Trends and Developments: Defending Commerciality and Price Reasonableness

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Overview

- Recent legislative and regulatory activity
- Trends in agency considerations of commercial item assertions and price analyses
- Best practices for contractors
Definition of Commercial Item

- FAR 2.101 requires the product or service to meet at least one of six “prongs.”
- Most commonly-used prongs:
  - (1) Item is “of a type” customarily used by the general public or by non-governmental entities for non-governmental purposes and (i) has been sold, leased, or licensed to the general public, or (ii) has been offered for sale, lease, or license to the general public.
  - (2) Item evolved from an item described in paragraph (1) through advances in technology or performance that is not yet commercially available, but will be available in the commercial marketplace in time to satisfy the delivery requirements under a government solicitation.
  - (3) Item would satisfy the criteria in paragraphs (1) or (2) but for (i) modifications customarily available in the commercial marketplace, or (ii) minor modifications not customarily available in the commercial marketplace, which do not significantly alter the non-governmental function or essential physical characteristics of the item.
Recent Legislative Activity: FY2016 NDAA

- National Defense Authorization Act (NDAA) for Fiscal Year 2016 (Pub. L. No. 114-92) provisions directed at commercial items:
  
  - Sec. 851 – requires DOD to establish a central authority to oversee commercial item determinations and provide public access to determinations
    - COs may presume items previously determined to be commercial items by a DoD entity are still commercial items unless agency head issues revised determination
  
  - Sec. 853 – requires CO to consider in price reasonableness determination evidence of recent prices paid by Gov’t for purchase of same or similar commercial items, if previous prices remain a valid reference considering time, quantities, etc.
Recent Legislative Activity: FY2016 NDAA (cont’d)

- Sec. 855 – requires DOD guidance on market research re commercial items
  - Agency may not enter into contract for non-commercial item IT products and services unless agency head determines no commercial items can meet needs
  - Market research must inform price reasonableness
  - Sec. 844 also includes requirements for training on market research, including for commercial item acquisitions

- Sec. 856 – limits converting procurements of commercial items/services over $1 million from FAR Part 12 to FAR Part 15, unless CO makes written determination that (1) earlier use of FAR Part 12 was in error and (2) DOD will realize significant cost savings from using FAR Part 15
Recent Legislative Activity: FY2017 NDAA

- S. 2943, Sections 871-80
  - Price reasonableness
    - Requires market research in price reasonableness determinations
    - Allows contractors to submit and COs to consider value of commercial items in price reasonableness, not just historical pricing
  - Revises central records requirement from FY2016 NDAA to include market research and price reasonableness, eliminates public access
  - Requires DFARS list of defense-specific statutes inapplicable to COTS and commercial items
Recent Legislative Activity: FY2017 NDAA (cont’d)

- Preference for commercial standards over military-specific
- Must procure certain services as commercial unless agency makes written determination, after market research, that no commercial services available
  - Facilities-related, knowledge-based, construction, medical and transportation
  - Agency head, Under Secretary, etc. must make determination for contracts over $10 million; CO can make determination for contracts under $10 million
- Items worth less than $10,000 and procured for multiple contracts will be treated as commercial items
- Pilot programs for acquiring “innovative” commercial items through a general solicitation and peer review of proposals
Recent Regulatory Activity: August 2015
Proposed Rule

  - Implemented Section 831 of FY2013 NDAA (Pub. L. No. 112-239)
    - Required guidance on use of the authority to require the submission of other than cost or pricing data
  - Added new definitions:
    - “Market-based pricing”: Pricing that results when nongovernmental buyers drive the price in a commercial marketplace.
      - There is a “strong likelihood the pricing is market based” when nongovernmental buyers account for 50% or more of sales by volume of a particular item
      - Market-based pricing would become the preferred method to evaluate price reasonableness in the absence of competition
    - “Sufficient nongovernment sales to establish reasonableness of price”:
      - Data are “sufficient” when they reflect “market-based pricing” and contain enough information to make adjustments to account for differing circumstances
      - Established standards and an order of precedence for the types of “relevant sales data” that should be considered
Recent Regulatory Activity: August 2015 Proposed Rule (cont’d)

