



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:

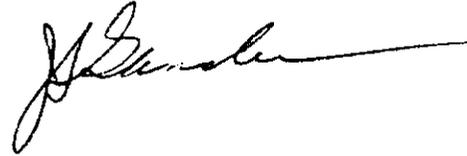
- ◆ Providing clarification on FAR Part 12 use to yield appropriate consistency across DoD;
- ◆ Establishing goals that DUSD(AR) will track to ensure the Department continues to make necessary progress;
- ◆ Requesting each Service and Defense Agency to provide me, within 90 days of the date of this memorandum, 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.

April ?



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 is 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.