Don’t Call It A Loophole: The Commercial Item Contracting Scandal That Wasn’t

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“In past days they knew many things that we’ve forgotten.”

-Lorca, Federico García,
La Casa de Bernarda Alba
(from English translation)

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Abstract

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This paper examines the recent criticisms of the federal, commercial item contracting regime and the proposed legislation to narrow the definition of a "commercial item." The analysis begins with a survey of the milestones that led to the existing commercial item contracting framework. The benefits of simplifying the federal procurement process have been documented over decades of practical experience and study. Such benefits are twofold: (i) increasing contractor participation, thereby promoting greater competition and innovation, and (ii) integrating the federal procurement market with the broader economy through reduced barriers to entry. Efforts to realize these benefits culminated with the passage of the Federal Acquisition Streamlining Act ("FASA") in 1994. The legislation represented the decades of deliberate analysis that preceded it, establishing a purposely broad, government-wide definition of "commercial item" for the first time. The broad scope of the commercial item contracting framework sought to put the government on par with large commercial buyers who can appropriately wield influence over suppliers without promoting protectionism or requiring complex compliance infrastructures. Since FASA, there has been a near-constant effort to erode the commercial item contracting regime. This paper identifies the more significant criticism of the existing commercial item framework, underscoring that it has focused on the price paid by the government in specific procurements without addressing the benefits of integrating the federal procurement market with the broader economy. There has not been any substantive criticism suggesting that the quality of the goods and services procured by the government under commercial item contracts are inferior or fail to meet applicable requirements. Nevertheless, the anecdotal criticisms of the prices the government has paid under several high-profile commercial item contracts have seemingly

convinced different factions that the present framework is fraught with loopholes and in need of reform. This paper concludes that the recent criticism misses the mark and that commercial item contracting and the streamlining of federal procurement policy should be expanded rather than curtailed.

Table of Contents

I. Introduction

In the world of U.S. Federal procurement, the mid-90's saw a paradigm shift in the statutory framework governing the Government's purchase of commercial items. This change did not come about quickly; rather, it was formed from decades of studies, analyses, and lessons learned. The prevailing wisdom, developed over time, was that the Government's myriad procurement regulations created steep barriers for commercial companies seeking to do business in the Federal market. These barriers, in many cases, resulted in the Government paying more for inferior products relative to what was available in the commercial market. The reduction of barriers to the federal market promotes efficiencies on two fronts. First, it creates a competitive environment in which more contractors can participate and offer their products or services to the government without having to implement a complex compliance infrastructure. Second, it integrates the federal procurement market (approximately $500 billion per year[1]) into the broader U.S. and international economies.

The so-called "800 Panel Report" in January 1993 was, in many respects, the culmination of the efforts to reduce barriers to the Federal market. Many of the 800 Panel's recommendations were adopted by Congress in passing the Federal Acquisition Streamlining Act ("FASA") and subsequent legislation such as the Clinger-Cohen Act and the Services Acquisition Reform Act. The deliberate and reasoned path that led to the existing commercial item contracting regime considered many of the issues that are percolating again, including the need to confirm price reasonableness and the appropriate breadth of the "commercial item" definition. Despite the creativity and pragmatism that helped bring about the existing framework, numerous voices have been critical of the existing statutes and regulations, including

[1] *See* Summary of Federal Spending: Financial Assistance and Procurement, available at: http://www.fedspending.org.

the Government Accountability Office ("GAO"), the Department of Defense ("DoD"), and private citizens.

Unfortunately, in many cases, the criticisms are uniquely focused on individual procurements or outcomes and do not consider broader policy goals. Nevertheless, the critical anecdotes seem to have a visceral appeal and have gained significant traction and momentum. The result has been a slow erosion of the commercial item contracting framework that threatens to re-install barriers to the Federal market that will hinder efficiency.

The trend against market integration is taking Federal procurement reform in the wrong direction. Instead, the government should be focused on increasing commercial item contracting and enforcing the existing regulations, policies, and preferences to further the integration of the Federal procurement market into the broader economy.

The following recent statements, from diverse sources, are indicative of the momentum behind advocates for significant changes to the government's commercial item contracting regime:

> Scott Amey, Project on Government Oversight:
>
> The argument that the elimination or scaling back of the 'commercial item' definition will inhibit so-called 'commercial companies' from doing business with the government is nonsense.[2]

> Dana Liebelson, *Time*:
>
> But the good news is that recently, efforts to close the loophole are gaining steam: the Pentagon and a pair of its advisory bodies are all urging that the definition be narrowed.[3]

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[2] Scott Amey, *Defense Department's New Definition of 'Commercial Item' Will Save Money*, May 2, 2012, available at: http://pogoblog.typepad.com/pogo/2012/05/defense-departments-new-definition-of-commercial-item-will-save-money/ (stating that concerns that narrowing the commercial item definition will dissuade commercial companies from doing business with the Government are "nonsense").

Department of Defense, Office of Inspector General:

> We believe the commercial item definition is broad and has allowed contracting officials to award contracts for defense systems and subsystems that had no commercial market. To limit this misuse of the definition and to gain more control in ascertaining fair and reasonable prices, restriction should be placed on the commercial item exception . . . by requiring that commercial items be sold in substantial quantities to the general public to qualify for exemption from submittal of certified cost or pricing data.[4]

Those who doubt that trends in federal procurement law and policy move in cycles, will have a difficult time explaining the recent -- actual and proposed[5] -- revisions of the commercial item contracting framework. Such efforts seek to amend the commercial item definition by removing language that has permitted the federal government broad access to the commercial marketplace that it would not otherwise benefit from or enjoy.[6] If adopted, these proposed changes would ignore decades of sound analysis that brought about the existing statutes, regulations, and policies that, together, comprise the commercial item contracting regime. While many of the anecdotes used to criticize the breadth of the "commercial item" definition may seem valid at first blush, they do not withstand scrutiny when viewed in the appropriate context, with a full understanding of the existing regime and the rationale from which it spawned. In fact, many of the purported criticisms are not critical of the existing framework, but instead highlight instances in which existing law and policy were not followed.

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[3] Dana Liebelson, *We Pause for This Commercial . . . Sale*, May 22, 2012, available at: http://nation.time.com/2012/05/22/we-pause-for-this-commercial-sale/.

[4] Department of Defense, Office of Inspector General, *Commercial Contracting for the Acquisition of Defense Systems*, D-2006-115 (Sept. 29, 2006), available at http://www.dodig.mil/audit/reports/FY06/06-115.pdf.

[5] *Report of the Acquisition Advisory Panel to the Office of Federal Procurement Policy and the U.S. Congress* (Jan. 2007), at 58, 99-102.

[6] Felix Kushnir, *Evaluating Offerors Without Past Performance Information: The Good, the Bad, and the Neutral*, 35 Pub. Cont. L.J. 317, 318 (Winter 2006) ("While . . . FASA and the FAR regulations have generally improved the ability of new firms and recent entrants to compete for federal contracts, there is more that can be done.").

Recently-proposed legislation would narrow the existing commercial item definition to exclude those items and services that are "of a type" used by the general public and that are merely "offered" for sale.[7] More specifically, these changes would limit Federal Acquisition Regulation ("FAR") Part 12 acquisitions to purchases of specific items or services that have been sold in significant quantities in the commercial marketplace. Practically speaking, this would prohibit the government from contracting on a commercial item basis for items that have been tailored to meet government requirements or that do not have significant commercial sales. Instead, contractors selling these items would be subject to robust compliance requirements, potentially including the requirement to implement a compliant accounting system and to provide detailed cost or pricing data to support prices offered. In many respects, the proposed changes to the commercial item definition would practically limit any distinction between commercial items and commercially available off-the-shelf (COTS) items.[8] Items without significant commercial sales or that have undergone any modifications that are not "minor" would be precluded from commercial item status and subject to burdensome, Government-unique compliance obligations. These limitations would significantly curtail commercial item contracting and, in the long run, would result in fewer choices, higher prices, and lower quality for procuring federal agencies. In essence, these proposed changes would set federal commercial item contracting back two decades and create even more barriers for contractors seeking to do business with the Federal Government.

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[7] The full "commercial item" definition is found at 48 C.F.R. § 2.101. *See also infra* note 109 for the complete definition and description of the changes proposed in the draft version of the FY2013 NDAA.

[8] FAR 2.101 defines COTS items as a commercial item sold in substantial quantities in the commercial marketplace that is offered to the Government without modification. The distinction between COTS items and commercial items is not insignificant. The regulations recognize that, in certain cases, it is appropriate to subject COTS contractors to fewer compliance obligations than commercial item contractors. For example, COTS contractors are exempt from requirements such as E-Verify (FAR 52.222-54) and the components test of the Buy American Act. *See* FAR 12.103; 12.503. The distinction and nuances in how COTS items are treated relative to commercial items reflects an appropriate balancing that would, in effect, disappear if the proposed narrowing of the commercial item definition is passed into law.

