAR Secretariat, "FAR Case 95-032, Independent Research and Development/Bid and Proposal Costs for Fiscal Year 1996 and Beyond, 61 Fed. Reg. 58,452 (Nov. 14, 1996)" 3 (Jan. 14, 1997) (on file with author).

- 46/ Letter from John T. Kuelbs, *supra* note 45.
- 47/ Memorandum from Clarence M. Belton, Chairman, Cost Principles Committee, to Director, DAR Council, "FAR Case 95-032, IR&D/B&P costs for FY 96 and Beyond" 2-3 (Mar. 26, 1997) (on file with author).
- 48/ Compare 61 Fed. Reg. 58,452 (Nov. 14, 1996) with 62 Fed. Reg. 64,931 (emphasis added).
- 49/ 62 Fed. Reg. 64,931.
- 50/ See, e.g., 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 (1999); John Cibinic, "Independent Research & Development, Bid & Proposal, and Precontract Costs: The Troublesome Troika," 6 Nash & Cibinic Rep. ¶ 42 (1992); John W. Chierichella, "IR&D vs. Contract Effort," 90-2 Costs, Pricing & Acct. Rep. 3 (Feb. 1990); Louis D. Victorino & Steven L. Briggerman, "The IR&D/B&P/Selling Costs Dilemma," Briefing Papers No. 87-10 (Sept. 1987).
- 51/ See, eg., General Dynamics Corp., ASBCA No. 10254, 66-1 BCA ¶ 5680, at 26,500 ("We are left then with the necessity of evaluating this appellant's IR&D programs in the light of the restrictions contained in ASPR 15-205(c)...The words of the section themselves do not solve the problem, and, unfortunately, we have found, or been directed to, little else which does.").
- 52/ See Press Release, DOJ, United States Files Suit Against Newport News Shipbuilding for Alleged Fraud Against the Navy (Feb. 3, 2003) (available at http://www.usdoj.gov/opa/pr/2003/February/03_civ_068.htm).
- 53/ See TRW, Inc., ASBCA No. 51172 et al., 01-1 BCA ¶ 31,390, at 155,072, 43 GC ¶ 258 (noting that "the contemporaneous record, more so than retrospective testimony, provides the objective basis for determining whether a contractor's principal primary purpose was to engage in activities of preparing or supporting a proposal on a potential Government contract" (citations omitted)).
- 54/ General Dynamics Corp. v. United States, 202 Ct. Cl. 347, 359 (1973), 15 GC ¶ 254 (quoting General Dynamics Corp., ASBCA No. 12814 et al., 68-2 BCA ¶ 7297, at 33,929, 10 GC ¶ 514).
- 55/ General Dynamics Corp., ASBCA No. 10254, 66-1 BCA ¶ 5680, at 26,500-02.
- 56/ 66-1 BCA ¶ 5680, at 26,501.
- 57/ 66-1 BCA ¶ 5680, at 26,501.
- 58/ Unisys Corp., ASBCA No. 41135, 94-2 BCA ¶ 26,894, at 133,894.
- 59/ 94-2 BCA ¶ 26,894, at 133,900.
- 60/ General Dynamics Corp. v. United States, No. CV89-6726, 1996 WL 200255, 40 C.C.F. (CCH) ¶ 76,933 (C.D. Cal. Mar. 25, 1996), 38 GC ¶ 164, rev'd on other grounds, 139 F.3d 1280, 1280-81 (9th Cir. 1998), 40 GC ¶ 166.
- 61/ 1996 WL 200255, at *2-3.
- 62/ 1996 WL 200255, at *5.
- 63/ 139 F.3d at 1282.
- 64/ 1996 WL 200255, at *17.
- 65/ 1996 WL 200255.
- 66/ 139 F.3d at 1286.
- 67/ Boeing Co. v. United States, 862 F.2d 290, 292-93 (Fed. Cir. 1988), 30 GC ¶ 416, reh'g denied (Feb. 24, 1989). See also North Am. Rockwell Corp., ASBCA No. 13067, 69-2 BCA ¶ 7812, at 36,301 (holding that costs of preparing proposal for second phase of two-phase subcontract were properly charged to B&P because they were not "incurred solely by reason of the terms of" the Phase I subcontract).
- 68/ 862 F.2d at 291.
- 69/ 862 F.2d at 291.
- 70/ 862 F.2d at 293 (emphasis added).
- 71/ United States ex rel. Mayman v. Martin Marietta Corp., 894 F. Supp. 218 (D. Md. 1995); see Douglas E. Perry, "Feature Comment: The Need for Reviewing IR&D Charging Practices After Mayman v. Martin Marietta," 37 GC ¶ 532; see also 39 GC ¶ 3.
- 72/ 894 F. Supp. at 221-22.
- 73/ 894 F. Supp. at 222 (citation omitted).
- 74/ 894 F. Supp. at 222.
- 75/ United States v. Newport News Shipbldg., Inc., 276 F. Supp. 2d 539 (E.D. Va. 2003).

