IDCC
Integrated Dual-use Commercial Companies

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OUSD (AT&L) DPAP/CPIC
Office of Director, Defense Procurement and Acquisition Policy
3060 Defense Pentagon,
Washington, DC 20301-3060

cc: Ms. Cassandra R. Freeman
OUSD (AT&L) DPAP/CPIC

Subject: Commercial Item Handbook Draft revision 2
Reference: Federal Register, September 29, 2011, Vol. 76, No. 189, Page 60474

Dear Ms. Freeman:

On behalf of the Integrated Dual-Use Commercial Companies (IDCC), I am pleased to provide comments on the proposed Commercial Item Handbook referenced above. IDCC was involved in the acquisition reform activities that led to the formulation of the commercial item procurement rules. We continue to monitor proposed changes that would compromise industry's willingness and ability to offer the Government commercial items (products and services) on the same terms that are offered in the commercial market place.

The IDCC was formed in 1991 as a consortium of predominantly commercial firms who seek to simplify and improve methods for doing business with the Federal Government. Member firms include Air Products & Chemicals, Bayer Material Science, Corning, Dow Chemical, Dow Corning, Eastman Chemical, Honeywell International, The Sherwin-Williams Co., Energizer, and W. L. Gore & Associates. These firms are industry leaders in several areas including industrial patents, research and development investment, and sales volume. All sell commercial items to the Government under the current FAR Part 12 commercial item provisions.

Thank you once again for providing the forum and opportunity to comment on the Commercial Item Handbook Version 2.0. From our reading of the revised version, it is clear that you gave fair consideration to the comments that were provided to you in 2009. We also recognize the considerable work and effort that has gone into the Commercial Item Handbook rewrite and commend you on the effort. This will be a valuable tool for Contracting Officers and Prime Contractors as they seek the benefits of commercial item purchases, and an important resource for their necessary exercise of judgment.

Our recommendations and suggestions to clarify several areas are presented below. IDCC hopes you will find them helpful.

1. One page 1 in the last paragraph the word "not" seems to be missing from the following:
   "To qualify as representing a minor modification, of a type not customarily available in the commercial marketplace made to meet Federal Government requirements, the modification must [not] significantly alter the nongovernmental function or essential physical characteristics of an item or component, or change the purpose of a process."

2. On Page 9 in the top section entitled **Subcontract Commercial Item Determination,** in the first sentence, we respectfully request that you delete the phrase:
   "*and adequately supports its determination of a fair and reasonable subcontract price*" and in the second sentence that you delete the phrase, "*to require submission of cost or pricing data if he or she determines that an item claimed to be commercial is, in fact, not commercial and that no other exception or waiver applies.*"
   These additions are contrary to (D)FAR 15.403.1 b3, which states:
   "(b) The contracting officer shall not require submission of cost or pricing data to support any action (contracts, subcontracts, or modifications) (but may require information other than cost or pricing data to support a determination of price reasonableness or cost realism)…
   (3) When a commercial item is being acquired."
   If the item is determined not to be a commercial item, then this handbook no longer applies and other processes would be followed. We feel that it is confusing to put in references that require the submission of cost and pricing data when the FAR explicitly excludes the practice for commercial items.

3. Also on page 9 under **Other Issues Relating to Commercial Items/Services, Other Transaction Authority**, the second bullet should be modified to read:
   "Is a follow-on contract for the production of an item or process begun as a prototype project under ~~an~~other transaction agreement; or as a research project carried out in accordance with 10 U.S.C. §2371",
   as "Other Transaction" is the title of the authority granted the DoD. In this context, the word "another" does not make sense.

4. On page 11, the citation "§2377" in the second major paragraph is incomplete. Is this from 41 U.S.C. or 10 U.S.C.? (We would suggest a cross check on the other references in the proposed draft of the handbook, as well.)

5. On page 38 in the next to the last bullet in the fifth line, we would recommend that you delete the words "for non-Government end-use". Sources to establish price reasonableness, from our perspective, can also come from Government sales such as sales under a GSA schedule. Limiting price information to only non-Government end-use sales again associates the concept of price with a commercial item determination. Sales to the Government will demonstrate that the price was previously found by a Government buyer to be reasonable.

