



A CONTRACTOR'S  
**GUIDE**  
TO PURCHASING  
COMMERCIAL ITEMS



BY  
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THE FEDERAL ACQUISITION STREAMLINING ACT (FASA), ENACTED IN OCTOBER OF 1994, CODIFIED THE GOVERNMENT'S PREFERENCE FOR PURCHASING COMMERCIAL ITEMS. IN 1995, *FEDERAL ACQUISITION REGULATION (FAR)* PART 12, "ACQUISITION OF COMMERCIAL ITEMS," WAS SIGNIFICANTLY REVISED TO INCORPORATE THE GOVERNMENT'S COMMERCIAL ITEM PREFERENCE INTO THE *FAR*.

The acquisition of commercial items in lieu of government-unique items offers several advantages, including:

- Allowing more companies to participate in government contracting,
- Access to the latest technology,
- Shortening acquisition lead times,
- Reducing the need for detailed design specifications,
- Limiting the number of *FAR* clauses that need to be included, and
- Perhaps most important, cost or pricing data, audits, and cost analysis are not required.

The theory behind this preference for commercial items is that the price set by the marketplace is, by definition, "fair and reasonable." Therefore, cost or pricing data and cost analysis is not needed.

While billions of dollars of goods and services have been acquired over the past two decades pursuant to the streamlined procedures of *FAR* Part 12, commercial acquisitions are not without controversy. The Department of Defense (DOD), in particular, believes contractors are using

the *FAR*'s overly broad definition of *commercial item* to avoid disclosing their cost or pricing data and as a result are overcharging the government. On the other hand, Congress and their allies in industry accuse DOD of being stuck in their ways, failing to take full advantage of the commercial acquisition procedures.<sup>1</sup>

### CONTRACTORS AS BUYERS OF COMMERCIAL ITEMS

While the DOD/Congress disagreement on the benefits of commercial acquisitions is an important one, DOD is not the only organization required to procure commercial goods and services when possible. Prime contractors also have a contractual obligation to award subcontracts for commercial items to the maximum extent practicable. As the *FAR* states:

Agencies shall require prime contractors and subcontractors at all tiers to incorporate, to the maximum extent practicable, commercial items in all goods and services supplied to the government.<sup>2</sup>

The requirement for contractors to prioritize commercial purchases is virtually universal. *FAR* 44.403 requires inclusion in

*all* contracts other than those for commercial items the clause at 52.244-6, "Subcontracts for Commercial Items," which states:

To the maximum extent practicable, the contractor shall incorporate and require its subcontractors at all tiers to incorporate, commercial items or nondevelopmental items as components of items to be supplied under this contract.<sup>3</sup>

Nondevelopmental items (NDIs) are defined by *FAR* 2.101 to be supply items previously developed exclusively for government purposes, which is the opposite of commercial items. Presumably, there are cost-efficiencies associated with reusing items previously developed for the United States or other governments. However, procurement of NDIs is beyond the scope of this article.

### COMMERCIAL PURCHASING AND CONTRACTOR RISK

Though the requirement for contractors to purchase commercial items where practicable seems innocuous and possibly beneficial, it also subjects contractors to compliance risk, which may be substantial in some cases. Failure to acquire com-



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mercial items when practicable means contractors are:

- In breach of a material term of their contract,
- Not taking advantage of the shortened acquisition lead time,
- Likely excluding potential subcontractors who have valuable goods and services to offer but won't agree to a government audit of their books and records, and
- At a competitive disadvantage with their competitors who are incorporating commercial items into their solutions and deliverables.

In addition, failure to acquire commercial items to the maximum extent practicable means the government may deem your purchasing system to be inadequate. For DOD contractors subject to the "Business Systems" rule,<sup>4</sup> this means the government can withhold payments until the purchasing system is deemed adequate. In addition, contractors with inadequate purchasing systems cannot bid solicitations that require an adequate purchasing system or obtain the "extra credit" evaluation points offered

by some solicitations. Lastly, contractors with inadequate purchasing systems must provide advance notification and obtain the contracting officer's consent before awarding certain subcontracts; however, advance notification and consent is a time-consuming process that, if not done correctly, subjects the contractor to risk of nonpayment for its subcontractor's costs.

