



ACQUISITION AND
TECHNOLOGY

THE UNDER SECRETARY OF DEFENSE

3010 DEFENSE PENTAGON
WASHINGTON, DC 20301-3010

JAN 5 2001

MEMORANDUM FOR SECRETARIES OF THE MILITARY DEPARTMENTS
DIRECTOR, DEFENSE CONTRACT MANAGEMENT AGENCY
DIRECTOR, DEFENSE LOGISTICS AGENCY

SUBJECT: Commercial Acquisitions

Defense acquisitions should emphasize performance-based requirements, include provisions that enable commercial practices, and encourage the participation of nontraditional commercial entities. The efforts of all members of the acquisition team are crucial to achieving increased use of commercial acquisitions, but the input of requirements personnel and program managers is particularly essential, since they impart knowledge of available technology to the team. To the maximum extent possible, commercial acquisitions should be conducted using Federal Acquisition Regulation (FAR) Part 12. The use of FAR Part 12 is designed to provide the Department of Defense (DoD) with greater access to commercial markets with increased competition, better prices, and new market entrants and/or technologies.

In March 1999, I directed the Deputy Under Secretary of Defense (Acquisition Reform) (DUSD (AR)) and the Director of Defense Procurement to charter an Integrated Process Team (IPT) to review DoD commercial item determinations and evaluate whether additional guidance, tools, or training were necessary. The IPT found that, while some progress has been made, many obstacles to accessing commercial items remain. These obstacles include inconsistent commercial item determinations, weak market research, and confusion concerning pricing of commercial items. Additionally, lessons learned as to the applicability of FAR Part 12 determinations are not being shared across DoD buying offices. These factors unnecessarily increase workload and acquisition cycle time.

To help overcome these barriers to accessing commercial items, I am taking the following actions:

- ◆ Providing clarification on FAR Part 12 use to yield appropriate consistency across DoD;
- ◆ Establishing goals that DUSD(AR) will track to ensure the Department continues to make necessary progress;
- ◆ Requesting each Service and Defense Agency to provide me, within 90 days of the date of this memorandum, an implementation plan outlining its methodology to ensure we meet our commercial item acquisition goals; and
- ◆ Requesting that the IPT determine the feasibility of establishing a pilot program so that the Services and Agencies may collect market research and Commercial Item Determinations in a central database, or developing tools to assist in ensuring commercial item determinations are reasonably consistent. I request that the recommendation regarding this action be presented to DUSD (AR) within 90 days of the date of this memorandum.



The attachment provides some immediate clarification. In addition, DUSD (AR) and the components are developing a Commercial Item Handbook to provide further guidance on sound business strategies for acquiring commercial items. This guidebook is scheduled for release in February 2001.

To effectively provide our warfighters with the technological advantage to win future conflicts, we must uniformly look first to the commercial marketplace before developing new systems; upgrading legacy systems; or procuring spare parts and support services.

A handwritten signature in black ink, appearing to read "J. S. Gansler", with a long horizontal flourish extending to the right.

J. S. Gansler

Attachment:
As stated

CLARIFICATION OF FAR PART 12 FOR CONSISTENCY

In implementing the guidance of FAR Part 12, misinterpretations and/or inconsistent applications have occurred with regard to the following definitions and issues: commercial-off-the-shelf; modified commercial items; of a type; Government-off-the-shelf; market versus catalog price; requirements definition; conduct of market research; use of Commerce Business Daily (CBD) Note 26; and, sole-source situations. The following clarifications are offered to create consistency across the Department.

Commercial Off-the-Shelf (COTS): A product does not have to be commercial-off-the-shelf (COTS) to meet the "commercial item" definition. COTS items are a subset of commercial items. The commercial item definition is much broader than products that are presently available off-the-shelf. It includes items that have only been "offered" for sale, lease, or license to the general public, as well as those that have evolved from a commercial item and are offered for sale, even if not yet available in the commercial marketplace. However, evolved items must be available in the commercial marketplace in time to satisfy solicitation delivery requirements. In addition, all other elements of the commercial item definition at FAR 2.101 must also be met.

Modified Commercial Items: When items available in the commercial market cannot meet the Department's need, DoD must determine whether market items can be or have been modified so that FAR Part 12 can be used. Two types of modifications are available: (1) modifications of a type available in the commercial marketplace; and, (2) minor modifications of a type not customarily available in the commercial marketplace made to Federal Government requirements. For modifications of a type available in the commercial marketplace, the size or extent of modifications is unimportant. For minor modifications, the item must retain a predominance of nongovernmental functions or physical characteristics.

