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**Re: Comments on Defense Federal Acquisition Regulation Supplement:
Evaluating Price Reasonableness for Commercial Items; DFARS Case
2013-D034; 80 Fed. Reg. 45,918 (Aug. 3, 2015)**

Dear Mr. Gomersall:

On behalf of the American Bar Association ("ABA") Section of Public Contract Law ("Section"), I am submitting comments on the proposed rule cited above.¹ The Section consists of attorneys and associated professionals in private practice, industry, and government service. The Section's governing Council and substantive committees include members representing these three segments to ensure that all points of view are considered. By presenting their consensus view, the Section seeks to improve the process of public contracting for needed supplies, services, and public works.

The Section is authorized to submit comments on acquisition regulations under special authority granted by the ABA's Board of Governors. The views expressed herein have not been approved by the House of Delegates or the Board of Governors of the ABA and, therefore, should not be construed as representing the policy of the ABA.²

¹ Mary Ellen Coster Williams, Section Delegate to the ABA House of Delegates, and Heather K. Weiner and Anthony N. Palladino, members of the Section's Council, did not participate in the Section's consideration of these comments and abstained from the voting to approve and send this letter.

² This letter is available in pdf format at http://www.americanbar.org/groups/public_contract_law/resources/prior_section_comments.html under the topic "Commercial Products and Services."

I. BACKGROUND AND INTRODUCTION

On August 3, 2015, the Department of Defense (“DoD”) issued the proposed rule to amend the Department of Defense Federal Acquisition Regulation Supplement (“DFARS”) for the stated purpose of “issu[ing] guidance on the use of the authority to require the submission of other than cost or pricing data.”³ The proposed changes to the DFARS, however, would alter the regulatory regime for the Government’s acquisition of commercial items and significantly affect the relationship between prime contractors and their commercial-item subcontractors.

Of particular concern to the Section, the proposed rule would narrow the definition of a “commercial item” in a manner that would significantly alter which items may qualify as commercial items under the Federal Acquisition Regulation (“FAR”). Specifically, DFARS 252.215-70XX and Alternate I, recognize only three commercial-item exceptions to the requirement to submit certified cost or pricing data: items priced based on a catalog; items priced using market-based; and items included on an active Federal Supply Schedule (“FSS”). If none of these three exceptions apply, DFARS 252.215-70XX and Alternate I require submission of certified cost or pricing data. These changes would effectively repeal the commercial item exception for items “of a type” or those newly “offered for sale” for which there are no catalog, market-based, or FSS prices. We do not think that is what the drafters intended given the context of Section 831 and the other sections of the proposed rule.

But if this is what the drafters intended, the proposed rule certainly goes further than providing DoD contracting officers with “guidance” and appears to exceed the direction from Congress that ostensibly prompted the proposed rule. Additionally, the proposed rule would also require commercial-item contractors to comply with onerous cost data requirements in connection with commercial-item procurements, which may undermine the acquisition-streamlining reforms of the 1990s.

The Section understands that the Government has an obligation to purchase supplies and services from commercial-item contractors at fair and reasonable prices.⁴ Nonetheless, the Section is concerned that the proposed changes to the commercial-item regulations are not only unnecessary, but also contrary to the Government’s interests and likely to hinder the Government’s ability to acquire vital, cutting-edge technologies from the commercial marketplace.

In the 1990s, Congress overhauled the Government’s commercial-item-contracting processes through reforms implemented in the Federal Acquisition Streamlining Act of 1994, Pub. L. No. 103-355 (“FASA”), and the Federal Acquisition Reform Act (or Clinger Cohen Act of 1996), Pub. L. No. 104-106 (“FARA”). Through these reforms, Congress expressed a preference for purchasing commercial items and implemented changes to the regulatory framework for commercial-item acquisitions

³ 80 Fed. Reg. 45,918 (Aug. 3, 2015).

⁴ See FAR 15.402(a).

designed to streamline the Government's purchase of commercial goods and services.⁵ Congress recognized that certain of these reforms would encourage commercial contractors' participation in the government marketplace because the reforms would "relieve commercial contractors from what they consider their number one disincentive to participating in government procurements—the burden of collecting cost data for the government."⁶

Section 831 of the National Defense Authorization Act ("NDAA") for Fiscal Year ("FY") 2013⁷ and DoD's proposed rule appears to be prompted by certain reports issued in recent years that have criticized DoD's commercial-item acquisitions.⁸ These reports indicated that, in some instances, DoD procured items misclassified as commercial or purchased commercial items without adequately justifying the nature of the procurements. Additionally, the results of the 2007 Acquisition Advisory Panel recommendations, which criticized in part the broad commercial-item definition currently in place, also appear to be motivating the proposed rule.⁹

Despite the concerns identified in these reports, the Section does not agree that implementing the proposed rule's changes to the regulations governing commercial-item acquisitions will ultimately benefit the Government. Because of the onerous requirements that the proposed rule imposes upon commercial prime contractors and subcontractors, the Section is concerned about the presumably unintended consequence that commercial firms will withdraw entirely from the government marketplace. The Section sees a substantial risk that these market changes will result from the proposed rule.

