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How Chinese Telecom Ban Should Affect Prototype 'Other Transactions'

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September 1, 2020, 3:11 PM EDT


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Recent regulations implementing a statutory ban on the use of certain Chinese telecommunications equipment and services have sent the government contracting industry into a compliance frenzy.

Just as contractors are working furiously to determine the prohibition's reach into their supply chains, federal agencies are experiencing similar struggles within their own acquisition programs. This has raised an interesting question: Do these new requirements apply to other transaction agreements, in particular the U.S. Department of Defense's other transactions, or OTs, for prototyping projects?

Other transaction agreements and prototype OTs — nonstandard acquisition instruments expressly exempted by Congress from most procurement-related laws and regulations — reportedly accounted for approximately $7.5 billion of the DOD's acquisition budget in fiscal year 2019, a number that is certain to be eclipsed this year. The popularity of OTs is driven in part by the relatively limited legal requirements that apply to their award and performance.

But the recent prohibitions against telecommunications equipment and services from Chinese companies like Huawei Technologies Co. Ltd. and ZTE Corporation are one regulation prototype OTs will not avoid, according to a memorandum recently issued by the DOD's acting principal director of defense pricing and contracting.[1] The legal underpinnings for that conclusion are unclear, though, and an objective examination of Congress' direction suggests a different result.

Application of Federal Law to Prototype OTs

If you have heard one thing about the DOD's prototype OTs, or other transaction agreements generally, it is likely that they are not subject to many onerous procurement laws and regulations, like the Federal Acquisition Regulation or the DOD's FAR Supplement. This is generally true: Unless a specific FAR or DFARS clause is expressly incorporated by text or reference in a prototype OT, the principles therein will not apply.

The common procurement statutes also do not apply, including the Competition in Contracting Act and the Truthful Cost or Pricing Data Act (still commonly referred to by its former name, the Truth in Negotiations Act).

But laws generally applicable to persons engaging with the government — such as the Freedom of Information Act, the False Claims Act, the Antideficiency Act, the Fair Labor Standards Act and the International Traffic in Arms Regulations, to name a few — do still apply, and govern the government's and the industry participants' actions under other transaction agreements.

So how does one determine whether a given statute or regulation applies to OTs? In the 27 years of the DOD's prototype OT authority (and the 62 years of general other transaction authority shared by NASA and other select agencies), no definitive framework has been established. But some have tried, including former Undersecretary of Defense for Acquisition and Technology Paul G. Kaminski and an Ad Hoc Working Group of the American Bar Association Section of Public Contract Law; each issued memoranda on the subject in 1996 and 2000, respectively. Although these analyses (to our knowledge) have never been tested in court, both are instructive.

To determine which laws apply to standard procurement contracts but not to other transaction agreements, one must first understand the legal distinction between the two.

Other transaction agreements are typically defined in terms of what they are not; that is, they are not "procurement contracts," "grants" or "cooperative agreements."[2] Each of the specific types of legal instruments is defined in the Federal Grant and Cooperative Agreement Act of 1977.

The "principal purpose" of procurement contracts is to "acquire (by purchase, lease, or barter) property or services for the direct benefit or use of the United States Government," whereas grants and cooperative agreements are "to transfer a thing of value" to another party "to carry out a public purpose of support or stimulation."[3]

Other transaction agreements do not squarely fit into any of these categories. Although they (typically) are not procurement contracts for the government's direct benefit, they are contracts, in the common law sense of the word. They comprise all the necessary elements — offer, acceptance, consideration and mutual intent to be bound — and they are enforceable in federal court.[4]

The DOD's prototype OTs are unique among other transaction agreements. Not only are they binding contracts, but they are contracts expressly authorized to acquire prototypes and prototyping services for the government's direct benefit, notwithstanding the limitations of the Federal Grant and Cooperative Agreement Act.[5]

The unique nature of the DOD's prototype OTs as acquisition instruments is reflected in Congress' adoption of familiar rules for their use, such as the Procurement Integrity Act and a requirement to use "competitive procedures" to "the maximum extent practicable."[6] The DOD has also recognized their nature as acquisition instruments in prior versions of its Other Transactions Guide for Prototype Projects.[7] As a result, the DOD's prototype OTs are in many ways indistinguishable in nature from standard procurement contracts, but are expressly exempt from the laws and regulations that apply to them.