"Of a Type": The phrase "of a type" is not intended to allow the use of FAR Part 12 to acquire sole-source, military unique items that are not closely related to items already in the marketplace. Instead, "of a type" broadens the commercial item definition so that qualifying items do not have to be identical to those in the commercial marketplace. The best value offer in a competitive Part 12 solicitation can be an item that has previously satisfied the Government's need but has not been sold, leased, licensed, nor offered for sale, lease or license to the general public (a nondevelopmental item as defined in 10 USC 403 (13)). In this scenario, the phrase "of a type" allows the best value offer to qualify for a Part 12 contract as long as it is sufficiently like similar items that meet the government's requirement and are sold, leased, licensed, or offered for sale, lease or license to the general public. In such instances, "of a type" broadens the statutory commercial item definition to allow Part 12 acquisition of a government-unique item that can compete with commercial items that meet the government's requirement. This avoids the undesirable result of shutting out otherwise price-competitive preexisting suppliers of government-unique items from Part 12 solicitations.

Government Off-the-Shelf (GOTS): GOTS is a commonly used term for nondevelopmental items (NDI) (as defined in 10 USC 403 (13)) that are Government-unique items in use by a Federal Agency, a State or local government, or a foreign government with which the United States has a mutual defense cooperation agreement. The words "of a type" facilitate the acceptance of a best-value GOTS/NDI offer in response to a competitive FAR Part 12 solicitation when the offered GOTS/NDI items are sufficiently like similar items sold, leased, licensed, or offered for sale, lease or license to the general public.

Market Price versus Catalog Price for Services: The commercial item definition includes services of two general types: services in support of a commercial item; and, stand-alone services. In order to meet the commercial item definition, stand-alone services must be "based on established catalog or market prices." The price for the services must be based on either catalog prices or market prices.

"Catalog Prices" mean a price included in a catalog, price list, schedule, or other form that is regularly maintained by the manufacturer or vendor, is either published or otherwise available for inspection by customers, and states prices at which sales are currently, or were last, made to a significant number of buyers constituting the general public.

"Market Prices" mean current prices that are 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.

The established market price for stand-alone services does not have to be published or written. Market research enables the Government to collect data from independent sources in order to substantiate the market price.

Requirements Definition: It is imperative that all members of the acquisition team are cognizant of available or emerging technology and that requirement statements reflect any available commercial solutions. Requirements personnel and contracting officers should work together to ensure that commercial items can be -- and are -- used. Contracting officers need the input, guidance, and support of requirements personnel (e.g., adopting more open system architectures, identifying possible commercial components and technologies) to enable the use of commercial item acquisitions. The key to this process is robust market research.

Market Research: Market research -- and the teaming it relies upon -- must be an ongoing activity throughout an acquisition, in order to gather the robust data needed to make smart acquisition decisions. Market research is not limited to locating commercial items, although that is one purpose of its conduct. At a minimum, market research should be used to define requirements, locate commercial best practices, and assist in determining price reasonableness.

Full Use of CBD Note 26: If market research establishes that the Government's need cannot be met by a commercial item, FAR Part 12 shall not be used. For proposed contract actions that require publication in the Commerce Business Daily (CBD), the contracting officer must include a notice to prospective offerors that the Department does not intend to use FAR Part 12 for the acquisition. For the Defense Department, this notification is accomplished through use of CBD Numbered Note 26. The Department must make full use of CBD Numbered Note 26, which reads as follows:

Based upon market research, the Government is not using the policies contained in Part 12, Acquisition of Commercial Items, in its solicitation for the described supplies or services. However, interested persons may identify to the contracting officer their interest and capability to satisfy the Government's requirement with a commercial item within 15 days of this notice.

Sole-Source Situations: Contracting officers and requirements personnel should work together to avoid sole-source situations. Competition is enabled when needs are broadly stated

in terms of performance outcomes. However, a sole-source situation may be unavoidable, presenting pricing challenges. Tools and techniques are available for assisting in the price reasonableness determination for sole-source commercial item procurements. Sometimes, sole-source suppliers may attempt to exploit the lack of competitive markets and demand unreasonable prices. In such circumstances, the team should consider revising negotiation strategies to consider innovative solutions (e.g., strategic supplier alliances); buying the bare minimum quantities and working to restate the need to expand possible solutions and qualify alternate suppliers; and ultimately upgrading systems to current, commercial technology. In some cases, it may be necessary to escalate negotiations. The first escalation should be to the Procurement Executive, then, if necessary, to the Head of the Agency.

ESTABLISHMENT OF COMMERCIAL ITEM ACQUISITION GOALS

Commercial item acquisition using FAR Part 12 procedures is designed to provide greater access to commercial markets. Benefits include increased competition; use of market and catalog prices; and, access to leading edge technology and "non-traditional" business segments. The Road Ahead published on 2 June 2000 by USD (AT&L) established as a goal "an accelerated rate of increase in the dollar value of FAR Part 12 acquisitions with primes". The baseline for this goal is \$12.6 billion in FY 1999. Therefore, goals for Part 12 acquisitions are established for the components as follows:

1. Each Service and Defense Agency should double the dollar value of FAR Part 12 contract actions awarded in 1999 by the end of fiscal year (FY) 2005. This would bring the DoD total FAR Part 12 contract actions from \$12.6 billion to \$25.2 billion.*
2. Each Service and Defense Agency should strive to increase the number of FAR Part 12 contract actions awarded to 50 percent of all Government contract actions awarded by the end of FY 2005.*

(*For purposes of these goals, a contract action is defined as any new contract award and/or new delivery order placed against a contract awarded with a value greater than \$25,000.)