Indeed, other critics of the proposed rule have expressed the same concerns. For example, in urging the immediate rescission of the proposed rule, Senator John McCain wrote: The rule "would effectively require high-tech commercial firms to build entirely new accounting systems just to do business with DoD, which is but a small fraction of their overall market share. This will not happen."¹⁰ The absence or withdrawal of these companies will leave the DoD unable to take advantage of the significant private investments that commercial companies have made to develop key technologies—including cutting-edge defense resources.

⁵ See FASA, Pub. L. No. 103-355, 108 Stat. 3243 at 3390; FARA, Pub. L. No. 104-106, 110 Stat. 186 at 649-56.

⁶ S. Rep. No. 103-258, at 6 (1994), *reprinted in* 1994 U.S.C.C.A.N. at 2566.

⁷ Pub. L. 112-239, enacted January 2, 2013.

⁸ See, e.g., DoD Office of the Inspector General, Commercial Contracting for the Acquisition of Defense Systems, D-2006-115 (Sept. 29, 2006); U.S. Government Accountability Office ("GAO"), GAO-06-838R, Contract Management: DoD Vulnerabilities to Contracting Fraud, Waste, and Abuse (2006).

⁹ See Acquisition Advisory Panel, Report of the Acquisition Advisory Panel to the Office of Federal Procurement Policy & the United States Congress (2007).

¹⁰ Letter from John McCain, Senator, to Ashton Carter, Secretary of Defense (Sept. 8, 2015) [hereinafter "McCain Letter"].

The proposed rule also conflicts with DoD's own "Better Buying Power" initiative. In particular, DoD's Better Buying Power 3.0 ("BBP 3.0") expresses the concern that the United States is at risk of losing its technological superiority and recognizes that technological innovation comes "increasingly" from the "commercial sector and from overseas."¹¹ DoD stated that "BBP 3.0 has a primary goal to incentivize greater and more timely innovation in the products DoD uses."¹² BBP 3.0 further recognizes that "[a]chieving this objective will require identification and elimination of specific barriers to the use of commercial technology and products."¹³

For these reasons, and those discussed below, the Section is concerned that DoD's proposed rule will result in a reversion to an outdated approach to commercial-item acquisition that is contrary to the acquisition reforms of the 1990s, is inconsistent with its current goals of encouraging commercial-item contractors to do business with the Government, and could have a significant adverse impact on DoD's ability to obtain critical goods and services from the commercial marketplace. The Section recommends that DoD withdraw the proposed rule or, at a minimum, make the revisions needed to address the concerns described below.

II. COMMENTS

A. If Adopted, the Proposed Rule Would Depart from the Statutory Definition of Commercial Item.

41 U.S.C. § 103 broadly defines "commercial item" under eight separate subparagraphs, each of which provides an independent basis for determining that an item is "commercial."¹⁴ The statute's broad definition expressly encompasses items that have not yet been sold and items that have been sold but not in "substantial" quantities. This intentionally broad definition enables the Government to take greater advantage of the commercial marketplace and provides incentives for commercial firms to offer new and innovative products and services using commercial practices. Under the Truth in Negotiations Act ("TINA"),¹⁵ an offeror is exempt from the requirement to provide certified cost or pricing data if the offered item is a "commercial item."¹⁶

The proposed rule, as currently drafted, however, appears to radically redefine the statutory and FAR definition by imposing a new requirement for the offeror to provide proof of actual sales of the offered item in order to qualify for an "exception" to the requirement to provide certified cost or pricing data. In so doing, DoD appears to be conflating two distinct analyses: (1) determining first whether an offered item is

¹¹ See Memorandum from Frank Kendall, Implementation Directive for Better Buying Power 3.0—Achieving Dominant Capabilities through Technical Excellence and Innovation at Attachment 2 at 1 (Apr. 9, 2015) available at [http://www.acq.osd.mil/fo/docs/betterBuyingPower3.0\(9Apr15\).pdf](http://www.acq.osd.mil/fo/docs/betterBuyingPower3.0(9Apr15).pdf).

¹² *Id.* at 9.

