Recommendation 1: Revise definitions related to commercial buying to simplify their application and eliminate inconsistency.

Problem

The FAR's commercial buying terms are confusing, poorly defined, or undefined altogether. The term *commercial item* is overly broad, encompassing both commercial products and commercial services. The terms *commercial item* and *commercially available off-the-shelf item* appear in the U.S. Code in numerous sections, but do not incorporate the same universal definition; in some instances, the terms are defined differently, and in other instances they lack any definition at all. Subcontracting, which is subject to dozens of unique definitions for the terms *subcontract* and *subcontractor*, reflects similar disharmony. The inconsistency among commercial definitions generates confusion and creates risk that contracting officers may fail to apply commercial practices uniformly.

Background

Commercial buying represents an important component of the DoD acquisition process. For more than 2 decades, Congress and DoD have sought to encourage use of commercial buying by easing the statutory, regulatory, and procedural framework for buying commercial goods and services, as well as broadening the scope of goods and services that are eligible for revised commercial buying policies. The Section 800 Panel recognized the potential of commercial buying and recommended a number of changes in law to facilitate its acceptance. Included within its preference for buying commercial items, the Section 800 Panel recommended a definition for commercial item.[1] The Section 800 Panel's efforts contributed to passage of the 1994 FASA in which Congress took a number of important steps to enhance the federal government's access to the broader commercial market. These steps included exempting qualifying items procured at the prime or subcontract level from various statutes, policies, and contracting requirements unique to the federal procurement process. For this reason, the matter of the definitions that serve as the criteria for determining if an item qualifies is critically important. Two years after FASA was signed into law, Congress passed the 1996 FARA, which furthered the preference for buying commercial items by creating a definition for COTS items.[2]

Notwithstanding these efforts to promulgate a wide-ranging commercial buying policy, DoD's acquisition workforce has struggled to consistently interpret and apply the policy.[3] Confusion over how to identify eligible commercial products and services has subjected DoD contracting officers to increased criticism and oversight.[4] It has also sparked frequent legislative and regulatory revisions in an effort to improve the policies and tools available to buy commercially.[5]

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[1] Acquisition Law Advisory Panel to the United States Congress, *Streamlining Defense Acquisition Laws*, accessed June 6, 2017, http://www.dtic.mil/docs/citations/ADA262699.
[2] FY 1996 NDAA, Pub. L. No. 104–106, 110 Stat. 186 (1996).
[3] USD(AT&L), *Guidance on Commercial Item Determinations and the Determination of Price Reasonableness for Commercial Items*, accessed June 6, 2017, http://www.acq.osd.mil/dpap/policy/policyvault/USA003554-16-DPAP.pdf.
[4] DoDIG, *Procuring Noncompetitive Spare Parts Through an Exclusive Distributor*, June 6, 2017, http://www.dodig.mil/audit/reports/fy08/08-048.pdf. GAO, *Contract Management: DOD Vulnerabilities to Contracting Fraud, Waste, and Abuse*, accessed June 6, 2017, http://www.gao.gov/new.items/d06838r.pdf.
[5] USD(AT&L), *Guidance on Commercial Item Determinations and the Determination of Price Reasonableness for Commercial Items*, June 6, 2017, http://www.acq.osd.mil/dpap/policy/policyvault/USA003554-16-DPAP.pdf.

Findings

The Section 809 Panel identified a number of problems regarding definitions used in the procurement of commercial items.

Definition of Commercial Item

Congress gave DoD the widest possible access to the commercial marketplace by including in the definition the phrase *of a type*, which provides DoD the flexibility needed to take full advantage of the vibrant and constantly changing commercial marketplace. Many challenges have been raised regarding portions of the definition intended to allow the federal government to acquire items that are of a type sold in the commercial marketplace or that have *minor* modifications to satisfy a government-unique requirement. The same is true for items that are newly *offered for sale*, allowing the government the opportunity to be among the first to procure these state-of-the-art products. Both government and industry have, in recent years, established a better understanding of the application of the definition. Issues typically arise regarding facts of a particular acquisition, not as a result of a serious deficiency in the statutory definitions. Tinkering with the definition to address unique, fact-specific examples would not give DoD the broadest reasonable definition for accessing the commercial marketplace.

