

DEFENDING COMMERCIALITY AND PRICE REASONABLENESS



Background

- ▶ Congress passed the **Federal Acquisition Streamlining Act** of 1994, “**FASA**” in part to capture for the federal government some of the benefits and efficiencies of commercial contracting
- ▶ Many large companies don’t sell to the government if it means taking on large regulatory burdens and legal liability
 - Technology industry
 - Banking
- ▶ The commercial item clauses are intended to mirror the terms and conditions found in the commercial marketplace, significantly reducing the burden associated with government contracting
 - Not all burdens or liabilities can be avoided
- ▶ Definition of “commercial item” is rather broad and the government often takes inconsistent views on what qualifies as a commercial item
- ▶ Establishing commerciality still requires that the government find the procurement to be “fair and reasonable”

Benefits of Commerciality

- ▶ Many of the FAR obligations (clauses) do not apply to commercial item acquisitions or are not flow down clauses if subcontract is for commercial items
- ▶ Statutory exemptions
 - TINA (submission of certified cost or pricing data)
 - Cost Accounting Standards
- ▶ Most of the company's standard commercial terms apply to the sale
 - Warranty
 - Intellectual Property
 - Termination
 - Changes
- ▶ ***If*** price reasonableness can be established, submission of cost data is not necessary
 - No scrutiny of fee/profit

Commercial Definition - Paragraph (1)

- FAR 2.101: Commercial Item means --
 - (1) Any item, *other than real property*, that is of a type customarily used for non-governmental purposes and that --
 - (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;





Commercial Definition - Paragraph (2)

- FAR 2.101(2): Any item that evolved from an item described in paragraph (a) of this definition through advances in technology or performance and that is not yet available in the commercial marketplace, but will be available in the commercial marketplace in time to satisfy the delivery requirements under a Government solicitation;



Commercial Definition - Paragraph (3)

- FAR 2.101(3): Any item that would satisfy a criterion expressed in paragraphs (a) or (b) of this definition, but for --
 - (i) Modifications of a type customarily available in the commercial marketplace;
 - or
 - (ii) Minor modifications of a type not customarily available in the commercial marketplace made to meet federal government requirements. Minor modifications mean modifications that do not significantly alter the nongovernmental function or essential physical characteristics of an item or component, or change the purpose of a process. Factors to be considered in determining whether a modification is minor include the value and size of the modification and the comparative value and size of the final product. Dollar values and percentages may be used as guideposts, but are not conclusive evidence that a modification is minor.



Commercial Definition - Paragraph (4)

- FAR 2.101(4): Any combination of items meeting the requirements of paragraphs (1), (2), (3) or (5) of this definition that are of a type **customarily combined** and **sold in combination** to the general public;

Commercial Definition - Paragraph (5)

- FAR 2.101(5): Installation services, maintenance services, repair services, training services, and other services if--
 - ▶ (i) Such services are procured for support of an item referred to in paragraph (1), (2), (3), or (4) of this definition, regardless of whether such services are provided by the same source or at the same time as the item; **and**
 - ▶ (ii) The source of such services provides similar services contemporaneously to the general public under terms and conditions similar to those offered to the Federal Government

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Commercial Definition - Paragraph (6)

- FAR 2.101(6): **Services** of a type offered and sold competitively in substantial quantities in the commercial marketplace based upon established catalog or market prices for specific tasks performed under standard commercial terms and conditions...



Commercial Definition - Paragraph (7)

- FAR 2.101(7): Any item, combination of items, or services referred to in paragraphs (1) through (6) of this definition, notwithstanding the fact that the item, combination of items, or service is transferred between or among separate divisions, subsidiaries, or affiliates of a contractor

Commercial Definition - Paragraph (8)

- FAR 2.101(8): A non-developmental item, if the procuring agency determines the item was **developed exclusively at private expense** and **sold in substantial quantities**, on a competitive basis, to **multiple State and local governments** or to **multiple foreign governments**.