- Solicitation clause 252.215-70XX, to be included when it is “reasonably certain” that certified or uncertified cost or pricing data will be required
  - Exceptions from the requirement to submit certified cost or pricing data
    - Contractors required to submit written request to the CO and certain minimum information to determine (a) **whether an exception to the requirement should be granted**, and (b) **the data necessary to determine price reasonableness**
    - Would require offerors to obtain from subcontractors at all tiers “whatever information is necessary to support a determination of price reasonableness,” including **cost data to support a commerciality determination**, cost realism analysis, should-cost review, or any other type of analysis addressed by FAR part 15 and DFARS part 215”
Recent Regulatory Activity: August 2015 Proposed Rule (cont’d)

- Widely criticized
  - Did not include items “of a type,” “offered for sale” or with “minor modifications” in “sufficient nongovernment sales to establish reasonableness of price”
  - Effectively eliminated those prongs of FAR 2.101 definition
- Withdrawn December 7, 2015 and folded into August 2016 proposed rule
Recent Regulatory Activity: August 2016 Proposed Rule

  - Implements FY2016 NDAA Sections 815 - 853 and 855 - 857, FY2013 NDAA
  - Adds new definitions:
    - “Market prices”: Current prices that are established in the course of ordinary trade and that can be substantiated through competition **or from sources independent of the offerors**
    - “Market research”: A review of existing systems, subsystems, capabilities, and technologies that are available or could be made available to meet the needs of DoD in whole or in part
      - Must include contacting knowledgeable individuals in Government and industry regarding existing market capabilities
Recent Regulatory Activity: August 2016 Proposed Rule (cont’d)

- Additional definitions:
  - “Relevant sales data”: Information provided by an offeror of sales of the same or similar items that can be used to establish price reasonableness taking into consideration the age, volume, and nature of the transactions (including any related discounts, refunds, rebates, offsets or other adjustments)
    - Data are “sufficient” when they reflect “market pricing” and contain enough information to make adjustments to account for differing circumstances
Recent Regulatory Activity: August 2016
Proposed Rule (cont’d)

- Solicitation clause with exceptions from the requirement to submit certified cost or pricing data
  - Contractors required to submit a written request to the CO and certain minimum information to determine (a) whether an exception to the requirement should be granted, and (b) the data necessary to determine price reasonableness
  - Would require offerors to “obtain from subcontractors the information necessary to support a determination of price reasonableness”
    - Does not require cost information from prospective subcontractors if there are “sufficient nongovernment sales of the same item to establish reasonableness of price”

- DoD policy guidance issued September 2, 2016 re DCMA Centers of Excellence and reliance on previous DoD commerciality determinations
Recent Regulatory Activity: August 2016 Proposed Rule (cont’d)

- Significant improvement from 2015 proposed rule, but still flawed
  - Incorporates comments on 2015 proposed rule
  - Definition of required “market research” does not include consideration of pricing conditions in the particular industry or marketplace, including profit
  - Does not require consideration of commercial item determinations by civilian agencies, even GSA Federal Supply Schedule
    - In fact, requires “proof that an exception [to the requirement for certified cost or pricing data] has been granted for the schedule item”
  - Conflates commerciality determination and price reasonableness
  - Includes confusing certification re “catalog pricing” and whether such pricing is based on “all relevant sales data”
Recent Cases

- *CGI Federal Inc. v. United States*, 779 F.3d 1346 (Fed. Cir. 2015)
  
  - FAR Part 12, which prohibits agencies from including noncustomary commercial terms in solicitations or contracts for commercial items, applies to agencies procuring commercial items via Federal Supply Schedule contracts under FAR Subpart 8.4
Recent Cases (cont’d)

- **Palantir USG, Inc. v. United States**, No. 16-784C (Fed. Cl. Nov. 3, 2016)
  - Army procurement of Distributed Common Ground System (“DCGS-A2”) to process and distribute multi-sensor intelligence and weather information to the warfighter
  - FAR Part 15 Solicitation for single award, cost-type contract for system data architect, developer and integrator of DCGS-A2
  - Agency conducted two studies, industry day events, three formal requests for information and informal meetings with contractors
    - Decided on single contractor for all requirements
  - Contractor argued solicitation was unduly restrictive of competition for commercial item offerors
    - Argued the agency should have used phased approach to acquire commercial data visualization and analytic tools (which it could provide) and a separate procurement for integration and development services

- GAO denied protest (**Palantir USG, Inc.**, B- 412746, May 18, 2016, 2016 CPD P 138)
Recent Cases (cont’d)

- Court of Federal Claims held that agency violated FASA preference for commercial items, 10 U.S.C. 2377
  - Requires procurement of commercial items to maximum extent practicable, opportunity for commercial item contractors to compete
  - Agencies must conduct market research and use results to determine whether commercial items are available to meet the agency’s needs