The definition of a commercial item encompasses both commercial products and commercial services. Defining an item as meaning either a product or service is confusing. The term *item* is not generally thought to include a *service*. For example, a standard dictionary definition for item is individual article or unit; 41 U.S.C. § 108, Item and Item of Supply, defines an item as "an individual part, component, subassembly, or subsystem integral to a major system;" and FAR 2.101, Definitions, defines a *common item* as a "material that is common to the applicable government contract and the contractor's other work."[6] To illustrate the confusion caused by the existing definition, a service can be a commercial item offered in support of a product that is also a commercial item. Furthermore, a COTS item is a subset of a commercial item, but the definition of a COTS item only includes products and does not include services.[7]

Commercial Services

Commercial services have become substantially more important in the 24 years since their inclusion in FASA. DoD obligated more than $23 billion for commercial services in FY 2017, which was 18 percent of all service obligations.[8] The important statutory language addressing commercial services lies buried within several subparagraphs of the definition of a commercial item. This aspect of the definition may lead to confusion over the distinction between services offered directly in support of a commercial item, and services unrelated to a specific commercial item, but of a type offered in the commercial marketplace.

Defining a commercial item in a way that includes both commercial products and commercial services does not reflect the significant roles services and commercial services play today in the DoD

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[6] Item and Item of Supply, 41 U.S.C. §108. Definitions, FAR 2.101.
[7] Commercially Available Off-the-Shelf Item, 41 U.S.C. §104.
[8] FPDS Data, accessed January 7, 2017.

procurement budget. Carefully bifurcating the existing definition into commercial products and *commercial services* would better serve DoD.

Addressing Commercial Processes

The existing definition of a commercial item does not properly consider the output of *commercial processes* because it fails to encompass products that are manufactured to federal government specifications or drawings by manufacturers that customarily manufacture to customer specifications and drawings (such as paint, castings, mounting components on circuit cards using their standard commercial processes).

The Section 800 Panel originally made the recommendation with the intention of providing the federal government access to this important element of the commercial marketplace.[9] The Section 800 Panel recommendation to allow DoD to access commercial processes, in addition to commercial products and services, continues to make sense and would benefit DoD today. For DoD to have broader access to the commercial marketplace and further the objective of greater integration of the commercial and defense industrial bases, it is important to expand the definition of a commercial item to include not only commercial products but also certain commercial processes.

Unintended Consequences of the Definition of COTS

In 1996, with the definition of commercial item less than 2 years old, Congress created a new definition for COTS item.[10] COTS items are a much narrower subset of the broader universe of commercial products.[11] The intent was to provide additional opportunities for the government to buy from the commercial market by providing for additional statutory exemptions for commercial items that satisfied the much narrower COTS definition. FAR 12.505, Applicability of Certain Laws for the Acquisition of COTS Items, and DFARS 212.570, Applicability of Certain Laws to Contracts and Subcontracts for the Acquisition of Commercially-Available Off-the-Shelf Items, were established to identify statutes that were inapplicable or modified in some fashion to further simplify the acquisition of COTS.

The definition of COTS has provided little additional opportunity for procuring commercial products, and may have unintended consequences of limiting the acceptance of the broader definition of commercial products.

Commercial products are defined, generally, as items of a type that have been sold, leased, or licensed—or offered for sale, lease, or license— to the general public. An item that is not yet available in the market, but evolved from one that is, may also be procured as a *commercial item*. By contrast, a COTS item must be sold in substantial quantities in the marketplace, a throwback to the pre-FASA days of the substantial sales-based commercial item TINA exception.

A product may be considered commercial if it includes a customary modification or a unique modification specifically to meet a federal government requirement, as long as that unique

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[9] Section 800 Panel Report, section 8.3.1.6.
[10] Clinger-Cohen Act of 1996, section 4203 (FY 1996 NDAA, Pub. L. No. 104-106).
[11] Commercially Available Off-the-Shelf Item, 41 U.S.C. §104. The term *COTS* does not apply to commercial services.

modification is *minor*. By contrast, a COTS item must be procured by the government *without modification* and in the same form as is sold in the commercial marketplace.

The combination of the requirement for COTS products to have sales in *substantial quantities* and be without modification substantially limits DoD's ability to leverage the commercial market, especially for new or state-of-the-art products. For example, if a commercial company offered for sale a new, substantially improved version of an existing server, DoD would need to wait until the server was sold in substantial quantities to be able to procure the product using the additional COTS exemption.