Establishing Commerciality

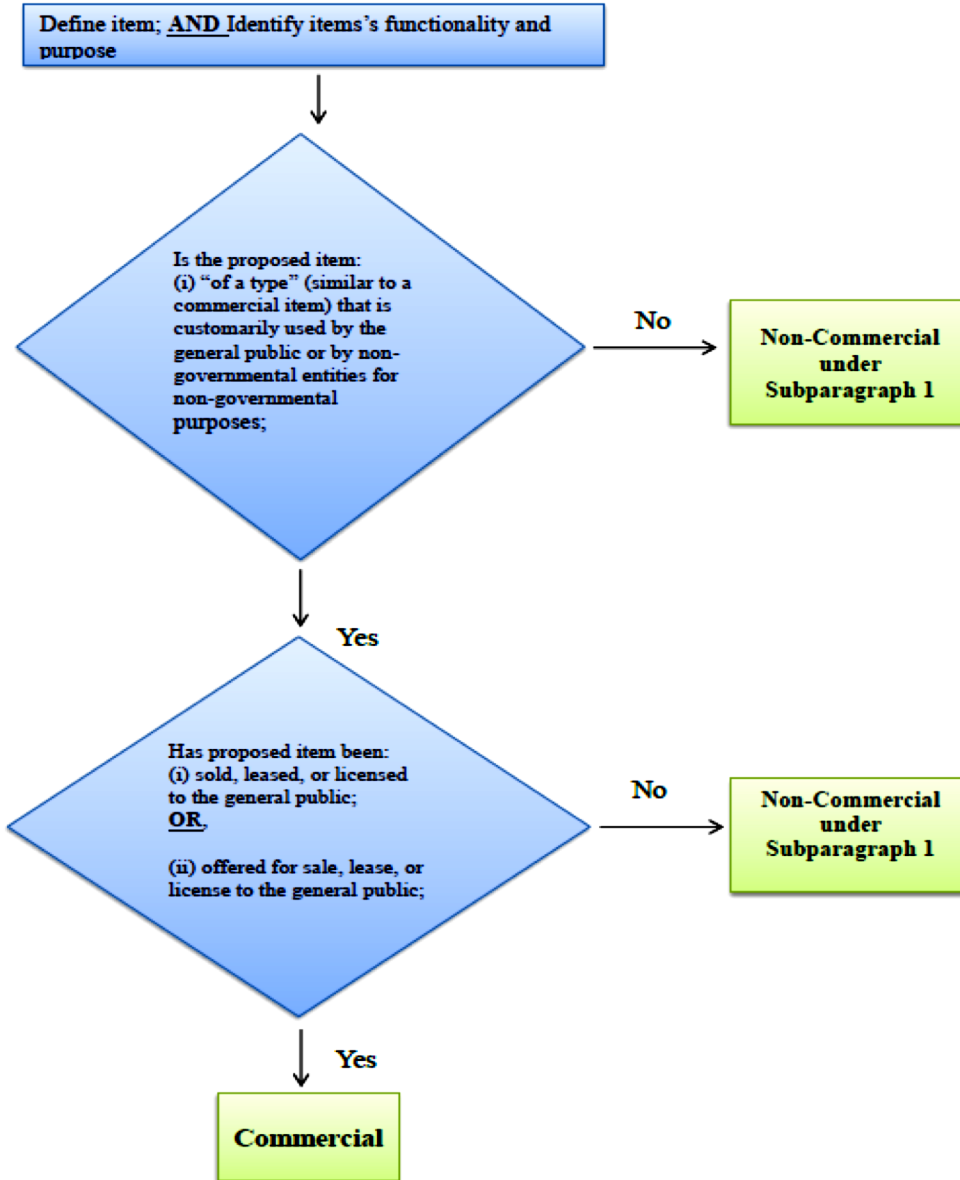
- ▶ Commercial Item Determinations (CIDs)
 - Performed by the contracting officer
 - Requires the submission of supporting documentation by contractor
 - **Technical specifications and drawings**
 - **Comparisons to commercial equivalents**
 - **Examples of previous commercial sales**
 - **Catalogues and price lists**
- ▶ Agency reliance of prior CIDs
 - DoD September 2016 Memorandum
- ▶ Prime Contractor CIDs

Establishing Commerciality

► “Of-a-type” Evaluation

- Sales of a commercial “of-a-type” item to the “general public” **do not include sales to the Federal, state, local, or foreign governments** (or through Foreign Military Sales) **except as provided in FAR 2.101(8) - see above.**
- There is usually no bright-line for making a CID in “of-a-type” scenarios. The comparison between the government’s requirements and available commercial items must account for differences in the functions to be performed, performance required, and essential physical characteristics.
- Each process should also take into account issues specific to the commercial item.

