

DIUx and DoD Other Transaction Prototype Agreements: The Fast Track to DoD Funding

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On February 7, the Department of Defense (DoD) awarded REAN Cloud a contract valued at up to \$950 million to work with defense agencies to migrate existing applications to commercial cloud solutions. The award is of significant relevance to efforts currently underway in connection with the upcoming DoD Joint Enterprise Defense Infrastructure—or “JEDI”—procurement. However, the award is also important in a broader context in that it was issued as a follow-on production contract to an “other transaction” (OT) prototype agreement awarded on an expedited basis by DoD’s Defense Innovation Unit Experimental organization (DIUx). The award, therefore, reflects DoD’s increased comfort with issuing high-value production contracts following preliminary work with DIUx under OT prototype agreements.

In 2015, DoD founded DIUx to increase its access to technical innovations from nontraditional contractors. Defense contractors’ spend on research and development in the last decade has been adversely impacted by increasing budget cuts, protracted procurement cycles, and numerous government shutdowns. As a result, DoD has both needed and wanted access to cutting-edge technology in the commercial sector, but commercial companies with robust global markets have historically been wary of the significant compliance obligations that come with traditional defense procurements. DIUx is the Department’s attempt to contract with these innovators in a way that mimics the speed and terms of commercial transactions and significantly reduces compliance obligations.

Essential to the success of this approach is the use of OT agreements to govern DIUx transactions. According to recent congressional testimony, since it was established, DIUx has awarded 61 OT agreements totaling \$145 million and averaging only 78 days from initial contact with a potential partner to signing an agreement. And, beginning in September of last year, DoD has followed some of those DIUx awards with follow-on production contracts. In addition to the recent \$950 million award to REAN, DIUx has awarded two more production contracts together valued at up to more than \$1 billion. Importantly, DoD can issue these high-value follow-on contracts without competition as long as competition was established for an initial DIUx OT award.

Recent efforts, therefore, suggest that DIUx, OT agreements, and follow-on production contracts are here to stay, and potential contractors of all sizes and sophistication should understand how they may impact the competitive landscape. Below are some key questions about DIUx and OT agreements that are worth considering:

What is an OT agreement?

DoD is one of six principal agencies with statutory authority to award OT agreements, and an OT prototype agreement is a specific kind of OT agreement that permits DoD to issue follow-on production contracts. OT agreements in general are best defined by what they are not; they are not procurement contracts, grants, or cooperative agreements. As a result, the Federal Acquisition Regulation (FAR), agency-specific addenda like the Defense Federal Acquisition Regulation Supplement (DFARS), and many of the statutory and regulatory obligations imposed on government contractors do not apply. At the same time, however, some of the protections in procurement statutes and regulations, such as default rights to inventions under the Bayh Dole Act and protections for proprietary data, need to be specifically negotiated into each OT agreement.

What are some of the advantages to an OT agreement?

Three key areas that typically present difficult challenges to companies considering their first government contract include: (i) competition requirements and bid protests; (ii) cost-based requirements; and (iii) the allocation of intellectual property rights. The procurement statutes that govern these three key areas do not apply to OT agreements. For example, the General Accountability Office (GAO) has found that OT agreements are not procurement contracts subject to the Competition in Contracting Act and, therefore, their solicitation and award are not directly subject to the GAO's bid protest jurisdiction. Similarly, although DoD may want to include cost requirements in an OT agreement, neither the cost principles in FAR Part 31 nor the Truth in Negotiations Act apply to OT agreements. In addition, DoD retains flexibility in OT agreements to negotiate intellectual property rights that may deviate from default rights established under the Bayh-Dole Act, Part 27 of the FAR, and Part 227 of the DFARS.

Are there any risks associated with an OT agreement?

For established contractors used to FAR-based contracts, OT agreements may present a unique negotiating challenge because an OT agreement does not incorporate some of the protections and familiarity offered by the FAR and procurement-based statutes, such as the Contract Disputes Act. In contrast, for entities that are not used to the FAR, contracting officers for DoD may try to impose the same forms and clauses that they would otherwise impose under procurement contracts, thereby limiting the value of entering into an OT agreement. Both private and government negotiators need to understand that an OT agreement is "commercial like" and can be drafted to meet the parties' needs.

In addition, one issue in particular that has not been completely resolved and presents an ongoing risk for OT agreements is the application of various socioeconomic policies and authorities that apply to transactions other than procurement contracts. For example, various agencies have interpreted nondiscrimination requirements under Title VI of the Civil Rights Act, which are triggered by the provision of financial assistance, to apply when funding is provided under an OT agreement. However, DoD has also taken the seemingly contradictory position that OT prototype agreements constitute "acquisition instruments" that are not fairly characterized as providing financial assistance.

Ultimately, participants in an OT transaction often need to consider on a case-by-case basis whether an OT agreement is subject to broadly applicable requirements that are tied to a method of providing funding or a particular source of funds, rather than a type of agreement like a procurement contract or grant.

Is DoD dedicated to the continued use of OT agreements?

It is still too early to determine whether DoD will continue to use OT agreements with the same enthusiasm that has been seen in recent years. However, DoD has dedicated significant resources to DIUx to date. In addition, in the 2018 Fiscal Year (FY) National Defense Authorization Act (NDAA), Congress established a preference for OT agreements in DoD science, technology, and prototyping programs, doubled the monetary thresholds for triggering heightened approval requirements for high-value OT prototype projects, expressly authorized the use of OT agreements as a method for entering into research agreements with industry, academia, and other researchers, and required DoD management to establish training on OT agreements. Previously, in the FY 2016 NDAA, Congress authorized DoD to award OT prototype agreements that provide for follow-on production contracts if (i) competitive procedures were used to select the parties participating in an initial OT transaction and (ii) the prototype project covered by the transaction was successful. The FY 2018 NDAA also recently clarified that eligible “transactions” authorizing the award of follow-on production contracts include subprojects awarded competitively within a consortium operating under a DoD OT prototype agreement.