As of January 2018, there are 18 statutes and associated FAR or DFARS clauses that are either exempt or modified with regard to their applicability to COTS products (see Appendix F, Table F-1). Of those 18, five exemptions/modifications are established in statute, 11 result from a determination by the FAR Council or Office of Federal Procurement Policy (OFPP), and two result from a determination by DoD. Only six of these 18 exemptions/modifications are identified in FAR 12.503 or DFARS 212.570.

Although these additional COTS exemptions appear helpful on the surface, they may, in fact have created two distinct classes of commercial products: the broad, inclusive commercial product, and the very narrow COTS product.

The effect of creating these two classes is that much of the streamlining Congress intended for commercial products is being more narrowly applied to COTS items. For example, FAR 52.222-50, Combating Trafficking in Persons, paragraph (h), requires contractors that offer supplies other than COTS to prepare and maintain a compliance plan. It is unclear why a contractor selling supplies that meet the narrow definition of a COTS product should be exempt from the requirement to prepare and maintain a compliance plan, yet a contractor selling similar supplies that differ only in that they are not sold in substantial quantities, should not also be exempt.

Granting relief to contractors selling COTS items, but not those selling the broader commercial products and commercial services, serves as an obstacle to the government's stated goal of attracting the best and the brightest to the government marketplace to solve its most difficult problems. If DoD is seeking a high-tech, cutting-edge solution, that solution will likely not satisfy the **sold in substantial quantities** and **without modification** criteria of the COTS definition. Rather, it is more likely to be *new and innovative* and, therefore, **sold in less-than-substantial quantities**; *offered, but not yet sold*; or *entirely new technologies* that evolved from existing products, all of which fall under the definition of commercial products.

It is time for Congress and DoD to fully accept and embrace the commercial product and commercial services definitions and use them with all the flexibility FASA intended. DoD needs greater access to the full breadth of the commercial market place, and especially the cutting edge of that marketplace. Relieving the burden of government-unique requirements is an important step DoD must take to make that happen, but relieving the burden on only the vary narrow universe of COTS products will not produce the desired result. Progress will only be made when real relief exists across the full spectrum of commercial products and commercial services.

Unique Statutory Definitions of Commercial Items

Congress codified the definition of a *commercial item* at 41 U.S.C § 103. This definition is used when determining whether an item qualifies for certain exemptions provided by Congress. To achieve the maximum benefit and avoid confusion, it is essential that the definitions be clear, well understood, and consistent. The Section 809 Panel analysis of 10 U.S.C. and 41 U.S.C. identified 40 distinct definitions of *commercial item*. Although the majority of these references point to the primary definitions at 41 U.S.C. § 103, many others do not, providing their own unique definitions, or none at all.

The definition from 41 U.S.C. § 103 is used for 34 of the 40 distinct citations for commercial items. Six terms in Title 10 do not incorporate the primary definitions by reference, whether due to the use of alternative definitions or through the absence of definitions entirely. Six instances of the term commercial item lacked a definition in accord with Title 41(see Appendix F, Table F-2). Four of the terms lacked any definition; a fifth term referred to a definition of commercial items later in its own section; and a sixth term referred only to the commercial acquisition procedures of FAR Part 12.

There does not appear to be any stated rationale for the differing definitions in the case of these six citations. The Section 809 Panel reviewed the legislative histories of each provision, but found no justification for omitting the primary definitions of Title 41.[12] The underlying statutes themselves also did not explain the lack of definitions, or the existence of separate definitions.

Harmonizing the Use of Terms in Statute

Commercial buying processes would benefit from harmonizing all U.S.C. references to commercial products and commercial services—including 41 U.S.C., 10 U.S.C., and other miscellaneous uses of the terms in other titles of the U.S.C.—with the primary definitions of those terms in Title 41. The Section 809 Panel identified more than 75 uses of the term commercial item in statute. Every use of the terms commercial product and commercial service in the U.S.C. should incorporate, by reference, the primary definitions of those terms at 41 U.S.C. §§ 103, 103a and 104, respectively.

An exception to this general perspective that requires further elaboration is the commercial item definition at Core Logistics Capabilities, 10 U.S.C. § 2464(a)(3). This unique definition of commercial item was crafted in 1998.