Subparagraph 1 definition (Only):

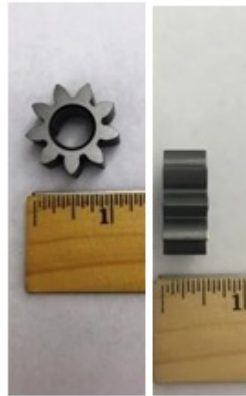
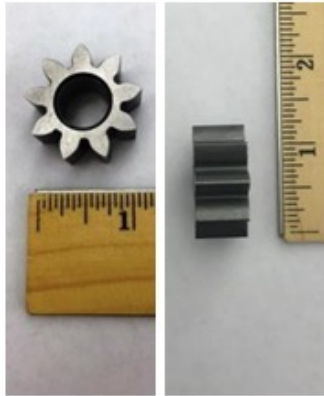


Determining Whether a Modification is “of-a-type”

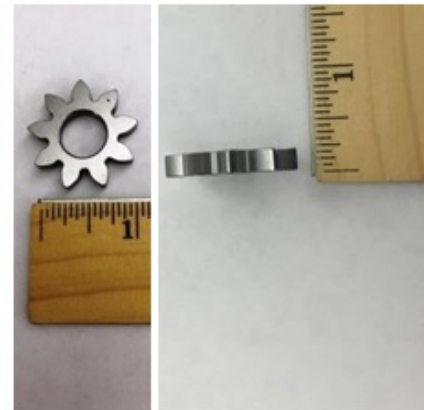
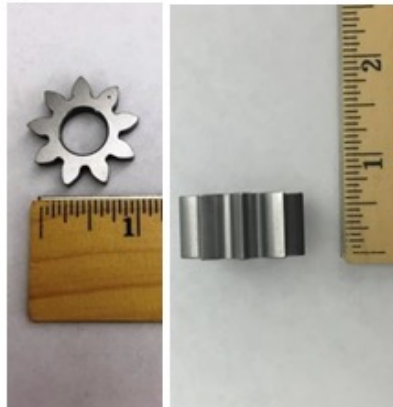
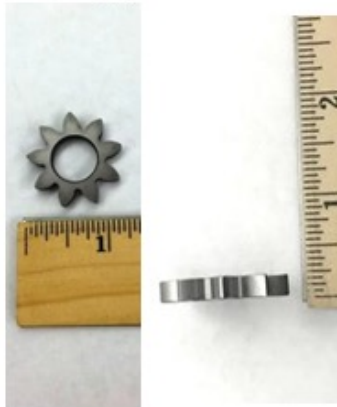
- ▶ How similar is the modified item to other modified items sold in the commercial marketplace?
 - If there are no similarities, the mod will not likely qualify as “of-a -type”
- ▶ Does the company perform similar mods for non-government customers?
 - If not, the modification is likely not “of-a-type”
- ▶ Are there differences in the manufacturing processes used to perform the modification for the Federal government and non-government customers?

Gov't Sale vs. Commercial Sale

Sold to USG



"of-a-type" commercial equivalents"



Fair & Reasonable Price Hurdle

- ▶ Often a more difficult task than establishing commerciality
- ▶ Requires examples of commercial price
 - Published price lists
 - Prior invoices
- ▶ The commercial price may be deemed fair and reasonable with adequate examples of past commercial sales
- ▶ If prior sales do not match in volume or are not recent, the CO may require more
 - CO may require **any information including cost data** “to the extent necessary to determine a fair and reasonable price”

Best Practices

- ▶ Build a library of supporting documentation for each part or service that should be sold commercially
 - Should be easy for a non-technical person to digest
 - Include items that would go in a CID
 - Non-government sales information
 - Keep file updated
- ▶ Build a catalogue price
 - Continue to update the file as products and services evolve
- ▶ Try to establish a united front with prime contractor
- ▶ Stay consistent!!

Recent Regulatory Trends in Commercial Items

Commercial Items: Recent Changes and Proposed Changes

- ▶ As noted earlier, commercial item acquisitions were first formally introduced through FASA as a mechanism for the government to save time and money by buying goods and services at commercial prices and terms.
- ▶ Every few years the pendulum swings in favor of and then against commercial item acquisitions.
 - When the pendulum swings in favor, the focus is on cost and time savings and eliminating barriers to sales.
 - When the pendulum swings away, the focus is on the supposed abuses of the process through commerciality determinations that are not supportable, and profit margins that the government deems inappropriate notwithstanding commercial acceptance.