¹³ *Id.*

¹⁴ See 41 U.S.C. § 103 (1)–(8); see also FAR 2.101 (defining "commercial item").

¹⁵ 10 U.S.C. § 2306a.

¹⁶ 10 U.S.C. § 2306a(b)(1)(B).

“commercial” as defined by FAR 2.101, and (2) after that determination has been made, determining whether the proposed price for that commercial item is fair and reasonable.

In particular, the proposed rule seeks to add a provision and an alternate provision (DFARS 252.215-70XX and Alternate I) that would require contracting officers to obtain certified cost or pricing data from an offeror unless the offeror asserts an exception on the basis that it is providing a “commercial item.” Although there is nothing new about that concept (a derivative of TINA), the proposed new provisions would limit the exception to only those offerors that have had actual sales of the item, even though actual sales are not required for an item to qualify as “commercial” under the existing statutory or regulatory definitions.

The new provisions provide, in relevant part:

Commercial item exception. For a commercial item exception, the offeror *shall submit, at a minimum, information on prices at which the same item or similar items have previously been sold in the commercial market that is adequate* for evaluating the reasonableness of the price for this acquisition.¹⁷

The new “exception” provision further states that, to qualify for an exception, offerors must provide information regarding the basis for the proposed price, which “shall include” the following:

- For prices based on a catalog: sales data or a detailed explanation if the proposed price is not consistent with the catalog price;
- For prices using “market-based pricing”: the methodology for establishing a market-based price—which the proposed rule states is established when 50 percent or more of the sales are to nongovernment customers—and all relevant sales data within 10 days upon request; or
- For items included on an active schedule contract: proof that the commercial-item exception has been granted for the schedule item.¹⁸

The proposed provisions thus run contrary to the plain terms of existing statutory and regulatory definitions. The provisions do not contemplate an item’s qualifying as a commercial item that is “of a type” customarily used by the general public and, although not yet sold by the offeror, have been offered for sale. Indeed, under such a scenario, the contracting officer would have no basis under the proposed rule to grant the offeror’s request for an exception to the requirement for certified cost or pricing data, even though the item satisfies the applicable statutory and regulatory definitions and is, by law, exempt from the requirement.¹⁹ The same holds true for an item that “evolved from [such an item] through advances in technology or performance *and that is not yet*

¹⁷ 80 Fed. Reg. at 45,922 (emphasis added).

¹⁸ See *id.*

¹⁹ See 10 U.S.C. § 2306a(b)(1)(B).

available in the commercial marketplace,” and for items that contain “minor modifications of a type *not customarily available in the commercial marketplace,”* but that otherwise do not significantly change the nongovernmental functions or essential characteristics of the item.²⁰

The Section is therefore concerned that, as currently drafted, the proposed rule is contrary to, and narrows, the statutory and FAR definition of commercial item by precluding an item from being considered by DoD as a commercial item (and therefore exempt from the requirement to submit certified cost or pricing data) if the item has only been offered for sale (as opposed to sold in substantial quantities); the item is a nondevelopmental item; or the item or similar items have been sold, but the pricing might not be based on a catalog, or “market-based,” as defined by the proposed rule.

If this is not what the drafters of the proposed rule intended, then the Section recommends that DFARS 252.215-70XX and Alternate I be changed to add a fourth commercial-item exception for items whose price reasonableness is determined using price analysis or cost analysis procedures contained in DFARS Procurement, Guidance, and Information (“PGI”) 215.404-1. The Section proposes adding a new paragraph (b)(ii)(D) to DFARS 252.215-70XX and Alternate I:

(b)(ii)(D) For items whose price reasonableness is determined using the price analysis or cost analysis procedures contained in DFARS PGI 215.404-1.

Again, the Section acknowledges the importance of ensuring that the prices DoD pays for commercial items are fair and reasonable. Nevertheless, injecting pricing concepts and a requirement for actual sales into the contracting officer’s consideration of whether an item qualifies as a “commercial item” does not serve that objective. Instead, it will likely introduce further confusion and ambiguity into the acquisition process.

The Section therefore recommends keeping distinct the processes for determining whether an item satisfies the definition of a commercial item and for conducting price analysis on data other than certified cost or pricing data, with price analysis guided by the techniques already established in FAR 15.404-1(b). For example, if DoD retains some aspects of the proposed rule, the clause provisions addressing exceptions to commercial-item determinations (proposed DFARS 252.215-70XX(b) in the basic and alternate versions) should be eliminated in their entirety. Alternatively, these proposed clause provisions could be redrafted to identify the statutory exceptions that currently exist under TINA, and then separately address the types of “other than certified cost or pricing data” that the contracting officer may require if an existing exception applies, and how that data could be analyzed to determine fair and reasonable pricing using the techniques in FAR 15.404-1(b).