While it is important to emphasize use of Part 12 acquisitions where appropriate, it is also important to balance these goals with the objectives to increase competition, achieve access to leading edge technologies and non-defense business segments. Therefore, in evaluating each of the goals established above, each Service and Defense Agency, together with DUSD (AR) should ensure that these objectives are not achieved at the expense of the use of product support requirements, use of strategic alliances, consolidated support service contracts or multiple award type contracts. These overlapping objectives may, unavoidably, create challenges for the components. These issues should be addressed in the implementation plans due to DUSD (AR) within 90 days. Specific activities, such as the Defense Logistics Agency, may also need to establish goals above these thresholds, depending on the nature of their business.

Commercial Policy Coordination

Clarification of Commercial Item Policy

COTs – General Counsel recommended adding a sentence to the end of the paragraph, which was accepted.

Of a Type – The Inspector General strongly recommended that the “of a type” characterization be clarified. General Counsel wrote the clarification provided in this memorandum.

Modified Commercial Items – There was universal concern from all parties regarding the statement “For minor modifications of a type not customarily available, the modifications generally should not alter the nongovernmental function or essential physical characteristics by more than 50 percent.” This clarification has been removed from the memorandum. Additionally, as recommended by the Air Force, the handbook will stress the importance of adequately documenting the logic leading up to these determinations.

Market Price vs Catalog Price – Both DCAA and the IG expressed concern regarding the use of the phrase “through competition” used in the market price definition. While this policy memorandum was being processed, the Federal Acquisition Council published a proposed case 2000-303 containing the proposed definitions used in this policy memorandum. That case is now pending publication as a final rule. This policy is consistent with that final rule, notwithstanding the DCAA and IG concerns.

Market Research – DLA wants to add the term “appropriate to the circumstances” to the discussion of market research. Generally that’s good, but in this case it enables DLA personnel to do the absolute minimum, like checking who we bought it from last time, and still be in compliance. We will address this issue instead, in the commercial handbook.

Goals

The draft policy memorandum circulated, used the metrics established in *The Road Ahead* approved by the USD (AT&L) in June 2000. Each service expressed concern regarding the metrics:

Air Force & Army – Supported using number of actions as a goal but not dollars. AF recommended changing the title to emphasize goals.

Navy – Characterized the goals as arbitrary and capricious, stating that they could not be met, recommending as an alternative very conservative goals.

DLA – Recommended changing the approach to recognize that the goals need to be tailored to the business base of the activity. DLA already meets and exceeds the stated goals.

Defense Procurement – Recommended conducting an analysis of progress to date with Part 12 acquisition, before projecting further goals.

DCMA – Recommended a two stage approach: 1) asking the services for implementation plans 2) tailored to the activity.

IG – Noted that the measurement of only actions and dollars (i.e. volume) did not recognize that this policy area is complex and must balance the need to consolidate acquisitions (e.g. strategic alliances, product support pilot programs, or consolidated support service requirements) with the need to attract non-defense companies, and sustain competition.

Resolution - DUSD (AR) does not fundamentally disagree with the IG or component concerns, however, it is essential that stretch goals be established for the department regarding Part 12 acquisitions to ensure leadership involvement and to raise awareness. DCMA's recommendation is a sound one, as is the IG approach, which when combined leads to a policy that modifies the goals slightly, still ensures the goals will raise awareness but requires the development of an implementation plan regarding Part 12 acquisition. It also clarifies that component progress will be measured at the service level, thereby allowing for potential variation within that component. This approach also allows DLA to promote their tailored plan.

Commercial Item Determinations Database

DLA – Recommended that DUSD (AR) fund the development of an on-line decision resource tool for the acquisition workforce instead of a database.

AF/Navy/Army – While generally in support of this approach during the circulation of this policy in draft, each has now expressed concerns regarding the resources involved in supporting the database, even the pilot effort.

Defense Procurement – Expressed concern regarding the resources involved and stated that this information should not be intended to provide justification on future determinations.

Resolution – Clearly, we do not yet have resolution on this issue. The memo has been modified to keep the IPT in place and to review whether to develop tools or the data base, within two months, reporting to DUSD (AR) and DP as to how to proceed further.

