

Commercial Item Procurements

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The Promise of Commercial Item Contracting

For the Government:

- Simplified processes
- New commercial technologies
- More competition
- Lower prices

For the Contractor:

- Eliminate government-specific requirements
 - Certified cost or pricing data
 - FAR part 31 and CAS coverage
 - Other clauses / administrative burden

Swinging Pendulum of Commercial-Item Policy



Early Stages– Building Momentum

- **Federal Acquisition Streamlining Act of 1994** [Pub. Law 103-355]
 - Broadens definition of commercial items to include those “of a type” used for nongovernmental purposes
- **Clinger-Cohen Act of 1996** [Pub. Law 104-106]
 - Amends Truth in Negotiations ACT (TINA) exception for commercial items
 - To be exempt, the item procured need not be sold in “substantial quantities to the general public” or at “established catalog or market price”
- **January 5, 2001 USD(AT&L) Policy Memorandum**
 - Use FAR Part 12 “To the maximum extent possible”
 - Part 12 procedures “provide . . . increased competition, better prices, and new market entrants and/or technologies”
 - “Commercial Item Acquisition Goals”
 - (1) Double the dollar value of FAR Part 12 contract actions by FY 2005
 - (2) “50 percent of all Government contract actions awarded by the end of FY 2005”

The Swinging Pendulum – Maximum Velocity

- 2003 – USAF: KC-767A Tanker is a commercial item



The Swinging Pendulum – Reversing Forces

Acquisition of the Boeing KC-767A
Tanker Aircraft
(D-2004-064)

March 29, 2004



Conclusion and Results Summary. The Air Force contracting officer decided to use a commercial item procurement strategy that Air Force management strongly encouraged for the sole-source Boeing KC-767A Tanker Program, valued at \$**.* billion, with The Boeing Company (Boeing). However, contrary to the Air Force interpretation, the military tanker aircraft is not a commercial item as defined in Section 403 of title 41, United States Code. Further, there is no commercial market to establish reasonable prices by the forces of supply and demand. By using a commercial item procurement strategy, the Air Force was also required to use a fixed-price type contract where the contractor retains all of the savings if the contractor's actual costs are lower than the estimates rather than a more appropriate mix of cost and fixed-price incentive type contracts. The commercial strategy also exempted Boeing from the requirement to submit cost or pricing data, which places the Government at high risk for paying excessive prices and profits and precludes good fiduciary responsibility for DoD funds. Without the Air Force gaining insight into Boeing's actual costs, the Air Force will also be at a disadvantage in any future tanker procurement negotiations.

The Swinging Pendulum – Reversing Forces

- And Another DoD IG Report

Contracting for and Performance of
the C-130J Aircraft
(D-2004-102)

July 23, 2004



- FY 2005 Nat'l Defense Auth. Act [Pub. Law 108-375 (Oct. 28, 2004)]
 - Amends Title 10 TINA provisions
 - Non-commercial modifications to commercial items are NOT exempt from requirement for certified cost or pricing data if they exceed the TINA threshold or 5% of the total price of the contract. (Further amended in FY 2008 NDAA to add “. . . at the time of award”). [see also FAR 15.403-1(c)(3)(iii)]

The Swinging Pendulum – Reversing Forces

- And *Another* DoD IG Report

Commercial Contracting for the Acquisition
of Defense Systems
(D-2006-115)

September 29, 2006



- COs “used the broad commercial item definition to justify acquiring defense systems and subsystems that did not achieve the benefits of buying truly commercial items”
- “to gain more control in ascertaining fair and reasonable prices, restriction should be placed on the commercial item exception found in section 2306a(b), title 10, United States Code”

The Swinging Pendulum – A New Direction

- **FY 2008 Nat'l Def. Authorization Act** [Pub. Law 110-181]
 - Limits use of commercial terms for major weapons systems [DFARS 234.7002]
 - Barriers to T&M / LH commercial contracting [DFARS 212.207]
 - Sales to foreign governments eliminated from consideration as evidence of a commercial market

- **FY 2009 Nat'l Def. Authorization Act** [Pub. Law 110-417]
 - Restricts commercial services “of a type” sold in the commercial market
[FAR 15.403-1(c)(3)(ii); final rule published 3-16-2011]