The existing commercial item regime is not arbitrary or ill-conceived. To the contrary, it was meticulously developed to address concrete concerns that the federal government was disadvantaged by the onerous requirements it placed on contractors. The current commercial item definition was penned specifically to address these concerns, among others. The history of how the existing framework was developed reflects the detailed efforts to reduce barriers to entry and improve the efficiency of federal procurement. A consistent theme of the studies and commissions that preceded legislation on commercial item contracting was the need to reduce regulatory barriers to doing business with the Government. Reducing barriers to entry would, in turn, further the integration of the federal procurement market with the broader U.S. economy, which yields significant benefits to public buyers and to the private sector. Yet, criticisms of commercial item procurements over the past decade have seemingly ignored this broad goal and long term benefits, focusing instead on the price paid by the Government in a relatively small set of procurements. Any short-term benefits that may be gained through additional regulation are far outweighed by the negative impact of isolating the federal market from the broader economy.

II. Summary History of the Legislation and Policy in Support of Commercial Item Contracting

Since the Department of Defense was created in 1947, the need for an efficient procurement system has been recognized,[9] and policies have been advanced in an effort to realize such efficiencies.[10] The benefits of procuring commercial items and of integrating the federal market into the broader economy have been recognized since at least the 1960's.[11] Indeed, the current definition of "commercial item" and the related commercial item policies,

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9 James F. Nagle, *A History of Government Contracting*, 333-59, 487 (2d ed. 1999).

10 Giorgio Scappaticci, *The Procurement of Non Developmental Items: Pros and Cons, Air Force Institute of Technology* (Sept. 1994)*;see also* Pub. L. No. 80-413, 62 Stat. 21 (1948) (codified at 10 U.S.C. § 2301 *et seq*.).

11 *Report of the Acquisition Advisory Panel to the Office of Federal Procurement Policy and the U.S. Congress* (Jan. 2007), at 47.

statutes, and regulations evolved over several decades and culminated with the passage of the Federal Acquisition Streamlining Act in 1994. Prior to this watershed event, however, there were numerous directives, initiatives, and mandates that helped bring about the current regime. Indeed, the 1972 *Report of the Commission on Government Procurement* cited the high cost of non-developmental items as a sound basis to broaden the government's procurement of commercial items and implementation of commercial practices.[12] It would take more than twenty years for this recommendation to become law.

During the two decades between the 1972 report and the passage of FASA, numerous government studies and initiatives confirmed the efficacy of commercial item contracting and its favorable public policy implications. In 1978, the DoD's Acquisition and Distribution of Commercial Products program sought to further the acquisition of commercial items by revising or eliminating certain contract clauses and specifications that were inconsistent with commercial practices and potentially onerous for commercial companies.[13] Concurrent with these efforts, certain contracting activities within DoD began an assessment of the feasibility of incorporating commercial components and subsystems into its weapons systems.

The Competition in Contracting Act ("CICA") of 1984 went a step further toward codifying a preference for commercial items. Specifically, CICA required the DoD to "promote the use of commercial products whenever practicable."[14] Also in 1984, the Defense Procurement Reform Act mandated the DoD's use of commercially available parts in the acquisition or development of defense products "whenever such use is technically acceptable and

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12 *Report of the Commission on Government Procurement*, Part D (1972).

13 DoD Directive 5000.37 (Sept. 29, 1978).

14 Pub. L. No. 98-369, div. B, tit. VII, 98 Stat. 494, 1186 (1984).

cost effective."[15] While many of the benefits of acquiring commercial items and reducing barriers to enter the federal procurement market seemed intuitive, there was no rush to embrace acquisition reform favoring commercial items.

Just two years after CICA was passed, the President's Blue Ribbon Commission on Defense Management ("Packard Commission") released a report summarizing its findings. The Packard Commission's findings confirmed many of the intuitive justifications to maximize commercial procurements by the Federal government: lower costs, shorter lead times, and more market participants. The Packard Commission concluded that the DoD should develop new or custom-made systems only where it is clear that the commercial marketplace cannot meet the government's needs. Specifically, the Packard Commission stated, "[n]o matter how DoD improves its organization or procedures, the defense acquisition system is unlikely to manufacture products as cheaply as the commercial marketplace."[16] On the heels of the Packard Commission, Congress used the FY 1987 National Defense Authorization Act ("NDAA") to require the DoD to use a "nondevelopmental item" (including "any item of supply that is available in the commercial marketplace") where such items would meet the DoD's needs.[17] In addition, the DoD was required to define its requirements to promote the use of nondevelopmental items[18] and perform market research to determine whether nondevelopmental

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15 Pub. L. No. 98-525, tit, XII, § 1202, 98 Stat. 2492, 2588-89 (1984).

16 *President's Blue Ribbon Commission on Defense Management, Final Report: A Quest for Excellence*, 60 (1986).

17 Pub. L. No. 99-661, § 907, 100 Stat. 3816, 3917 (1986).

18 *See* FAR 2.101. Nondevelopmental item means an item of supply (i) previously developed exclusively for governmental purposes; (ii) requiring only minor modification of a type available in the commercial marketplace to meet government requirements; or (iii) being produced, but not meeting the definitions set forth in (i) or (ii) solely because the item is not yet in use.

items "are available or could be modified to meet agency needs" before undertaking efforts to develop a unique government requirement.[19]

The FY 1990 and 1991 NDAA carried the preference for commercial contracting further by directing the DoD to issue streamlined regulations for commercial products and to rescind any regulations that would interfere or create inconsistencies with the commercial preference.[20] These efforts by Congress to promote commercial contracting continued in the FY1991 NDAA (Section 800), which chartered the so called "800 panel" to undertake a comprehensive assessment of the DoD procurement laws and regulations and to propose measures to streamline the federal acquisition system.[21]

It is fitting that the FY1993 NDAA stated, "it is the policy of Congress that the United States attain the national technology and industrial base objectives set forth in [10 U.S.C. 2501(a)] through acquisition policy reforms that have the following objectives . . . (3) Reducing Federal Government barriers to the use of commercial products, processes, and standards."[22] While this policy seems sound on its face – and was supported by decades of analysis – it had yet to be carried out. Indeed, despite the numerous studies, panels, and statutes touting the benefits of commercial contracting by the federal Government, by 1993, the Government, and particularly DoD, was not procuring commercial items in any significant quantities. The stated policies and preferences simply were not having the desired effect. Against this backdrop, the "Section 800 Panel" released its report in January 1993. The Panel's report, in many respects, was the beginning of a paradigm shift in federal contracting, as it became the foundation of the 1994 Federal Acquisition Streamlining Act.

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[19] Pub. L. No. 99-661, § 907, 100 Stat. 3816, 3917 (1986).
[20] Pub. L. No. 101-189, § 824(b). 103 Stat. 1352, 1504-05 (1989).
[21] Pub. L. No. 101-510, § 800, 104 Stat. 1485, 1587 (1990).
[22] Pub. L. No. 102-484, § 4211, 106 Stat. 2659 (1992) (emphasis added).

A. Section 800 Panel Report

The Acquisition Law Advisory Panel was established pursuant to Section 800 of the FY 1991 National Defense Authorization Act, Pub. L. No. 101-510 (1990), for the purpose "of rationalizing, codifying, and streamlining" the body of law applicable to defense procurement that had developed incrementally over many years.[23] The Panel was specifically chartered to re-examine defense procurement practices in light of the new realities that existed at the end of the Cold War.[24]

Early in its deliberations, the 800 Panel adopted a set of overall "objectives" to guide its work. The objectives that are relevant to the Panel's ultimate recommendations concerning the acquisition of "commercial items" included the following:

> (4) Acquisition laws should, without alteration of commercial accounting or business practices, facilitate:
>
> (a) Government access to commercial technologies; and
>
> (b) Government access to the skills available in the commercial market place to develop new technologies.
>
> (5) Acquisition laws should, without requiring contractors to incur additional costs, facilitate the purchase by DOD or its contractors of commercial or modified commercial products and services at or based on commercial market prices.
>
> (6) Acquisition laws should enable companies (contractors or subcontractors) to integrate the production of both commercial and

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[23] Streamlining Defense Acquisition Laws, Report of the Acquisition Law Advisory Panel to the U.S. Congress ("800 Panel Rpt."), at I-1 (January 1993).

[24] As described herein, the 800 Panel was one in a series of panels or commissions that Congress established to examine the procurement process, including the 1972 Commission on Government Procurement and the Packard Commission. Both of these groups made recommendations that were precursors of those made by the 800 Panel, including recommendations intended to increase the acquisition of commercial products. *See* 800 Panel Rpt., at 8-3. In addition, on September 14, 1993, in connection with Vice President Gore's National Performance Review, the White House issued a National Performance Review Systems Report entitled "Reinventing Federal Procurement," which advocated a more streamlined procurement system and a framework for increased acquisition of commercial products and services.

> Government-unique products in a single business unit without altering their commercial accounting or business practices.[25]

The final recommendations of the 800 Panel satisfied these basic objectives by proposing changes to laws that would simplify the terms and conditions applicable to contracts for the acquisition of commercial items, and by making certain laws inapplicable to those procurements, thereby making contracts with the Government more attractive to providers of commercial items. The Panel explicitly recognized that a separate Federal procurement market, with a limited number of contractors able to effectively compete, was not consistent with the public interest and did not further the universally accepted goals of maximizing efficiency, competition, quality, and value.[26] Thus, one of the fundamental recommendations of the Panel was to reduce the barriers to entry that prevented many contractors from participating in the Federal market, thereby further integrating the Federal procurement into the overall economy.

