

## **ISSUE: Commercial Item and Price Reasonableness Determinations for Legacy Spare Parts**

Rapid and cost-effective access to commercial items has long been, and remains a paramount objective of Government and industry alike. Today's business environment, however, is one largely defined by both a rapidly evolving commercial marketplace and precipitously declining Department of Defense budget. Today, perhaps more than ever, DoD stands to benefit from private industry's substantial commercial investments in technologies which advance the state-of-the-art without Government investment. Given the extensive research, analysis and reports issued by Government and industry organizations over the last several years (some of which gave rise to current statutes and regulations), it is now beyond reasonable dispute that when DoD qualifies and purchases "commercial items" it does so at significant cost savings and value to both the warfighter and taxpayers.

Unfortunately, not all of opportunities available under current legislation and regulations are being captured. One area of particular concern is DoD's treatment of legacy spare parts -- from both a commercial item and price reasonableness perspective. Given the increasingly lengthy lifespan of systems the Government relies upon, it is not uncommon to find disparity between DoD's treatment of spare parts currently sold in the commercial marketplace, and those that have been (but are not actively) sold, leased or licensed to the general public for non-governmental purposes.

Sometimes, commercial spare parts required by the Government are no longer sold in the commercial marketplace simply because the commercial marketplace has moved to other alternatives and no longer has requirements for those parts. In these circumstances, it is common for DoD contracting, auditing and other acquisition officials to (1) assert categorically that it is impossible to assess price reasonableness without detailed cost data, and (2) conclude therefore that spare parts historically purchased on FAR Pt 12 terms no longer qualify as "commercial items."<sup>1</sup> The buying command's subsequent insistence on receiving certified cost or pricing data leads to protracted negotiations that drive Government and contractor overhead costs up unnecessary and extend acquisition cycle times significantly. In some cases, contractors have simply declined to sell to the Government.

### **DISCUSSION:**

Congress has addressed concerns about DoD proposed changes in how it acquires commercial items for the past three years, each time re-emphasizing that commercial items are broadly defined to include items that are "of a type" sold or offered for sale lease or license to the general public. In fact, in response to the Administration's 2012 request for legislative amendments intended to grant DoD greater access to cost or pricing data associated with commercial items, Congress, in the Conference Report for the FY 13 NDAA, reemphasized the importance of maintaining DoD access to commercial items, particularly in fast moving commercial markets. The Committee recommended that the DoD develop additional tools, guidance and training rather than change the definition of commercial items. Thus, section 831 of P.L. 112-239 requires the Under Secretary of defense for Acquisition, Technology and Logistics to issue guidance on the use of the authority provided by sections 2306a(d) and 2379 of title 10, United States Code, within 180 days of January 2, 2013, the date of enactment. Subsection (a)(4)

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<sup>1</sup> This practice of basing commercial item determinations in whole or part price reasonableness objectives is concerning. While we acknowledge that contracting officers are, as they should be, directed to acquire supplies and services at fair and reasonable prices, it is clear to us that price reasonableness and commerciality are properly treated as separate items under TINA and applicable regulations. Consider, for example, FAR 15.403-4, which directs contracting officers to require certified cost or pricing "only if" the contracting officer first concludes that none of the exceptions to TINA and FAR 15.403-1(b) apply -- commercial items being a major exception. Thus, contracting officers are directed to *first* determine whether a given item or service is commercial or in order to later determine whether certified cost or pricing data may be demanded. Only if an exception to TINA is identified is certified cost or pricing data to be required. FAR 15.403-1(b). If an exception is identified, other than certified cost or pricing data may only be required if there is "no other means" to determine reasonableness of price. FAR 15.404-1(b). As the authors of FAR have found, and our collective experience evidences, "[r]equesting unnecessary data can lead to increased proposal preparation cost, generally extend acquisition lead time, and consume additional contractor and Government resources." FAR 15.402(a)(3).

specifically provides that “no additional cost information may be required in any case in which there are sufficient non-Government sales to establish reasonableness of price”.

Honeywell is concerned with the continued inconsistencies and uncertainties with the DoD’s acquisition of commercial items (See Attachment #2). This is especially problematic for legacy spare parts. As mentioned above, these are items that were historically determined to be “commercial,” but for which the government is now the only buyer. The contractor remains a commercial entity, operating in a commercial market, using commercial business practices. Those business practices should not change simply because the market for a particular item has dwindled. The government has already benefited and continues to benefit from the commerciality of the item as intended under commercial item acquisition policy. This value includes:

- Leveraging the company’s innovation and investment in new technology;
- Reducing or eliminating development cost and time;
- Sharing in the results of a healthy, competitive industrial base;
- Sharing in a product support infrastructure that serves a broad global market;
- Leveraging a larger sales base to reduce the overall costs of every item produced;
- Shifting inventory carrying costs and associated risks to the contractor;
- Shifting the risk for supply chain integrity and parts obsolescence; and
- Avoiding procurement and/or redevelopment costs for mature product lines

Companies should be able to rely on the precedence of prior commercial item determinations, and, the DoD should routinely recognize prior commercial item determinations. In order to make prudent investment decisions regarding product line enhancement and obsolescence management, a company must be able to assume that prior commercial item determinations will not be reversed, and cannot reasonably be expected to develop costly unique cost and pricing data for a commercial item solely because the government becomes the only remaining customer for that item.