- **2010 FAR Revisions**
 - Re-interpret TINA
 - Create a new framework focused on Government access to contractor data, even for commercial items

Major Weapons Systems

Major Weapons Systems

- Can only be deemed commercial if:
 - (1) the Secretary of Defense determines that--
 - (A) the major weapon system is a commercial item under FAR 2.101;
and
 - (B) such treatment is necessary to meet national security objectives;
 - (2) the offeror has submitted sufficient information to evaluate, through price analysis, the reasonableness of the price for such system; and
 - (3) the congressional defense committees are notified at least 30 days before such treatment or purchase occurs.

[DFARS 234.7002(a)]

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Major Weapons Systems

“Subsystems” of Major Weapons Systems

- If not COTS, then only treated as a commercial item if:
 - (1) intended for a major weapon system purchased under the new procedures above; OR
 - (2) The contracting officer determines in writing that--
 - (A) the subsystem is a commercial item under FAR 2.101, and
 - (B) the offeror has submitted sufficient information to evaluate, through price analysis, the reasonableness of the price for such subsystem.

[DFARS 234.7002(b)]

Major Weapons Systems

Components / spare parts of MWS:

- **if not COTS, then only treated as commercial items if:**
 - (A) the component or spare part is intended for--
 - (i) a major weapon system purchased under the new procedures above; or
 - (ii) a subsystem of a major weapon system purchased under the new procedures above; or
 - (B) the contracting officer determines in writing that--
 - (i) the component or spare part is a commercial item under FAR 2.101, and
 - (ii) the offeror has submitted sufficient information to evaluate, through price analysis, the reasonableness of the price for such component or spare part.

- **LIMITED APPLICATION:** Provision applies only for components and spare parts:
 - (1) acquired by DoD through a prime contract or modification to a prime contract; or
 - (2) through a subcontract under a prime contract or modification to a prime contract on which the prime contractor adds no, or negligible, value.

[DFARS 234.7002(c)]

Major Weapons Systems

Information for price analysis

- To the extent necessary to make a determination, the contracting officer may request –
 - (1) prices paid for the same or similar commercial items under comparable terms and conditions by both government and commercial customers; and
 - (2) if the information described in paragraph (1) is not sufficient, then other relevant information regarding the basis for price or cost, including information on labor costs, material costs, and overhead rates.

[DFARS 234.7002(d)]

Commercial Services & TINA

Cost or Pricing Data for Commercial Services – Narrowed Statutory Exception

- If services are only “*of a type*” offered and sold competitively in substantial quantities in the commercial marketplace, then not exempt from providing certified cost or pricing data unless:

Contracting Officer determines, in writing, that the offeror has submitted sufficient information to evaluate the reasonableness of the price.

[FAR 15.403-1(c)(3)(ii)]

Commercial Services – T&M/LH

Services under T&M or Labor Hour Contracts:

DoD SPECIAL RULE

- such services must not only meet FAR 2.101 requirements, but also be *inter alia*:
 - (1) procured for the support of a commercial item; OR
 - (2) emergency repair service; OR
 - (3) approved by head of agency as, *inter alia*, “commonly sold” to the general public using T&M / LH contracts

[DFARS 212.207]

2010 FAR Revisions

- Perceived problem:
“some contractors incorrectly believed that the FAR definition of ‘information other than cost or pricing data’ . . . precluded the contracting officer from obtaining uncertified cost or pricing data.”

[75 Fed. Reg. 53199, Aug. 30, 2010]

- *Old* FAR 2.101
 - “Cost or Pricing Data” are “data that require certification . . .”
 - “Information other than cost or pricing data” means “information that is not required to be certified . . . [and] may include pricing, sales, or cost information . . .”
- TINA Exception
 - “Submission of certified cost or pricing data *shall not* be required ... for the acquisition of a commercial item.”