1. 800 Panel Recommendations

Importantly, the Panel closely considered many of the aspects of commercial item contracting that have come under recent scrutiny. For example, the Panel's final recommendations included a policy preference for the acquisition of commercial items, a new commercial item definition in 10 U.S.C. § 2302,[27] expanded exemptions for commercial items under the Truth in Negotiations Act ("TINA"), relief from requirements to provide cost and pricing data, and the inclusion of items modified to meet Government requirements within the

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[25] 800 Panel Rpt., at I-9 (emphasis added).

[26] *Id*. at 8-6, 8-7.

[27] The 800 Panel's proposed definition evolved from a series of earlier statutory and regulatory efforts to increase the Government's acquisition of commercial products. These efforts include the DoD issued Directive 5000.37, entitled Acquisition and Distribution of Commercial Products, the Defense Procurement Reform Act (a component of the FY85 National Defense Authorization Act), and Section 907 of the FY87 National Defense Authorization Act. The structure and content of paragraph (A) of the 800 Panel's proposed definition closely resembled the definition DoD adopted in 1991 at DFARS 211.7001, implementing Section 822(b) of the National Defense Authorization Act for FYs 1990-1991, Pub. L. No. 101-189 (1989). That section required DoD to develop new regulations governing the acquisition of commercial products and a simpler format for the acquisition of commercial items to the maximum extent practicable. *See* 56 Fed. Reg. 18610 (Apr. 23, 1991).

"commercial item" definition. At the heart of the Panel's recommendations was the intent to reduce the barriers to entry into the Federal market. Reduced barriers lead to greater competition and, ultimately, better prices and quality in the marketplace.[28]

Chapter 8 of the 800 Panel Report described the Panel's recommendations to facilitate the Government's acquisition of commercial products and services. The Panel first sought to identify those statutes and regulations that represented barriers to companies that would otherwise sell commercial products and services to the Government, and then made recommendations for removing the more significant barriers.[29]

The Panel defined a policy clearly favoring the acquisition of commercial products, and establishing a different, simpler and less intrusive set of requirements applicable to the acquisition of such products. The first step was the establishment of a new definition of the products/services to be acquired under this new and streamlined process. The Panel provided the following basic rationale for its proposed commercial item definition:

> From the outset, the Panel believed that a primary purpose of defining a commercial item was to be able to exempt items so defined from the reach of those statutes and implementing regulations which have created barriers to the acquisition of commercial items.[30]

The Panel thus linked the "commercial item" definition it proposed to the underlying purpose of the definition: those items that qualify as "commercial items" are those items which by their

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[28] Elliott Yoder, *Engagement Versus Disengagement: How Structural and Commercially-Based Regulatory Changes Have Increased Government Risks in Federal Acquisitions*, 6, Naval Postgraduate School (Nov. 2004).

[29] At the beginning of Chapter 8, the Panel recognized that adherence to the FAR Part 31 Cost Principles and the Cost Accounting Standards, along with TINA, were among the "most expensive and disruptive requirements" of doing business with the Government, and constituted significant barriers for companies otherwise having commercial products the Government wanted to buy. 800 Panel Rpt., at 8-6 to 8-7.

[30] *Id.* at 8-18 (emphasis added).

nature should be exempt from otherwise standard Government procurement requirements (*e.g.*, TINA and the Cost Accounting Standards).

2. The Distinction Between Determining Commerciality and Price Reasonableness

The Panel also recognized at the outset that the definition of a "commercial item" was a concept distinct from how the Government should price a commercial item. In this regard, the Panel stated:

> Once the Panel had defined the universe of items which should be acquired with a minimum of regulation unique to Government contractors, the Panel went on to deal specifically with pricing (in proposed section 2xx5) and quality (in proposed section 2xx4) rather than attempting to load these functions into the definition.[31]

Thus, while different, the definition of a commercial item and the pricing of commercial items are related. This is an important point that is significant to understanding and analyzing the flaws in many recent criticisms of the commercial item regime.[32] After a contracting officer determines that an item meets the commercial item definition, the reasonableness of such item's price is determined through either competition or "price analysis." In rare cases, where these methods cannot confirm that the pricing is fair and reasonable, cost analysis may be utilized. In

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[31] 800 Panel Rpt., at 8-18.

[32] It is important to emphasize that, as explained in greater detail in Section II.A.3, the determination that a product meets the FAR 2.101 definition of "commercial item" is separate and distinct from the determination that the price for the item is "fair and reasonable." *See* FAR 15.402(a). The latter determination can be made easily when there is adequate price competition. If there is no competition, however, the reasonableness of the price for a commercial item is to be based upon "information other than cost or pricing data." *See* FAR 15.404-1(a)(2)-(3). This determination will be based upon a Government "price analysis," or, as a last resort, upon a "cost analysis." *See* FAR 15.404-1(a)-(c). Thus, the FAR contemplates situations in which a product meets the definition of a commercial item, but cannot be readily priced in the commercial marketplace, making some reliance on other data, including contractor cost data, necessary to insure fair and reasonable pricing. In addition, this means that a product might be sufficiently similar (is "of a type") to items sold commercially that it meets the definition of "commercial item," even though the market does not provide a clear price for the product. The Section 800 Panel reached the same conclusion. While it did not use the phrase "information other than cost or pricing data," it did contemplate the occasional need for the Government to obtain cost data from the contractor to support the price of a commercial item. This portion of its legislative recommendations was not adopted by Congress in FASA but was incorporated in FAR Part 15.

fact, the 800 Panel contemplated a robust analysis of commercial item pricing to confirm its reasonableness. Much of the recent criticism of commercial item procurement and recommendations to significantly narrow the definition of a "commercial item" fail to recognize this distinction.

3. The Commercial Item TINA Exemption

As previously noted, the 800 Panel developed its proposed definition of "commercial item" with the end purpose of offering contractors, particularly commercial companies, an opportunity to participate in the government marketplace without taking on the burdens traditionally imposed upon government contractors.[33] It concluded first that commercial item procurements should not be entirely exempt from all Government and DoD-unique requirements such as those involving socio-economic, ethics and certain other regulatory policies.[34] Instead, it determined that the following criteria should be used to decide which statutes would not be applicable to commercial item acquisitions:

> (i) whether compliance with a statute was practical if a commercial item was purchased out of inventory;
>
> (ii) whether compliance would disrupt sources of supply, personnel practices, and business methods that would typically be in place in a company which served primarily the commercial market; and
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> (iii) whether compliance with a contract-unique requirement would impose substantial expense on a "typical" commercial company.[35]

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[33] 800 Panel Rpt., at 8-31.

[34] *Id.* Moreover, commercial item contracts have not been immune from added compliance obligations in the last five years. Commercial item contractors and subcontractors are now required to comply with requirements related to ethics and business conduct (FAR 52.203-13), employment eligibility (FAR 52.222-54), and executive compensation reporting (FAR 52.204-10). FAR 52.212-5 includes a complete list of contract clauses and statutory requirements that may apply to specific commercial item contracts.

[35] *Id.* (emphasis added).

The 800 Panel thus believed that two of the factors that were relevant in determining whether a product should be treated as a commercial item were whether its acquisition using standard Government procurement requirements would (i) disrupt the business methods of a company that serves "primarily the commercial market," or (ii) "impose substantial expense" on the commercial company.

The 800 Panel recognized that there were two related issues that arose in connection with the pricing of commercial items. First, the requirement to submit cost or pricing data under TINA was a major barrier to commercial companies entering the Government market. According to the 800 Panel, TINA fit squarely within the profile of statutory requirements from which companies selling commercial items should be exempt. The Panel also recognized, however, that the Government was still required to determine that the price it was paying for a commercial item was "fair and reasonable." To satisfy these two – sometimes inconsistent – objectives, the Panel recommended two groups of change.

Specifically, the Panel proposed to expand the TINA exemption for "adequate price competition," which was explained in the 800 Panel Report as follows:

> The proposed amendment specifically provides that a procurement can be exempted from TINA under the adequate price competition exemption if: (1) the price is fair and reasonable, and (2) the item is to be purchased from a company or business unit that produces the same or similar item for the commercial market using the same or similar commercial production processes as those used to produce the offered item for the Government.[36]

The Panel's guidance on determining price reasonableness is very similar to that reflected in the current FAR 15.404-1(b), describing the factors to be considered in performing a "price analysis." Based on the above, the 800 Panel would have been comfortable exempting a

[36] *Id.* at I-127.

procurement from TINA where the item was being purchased from a company that produces the "the same or similar item for the commercial market using the same or similar commercial production processes." The 800 Panel further recognized the need for an explicit TINA exemption for noncommercial modifications to commercial items that do not change the item from a commercial item to a noncommercial item.[37]

The Panel also made recommendations affecting the pricing of commercial items, including one to create the concept of "documentation" that could be requested to support the reasonableness of a contractor's price. This documentation was to be distinguished from certified or formal "cost or pricing data" under TINA and was in most respects equivalent to the current FAR concept of "other than cost or pricing data."[38] Specifically, the Panel recommended that in the event the price of a commercial item was not based upon (i) an established catalog or market price supported by sales of substantial quantities, or (ii) full and open competition, then "the contracting officer shall use price analysis, relying if needed on documentation submitted under subsection (b), to determine that the price is fair and reasonable."[39] However, the Panel recognized that:

> there may be unusual circumstances in which the reasonableness of a proposed price cannot be established through price analysis as contemplated in section 2xx5. If this occurs, then under section 2xx5(a)(3), the provisions of TINA then apply to the acquisition. If at that point a contractor can meet whatever requirements TINA places on the acquisition – possibly including certified cost or pricing data – the transaction can go forward.[40]

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37 *Id*. at I-126.

