

Scrutiny Over Commercial Item Contracts Continues

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For nearly two decades, Government agencies and contractors alike have benefitted from the more streamlined rules and contract clauses that govern the acquisition of "commercial items." Over the past few years, however, there have been numerous efforts to place limits on the Government's ability to acquire products and services as "commercial items," and to require heightened scrutiny and oversight of the use and pricing of commercial item contracts. (See for example our November 22, 2011 alert regarding recent changes to the DFARS data rights rules affecting commercial item contracts). The DoD has recently issued two policy statements that illustrate this continuing trend.

First, in September 2011, the Defense Contract Audit Agency (DCAA) issued a memorandum to regional directors and other DCAA officials providing guidance on audits of commercial item subcontracts. Of particular note, DCAA's recent guidance directs DCAA auditors to closely scrutinize and assess the adequacy of prime contractors' commercial item determinations (CIDs) as well as prime contractors' evaluations of the reasonableness of their commercial item subcontractors' proposed prices—even though the memorandum explicitly acknowledges that prime contractors are vested with discretion to determine whether a particular subcontract item meets the definition of a "commercial item" and to establish the reasonableness of related proposed subcontract costs/prices.

In carrying out this guidance, auditors are cautioned to avoid "excessive reliance" on prior CIDs, and are instructed to pay particular attention and consider requesting technical assistance when evaluating commercial items that are "of a type," "evolved" or "modifications." In addition, auditors are reminded that in deciding

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whether an item meets the definition of a commercial item, sales to the "general public" does not include the federal Government, or state, local or foreign governments. Auditors are also reminded that inclusion of the item in a catalog, or prior sales to the prime contractor, by themselves are not enough to establish price reasonableness.

According to the guidance memorandum, if the auditor concludes that a prime contractor's CID is "inadequate," the auditor should raise the issue with the contracting officer and recommend that the prime contractor direct the prime contractor to provide an "adequate" CID. If that revised CID is still deemed inadequate, the guidance memorandum directs auditors to recommend that the contracting officer require the subcontractor to submit certified cost or pricing data and to issue a finding that the subcontractor costs are unsupported.

At around the same time that DCAA issued its audit memorandum, DoD issued a long-awaited draft update to its Commercial Item Handbook, which had not been updated in more than a decade. 76 Fed. Reg. 60474 (Sept. 29, 2011). Like the earlier version, the revised Handbook recognizes that the definition of commercial items is "broad" and is not limited to "off the shelf" items. At the same time, the revised Handbook has also been updated to reflect many of the changes and limitations on commercial item contracting that have been imposed over the past several years.

For example, like DCAA's recent audit guidance, the revised Handbook acknowledges that prime contractors are responsible for determining the commercial item status of their subcontractors, yet goes on to suggest that contracting officers should request certified cost or pricing data if they determine that a subcontract does not qualify as a commercial item and no other Truthful Cost or Pricing Data Act (formerly TINA) exception or waiver applies.

The Handbook also has been updated to include guidance regarding the rules for awarding commercial item time-and-materials contracts (which were not explicitly authorized when the Handbook was first issued), as well as the limitations on the use of commercial item contracts to acquire major weapons systems, based on Section 803 of the FY2006 NDAA.

Finally, the revised Handbook includes extensive discussion of various techniques for analyzing price reasonableness when acquiring commercial items, including the contracting officer's specific obligation under Section 868 of the FY2009 NDAA and FAR 15.403-1 to obtain adequate documentation to support his or her determination of price reasonableness when acquiring services that are "of a type" offered and sold in the commercial marketplace.

Together, the DCAA audit guidance as well as the revised DoD Handbook demonstrate the increasing scrutiny and restrictions that have been placed on the use of commercial item contracts and subcontracts. Contractors and subcontractors would therefore be well advised to ensure that they understand these changing rules when entering into contracts or subcontracts for commercial items.