2010 FAR Revisions

Government solution -- Reinterpret TINA and Redefine the terms

“cost or pricing data”

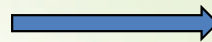


“certified cost or pricing data”

“data other than cost or pricing data”



“data other than certified cost or pricing data”



“cost or pricing data”

2010 FAR Revisions

The New Definitions

- Cost or pricing data
 - “all facts . . . prudent buyers and sellers would reasonably expect to affect price negotiations”
- Certified cost or pricing data
 - “means ‘cost or pricing data’ that were required to be submitted . . . and have been, or are required to be, certified”
 - Commercial items still are excepted by statute

2010 FAR Revisions

The New Definitions

- Data other than certified cost or pricing data (DOTCCPD)
 - “pricing data, cost data, and judgmental information . . .”
 - “may include the identical types of data as certified cost or pricing data . . . but without the certification . . .”
 - Also includes
 - Sales data
 - Any information reasonably required to explain the offeror’s estimating process
 - Judgmental factors applied
 - Nature and amount of any contingencies in the price

2010 FAR Revisions

- **Collection of DOTCCPD**

- Hierarchy of sources:

- Obtain DOTCCPD from contractor only “when there is no other means for determining a fair and reasonable price” [FAR15.404-1(b)]
- If DOTCCPD must be obtained from contractor, “generally” follow the order of preference in FAR 15.402(a)(2)(ii):
 1. Data related to prices
 - » From within the government
 - » From sources other than the offeror
 - » From the offeror
 2. Cost data

- Adequate price competition – usually sufficient alone [FAR 15.403-3(b)]

2010 FAR Revisions

- **Collection of DOTCCPD**

- Scope: COs are to obtain only “to the extent necessary to determine a fair and reasonable price” [FAR 15.403-3(a)(1)(ii)]
- “current”: CO shall ensure that data are “sufficiently current” to negotiate a fair and reasonable price [FAR 15.403-3(a)(3)]
- Form: For commercial items, “to the maximum extent practical, limit the scope of the request for data . . . to include only data that are in the form regularly maintained by the offeror” [FAR 15.403-3(c)(2)(ii)]

Strategies for Reducing Disclosure Risks

- Supporting commercial-item status
- Identifying market comparisons
- Defining the disclosures
- Internal controls

Questions?

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**AUDITS & DEFECTIVE PRICING:
TEN ESSENTIAL LESSONS FOR
AVOIDING THE AUDIT
NIGHTMARE**

David Z. Bodenheimer

Audits & Defective Pricing

Audit Disputes from Hell

Are These Your Goals?

- Antagonize Auditors
- Entice Fraud Investigators?
- Waste Money & Put Your Company at Risk?
- Engender Bitter & Protracted Litigation?



Essential Audit Lessons

How to Survive the Audit

1. Remember 5 Points of Proof
2. Preserve the Documents
3. Avoid Unnecessary Admissions
4. Fight for Judgments
5. Focus on Disclosure, Not Use
6. Beware Inconsistencies
7. Embrace your Subcontractor
8. Check the Offsets
9. Rebut the Audit
10. Battle the FCA Allegations



DEFENSE CONTRACT AUDIT AGENCY
AUDIT REPORT NO. 3311-20 02K11010001



May 13, 2004

When Auditors Come



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Proving Defective Pricing

Remember the 5 "Points"

Government bears burden of proof for **"five points"** of defective pricing

1. **Cost or Pricing Data**
2. **Data Reasonably Available**
3. **Not Disclosed or Known to Government**
4. **Government Reliance on Data**
5. **Causation of Increased Price**

DCAA Audit Manual

14-102 The DCAA Postaward Audit Program

a. Defective pricing occurs when a contractor does not submit or disclose to the Government cost or pricing data that is accurate, complete, and current prior to reaching a price agreement. Generally, the auditor establishes the existence of defective pricing in a postaward audit by examining and analyzing the records and data available to the contractor as of the date of prime contract price agreement and comparing them with the submitted cost or pricing data.

b. The objective of a postaward audit is to determine if the negotiated contract price was increased by a significant amount because the contractor did not submit or disclose accurate, complete, and current cost or pricing data. To show that defective pricing exists, the audit must establish each of the following five points:

(1) The information in question fits the definition of cost or pricing data.

(2) Accurate, complete, and current data existed and were reasonably available to the contractor before the agreement on price.

(3) Accurate, complete, and current data were not submitted or disclosed to the contracting officer or one of the authorized representatives of the contracting officer and that these individuals did not have actual knowledge of such data or its significance to the proposal.

