Developments in DoD's Treatment of Commercial Item Assertions

Government Contracts Alert

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UPDATE
The comment period for DoD's proposed rule amending DFARS 212 has been extended to November 10. Click here.

The passage of the Federal Acquisition Streamlining Act of 1994 and the Clinger-Cohen Act of 1996 saw the dawning of a new era in procurement policy, pursuant to which sweeping changes to the procurement laws and regulations governing the acquisition of goods and services offered and sold in the commercial marketplace took hold. These goods and services are referred to, and defined, in the Federal Acquisition Regulation ("FAR") as "commercial items." Two major effects of these legislative landmarks were: (1) the streamlining and modification of certifications and clauses required in solicitations and contracts for commercial items; and (2) the exemption of commercial item suppliers from the requirement to submit certified cost or pricing data under the Truth in Negotiations Act ("TINA").

In the twenty-odd years that have followed the enactment of this legislation, commercial items suppliers to DoD (both prime and subcontractors) have encountered increased difficulty in taking advantage of their commercial status because DoD and the Defense Contract Audit Agency ("DCAA") have been taking an increasingly skeptical stance on commerciality determinations made by suppliers, often challenging whether the items to be supplied are in fact commercial items entitled to the streamlined benefits accorded such acquisitions under the FAR and the Defense Federal Acquisition Regulation Supplement ("DFARS").

In the National Defense Authorization Act for Fiscal Year 2016 (enacted November 25, 2015) ("FY2016 NDAA"), Congress provides clear but limited direction to DoD that it should alleviate burdens placed on commercial item suppliers in contracting with the government. In response, on August 11, 2016, DoD issued a proposed rule amending the DFARS addressing commercial item determinations (81 Fed. Reg. 53101) ("DoD's Proposed Rule"), and on September 2, 2016, DoD's Director of Defense Procurement Policy issued a Policy Memorandum (the "Memorandum") providing guidance on commercial item determinations, rescinding a February 4, 2015, policy memorandum in which DoD openly complained about the protracted length of time contracting officers were taking to make such determinations.

Here is a summary of the developments:

The FY2016 NDAA

- The FY2016 NDAA instructs the Secretary of Defense to issue guidance to ensure that acquisition officials comply with 10 U.S.C. § 2377, which establishes ***a preference for commercial items, and to conduct market research before engaging in procurements above the simplified acquisition threshold to determine if a commercial item exists to satisfy the agency's needs.***

- The statute expands the definition of "market research" beyond that in FAR Part 10 to include "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." In addition to the techniques for conducting market research in FAR 10.002(b)(2), the definition suggests that the contracting officer, at a minimum, contact knowledgeable individuals in government and industry regarding existing market capabilities.
- The statute requires DoD to include in the guidance that noncommercial item purchases for information technology products and services (a term of art statutorily defined to include computers and peripheral and ancillary equipment) ***cannot*** be authorized unless a written determination is made that no commercial items are suitable to meet the agency's needs in advance of the commencement of any procurement for noncommercial items.
- The FY2016 NDAA amends 10 U.S.C. § 2306a(b) to specify that in applying the commercial item exception to the submission of certified cost and pricing data under TINA, a contracting officer ***"may presume that a prior commercial item determination made by a [DoD entity] shall serve as a determination for subsequent procurements of such item"*** (emphasis added). The Act further provides that if the contracting officer does not make the presumption, he or she must obtain a "review" of the determination by the "head of the contracting activity," who is obligated to provide within thirty days a written confirmation or a revised determination with an explanation for the revision.
- The statute includes a provision (now codified at 10 U.S.C. § 2380A) stating that ". . . items and services provided by nontraditional defense contractors . . . may be treated by the head of an agency as commercial items for purposes of this chapter." The new Section 2302(9) defines a "nontraditional defense contractor" as "an entity that is not currently performing and has not performed, for at least the one-year period preceding the solicitation of sources by the Department of Defense for the procurement or transaction, any contract or subcontract for the Department of Defense that is subject to full coverage under the cost accounting standards prescribed pursuant to section 1502 of title 41 and the regulations implementing such section."
- The FY2016 NDAA includes instructions to DoD (now codified at 10 U.S.C. § 2380) requiring the Secretary of Defense to establish and maintain a ***"centralized capability with necessary expertise and resources to oversee the making of commercial item determinations . . . and to provide public access to DoD commercial item determinations"*** (emphasis added).

DoD's Proposed Rule

- Proposed DFARS 212.102(a)(iii) adopts a presumption that a prior commercial determination by a component of DoD "shall serve as a determination for subsequent procurements of such item." Any deviation requires a thirty-day review of the determination by the head of the contracting activity.
- Proposed DFARS 212.001 adopts the expanded definition of "market research" included in the FY2016 NDAA.
- Proposed DFARS 212.102(a)(iv) affirms that supplies and services provided by nontraditional defense contractors (using the same definition as in the FY2016 NDAA) may be treated as commercial items. The rule expressly states that its intent is to "enhance defense innovation and create incentives for cutting-edge firms to do business with DoD."