National Defense Authorization Acts (NDAA)

- ▶ The NDAA for each fiscal year authorizes defense spending levels and sets relevant procurement policies. While only applicable to the DOD, it influences policy at other agencies and signals Congressional preferences and direction.
- ▶ In each of the past several years significant changes have been introduced in the NDAA that would favor contractors and broaden commercial acquisitions, signaling that Congress is again paying attention to commercial items.
- ▶ Although many provisions have not made it to the final bills, pendulum now swinging back in favor of commercial item acquisition.

NDAA FY18 Changes

▶ Section 846

- Requires DoD to contract with multiple commercial online marketplaces for the procurement of certain commercial-off-the-shelf (COTS) products

▶ Section 848

- Modifies 10 U.S.C. 2380(b) to provide that a contract for an item using FAR part 12 procedures serves as a commercial item determination, with some exceptions
 - November 2020: proposed DFARS Rule issued to implement this provision

NDAA FY19 Changes

▶ Section 836

- Revises definition of “commercial item” by separating it into two new definitions: “commercial product” and “commercial service.” Statutory definitional changes took effect on January 1, 2020
 - October 2020: proposed FAR Rule issued to implement this provision; open DFARS case

▶ Section 838

- Authorizes GSA to develop procedures for procurements through the e-commerce portal
- Under those procedures, procurement will satisfy competition requirements if there are at least two suppliers that offer comparable products on the portal
- Portal is expected to “ensure reasonable pricing of commercial products”

NDAA FY20 & FY21 Changes

- ▶ NDAA FY 2020, Section 818
 - Requires head of an agency to document market research results related to commercial item determinations “in a manner appropriate to the size and complexity of the acquisition”
- ▶ NDAA FY 2021, Section 816:
 - Encourages DoD COs to seek support from DCMA, DCAA, or “other appropriate experts in the Department” when making commercial item determination
 - COs may also “consider the views of appropriate public and private sector entities” when making determination
 - Requires COs to prepare a memorandum within 30 days of award summarizing commercial item determination

Other Regulatory Changes

- ▶ January 2018: DoD issued the Guidebook for Acquiring Commercial Items
- ▶ Comprised of two parts: Part A– Commercial Item Determination; and Part B– Pricing Commercial Items.
 - Part A proposes procedures and “decision trees” for DoD personnel to use in assessing whether a product or service qualifies as a “commercial item” under FAR 2.101;
 - Part B provides procedures for DoD personnel conducting a price analysis; aids in determining the appropriateness of a contractor's proposed commercial item pricing.

Other Regulatory Changes

- ▶ DFARS Final Rule, *Procurement of Commercial Items* 83 FR 4431, 4435 (Jan. 31, 2018)
 - Issued a final rule amending DFARS implementing sections of the NDAA for FYs 2013, 2016 and 2018. Changes include:
 - Formalizes presumption of commerciality for items that DoD previously treated as commercial (from NDAA FY 2016).
 - Permits COs to treat supplies and services sold by “nontraditional defense contractors” as commercial items.
 - Establishes a "hierarchy" for data that COs should rely on when conducting price reasonableness analyses for commercial and non-commercial items. Top of list = market research

Preparing an Effective CIJ Package

Commercial Item Determination Package

- ▶ To establish commerciality, contractors submit "**Commercial Item Justification**" (**CIJ**) packages.
- ▶ The CIJ package is the contractor's opportunity to support the claim that the product (or service) sold qualifies as a "commercial Item" as defined by the FAR.
- ▶ The final determination is exclusively at the discretion of the government (contracting officer).
- ▶ CIJ packages are also an opportunity to demonstrate *price reasonableness*.

Step 1 - Describe the Product

The three most important descriptions for commerciality:

- ▶ **Function** – what does the product do?
 - Consider from the perspective of a layperson; avoid hyper technical descriptions
- ▶ **Form** – what are the physical characteristics of the product?
 - Material components, dimensions, manufacturing locations and techniques
- ▶ **Fit** – how does the product interact with other products and systems (if applicable)?

Step 2 – Describe How the Product Meets the FAR Commercial Item Definition

Examples:

- ▶ Is the product one that has been sold or offered for sale in the commercial marketplace?
- ▶ Has a similar product been sold or offered for sale by you or your competitors in the commercial marketplace?
- ▶ Is the product similar to a commercial product *but for* some modifications that make the item no longer “of a type”?
- ▶ Total of eight “paths” to commerciality described below

Step 3 - Determine the Content of the CIJ Package

Identify what must be proven and needed materials.

- ▶ The elements to prove mirror the definitions.