(4) The Government relied on the defective data in negotiating with the contractor.

(5) The Government's reliance on the defective data caused an increase in the contract price.

Establishing these five points is a necessary prerequisite to support recommended price adjustments and provide the contracting officer with the information to achieve price reductions to contracts.

Preserving the Documents

Save the Documents

• **When post-award audit is likely:**

1. ID key players

2. Get out "hold" notice

3. Collect key documents

- **Proposals & revisions**
- **Pricing workpapers**
- **Negotiation records & notes**
- **Price negotiation memo (PNM)**
- **Data disclosures**
- **Pre-award audit reports**
- **Emails!!!!!!**



Losing with Lost Records

• **Audit Statute** (10 U.S.C. § 2313)
(duty to make records available for audit)

• *Whittaker Corp. (Straightline Manu.)*, ASBCA No. 17267, 74-2 BCA 10,938
(no proof of nondisclosure & defective pricing where audit files were lost)

• ***Perelman Wins \$1.4 Billion Total in Suit Against Morgan Stanley***
(Associated Press, May 19, 2005)
(adverse jury instruction due to destruction of email & noncompliance with court order)

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Avoiding Admissions

Avoid Unchecked Admissions

Classic Admission Traps:

- **Hidden Disclosure**

- DCAA Assist Audits
- Audit Workpapers



- **Unreliable Data**

- Express Limits on Data
- Never Used in Negotiations

- **Questionable Causation**

- PCO use of price analysis
- Disconnect in DCAA theories



Impact of Admissions

McDonnell Douglas Helicopter Sys., ASBCA No. 50341, 99-2 BCA 30546 (MDHS Chief negotiator admitted reasonable availability of data)

Lansdowne Steel & Iron Co., ASBCA No. 17746, 74-1 BCA 10461 (PCO conceded contractor's offset)

McDonnell Aircraft Co., ASBCA No. 44504, 03-1 BCA 32154 ("McAir waives all defenses" to defective pricing claim except 'reasonable availability'")

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Fighting Judgments

War on Judgments

- **Escalation Attacks**
 - Vendor escalation
- **Engineering Labor Judgments**
 - Stale productivity estimates
- **Software Coding Estimates**
 - Projections on coding efficiency
- **Quantitative Risk Analyses**
 - Judgments on ranges of risk
- **FAR Table 15-2**
 - Disclosure of estimating methods



Judgments Okay

- **Cost or Pricing Data Definition**
 - FAR § 2.101 (judgments)
- **Recognized Estimating Techniques**
 - Contract Pricing Reference Guide
 - “Educated guesses”
- **Audit Guidance (DCAM 14-104.7)**



14-104). Therefore, errors in estimates (i.e., estimated escalation factors, estimated direct labor rates, etc) generally would not result in defective pricing because these estimates represent judgments rather than factual, verifiable data (i.e., cost or pricing data).

Focusing on Disclosure

Disclosure is Key

- **Disclose, disclose, disclose**
- **Johnson Rule: When in doubt.**
- **"TINA is a disclosure statute."**

"The plain language of the Act does **not obligate a contractor to use** any particular cost or pricing data to put together its proposal. Indeed, TINA does not instruct a contractor in any manner regarding the manner or method of proposal preparation."

United Technologies Corp., 04-1 BCA 32,556 at 161,024

Disclosure – Not Use

- **DCAA Practice**

Common complaint that contractor did not **"use"** cost or pricing data

- **Against DCAA Policy**

14-104.7 Errors in Cost or Pricing Data

TINA addresses only the submission of cost or pricing data. It does not require a contractor to use such data in preparing its proposals or for there to be a relationship between the proposals and the conclusions that can be drawn from such data. Furthermore, the certification relates only to the cost or pricing data. The offeror does not certify its proposal. Therefore, under TINA, the proposal does not constitute cost or pricing data and, therefore, does not have to be free from mathematical errors.