Conversely, using the commercial acquisition procedures to purchase an item that does not meet the FAR definition of a *commercial item* is even riskier for the prime contractor. Initially, this may also result in the purchasing system being deemed inadequate. However, there are other reasons for concern. As previously stated, commercial acquisitions require only a limited number of FAR clauses. If it is ultimately determined the item did not qualify as a *commercial item*, the government will enforce all FAR clauses in the prime contract that should have been included in noncommercial subcontracts. This means the prime contractor may assume liabilities that would have been the responsibility of the subcontractor had the correct clauses been flowed down.

Commercial acquisitions exceeding \$750,000, the current threshold for certified cost or pricing data, are especially risky for contractors. The government may determine the item or service did not qualify as a *commercial item* and as a result, cost or pricing data should have been requested and analyzed. If this is discovered during a proposal audit, the proposed costs will be viewed by the government as unauditible and unsupported. Worse for the contractor, if this is discovered after the fact, such as in an incurred cost audit, the cost incurred for the "improper" commercial acquisition may be disallowed in part or even in its entirety.

### DEFINITION OF COMMERCIAL ITEMS

In order to incorporate, to the maximum extent practicable, commercial items in all goods and services supplied to the government, prime contractors must first understand the definition of a *commercial item*. FAR Part 2 provides separate definitions for *commercial items* and *commercial services*. Per the FAR, *commercial item* means:



Any item, other than real property, that is of a type customarily used by the general public or by non-governmental entities for purposes other than governmental purposes, and—

- i. Has been sold, leased, or licensed to the general public; or
- ii. Has been offered for sale, lease, or license to the general public.<sup>5</sup>

The definition also allows for items not yet commercially available, but that will be by the time the delivery to the government is required. Items that need modifications can also qualify as commercial if modifying the item is a standard commercial practice or is considered “minor.”

The FAR defines *commercial services* in two different ways. “Installation services, maintenance services, repair services, training services, and other services” are considered to be *commercial* if the services are in support of a commercial item and the contractor provides similar services to the general public under substantially similar terms and conditions.<sup>6</sup>

This is a fairly straightforward definition. An example is the annual maintenance agreement for a copier/printer. Since the copier/printer is almost assuredly a *commercial item*, as defined by the FAR, the maintenance agreement will be similarly deemed a *commercial service*.

The definition for *commercial services unrelated to support of a commercial item* is more challenging to interpret:

Services of a type offered and sold competitively in substantial quantities in the commercial marketplace based on established catalog or market prices for specific tasks performed or specific outcomes to be achieved and under standard commercial terms and conditions.<sup>7</sup>

Significantly, the FAR definition of *commercial items* states that items or services transferred between affiliated organizations can also qualify as *commercial items*.

This means contractors can organize themselves such that some of the products or services are sold on a cost-buildup basis and other products or services, even when utilized on the same contract, are shielded from government audit.

## MARKET RESEARCH

Once the definition of a *commercial item* is understood, the next step is to determine if there are any commercial items that meet the government's requirements. In order to make a commercial item determination, the purchaser must have a thorough knowledge of the commercial marketplace. This knowledge is obtained through *market research*, defined as “collecting and analyzing information about capabilities within the market to satisfy agency needs.”<sup>8</sup>

Just in case the need to research the market is not intuitive, FAR 52.210-1, “Market Research,” is required to be included in all contracts that exceed \$5.5 million other than those for commercial items. That clause requires the contractor to conduct market research before awarding any subcontract over the simplified acquisition threshold, currently \$150,000.

The purpose of the market research is to determine if there are commercial items that can meet the government's needs, and if not, to determine whether the government's needs can be reasonably modified such that the requirement could be met with a commercial item. To the extent commercial items are available, market research also determines the customary commercial terms and conditions for the sale of the commercial item and the current price as set by the market. The information on commercial prices is required to perform a price analysis if the commercial item is being acquired on a sole- or single-source basis. Market research is also used to determine if there are any small businesses that provide the item or service.

Market research can be as formal as issuing a request for information or meeting with representatives of commercial com-

panies, and as informal as attending trade shows or conducting internet research. In any event, market research should be commensurate with the size and complexity of the acquisition.

