Fed. Circ. To Decide Future Of Commercial Item Contracting

By **Nathaniel Castellano and Charles Blanchard** (February 9, 2018)

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On Feb. 8, 2018, the United States Court of Appeals for the Federal Circuit heard oral argument in Palantir USG v. United States,[1] that will decide the future of commercial item contracting, and perhaps determine how the government will purchase next-generation technology. More specifically, the Federal Circuit will decide the extent of the government's obligations under the Federal Acquisition Streamlining Act (FASA) to prioritize, to the maximum extent practicable, the acquisition of commercial and nondevelopmental solutions.

The decision could either: (1) breathe a new life into FASA's preference for purchasing commercial and nondevelopmental solutions, while also creating a powerful new protest ground and increasing agency documentation burdens, or (2) reinforce broad agency discretion to choose developmental approaches at a time when it is readily apparent that the United States' technological and battlefield superiority depend on its ability to harness technologies from the commercial sector and become a more commercial-friendly business partner.

Background

Palantir concerns the U.S. Army's Distributed Common Ground System ("DCGS-A") — pronounced "dee-sigs." DCGS-A is the Army's primary system for processing and disseminating multi-sensor intelligence and weather information.[2] The Army intends to procure a system that combines all intelligence software and hardware capabilities into one program with the ability to access and be accessed by, not only Army intelligence and command components, but also other members of the broader distributed common ground and surface system.[3]

A principal element of DCGS-A is its data management architecture. Palantir sells a commercial data management architecture called Gotham. While Gotham is successfully used in commercial and U.S. Department of Defense markets, the Army has consistently declined to purchase Gotham to satisfy DCGS-A program requirements.

There are, thus far, two increments of DCGS-A. The Army has already attempted to procure and field the first increment, referred to as DCGS-A1. In doing so, the Army adopted a developmental approach, which lasted nearly two decades, cost over $6 billion, and generated significant stakeholder complaints. Congressional scrutiny and criticism was plentiful, particularly regarding the Army's insistence on continued use of a developmental approach, despite cost overruns, performance problems, schedule delays, and strong end-user support for commercial options such as Palantir's Gotham platform.[4]

When the Army began to conduct market research and gather industry input to support its

acquisition of the second increment of DCGS-A, referred to as DCGS-A2, Palantir encouraged the Army to procure its Gotham platform on a firm fixed price, commercial item basis, with additional modifications as needed to meet the full DCGS-A2 requirements. However, the Army's "requests for information" and other industry outreach suggested that the Army was once again only interested in a developmental approach to DCGS-A2, procured on a cost-plus basis. Despite Palantir's repeated explanations that a commercial item approach would be preferable, the Army issued a DCGS-A2 solicitation that called for developmental solutions on a cost-plus basis. Palantir filed a pre-award bid protest at the Government Accountability Office challenging the terms of the DCGS-A2 solicitation.

At the GAO, Palantir's primary argument was that the Army failed to comply with its obligations under 10 U.S.C. § 2377, enacted as part of FASA, to conduct market research into and maximize use of commercial item and nondevelopmental solutions. Specifically, § 2377(b) requires an agency, "to the maximum extent practicable," to "acquire commercial items" "to meet the needs of the agency."[5] To that end, § 2377(c)(1) requires an agency to "conduct market research appropriate to the circumstances" into the availability of commercial items. Then, § 2377(c)(2) requires the agency to "determine whether there are commercial items" that can (1) meet the agency's requirements; (2) be modified to meet the agency's requirements; or (3) meet the agency's requirements if those requirements were modified to a reasonable extent.

The GAO denied the protest, but not before holding an evidentiary hearing and receiving testimony from Army procurement officials. The GAO ultimately deferred to the Army's decision to adopt a developmental approach, particularly in light of findings that the Army determined: (1) no commercial item could meet all of the DCGS-A2 requirements, and (2) the best acquisition approach was selecting a single contractor to perform the noncommercial lead systems integrator (LSI) services of acquiring and integrating all components necessary to meet the DCGS-A2 requirements — i.e, shifting integration risk to the LSI.[6]

Undeterred, Palantir filed a protest at the United States Court of Federal Claims. Notably, one day after Palantir filed at the court, the Army issued a formal determination that DCGS-A2 is not a commercial item. This post-hoc documentation ultimately proved ineffective — if not detrimental.[7] In a 100-plus page decision, Judge Marian Blank Horn held that the Army failed to meet its obligations under § 2377 and permanently enjoined any award under the solicitation.[8] Recognizing that it was presented with an issue of first impression,[9] the court carefully explored the statutory text, emphasizing the phrase "maximum extent practicable."[10]