38 "Information other than cost or pricing data" is defined under FAR 2.101 to mean "any type of information that is not required to be certified" under TINA, but "may include pricing, sales, or cost information, and includes cost or pricing data for which certification is determined inapplicable after submission." (Emphasis added.)

39 800 Panel Rpt., at 8-43 (emphasis added).

40 *Id.* at 8-44.

These overall pricing recommendations underscore the Panel's view that the determination of price reasonableness could, in most cases, be made without relying on formal or certified cost or pricing data, and that this, when coupled with a more expansive definition of "commercial item" would facilitate the acquisition of commercial items without endangering the Government's legitimate procurement interests.

Importantly, the 800 Panel does not suggest that reducing barriers to doing business with the federal government would have any impact on the quality of goods and services available to federal agencies. In fact, the 800 Panel report indicates that expanded commercial item contracting could facilitate an improvement in quality. For example, new technologies tend to emerge sooner in the commercial marketplace than in defense industries.[41] Moreover, the Panel found that government requirements and regulations can interfere with relationships between prime contractors and their suppliers and subcontractor and cause schedule delays. Such interference and delay often impact quality as well as price.[42] Thus, the expansion of commercial item contracting and the integration of the federal procurement market with the broader economy has the potential to reduce prices, improve quality, and increase the industrial base.

III. New Legislation Based on the 800 Panel

Thus, the 800 Panel Report illustrated in detail the various shortcomings of a complex and overly risk-averse Government procurement system. With its unique entry requirements and other departures from commercial purchasing practices, the Government market had been avoided by many of the businesses offering the most innovative technologies to the commercial marketplace at competitive prices. Following the release of the 800 Panel Report in January

41 800 Panel Rpt., at 8-11, 8-14.
42 *Id*. at 8-14.

1993, the House and Senate each introduced bills to streamline procurement across the entire Government, reduce many Government-unique statutory requirements, and encourage the acquisition of commercial items to the maximum extent practicable. The House bill, H.R. 2238, was introduced on May 24, 1993 as the "Federal Acquisition Improvement Act of 1993."[43] The Senate's version, S. 1587, was introduced on October 26, 1993.[44] While the broad intent of the two bills was similar, there were material differences that needed to be resolved. As discussed below, a committee was appointed and tasked with addressing such differences. Ultimately, Congress enacted FASA on October 13, 1994. At the time, it was arguably the most significant procurement-reform legislation since the Competition in Contracting Act of 1984. Whereas the 800 Panel established a compelling legal and business case for radically reforming government procurement and taking advantage of the commercial marketplace, FASA transformed many of those recommendations into law. In sum, it reflected the principles upon which the commercial item procurement regime rests.

FASA introduced for the first time, among other things, a single, government-wide definition of commercial item, and greatly expanded the list of government contract obligations from which the commercial item supplier would be exempt (including TINA disclosure requirements). In recent years, however, in the wake of several highly publicized procurement "scandals"[45] involving major commercial-item acquisitions, Congress has begun to chip away at some of the reforms implemented by FASA. The most recent example of this retrenchment is the proposed narrowing of the commercial item definition under Section 806 of the draft National Defense Authorization Act for FY 2013.

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[43] H.R. 2238, Rpt. No. 103-545, pt. I and II, 103rd Cong., 2nd Sess. (1994).

[44] Cong. Rec. S14384 (Oct. 26, 1993).

[45] While some observers have characterized what they deem to be improper commercial procurements as scandals, such characterizations may be overly dramatic and, in some cases, misplaced.

A. The Federal Acquisition Streamlining Act

Until FASA, federal procurement laws did not provide a single, government-wide definition of commercial item. Given the 800 Panel Report and Congress' desire to enact reform legislation, a generic commercial item definition was proposed to identify those products and services the Government could purchase, for policy and business reasons, using far fewer Government-unique terms and conditions than it had relied upon in the past.

FASA further streamlined the federal acquisition process by requiring fewer clauses, terms and conditions than are required for non-commercial procurements, and by making inapplicable many laws and statutory requirements that otherwise hinder the efficient performance of government contracts. A major goal of this statute was to eliminate government-unique requirements and to encourage the use of commercial best practices.

With respect to products, the definition included items sold or merely offered for sale to the general public, provided they were "of *a* type regularly used by the general public."[46] In keeping with the 800 Panel Report, the definition also included items that could be modified and still be considered a commercial item.

The Conference Committee Report on S. 1587, published on August 21, 1994, documented the work of the committee appointed to resolve the outstanding differences between S. 1587 and H.R. 2238.[47] With respect to the commercial item definition, the report discussed the negotiation of language inserted in subparagraph (A) – "of a type customarily used" for other than governmental purposes – and how it ought to be interpreted:

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[46] S. 1587, § 8001, 103rd Cong., 1st Session (1993) (emphasis added). The very similar phrase "of *the* type" was used in the 800 Panel Report definition of commercial item to capture the range of modifications that could be made to an item which (i) meets the criteria for a commercial item and (ii) as modified, still qualifies as a commercial item. As noted above, the 800 Panel promoted the inclusion of modified commercial items within the definition to enable DoD "to have the same flexibility as a commercial company to obtain modifications that would be available to, for example, a Fortune 100 company." 800 Panel Rpt., *supra* note 23, at 8-20.

[47] H. Rpt. No. 103-712, 103rd Cong., 2nd Sess. (1994).

> The definition of "commercial items" in the Senate bill would include items not yet available in the commercial marketplace that will be made available for commercial delivery within a reasonable period, but only if the items are "of a type customarily used" for other than governmental purposes. The House amendment included such items if they are "intended to be used" for other than Federal government purposes.
>
> The conference agreement would provide that items that are not yet available in the commercial marketplace would be included in the definition of commercial items if they evolve out of commercial items based on advances in technology or increases in capability and will be available for delivery in the commercial marketplace in time to meet government requirements. The provision is intended to ensure that new generations of commercial products are included in the definition. At the same time, this provision should ensure that there is some yardstick in the commercial marketplace against which to measure price and product quality, and to serve as a surrogate for the imposition of government-specific requirements.[48]

Thus, the commercial marketplace was seen, in some respects, as a "surrogate" for government-specific requirements from which product quality and price reasonableness could be derived. However, it was clearly contemplated that there would be instances in which the Government would buy items under the commercial item contracting procedures that did not emanate from a robust commercial market. Thus, the recent consternation over the breadth of the "commercial item" definition cannot be seen as a correction of an unintended consequence of FASA. Rather, the recent efforts to narrow the definition would represent a dramatic shift in the opposite direction and a departure from the robust analysis and procedures that brought about the existing commercial item contracting regime.

B. The Clinger-Cohen and Services Acquisition Reform Acts

[48] *Id.* at 225 (emphasis added).

In 1996, Congress passed the Clinger-Cohen Act[49] to further advance the procurement of commercial items. Notably, the Clinger-Cohen Act exempted commercial item suppliers from TINA's cost and pricing data requirements, one of the most commonly cited reasons for commercial companies' reluctance to contract with the federal government.[50]

In 2003, Congress passed the National Defense Authorization Act for Fiscal Year 2004,[51] which incorporated the Services Acquisition Reform Act ("SARA") (formerly H.R. 1837) as Title XIV. SARA built on the critical procurement reform initiatives of the 1990s by recognizing that the economy and the needs of the Government had become increasingly service and technology oriented. Section 1431(a) of the Act amended the Office of Federal Procurement Policy (OFPP) Act to permit a performance based contract or task order for the procurement of services to be treated as a "commercial item" contract in certain circumstances. Section 1432 amended the FASA (Section 8002(d)) to authorize the use of a time-and-materials contract or a labor-hour contract in the procurement of commercial services (a type of "commercial item") if, among other things, those services were (i) commonly sold through the use of either type contract and (ii) purchased by the procuring agency on a competitive basis. Additionally, Section 1433 clarified the "stand-alone services" definition of a commercial item.

These statutes also contained provisions directing the FAR drafters to implement regulations that would permit a more user friendly set of acquisition procedures and eliminate many barriers to the market. The intent of the new regulations was to increase competition in selling commercial items to the federal Government, while decreasing related acquisition costs.

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[49] Pub. L. No. 104-106; see also Mason C. Alinger, The Impact of Procurement Provisions In Appropriations Acts on the Federal Acquisition System, 36 Pub. Cont. L.J. 583, 584 (Summer 2007) (The Competition in Contracting Act of 1984, the Federal Acquisition Streamlining Act of 1994, the Clinger-Cohen Act of 1996, and the Services Acquisition Reform Act of 2003 were all efforts focused on streamlining the federal acquisition system.").

[50] 800 Panel Rpt., at 8-7, 8-8.

[51] Pub. L. No. 108-136.

