

## DoD Revises Procurement Policy to More Closely Scrutinize Commercial Prices

**Introduction:** On June 8, 2007, the Department of Defense (“DoD”) Director of Procurement and Acquisition Policy, Shay Assad, issued a memorandum transmitting May 31, 2007 Procedures, Guidance and Instructions (“PGI”) 215.4, “Contract Pricing.” PGI 215.4, as revised, provides guidance for determining fair and reasonable contract pricing for DoD contracts, including contracts for commercial items. The memo and attached procedures signal an increased emphasis on the need to obtain adequate data to support a determination of price reasonableness, even for commercial items.

This update summarizes DoD's revised PGI 215.4, discusses the practical implications of this revised PGI, and offers some practitioners' tips to help navigate DoD's increasingly stringent policies on price reasonableness.

**Background:** As part of efforts to boost the extent to which the Federal government took advantage of the highly-efficient American commercial marketplace, Congress passed the Federal Acquisition Streamlining Act of 1994 (“FASA”). FASA expressed the government's preference for commercial items by establishing federal procurement policies that mirrored practices used by purchasing entities in the commercial marketplace, such as:

- In procurements of commercial items, the Cost Accounting Standards do not apply to certain fixed-price contracts. See FAR 12.214.
- Commercial items are exempt from the requirement for certified cost or pricing data in noncompetitive procurements. See FAR 15.403-1.
- Despite being required to make determinations of price reasonableness, contracting officers are directed to be cognizant of customary commercial terms and conditions in the pricing of commercial items. See FAR 12.209.

Some agencies, however, took an expansive view of what might qualify as a commercial item and did not necessarily obtain data to support price reasonableness, even when the commercial item included significant modifications to the product sold in the commercial marketplace. In an apparent attempt to guard against misuse of the exceptions for commercial items, PGI 215.4 scales back some of the market flexibility available under FASA and its implementing regulations in favor of ensuring an audit trail of the contracting officer's determination of price reasonableness. PGI 215.4 establishes policies and procedures that more stringently analyze contractors' commercial item pricing.



## Summary of the Revised PGI:

- Commercial Item Pricing Analysis – PGI 215.402 states that, in instances where the Truth in Negotiations Act does not require offerors to submit certified cost or pricing data (e.g. procurement of commercial items), FAR 15.402 requires offerors to provide sufficient information to allow a contracting officer to determine the reasonableness of prices.
  - PGI 215.403-1(c)(3)(A) states that, when pricing a commercial item, prior non-government sales data must be obtained in most instances.
  - "Available commercial sales, published catalogs or prices, etc., can sometimes be obtained through market research" and may also provide the basis for a determination of reasonableness. PGI 215.404-1(b)(i).
  - When providing a contracting officer with previous sale prices for the same or similar items or services, the offeror's data must reflect prices for comparable quantities, capabilities and specifications.
  - Significantly, the contracting officer is required to take "[s]ufficient steps ... to verify the integrity of [such] sales data, *to include assistance from the Defense Contract Management Agency ["DCMA"], the Defense Contract Audit Agency ["DCAA"], and/or other agencies if required.*" PGI 215.403-3(1) (emphasis added).
  - Where such prior sales data is insufficient to make a determination of price reasonableness, the contracting officer will need to obtain additional information. PGI 215.404-1(b)(v); PGI 215.403-1(b).
- Cost Analysis In Lieu of Pricing Analysis – Where, however, a price analysis cannot be performed due to lack of sufficient information, a cost analysis is required. In such an instance, cost data may be provided in whatever format the offeror normally keeps it. PGI 215.404-1(c)(iii). The contracting officer is required to consider the need for support from DCMA, DCAA and possibly other agencies.
- Relying on Prior Prices Paid by the Government – Contracting officers often rely on other prices previously paid by the government for the same or similar items to support their findings of price reasonableness.
  - PGI 215.403-3(4) requires contracting officers to verify and document that prior prices paid by the government were paid with sufficient analysis to determine the reasonableness of the prices. In addition, the prices previously paid must have been paid for similar quantities of the item or services.
  - To comply with these requirements, Contracting officers must, at a minimum, conduct and document discussions with the contracting agencies that previously purchased the items. See also PGI 215.404-1(b)(iii)(A).

- Sole Source Procurements – DoD's revised PGI places great emphasis on the steps required in determining price reasonableness in sole source procurements of commercial items. PGI 215.402 states that obtaining reliable cost or pricing data is especially important in the context of sole source procurements of commercial items.
  - "When purchasing sole source commercial items, the contracting officer must request non-Government sales data for quantities comparable to those in the solicitation." PGI 215.404-1(b)(iii)(B); PGI 215.402(3).
  - Where prior sales data is insufficient to determine price reasonableness, the contracting officer is required to obtain information other than cost or pricing data, and may perform a cost analysis, if necessary. PGI 215.404-1(b)(iii)(B).
  - Essentially, the offeror will be required to submit "whatever cost information is needed to determine price reasonableness." PGI 215.404-1(b)(ii).

**Practical Implications and Practitioners' Tips:** DoD's revised PGI signals a shift away from reliance on the protections inherent in the commercial marketplace and towards reliance on the verification of pricing. While "[t]he request for additional information shall be limited to only that needed to determine prices to be fair and reasonable," the policies and procedures outlined in DoD's revised PGI place an increased burden on the contracting officer to obtain additional data, even for items that are clearly commercial. DoD's requirements provide for little of the simplification and streamlining the procurement community has come to expect from commercial item procurement. Contractors should anticipate increased requests for cost information "other than cost or pricing data" to support their prices on modifications.

To ensure that their proposed prices stand up to DoD scrutiny, contractors may implement and/or strengthen the following practices:

- Maintain records of the prices at which commercial items are sold to governmental or non-governmental customers. If a contractor is unable to provide such information, PGI 215.402(3) requires the contracting officer to obtain cost data.
- Maintain detailed records of any prior government determination finding your prices to be reasonable. Being able to help the contracting officer in establishing the thoroughness of such prior determination can save you headaches and enhance your firm's reputation in the eyes of your contracting officer.
- Vigorously resist attempts by agencies to require certified cost or pricing data where exceptions, such the one for commercial items, exist. PGI 215.4 does not eliminate the commercial item exception to the requirement to supply certified cost or pricing data.
- Contractors who perform a significant amount of work for the government may want to ensure that their accounting systems adequately capture the costs that the government is likely to want to examine.



**For further information please contact:**  
**Rebecca Pearson at (202) 344-8183 – [repearson@venable.com](mailto:repearson@venable.com),**  
**Jackson Reams at (202) 344-4080 – [jtreams@venable.com](mailto:jtreams@venable.com),**  
**or any of the other attorneys in Venable's Government Contracts Groups**  
**575 7<sup>th</sup> Street, NW, Washington, DC 20004-1601**  
**[www.Venable.com](http://www.Venable.com) ~ 1.888.VENABLE**

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