²⁰ See 41 U.S.C. § 103(2)–(3) (emphasis added).

B. The Proposed Rule Appears to Exceed Congress's Direction That DoD Issue Guidance, Not Substantive Regulations.

The proposed rule would implement significant, substantive changes to the regulatory framework governing the acquisition of commercial items. The Section also believes that the substantive changes to the commercial-item definition, reflected in DoD's proposed rule, are contrary to the Congress's mandate set forth in Section 831 of the FY 2013 NDAA, which DoD says is the basis for the proposed rule.

1. *The Proposed Rule Regulates Beyond the Requirements of the FY 2013 NDAA.*

In the background to the proposed rule, DoD states that it proposed amending the DFARS in order to implement portions of Section 831 of the FY 2013 NDAA.²¹ The proposed rule further recognizes that "Section 831 requires the issuance of *guidance* on the use of the authority to require the submission of other than cost or pricing data."²²

Indeed, Section 831 specifically called upon DoD to provide guidance and training to its contracting officers on using the authority to request other than cost or pricing data as provided in sections 2306a(d) and 2379 of title 10.²³ Congress further directed that the "guidance" address the following areas: (1) "standards for determining whether information on the prices at which the same or similar items have previously been sold is adequate for evaluating the reasonableness of price"; (2) "standards for determining the extent of uncertified cost information that should be required in cases in which price information is not adequate for evaluating the reasonableness of price"; (3) "ensur[ing] that in cases in which such uncertified cost information is required, the information shall be provided in the form in which it is regularly maintained by the offeror in its business operations"; and (4) "provid[ing] that no additional cost information may be required by the [DoD] in any case in which there are sufficient non-Government sales to establish reasonableness of price."²⁴

The proposed rule appears to go farther than merely providing guidance for contracting officers. Instead, it makes substantive changes to the commercial-item procurement regulations. The Section believes that by proposing such changes to the regulatory framework for commercial-item procurements, DoD may have unnecessarily exceeded the authority delegated to DoD in Section 831. Congress called upon DoD to issue guidance and training for the agency on the requirements for commercial-item procurements already in place. Congress did not direct DoD to alter the way in which it,

²¹ 80 Fed. Reg. at 45,919.

²² *Id.* (emphasis added).

²³ FY 2013 NDAA, Pub. L. No. 112-239, § 831, 126 Stat. 1632, 1842-43 (2013). Notably, 10 U.S.C. § 2379, which addresses the requirements for a determination by the Secretary of Defense and notification to Congress before procurement of major weapon systems as commercial items, appears nowhere in DoD's proposed rule.

²⁴ *Id.*

and its prime contractors, will acquire commercial items through changes to the regulatory regime for commercial-item procurements.

The proposed rule is thus susceptible to being vacated on judicial review. “[A]n administrative agency’s power to promulgate legislative regulations is limited to the authority delegated by Congress.”²⁵ Accordingly, regulatory actions that are “in excess [of the agency’s] statutory jurisdiction, authority, limitations, or [are] short of a statutory right” are unlawful and must be set aside.²⁶ Moreover, “[w]here Congress prescribes the form in which an agency may exercise its authority [a reviewing court] cannot elevate the goals of an agency’s action, however reasonable, over that prescribed form.”²⁷

Section 831 of the FY 2013 NDAA gave DoD the authority to issue *guidance* only on certain commercial-item standards and, accordingly, prescribed the form in which the agency had the authority to act.²⁸ Because Congress did not grant DoD authority to issue substantive, legally-binding regulatory changes to commercial-item procurements, the proposed rule unnecessarily departs from the congressional mandate.

2. The FY 2013 NDAA’s Legislative History Reinforces That Congress Rejected the Proposed Rule’s Aims.

Legislative history demonstrates that Section 831 of the FY 2013 NDAA was a House response to an earlier Senate amendment that was ultimately rejected.²⁹ Section 841 in the Senate bill would have expressly authorized DoD to request additional contractor data to evaluate price reasonableness of certain commercial items procured to support major weapons systems.³⁰ In connection with Section 841, the Senate Committee on Armed Services also considered a request to make certain changes to the commercial-item definition in 41 U.S.C. § 103.³¹ Implementing the requested changes would have meant that items merely “offered for sale” or “of a type” offered for sale in the commercial marketplace would no longer be considered commercial.³² The committee declined to narrow the commercial-item definition in this manner, expressly recognizing that FASA had intentionally set a broad reach:

[FASA] adopted a broad definition of commercial items to ensure that federal agencies would have ready access to products that are available in the commercial marketplace—including new products and modified

²⁵ *Bowen v. Georgetown Univ. Hosp.*, 488 U.S. 204, 208 (1988).