When determining whether a statute or regulation applies only to a procurement contract, one must start with the plain text of the law or regulation. Some make it easier than others. The statutes in Title

10 of the U.S. Code, Chapter 137, for example, including the Competition in Contracting Act, expressly apply only to "procurement," in accordance with Title 10 of the U.S. Code, Section 2303(a). Similarly, the Contract Disputes Act applies only to express or implied contracts for "the procurement of property ... services ... construction ... or disposal of real property."[8]

Other statutes are more difficult to pin down. For example, the Anti-Kickback Act prohibitions in Title 41 of the U.S. Code, Chapter 87, apply to any "contract or contractual action entered into by the Federal Government to obtain supplies, materials, equipment, or services of any kind."[9] As noted, a prototype OT is a contract or contractual action whereby the government obtains prototypes or prototyping services, seemingly falling within the plain text of the statute.

Where the plain text is not clear, one may need to look at a statute's placement within the U.S. Code or to legislative history to discern Congress' intent. In the case of the Anti-Kickback Act example, the relevant chapter is in Title 41, Subtitle IV, "Miscellaneous," rather than Subtitle I, which contains "Federal Procurement Policy." Other requirements in Subtitle IV, "Miscellaneous," expressly apply only to procurement contracts, such as the drug-free workplace requirements in Chapter 81.[10]

Because the Anti-Kickback Act prohibition applies more broadly to any "contract or contractual action ... to obtain" goods or services of any kind, Congress seemingly intended it to apply beyond just procurement contracts, and thus it can be fairly applied to the DOD's prototype OTs.

Prohibition on Use of Covered Telecommunications Equipment or Services

Turning back to the recent prohibition on certain telecommunications equipment and services, required by the National Defense Authorization Act for Fiscal Year 2019, there are two mandates of concern.

The first went into effect last year and prohibits federal agencies from "procur[ing] or obtain[ing]" any "equipment, system, or service that uses covered telecommunications equipment or services as a substantial or essential component of any system, or as critical technology as part of any system."[11]

It has been relatively straightforward for contractors to comply with this requirement, as it affects only goods or services actually delivered to the government. Furthermore, as discussed below, because this requirement is directed to the government's use of covered equipment and services, and covers not only procurement but obtaining the software, it arguably applies to the DOD prototype OTs.

The second prohibition, which just went into effect last month, is much broader, and seemingly should not apply to OTs. Specifically, Section 889(a)(1)(B) prohibits federal agencies from "enter[ing] into a contract ... with an entity that uses any equipment, system, or service that uses covered telecommunications equipment or services as a substantial or essential component of any system, or as critical technology as part of any system."

On Aug. 13, the FAR Council implemented this requirement through a revised certification, at FAR 52.204-24, requiring offerors to represent, after conducting a reasonable inquiry, whether they "use any equipment, system, or service that uses covered telecommunications equipment or services," and a corresponding prohibition on such use in FAR 52.204-25.[12]

That same day, the acting principal director of defense pricing and contracting issued a memorandum to the acquisition components in each DOD command, department, and agency, requiring all prototype OT

solicitations or agreements issued or awarded after Aug. 13 to contain the representation in FAR 52.204-24 and the prohibition at FAR 52.204-25.

Furthermore, the memorandum directed that if any existing prototype OT agreement is extended or renewed, or moved into a new phase, it must be amended to include both clauses. The memorandum does not include an analysis of legal applicability or legislative intent, but simply states that the Section 889(a)(1)(B) requirement applies to prototype OTs and notes, "While the interim [FAR] rule and [director of defense pricing and contracting] implementation memorandum are directed to FAR-based contracts, the principles and requirements provided therein shall apply to OTs for Prototype Projects agreements authorized under 10 U.S.C. § 2371b."

But a review of the statute, bearing in mind the principles of interpretation above, suggests this broader prohibition in paragraph (a)(1)(B) does not apply to prototype OTs.

The heading of paragraph (a) specifies it is a "Prohibition on Use or Procurement," with the prohibition on the government's "Use" represented in paragraph (a)(1)(A), and the prohibition on the government's "Procurement" represented in paragraph (a)(1)(B). Although paragraph (a)(1)(B) refers only to a prohibition on entering into a "contract," the context provided by the heading suggests the prohibition is directed to procurement contracts — and the provision must be read in the context of the statute as a whole, not in a vacuum.