For all categories, include past commerciality determinations:

- ▶ **Must include** prior DoD determination if applicable.
- ▶ **Should include prior** civilian agency determination if applicable.
- ▶ **May include** determinations by prime contractors.

Step 4 - Constructing the Technical Narrative

- ▶ The core of the package is the narrative: the more detailed and comprehensive the more convincing. Prepare a technical explanation for the layman (non engineer).
- ▶ If the offered item is "of a type," explain the technical similarities, considering whether the **essential salient physical characteristics** and **function** of the items are the same. **Function** is more important than physical characteristics.
- ▶ Address any overlapping production processes, testing procedures, personnel, and policies.
 - **Charts** are helpful.
- ▶ Must demonstrate any modifications are similar to those offered commercially or are comparatively minor.
 - For **minor modifications**, charts showing the relative cost and size of the modification comparative to the overall item are critical.

Step 5 - Establish Price Reasonableness

Gather materials supporting price reasonableness.

- ▶ Price reasonableness is separate from commerciality.
- ▶ If CIJ package is effective, customer should be convinced that price is reasonable based on included *price data*.
- ▶ If prior sales do not match in volume or are not recent, the CO may require more.
 - CO may require **any information including non-cost data** “to the extent necessary to determine a fair and reasonable price”
- ▶ CIJ package should include material demonstrating price reasonableness—
 - Invoices (redacted if appropriate);
 - Commercial research;
 - Other material showing market price;
 - Commercial data may be from other companies.

Step 5 - Establish Price Reasonableness

- ▶ If the price varies from the commercial pricing, provide explanation.
 - Pricing bands for quantity purchases.
 - Escalation rates and learning curves.
 - Complexity of materials or additional features.
- ▶ The less recent the price data, the less persuasive, and more likely that cost data will be required.
- ▶ If a similar product is sold by competitors, conduct market research—these prices can be persuasive.

Protest Considerations

Commercial Item Determinations in Bid Protests

- ▶ Commercial item-related protests come in three broad categories:
 - Solicitation challenges alleging that the procurement should (or should not) be conducted under FAR Part 12.
 - Challenges to an offeror's exclusion from the competitive range or non-selection for award on the basis that the offeror's product or service does not meet the definition of commercial item.
 - Challenges to the agency's determination that the awardee's product or service is a commercial item.

Commercial Item Determinations in Bid Protests

- ▶ GAO views the determination of whether a product is a commercial item as largely within the discretion of the contracting agency. It, therefore, will not disturb the determination unless it is shown to be unreasonable. *Gichner Systems Group, Inc.* B-414287, B-414287.2, B-414287.3: Apr 27, 2017.
- ▶ GAO gives similar deference to agencies in deciding whether to solicit products or services under FAR Part 12 or FAR Part 15. Agencies must conduct the market research required under FAR Part 10 to determine whether commercial items are available that could meet the agency's requirements, but the assessment of whether or not the research requires or supports a commercial item procurement is, again largely within the discretion of the contracting agency, and will not be disturbed by GAO unless it is shown to be unreasonable. (*Voith Hydro, Inc.*, B-401244.2; B-401771, November 13, 2009.)

Commercial Item Determinations in Bid Protests

- ▶ The U.S. Court of Appeals for the Federal Circuit has weighed in on these issues, affirming a decision by the Court of Federal Claims that the Army had violated the Federal Acquisition Streamlining Act of 1994 (FASA) in determining that the items sought under a particular solicitation could not be procured as a commercial product.
- ▶ The Federal Circuit affirmed that the Army had violated FASA by failing to fully consider whether:
 - Commercial items could meet the agency's needs;
 - Commercial items could be modified to meet the agency's needs;
 - The requirements could be modified so commercial items could be used.
- ▶ *Palantir USG, Inc. v. United States*, No. 2017-1465 (Fed. Cir. Sept. 13, 2018)

Conclusion

- ▶ Establishing commerciality is a significant way to reduce regulatory burdens imposed on contractors
- ▶ The Government remains concerned that commerciality is being abused:
 - Concern that “of a type” is being stretched—for example, armored military vehicles are not necessarily “of a type” with vehicle armor used in the commercial marketplace;
 - DOD continues to worry that high profit margins mean the government is not paying fair prices, notwithstanding that the focus should be on the price the market accepts.
- ▶ Nonetheless, the pendulum is swinging back in favor of commercial item acquisitions, as shown by Congressional intervention in each of the past three years.

Questions?