- 76/ 276 F. Supp. 2d at 554.
- 77/ 276 F. Supp. 2d at 555.
- 78/ See Press Release, DOJ, Northrop Grumman To Pay \$80 Million for Overcharging the U.S. and Selling Defective Military Equipment to the Navy (Aug. 20, 2003) (available at http://www.usdoj.gov/opa/pr/2003/August/03_civ_465.htm).
- 79/ *Coflexip & Servs., Inc. v. United States*, 961 F.2d 951 (Fed. Cir. 1992), 34 GC ¶ 306.
- 80/ 961 F.2d at 952.
- 81/ 961 F.2d at 953.
- 82/ 961 F.2d at 953.
- 83/ 961 F.2d at 954.
- 84/ *TRW, Inc. v. United States*, 28 Fed. Cl. 155 (1993), 35 GC ¶ 310.
- 85/ 48 C.F.R. § 9904.402.
- 86/ 28 Fed. Cl. at 157, 159.
- 87/ 28 Fed. Cl. at 158.
- 88/ 28 Fed. Cl. at 160.
- 89/ 28 Fed. Cl. at 160 (footnote omitted).
- 90/ ASPR 15-205.35(b) (1955 ed. rev. 50) ("Development is the systematic use of scientific knowledge which is directed toward the production of, or improvements in, useful products to meet specific performance requirements, but exclusive of manufacturing and production engineering.").
- 91/ ASPR 15-205.35(a)(3)(1972) ("Development is the systematic use, under whatever name, of scientific and technical knowledge in the design, development, test, or evaluation of a potential new product or service (or of an improvement in an existing product or service) for the purpose of meeting specific performance requirements or objectives. Development shall include the functions of design engineering, prototyping, and engineering testing.").
- 92/ *Battelle Mem'l Inst.*, ASBCA No. 20626, 78-1 BCA ¶ 12,884, at 62,724, *aff'd* on recons., 78-1 BCA ¶ 13,183.
- 93/ 78-1 BCA ¶ 12,884, at 62,724.
- 94/ *Aydin Corp. (West)*, ASBCA No. 42760, 94-2 BCA ¶ 26,899, at 133,937, *aff'd* in part and *rev'd* in part on other grounds, 61 F.3d 1571, 1571-72 (Fed. Cir. 1995).
- 95/ 94-2 BCA ¶ 26,899, at 133,941.
- 96/ 61 F.3d at 1580.
- 97/ *United States ex rel. Bagley v. TRW, Inc.*, No. CV95-4153 AHM (C.D. Cal. Oct. 18, 2001).
- 98/ *Bagley*, slip op. at 4.
- 99/ *Bagley*, slip op. at 5.
- 100/ *Bagley*, slip op. at 9-11.
- 101/ *Bagely*, slip op. at 28-30.
- 102/ See *TRW, Inc.*, ASBCA No. 51172, 02-2 BCA ¶ 31,872, at 157,474-75 (IR&D appeal); *TRW, Inc.*, ASBCA No. 51530, 02-2 BCA ¶ 31,873, at 157,478-79 (B&P appeal).
- 103/ *TRW, Inc.*, ASBCA No. 51172, 02-2 BCA ¶ 31,919, at 157,720-22, 44 GC ¶ 296 (IR&D appeal); *TRW, Inc.*, ASBCA No. 51530, 02-2 BCA ¶ 31,944, at 157,811-13 (B&P appeal).
- 104/ See 45 GC ¶ 248.
- 105/ *Lockheed Martin Systems Integration—Owego, Comp. Gen. Dec. B-2871890.2*, et al., 2001 CPD ¶ 110.
- 106/ *Lockheed Martin Systems Integration—Owego, Comp. Gen. Dec. B-287190.5*, 2002 CPD ¶ 49, 44 GC ¶ 135.
- 107/ 2002 CPD ¶ 49, at 3-4.
- 108/ *United States ex rel. Bagley v. TRW, Inc.*, No. CV 95-4153 AHM, 2000 WL 33400196 (C.D. Cal. Dec. 12, 2000).
- 109/ *TRW, Inc.*, ASBCA No. 51530, 02-2 BCA ¶ 31,944, at 157,811-13.
- 110/ 2000 WL 33400196, at * 2.
- 111/ 2000 WL 33400196, at * 2.
- 112/ 2000 WL 33400196, at * 2.
- 113/ 2000 WL 33400196, at * 6.
- 114/ 2000 WL 33400196, at * 7.
- 115/ 2000 WL 33400196, at * 7.
- 116/ See generally J. Robert Humphries & Andrew D. Irwin, "Teaming Agreements," Briefing Papers No. 03-10 (Sept. 2003).
- 117/ FAR 9.602.
- 118/ *Cf. W.J. Schafer Assocs., Inc. v. Cordant, Inc.*, 493 S.E.2d 512 (1997) (reversing jury verdict for breach of contract damages and holding that the parties' teaming agreement was an unenforceable "agreement to agree").

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