Lastly, we feel that this handbook can also be an important tool for prime contractors and subcontractors to use in the process of acquiring Commercial Items on behalf of the U.S. Government. We think that an additional appendix would be beneficial as an aid in this acquisition process. The members of the IDCC have compiled a list of "Lessons Learned" resulting from acquisitions that generated misunderstanding, concerns over liability, or just an effort where one side applied inappropriate leverage in negotiations. We believe that the inclusion of these "Lessons Learned" along with guidance to use in these situations will significantly improve the acquisition process and avoid improper practices that subvert the intent of Congress in acquiring commercial items. Following the best practices for acquiring commercial items will provide access to better technology to the benefit of the US Taxpayer.

We recommend the following paragraphs replace the second paragraph on page 53 in the section: **Subcontracts For The Acquisition Of Commercial Items.** These will introduce the appendix:

> *Prime and other higher-tier contractors have an important role in carrying out the intent of Congress in FASA. For every major prime contract, there may be dozens or even hundreds of subcontracts down through the subcontracting chain. If the buyers in these transactions are not conducting them in accordance with FASA, FAR, the DFARS, and the principles set forth in this Handbook, they will not be taking full advantage of the products and innovations available in the commercial marketplace. In addition, the end cost to the Government is likely to be higher if buyers are not taking full advantage of effective commercial item purchases.*
>
> *Since the first Handbook was released in 2001, buyers and sellers have had over ten years of experience in applying the commercial item procedures. From this, several common concerns have been raised by the selling community. Most of these involve practices by buyers that reflect misunderstandings about the commercial item definition and the practices for buying commercial items. A few practices seem to be intentional, such as buyers refusing to agree that an item is commercial until the seller agrees to provide cost data.*
>
> *For these reasons, a new Appendix has been added to this version of the Handbook. Appendix ___, "Lessons Learned from Prime-Sub Transactions", is a collection of the most frequent examples that generated misunderstanding, concerns over liability, or an effort on the buyer's side to apply inappropriate leverage in commercial item negotiations. The guidance in these examples will significantly improve the acquisition process for the US Government, Prime contractors and Subcontractors and avoid improper practices that subvert the FASA, FARS and DFARS.*

Attached to this letter is our list of Lessons Learned with our recommendation for guidance in each situation. We encourage you to consider the addition of these in an appendix to your final Commercial Item Handbook version 2.0.

The IDCC wants to thank you again for this opportunity to participate in the revision process and welcomes future dialog to discuss these issues directly. I would like to request that you, or someone from your office, meet with the IDCC membership to discuss this Commercial Item Handbook revision in more detail. Our next meeting in Washington DC will be January 31 from 1 pm to 5:30 pm and February 1 from 9 am to noon. If you are able to meet with us during this time, please contact me at (860) 633-6772 or adayers@idcc.org to confirm the specific time and location

Sincerely,

Alan D. Ayers
President

Attachment

New Appendix:
Appendix **, **Lessons Learned From Prime-Sub Transactions**

Since the publication of the first Commercial Item Handbook in 2001, buyers (both Government and upper-tier contractors) have made hundreds of thousands of commercial item determinations. While most have been conducted in accordance with the requirements of FASA and the FAR, many have fallen short. Most of these are probably the result of a failure to understand fully the commercial item definition. However, sellers report many instances of improper practices, such as buyers withholding a commercial item decision to extract cost data from the seller, mixing a price reasonableness determination with a commercial item determination, and retaining contract clauses that only apply to non-commercial items.

The following examples are drawn from the experiences of subcontractors in dealing with prime or other higher-tier contractors. However, they are equally applicable to commercial item determinations made by the Government. Accordingly, the term "buyer" could be the Government or a higher-tier contractor. For consistency, we will use the terms "buyer" and "seller" wherever applicable throughout this appendix.

Example 1: The prime contractor for a military aircraft tells its suppliers that their products cannot be commercial items, because they are being used on a military aircraft.

Guidance: While this one seems to be such a clear misapplication of the commercial item definition that no one should make that mistake, it has happened in the field. Therefore, it is important to emphasize that any product at any level of the supply chain can be a commercial item, regardless of the characterization of the final product at the contract level above it.

Example 2: A seller asserts that its product is a commercial item. The buyer objects, stating that he has been buying the product for years, and the seller has not claimed it was commercial before; why should it now be commercial.

Guidance: In this example, the issue is whether the product meets the commercial item definition. The buyer should evaluate the item and the seller's justification in accordance with the commercial item definition, and determine whether the product is commercial. If it is, then FASA, the FAR, and DFARS spell out how the product is to be treated by the buyer.

