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Commercial Item Pricing Changes Will Impact Government Sales

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Companies who are selling commercial products and services to the federal government may have a difficult time demonstrating their prices are fair and reasonable under new Department of Defense (DoD) rules. In response to a DoD Inspector General report that was highly critical of DoD buying practices, the Defense Procurement and Acquisition Policy (DPAP) office recently issued revised guidance regarding the determination of fair and reasonable contract prices, particularly with respect to sole source or noncompetitive commercial item acquisitions. The revised guidance, or Procedures, Guidance and Instruction (PGI), highlights the requirement for contracting officers to obtain whatever information or cost data is necessary to determine a fair and reasonable price when the Truth In Negotiation Act (TINA) does not require the submission of certified cost or pricing data. For commercial item vendors doing business with the Department of Defense or one of its components, this guidance will likely generate increased requests by contracting officers for "information other than cost or pricing data," and thus, make it more difficult for commercial companies to do business with the government. Moreover, the PGI directs contracting officers to use the Contractor Performance Assessment Reporting System to document a contractor's refusal to provide requested pricing or cost data.

Commercial Items Acquisitions

Federal law encourages the heads of agencies to implement policies, practices, and procedures that, to the maximum extent practicable, reduce impediments to the acquisition of commercial items. 10 U.S.C. § 2377(b)(5) & 41 U.S.C. § 264(b)(5). This statutory objective is implemented at Part 12 of the Federal Acquisition Regulation (FAR), which sets forth terms, conditions, and procedures for commercial item acquisitions that are more in line with commercial practices than traditional FAR procurements. For example, the requirements regarding inspection/acceptance, changes, disputes, data rights, terminations for convenience and for cause, and warranties are far less rigorous than those imposed on traditional FAR procurements. Of particular note, commercial item acquisitions are not covered by the burdensome and potentially risky TINA.^[1]

TINA requires that contracting officers obtain certified cost or pricing data for procurements over the TINA threshold (currently \$650,000), unless otherwise prohibited from doing so. Cost or pricing data is any factual information that prudent buyers and sellers would reasonably expect to affect price negotiations significantly. Cost or pricing data includes factors such as vendor quotations, nonrecurring costs, information on changes in production methods or volumes, data supporting business projections or make-or-buy decisions, and information on management decisions that could have a significant bearing on costs.^[2] Contracting officers use this information to determine whether proposed contract prices are fair and reasonable. When TINA applies, the contractor or prospective contractor must certify the data is "accurate, complete, and current."^[3] There are serious penalties for the submission of inaccurate data or nondisclosure of data.

Contracting officers are prohibited from obtaining cost or pricing data for commercial item acquisitions. Congress intended to encourage more firms to bid on government contracts by exempting commercial contractors from TINA and eliminating a major disincentive to participating in government procurements, i.e., the collection of cost data. What this really means is contracting officers may not request certified cost or pricing data. Contracting officers may request "information

other than cost or pricing data," however. "Information other than cost or pricing data" is a term of art. It is defined as:

[A]ny type of information that is not required to be certified in accordance with 15.406-2 and is necessary to determine price reasonableness or cost realism. For example, such information may include pricing, sales, or cost information, and includes cost or pricing data for which certification is determined inapplicable after submission.^[4]

This category of data may include price and cost information that would otherwise constitute cost or pricing data if certified.

Department of Defense (DoD) Inspector General Report

DPAP issued the revised guidance in response to the findings contained in the DoD Inspector General's Report D-2006-122, "Commercial Contract for Noncompetitive Spare Parts with Hamilton Sundstrand Corporation," dated September 29, 2006. That report was critical of the Air Force's "commercial item" determination that exempted Hamilton Sundstrand from the requirement to submit cost or pricing data on an \$860 million contract for noncompetitive spare parts used on Defense weapon systems and its failure to establish an effective means by which to determine the price reasonableness of the exempt commercial items. The spare parts consisted primarily of components and component parts for military aircraft. The report raised concerns about the Air Force's commercial item determinations because they were inconsistent with the intent of the commercial items definition, as clarified by the Undersecretary of Defense for Acquisition and Technology (now Acquisition, Technology and Logistics) and failed to evaluate whether there was a commercial market for the items.