10 U.S.C. §2464 (a)(5), Core Logistics Support states,

> *(5) The commercial items covered by paragraph (3) are commercial items that have been sold or leased in substantial quantities to the general public and are purchased without modification in the same form that they are sold in the commercial marketplace, or with minor modifications to meet Federal Government requirements.*

It consists of portions of the definitions of a COTS item (41 U.S.C. § 104) and a commercial item (41 U.S.C. § 103). This unique definition likely represented the early thinking and concerns about how

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[12] Based on Section 809 Panel analysis.

the relatively new definition (1995) of commercial item at 41 U.S.C. § 103 might be implemented and the effect it may have on weapon systems, subsystems, and components.

The definition states that the covered items addressed in 10 U.S.C. § 2464 are commercial items (a term that is defined in 10 U.S.C. § 2302 and 41 U.S.C. § 103), but then continues by carving out portions of the commercial item definition as well as portions of the definition of a COTS item (also defined at 10 U.S.C. 2302 and 41 U.S.C. § 104). The 10 U.S.C. § 2464 definition of commercial item does not include items of a type, items offered for sale, items that *evolved from commercial items*, and items that are not yet available in the commercial marketplace but will be available in time to meet the federal government delivery requirement. These are all important elements of the commercial item definition Congress created to give the federal government the opportunity to procure items that are state-of-the-art but may not otherwise be available to them under a COTS sold in substantial quantities criteria. The 10 U.S.C. § 2464 definition allows for minor modifications unique to the federal government, but does not include modifications to commercial items that are *customarily available in the commercial marketplace*. The 10 U.S.C. § 2464 definition appears to reflect the early concerns that contracting officers would take a very liberal approach to the definition, procuring many items as commercial, to the point that it would potentially undermine the depot role in weapon system readiness by tying support of such items to industry.

The potential concerns expressed above were prevalent in the late 1990s, but over time, they have generally proven unfounded. The distinction between commercial and noncommercial items has remained firm, particularly in regard to the kinds of items that would likely be maintained in a depot. Contracting officers have been careful to understand the commercial marketplace for an item and the extent of minor modifications necessary to meet the federal government requirements before making a determination that an item is a commercial item. Contracting officers have also been careful to consider the realities of the commercial marketplace (most notably concerning technical data) and to address the data already available to other customers in the commercial marketplace, as well as data necessary for the minor modifications.

The unique definition of a commercial item at 10 U.S.C. § 2464 presents a potential practical problem for the DoD acquisition and logistics support workforce. As noted above, at the time an item is being considered for procurement as a commercial item, the contracting officer considers all the available information and, based on the definition at 41 U.S.C. § 103 (commercial item) or § 104 (COTS item), determines if the item satisfies the appropriate definition and may be procured using the unique FAR policies and procedures for commercial items and COTS items. Later, when that same item is being considered for logistics support, the logistics community makes another determination of the item's *commerciality* using the unique definition at 10 U.S.C. § 2464.

These two separate determinations, using two distinct definitions of *commercial item*, create considerable conflict, and ignore the reality that the decisions made at the time of initial procurement, including decisions with regard to the procurement of technical data, make later decisions using different criteria difficult, if not impractical. This situation is especially relevant when an item originally procured and planned for support as a commercial product or COTS product under 41 U.S.C. §§ 103 or 104, later is determined by the logistics support team not to meet the 10 U.S.C. § 2464 definition, but lacks the data necessary for depot-based support. The logistics support

community should participate at the time the initial determination of *commerciality* is made by the contracting officer using the definition at 41 U.S.C. §§ 103 or 104, and then carry forward that determination into the logistics support phase. Making a separate determination, using a different definition at a later point in time, leads to confusion and inconsistency in the determination. Congress has recently taken steps at 10 U.S.C. § 2306a(b)(2) to avoid similar inconsistencies in how the initial commercial item determinations are handled by DoD.

The past 22 years have established a firm foundation for the application of the 41 U.S.C. § 103 commercial item definition and its impact on the depot logistics support, and no longer represents a compelling argument in favor of a unique definition of commercial item. For these reasons, 10 U.S.C. § 2464 should not retain its own unique definition. The citation should be conformed to the primary definition at 41 U.S.C. § 103 (commercial item).