Example 3: A seller asserts that an item meets the commercial item definition. The buyer refuses to agree that the item is commercial until the seller provides more "visibility" into its costs.

Guidance: This often happens on large programs, where prime contractors have become accustomed to obtaining cost data from sellers. As a result, some prime contractor buyers have found it difficult to give up their reliance on cost data. They then condition their commercial item determination on whether the seller agrees to continue to provide cost data, even if it is not certified cost or pricing data.

This is a reversal of the way the process should work. In passing FASA, Congress determined that if an item is commercial, certain consequences follow as a result. Among those are

exemptions from CAS and TINA, exemptions from other procurement laws that apply to non-commercial items, and a much-reduced set of mandatory FAR and DFARS clauses, both in a prime contract and in subcontracts. Therefore, a prime contractor should first determine whether an item is commercial. If it is, the remainder of the buying process should follow commercial item procedures, as set forth by law and in the FAR and DFARS. Prime contractors should not use their buying power to force cost data from sellers when the item is commercial.

Example 4: A prime contractor requires sellers to fill out a "Commercial Item Justification" form. The form includes the criteria from the FAR commercial item definition. However, it also requires the seller to provide information on its previous sales and prices for the item.

Guidance: There are two issues involved in this situation: the commercial item determination, and a price reasonableness determination. A prime contractor is responsible for making both determinations. While there is some overlap between the information that might be required for each, they are separate and independent determinations and should not be merged. In particular, the commercial item determination should not depend on an evaluation of the price.

A commercial item determination is based on the physical characteristics and function of the item itself. Note that in the definition of a commercial item, there is no mention of the price (except as part of the definition of commercial services). Accordingly, the decision on whether an item is commercial should be based on an evaluation of the item itself, its physical characteristics, its function, and any modifications that were made to it to meet the Government's requirements. Note that the sample commercial item checklist in Appendix B to this Handbook appropriately does not request price information.

A price reasonableness determination, as the name suggests, is based on the price at which the item itself is being offered, as compared to the prices of similar items in the commercial marketplace. A prime contractor is certainly entitled to request this information as part of its price reasonableness determination, and a seller should expect to provide it. However, this should be a separate step from the determination that the item itself is commercial.

There is nothing inherently improper with including a request for price information on a form for a commercial item justification. However, this practice may lead a buyer to merge the two steps, or make the commercial item determination contingent upon receiving price information. It also allows the buyer to shift the responsibility for market research from itself to the seller. It may even lead a buyer to conclude that an item should not be treated as commercial (and receive the full benefits and exemptions of being a commercial item) if the price seems unreasonable. This leads buyers to improperly use the commercial item determination as leverage in price negotiations.

Example 5: A buyer requires a seller to certify that its item is commercial, or requires a seller to indemnify it if the Government disagrees with its commercial item determination.

Guidance: The DFARS makes a prime contractor responsible for determining whether a subcontract item is commercial (see DFARS 244.402). Prime contractors are understandably concerned over their liability if a contracting officer disagrees with its decision. As a result, they often add clauses to their subcontracts that require subcontractors to certify that their items are

commercial, or require the subcontractor to indemnify the prime for any damages or losses incurred if the Government disagrees with a commercial item determination.

The issue here is whether the prime contractor's concerns are justified, and what liability it actually faces if a contracting officer disagrees with its commercial item determination. The only regulatory guidance comes from DFARS 244.402, which states, after noting that a prime contractor is responsible for making a commercial item determination, that "This requirement does not affect the contracting officer's responsibilities or determinations made under FAR 15.403-1(c)(3)." FAR 15.403-1(c)(3) states in part:

> If the contracting officer determines that an item claimed to be commercial is, in fact, not commercial and that no other exception or waiver applies, (*e.g.* the acquisition is not based on adequate price competition; the acquisition is not based on prices set by law or regulation; and the acquisition exceeds the threshold for the submission of certified cost or pricing data at 15.403-4(a)(1)) the contracting officer shall require submission of certified cost or pricing data.

Accordingly, it appears that the only consequence to a prime contractor if a contracting officer disagrees with its commercial item determination, would be a requirement to obtain certified cost or pricing data from the subcontractor. Prime contractors should consider this in creating an appropriate clause in their subcontracts.