The Policy Memorandum

- The Memorandum reiterates DoD's concern that commercial item determinations are taking too long – "particularly for items not sold in the competitive commercial marketplace" – and that inconsistent determinations are being made by contracting officers with DoD.
- The Memorandum announces that the Defense Contract Management Agency ("DCMA") has established Commercial Item Centers for Excellence ("CoEs"), staffed by engineers and price/cost analysts, to advise contracting officers with respect to commercial item determinations.
- The Memorandum instructs contracting officers to "adopt the practice of recognizing prior known determinations." Contracting officers are instructed that in making a determination they "need only include a copy of the prior determination in the contract file" along with an affirmation that the prior determination remains valid. If a contracting officer disagrees, he or she must take it up the "chain of

command and the DCMA Commercial Item CoE prior to making a determination that deviates from prior decisions."

- The Memorandum anticipates that at some time in the future, there will be a "robust database" of commercial item determinations providing acquisition professionals access to both the determinations and rationale, but it neither sets a timetable for nor mentions public accessibility to the database, despite the statutory obligation to provide such accessibility.
- The Memorandum states that the Directors of Defense Pricing and DCMA's Cost & Pricing Center are working with "interested companies" – through the use of advance agreements – to define "the types of information needed to support commercial item determinations." It appears to encourage contractors to pursue an agreement to pre-identify and designate specific products and services as commercial items. The Memorandum states that the agreements will be uploaded to the Contract Business Analysis Repository ("CBAR") for use by contracting officers, but gives no instructions on how to participate or whether the information will be made public.
- Despite lamenting the length of time it takes to make commercial item determinations for products not yet in the commercial marketplace, neither the Memorandum nor the Proposed Rule provides any guidance on determinations regarding these products.

Observations and Practical Tips

1. DoD suppliers now have a statutory basis (and presumably soon will have regulatory support) to insist that the procuring agency rely on prior commerciality determinations. Accordingly, suppliers should inquire as to the existence of prior determinations and should insist that the procuring authority rely on them if and as they are available.
2. The statute's and proposed regulation's declaration that items provided by nontraditional defense contractors may be treated as commercial items simply states a truism that already exists in law and regulation. It does nothing to further encourage non-DoD commercial suppliers to sell to the DoD. Suppliers with a history of non-DoD government sales should direct procuring authorities to DoD's Commercial Item Handbook ("Handbook"). Appendix K to the 2001 Handbook, added to provide streamlined approaches to commercial item determinations, which advises that when a prior determination has been made by ***"Government acquisition personnel"*** (emphasis added) (not just DoD acquisition personnel) that an item meets the definition of a commercial item, it is "not necessary to repeat a full-scale commerciality determination in subsequent acquisitions." The Handbook has long required DoD to document in writing any determination to overturn a prior agency determination. The Appendix goes on to suggest that an agency can rely on a prior ***prime contractor's determination*** of commerciality of a subcontractor's product or service, and vice versa. This guidance also appears (in a watered-down form) in the updated draft Commercial Item Handbook (Version 2.0) (first published in 2011 and never finalized).
3. Suppliers without any governmental sales history (or with no history at all) should attempt to anticipate a DoD agency's needs and assist the agency (or the prime contractor) with its market research to provide information regarding commercial sales and/or demonstrate that products "of a type" offered by the supplier have previously been sold to the government as commercial items. (To qualify for commercial item status under FAR 2.101, the products need only be "of a type customarily used by the general public or by non-governmental entities" that have been sold or offered for sale to the general public.) FAR Part 12.101 obligates DoD to conduct independent market research (the definition of which has now been expanded by FY2016 NDAA and the proposed regulation) to determine the availability of commercial items to satisfy the statutory preference for such items. A good place to start is with the U.S. General Services Administration Federal Supply Schedules, whose product and service offerings are by definition considered commercial. Suppliers should ask procuring authorities about the availability of "advance agreements" long before responding to solicitations seeking their products or services. In fact, these discussions should commence as early in the acquisition process as possible – *e.g.*, at industry-day presentations and when sources-sought notices are released.
4. Where there is little or no market information to research, and the supplier is offering a new product or a product with little or no sales, the supplier must take all steps necessary to transparently and publicly offer the product for sale. Remember that the definition of commercial item at FAR 2.101 includes items "offered for sale." The supplier should see that its product is prominently featured on

its website as well as in its catalog and any other mechanisms it uses to publicize its product offerings. The supplier should record all inquiries by prospective buyers, including requests for price quotations. Finally, the supplier should utilize all venues available for the advertisement of the product, whether through participation in trade shows, online industry listings and databases, or other means of demonstrating that its product is offered for sale in the commercial marketplace.

5. Finally, once the DoD agency is convinced of commercial item status, the supplier must remain vigilant to ensure that it receives the benefits of being a commercial item supplier. This means, among other things, taking advantage of exemptions to the applicability of the Cost Accounting Standards and the obligation to provide certified cost or pricing data under TINA, and insisting that noncommercial item solicitation provisions and clauses (i.e., those prescribed in FAR Part 12 and DFARS Part 212) be justified and kept to a minimum.