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Commercial Items

View From Wiley Rein: Four Steps Contractors Can Take to Support Their Commercial Item Assertions



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Twenty years ago, with the Federal Acquisition Streamlining Act of 1994 (FASA), Congress enacted significant changes to facilitate the policy goals of improving the U.S. Government's access to commercial products and technologies and encouraging commercial firms to do business with the federal government. In order to achieve these goals, FASA changed the definition of commercial item to expressly include items that are offered for sale to the general public, eliminating any requirement for actual sales or a specific level of sales. The definition expressly includes items that are not identical to, but are "of a type" offered or sold in the commercial marketplace, and items that include minor modifications that are not "of a type" customarily available to commercial customers, but do not significantly change the item's functionality or essential physical characteristics.

Despite these decades-old changes and the significant policy objectives they were meant to achieve, many contracting officers continue to struggle with the definition of a commercial item—particularly when the item is "of a type" or includes minor modification—and frequently demand detailed documentation regarding the contractor's commercial sales to determine whether the offered item is "commercial." Such demands are incon-

sistent with the commercial item definition, for which actual sales are not required, and conflate the concepts of commerciality and price reasonableness. However, even when the definitional hurdle can be overcome, the offered price must still be determined to be fair and reasonable—a step that appears to present even greater challenges for many contracting officers.

Federal Acquisition Regulation (FAR) 15.403-3 and 15.404-1 instruct contracting officers to conduct market research and first obtain information from government or sources other than the contractor, and describe various price analysis techniques that can be used to determine price reasonableness, including value analysis. Yet, in the author's experience, these steps and analytical techniques are frequently bypassed in favor of requests for uncertified cost data, unless the contractor can provide detailed documentation showing that the *same* items were sold to commercial customers in significant quantities at the same prices. This is so even though FAR 15.404-1(b) expressly contemplates that a price may be found fair and reasonable based on a comparison with prices for *similar* items, including items "of a type," and that the price comparison can take into account differing terms and conditions, quantities, market and economic factors, and material differences between the similar item and the item being procured.

Such requests are perhaps unsurprising given the numerous recent audit reports issued by the Department of Defense Office of the Inspector General (DoD IG) that have been critical of contracting officers' commercial item determinations and price reasonableness

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analyses. For example, a July 2014 report criticized the contracting officer for failing to obtain contractor cost data based on the IG's application of a 45% threshold of contractor sales to commercial customers for the same items. See DOD IG Report No. DODIG-2014-088, July 3, 2014. The DOD IG acknowledged that there is no legal requirement for the application of such a threshold, and that the pre-FASA threshold of 55% was eliminated by Congress, but nonetheless concluded that the contracting officer should have rejected the contractor's market-based prices and obtained cost data from the contractor for items with commercial sales of less than 45%. The DOD IG further recommended that the Director, Defense Pricing, issue guidance to establish a percentage of commercial sales that would be sufficient to determine price reasonableness—a recommendation to which the Director, Defense Pricing concurred and indicated would be forthcoming.

More recently, in a February 4, 2015, memorandum issued by the Director, Defense Pricing entitled, "Commercial Items and the Determination of Reasonableness of Price for Commercial Items," DoD acknowledged that commercial item determinations, particularly for "of a type" items, have been difficult for contracting officers, but underscored the importance of making such determinations promptly, setting a goal of 10 days. The Memo emphasized, however, that the "key consideration" is determining whether the price to be paid is fair and reasonable: "whether a reasonable businessman or business woman reviewing the data would conclude that it is sufficient to demonstrate that the taxpayers are paying a fair and reasonable price for the item." Although the Memo reinforced that "other than certified cost or pricing data" "takes many forms" and is not just limited to cost data, and that even if adequate "market based pricing is not available," a contracting officer is "not required to use cost-based analysis as the means of determining price reasonableness," contractors should expect heightened scrutiny in this area and continued challenges in demonstrating both commerciality and price reasonableness, particularly in the absence of cost data.

With this backdrop in mind, below are four steps contractors can take to support their commercial item assertions and demonstrate price reasonableness:

Be Prepared. Contractors should not assume that because their products and services were previously accepted as commercial items that they are out of the woods. Contracting officers may be reluctant, particularly in light of the heightened audit and oversight attention, to make a commercial item determination (CID) based on a CID made by another CO, even if the CID is recent. Thus, contractors should expect that prior CIDs will be revisited by both COs and prime contractors and for all future offerings, including for follow-on contracts. Contractors should consider organizing a centralized repository of commercial-item assertions and supporting data so that all program teams are aware of and have access to the work other teams have done on commerciality. Advance planning and preparation will better position you to respond to these requests and also allow you to identify any potential weaknesses in your position and develop an appropriate strategy.

Determine and Justify the FAR 2.101 Basis for Commerciality. Contractor teams composed of appropriate personnel from contracts, engineering (technical), and

legal should identify which of the six "prongs" of the FAR 2.101 definition applies, singly or in combination, to the offered item. Questions to ask include:

- What is it? What is its function or purpose?
- Do you sell the item to commercial customers (i.e., non-governmental end-users)? If so, what are some examples? Do you offer it for sale generally? Would you offer it for sale in response to a request for quote?
- Do other companies provide a similar item or service to commercial customers? Who are they? How are the items or services similar to what is being offered to the Government? In what ways are they different? Are the differences significant? If not, why not?
- If the item is "of a type," why is it modified? What is the purpose of the modification? Does the modification significantly alter the item's functional or physical characteristics? Why not? Does the modification change the item's purpose? Is the form, fit and function essentially the same? Do you (or others in the commercial marketplace) routinely offer or make modifications to the item for other commercial customers? Would you if asked? What examples can you provide? What is the scope of the modification relative to the item's overall size, dollar value, level of effort?

Document Your Analysis. Prepare a detailed narrative, with specific examples, to explain to the customer (government or prime contractor) how the item satisfies the FAR 2.101 definition. If the item has been modified, focus on explaining, again with specific examples, of why the modifications are either "of a type" that are performed in the commercial marketplace, or do not change the item's primary function or purpose. Tell the story. The narrative should be easy for a non-technical lay person to read and understand. Be prepared to support with appropriate documentation.

Develop Supporting Documentation to Show That the Offered Price is Fair and Reasonable. At bottom, this is the government's "key consideration." As you develop and assemble the data and documentation needed to show that the item is "commercial," assemble the support also needed to show that the price is fair and reasonable. This could include:

- Copies of catalog or published prices, yours and others' (assuming, of course, the others' data are public).
- Copies of purchase orders (or other sales data) showing the prices paid by commercial (non-government customers) for the same or similar items (i.e., the items that you used to support your "of a type" analysis); legal should be consulted before any release to ensure that any release of the data is consistent with any confidentiality or contractual restrictions that may be in place.
- If the offered price is different from those offered to commercial customers for the same or similar items, or from prices previously paid by the government, explain why. Is it because of different contract terms and conditions, material, quantities, or other economic factors? If so, explain why and show how the prices compare if these differences are appropriately accounted for. If you can't get there, the CO (or prime contractor) will likely not be able to either and could portend a likely request for uncertified cost data.

The data should be relatively recent and contractors should expect that the government will want to see a “sufficient” level of sales to non-governmental end users to support their analysis without obtaining uncertified cost data.

At the end of the day, contractors looking to avoid demands for uncertified cost data need to be able to have

a solid explanation for why the offered price is fair and reasonable. By taking a proactive approach, contractors will be better positioned to support and defend their commercial item assertions and potentially avoid onerous requests for additional documentation and uncertified cost data.