²⁶ 5 U.S.C. § 706(2)(C).

²⁷ *Amalgamated Transit Union v. Skinner*, 894 F.2d 1362 (D.C. Cir. 1990); *see also Motion Picture Ass’n of Am., Inc. v. FCC*, 309 F.3d 796 (D.C. Cir. 2002) (agency did not have statutory authority to issue regulations where the statute “authorized and ordered the [agency] to produce a report—nothing more, nothing less”).

²⁸ *See* FY 2013 NDAA, Pub. L. No. 112-239, 126 Stat. 1632, 1842 (2013).

²⁹ *See* H.R. Rep. No. 112-705, at 806 (2012); S. 3254, 112th Cong. § 841.

³⁰ S. Rep. No. 112-173, at 143 (2012).

³¹ *Id.*

³² *Id.*

products that are just becoming available. Such access remains particularly critical in fast moving commercial markets, including the markets for information technology and other advanced products.³³

Congress thus declined DoD's request to circumscribe the definition of what qualifies as a "commercial item" when considering Section 841.

Here, by contrast, the proposed rule would alter the commercial-item definition by effectively requiring actual sales of the items that the offeror proposes to sell to the Government. Accordingly, DoD's proposed rule would effect a change for DoD acquisitions that is very similar to the proposed statutory adjustment from DoD that Congress previously rejected. The Section therefore believes that narrowing the commercial-item definition in the manner contained in the proposed rule would be contrary to Congress' desire to maintain a broad commercial-item definition that facilitates the Government's procurement of critical, cutting-edge commercial technologies.

3. The Proposed Rule's Other Cited Statutory Basis Does Not Appear to Support the Proposed Rule's Substantive Changes.

DoD's alternate authority for the proposed rulemaking, 41 U.S.C. § 1303, further suggests that DoD's proposed rule goes too far. Under this provision, executive agencies, including DoD, have the authority to issue agency-specific procurement regulations outside of the FAR if the "regulation [is] essential to implement Government-wide policies and procedures within the agency" or if "additional policies and procedures [are] required to satisfy the specific and unique needs of the agency."³⁴ Neither circumstance appears to be present for the proposed rule.

Indeed, the proposed rule would change the way DoD and its prime contractors determine whether offered items or services qualify as commercial items and would prompt contracting officers and prime contractors to collect significant amounts of information, be it pricing or uncertified cost data. For instance, the proposed rule directs prime contractors to obtain cost data from subcontractors to support commerciality determinations.³⁵ The burden of addressing government demands for data has been, and will continue to be, a significant disincentive for commercial firms to do business with the Government or its prime contractors. DoD's proposed rule mandates data collection and analysis that is inconsistent with the streamlining reform that FASA was intending to achieve and inconsistent with Congress' intent.

³³ *Id.*

³⁴ 41 U.S.C. § 1303(a)(2).

³⁵ 80 Fed. Reg. at 45,922.

C. The Proposed Rule May Create a Conflict Between the DFARS and the FAR.

The Section further notes that DoD's proposed rule mandates provisions that could lead to data collection from contractors in a fashion contrary to the requirements of FAR 15.402. The FAR requires that the Government collect cost data related to the prices at which it procures supplies or services from the following specific sequence of sources: (1) "data available within the Government"; (2) "data obtained from sources other than the offeror"; and (3) "if necessary, [] data obtained from the offeror."³⁶

The proposed rule would add requirements and provisions that create a risk that contracting officers will proceed contrary to FAR 15.402. First, proposed DFARS 212.209 provides that contracting officers "shall obtain adequate commercial marketplace sales data . . . to ensure the price offered to the Government is reasonably consistent with market-based pricing."³⁷ The definition of market-based pricing and the new proposed DoD provisions, discussed in more detail below, may lead contracting officers to conclude that the information that they are now obligated to collect must be obtained from the offeror. That conclusion would be directly contrary to the data-collection requirements in FAR 15.402.

Second, the proposed clause DFARS 252.215-70XX, Requirements for Certified Cost or Pricing Data and Data Other Than Certified Cost or Pricing Data, requires that an offeror provide a description of "all relevant sales data" to assert commercial-item status based on market-based pricing.³⁸ The term "relevant sales data" is defined as "the subset of an offeror's sales data that, as considered by a prudent person, could reasonably be expected to influence the contracting officer's determination of price reasonableness, taking into consideration the age, volume, and nature of the transactions (including any related discounts, refunds, rebates, offsets or other adjustments) in the data subset."³⁹ This is an extremely broad data-collection requirement that could be interpreted as a condition precedent to a commercial-item determination. The Section recognizes that the proposed provision calls on contractors to provide "a description of" its pricing, including "all relevant sales data," and not the relevant sales data itself—at least initially. Nonetheless, the Section is concerned that DoD contracting officers will default to requesting the more robust data set, rather than first relying on other data sources as required by FAR 15.402.