Another exception that requires further elaboration is the commercial item definition at 10 U.S.C. § 2321, Validation of Proprietary Data Restrictions. This section addresses the contractor justifications for data use or release restrictions and DoD review and challenge of these restrictions. Paragraph (f) of this section addresses the special rules "with respect to technical data of a contractor or subcontractor under a contract for commercial items." Subsection (f)(1) provides, generally, that "the contracting officer shall presume the contractor or subcontractor has justified the restriction on the basis that the item was developed at private expense." This presumption applies, according to (f)(2)(A):

> *with regard to a commercial subsystem or component of a major system, if the major system was acquired as a commercial item in accordance with section 2379(a) of this title;*
> *with regard to a component of a subsystem, if the subsystem was acquired as a commercial item in accordance with section 2379(b) of this title; and*
> *with regard to any other component, if the component is a commercially available off-the-shelf item or a commercially available off-the-shelf item with modifications of a type customarily available in the commercial marketplace or minor modifications made to meet Federal Government requirements*

Paragraph (i) provides that a *commercial subsystem* or *component of a major system* qualifies for the special presumption because it *was acquired as a commercial item*. In this paragraph (i), the term commercial item has the meaning in 10 U.S.C. § 2302, Definitions, subsection which refers back to the definition at 41 U.S.C. § 103. The same analysis is true in paragraph (ii) for components of a subsystem, if the subsystem was acquired as a commercial item.

Subsection (f)(2)(A)(iii) provides that a component that is not part of a major system or subsystem would only qualify for the presumption of being developed at private expense if it is a COTS item or a COTS item with modifications of a type customarily available in the marketplace or minor modifications made to meet federal government requirements.[13] This later portion of subparagraph (iii) is actually a blending of the existing COTS definition at 41 U.S.C. § 104 and the commercial item

[13] Validation of Proprietary Data Restrictions, 10 U.S.C. § 2321 (f)(2)(A)(iii).

definition at 41 U.S.C. § 103, with several key elements of the commercial item definition left out. The legislative history provides no rationale for this unique definition.

This unique definition sets up a number of conflicts and adds confusion over the critical issue of proprietary data restrictions for products procured in the commercial marketplace. The following are examples:

- By virtue of being in Chapter 137, 10 U.S.C. § 2321 is tied to the definition of commercial item and COTS item at 41 U.S.C. § 103 and § 104, respectively. The text of 10 U.S.C. § 2321 includes its own twist on these two established definitions, introducing unnecessary confusion and potential conflict.

- The blended language raises questions with regard to the criteria for items with minor modifications. For example, if an item is a "commercially available off-the shelf item with …minor modifications made to meet Federal Government requirements,"[14] it is unclear if that means it must meet the sold in substantial quantities criteria in the COTS definition to qualify for the presumption. It is also unclear if an item with minor modifications incorporated to meet unique federal government requirements is likely to be sold in substantial quantities to the general public.

The language of § 2321 (f)(2) is intended to define when a component is a commercial component, yet 41 U.S.C. § 102 already defines a commercial component as a "component that is a 'commercial item.'"[15]

When procuring a component found in the commercial marketplace, the contracting officer will evaluate the item against the criteria for a commercial item in Definitions, FAR 2.101. The language of 2.101 is the same definition found in Definitions, 41 U.S.C. § 103. When evaluating the contractor or offeror assertion that a component was developed at private expense, the contracting officer must use the unique definition in 10 U.S.C. § 2321 to establish if the component meets the criteria for the special presumption. The possibility exists that the contracting officer could determine a component meets the definition of a commercial item but does not meet the criteria for the presumption of being developed at private expense. This ambiguity unnecessarily complicates the contracting officer's already difficult task.

Because the standard 41 U.S.C. § 103 definition of a commercial item is not used in § 2321(f)(A), certain components would not qualify, such as those that are of a type customarily used by the general public or items sold, leased, or licensed to the general public at less than the substantial quantities criteria found in the COTS definition; or "any item that evolved…through advances in technology or performance and that is not yet available in the commercial marketplace."[16] These items are exactly the types of state of-the-art technologies DoD is pursuing. This type of confusion can lead to frustration

[14] Ibid.
[15] Commercial Component, 41 U.S.C. § 102.
[16] Commercial Item, 41 U.S.C. § 103 and Commercially Available Off-the-Shelf Item, 41 U.S.C. § 104.

and unnecessary issues over protection of proprietary data for these types of item, making it more difficult to do business in the high-tech marketplace.