This interpretation is reinforced by the statute's placement within a division of the U.S. Code titled "Procurement." Congress added it as a note to Title 41, Chapter 39, which falls within Division C, "Procurement," of Subtitle I, "Federal Procurement Policy" — the same division that houses the Competition in Contracting Act and the Truth in Negotiations Act, statutes that indisputably do not apply to other transaction agreements.

Congress specifically identified the circumstances under which the prohibition would apply and those circumstances depend on the instrument used. For example, Congress expressly prohibited the expenditure of grant funds to procure or obtain covered equipment or services. Had Congress wanted to apply the ban on using such equipment or services to OT participants, it would have done so.

Examination of Congress' more targeted prohibition in paragraph (a)(1)(A) further supports this interpretation. As mentioned, by prohibiting agencies from "procur[ing] or obtain[ing] any equipment, system, or service that uses telecommunications equipment or services," this paragraph arguably does apply beyond standard procurement contracts.

There can be little doubt Congress intended this first prong of the "Prohibition on Use or Procurement" to extend to all situations where the government "obtains" telecommunications equipment or services, without limiting the restriction to federal procurement alone. Although placed within a section of the U.S. Code devoted to procurement, like the specific prohibitions on grants and loans, it seems Congress intended the more limited prohibition in paragraph (a)(1)(A) — but only that more limited prohibition — to apply to prototype OTs.

Based on the plain language of the statute and its context, Section 889(a)(1)(A) prohibits the DOD from awarding prototype OTs to obtain covered telecommunications equipment or services, but Section 889(a)(1)(B) does not prohibit the DOD from partnering with prototype OT participants that use covered telecommunications equipment or services separately from their work for the government.

This conclusion, which mirrors the statute's application to federal grants, balances and harmonizes the policies underpinning both the prohibition on nefarious suppliers (e.g., protecting the government's and its industrial base's sensitive information and intellectual property from misappropriation) and the DOD's specific authorization to award prototype OTs (e.g., access to nontraditional defense contractors, expediency in developing advanced technologies and capabilities).

The government's security interest is protected because OT participants will be prohibited from delivering telecommunications equipment or services from the identified companies, without foreclosing access to the DOD's prototype OTs to the nontraditional defense contractors, which may not be able to comply with the more onerous requirement to identify and replace all covered telecommunications equipment or services from their nongovernmental operations.

Ultimately, those nontraditional defense contractors have the most to lose from the DOD's extension of the prohibition to prototype OTs, as traditional contractors performing prototype OTs are likely to be covered by their procurement contracts, which will include FAR 52.204-24 and FAR 52.204-25, as Congress intended. Access to these nontraditional defense contractors is precisely why Congress gave the DOD the flexibility to negotiate prototype OTs.

As we understand the current state of play, whether grounded in law or policy, all DOD prototype OTs must include FAR 52.204-24 and FAR 52.204-25, prohibiting use of telecommunications equipment or services from Huawei, ZTE, their affiliates and certain other Chinese entities. But there are good reasons — in both law and policy — for the DOD to reconsider its approach.

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[1] Memorandum, "Implementation Guidance for Section 889(a)(1)(B) Prohibition on Contracting with Entities Using Certain Telecommunications and Video Surveillance Services or Equipment on Other Transactions for Prototype Projects" (Aug. 13, 2020), available at https://www.acq.osd.mil/dpap/policy/policyvault/USA001717-20-DPC.pdf.

[2] See 10 U.S.C. § 2371 (granting DoD authority to enter into "transactions (other than contracts, cooperative agreements, and grants)"); 51 U.S.C. § 20113(e) (granting NASA authority to enter into "contracts, leases, cooperative agreements, or other transactions" (emphasis added)).

[3] 31 U.S.C. §§ 6303-6305.

[4] See, e.g., Spectre Corporation v. United States, 132 Fed.Cl. 626 (2017).

[5] See 10 U.S.C. § 2371b.

[6] See 10 U.S.C. §§ 2371b(b)(2), (h).

[7] See Dep't of Def., Other Transactions Guide for Prototype Projects, Ver. 1.2.0, § C1.1.2 (Jan. 2017).

[8] 41 U.S.C. § 7102(a).

[9] 41 U.S.C. § 8701(4).

[10] See 41 U.S.C. § 8102(a)(1) (applying "for the purposes of being awarded a contract for the procurement of any property or services").

[11] Pub. L. 115-232, 132 Stat. 1636, 1917, §889(a)(1)(A) (Aug. 13, 2018).

[12] See 85 Fed. Reg. 42,665, 42,678.