Techniques for conducting market research include:

- Contacting knowledgeable individuals in government and industry regarding market capabilities to meet requirements;
- Reviewing the results of recent market research undertaken to meet similar or identical requirements;
- Publishing formal requests for information in appropriate technical or scientific journals or business publications;
- Querying government or contractor databases that provide information relevant to the acquisition;
- Participating in interactive, online communication among industry, acquisition personnel, and customers;
- Obtaining source lists of similar items from other purchasing departments, trade associations, or other sources;
- Reviewing catalogs and other generally available product literature published by manufacturers, distributors, and dealers or available online; and
- Conducting interchange meetings or holding pre-solicitation conferences to involve potential offerors early in the acquisition process.

More generally, market research needs to be viewed as a team effort. In addition to the buyer/subcontract administrator, market research often requires the participation of employees from other organizations such as operations, legal, pricing, and business development. In addition, buyers/subcontract administrators should view general market research for their respective markets as an ongoing responsibility rather than something done on a case-by-case basis and then forgotten until the next purchase requisition is received.



## FLOW DOWN CLAUSES FOR COMMERCIAL SUBCONTRACTS

Commercial item subcontracts will have far fewer *FAR* clauses than similar-sized government-oriented subcontracts. If the prime contract was commercially awarded pursuant to the terms of *FAR* Part 12, the required flow-down clauses are listed in 52.212-5 "Contract Terms and Conditions Required to Implement Statutes or Executive Orders—Commercial Items." Paragraph (e) of that clause lists 18 potential flow-down clauses with the caveat that the extent of the flow down shall be as required by the clause. For example, the "Service Contract Labor Standards" clause would not be flowed down if the subcontract was not for services.

If the prime contract was not a commercial contract, the flow-down requirements for commercial subcontracts are specified in *FAR* 52.244-6. Paragraph (c) of that clause lists 14 *FAR* clauses to be flowed down to the extent they are applicable to the subcontract. For DOD contractors, *Defense FAR Supplement (DFARS)* 252.244-7000, "Subcontracts for Commercial Items," states that the contractor is not required to flow down any *DFARS* clauses in commercial subcontracts.

All three clauses, though purporting to limit the number of *FAR* and *DFARS* clauses that need to be included in a commercial subcontract, allow the contractor to flow down a "minimal" number of other clauses that are necessary to satisfy the contractual obligations. Examples of additional flow-down clauses that a prime contractor might want to include in a commercial subcontract include, just to name a few:

- "Inspection and Acceptance,"
- "Warranties,"
- "Termination,"
- "Stop Work,"
- "Data Rights,"
- "Patent Indemnity,"
- "Changes,"
- "Taxes," and
- The Defense Priorities & Allocations System rating.

Commercially available off-the-shelf (COTS) items are a subset of commercial items, albeit a *large* subset. COTS items are defined to be supplies, other than bulk cargo, that:

- Meet the definition of a *commercial item*,
- Are sold in substantial quantities in the commercial marketplace, and

- Are offered to the government without modification.

The distinction between commercial items and COTS items is important because in addition to the limited *FAR* clauses required for commercial items, COTS items are exempt from the component test associated with the Buy American statute<sup>9</sup> and the requirements for a certification and estimate of the percentage of recovered material. Also, per *FAR* 12.505, COTS vendors do not need a human trafficking compliance plan and certification, as would normally be required by *FAR* 52.222-50.

## SUBCONTRACT TYPE

Per *FAR* 12.207, commercial contracts should be firm-fixed-price or fixed price with an economic price adjustment. Cost-reimbursement contracts are not allowed to be used for the acquisition of commercial items. Time and material (T&M) contracts may only be used if it can be shown that no other contract type is suitable. Though this language is addressed to contracting officers, it appears equally applicable to commercial purchases made by contractors. Contractors who maintain an adequate purchasing system already should require a similar statement in the file prior to awarding any T&M subcontract, so this shouldn't be a particularly burdensome requirement.<sup>10</sup>

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## FILE DOCUMENTATION

Each file for a subcontract exceeding the simplified acquisition threshold should document that the required market research was conducted. Documenting the market research not only supports the commerciality decision for that particular item or purchase, but it also “saves” the market research for reuse on future procurements. Though the FAR does not require a specific format for documenting market research, a best practice is to develop a “Summary of Market Research” form to be used to both guide the nature of the market research required and ensure it is documented.