It is problematic to have a unique definition of commercial product solely for the purpose of protecting proprietary data that is inconsistent with the standard definition of the term used throughout the U.S.C. and the FAR. This inconsistency can only lead to further confusion and complexity, and potentially serve to discourage high technologies firms in the commercial marketplace from offering their best to DoD.

Definitions of Subcontract and Subcontractor

In today's defense marketplace, prime contractors typically subcontract more than 60 percent of their work to other firms through numerous tiers of commercial and noncommercial subcontracts. Even for the most complex, government-unique items, the further down the supply chain one looks, the more likely one is to find commercial suppliers with commercial items. Through the flow down process, the commercial item policies, procedures, and government-unique terms also generally apply to these subcontracts, regardless of tier, which complicates the process for procuring commercial items and commercial services at the subcontract level.

The FAR currently defines the term *contract*, an important term used widely throughout the FAR and DFARS. However, neither the FAR nor DFARS defines the term *subcontract*, another term used throughout the FAR and DFARS. The FAR would benefit from a definition for the terms *subcontract* and *subcontractor*, both of which today have numerous definitions in the FAR and DFARS.

A search of the FAR and DFARS produced 27 distinct definitions of the term *subcontract*. Seventeen of these definitions were essentially the same with only minor differences. The other 10 were unique in one way or another, but shared many of the same common elements. 41 U.S.C. § 87, the Anti-Kickback Act, implemented at FAR 3.5 was the only definition based in statute (see Appendix F, Table F-3).

The FAR and DFARS search also produced 21 distinct definitions of *subcontractor*. Most of those definitions shared common elements that could be conducive to drafting a single, common definition. Several had a unique element that would require accommodation (see Appendix F, Table F-4).

Subcontracts for Commercial Items for Inventory or Multiple Contracts

The Section 809 Panel heard from many companies regarding the cost and significant administrative effort required to flow down terms and conditions to their subcontracts. Of particular interest to the Panel were the issues associated with the flow down of government-unique terms and conditions to commercial suppliers, and where the contractor procured items and components from its subcontractors for multiple contracts or for their inventory and not for a specific contract.

The requirement to flow down a clause to subcontractors may be mandatory or subject to certain criteria contained within the clause. A relative few clauses limit the flow down to prime contractors' first tier of subcontractors, yet other clauses flow down to subcontractors at all tiers that meet the specified criteria contained in the clause.

The mechanics of flowing down such clauses is often administratively complex, costly, and time consuming for prime contractors, and potential subcontractors at each successive tier. Before accepting

these terms and conditions, proposed subcontractors must evaluate each of the clauses, assess the effects of the requirements of the clause on their businesses and confirm their ability to comply with each of the individual requirements. In the government business environment, there is an expectation of strict literal compliance with these requirements, and there is considerable oversight to ensure such compliance.[17] A subcontractor would be taking a substantial business risk to shortcut this important process.

For those firms that regularly participate in the federal government procurement process at the prime contractor or subcontracting tier, the flow down of terms and conditions is difficult, complex, and carries potentially great business risk, yet it is a process that has become one of the *costs of doing business* with the federal government. For a prime or subcontractor that sells in both commercial and government markets, or one that sells only in the commercial market, it is more than just a cost of doing business.

Federal government contracting regulations generally assume that procurements are fulfilled on a *job-order* basis, for which each contract stands alone and subsystems and components are only procured subsequent to, and in direct response to, the award of the higher-tier contract. Commercial business is most often based on forecasts of future sales and anticipated demand, for which contractors' order materials and subcomponents from their suppliers to satisfy current production and inventory for meeting future market demands.

The dichotomy between government and commercial markets presents a number of practical and compliance risks. For example, a contractor in the commercial market, manufacturing a commercial product, will typically procure commercial components for inventory without knowing, at the time the orders are placed, who the customers will be for the yet-to-be-manufactured end items. If the government subsequently procures even one of those commercial end items, the prime contractor must accept the government-unique terms, including the requirement for mandatory flow down to lower-tier suppliers. The prime contractor is then faced with the dilemma of asserting that its suppliers have been given the mandatory terms even though it has already procured the components, and the components currently reside in its inventory.