The latter goal is a key point that is often not considered among the benefits of commercial item contracting. There is cost to the Government associated with auditing contractor costs and evaluating certified cost or pricing data. The reduced cost of conducting a commercial item procurement cannot be ignored in evaluating the benefits of the commercial item contracting regime.[52] In many respects, 2004 (ten years after FASA) represented the high water mark for commercial item contracting. Since then, there have been increasing efforts to narrow the commercial item preference and re-establish barriers to the federal procurement market.

IV. Efforts to Narrow the Definition of "Commercial Item"

Almost from the time FASA was passed, voices within the Federal Government have been critical of commercial item contracting. These criticisms focus on the prices paid under commercial item purchases and seemingly ignore the broader policy goals of integrating the Federal procurement market with the broader economy. Unfortunately, however, these criticisms have prompted revisions in the commercial contracting regime, particularly within the DoD, that tend to reinstitute barriers to competition and thus reduce the pool of contractors that can meet the minimum requirements of doing business with the Government. While there are numerous examples of these criticisms, four are highlighted herein.[53] Notably, none of the criticisms call the quality of commercial item goods and services into question; all are focused on pricing.

For example, the DoD Office of Inspector General ("OIG") and the GAO have issued numerous reports in recent years in which they have reviewed commercial item determinations made by DoD agencies, and found them wanting. These reports offer a glimpse of the

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[52] *House Committee Circulates Draft of Revived Procurement Reform Bill*, 35 GC ¶294 (May 5, 1993).

[53] Other critical reports not discussed in detail include: *Contracting for and Performance of the C-130J Aircraft* (D-2004-102) (July 23, 2004) and *Procurement Procedures Used for F-16 Mission Training Center Simulator Services* (D-2006-065) (March 24, 2006).

constraints that may be placed on contracting officers in the future when deciding whether to proceed under FAR Part 12 and do without cost or pricing data under TINA.

A. 1999 GAO Report

In 1999, just five years after the passage of FASA, the GAO issued a report summarizing its review of sixty-five commercial sole source purchases.[54] While not directly criticizing the Federal commercial item contracting regime, the report concluded that the price analyses performed by contracting personnel were inadequate. For example, in 33 of the 65 procurements reviewed by the GAO, the price analysis consisted only of comparing the offered price to a catalog or list price.[55] The other 32 procurements used more robust price analysis techniques, including requesting cost data, but the GAO concluded that the contracting personnel were generally too accepting of contractor pricing and did not sufficiently negotiate where appropriate.

Contracting personnel who were questioned about the sparseness of their price analyses offered a broad range of justifications. In many cases a lack of time was cited, others blamed a lack of negotiating leverage in a sole-source buy, and in some cases the contracting personnel indicated that placing orders quickly was a higher priority that negotiating a low price.[56] This report did not explicitly recommend revisions to the existing laws and regulations, but it certainly suggested that the "commercial item" definition was too broad and posed practical problems to agencies seeking to confirm the reasonableness of offered prices.

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[54] U.S. General Accounting Office, *Contract Management: DoD Pricing of Commercial Items needs Continued Emphasis*, GAO/NSIAD-99-90 (June 1999), available at http://www.gao.gov/archive/1999/ns99090.pdf..

[55] *Id*. at 2.

[56] *Id*. at 8.

B. 2004 DoD OIG Tanker Report

On March 29, 2004, the DoD OIG issued a report related to the acquisition of the Boeing KC-767A Tanker Aircraft ("Tanker Report").[57] While the Tanker Report addressed a variety of issues, the most relevant discussion focused on the Air Force's commercial item procurement strategy to lease and purchase the KC-767A tanker.

The Tanker Report criticized the Air Force's determination that the KC-767A met the statutory definition of a commercial item.[58] The DoD OIG argued that no commercial market existed for the tanker that could establish reasonable prices by the forces of supply and demand.[59] The DoD OIG ultimately concluded that the commercial item procurement strategy used by the Air Force did not provide sufficient cost or pricing data for a multi-billion dollar procurement, thereby undermining the determination that the prices offered were fair and reasonable.[60]

The Air Force contracting officer classified the KC-767A as a commercial item because the modifications Boeing proposed to make to its "green" 767 aircraft allegedly would not change its non-governmental function (*e.g.*, the KC-767A would still transport people and cargo by air) and would not change the aircraft's essential physical characteristics (*e.g.*, it would still

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57 *Acquisition of the Boeing KC-767A Tanker Aircraft* (D-2004-064) (Mar. 29, 2004), available at http://www.dodig.mil/audit/reports/fy04/04-064.pdf.

58 *Id.* at i.

59 *Id.* at ii. As mentioned above, a buying agency must make two separate determinations: (i) does the item meet the statutory definition of a commercial item; *and separately* (ii) is the price of the commercial item fair and reasonable. The "Results" section of the Tanker Report reflects DoD OIG's inappropriate blending of the commercial item determination with the separate determination of the fairness of the price. For example, the DoD OIG asserted that "[c]ontrary to the Air Force interpretation, the Boeing KC-767A Tanker Program does not meet the statutory definition of a commercial item. No commercial market for this tanker aircraft exists in order to establish reasonable prices by the forces of supply and demand." *Id.* at ii. This convergence of the two different determinations, evident in multiple DoD OIG reports on commercial item acquisitions, blurs the analysis of whether an item is a commercial item.

60 *Id.*

have a fuselage, wings, tail, engine and avionics).[61] As a result, the contracting officer concluded that the reconfiguration of the 767 passenger or freighter version to a tanker was a minor modification under subparagraph (3)(ii) of the FAR 2.101 definition of commercial item.

The DoD OIG disagreed, concluding that Boeing's proposed modifications to the 767 were not minor noncommercial modifications.[62] Specifically, the DoD OIG found that the modifications were "not minor, were for unique military-specific purposes, and cost **.* percent of the base commercial aircraft price . . . In addition, the modifications significantly changed the aircraft's primary purpose and function from that of transporting people and cargo to that of a military tanker."[63] The DoD OIG further stated "[t]he major modifications that will be made to the Boeing 767-200ER commercial aircraft will create a military-unique tanker aircraft that does not currently exist."[64]

Finally, the DoD OIG concluded that the KC-767A did not meet the "intent" of the phrase "of a type" in the commercial item definition. The Tanker Report quoted a 2001 DoD policy memorandum for the proposition that the phrase "of a type" was not intended to allow the use of FAR Part 12 for the acquisition of sole-source, military-unique items that are not closely related to items already in the market place.[65]

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61 *Id.* at 7.

62 *Id.* at 9

63 *Id.*

64 *Id.*

65 *Id.* The DoD OIG also asserted that there was no commercial market for the KC-767A to establish the reasonableness of the pricing by market forces. As a result, the DoD OIG concluded the Air Force created a high-risk procurement strategy and that a cost or fixed-price-incentive contract would have been a more appropriate vehicle for the KC-767A.

C. 2006 DoD OIG Report

In 2006, the DoD OIG published a report summarizing its review of 86 contract actions under 42 contracts totaling $4.4 billion.[66] The 2006 report concluded that federal contracting officials did not sufficiently justify the commercial nature of the items being procured in 35 of the 42 contracts reviewed.[67] The DoD OIG concluded that the Government would have been better positioned to negotiate a better price if it had required the contractors to submit cost or pricing data. That is, by conducting the procurement under FAR Part 12 as opposed to Part 15, the Government risked paying an unreasonable price, particularly where a commercial market for the item sought does not exist.[68] Notably, in many cases, this criticism seemed to reflect a disagreement with existing law rather than with the individual procurements. For example, the report noted that often the item procured did not represent a "true" commercial product.[69] This comment suggests that the DoD OIG's view of what should be a commercial item is distinct from the current definition.

Moreover, the DoD OIG cited the broad definition of a "commercial item" as problematic in that it allowed contracting officials to use "loopholes" to conduct commercial item procurements for items whose commercial nature is dubious.[70] For example, the report noted that commercial items include items that are "of a type" available in the commercial marketplace and need only be "offered for sale," not actually available for sale. The report pointed to the

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66 Department of Defense, Office of Inspector General, Commercial Contracting for the Acquisition of Defense Systems, D-2006-115 (Sept. 29, 2006), available at http://www.dodig.mil/audit/reports/FY06/06-115.pdf.
67 *Id*. at i, 5.
68 *Id*. at 6.
69 Id. at 5.
70 *Id*. at 7.

FAR Part 12 procurement of engines for the V-22 Osprey Aircraft and concluded that there was insufficient documentation of the similarity to the commercial engine.[71]

The 2006 report went a step further than previous criticisms by making specific recommendations that the "commercial item" definition be narrowed so that certified cost or pricing data would be required for items that are of a type or that have been merely offered for sale. That is, cost or pricing data would be required for items without a "proven commercial market."[72]

D. 2009 Panel on Contracting Integrity

The FY2007 NDAA established a panel to review a broad spectrum of issues related to contracting integrity.[73] One of the items under the panel's purview was "adequate pricing," which included an assessment of commercial item procurements. Similar to the GAO and DoD OIG reports cited herein, the panel found that, in some instances, DoD contracting personnel failed to adequately document both the determination of commerciality and the reasonableness of the price paid. Based on these findings, the panel recommended that the "commercial item" definition be revised to exclude items "of a type" and items "offered for sale." In the interim, the panel recommended that the DoD implement requirements to escalate the determination of commerciality above the contracting officer level.[74] The panel concluded that such amendments to the definition would address "contract pricing vulnerabilities" under commercial item

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71 *Id.*

72 *Id.* at 7, 12-13.