The value of commercial item acquisition remains as sound now as it always has been. The company making legacy “end-of-product-line” commercial items is still a commercial company; the product is still being made using commercial design, manufacturing and business processes. The item remains in its commercial configuration/specification and has not been extensively modified for a defense-specific application. The item cannot be sold on a contract cost accounting basis because commercial companies do not manage business systems on a contract by contract basis. The government continues to benefit from the factors above even though there are no longer sales in the commercial marketplace. In these circumstances DoD should be able to document the benefits of commerciality in support of the determination that the item is a commercial item.

In these cases, the answer is not for DoD to request additional cost information solely because there are no longer commercial sales of the commercial item. Price reasonableness should be determined based on market research, historical prices paid by the Government, evaluation of similar items and parametric estimating methods without seeking detailed cost and pricing data. Documenting the value from the commerciality of the entity is an additional step that should be used to support the determination of commerciality and price reasonableness without undermining the definition of commercial item or making overly burdensome requests to the contractor. This provides the benefits of commercial items for the warfighter and protection to the taxpayer.

Honeywell requests that the legislative proposals and recommended report language in Attachment #1 be included in the FY 2016 National Defense Authorization.

Attachment #1 – Bill and Report Language Recommendations:

Recommendation #1 – Legislative Proposal for Commercial Item Determination

**Sec. 8\_\_ . Commercial Item Determination**

(a) *IN GENERAL.*—(1) Chapter 137 of title 10, United States Code, is amended by adding after section 2306d the following new section:

**“Sec. 2306e. Commercial item determination.**

*The contracting officer shall presume that a prior determination by an agency official that an item may be treated as a commercial item for the purposes of section 2306a is justified for all subsequent acquisitions of such item unless the head of the contracting activity determines, based on information provided by the Department of Defense, that the original determination was made in error or was based on inadequate information.”*

(2) *The table of sections at the beginning of such chapter is amended by adding after the item relating to section 2306d the following new item: “2306e. Commercial item determination.”*

(b) *IN GENERAL.*—(1) Chapter of title 41, United States Code, is amended by adding after section 103(8) the following new section:

(9) *The Government has acquired the item under FAR part 12 any time in the past unless the head of the contracting activity determines, based on information provided by the Department of Defense, that the original determination was made in error or was based on inadequate information.*

Explanation of Bill Language (for accompanying report)

**Section 8XX-Commercial Item Determination**

The committee is concerned that the DoD is changing the determination of a commercial item to a military unique item during the sustainment and maintenance of legacy spare parts and components. This approach is inconsistent with the Congressional intent of commercial item determination. In the cases when the DoD changes the commercial item determinations, the contractor remains a commercial entity, operating in a commercial market, utilizing a commercial supply chain and manufacturing base, as well as using commercial business practices. Those commercial business practices and circumstances do not change simply because the commercial market for a particular item has dwindled. The government has already benefited and continues to benefit from the commerciality of the item as intended under commercial item acquisition policy. Furthermore, the committee believes that time does not change the commercial item determination. If the government determined an item to be commercial during acquisition, that determination should not change during sustainment simply due to time or that the commercial market has moved on to the next generation of technology for those commercial items.

Recommendation #2 – Legislative Proposal for Commercial Item Exception

**Sec. 8\_\_ . Commercial Item Exception to Required Cost or Pricing Data and Certification**

(a) *IN GENERAL.*—(1) Chapter of title 10, United States Code section 2306a, is amended by adding a new section(b)(4) as follows:

*“(4) Prices Paid By The Government For Commercial Items. Prices paid by the Government shall be viewed as a significant indicator of a “fair and reasonable price” and shall establish a baseline for price reasonableness analysis on subsequent purchases of identical or similar items.”*

Explanation of Bill Language (for accompanying report)

The committee notes the increasingly lengthy lifespan of systems the Government relies upon. The committee has learned that under these circumstances, it is not uncommon to find disparity between DoD's treatment of spare parts currently sold in the commercial marketplace, and those that have been sold, leased or licensed to the general public for non-governmental purposes.

The committee is concerned that in the instances where the government has acquired commercial items in the past, the government is not using the prices they paid for these items in the past to determine price reasonableness. The committee has learned that the DoD is actually requiring the use of certified cost and pricing data to determine fair and reasonable pricing on legacy components and parts already acquired as a commercial items. The committee strongly believes the government should use the prices paid by the government from previous contracts as a baseline for price reasonableness analysis on subsequent purchases of identical or similar items.