Beware Inconsistencies

Common Contradictions

- **Documents vs. Testimony**
 - Premium on records
- **Then vs. Now**
 - Negotiation context vs. post-award
 - *Lockheed Martin, d/b/a Sanders*, 02-1 BCA 31,784
- **Half of Two-Way Error**
 - Government ignores favorable errors
 - *Sparton Corp.*, 67-2 BCA 6539
- **Liability vs. Damages**
 - Kaleidoscope theories = no damages
 - *American Machine & Foundry*, 74-1 BCA 10409



Contradictions Kill

Mr. Rhodeback's statements of reliance on BAFO cost or pricing data at trial were unsupported by any contemporaneous project records. Those records of the CO that were adduced—and that we discussed above—show that competitive forces, rather than the defective 1983 BAFO cost or pricing data were relied upon to make the awards and to exercise the options for additional purchases for FYs 86-90. In the face of such credible, contemporaneous evidence, we believe that Mr. Rhodeback's unsupported trial statements to the contrary were unpersuasive.

United Technologies Corp., 05-1 BCA 32,860

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Embracing Subcontractors

• Subcontractors & Defective Pricing

- Get Indemnified: Prime contractor liability
- Watch the Clock: Statute of limitations
- Beware 2-Front War: "5 Points" of Proof



Subcontractor

**Prime
Contractor**



Checking Offsets

Offsets are Great if . . .

- **Five Points of Proof**
 - Mirror image of defective pricing
- **Certified Offsets**
 - Get audit help
 - Avoid 18 U.S.C. § 1001
- **Offset Not Knowingly False**
 - Barred if "known to be false"
 - 10 U.S.C. § 2306a(e)(4)(B)(i)
- **Not FCA Case**
 - FCA law undecided
 - DOJ will fight to the death

"Intentional" Offsets

- **DCAA Practice**
- Commonly calls all offsets "intentional" because contractor was "aware"
- **Against DCAA Policy**

(4) The first exception prohibits an offset if the contractor intentionally withheld from the Government information showing a higher cost for an item or service. To deny an offset for this reason, it is not enough that someone in the contractor's organization was aware of the true cost of the item or service. Rather, the Government must establish that someone in the contractor's organization knew of the cost or pricing data and knew the certificate was inaccurate when submitted.

Rebutting the Audit

Contractor's Rebuttal

- **Contract Disputes Act**
 - 41 U.S.C. §§ 601-613
 - Encourages resolution, not litigation
- **Regulatory "Due Process"**
 - FAR § 15.407-1(d)
 - Contractor opportunity to respond
- **Contractor Rebuttal**
 - Get the documents
 - Scour the audit
 - Tell your story



3rd Party Oversight

- **ADR Policy (FAR § 33.204)**

"Agencies are encouraged to use **ADR** procedures to the **maximum extent practicable.**"

- **ADR Procedure (FAR § 33.214)**

- Objective: inexpensive & expeditious
- Agreement (*e.g.*, ASBCA form)

- **Other Ideas**

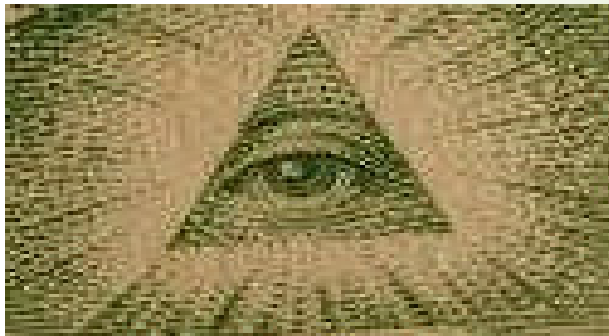
- Contracting Officer as Neutral
- Government Counsel as Gatekeeper



Battling Fraud Allegations

TINA → Fraud

- **TINA Certification**
 - “current, accurate & complete”
- **Emergency Contracting**
 - Procuring agencies in a hurry
- **Expanding FCA Market**
 - DOJ involvement
 - Inspector General audits
 - *Qui tam* allegations



FCA Landmines

- **Elements of Proof**
 - More or Less? (e.g., “reliance”)
 - FCA + TINA? Like *J.T. Construction*
- **Presumption of Causation**
 - Benefit of TINA presumption?
 - *U.S. ex rel. TAF v. Singer* (4th Cir. 1989)
- **False Estimates**
 - Objective falsity vs. subjective estimates
 - *Harrison v. Westinghouse* (4th Cir. 1999)



Questions?

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