Recently we published **an article** on the Department of Defense's proposed revisions regarding how Contracting Officers will make commercial item determinations. We opined that the proposed DFARS rule revision seemed to be an overreach from what Congress intended in the FY 2013 National Defense Authorization Act, cited by the rule-makers as the impetus for their rule-making action. (Left uncited was the fact that DoD itself actually requested the initial Congressional action.) We opined that the proposed rule was "simply the return of the pre-FASA application of rigid mathematical formulae to determine commerciality."

In short, we did not care for the proposed rule and we urged readers to submit their comments to the DAR Council before the October 2, 2015 deadline.

But we were not alone in expressing concerns with the proposed DFARS revisions.

On September 3, 2015, the Council of Defense and Space Industry Associations (CODSIA), led by the National Defense Industrial Association (NDIA), submitted **a letter** to the DAR Council requesting that the proposed rule be withdrawn. The letter stated—

The proposed DFARS rulemaking … is inconsistent with (1) the requirements of Section 831, DoD's own attempts to engage the commercial and non-traditional business sectors more actively, and (2) pending legislative proposals that, if passed, would contradict and obviate the proposed DFARS rulemaking. Moreover, the rules are inconsistent with already-existing law, provisions related to price analysis and commercial items in the Federal Acquisition Regulation, and the conclusions of the recently completed GAO study on the subject.

On September 8, 2015, Senator John McCain (Chairman of the Senate Armed Services Committee) sent a letter to Secretary of Defense Ash Carter, urging him to "rescind the proposed rule immediately." **The letter** said—

I am deeply concerned by a new proposed Defense Federal Acquisition Regulation rule on commercial item acquisition (DFARS Case 2013-D034), which could effectively preclude any significant participation by commercial firms in defense programs.ÂÂ This is all the more troubling in light of the high priority that each of us has placed on defense innovation and creating better incentives for cutting-edge commercial firms to do business with the Department of Defense. Indeed, this regulation was released just weeks before your latest visit to Silicon Valley and would have the unfortunate effect of undermining many of the key objectives of your visit. …

As you know, even if commercial firms are willing to help solve national security problems, they face severe barriers to their participation in the defense market due to DOD's unique acquisition processes, audit and oversight requirements, treatment of intellectual property, and security and export control constraints. … DFARS Case 2013-D034 is completely at odds with our shared priorities. This new regulation would likely deter privately held start-up companies from offering their products and services to DOD, because it would impose cumbersome and excessive bureaucratic requirements on these firms to provide detailed cost data for precisely the types of solutions that DOD needs.ÂÂ This rule would undermineÂÂ theÂÂ commercial item exemptions in existing law through a newÂÂ percentageÂÂ of market-based criteria that wouldÂÂ significantly limit the use of commercial market pricing and price-based analysis to determine the reasonableness of price paid by DOD.ÂÂ This would create a major disincentive for high-tech commercial firms to venture into the development of innovative new defense capabilities—such as first-to-market cyber tools, disruptive solutions that compete with existing DOD systems, and products similar to those in the commercial marketplace but modified to meet national security needs—thereby denying them to our warfighters.

Put simply, this kind of red tape 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.ÂÂ That will not happen. Instead, this regulation sends a signal that DOD has little interest in realistic commercial acquisition practices and will continue to operate under its archaic, defense-unique, cost-based oversight system. This will drive our leading innovators away from DOD and continue the dangerous erosion of our defense technological advantage.

In response to the criticism, Under Secretary of Defense (AT&L) Frank Kendall tried to strike a reasonable, middle-of-the-road position. According to Sandra Irwin, writing in National Defense Magazine, he stated—

The issue of how to balance the Pentagon's desire to attract innovative commercial suppliers against the need to exert proper oversight of contractors is a tough one for Kendall, he recognized. 'The DoD inspector general expects me to ensure fair pricing,' he said. Defense contractors, meanwhile, for years have complained to Pentagon officials and members of Congress that they are being asked to provide sensitive internal company data to the government to substantiate prices they charge for products that are sold commercially and for which price data already exists. Among the most disputed items have been aircraft spare parts.

'I get pulled by the Hill in both directions,' said Kendall. 'I get pulled internally in both directions.'

Mr. Kendall also responded directly to Senator McCain's criticism. According to **this article**, written by Sydney Freedberg, Jr., for Breaking Defense, he stated—

'First of all, it's a draft rule, it's out for comment. So Sen. McCain gave us a comment, we took that seriously,' Kendall said, with a barely audible chuckle, when I raised the issue at the ComDef conference here this morning.

What's more, Kendall continued, the senator has a point: 'The rule as it's written is very general. I would like it frankly to be more specific, and I'm working with my contracting people on how to do that.'

The particular provision that's problematic, Kendall said, is one that defines a 'commercial item.' While high-profile weapons programs develop uniquely military products – missiles, armored vehicles, warships – where there are few competitors and only one customer, the Defense Department spends billions on widely available items from spark plugs to software, where a fair price is set by many buyers and sellers in the free market. You don't need the same kind of elaborate oversight and cost accounting on literal nuts and bolts as you do on a stealth fighter.

'We've been working for sometime now to make this process quicker and more predictable,' Kendall said, 'so when somebody goes out and buys something from a catalogue or from a vendor… they can make a fairly quick determination of whether it's a commercial item or not.' The Defense Contract Management Agency (DCMA) is even standing up a help desk of technical experts that other agencies can call for help.

But here we come to the sticking point. To simplify the determination whether something is a commercial item or not, the draft regulation says that if more than 50 percent of an item's sales are to commercial customers (rather than the government), it counts as commercial.

The rule is meant to make it *easier* to declare an item commercial, Kendall said: If more than 50 percent of sales are commercial, the item's commercial too, end of story. If less than 50 percent of sales are commercial, however, the item might still qualify as commercial on some other grounds. Said Kendall, 'that's not a hard rule that says you *have* to have more than 50 percent [commercial sales] to be considered commercial.'

The problem is that the rule as written (apparently) doesn't make that clear. So risk-averse procurement officials might interpret it narrowly, not as one way among many to qualify as commercial, but as the only way. Under this reading, if less than 50 percent of sales are commercial, the item isn't commercial. If a product is brand-new — consider cutting-edge cybersecurity again, or SpaceX's rockets — then it has *no* sales and automatically fails this test. This is the *opposite* of the intended meaning, but it wouldn't be the first time the bureaucracy has perverted the intentions of its leaders.

'There's been a reaction that said, people will apply this rigorously, they'll apply it as an iron line between commercial and non-commercial. That is not the intent,' Kendall said, '[but] I think this is a fair criticism.'

As noted, the comment period for this proposed DFARS rule revision ends October 2, 2015. We here at Apogee Consulting, Inc., urge affected readers to submit their comments to the DAR Council. The link to the proposed rule (which details how to submit those comments) may be found in our original article.