- RFIs sought information for “development projects that are similar in scope and process to the DCGS-A program”

- Market research studies similarly made assessments of potential success of DCGS-A2 development effort through commercial item procurement
  - No genuine inquiry of commercial capabilities to support conclusion that no commercial solution was available
    - No discussion of possible commercial items in market research analysis
    - “Singularly focused on a development procurement”
Agency Trends in Commerciality Determinations and Price Reasonableness

- Requiring item be identical to one offered or sold to the public
  - Contrary to FAR 2.101 definition
    - Ignores “of a type” (effectively reads out of definition)
    - Fails to analyze whether modifications are customary or minor

- Refusing to accept previous commercial item contracts and subcontracts for same item or inclusion on Federal Supply Schedules
  - Argument that contracts/subcontracts do not necessarily mean a CO made a determination
  - Contrary to FY16 NDAA
  - Items on Schedule are commercial items by definition
Agency Trends in Commerciality Determinations and Price Reasonableness (cont’d)

- Conflating commerciality determination and price reasonableness
  - Analysis of sales data in commerciality determinations, not commercial if insufficient percentage of sales to non-government customers

- Recent DoD IG reports arguing cost data is necessary to determine price reasonableness if non-government sales are less than a certain percentage
  - Director, Defense Pricing concurred and stated DoD was preparing guidance to “require evidence that the ratio of commercial to government sales supports the conclusion that this is a commercial item and not one dominated by government procurement”
  - Methodology expressly rejected when Congress developed commercial item contracting in Federal Acquisition Streamlining Act
  - Cost analysis fails to consider profit expectations/experience in industry and marketplace

- Little evidence so far of CO reliance on DCMA Centers of Excellence
  - Unclear how advice from DCMA would be different from current CO practices
Best Practices for Contractors

- Be prepared
  - Don’t assume COs will accept commerciality even if the same or similar items were previously procured as commercial items
  - Anticipate questions and have responses ready
    - Technical descriptions, market research, price analysis
  - Maintain information in central repository so multiple product teams can leverage previous work product
Best Practices for Contractors (cont’d)

- Determine and justify FAR 2.101 basis for commerciality
  - Which prong of FAR 2.101 definition applies?
    - Sold to the public, of a type, customary modifications, minor modifications
      - What is the function or purpose of the item?
      - Does the company sell the item to non-government end users? Identify examples
      - Does the company offer the item for sale to public? Would you in response to a request for quote?
      - Do other companies sell similar items to non-government customers?
        - Identify examples of companies and products
        - How are they different from your products?
  - Be aware that more than one prong may apply
Best Practices for Contractors (cont’d)

- Of a type
  - Identify all similar products the company (or other companies) sell or offer for sale for non-governmental purposes
    - This may be an entire class of products or one or more specific products
  - Document how the of a type item is similar to the other product(s)
    - Function/purpose
    - Materials
    - Dimensions
    - Manufacturing processes
  - Analyze any differences in the products
    - If differences aren’t significant, document why not
  - Review sales data
    - May influence which products to cite as examples to CO
Best Practices for Contractors (cont’d)

- Customary or minor modifications
  - “Customarily available”
    - Does the company (or competitors if information is publicly available) offer the same type of modifications to the same or similar products for non-government customers?
      - E.g., all such products may be customized to fit the customer’s available space, type of connectors, or specific performance requirements
      - If the modifications are not similar, are the differences significant, or just variations in scope?
      - Identify and document examples
    - Would the company offer the same type of modifications if asked?
  - “Minor”
    - What is the purpose of the modification?
    - Does it alter the item’s physical characteristics?
    - Does it alter the item’s form, fit or function?
    - How does scope of the modification compare to the item’s size, dollar value, level of effort, etc.?
Best Practices for Contractors (cont’d)

- Price reasonableness, the “key consideration”
  - Collect data on prices previously paid by government or commercial customers for the same or similar items
    - Catalog or price lists
    - Purchase orders or contracts
    - Publicly-available competitor prices
  - Prepare analysis of any differences between offered price and prices previously paid
    - Result of different terms and conditions, material, quantities, time periods, market factors?
      - How can those differences be accounted for?
Best Practices for Contractors (cont’d)

