



ISSUE PAPER

Why FAR Part 12 authorities must be retained

Background

In the early 1990s Congress recognized the opportunities commercial products provided to the Government and that procurement statutes were not well-suited to acquiring those items from commercial companies. Statutes were enacted to incorporate free-market principles into the Federal Acquisition Regulation (FAR) by encouraging both the acquisition of commercial items and services and the use of commercial practices. The recommendations of the Section 800 Panel Report of 1993 were to simplify the regulations and to more closely parallel commercial contracting practices. Specifically, FAR Part 12, “Acquisition of Commercial Items,” and the corresponding definitions of “commercial item” at FAR Part 2 were rewritten to exempt commercial item vendors from many burdensome regulatory provisions.

The Government wisely created an acquisition framework to include streamlined authorities to procure commercial items to help reduce costs and obtain the benefit of commercial investments in research and development and manufacturing processes for products often developed for use in the global marketplace. The laws and regulations developed to provide the balance to attract commercial companies to do business with the Government, while also preserving authority to buy government unique capabilities were carefully crafted to limit the number of unique requirements applicable to commercial item acquisition. However, in the ensuing 15 years since these significant changes were put into effect, the commercial items rules have become increasingly onerous, with both Part 12 and the definitions in Part 2 having been amended in favor of more exacting and restrictive regulations. As a result, the commercial item regulations have steadily diverged from commercial practices. The current complexity of the rules limits contractors’ ability to assess the risks and costs of commercial item procurements and thus reduces the overall amount of competition for contract awards. This is plainly contrary to what Congress initially intended with the FAR revisions. Congress must now reinvigorate their support of the original free market principles incorporated into the FAR

However, the proliferation of Government-unique requirements on companies desiring to sell commercial products and services to the Government undermines the Congress’ intentions aimed at enabling the use of commercial items: increasing competition; reducing costs; attracting non-traditional, commercial sources to Government business; encouraging innovative small businesses to participate as prime contractors; and increasing the likelihood that the best American technology can be acquired by the Government.

Benefits of Commercial Item Acquisition

Since the implementation of the Federal Acquisition Streamlining Act (FASA) in 1995, the Government and its industry partners have undertaken to significantly streamline acquisition practices. These streamlining efforts have largely focused on those authorities provided for in FASA and the Federal Acquisition Reform Act of 1996 (FARA) and in particular, the authority to acquire commercial items. Over that time, the regulatory framework established in FAR Part 12 has been integrated within both the Government acquisition community and in industry. Much of the progress has been focused on the specific authorities provided for in FASA including use of commercial terms and conditions, commercial-like financing techniques, and the exemption of commercial items from the burdens of the traditional focus on cost or pricing data and cost accounting standards. FASA enabled an efficient, timely, and cost effective system of acquiring commercial products and services to meet the Government’s requirements.

U.S. manufacturers of information technology products and other commercial items are being challenged as never before to compete internationally as industry supply chains become global. Savings from process improvements are becoming more important than ever. The costs associated with Government-unique requirements applicable to suppliers of commercial technologies to the Government and to Government prime contractors risk pushing commercial companies out of the

federal marketplace. Commercial companies who do a relatively small percentage of their business with the federal government and must still compete globally have different business models and competitive pressures that make it very difficult to add unique requirements without losing the competitive advantage of investments they have made in production processes and products. Companies are faced with the choice of achieving competitiveness at the global level or maintaining relatively small scale sales for the U.S. Government market. The companies most successful in the global market place are often precisely those with the capabilities to supply cutting edge technologies to the U.S. Government.

Based on the FASA-era reforms, many small to mid-tier companies were able to consolidate their operations to provide a single commercial/military enterprise. These synergies reduced costs and were a win-win for both companies and their customers. No longer were separate divisions or facilities required to perform Government contracts. Contrary to the documented difficulties the Government experienced acquiring commercial products during the Gulf War; there have been no publicized incidents where the Government has been unable to meet their needs for current wartime operations. This likely would not be the case if the commercial item procurement procedures of FAR Part 12 did not exist.

There have been many examples of successful integrations of state-of-the-art technologies from commercial industry into Government systems. In many cases, the Government has access to commercial products and services at the same time they are offered for sale in the commercial market. Even in cases where there are modifications to meet specific Government requirements, commercial products and technologies can be produced on the same supply chain as similar products produced for commercial customers. There have been many studies and reports documenting the benefits of the use of commercial item contracting over the intervening years by both Government and academic sources. Collectively, those benefits are identified below:

- Leverage state of the art technologies developed in the commercial marketplace
 - The Government can take advantage of technological advances being made in the commercial marketplace without funding the development. For example, advances in avionics display technologies that led to the use of Cathode Ray Tubes and then flat panel Liquid Crystal Displays has been almost entirely funded by commercial suppliers of display products.
 - Utilization of open industry standards
 - Utilization of commercial open industry standards allows the Government to take advantage of increased opportunities for competition as well as opportunities for technology advancements. Commercial enterprises often upgrade their products while maintaining backward compatibility with defined open industry standards. Use of open commercial standards will also better facilitate future re-competition of products.
 - Parts obsolescence managed by suppliers
 - It is standard practice for commercial suppliers to manage parts obsolescence issues. In most DoD noncommercial programs, the DoD must directly fund the replacement of obsolete parts.
 - Savings of research and development expenditures
 - Commercial acquisition techniques enable the Government to take advantage of private investments made in the commercial sector. Further, commercial enterprises are often willing to target their R&D investments toward products that will meet Government needs when there is a likelihood that they will be able to compete for Government procurements.
 - Establishment of a market price as a price analysis tool
 - Establishment of fair and reasonable prices by using market price analysis methods is much more administratively efficient than traditional FAR Part 15 cost analysis methods.
 - Integration of the defense and commercial industrial bases to benefit the Nation's security and economy
 - Unique Governmental (non-commercial) requirements will drive companies to separate their commercial and Government businesses, or, to not participate in the Government market. This disintegration or withdrawal from the Government market would be contrary to our economic and security interests.
 - Reduced economic risk associated with developing new DoD unique items
 - The economic risks to the Government associated with using commercially developed items are mitigated as the products can be proven in the commercial marketplace before acquisition.
 - More rapid deployment of state-of-the art technologies
 - Commercial item development cycle times, because of market pressures, tend to be significantly shorter than DoD developmental activities.
 - Access to proven advanced technologies
 - Use of technologies that have been proven in the commercial marketplace reduce the need for extensive developmental testing.
 - Opportunities for increased competition
 - Acquisition strategies that provide for the maximum participation by historically commercial enterprises enable the Government to increase competition. For example, if the Government purchases items, either end items or subassemblies, by specifying commercial open interface standards, current and future procurements of those items can be easily competed.
- AIA members believe that these enumerated benefits are enormously important, particularly with the global war on terror, the need for rapid deployment of the latest technologies, and the

pressures on program funding. In addition, the systemic benefits to the procurement system, such as process improvement from the use of simplified acquisition techniques, increased acquisition processing speed, built-up commercial item expertise in the acquisition community, and enhanced flexibility in managing a stressed acquisition workforce are also major contributors to a successful acquisition result.

Most recently, within the Department of Defense, Secretary Gates and Under Secretary Carter have announced initiatives to restore affordability and productivity to Defense spending. Restoring maximum flexibility to procure commercial items and services on commercial terms using commercial practices would be a key enabler of this objective. In that regard, AIA has recently advocated a refresh of the Coopers & Lybrand/TASC study of the costs associated with defense procurements in comparison with commercial transactions, which identified an 18% premium associated with defense procurements. Renewed attention is long overdue.

Problem Statement

Like all large institutional processes growing to maturity, however, FAR Part 12 has become burdened with added regulatory and process requirements over time, resulting in the layering of more formal acquisition processes onto the framework of commercial item acquisition. This has led to a reduction in the efficient use of commercial item acquisition techniques. This impact has been felt most acutely and notably in the ability of the Government to acquire commercial products, services and systems at a pace timely enough to meet Government's requirements and still be state of the art. Many of these added regulations are a result of insufficient price analysis in the preaward contracting phase. Ironically, rather than focusing on training and continuous improvement, the Government is seeking to limit the existing regulatory authority. This risk averse behavior will result in limiting access to the commercial marketplace. For example, the DoD is seeking to change to the definition of commercial item by removing "of a type" and "offered for sale" from the definition. These are exactly the restrictive terms that the Section 800 Panel cited in its report as barriers to the commercial marketplace. AIA members are concerned that many legislative changes to the existing commercial item authority and certain recent FAR cases have all been steps backward. AIA members believe these regulatory changes will be an impediment for commercial firms doing business with the Government.

Perhaps of greatest concern is the potential impact of the current trend on the supply chain supporting major defense systems as more restrictions and requirements on the use of commercial items and technologies are flowed down. It is in these supply chains where the market pressures on cost are most acute and the impact of disincentives on commercial suppliers could be the most serious in terms of program costs and systems capabilities

The Defense Science Board March 2009 study emphasized the importance of commercial item acquisition and related cost and schedule benefits. For these reasons, it is important to target

legislative or regulatory changes in a manner that does not limit the Government's access to the commercial marketplace while addressing any identified weaknesses in the procurement process.

Recommendation

The case for the expansion of, and/or a reinvigoration of, commercial item acquisition rules specifically designed to address current acquisition challenges is very strong. If the commercial item procurement policies continue to erode, fewer commercial companies will be inclined to do business with the Government. That is certainly not what Congress intended when it encouraged commercial contracting. But it is equally certain that this will be the result if something is not done to rethink the policies behind commercial item contracting. A fresh, objective look is essential because the federal procurement system is not geared toward or entirely comfortable with commercial enterprise. Proof of this is the push toward increasing access to cost data—data never provided in the private sector. Thus, only the administration at a high level or Congress has the ability to reverse the trend away from commercial contracting. If these issues are not addressed soon, then the inertia of increasing regulations will stifle commercial contracting, which would be a major setback to the federal procurement system.