To the extent the market research indicated a commercial item was available, the commercial item determination also needs to be documented. Most contractors—and contracting officers for that matter—use some form of a commercial item checklist modeled after the FAR definition of a *commercial item*. The typical checklist lists the various FAR commercial item definitions followed by a “Yes” or “No” block. For questions answered “Yes,” the checklist prompts the buyer/subcontract administrator to provide the supporting documentation.

## WRITTEN POLICY AND PROCEDURE

Compliance with virtually every government contracting requirement requires a written policy and procedure, and commercial purchasing is no exception. At a minimum, a commercial purchasing policy should include:

- The contractor’s commitment to purchase commercial items to the maximum extent practicable,
- Pertinent definitions,
- The requirement to conduct market research,
- A reference to the required FAR flow-down clauses for commercial purchases,
- The requirement to prepare commercial item determinations to support the commercial purchase,
- The requirement to flow down FAR 52.244-6, and
- File documentation requirements.

## CONTRACTOR PURCHASING SYSTEM REVIEWS (CPSRS)

One of the reasons for the government’s relatively slow adoption of commercial purchasing is that most government procurement officials do not have commercial purchasing expertise or even experience. The lack of government commercial purchasing expertise, at least for CPSRs, has recently been addressed by Defense Contract Management Agency, which has formed a Commercial Items Group (CIG) that now participates in CPSRs. Members of the CIG have received special training on the commercial purchasing requirements imposed on contractors.

During a CPSR, the CIG group will be focused on whether the contractor has procured commercial items to the maximum extent practicable. Specifically, the CIG will:

- Review the contractor’s commercial purchasing policy and procedure,
- Examine purchases exceeding the simplified acquisition threshold to see if the required market research was conducted and whether the commercial item determination was correctly made, and
- Determine if the commercial price was adequately supported.

## CONCLUSION

Contractors interested in maintaining a CPSR-compliant purchasing system should review their commercial purchasing policies for adequacy and ensure that market research is being conducted and documented for all purchases that exceed the simplified acquisition threshold. When the market research indicates commercial items are available, the purchasing file should contain the commercial item determination accompanied by the supporting data. Commercial prices need to be supported by competition or price analysis based on the market research. Commercial subcontracts also need to be reviewed to ensure the correct FAR clauses are being flowed down and unnecessary FAR clauses are removed.

Training in the requirements of commercial purchasing may be necessary. For contractors required or aspiring to maintain an adequate purchasing system, the days of merely paying lip service to purchasing commercial items or failing to formerly document the results of their market research are probably over. **CM**

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## ENDNOTES

1. This issue, which has received much attention in the media, may be resolved by DOD’s draft *Guidebook for Acquiring Commercial Items*, available at [www.acq.osd.mil/dpap/cpic/cp/docs/Version\\_2.1\\_Commercial\\_Item\\_Determination\\_Guidebook\\_Part\\_A\\_\(Final\\_Draft-24\\_Feb\\_2017\).pdf](http://www.acq.osd.mil/dpap/cpic/cp/docs/Version_2.1_Commercial_Item_Determination_Guidebook_Part_A_(Final_Draft-24_Feb_2017).pdf).
2. FAR 12.101(c).
3. FAR 52.244-6(b).
4. I.e., *Defense FAR Supplement (DFARS)* 252.242-7005, “Contractor Business Systems.”
5. FAR 2.101.
6. *Ibid.*
7. *Ibid.* (Please note, unlike commercial items, commercial services must have been sold in the commercial marketplace in substantial quantities. A *catalog price* means a price that is set forth in a catalog or price list that is maintained by the seller, available to the public, and includes prices that are currently being paid for the services by a significant number of buyers. A *market price* means a price that is established in the course of ordinary trade between buyers and sellers free to bargain and that can be substantiated through competition or from sources independent of the offerors.)
8. *Ibid.*
9. 41 USC 83, formerly the “Buy American Act” (BAA).
10. Please note, for commercial subcontracts, any costs billed through the “M” portion should be handled as described in FAR 52.212-4 Alt 1 or the application of indirect rates to other direct costs should be prohibited.

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