73 Pub. L. 109-364 § 813.

74 *Panel on Contracting Integrity*, 2009 Report to Congress, Tab H, available at: http://www.ndia.org/Advocacy/LegislativeandFederalIssuesUpdate/Documents/March2010/Contracting_Integrity_panel_report_2009_to_Congress.pdf.

procurements.[75] Notably, the panel did not discuss, and seemingly did not consider, the concern of creating additional barriers and impediments to doing business with the Federal Government.

V. The Critical Reports Do Not State a Case for Gutting the Commercial Item Regime.

Notably, the 800 Panel and the drafters of FASA considered the very issues raised by the reports described above in drafting recommendations for the current commercial contracting framework. At the time, there was broad concurrence that the requirement to provide certified cost or pricing data was one of the greatest barriers to entering the Federal procurement market.[76] Moreover, it was contemplated that in some cases there may not be an established commercial market for specific items and, in those cases, it may be appropriate to require cost data.[77] However, the fundamental reason for creating a broad definition for commercial items and for exempting commercial item procurements from a number of requirements was to reduce the barriers and integrate the federal market into the broader economy. The "of a type" and "offered for sale" language was specifically developed to put the federal Government in a situation similar to that of a large, commercial buyer. The relatively recent criticisms of the commercial item regime do not appear to consider these broader policy objectives. Rather, they rely on anecdotal evidence and short term interests in advocating for significant revisions to a well-laid framework.

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[75] *Id.*
[76] 800 Panel Rpt., at 8-7.
[77] *Supra* n. 25.

A. Benefits of Integrating the Federal Procurement Market

The benefits of an integrated federal procurement system are intuitive and as basic as the rationale behind economies of scale.[78] As noted in the 800 Panel report, significant Government-unique requirements result in commercial contractors either adding layers of cost by establishing separate business units for their Government business or electing to forego the Government market entirely.[79] By imposing requirements that create separate business units and limited competition, the Government is unwittingly fostering an environment in which there is less competition, less innovation, inferior quality, and higher prices. In effect, two markets for the same or similar products are created. In many cases this results in higher prices for both government and commercial buyers.[80] Notably, the recent criticisms of the commercial item contracting framework do not consider the opportunity costs of increased regulations or the less tangible benefits of an integrated federal procurement market, including reduced procurement costs, increased contractor participation, and innovation.

Furthermore, the barriers to doing business with the federal government can impede the government's ability to procure goods and services needed to respond to a crisis. For example, the "Buy American" provisions of the 2009 American Recovery and Reinvestment Act of 2009 likely delayed billions of dollars in procurements intended to stimulate the sluggish U.S. economy.[81] In addition, government-specific accounting requirements effectively preclude the participation of foreign contractors in the federal procurement market.[82]

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78 Albert Graells, *Are the procurement rules a barrier for cross-border trade within the European market? A view on proposals to lower that barrier and spur growth*, at 2-3, Preliminary Draft (Jan. 16, 2012).

79 800 Panel Rpt., at 8-6.

80 Albert Graells, *Distortions of Competition Generated by the Public (Power) Buyer: A Perceived Gap in EC Competition Law and Proposals to Bridge It*, n. 31, available at http://ssrn.com/abstract=1458949.

81 *See, e.g.*, Burgett, Leibowitz, and Ertley, *Feature Comment: How Will Buy America Restrictions Affect Economic Stimulus Spending?* 51 No. 7 Gov't. Contractor ¶ 51 (Feb. 18, 2009); *see also* Steven L. Schooner and

The sound policy behind integrating markets is underscored by the Supreme Court's jurisprudence related to the Constitution's Commerce Clause. Just as the Supreme Court has sought to avoid economic protectionism among the states,[83] the Executive branch should not promote protectionism with its procurement policy. Indeed, it is widely accepted that one of the Commerce Clause's most important objectives is to realize the benefits that stem from economic integration.[84] Commerce Clause jurisprudence underscores the positive implications of integrating the federal procurement with that of the broader economy

One of the government's primary concerns with the reduced regulatory requirements around commercial item purchases is that it will create an environment in which the contractor will be more likely to cheat the Government and the Government official will be less likely to act to protect the Government's interests. This risk-averse approach is misplaced and, in fact, often achieves the opposite of the intended result. For example, a market in which only a handful of large companies are able to effectively compete for significant contracts fosters an environment that is ripe for price fixing and other anticompetitive behaviors.[85] But even if the few remaining competitors abstain from blatant criminal acts, the smaller number of market participants do not bring pressure to innovate and maximize efficiency, as there is little or no fear of new entrants

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Christopher R. Yukins, *Feature Comment: Tempering 'Buy American' In The Recovery Act – Steering Clear Of A Trade War*, 51 No. 10 Gov't. Contractor ¶ 78 (Mar. 11, 2009).

82 *See* D. Daniel Sokol, *Limiting Anticompetitive Government Interventions That Benefit Special Interests*, 17 Geo. Mason L. Rev. 119, 124 (Fall 2009); *see also* Lawrence S. Rabyne and Steve Gruenwald, *Waivers of Cost Accounting Standards*, 08-7 Briefing Papers 1 (June 2008) ("simultaneous compliance with a second set of [accounting] rules might be not only burdensome but, in some cases, impossible.").

83 *See New Energy Co. v. Limbach*, 486 U.S. 269, 273-74 (1988) ("[T]he commerce clause prohibits economic protectionism – that is, regulatory measures designed to benefit in-state economic interests by burdening out-of-state competitors.").

84 Evan Weiss, *Fixed Income Insecurities: Municipal Bonds and the Erosion of Dormant Commerce Clause Scrutiny in Department of Revenue v. Davis*, 33 Wash. U. J.L. & Policy 329, 331-32 (2010).

85 Gustavo Piga and Khi Thai, *Advancing Public Procurement: Practices, Innovation and Knowledge-Sharing* (Dean Brunk, Ch. 8 *Government Procurement: 'FAR' from a Competitive Process*), at 163, PrAcademics Press (2007).

winning market share.[86] Moreover, layers of statutory requirements can enable sophisticated contractors to manipulate the regulatory framework by creating delays or otherwise imposing added costs to the detriment of new entrants.[87] In fact, many of the rules particular to Government contracting curtail discretion by contracting officers in an effort to reduce corruption, but instead produce a system where the numerous rules generate significant inefficiency while, at best, helping to avoid abuses that occur in only a small percentage of procurements.[88]

Another repeated concern with using commercial item procurements to acquire goods and services that are "of a type" or have only been offered for sale, is that the price offered to the Government does not reflect market-based competition and could be inflated.[89] As an initial matter, this concern wholly disregards the long-term benefits of reduced barriers to entry into the Federal procurement market. Reduced regulations can act to expand the supplier base and eliminate the need to house government business in separate operating units.[90] Intricate, complex regulations inherently advantage large, incumbent contractors that have developed the infrastructure and expertise required to navigate applicable statutes, rules, and regulations.[91] Such a byzantine regulatory environment furthers the entrenchment of established players and

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86 *Id.*

87 James Cooper and William Kovacic, *U.S. Convergence With International Competition Norms: Antitrust Law and Public Restraints on Competition*, 90 B.U. L. Rev. 1555, 1562-63 (2010).

88 Steven Kelman, *Remaking Federal Procurement*, at 13, Working Paper No. 3, John F. Kennedy School of Government.

89 Department of Defense, Office of Inspector General, *Commercial Contracting for the Acquisition of Defense Systems*, D-2006-115 (Sept. 29, 2006).

90 Hershel Kanter and Richard Van Atta, *Integrating Defense into the Civilian Technology and Industrial Base*, III-13, III-15, Institute for Defense Analysis (February 1993).

91 *See* Cooper and Kovacic, *supra* note 87, at 1562, *citing* William E. Kovacic, *Regulatory Controls as Barriers to Entry in Government Procurement*, 25 Pol'y. Sci. 29, 34-37 (1992).

discourages new entrants.[92] The mere lack of a requirement to have a compliant accounting system reduces contractor costs and fosters efficiencies that help control costs. Moreover, large commercial entities often purchase items from suppliers that need to be modified for specific uses and, therefore, have limited commercial sales. Commercial entities regularly negotiate reasonable prices for such items and can serve as an example for Government.[93] Finally, as set forth herein, the Government has numerous price analysis techniques available in confirming the reasonableness of prices paid, including requiring cost data in limited circumstances.[94] In sum, the stated concerns seem to misunderstand the broader goals of the existing regime and simply do not justify the radical changes that have been proposed.

B. The European Union Approach to Market Integration

In addition to large corporations and the U.S. Government, foreign governments have also developed systems for purchasing goods and services with public funds and in significant quantities. As with the U.S., foreign governments have struggled with the issue of how to streamline procurements to reduce barriers for potential offerors where possible. One of the main goals of European Union ("EU") procurement law, for example, is market integration.[95] Moreover, the significant costs of bidding for government business is well-accepted in the EU.[96]

The EU Procurement Directives establish threshold amounts below which the procurement directives do not apply. Presently the threshold amounts are €130,000 for supplies

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92 *Id.*

93 U.S. Congress, Office of Technology Assessment, *Holding the Edge: Maintaining the Defense Technology Base*, 5 (1989).