After a detailed review of the administrative record, supplemented by expert testimony from both parties, the court determined that, even though there is no formal documentation requirement associated with § 2377, the Army's documented market research was insufficient. The decision was careful to state that it was not requiring the Army to procure a commercial item,[11] but only holding that the Army "failed in its obligation under 10 U.S.C. § 2377 to fully investigate if Palantir, or any other potential offeror, could meet the requirements of the Army's procurement needs on a commercial basis, in part or in full."[12]

The court emphasized that the Army was repeatedly notified by Palantir that commercial items could meet its needs, yet the Army's market research appeared to be limited to developmental approaches, as if the Army had already decided that the DCGS-A2 solicitation would require a developmental solution. The court also found that there was no indication the Army considered how commercial items could be modified to meet the DCGS-

A2 requirements, or how those requirements could be reasonably modified to allow a commercial solution.[13]

The government appealed the Court of Federal Claims' decision to the United States Court of Appeals for the Federal Circuit, framing this as a case of first impression.[14]

Arguments on Appeal

The government's argument on appeal is two-pronged. First, the government argues that the Court of Federal Claims erred as a matter of law by adding to FASA a requirement that the government "fully investigate" availability of commercial items. Specifically, the government argues: "If the court's holding is left intact, it creates market research obligations beyond the statutory and regulatory language, and undermines the discretion afforded to agencies in conducting market research and deciding the most appropriate acquisition approach."[15]

The government's second argument is that the Army's market research and determinations were sufficient in this case.[16] Specifically, the government argues that the Court of Federal Claims "plainly erred in jettisoning the presumption of regularity, and substituting the unsubstantiated inference that market research was premised on the Army's predetermination that the DCGS-A2 solicitation would be for a developmental/cost-reimbursement contract, and not a commercial item contract under FAR Part 12."[17] To support its factual premise, the government contends the Army knew from the outset, based on its experience with DCGS-A1, that it wanted to use a lead systems integrator approach instead of assuming responsibility for integration of various commercial and government-unique software. According to the government — regardless of what any single document may demonstrate — the Army's market research was reasonable under the circumstances and satisfied FASA because the Army knew that no single commercial item could meet all of its needs, decided to take an LSI approach, and did not consider those LSI functions to be commercial.[18] The government further emphasizes that it's decision to use a noncommercial LSI approach for the prime DCGS-A2 contract does not mean that the LSI chosen will not be required to conduct market research to maximize use of commercial items components, satisfying the spirit of FASA.[19]

The overarching theme of Palantir's response is that the government's legal position "makes a mockery of the statutes requirement that agencies 'acquire commercial items' to 'the maximum extent practicable.'"[20] As a factual matter, Palantir asserts that the government cannot "escape the fact that the market research the Army did conduct was entirely focused on a developmental approach."[21]

Palantir's briefing proceeds to demonstrate that the government's market research failed to meet two, independent obligations of § 2377, either of which provides a sufficient basis to affirm the decision on appeal. First, Palantir argues that the government failed to conduct adequate market research into the availability of commercial item solutions. Second, Palantir argues that the government failed to determine whether commercial items could (1) meet the Army's requirements; (2) be modified to meet the Army's requirements; or (3) meet the Army's requirements if those requirements were modified to a reasonable extent.[22]

Technology Network, an association of chief executive officers and senior executive of leading technology companies from across the nation, submitted an amicus cuarae brief in support of Palantir.[23] TechNet "believes that this case could have implications extending far beyond the interest of any single company and could jeopardize TechNet's goal of

modernizing information technology systems throughout the federal government."[24] TechNet's brief provides the circuit with thorough, useful context for the FASA provisions at issue and congressional scrutiny of the DCGS-A acquisition. With that context, TechNet asserts that the Army's approach to DCGS is product of a DOD culture predisposed to favor full development of government-unique solutions instead of relying on the commercial and nondevelopmental solutions that FASA directs agencies to favor.[25]

Oral arguments were held on Feb. 8, 2018.[26] The panel consisted of Judges Pauline Newman, Haldane Robert Mayer and Kara Farnandez Stoll. Although full of interesting exchanges, the arguments did not provide meaningful clues as to how a majority of the panel might decide the case.

Potential Implications

If the Federal Circuit affirms, it could breathe a new life into FASA's requirements to favor nondevelopmental approaches. The GAO and the Court of Federal Claims routinely show great deference to agency decisions about how to structure an acquisition, but the Federal Circuit's decision in Palantir could open the gates for all manner of challenges to the adequacy of an agency's market research and the terms of a solicitation. Commercial companies that are wary of government-unique clauses requiring cost and pricing information or data rights, for example, may gain great leverage through Palantir in their efforts to convince agencies to make their solicitation's more friendly.