D. The Proposed Rule Would Add Defined Terms That Lack Clarity or Create Other Concerns.

The proposed rule would add several new defined terms that lack clarity, create other concerns, and, therefore, ultimately will fail to provide DoD contracting officers

³⁶ FAR 15.402(a)(2)(ii)(A).

³⁷ 80 Fed. Reg. at 45,920.

³⁸ *Id.* at 45,921-22.

³⁹ *Id.* at 45,922.

with guidance as intended. The proposed rule also contains terms of art that are undefined. If the proposed rule is implemented, DoD contracting officers and offerors will rely on these new definitions and undefined terms when making determinations of price reasonableness. Accordingly, it is crucial that the plain language used in the new defined terms is precise and designed to further the objectives of streamlined and predictable commercial-item procurements, and that all terms of art are defined. The Section accordingly recommends that DoD clarify the proposed rule, as set forth below.

1. Market-Based Pricing

Definition: Pricing that results when nongovernmental buyers drive the price in a commercial marketplace. When nongovernmental buyers in a commercial marketplace account for a preponderance (50 percent or more) of sales by volume of a particular item, there is a strong likelihood the pricing is market based.

The proposed definition of “market-based pricing” presents several concerns for the Section. As Senator McCain has also recognized, and as discussed in more detail in Section II.A., above, this new market-based criteria would undermine the commercial-item exemptions in existing law and may significantly limit the use of commercial-market pricing and price-based analysis to determine the reasonableness of prices paid by DoD.⁴⁰

First, the phrase “when nongovernmental buyers drive the price” does not contemplate situations in which a seller is the industry leader or has such market command that the seller, not buyers, drives the price in the commercial marketplace. As a result, a seller’s nongovernmental sales, even when over the threshold of 50 percent, might fail the market-based pricing test as currently defined in the proposed rule.

Second, the definition of market-based pricing omits the use of prior government sales and pricing to evaluate price reasonableness. FAR 15.402 specifically contemplates that the offeror shall include “appropriate data on the prices at which the same or similar items have been sold previously, adequate for evaluating the reasonableness of the price.” An August 2015 GAO report responding to Section 831 of the FY 13 NDAA also recognized that DoD contracting officers frequently use prior government prices as a basis for determining that the price of a commercial item is fair and reasonable.⁴¹ The omission of prior government sales and pricing from the definition of market-based pricing may well lead DoD contracting officers to erroneously conclude that a well-established and effective method for determining price reasonableness is no longer available to them.

⁴⁰ See McCain Letter, Introduction, p.3.

⁴¹ See U.S. GAO, GAO-15-680, Defense Contracts: DoD’s Requests for Information from Contractors to Assess Prices (2015).

Third, the definition of market-based pricing addresses only the use of actual sales. As a result, the term “offered for sale” is at risk of being improperly read out of the statutory and regulatory definition of commercial item. This proposed definition is also potentially inconsistent with the legislative proposals currently in conference for the FY 2016 NDAA, which are intended to better facilitate the streamlined acquisition of commercial items.

Fourth, the inclusion of the 50 percent threshold for nongovernmental sales is a return to the pre-FARA application of a strict mathematical formula for determining commerciality. Such an exact threshold even goes beyond the “like quantities” concept that DoD had requested in its legislative proposal to change the commercial item definition in the FY 2013 NDAA, which—again—Congress rejected. Moreover, the 50 percent threshold would create only a “strong likelihood” that the pricing is market based. Such ambiguous language in a critical definition does not provide guidance to the DoD contracting officer. Instead, it creates uncertainty because the DoD contracting officer may still conclude that market-based pricing does not exist even if the threshold is met, leading the contracting officer to subsequently demand data other than certified cost or pricing data. The Section is also concerned that the definition, as written, stands for the proposition that an item will not qualify as a commercial item if the 50 percent threshold is not met.

Finally, the requirement that “nongovernmental buyers in a commercial marketplace account for a preponderance (50 percent or more) of sales by volume of a particular item” creates a lack of clarity for contracting officers because the FAR definition of commercial items includes those items “of a type” sold in the commercial marketplace, as well as modified versions of items sold in the commercial marketplace. The use of “particular item” is inconsistent with the FAR definition of a commercial item. For each of these reasons, the Section urges DoD to reconsider its proposed definition of “market-based pricing.”