### Recommendation #3 – Item of Special Interest – Commercial Price Reasonableness:

#### **Commercial price reasonableness**

The committee understands that when commercial spare parts required by the Government are no longer sold in the commercial marketplace in quantities similar to what the Government contemplates buying, simply because the commercial marketplace has moved to other alternatives, it is common for DoD contracting, auditing and other acquisition officials to assert categorically that it is impossible to assess price reasonableness without detailed cost data, and to conclude therefore that spare parts historically purchased on FAR Pt 12 terms no longer qualify as “commercial items”.

The committee believes that the insistence on receiving certified or other than certified cost or pricing data in this context leads to protracted negotiations that drive Government and contractor overhead costs up unnecessary and extend acquisition cycle times significantly. In some cases, contractors have simply declined to sell to the Government.

The committee directs the Under Secretary of Defense for Acquisition, Technology and Logistics to issue guidance that reemphasizes that price reasonableness determinations must take into consideration all relevant information available from the following priority order:

1. Pricing and other information from within the Government (including market research), with the understanding that the most recent price paid by the Government for the same or similar item should establish a baseline for price reasonableness ;
2. Pricing and other information from sources other than the offeror;
3. Pricing and other information from the offeror ; and
4. That price data associated with the procurement of commercial items must be fully evaluated and demonstrated in writing to be insufficient in connection with the procurement of commercial items before cost data of any sort is requested from the contractor.

The committee is concerned that failure to address this will ultimately increase the DoD acquisition costs as commercial companies may decide it does not make good business sense to sell to the DoD given inconsistent, and often time incorrect, application of commercial price reasonableness determinations.

## Attachment #1 - Honeywell Commercial Challenges

1. **Commercial Item Re-certification.** The military services are requiring preparation and submittal of refreshed commercial item justification (CIJ) documentation to support contract renewals. For example, the F-15 Avionics repair and overall program is a FAR-12 contract that ends in September 2014. We are currently in discussions for renewal and are now required to resubmit CIJ. Other examples of where we have to continually “recertify” commerciality:
  - a. Air Force F-35 Inertial Measurement Unit;
  - b. Guided Multiple Launch Rocket System Inertial Measurement Unit;
  - c. Marine Corps C-130T RDR-400M Radar;
  - d. C-130, KC-135, C-5, and C-17 Traffic Collision Avoidance System (TCAS) Antenna;
  - e. Army UH-60 Starter, Pneumatic Valve and Mixing Valve, and
  - f. Army CH47, AH64, UH60, and OH58 Radar Altimeters and Searchlights.
2. **Sustainment Commercial Item Re-classification.** With regard to components we have sold to the military services as commercial (FAR-12) during acquisition, we are now experiencing “re-classification” challenges (FAR-15) when we attempt to enter into sustainment contracts for these components. For example, we are providing the Reaper TPE331 engine to General Atomics as a commercial item during procurement. We continue to support that engine as a commercial item under their follow-on Contractor Logistics Support program. However, as we approached the Air Force to meet their requirement of establishing depot capability for the engine –CIJ will be required relative to the depot repair capability for the engine.
3. **Military versus Commercial Part Numbers.** Military services are requesting that we show commercial sales data on military part numbers (PN). In short, if Honeywell is not able to show the exact PN, instead of similar part number, being sold in the commercial marketplace, the item is then challenged. This underscores the problem with the appropriate use regarding “of-a-type” commercial products. It is important to note that military parts associated with commercial of a type parts are often re-identified with alternate PNs to ensure segregated for military use vice PNs used on commercial platforms in service with commercial industry. This is done to address FAA concern for ensuring segregation of inventories and parts traceability. (Example: USAF Tinker Corporate Contract Renewal).
4. **Misclassification of Commercial Items.** Military services are classifying commercial of a type components as military items to obtain certified cost and pricing data. This adds cost to our commercial suppliers as they are not Cost Accounting Standards compliant. Specifically, the Commercial Operation and Support Savings Initiative (COSSI) Clutch for the Auxiliary Power Unit (APU) on the AH-64 Helicopter was designated a commercial item and serviced under the Boeing contractor logistics support contract. However, under the pending Enterprise Performance Based Logistics request for proposal, the COSSI Clutch was determined a FAR-15 military item by the Army. To further illustrate the current of commerciality conflicts, it should be noted, the COSSI clutch (as the acronym indicates) was originally provided to the Apache program via a Government-sponsored partnership initiative with industry to leverage commercially-developed products and technology for military application.
5. **“Timely” Sales Data.** Many of the items we have sold to the Department of Defense currently installed on legacy platforms are no longer being sold commercially. We have updated these product lines for the commercial market. In many instances, the components military services use today are the grandparents - or great, great grandparents – of today’s commercial products. The Government uses the lack of timely sales data to challenge an item’s commerciality.