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Problematic Aspects Of DOD Commercial Item Rule

By **Angela Styles and Josh Freda** (February 8, 2018, 1:02 PM EST)

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Six weeks after the passage of the 2018 National Defense Authorization Act,[1] the U.S. Department of Defense issued a final rule implementing commercial item provisions contained in the 2016 NDAA.[2] The new rule contains significant changes to the Defense Federal Acquisition Regulation Supplement to treat products and services from nontraditional defense contractors as commercial items, require the recognition of prior commercial item determinations from other DOD components agencies, and add a new contract clause for certain commercial item contracts and subcontracts. Curiously, in implementing the 2016 NDAA commercial item provisions, the final rule ignores updated and conflicting commercial item provisions in the 2017 and 2018 NDAAs and creates layers of bureaucracy and cost for contractors and contracting officers. At a time when Congress and the White House are making marked strides to reduce the regulatory burden, the final rule adds significant burdens to commercial item contracting. Particularly ironic, the final rule was issued on the same day as the Section 809 panel (also created by the 2016 NDAA) released the first of three volumes on streamlining DOD acquisition regulations — with a clear focus on streamlining commercial item contracting.[3]

The Treatment of Products and Services from Nontraditional Defense Contractors as Commercial Items

In 2016, Congress amended Section 2380a of Title 10, United States Code, to allow products and services that do not meet the statutory definition of a commercial item, but are provided by nontraditional defense contractors, to be treated as commercial items.[4] As defined by statute, a "nontraditional defense contractor" is as an entity that is not currently performing and has not performed, for at least the one-year period preceding the solicitation of sources, any contract or subcontract for the DOD that is subject to full coverage under the cost accounting standards.[5] The 2017 NDAA expanded the authority to require "services provided by a business unit that is a nontraditional defense contractor" to be treated "as commercial items ... to the extent that such services use the same pool of employees as used for commercial customers and are priced using methodology similar to methodology used for commercial pricing."[6]

While the final rule does "allow" a contracting officer to "treat supplies and services provided by nontraditional defense contractors as commercial items," it appears to ignore the mandate of the 2017

NDAA requiring services be treated as commercial items. The final rule states:

[W]hen appropriate, contracting officers may consider applying commercial item procedures to the procurement of supplies and services from business segments that meet the definition of "nontraditional defense contractor" even though they have been established under traditional defense contractors.[7]

There are three possible explanations for the DOD's failure to implement the mandate in the 2017 NDAA: (1) The DOD has not yet implemented the 2017 NDAA provisions on nontraditional defense contractors; (2) the DOD did not want to implement the statute as written; or (3) the DOD misread the 2017 NDAA. None of these are very good answers. If the DOD has yet to implement the 2017 NDAA provisions, then why does the final rule mention business units at all? Business units were not raised in the context of nontraditional contractors until the 2017 NDAA, so if the final rule is going to mention business units, it should have articulated the current statutory requirements accurately.

While certainly the statute and the final rule as written are good news for DOD and nontraditional defense contractors, hopefully providing real access to commercial innovation, Congress established a mandate — stating that services provided by a business unit that qualifies as a nontraditional defense contractor shall be treated as commercial items.[8] Congress did not give the DOD discretionary authority to treat the services of a traditional defense contractor's nontraditional business segment as anything but a commercial item.

The Recognition of Prior Commercial Item Determinations From Civilian Agencies

In an effort to streamline commercial item determinations, Congress included broad language in the 2018 NDAA that requires DOD contracting officers (with limited exceptions) to rely on prior commercial item determinations.[9] Section 848 of the 2018 NDAA states "a contract for an item acquired using commercial item acquisition procedures under part 12 of the Federal Acquisition Regulation shall serve as a prior commercial item determination with respect to such item."[10] In contrast, the 2016 NDAA limited the reliance of DOD contracting officers to prior commercial item determinations made by a military department, defense agency or other component of the Department of Defense for the purpose of implementing the statutory exception to provide certified cost or pricing data for a commercial item contract.[11] While the 2016 provision was placed in the section of the statute relating to the provision of certified cost and pricing data under the Truth in Negotiations Act and the 2018 NDAA provision was placed in a different portion of the statute, the two statutes must be give effect and reconciled.

The 2018 commercial item determination language does not limit the DOD to relying on commercial item determinations of other military departments. Indeed, Section 848(b)(2) of the 2018 NDAA restricts the DOD from using appropriated funds for the procurement under part 15 of the FAR of an item that was previously acquired under a contract using commercial item acquisition procedures under FAR part 12. On the face of the 2018 NDAA, Congress appears to have intended to expand the DOD's reliance on prior commercial item determinations by civilian agencies to DOD acquisitions.[12] While two distinct statutes remain, if the commercial item determination language in the 2018 NDAA is not for the purpose of utilizing the exception to providing certified cost and pricing information, then the purpose of the statutory provision is entirely unclear.