2. *Nongovernment Sales*

Definition: Sales of the supplies or services to nongovernmental entities for purposes other than governmental purposes.

The definition of “nongovernment sales” in the proposed rule is limited to sales “for purposes other than governmental purposes.” Sales made to prime contractors are arguably excluded from this definition. The Section notes that sales to prime contractors are routinely considered to be commercial sales by the General Services Administration for administration of one of its tools for ensuring fair and reasonable pricing, the Price Reductions Clause, even if the Government is the ultimate end user. Thus, the proposed definition conflicts with the acquisition policy of other federal agencies. The proposed definition also will make it more difficult for offerors to provide sufficient nongovernment sales to establish market-based pricing. The Section urges that the phrase “for purposes other than governmental purposes” be removed or modified so that it is clear that sales made to prime contractors are not excluded from the definition of nongovernment sales.

3. Relevant Sales Data

Definition: The subset of an offeror's sales data that, as considered by a prudent person, could reasonably be expected to influence the contracting officer's determination of price reasonableness, taking into consideration the age, volume, and nature of the transactions (including any related discounts, refunds, rebates, offsets or other adjustments) in the data subset.

The definition of "relevant sales data" is vague and contains overbroad language. The phrases "prudent person" and "could reasonably be expected to influence the contracting officer's determination of price reasonableness" provide little practical guidance to contracting officers and create uncertainty for contractors. Furthermore, the requirement for submitting data relating to "any related discounts, refunds, rebates, offsets or other adjustments" is too broad and poses substantial risk to contractors. The Section is concerned that many contracting officers will default to a request for uncertified cost data as a result of this open-ended definition. These increased requests for cost data would undermine the objective of providing a more streamlined acquisition process for commercial items.

4. Sufficient Nongovernment Sales to Establish Reasonableness of Price

Definition: Exist when relevant sales data reflects market-based pricing, are made available for the contracting officer to review, and contains enough information to make adjustments covered by FAR 15.404-1(b)(2)(ii)(B).

In addition to requiring offerors to show that at least 50 percent of their sales have been to nongovernmental entities, this definition requires that offerors provide sales data sufficient to allow the contracting officer to adjust the prior price "to account for materially differing terms and conditions, quantities and market and economic factors."⁴² It is impracticable for many commercial offerors to furnish such detailed data, and if they are unable to provide such data, contracting officers will likely request uncertified cost data. This requirement is inconsistent with DoD's attempts to attract and retain new commercial firms to the defense market and represents a move away from the objectives of commercial-item acquisition.

5. Spare Parts and Support Equipment

The proposed rule would add DFARS section 215.404-1-70, which provides an analysis for "spare parts or support equipment."

The terms "spare parts" and "support equipment" are not defined in the proposed rule. The Section suggests that these two terms be defined to provide clarity and avoid

⁴² See FAR 15.404-1(b)(2)(ii)(B).

confusion on the part of offerors and contracting officers. Additionally, without clarification of when this additional proposal analysis should be performed, both contractors and contracting officers will be left with little guidance on how or when these procedures apply.

E. The Proposed Rule Would Have Potentially Adverse Impacts on the Prime/Subcontractor Relationship.

The proposed rule adds an unnecessary provision regarding subcontract price evaluation that will increase complexity and cost in prime contractors' supply chains. The subcontractor provision also exceeds the mandate of Section 831 of the FY 2013 NDAA, which addresses uncertified cost information only at the prime contractor level. The problems described above are amplified by expanding the rule's reach further into commercial supply chains.

The current regulations afford prime contractors wide discretion to use their best business judgment in analyzing subcontractors' prices for commercial items. The FAR requires prime contractors to conduct "*appropriate* cost or price analysis to establish the reasonableness of proposed subcontract prices."⁴³ Commercial contractors have an inherent incentive to drive cost out of the supply chain and leverage best commercial practices to achieve reasonable subcontract pricing. Rather than relying on this commercial process, the proposed rule would require prime contractors to obtain "*whatever information is necessary* to support a determination of price reasonableness" and would prescribe the types of data potentially necessary. This departure from allowing prime contractors to conduct an "appropriate" price analysis undermines contractors' business judgment as to the best way to achieve fair and reasonable pricing. The change would also require contractors to further isolate their commercial and military sourcing organizations, frustrating DoD's announced goals of expanding access to commercial markets.