What is an OT consortium and should I join one?

An OT consortium is an organized group of entities that operate under a prime OT agreement with the government. OT consortia exist in a variety of areas including defense and have been driven by traditional DoD contracting offices outside of DIUx. Members agree to participate under common sets of rules established by overall management organizations and generally must execute subagreements that reflect the requirements of a consortium’s prime OT agreement. OT consortia are designed to minimize barriers for companies that are new to government contracting—typically requiring short-form applications and small annual fees. However, OT consortia also often have restrictions on foreign ownership or control that can be problematic for some nontraditional contractors, though these restrictions can sometimes be satisfied by contracting through a domestic affiliate.

Government customers may issue calls for whitepapers through a consortium, ultimately selecting a small number of participants to submit more formal proposals. After reviewing those proposals, the Government selects one or more participants for award and typically delivers funding to those selected through the consortium management organization. With pre-established terms flowed down from a consortium entity’s prime OT agreement, awards to members can typically be negotiated within a few months and can involve collaborations between multiple members. However, because the relevant DoD OT agreement is typically with the consortium rather than an individual member, there may be limited flexibility to negotiate unique terms, and not having a direct contractual relationship with the Government can create some unease with members. As a result, it is essential that members understand their rights with regard any technology being developed, the consortium management organization, other members, and the government. In addition, it is important for members to ensure that their rights are sufficiently protected in each interlocking agreement.

What conditions must be met for the award of a DoD OT prototype agreement?

A DoD OT prototype agreement must involve a project that enhances mission effectiveness of military personnel, and supporting platforms, systems, components, or materials, or improves these items when in use by the armed forces. Although there is no statutory definition of prototype, DoD's internal guidance defines a prototype as a "preliminary pilot, test, evaluation, demonstration, or agile development activity used to evaluate the technical or manufacturing feasibility or military utility of a particular technology, process, concept, end item, effect, or other discrete feature." In addition, the prototype project must include one of the following: (i) at least one nontraditional defense contractor or nonprofit research institution participating to a significant extent; (ii) all significant participants qualifying as small businesses or nontraditional defense contractors; (iii) at least one-third of the total cost being paid by sources other than the federal government; or (iv) a waiver of these requirements by a senior DoD procurement executive.

In this context, a nontraditional defense contractor is not just a company that is new to government contracting. Instead, a nontraditional defense contractor for purposes of a DoD OT prototype agreement is one that is not currently performing (and has not performed for at least one year preceding the solicitation of sources for a transaction) any contract or subcontract for the DoD that is subject to full Cost Accounting Standards (CAS) coverage. Full CAS coverage generally applies to high-value cost-reimbursement contracts, and high-value, sole-source, non-commercial fixed-price contracts, awarded to entities that do not qualify as small businesses. This means that many large commercial-item contractors are considered nontraditional defense contractors eligible to receive DoD OT prototype agreements.

Traditional defense contractors also may have a role in OT prototype agreements, either by sharing in the costs of a particular transaction or in pairing with nontraditional contractors, nonprofit research institutions, and/or small businesses. Traditional contractors can also participate in awards under other OT authorities to varying degrees.

What is the process used by DIUx to award OT agreements?

DIUx lets offerors know about its needs by posting Areas of Interest (AOIs) on its website. Interested vendors then submit solution briefs via the website, individually consisting of a white paper or short slide deck. These solution briefs/presentations are expected to address two points: the offeror's technology and the offeror itself. Upon receipt of these solution briefs/presentations, DIUx conducts a three-phase evaluation that mimics funding pitches in the commercial world. In Phase I, DIUx evaluates an offeror's solution to determine if (i) it is relevant; (ii) has technical merit; (iii) is offered by a company or team that has the resources to accomplish the project; and (iv) is innovative. Because the AOI is broad, each solution is evaluated on its own merit rather than by comparison. The result of Phase I is either a non-selection letter or an invitation to continue.

If an offeror is invited to proceed, Phases II and III involve interactions with the DoD customer, DIUx, and the DOD contracting team to allow both sides to explore the proposed solution and the potential cost and schedule. If the DoD customer and DIUx want to proceed with the project, DIUx will issue a Request for Prototype Proposal through a contracting support organization within DoD. The parties will then agree on a statement of work as a collaborative effort and negotiate an OT agreement. Typically, for each dollar that DIUx contributes to the funding of an OT agreement, the DoD customer will contribute four or five dollars. The amount funded for the prototype agreement is intended to cover a proof of concept or demonstration of specific technology. However, as indicated above, if an OT prototype agreement is awarded subject to competition, the DoD customer will be free to award a follow-on production contract without further competition.

Conclusion

OT agreements have been used successfully in parts of DoD for many years. However, DoD's current emphasis on OT prototype agreements should be of interest to new and established contractors alike given the resources being allocated to DIUx and DoD's recent track record of awarding high-value follow-on production contracts. In FY 2019 alone, the Administration is proposing to increase funding to DIUx from \$41 to \$71 million for OT agreements that can result in separate awards of much higher values. Accordingly, understanding this process and knowing how to navigate OT agreements and follow-on awards could provide a number of potential offerors with a competitive edge.

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