But such a rejuvenation of FASA may prove to be a double-edged sword. If Palantir's arguments on appeal are accepted as given, it would seem that any agency seeking to avoid pre-award protest would need to issue a pre-solicitation written determination describing its market research and supporting its determinations whether commercial items can (1) meet its requirements; (2) be modified to meet its requirements; or (3) meet its requirements if those requirements were modified to a reasonable extent. Even if sufficient documentation of those determinations exists for the agency to succeed on the merits of a pre-award protest, that does not protect the agency from defending itself in litigation at the Court of Federal Claims. In a market where many different companies are vying to influence the terms of a solicitation, such litigation could grow complex and unwieldy, particularly with respect to the scope of corrective action. These potential complications could limit the effectiveness of commercial item contacting. If the requirements associated with commercial item contracting (supposedly simplified compared to noncommercial contracting) become too onerous, it may fuel recent trends of moving acquisition to nonprocurement channels, particularly "other transactions," for which oversight and judicial review are less readily available.

Further issues could arise in a procurement where there are multiple potential government solutions in the commercial market. If the government has to determine how every potential commercial solution might be modified to meet its needs, and how its requirements might be modified to better accommodate each commercial solution, that decision making process could become very burdensome, particularly if subject to judicial review. Further, it would seem to create a scenario where agencies might begin to engage in source selection activities well before the solicitation is ever issued. In this respect, if the Federal Circuit's decision in Palantir interprets FASA's obligations too broadly, not only might market research become an overly burdensome process, but it could also begin to undermine the policies favoring competition enshrined in the Competition in Contracting Act.

The implications of reversal would depend greatly on the wording of the opinion. On one hand, the circuit could conceivably adopt Palantir's legal position, creating a legitimate

enforcement mechanism for § 2377 compliance, while reversing the decision below for various reasons, which may or may not include a factual determination that the Army met its obligations in this case. On the other hand, a reversal based on blind deference to the Army's acquisition decisions could have detrimental impact, essentially enabling the government to continue to prioritize developmental work instead of catering its acquisition process to the commercial marketplace. It is no secret that the speed of technological innovation has long outpaced government acquisition cycles, and the bulk of modern innovation is occurring in commercial markets by companies who are not dependent on the federal government for revenue. Indeed, it is no longer novel to suggest that the United States' technological and battlefield superiority depend on the federal government's ability to attract commercial suppliers and harness their innovation. Given that context, and in the current political climate where congressional action is the exception, the best hope for enforcing FASA's mandate may be the Federal Circuit's opinion in Palantir.

Finally, the Palantir decision should be considered in context of the 809 panel's recommendations to streamline defense acquisitions. As the first volume of the panel's final report reveals, many of the recommendations are directed at reforming the commercial item acquisition process to make it more simple and effective.[27] Any changes Congress may make in response to the 809 panel's recommendations should be made with Palantir in mind.

Conclusion

Through Palantir, the Federal Circuit has an opportunity to decide the future course of commercial item contracts, and perhaps even the extent to which the U.S. government will be able to harness the next generation of commercial innovation. Regardless of the outcome, this decision is sure to carry great implications for contractors, their counsel, and those responsible for shaping acquisition policy.

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[1] See Palantir USG, Inc. v. United States, No. 2017-1465.

[2] See Palantir USG, Inc. v. United States, 129 Fed. Cl. 218, 222-23 (2016).

[3] Id.

[4] SeeTechNet Amicus Brief, No. 2017-1465 at 15-22 (detailing relevant congressional hearings).

[5] 10 U.S.C § 2377(b)

[6] Palantir USG, Inc., B-412746, May 18, 2016, 2016 CPD ¶ 138.

[7] Palantir USG, Inc. v. United States, 129 Fed. Cl. 218, 232 (2016).

[8] Id.at 266-69.

[9] Id.at 266.

[10] Id.at 266-68.

[11] Id.at 282.

[12] Id.

[13] Id.at 276-77.

[14] United States Opening Br. at 29.

[15] Id.at 32-33, 37-38.

[16] Id.at 1-2.

[17] Id.at 31.

[18] Id.32-33.

[19] Id.30-31. The Government also challenges the Court of Federal Claims' decision to supplement the administrative record with testimony from Palantir and Government experts. Of course, such issues are reviewed under a highly deferential abuse of discretion standard. Nevertheless, in a recent decision cited as supplemental authority by the Government, the Federal Circuit did reverse the Court of Federal Claims based on the Claims Court's decision to supplement the record without providing adequate explanation for why supplementation was necessary.See AgustaWestland N. Am., Inc. v. United States, __ F.3d. __, 2018 WL 503540 (Fed. Cir. Jan. 23, 2018).

[20] Palantir Response at 3.

[21]Id.

[22] Id.at 1, 3-4.

[23] TechNet Amicus Brief at 2.

[24] Id.at 3.

[25] Id.at 4-5.

[26] Recording available at http://www.cafc.uscourts.gov/oral-argument-recordings

[27] Available at https://section809panel.org/