This is kind of a puzzler. We seem to have two contradictory conclusions, each of which may be a reasonable interpretation of the same set of facts and circumstances. An antinomy, if you will.

Let's start with the Department of Defense Office of Inspector General, whose July 7, 2014, **report**, entitled "Defense Logistics Agency Aviation Potentially Overpaid Bell Helicopter for Sole-Source Commercial Spare Parts," reported that the DOD IG had found:

The contracting officer did not sufficiently determine whether prices were fair and reasonable for sole-source commercial parts negotiated on contract SPE4AX-12-D-9005. This occurred because the contracting officer did not perform an adequate analysis when procuring sole-source commercial parts. … the contracting officer did not obtain cost data to perform cost analysis, and DLA potentially overpaid Bell about $9 million on 33 of 35 sole-source commercial spare parts reviewed. In addition, DLA may overpay as much as $2.6 million over the next 12 months on future orders under this contract.

On its face, that's a pretty weird finding, right?

What does the phrase "sole-source commercial parts" even mean? Why would commercial parts ever be procured on a sole source basis? Let's think about it.

A commercial item – any item – is commercial because it is of a type that is customarily used by the general public, and it has actually been sold (or offered for sale) to the general public. (See the definition of “commercial item” at FAR 2.101.) A sole source acquisition is a contract that is solicited from one and only one source. (See FAR 2.101 again.) FAR Part 6 states that the policy of the U.S. Government is to procure goods and services using “full and open competition” unless a statutory exemption from that policy exists. There is one exemption that might apply to the situation where the DLA wants to acquire spare parts for military helicopters: “only one responsible source and no other suppliers or services will satisfy agency requirements.” Putting all this together, we’re guessing that the contracting officer needed to buy spare parts for helicopters manufactured by Bell Helicopters, and Bell Helicopters was the only known source for those spare parts.

But if Bell Helicopter was the only known source for spare parts for its own helicopters, then how did the company justify the commerciality of its parts? How did the contracting officer justify the finding that the spare parts met the FAR definition of commercial items?

We don’t know the answer to those questions, primarily because the DOD IG classified its audit report as “For Official Use Only” and didn’t provide the full report to the public for review. (Nice transparency, that.) But we can speculate that Bell Helicopter must provide the same (or very similar) parts to “the general public”—or at least to non-governmental entities such as state or local law enforcement agencies. If that was the case, then Bell could have argued that the market had established the prices for those spare parts, and if those prices were good enough for Joe Public (or at least for LEO Public) then they should be good enough for the DLA.

We also know (because it was in the publicly released summary) that the DOD IG was concerned that “the contracting officer used the previous DoD purchase price without performing historical price analysis and accepted Bell’s market-based pricing strategy in a noncompetitive environment without performing a sufficient sales analysis.” That tells us at least two things. First, it tells us that DOD had purchased the parts before, and (presumably) had established that the prices it had paid at that time were fair and reasonable. Reading between the lines, we can speculate that the contracting officer used those prior prices as the basis for finding Bell’s current prices were fair and reasonable … but that the CO didn’t actually compare the prices (after adjusting for inflation, quantity, and other terms and conditions).

The second thing we can infer from the little bit of IG audit report that was released is that the

CO did not actually review the prices paid by the non-governmental entities for the parts, and did not compare the prices s/he was going to pay to those historical prices (after adjusting for inflation, quantity, and other terms and conditions).

Or maybe the CO did all that stuff but didn't document the analyses performed in the file. We don't know.

But the DOD IG report went further than that. The IG report found that: "the contracting officer did not obtain cost data to perform cost analysis." That finding would make sense if the items didn't qualify as commercial items. If that were the case, then the CO would have had to perform a rigorous cost analysis (since there was no competition to permit price analysis alone to support the finding that the prices were fair and reasonable). So we can infer that the IG was asserting the items did not qualify as commercial items and thus required cost analysis, which was not performed because cost information was not requested from Bell Helicopter. We can infer that the CO didn't request cost information because s/he didn't think a cost analysis had to be performed. We can infer the CO concluded that cost analysis did not need to be performed because either (a) the parts qualified as commercial items, or (b) the CO had historical prices that were reasonably close to current prices.

We can make a lot of inferences, suppositions, speculations, and guesses about the situation. But we don't know for sure because the DOD IG didn't release the audit report to the public. In order to obtain a copy, one needed to submit a Freedom of Information Act (FOIA) request, pay the fees, and hope the IG decided to release the report.[1] Who was going to do that?

Bloomberg **did** .