- Prime/subcontractor considerations
  - Prime is responsible for making commercial item determinations for its subcontractors, but CO can disagree and demand justification
  - Prime often merely a pass-through, with most substantive communications between subcontractor and gov’t
    - But may be more successful with a united front
    - Even if not responsible for substantive responses to CO, prime should stay involved because decision could affect negotiation and pricing of prime contract
  - Both prime and subcontractor should have documentation to support commercial item determination and price reasonableness
    - Amount of required information and possible certification may differ with size of overall program, size of subcontract, type of product/service, etc.
Best Practices for Contractors: Documentation

- Maintain analyses and supporting documentation
  - Prepare detailed, written narrative explaining why the item meets the relevant prong(s) of the FAR 2.101 definition
    - Make it easy for a non-technical person (the CO) to understand
  - Include examples and relevant supporting documentation
    - Specifications, engineering drawings, bills of material
    - Catalogs or price lists, publicly-available competitor pricing information
    - Commercial customer lists, contracts and/or subcontracts with commercial and government customers
      - Consult legal before releasing any customer data
    - Previous commercial item determinations for similar products

- Continue to update data and analysis, particularly any CO determinations of commerciality
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Jon counsels government contractors and subcontractors on a range of legal matters. He regularly litigates bid protests before the Government Accountability Office (GAO), the Court of Federal Claims (COFC), and federal agencies, including classified protests. Jon conducts internal investigations involving allegations of contractor fraud or abuse in conjunction with Department of Justice (DOJ) and Inspector General (IG) subpoenas, suspension and debarment proceedings, and employee whistleblower claims, and helps clients develop and maintain internal compliance and training programs. He also has experience in mergers and acquisitions and other due diligence activities unique to government contractors.

Representative Experience

- Litigates bid protests at the GAO and COFC.
- Conducts due diligence on behalf of buyers, sellers, and underwriters on issues unique to government contractors.
- Defends False Claims Act (FCA) and qui tam claims in the federal district courts, including claims of whistleblower protection violations.
- Represents government contractors in defense of suspension and debarment proceedings, including negotiation of administrative agreements resolving suspensions and debarments.
- Represents government contractors in disputes with the federal government, including threatened terminations, claims under the Contract Disputes Act (CDA), and appeals of contracting officer final decisions to the Boards of Contract Appeals.
- Conducts internal investigations and defends DOJ and/or agency IG investigations, including representing government contractors during employee interviews conducted by the DOJ or IG investigators.
- Assists with the development and implementation of internal compliance and training programs.
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Suzette serves as Chief Counsel in the Boeing Law Department, practicing in the areas of litigation and investigations and cost policy. She has nineteen years’ experience as a government contracts lawyer, with expertise in bid protests, contract disputes and claims, contract administration, government investigations, mergers and acquisitions, and compliance. Suzette joined the Boeing Law Department in February 2013.

Suzette joined Boeing from Honeywell International Inc., where she served most recently as General Counsel to Honeywell Technology Solutions Inc. and Assistant General Counsel to Honeywell Defense & Space. Before that, she was a partner in the DC office of Perkins Coie, where she represented a variety of clients on government contract issues. Suzette is a graduate of Cornell Law School and Smith College.
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Tracye counsels and represents government contractors and subcontractors on a broad range of government contracting issues, including bid protests, contract claims and disputes, subcontract formation and performance issues, compliance with ethics and procurement integrity laws, and government investigations and audits.

Representative Experience

- Represents government contractors in disputes with the federal government, including monetary claims under the Contract Disputes Act (CDA) and appeals of terminations for default, including defective pricing claims under the Truth in Negotiations Act (TINA), to the Boards of Contract Appeals and the Court of Federal Claims (COFC).
- Prosecutes and defends bid protests before the Government Accountability Office (GAO), COFC, and state courts and procurement agencies, including GAO protests involving the U.S. Department of Health and Human Services’ (HHS) award of Medicare Administrative Contractor (MAC) contracts.
- Conducts internal investigations and assists government contractors with responding to Inspector General (IG) and Department of Justice (DOJ) subpoenas and investigations, including allegations of False Claims Act (FCA) violations.
- Assists government contractors in responding to government suspension and debarment officials.
- Represents government contractors in negotiation of teaming and subcontracting agreements and prime-subcontractor disputes.
- Counsels clients in the development and implementation of government contracts ethics and compliance and training programs.
- Advises government contractors on recent statutory and regulatory developments, including questions related to the Buy American Act and Trade Agreements Act (TAA).
- Conducts due diligence on behalf of buyers, sellers, and underwriters on issues unique to government contractors.