94 *Supra* n. 32.

95 Albert Graells, *Are the procurement rules a barrier for cross-border trade within the European market? A view on proposals to lower that barrier and spur growth*, at 2, n. 2, Preliminary Draft (Jan. 16, 2012).

96 Stephen Woolcock, *Public Procurement and the Economic Partnership Agreements: assessing the potential impact on ACP procurement policies*, at 6, Table 1, London School of Economics (May 2008).

and services and €5,000,000 for "works."[97] While procurements under these thresholds are exempt from the EU Procurement Directives, they are still subject to the basic European Community Treaty principles of transparency, equal treatment, and proportionality.[98] The threshold amounts help to reduce barriers to participation under public procurements, but only for relatively low dollar opportunities. In certain respects, this is similar to the simplified acquisition rules under the FAR.[99] Given the limited reach of the thresholds, industry groups in the EU have been advocating for increases in the threshold amounts to further reduce barriers to entry.[100]

While the EU thresholds set bright-line values for procurements subject to reduced regulatory requirements, the U.S. has focused on the nature of the item being procured to determine which requirements apply. Opinions as to which system is more effective will vary, but the U.S. approach undoubtedly brings a much larger segment of its purchases under a more streamlined acquisition system.[101] This was the intent of FASA in creating a broad commercial item definition. In contract to the EU, the U.S. system represents a more complex and arguably more creative approach to removing barriers to participation.

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97 *See* EU Thresholds, available at: http://www.ojec.com/Threshholds.aspx; *see also* EU Procurement Directive 2004/18/EC.

98 Organisation for Economic Cooperation and Development (2010), "Public Procurement in EU Member States - The Regulation of Contract Below the EU Thresholds and in Areas not Covered by the Detailed Rules of the EU Directives", at 12-14, *Sigma Papers*, No. 45, OECD Publishing. Available at: http://dx.doi.org/10.1787/5km91p7s1mxv-en.

99 *See generally* FAR Part 13.

100 Socitm Policy Briefing, *European Union Evaluation of the Public Procurement Directives* (Jan. 2011) ("A simple way to reduce regulation and bureaucracy would be to significantly raise the level of the EU procurement threshold."), available at: http://www.socitm.net/downloads/download/381/european_eu_evaluation_of_the_public_procurement_directives-socitms_response_and_supporting_notes; *see also* OECD (2010), *supra* note 98, at 28-44.

101 *See, e.g.*, FAR Subpart 13.5 (authorizing, as a test program, the use of simplification acquisition procedures for procurements up to $6.5 million where the contracting officer reasonably expects that offers will include only commercial items).

This contrast underscores the universally understood benefits of market integration and the sophistication of the U.S. commercial item contracting framework. Nevertheless, the criticisms of the U.S. system continue. Despite the shortcomings of these critiques, significant changes to the regime continue to be proposed.

VI. Criticisms Have Resulted in Statutory and Regulatory Changes and Proposed Changes to the Commercial Item Contracting Framework

Despite the anecdotal nature and exclusive focus on price, the reports cited above have been followed by changes to the commercial item contracting framework. These changes have not erased the fundamental progress achieved by FASA, but are nevertheless slowly putting back into place many of the barriers to doing business with the federal Government that FASA sought to remove.

A. The Erosion of Exemptions for Modifications to Commercial Items

In the wake of DoD OIG reports critical of certain major DoD commercial item acquisitions, Congress has reversed some of the reforms implemented through FASA. For example, Section 818 of the Ronald W. Reagan National Defense Authorization Act for FY 2005, entitled "Submission of Cost or Pricing Data on Noncommercial Modification of Commercial Items," added a new paragraph (3) to 10 U.S.C. § 2306a which limits the scope of the TINA exemption applicable to commercial items.[102] This statutory change was implemented by FAR 15.403-1(c)(3)(iii)(C), which provides that the exception for commercial items, which prevents the Government from obtaining certified cost or pricing data, does not apply to

[102] Pub. L. No. 108-375 (2005). Another example of Congress' retrenchment on commercial item procurement is Section 803 of the National Defense Authorization Act ("NDAA") for FY 2006, Pub. L. No. 109-163 (2005) (codified at 10 U.S.C. § 2379), which requires a determination by the Secretary of Defense or Deputy Secretary of Defense and notification to Congress before a major weapon system may be procured as a commercial item. *See* 10 U.S.C. § 2379(a)*; see also* DFARS 234.7002. According to the legislative history, this requirement was implemented to address "continuing problems resulting from 'commercial item strategies' pursued by the Department of Defense over the last decade," which problems were highlighted in testimony received by the AirLand Subcommittee of the Senate Armed Services Committee. *See* S. Rpt. No. 109-69, 109th Cong, 1st Sess., at 353.

noncommercial modifications to a commercial item that are expected to cost, in the aggregate, more than $700,000 or more than five percent of the total price of the contract, whichever is greater.[103] This amendment covers modifications of contracts or subcontracts made on or after June 1, 2005 for acquisitions funded by DoD, NASA, or the Coast Guard.[104]

Thus, unless another exception applies, a subcontractor who is required to make noncommercial modifications above certain dollar-value thresholds to an otherwise commercial item would be required to submit cost or pricing data to the Government (via the prime contractor) to support the pricing of that modification. This requirement significantly altered the commercial item analysis under a DoD, NASA, or Coast Guard contract.

First, it narrowed the scope of the commercial item exemption under TINA. A commercial company could be forced during performance to submit data that it is not equipped to produce. The 800 Panel discussed this very problem in recommending that the commercial item exemption be expanded to include minor noncommercial modifications.[105] Moreover, the new requirement is inconsistent with the broader intent of FASA to make Government procurement more attractive to commercial companies.

Second, at least with respect to the TINA commercial item exemption, the establishment of bright-line thresholds departs from the definition of minor modification in FAR 2.101 by creating an arbitrary dollar-value and percentage as the sole determinant of whether a noncommercial modification is minor. This is counter to the commercial item definition at FAR 2.101, which calls for a balancing test and permits dollar values and percentages to be used as

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[103] 10 U.S.C. § 2306a(3); FAR 15.403-1(c)(3)(ii)(C).
[104] *Id.*; *see also* Pub. L. No. 108-275, § 818(b).
[105] 800 Panel Rpt., at 1-126.

"guideposts, but . . . not conclusive evidence that a modification is minor."[106] Because the commercial item exemption from TINA is critical to commercial companies, the potential for the more narrow definition implemented at FAR 15.403-1(c) to replace the more flexible definition at FAR 2.101 in certain circumstances is significant.

B. 2012 Initiatives by DoD to Restrict Commercial Item Contracting

Based on the recommendations of the 2009 Panel on Contracting Integrity, the DoD recently sought to amend both the DFARS (to require additional levels of reviews for commercial item procurements) and the commercial item definition (to eliminate "of a type" and "offered for sale" from the definition). The former endeavor was successful, while the latter was – at least initially – not.

In March 2012, DoD issued a final rule requiring that commercial item procurements over $1 million be approved at a level higher than the contracting officer where the commercial item has undergone a minor modification to meet government requirements, or where the determination of commerciality is based on the "of a type" or "offered for sale" language in the definition.[107]

While this requirement may be ostensibly justified as a measure to ensure compliance with existing regulations, the effect on commercial item contracting is likely to be chilling. Rather than seek the requisite approvals, contracting personnel are more likely to conduct a non-commercial item procurement. Such an approach would avoid additional effort and scrutiny from supervisors. The result will be more procurements that impose onerous requirements and create barriers that inhibit participation by commercial companies.

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[106] FAR 2.101, subparagraph (3)(ii) of the commercial item definition.

[107] 77 Fed. Reg. 11480, 114881 (Mar. 12, 2012); *see also* DFARS 212.102.

The DoD also initiated an effort to modify the statutory and regulatory definition of "commercial item" through the FY2013 NDAA. As proposed, the commercial item definition would be changed to eliminate items "of a type" and items or services that are "offered" for sale, lease, or license (but with no realized sales) from the existing definition. In addition, the requirement for sales of "substantial" quantities would be changed to "like" quantities[108] The current FAR definition of commercial item would be materially changed if the proposed legislation is passed.[109]

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[108] Dept. of Defense, "Sec. 806 Revision to Definition of Term 'Commercial Item' for Purposes of Federal Procurement Statutes Providing Procedures for Procurement of Commercial Items."

