Twenty years or so ago, the FAR definition of “commercial item” was substantially revised in order to make it easier for the Federal government to acquire such items. As the DoD’s Commercial Item Handbook (Version 2.0) states –

Since the passage of the Federal Acquisition Streamlining Act of 1994 (FASA), the preference within the Federal Government has shifted from the acquisition of items developed exclusively for the Government to the acquisition of commercial items. This change was necessary to take full advantage of available and evolving technological innovations in the commercial sector. The Government’s increased reliance on commercial items is essential to provide technology solutions that increase war fighter capabilities.

FASA signaled a dramatic shift in the course of acquisition policy for the Federal Government. It was the most far-reaching acquisition reform in the last fifty years. FASA promoted maximum use of commercial items to meet the government’s needs and streamlined the process to acquire such items following commercial market practices. Commercial practices are overarching and affect every functional area within acquisition. All of acquisition must move to a price-based, market-driven environment from requirements development through property disposal. Source selection must be made on a ‘best value’ not ‘cheapest price’ basis. Agencies must evaluate their business processes, and reengineer those necessary to ensure streamlined acquisition and operating practices. This will be a never-ending process of mission identification, analysis, planning, implementation, measurement and results. Continuous process improvement will become the norm in the Department.

The FASA preference for commercial items is incorporated into the Federal Acquisition Regulation Statement of guiding principles for the Federal Acquisition System in FAR Section 1.102.

The FASA-era reforms were based on laudable goals, no doubt about it. But for the past twenty years certain groups (that seem to be mostly within DCAA and the DoD Pricing Directorate) have been pushing back. Now, a recent **proposed revision** to the Defense Federal Acquisition Regulation Supplement (DFARS) seems to signal a retreat from FASA-era acquisition reforms and a return to the days in which the commerciality of an item was determined by rigid application of mathematical formulae.

In the pre-FASA days, the commerciality of an item was determined by a strictly prescribed set of criteria that led to a black/white, yes/no decision based on the percentage of sales to non-Governmental entities. Generally, the pre-FASA requirement was that at least 55 percent of an item's sales had to be proven to be to non-Governmental entities. If the contractor couldn't establish that at least that percentage of sales, then its item would not be determined to be a commercial item.

The problem with that approach was that the companies who offered commercial items for sale were the same ones who didn't keep their books and records in the format that the DoD auditors liked to see. Consequently, the commercial companies struggled with the process. The prices of items that could not be certified (by the auditors) as being commercial in nature had to be supported by cost or pricing data—which meant that those commercial entities had to struggle with the process of submitting bids via SF 1411 (which we would now call FAR Table 15-2 requirements). Then they had to support their cost proposals through audit and negotiation. According to a Coopers & Lybrand study at the time, the DoD was paying a premium of at least 17 percent because it refused to acquire goods and services the way the marketplace offered and priced them. In addition, many companies (including leading-edge technology companies) simply refused to sell to DoD because they didn't want to put up with all the nonsense for a relatively small sales channel. Thus, DoD had trouble availing itself of the latest technology for its warfighters.

The FASA-era reforms were intended to change that paradigm and open the door for DoD to enter the commercial marketplace as just another buyer. The recent proposed DFAR rule revisions seem to signal a walk back to the pre-FASA days. That's puzzling – at least to us – because why would the DoD be trying to make it harder to acquire goods and services from non-traditional defense contractors at the very same time the Secretary of Defense has publicly proclaimed that the DoD wants to get more of the Silicon Valley cutting-edge technology and innovation?

The proposed rule points to the FY 2013 National Defense Authorization Act (NDAA) as the driver for the proposed rule changes. Left unsaid in the background section of the proposed

rulemaking action is the fact that it was the DoD **itself** that requested Congress take action on the matter. (*H/T Project on Government Oversight for the link to the original DoD request.*) It seems a bit disingenuous to submit a legislative request to Congress, and then to blame Congress for the unfortunate necessity of having to revise the rules. But maybe that's just us.

Importantly, the proposed rulemaking action seems to go far above what Congress directed. This is hardly surprising, given the long history of certain DoD constituencies seizing every opportunity to roll back FASA-era reforms in this area. In fact, according to the proposed rule, the NDAA required DoD to take the following actions – and *only* the following actions:

Section 831 requires the issuance of guidance on the use of the authority to require the submission of other than cost or pricing data. Specifically, section 831, paragraph (a) provides that the guidance accomplish the following:

1. Include 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;Show citation box

2. Include 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. Ensure 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. Provide that no additional cost information may be required by the Department of Defense in any case in which there are sufficient nongovernment sales to establish reasonableness of price.

Key to the DAR Council's implementation of the four Congressional-mandated actions is to

define a new term—"market-based pricing". According to the proposed rule—

Market-based pricing means 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.

Gee, does that look familiar to anybody? We guess that 50 percent is better than 55 percent but, really, what's the difference in philosophy? *None.* This is simple the return of the pre-FASA application of rigid mathematical formulae to determine commerciality.

Moreover, note the phrase "there is a strong likelihood" in the above definition. To us, that means that the offeror can provide sales data that shows it sells 90 percent of its goods to non-governmental entities, but the Contracting Officer can still determine that the item is not commercial in nature—in the name of being prudent and to protect the Government's interest, of course.

Another definition in the proposed rule caught our eye. What are we to make of this one?

Sufficient nongovernment sales to establish reasonableness of price (see 215.402(a)(3)) 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 other words, in addition to showing that at least 50 percent of its sales have been to non-governmental entities, the offeror must also provide sufficient data to allow the Contracting Officer or pricing analyst to adjust the prior prices "to account for materially differing terms and conditions, quantities and market and economic factors." How many commercial entities are going to have all that data handy?

The proposed rule also permits the Contracting Officer to request, obtain and review "uncertified cost data" when necessary to determine the price being offered is fair and

reasonable. Uncertified cost data is defined (in the proposed rule) to mean uncertified cost or pricing data that relates to the offeror's costs. In other words, the offeror may be required to submit cost data in support of its proposed prices, even if it sells 90 percent of its goods to non-governmental entities.

In fairness, we have to report that the proposed rule states, "If the contracting officer requires the offeror to provide uncertified cost data, it shall be the form in which it is regularly maintained by the offeror in its business operations." That would be a bigger relief if we didn't already know that commercial entities don't maintain, as a general rule, detailed cost subledgers or detailed timekeeping systems. They do not, as a general rule, know the cost of their individual products. Instead, they know their costs of goods sold, which is a number that encompasses the sales of *all* products, not just the ones being offered for sale to DoD in response to a particular RFP.

There's more where that came from. In the interest of time (and typing fatigue) we're not going to discuss the rest. If your company sells—or would like to sell—commercial items or services to the Department of Defense, then we urge you to follow the link in this article and read the entire proposed rule for yourself.

Comments on the proposed rule should be submitted in writing on or before October 2, 2015. They may be submitted to the DAR Council via one of several means. (See the proposed rule for a list of all communication avenues.) One easy way is to e-mail *osd.dfars@osd.mil* and include DFARS Case 2013-D034 in the subject line of the message.