Sole Source Pricing Trends

Despite the fact that the IG has been a member of the working group that developed this policy clarification, they chose to wait until coordinating on this policy to indicate that the primary issue requiring clarification was sole source pricing trends. The working group did not identify this issue specifically. In their second written non-concurrence,

they stated that an escalation sequence needed to be established that included OSD intervention for pricing issues.

Resolution – DUSD (AR) has specifically added language to address the IG's concerns, however recommends that the escalation process should be contained within the services/components. Specifically, The first escalation should be to the Procurement Executive, then, if necessary, to the Head of the Agency. This position was coordinated with the Section 803 pricing working group, chaired by Defense Procurement.

Unified Management

IG - Despite the fact that the IG has been a member of the working group that developed this policy clarification, they chose to wait until coordinating on this policy to remind DUSD (AR) that, in their opinion, Section 803 (d) of the 1999 Authorization Act had not been implemented. The working group did not identify this issue specifically.

Resolution – DUSD (AR) does not think this policy memorandum is the appropriate forum to resolve this issue.

Emphasis on Program Managers

IG - Requested that the role of the Program manager be emphasized. The tone of the memo has been strengthened to address their concerns.

Air Force Plan of Action: FAR Part 12 Increased Usage Goals

PURPOSE: Ms. Lee intends to ask Service reps at the 13 February Interdepartmental Staff Meeting (IDS) to share their "plans and thoughts" regarding USD(AT&L)'s 5 January letter (and the included goals).

DISCUSSION:

- Air Force fully supports maximum use of commercial practices, commercial products and actively encourages participation of non-traditional defense firms.
- OSD goals as called out in letter are at best "ambitious;" at worst do not measure effectiveness of commercial practices against stated goals
- Goal 1: **double dollar** value of FAR Part 12 actions awarded in 1999 by end of FY 2005.
 - Our earlier comments did not advocate this as a metric or goal; doesn't allow each MAJCOM to tailor commercial practices to its particular mix of warfighter requirements.
 - 85 percent of Air Force dollars are at AFMC; less than 9 percent of their FY00 dollars were FAR Part 12
 - Current FAR Part 12 dollars run between 7 and 10 percent of all dollars
 - Air Force 1999 Part 12 dollar value: \$3B; OSD's Goal: \$6B by 2005
 - Concerns:
 - dollars can be inconsistent; a single large FAR Part 12 contract award can skew the stats in a given year
 - AFMC FAR Part 12 dollars are mostly at subcontract level; need visibility into prime's subs and dollars
 - Need a better idea of where new administration plans to put defense dollars to pull together a good plan for five years out
- Goal 2: "strive" to **increase number of FAR Part 12 actions to 50 percent** of all actions by end of FY 2005
 - Air Force FAR Part 12 actions ran from 15 to 18 percent over past four years
 - Our comments to draft letter: set goal to increase actions by 50 percent over FY00
 - FY00 = 18 percent; proposed FY05 = 27 percent
 - We think Air Force can achieve a FAR Part 12 usage of 30 percent of all actions
 - Concerns expressed at October's Worldwide
 - May have peaked at 18 percent
 - Need to be able to consider construction contracts to be commercial
 - Need expanded use of time & materials line items (or cost reimbursement)
 - Especially important for services efforts

-- 47 percent of FY00 Air Force dollars went to Services (52 percent in FY99)

PROPOSED PLAN:

- Work with MAJCOM and Center Competition/Commercial Advocates
 - Hold Competition/Commercial Advocate conference to build buy-in
 - Develop process to analyze data and target opportunities for increased use
- Tailor targeting to each MAJCOM's unique blend of warfighter requirements
 - Systematically peel back the Federal Stock Code onion for each MAJCOM
 - What does each MAJCOM buy?
 - Where do they have FAR Part 12 volume?
 - What prevents them from increasing FAR Part 12 use in high volume FSCs?
 - Develop a consistent process for monitoring and addressing trends
 - Develop a web-based data mining tool to allow for consistent continuous monitoring and improvements
- Build visibility by including FAR Part 12 activity in annual competition/commercial plan and goals
 - Reported FY00 data in this year's plan
 - Add to Air Force Instruction re-write
- Establish a process for reviewing DD350 data inputs to ensure accuracy and consistency.
 - Appoint and train commercial reporting monitors where appropriate
- Consider developing into a Lightning Bolt

OTHER:

- 5 January letter includes an "explanation" of "of a type" written by OSD General Counsel and not coordinated with Agencies or Services.
 - May be some discussion on this
 - States: "Of a type" broadens the statutory commercial item definition to allow Part 12 acquisition of a government-unique item that can compete with commercial items that meet the government's requirement."
- Explore development of commercial item determinations database
 - Nonconcurrent in our comments to draft
 - not budgeted for development, deployment or training
 - Concerns about availability of database information (recommend password protect or .mil domain access only)

RECOMMENDATION: None. For information and IDS discussion.