To address this risk, commercial manufacturers may choose to flow down government-unique terms to all of their subcontractors (some of which may not accept them) on the chance the government might at some point procure one of its end items. A commercial contractor that has little or no expectation of selling to the government would have no reason to take such an inclusive approach to flow down at the time it procures its components. If the government wanted to procure a commercial item from such a company, the contractor might be faced with the risk of accepting the terms without the ability to flow the terms down because the product or components are already on the shelf. The FAR makes no provisions for situations in which a commercial product is manufactured with components that were

[17] "Men must turn square corners when they deal with the government," Supreme Court Justice Oliver Wendell Holmes, Jr. *Rock Island C.R.R.* v. *United States,* 254 U.S. 141, 143 (22 November 1920). In today's federal market, oversight includes formal oversight from DCMA, DCAA, DOD/IG, GAO, and Congress, and informal oversight by public watch-dog groups, whistle blowers, and False Claims Act relators.

procured for general inventory and already in the prime contractor's inventory before contracting with the government.

One commercial contractor that spoke to the Section 809 Panel cited a specific example of an increased subcontractor workload resulting from flow-down requirements. This commercial contractor sells the same or similar items in both government and commercial markets but procures its common components from its suppliers by administratively issuing two separate purchase orders for the same part number—one with the mandatory government flow-down terms to satisfy anticipated government demand and another without the flow down to satisfy anticipated demand from its commercial customers. This idea of segregating the procurement of the identical parts simply to satisfy flow down requirements raises the question of whether the contractor also needs to segregate the parts in the warehouse. Situations such as this one represent an unreasonable burden on contractors and their commercial suppliers, and likely serve as a deterrent to firms contemplating entering the government marketplace.

Congress recently noted this burden and took several steps to address it in two similar sections of the FY 2017 NDAA. Section 877, Treatment of Commingled Items Purchased by Contractors as Commercial Items, (codified at 10 U.S.C. § 2380B) addresses the burden associated with the flow down of mandatory, government-unique terms and conditions on relatively low-value items (less than $10,000). Section 874, Inapplicability of Certain Laws and Regulations to the Acquisition of Commercial Items and Commercially Available Off-The-Shelf Items, (codified at 10 U.S.C. § 2375 (c)(3)) addresses the issue in a different manner by excluding procurement of certain items from treatment as a *subcontract,* and thus the requirement for flow down of government-unique terms. Below is a summary comparison of the two provisions.

10 U.S.C § 2380B

- Applies to *items* (presumably both commercial and noncommercial) with a value of less than $10,000.
- For use in performance of multiple contracts with the department of defense and other parties.
- Not identifiable to any particular contract.
- Must be treated as a *commercial item* (and still receive terms to be flowed down, but presumably only terms and conditions associated with *commercial products*).

10 U.S.C § 2375(c)(3)

- Applies to agreements for *commodities* (the term *commodities* is undefined).
- Is intended for use in performance of multiple contracts with DoD and other parties.
- Is not identifiable to any particular contract.

- Agreement must not be considered a *subcontract* for a commercial item (and, therefore, is not subject to flow down of any government-unique terms and conditions).
- Is limited in its application to "this subsection."

Section 874 uses the term *commodities*. This term is undefined, and the Section 809 Panel was unable to identify an established DoD definition of the term but did identify the DoD standard definition of the term *commodity loading*, an indication of how the term might be defined:

> *commodity loading — A method of loading in which various types of cargoes are loaded together, such as ammunition, rations, or boxed vehicles, in order that each commodity can be discharged without disturbing the others.*[18]

A standard dictionary definition provides an alternative, narrower approach, defining a commodity as "a mass-produced unspecialized product: *commodity* chemicals, commodity memory chips."[19]

10 U.S.C. § 2380B and 10 U.S.C. § 2375(c)(3) are positive steps, but procurement of common commercial items and commercial services can be further simplified. The most practical approach would be to exclude from the scope of the term *subcontract* the procurement of commodities as well as commercial products and commercial services that are intended for use in multiple current or future contracts. Commercial products are, by their very nature, fungible and likely to be procured from suppliers not generally engaged in business with the federal government and consequently not subject to the burdens and risks discussed above. Likewise, commercial services are often procured to meet specialized needs that cross many products, product lines, and contracts. Exempting commercial products and common commercial services from flow down of government-unique terms makes clear to both government and industry that Congress is serious about simplifying the procurement process, especially for items that are clearly available on the commercial market, for which the burden would be the greatest.