The proposed rule would create new and potentially onerous requirements for prime contractors to analyze subcontractors' commerciality assertions. We believe these requirements are unnecessary—the Defense Contract Management Agency already reviews prime contractors' analyses of commerciality determinations through contractor purchasing system reviews. Yet the proposed rule states that prime contractors may be required to obtain "cost data to support a commerciality determination."⁴⁴ The proposed rule also states that no "additional" cost data may be required from subcontractors with sufficient non-government sales. By implication, the prime contractor may be required to collect cost data to establish commerciality. This requirement is inconsistent with the FAR definition of commercial items. Because a commercial item is one "of a type customarily used by the general public . . . and . . . sold . . . or offered for sale . . . to the general public,"⁴⁵ a subcontractor's costs or margin should be irrelevant to the prime

⁴³ FAR 15.404-3 (emphasis added).

⁴⁴ 80 Fed. Reg. at 45,922.

⁴⁵ FAR 2.101.

contractor's commerciality analysis. Many commercial subcontractors thus may refuse to provide cost information to justify commerciality.

The proposed rule also imposes new requirements for prime contractors to obtain technical information from subcontractors. If a contractor relies on relevant sales data for "similar items" to determine the subcontract price is reasonable, the proposed rule would require the contractor to obtain "technical information necessary to support" the contractor's conclusion that "[t]he items are similar" and "[a]ny dissimilarities should not produce a material price difference." The proposed rule, however, provides no guidance to contractors in performing these technical assessments, including when determining whether any technical dissimilarities should "produce a material price difference."

The proposed rule would create uncertainty and confusion as prime contractors undertake to comply with new cost- and technical-analysis requirements. Prime contractors may face audits against unclear standards and thus may default to requiring cost data from subcontractors. Similarly, without any guidance on what technical information should be requested and when technical dissimilarities should "produce a material price difference," contractors may feel it necessary to request voluminous technical data from subcontractors. This increased collection and analysis of cost and technical data will increase transaction costs and may limit the number of subcontractors willing to supply commercial items to DoD-funded contracts. These results would again run counter to the FASA and FARA reforms.

In addition, the proposed rule does not provide guidance for contracting officers or prime contractors to deal with instances in which subcontractors are unable or unwilling to provide such data. Commercial subcontractors often have valid reasons for refusing to supply cost information to prime contractors (and subcontractors likely would cite similar reasons for refusing to supply certain technical information). Many companies view cost data as "crown jewels" that are never provided outside the organization for any purpose. Both cost and sales data may be subject to contractual confidentiality provisions that prohibit the subcontractor from disclosing the information to third parties.

Many prime contractors already struggle to identify commercial subcontractors willing to accept the flowdown of DoD requirements and the risks associated with government contracting. The Section expects that at best, the proposed rule will increase the time prime contractors need to execute contracts with commercial subcontractors. At worst, the proposed rule's requirements drive such subcontractors away entirely. If commercial subcontractors exit the DoD supply chain, prime contractors will be forced to develop or expand relationships with non-commercial subcontractors, thus increasing cost and schedule to the Government.

F. The Section's Other General Observation.

The proposed rule contains a new clause, at 252.215-70XX, as well as an Alternate I.⁴⁶ Other than differences in language in subparagraph (c), the base clause and the alternate appear to be identical. The Section recommends that DoD amend the proposed rule so that the Alternate I clause contains only the text distinct from the base clause. This adjustment will add to clarity for DoD contracting officers and contractors and will avoid the unnecessary duplication of text in the DFARS.

III. CONCLUSION

The Section believes that the proposed rule does not achieve its stated objective of providing guidance for DoD contracting officers regarding evaluating price reasonableness for commercial items. Instead, the proposed rule would make substantive changes to what can qualify as a commercial item—changes that appear to be inconsistent with the congressional mandate for guidance and otherwise inconsistent with DoD's rulemaking authority. Additionally, the proposed rule adds defined terms that are vague and ambiguous or otherwise present concerns as demonstrated above.

Thus, the Section recommends that DoD withdraw the proposed rule. As an alternative, the Section suggests that DoD carefully consider adjustments to address the foregoing issues. In the Section's view, DoD should revise the text of the proposed rule and distribute the guidance by means of a Procedures, Guidance, and Information provision or other means rather than promulgating further regulation. This alternative approach would help to ensure that contracting officers receive meaningful and practical guidance rather than further regulatory requirements on what is intended to be streamlined acquisition.

The Section appreciates the opportunity to provide these comments and is available to provide additional information or assistance as you may require.

Sincerely,



David G. Ehrhart
Chair, Section of Public Contract Law

cc:

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Council Members, Section of Public Contract Law
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⁴⁶ See 80 Fed. Reg. 45,921-22.

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