The definition of commercial items includes, among other things, items "of a type" customarily sold to or offered for sale or lease to the general public, or similar items. On January 5, 2001, the Under Secretary of Defense for Acquisition and Technology issued guidance clarifying the criteria for commercial items, stating:

The phrase "of a type" is not intended to allow the use of [Federal Acquisition Regulation] Part 12 to acquire sole-source, military unique items that are not closely related to items already in the market place. Instead, "of a type" broadens the commercial item definition so that qualifying items do not have to be identical to those in the commercial marketplace ... [T]he phrase "of a type" allows the best value offer to qualify for a Part 12 contract as long as it is sufficiently like similar items that meet the government's requirement and are sold, leased, licensed, or offered for sale, lease or license to the general public.

Based on this guidance, the DoD Inspector General questioned the basis for the contracting officer's determination that the parts were "of a type" or similar to items commonly found in the commercial marketplace. In doing so, the DoD Inspector General specifically noted the government's failure to adequately identify the same or similar items sold in the commercial marketplace as well as the conflicting opinions of the government technical experts as to whether the parts were commercial items. Finally, the Inspector General criticized the contracting officer for failing to require the submission of sufficient data (other than cost or pricing data) to determine whether the prices were fair and reasonable.

The report recommends, among other things, that Under Secretary of Defense for Acquisitions, Technology and Logistics take the following measures: (1) clarify exceptions to cost or pricing data for noncompetitive commercial items that, at a minimum, requires the submission of data on the prices at which the same or similar items have been sold in the commercial market and requires the contracting officer to obtain additional "information other than cost or pricing data" when commercial sales information is inadequate to determine price reasonableness; and (2) consider whether uncooperative contractors that refuse to provide either commercial sales information or "information other than cost or pricing data" should receive unsatisfactory out-of-cycle ratings in the Contractor Performance Assessment Reporting System under Business Relations. These recommendations are incorporated into the PGI.

Revised Procedures, Guidance and Instruction (PGI)

The revised PGI sets forth procedures and guidance for determining when to conduct a price or cost analysis, highlighting a contracting officer's responsibility to adequately assess the price

reasonableness of a commercial item acquisition and to obtain “information other than cost or pricing data” when necessary to make this determination. While often, contracting officers can obtain sufficient information through market research for determining whether proposed prices are fair and reasonable, this will not always be the case. This is especially true for supplies or services that have only been “offered” for sale or purchased on a sole source basis without prior commercial sales. In such case, the PGI directs the contracting officers to obtain whatever cost information is necessary to determine price reasonableness.

In a nutshell, the PGI sets forth detailed procedures for conducting a price or cost analysis in accordance with FAR 15.404-1, Prohibition on Obtaining Cost or Pricing Data, including obtaining sufficient information to confirm that previous prices paid by the government were based on a thorough price or cost analysis, requesting and analyzing non-government sales data when purchasing sole source commercial items, and performing a cost analysis when necessary. The PGI also sets forth procedures governing the use of exceptional case TINA waivers. The DoD Inspector General review of the noncompetitive award to Hamilton Sundstrand also prompted revised guidance regarding past performance reporting, including noting a contractor’s refusal to provide requesting pricing or cost information. This is especially important because adverse past performance ratings will affect a company’s ability to obtain government business.

Conclusion

By eliminating the requirement for submission of cost or pricing data in commercial item acquisitions, Congress clearly intended to encourage greater participation by commercial vendors in government procurements. The revised PGI requirements that include obtaining detailed cost information from commercial vendors will once again make it difficult for many commercial companies to compete in the government market.

[1] 10 U.S.C. § 2306a, 41 U.S.C. § 254a.

[2] FAR 2.101, Definitions

[3] FAR 15.406-2, Certificate of Cost or Pricing Data

[4] FAR 2.101, Definitions