Conclusions

The following actions would enhance the federal government's preference for acquiring commercial items:

- Bifurcate the definition of commercial items into commercial products and commercial services, creating two separate definitions.
- Incorporate in the definition of a commercial product a provision for a product that the commercial marketplace manufactures from a customer's drawings or specifications using its commercial processes.
- Remove the definitions of COTS from 41 U.S.C. § 104. Congress and DoD have avoided granting the relief from government-unique requirements needed to access the full breadth of

[18] DoD Dictionary of Military and Associated Terms, August 2017.
[19] Merriam Webster Dictionary.

the commercial marketplace, and the COTS item definition has had an unintended consequence of contributing to this problem.

- Align the definitions of commercial products and commercial services. In most instances, the variation in definitions for commercial items represent an oversight or drafting error, rather than a deliberate policy decision. This lack of definitional unity can carry real consequences, potentially generating confusion and risking disputes among stakeholders applying differing interpretations of commercial products and commercial services to the procurement process.

- Harmonize the use of terms in statute. Commercial buying processes would benefit from harmonizing all U.S. Code references to commercial products and commercial services—including 41 U.S.C., 10 U.S.C., and other miscellaneous uses of the terms in other titles of the U.S. Code—with the primary definitions of those terms in 41 U.S.C. Every use of the terms commercial item in the U.S. Code should incorporate, by reference, the primary definitions of those terms at 41 U.S.C. §§ 103, 103a, and 104, respectively. This recommendation should be implemented in accordance with the previous recommendation to split the term commercial item into commercial product and commercial service in 41 U.S.C. §§ 103 and 103a.

- Establish a uniform definition of subcontract in the U.S. Code and the FAR. The dozens of distinct definitions of the term subcontract are unnecessary. The difference between the definition of subcontract at 41 U.S.C. § 87 and the recommended U.S. Code definition is inconsequential, and using a single definition will simplify the procurement process. A few instances exist for which it is appropriate to supplement the general definition of subcontract to accommodate a unique component of the definition.

- Establish a uniform FAR definition of subcontractor. It is unnecessary to have 21 distinct definitions of the term subcontractor when the differences among them are inconsequential.

- Exclude from the definition of subcontract procurements of commodities, commercial products, and commercial services to be used on multiple contracts. The flow down of government-unique terms and conditions represents a costly and administratively complex demand on contractors engaged in the sale of commercial products to the federal government. The federal government cannot, however, expect to successfully pursue a preference for commercial products at all tiers of the supply chain and attract new, innovative commercial supplies, while still imposing a burden and risk on the procurement of commercial components. Congress should take bold steps beyond the current language of Sections 877 and 874 of the FY 2017 NDAA by adding a new definition of subcontract to 41 U.S.C. and 10 U.S.C. § 2302. The definition would exempt purchases of commodities, commercial products, and commercial services that are being procured for multiple contracts from the flow down of government-unique terms.

Implementation

Legislative Branch

- Delete the definition of *Commercial Item* at 41 U.S.C. § 103.
- Establish the definition of *Commercial Product* at 41 U.S.C. § 103, and add language to address commercial process in the definition.
- Establish the definition of *Commercial Service* at 41 U.S.C. § 103a.
- Delete the definition of *Commercially Available Off-the-Shelf Item* at 41 U.S.C. § 104.
- Revise all references in U.S. Code to the above terms.
- Revise U.S. Code to align all definitions of the above terms with the definitions at 41 U.S.C. Chapter 1.
- Revise the definition of *Commercial Component* at 41 U.S.C. § 102.
- Revise the definition of *Non-developmental item* at 41 U.S.C. § 110.
- Establish a definition of *Subcontract* at 41 U.S.C. § 115.
- Revise the references to the above terms at 10 U.S.C. § 2302.

Executive Branch

The FAR Council should do the following:

- Amend FAR 2.101, Definitions of Words and Terms, to align with the changes to U.S. Code described under Legislative Branch above.
- Modify FAR and DFARS references to align with the changes to U.S. Code described under Legislative Branch above.
- Establish the definition of subcontractor in FAR 2.101, Definitions of Words and Terms.
- Modify FAR and DFARS to align with the new definitions of subcontractor.

Implications for Other Agencies

- FASA, Title VIII, placed the commercial item and COTS definitions in the OFPP Act (41 U.S.C. § 103), making the definitions applicable to all federal government agencies that are subject to the FAR. Changes to the definitions of subcontract and subcontractor would be made in the FAR and would be applied to most federal agencies.