The DOD, however, in implementing the 2016 NDAA ignores the 2018 NDAA language in its entirety.[13] As promulgated, the final rule does not allow contracting officers to rely on the prior determinations of civilian contracting officers and does not resolve the conflict between the two statutory provisions. The

situation is particularly problematic for DOD contracting officers because the failure to rely on a commercial item determination by a civilian agency could result in a violation of the Anti-Deficiency Act.[14] If a DOD contracting officer fails to rely on prior civilian agency commercial item determinations while they are spending 2018 appropriations, they risk an Anti-Deficiency Act violation. Alternatively, reliance on a civilian agency commercial item determination would be a clear violation of the final rule.

The New Commercial Item Contracts Clause

Perhaps the most significant disconnect between the DOD and Congress is the final rule's creation of a lengthy and burdensome contract clause for commercial item contracts. When a DOD contracting officer is "reasonably certain" that "other than certified cost or pricing data will be required" to determine the price reasonableness of a commercial item contract, the contracting officer must include the contract clause at DFARS 252.215-7010 in the solicitation.[15] Under the new contract clause, to qualify for the statutory exception to providing certified cost or pricing data under the Truth in Negotiations Act, each offeror must submit detailed information for the contractor and their proposed subcontractors that is "adequate for evaluating the reasonableness of the price."[16]

The new contract clause is particularly troubling when coupled with DOD guidance. Prior to the final rule, if a contracting officer requested "other than cost or pricing information" that an offeror was not comfortable providing, the offeror could simply walk away from the solicitation, no harm, no foul. Now, however, DOD guidance provides clear ramifications. A DOD publication titled "Guidebook for Acquiring Commercial Items" dated January 2018 states that when a company in the offer process does not provide information to the contracting officer to allow them to make a price reasonableness determination:

[T]he cognizant Government employee should enter the offeror's inability to provide the requested data into the past performance system (www.cpars.gov). Comments on a subcontractor's refusal to submit data must be documented in the performance assessment of the prime since the Government only has privity of contract with the prime.[17]

In addition, by simply responding to a solicitation with this contract clause, the offeror grants

[T]he Contracting Officer or an authorized representative the right to examine, at any time before award, books, records, documents, or other directly pertinent records to verify any request for [a commercial item exception] under this provision, and to determine the reasonableness of the price.[18]

Once a company, even one that has never done business with the DOD, submits an offer in response to a solicitation containing this clause, the company's books and records appear to be fully open to examination. No privity, nor allegations of fraud required. This will almost certainly discourage nontraditional defense contractors that want to participate in the DOD contracting space. And traditional defense contractors should get ready to submit new reams of data to support price reasonableness for themselves and their subcontractors or refuse to submit sufficient information and assume the risk of negative past performance ratings.

The clause and the guidance are striking in (1) the breadth of discretion given to contracting officers to include the clause, (2) the failure to reiterate that, in instances where adequate price competition is expected, no additional cost or pricing information should ever be required from offerors, (3) the broad application to subcontractors that did not exist in prior contract clauses; and (4) the potential to effect past performance ratings. At a time when both parties in Congress and the White House have been

pushing for commercial item reform for years, the final rule is particularly tone-deaf.

Conclusion

The final rule evinces a wide disconnect between Congress and the DOD on acquisition reform. While the Section 809 panel is busy making excellent recommendations for streamlining, the department is busy regulating. It is hard to fathom how the DOD could conclude that the final rule will result in "public cost savings in millions."[19] The DOD should give this final rule a hard second look with an eye toward implementing Congress' intent in each of the defense authorizations from 2016 to 2018.

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[1] National Defense Authorization Act of 2018, Pub. L. No. 115-91 (2017).

[2] Defense Federal Acquisition Regulation Supplement: Procurement of Commercial Items, DFARS Case 2016-D006, 83 Fed. Reg. 4431 (to be codified at 48 C.F.R Part 200).

[3] Report of the Advisory Panel on Streamlining and Codifying Acquisition Regulations (January 2018)

[4] National Defense Authorization Act of 2016, Pub. L. No. 114-92, Sec. 857 (2016).

[5] 10 U.S.C. 2302(9).

[6] National Defense Authorization Act of 2017, Pub. L. No. 114-328, Sec. 878 (2016)

[7] 83 Fed. Reg. 4442.

[8] National Defense Authorization Act of 2016, Pub. L. No. 114-328, Sec. 878 (2016).

[9] National Defense Authorization Act of 2018, Pub. L. No. 115-91, Sec. 848 (2017).

[10] Id. (emphasis added).

[11] National Defense Authorization Act of 2016, Pub. L. No. 114-92, Sec. 851 (2016).

[12] When the provision was first included in the Senate version of the 2018 NDAA, it also applied to commercial item subcontract determinations by prime contractors, but the language was removed from the final statute.

[13] Supra footnote 2.

[14] Anti-Deficiency Act (ADA), 31 U.S.C. § 1341 (1990).

[15] Supra footnote 2 (amending 48 C.F.R. § 212.301(f)(vi)(E) (2016) (Solicitation provisions and contract clauses for the acquisition of commercial items)).

[16] Id.

[17] Department of Defense, Guidebook for Acquiring Commercial Items (2018).

[18] Id.

[19] 83 Fed. Reg. 4441.