Example 6: A buyer does not conduct market research for itself. Rather, it makes the seller provide information on its own sales and comparable sales from other sellers.

Guidance: Market research is primarily the responsibility of the buyer. While it is certainly reasonable to ask a seller to provide information on its own sales of the item and comparable products, the buyer should not place the entire burden on the seller. For example, when buying a consumer item for personal use, you would not require the seller to provide a list of prices from other sellers that you can use for comparison.

Chapter 4 of this Handbook provides a guide to conducting the research for pricing commercial items, and is an excellent resource for prime contractor buyers. Appendices G and H also have resources that can be used in the price-reasonableness analysis.

Example 7: The buyer obtains a commercial item justification from a seller. Instead of making a commercial item determination, the buyer says that its decision must get approved by the contracting officer.

Guidance: The buyer is responsible for making a commercial item determination, whether that buyer is the Government or a prime or higher-tier contractor. As noted in the response to Example 5 above, the DFARS, at 244.402(a), specifically states that "Contractors shall determine whether a particular subcontract item meets the definition of a commercial item." In this case, it is likely that the buyer is concerned about making a wrong decision, and is unwilling to make a decision without knowing whether the contracting officer would agree. However, as long as the buyer exercises reasonable business judgment in making his decision, and documents the files accordingly, there should be no reason to seek the approval of the contracting officer.

Example 8: A seller submits a commercial item justification for a product that is modified from its standard commercial product. The buyer demands to see evidence that the seller has sold the same item commercially.

Guidance: This is another example of a misapplication of the commercial item process. There are two responses to this.

First, there is no requirement that the seller have sold the same item commercially. The item could have been sold by any seller on the marketplace. The key is that the item itself must meet the commercial item definition, regardless of who sells it. Even if the item is a COTS item, there is no requirement that a seller must have sold that item itself previously.

Second, the item need not ever have been sold commercially, as long as it is "of a type" or modified from a commercial item in accordance with the definition. The modifications made for the Government customer, whether unique to the Government or the same as made for any commercial customer, may well make the item unique. Nevertheless, as long as the modifications fall within the parameters of the commercial item definition, the item is acceptable.

Example 9: A buyer agrees that a seller's product is a commercial item. However, the buyer's standard subcontract form has clauses in it that are far in excess of the mandatory clauses for commercial items. The buyer claims that all of the clauses are necessary to allow it to fulfill its contractual obligations in its contract with the customer.

Guidance: The issue of the flowdown of clauses from a higher-tier contract to a lower is complicated. Every buyer has its own subcontract forms that it uses for its purchases, and it is safe to assume that no two buyers flow down the same FAR and DFARS clauses. Nevertheless, it is possible to state some general principles. First, there are certain minimum clauses that must be included in all subcontracts for commercial items. These are set forth in FAR 52.212-5(e) and 52.244-6(c), and in DFARS 52.212-7001(c) and 52.244-7000. The buyer must include these clauses in the appropriate subcontract.

Second, there are certain other clauses that are generally considered to be "necessary" clauses in subcontracts, even though the FAR and DFARS do not make them mandatory. Included in this category are the Stop Work clause, the DPAS clause, any clause dealing with manufacturing or content requirements, such as a Buy American Act clause or a Trade Agreements Act clause, and data rights clauses. The buyer should include any clauses that are considered "necessary."

Finally, there are all other clauses that show up in a prime contract. The buyer should only include those clauses that state obligations that the seller must perform to enable the buyer to fulfill its obligations in its contract. The FAR states that "the contractor may include in its subcontracts for commercial items a minimal number of additional clauses necessary to satisfy its contractual obligations." (FAR 52.212-5(e)(2)). A similar statement is at 52.244-6(c)(2). Note that there are two concepts in that statement. First, that the number of additional clauses must be "minimal", and second, that they must be necessary to satisfy the buyer's contractual obligations.

With respect to whether a clause is necessary, buyers should ask what obligation they would not be able to meet without the seller performing the obligation in the clause. When viewed from that perspective, there are few clauses that would be necessary.

In summary, a common experience sellers share is that buyers flow down too many clauses in their subcontracts. This then becomes an unnecessary point of contention in negotiations. Buyers may do this out of an excess of caution, or because they have not fully transitioned their purchasing practices to a commercial item process. Whatever the reason, the intent of Congress is not fully realized when buyers simply flow down what is in their contracts without regard to the simplified provisions that are allowed for commercial items.