Bloomberg reported the following additional facts—

The alleged overcharges were incurred on Bell's 2012 sole-source, $128 million contract to support Navy and Marine Corps H-1 and Army OH-58 Kiowa helicopters. The contract is in place until February 2017. … Auditors for the inspector general calculated the potential overpayments based on cost data that Bell Helicopter provided under an administrative subpoena, according to the report. …

In response to the inspector general's recommendation that the Defense Logistics Agency pursue options including a voluntary refund from Bell, Matthew Beebe, the agency's director of acquisition, told auditors that 'Bell has consistently refused to provide cost data for commercial parts' it sells the Pentagon. Agency officials do 'not believe they have the ability to obtain cost data,' the report said.

Apparently, then, the DLA continues to believe that the spare parts qualified as commercial items under the FAR definition. Accordingly, it is difficult to see why the contracting officer would have been required to perform cost analysis or would have needed to obtain the cost data that the IG need to use a subpoena to obtain.

The official DLA position on the matter was reported by Bloomberg as follows:

Michelle McCaskill, a spokeswoman for the agency, said today in an e-mailed statement that it's not going to press Bell Helicopter for a refund 'because DLA procured the items under current commercial contracting procedures and pricing methodology.'

'The prices on this contract are fair and reasonable in accordance with current federal and defense acquisition regulations as well as commercial item pricing guidance,' she said.

On one hand, we have an IG audit report that seems to assert the spare parts were not commercial items but, on the other hand, we have both the contractor and acquiring agency firmly maintaining that the spare parts were, indeed, commercial items. It's an antinomy.

If the prices were fair and reasonable in accordance with the rules governing such matters, then what was the IG's beef? Was Bell Helicopter not allowed to make the same margin on its parts when selling to the DLA as it made from selling to non-governmental entities? Doesn't that position violate both the spirit and letter of applicable statutes and regulation?

How can Bell Helicopter be overcharging the DLA when its pricing is fully compliant with

applicable laws and regulations? We don't get it.

We also don't get the title of the IG audit report. What does "potentially overpaid" mean in this context? The only interpretation we can make is that the IG is saying that, had the CO obtained cost and pricing data, and performed a rigorous cost analysis (including an analysis of profit using DOD's weighted guidelines approach to structured profit analysis), then the CO would have concluded that Bell Helicopter's proposed prices were not fair and reasonable—and would have negotiated a lower price.

If that's the IG's position, we have trouble buying it. That position would ignore the fact that Bell Helicopter was the sole source for the spare parts. Presumably DOD could not obtain the parts from any other source so, to a very great extent, the CO had to pay the price Bell Helicopter was asking. After all, Bell could simply choose not to sell DLA the spare parts. What is a completely unreasonable profit expectation in a competitive situation may turn out to be a very reasonable profit in a non-competitive situation. That's the power of monopoly supply.

Moreover, what's the deal with "potentially overpaid" in an audit report? Either the spare parts were fairly priced or they were not. If the parts were priced and negotiated in accordance with applicable statutes and regulations, then in fact DLA did not overpay for them. If the parts were improperly priced (based on a non-legitimate claim of commerciality), then the audit report ought to come right out and say so. Instead, the IG seems to be overreaching by attacking the CO's judgment, even though the CO followed all the rules (according to the DLA). Such a headline smacks of sensationalism, which ought to have no place in a serious audit report that may affect the career of a civil servant—especially when that sensationalist headline is picked up by other sources and used to bash DOD's fiscal responsibility yet again.

Thus, for a number of reasons we believe this particular DOD IG audit report fell short of the standards we expect of such an important topic. We think Baron von Steuben would be disappointed.

Interestingly, the DOD Director of Defense Pricing may tend to agree with the IG's ambivalent position. The released report summary stated—

The Director, Defense Pricing, should issue guidance to establish a percentage of commercial sales that is sufficient to determine fair and reasonable prices when items are being acquired on a sole-source contract and market-based prices are used. The guidance should also require contracting officers to request 'information other than cost or pricing data,' to include cost data, if sales data are not sufficient. … Comments from the Director, Defense Pricing, addressed Recommendation 1. No further comments are required.

That seems to indicate that the Director, Defense Pricing, agreed with the IG's recommendation. (If there was no agreement, it almost certainly would have been noted.) That seems to indicate that the Director, Defense Pricing, would like to issue guidance to establish a percentage of sales that would qualify a part as a commercial item. That seems to indicate that the Director, Defense Pricing, would like to roll back provisions of the 20 year-old Federal Acquisition Streamlining Act (FASA). We will have to see what the future holds in that regard.

Meanwhile, Bell Helicopter and other contractors in similar positions will continue to sell the Pentagon parts under the current FAR definition of "commercial items." They will continue to price those parts at prices set by the marketplace, instead of prices set by their costs as marked-up by a fairly arbitrary profit percentage. They will continue to comply with public laws and federal regulations, while certain parties may insinuate there is something wrong with the process, even though there is no allegation of any actual noncompliance.

[1] In a related note, did you know that "FOIA Denial Officer" is a real job? Go ahead and Google it if you don't believe us.