[109] 48 C.F.R. § 2.101. The "commercial item" definition provided here is the regulatory definition found in FAR 2.101. The statutory and regulatory definitions of "commercial item" are substantially the same. The only distinction of note is the FAR definition's further clarification of "minor modifications" in section (3)(ii). The statutory definition is codified at 41 U.S.C § 403(12). The same statutory definition is incorporated by reference in the Armed Services Procurement Act at 10 U.S.C. § 2302(3)(I) and in FASA at 10 U.S.C. § 2376(1). The following FAR definition of "commercial item" illustrates the changes proposed by the FY2013 NDAA by striking through the language that would be removed if the legislation is passed:

> "Commercial item" means—
> (1) Any item, other than real property, that ~~is of a type~~ customarily used by the general public or by non-governmental entities for purposes other than governmental purposes, and—
> (i) Has been sold, leased, or licensed to the general public; or
> ~~(ii) Has been offered for sale, lease, or license to the general public;~~
> (2) Any item that evolved from an item described in paragraph (1) of this definition through advances in technology or performance and that is not yet available in the commercial marketplace, but will be available in the commercial marketplace in time to satisfy the delivery requirements under a Government solicitation;
> (3) Any item that would satisfy a criterion expressed in paragraphs (1) or (2) of this definition, but for—
> (i) Modifications ~~of a type~~ customarily available in the commercial marketplace; or
> (ii) Minor modifications of a type not customarily available in the commercial marketplace made to meet Federal Government requirements. Minor modifications means modifications that do not significantly alter the nongovernmental function or essential physical characteristics of an item or component, or change the purpose of a process. Factors to be considered in determining whether a modification is minor include the value and size of the modification and the comparative value and size of the final product. Dollar values and percentages may be used as guideposts, but are not conclusive evidence that a modification is minor;
> (4) Any combination of items meeting the requirements of paragraphs (1), (2), (3), or (5) of this definition that are ~~of a type~~ customarily combined and sold in combination to the general public;
> (5) Installation services, maintenance services, repair services, training services, and other services if—
> (i) Such services are procured for support of an item referred to in paragraph (1), (2), (3), or (4) of this definition, regardless of whether such services are provided by the same source or at the same time as the item; and
> (ii) The source of such services provides similar services contemporaneously to the general public under terms and conditions similar to those offered to the Federal Government;
> (6) Services ~~of a type offered and~~ sold competitively in ~~substantial~~ **(like)** quantities in the commercial marketplace based on established catalog or market prices for specific tasks performed or specific

Industry response to this proposed legislation was swift and decidedly opposed. Industry associations noted that the proposed legislation would create barriers for many commercial companies, including small businesses, seeking to do business with the Government.[110] Industry groups also noted that the proposed change would alter the government-wide definition of commercial item to address concerns that are exclusive to the DoD.[111] Ultimately, the proposed changes were not included in either the House or Senate versions of the FY2013 NDAA. Thus, the commercial item definition has initially survived this proposed legislation unchanged.

Despite having prevailed in the short term, Government contractors nevertheless remain wary that the DoD is intent on curtailing commercial item contracting in favor of requiring compliance with more Government-unique requirements, including the requirement to submit cost or pricing data.[112]

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outcomes to be achieved and under standard commercial terms and conditions. For purposes of these services—

(i) "Catalog price" means a price included in a catalog, price list, schedule, or other form that is regularly maintained by the manufacturer or vendor, is either published or otherwise available for inspection by customers, and states prices at which sales are currently, or were last, made to a significant number of buyers constituting the general public; and

(ii) "Market prices" means current prices that are established in the course of ordinary trade between buyers and sellers free to bargain and that can be substantiated through competition or from sources independent of the offerors.

(7) Any item, combination of items, or service referred to in paragraphs (1) through (6) of this definition, notwithstanding the fact that the item, combination of items, or service is transferred between or among separate divisions, subsidiaries, or affiliates of a contractor; or

(8) A nondevelopmental item, if the procuring agency determines the item was developed exclusively at private expense and sold in ~~substantial~~ **(like)** quantities, on a competitive basis, to multiple State and local governments.

110 April 19, 2012 letter from S. Soloway, President, Professional Services Council to Hon. Adam Smith, Chairman, House Armed Services Committee, available at http://www.pscouncil.org/c/b/AcquisitionPolicy/Acquisition_Policy.aspx.

111 *Id*.

112 November 5, 2012 letter from M. Blakey, President, Aerospace Industries Association to Hon. Frank Kendall, Under Secretary of Defense (AT&L) (voicing concerns with the Senate Armed Services Committee's version of the FY 2013 NDAA and stating that it is intended to replace the proposed legislation to eliminate "of a type" from the commercial item definition); *see also* David Hansen, *Potential Redefinition of 'Commercial Items' Causing Angst Among Federal Contractors*, 98 FCR 55 (July 17, 2012).

VII. Sound Public Policy Would Further Encourage Rather Than Restrict Commercial Item Contracting.

Although much of the criticism of commercial item contracting is anecdotal and ignores broader policy considerations in favor of short-term interests, the calls for reform have gained traction both within and outside of the government. The above-cited reports reflect an inherent discomfort with not having access to detailed cost build-up information and certified cost or pricing data. Moreover, the examples of military products being purchased as commercial items are, in some cases, blindly accepted as compelling,[113] or, in others, spark outrage among observers not familiar with the well-founded underpinnings of the existing commercial item contracting rules.

For example, a recent article in *Time* magazine decried the sale of C-130J cargo planes as commercial items on the grounds that no one would purchase this aircraft for personal use.[114] This commentary seemingly advocates for the commercial item definition to be tied to the consumer market at the household level and egregiously misunderstands the existing framework and the broad policies behind it. Furthermore, the article characterized the "of a type" language that permitted the commercial classification as a "loophole."[115] Such criticism may have a visceral appeal, but it ignores the assiduous efforts to purposely craft a broad "commercial item" definition that would reduce barriers to selling to the government and put the government in a position similar to that of a large commercial buyer.

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113 Michel Golden and Heather Weiner, *The Mid-90s Commercial Item Reforms: Turning Back the Clock?*, 98 FCR 210 (Aug. 14, 2012) ("The government supporters of changing the commercial item definition clearly fear that the government is paying more than necessary for products because these acquisitions avoid traditional competitive procedures. Certainly, this is supported by the DOD IG, GAO, AAP, and DOD reports.").

114 Dana Liebelson, *We Pause for This Commercial . . . Sale*, May 22, 2012, available at: http://nation.time.com/2012/05/22/we-pause-for-this-commercial-sale/.

115 *Id.*

Furthermore, these criticisms tend to be rather cavalier as to the costs of implementing compliant accounting systems that contractors would need to be able to provide certified cost or pricing data to the government.[116] The cost of complying with layers of Government-unique requirements are significant. Of course, in a vacuum, it may be that the government could negotiate a more favorable price on a single procurement by requiring insight into a contractor's costs as opposed to evaluating the offered price for reasonableness. However, in the long run, such tactics will only make the overall cost of selling to the Government increase, and we will be on the path to creating an environment that offers fewer choices and higher prices to the Government buyer.

This path must be avoided. Instead of promoting the current efforts against commercial item contracting, the Government should be mandating the increased use of commercial items and give teeth to the existing FAR Part 12 policy to procure commercial items where available to meet agency needs. As mentioned herein, the existing commercial item contracting framework provides the government with the necessary tools to determine commerciality and to verify price reasonableness. In fact, the bulk of the criticisms focused on Federal contracting personnel not taking needed steps to conduct an adequate price analysis rather than on contractor mischief. The existing regime is well-laid and has been effective in reducing barriers to entry into the Federal market. The Government should embrace its own policies rather than seeking to reverse decades of progress.

To that end, the Government should consider statutory revisions or enforcement of existing regulations to increase commercial purchases. For example, FAR 12.101(b) already

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[116] Scott Amey, *Defense Department's New Definition of 'Commercial Item' Will Save Money*, May 2, 2012, available at: http://pogoblog.typepad.com/pogo/2012/05/defense-departments-new-definition-of-commercial-item-will-save-money/ (stating that concerns that narrowing the commercial item definition will dissuade commercial companies from doing business with the Government are "nonsense").

states a preference for commercial items and requires agencies to acquire commercial items when they meet an agency's needs. However, there is no material enforcement of this requirement within the government. Rather, agencies are typically given broad discretion to determine which items are best suited to meet their needs.

Similarly, FAR 12.101(c) requires prime contractors and subcontractors to incorporate commercial items "to the maximum extent practical" into deliverables. Requiring the incorporation of commercial items to the maximum extent practicable effectively permits contractors and subcontractors to procure developmental items at their discretion even where commercial items are available to meet agency needs. The public's interests would be served if existing policy were enforced so that agencies and contractors carried out the stated commercial item preference.

At present, much more time and attention has been spent by watchdog groups to scrutinize procurements that have been conducted on a commercial litem basis. There are likely significant savings to be realized if similar attention were focused instead on non-commercial procurements that improperly purchased developmental items.

Conclusion

In sum, the Government's resistance to commercial item contracting is a troubling trend that ignores the most basic rationale for the major reforms of the mid-90's: the reduction of barriers for commercial companies seeking to do business with the Federal Government. While the existing statutory and regulatory regime is based on a methodical process, much of the recent criticisms are anecdotal in nature or misunderstand the existing law and policy. The Government should be redoubling its efforts to ensure that the existing policy of requiring the procurement of commercial items where they meet the agency's needs is carried out. That is, the effort should be focused on scrutinizing non-commercial procurements to ensure that there are no commercial items reasonably available that could meet the government's needs. Thus far, it appears that scrutiny has been applied only to the appropriateness of commercial item contracts with the effort focused on dissuading such procurements. The focus should be reversed and the continuing attempts to narrow the commercial item definition should be abandoned.