

Government Contracts: Reduced Risk Through Commercial Item Contracting

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This Practice Note explains the concept of commercial item contracting between suppliers of goods and services and the federal government. This Note reviews the advantages of commercial item contracting over traditional government contracting and advises current and prospective federal government contractors on how they can benefit from this aspect of procurement reform. This Note includes a discussion of Federal Acquisition Streamlining Act of 1994 (FASA), the implementing regulations under the Federal Acquisition Regulation (FAR), and required contract clauses for commercial item prime contracts and subcontracts.

The US government spends a significant amount of money each year procuring a wide variety of goods and services from contractors, ranging from typical government purchases, such as weapons and aircraft, to what may be considered atypical purchases, such as advertising, consulting, and construction services as well as mundane goods, such as office supplies, clothing and food.

The concerns of companies that are wary of entering into the federal government marketplace, however, are well-founded. Government-unique auditing and accounting requirements, specifications and standards, and other requirements have dissuaded many commercial contractors from selling their goods and services to the federal government. However, due to acquisition reform in the 1990's and the concept of commercial item contracting, the federal government can now procure commercial supplies and services from contractors on terms and conditions similar to commercial contracts.

This Note discusses the federal government concept of commercial item contracting, its benefits, and how contractors can exploit this aspect of procurement reform. It explains:

- The statutory reforms in the 1990's that established commercial item contracting.
- What qualifies as a commercial item.
- Required contract clauses applicable to commercial item contracts.
- Government specific requirements that still apply to commercial item contracts.
- The differences between commercial item contracts and traditional government contracts.
- How to find and respond to commercial item solicitations from the federal government.
- The benefits and risks of commercial item contracting.

REFORMS ESTABLISHING COMMERCIAL ITEM CONTRACTING

Before the passage of the Federal Acquisition Streamlining Act of 1994 (FASA), many commercial contractors refused to sell goods and services to the federal government based on the significant additional costs and risks associated with government-unique specifications, auditing requirements and other onerous terms and conditions.

UNDER FASA

In October 1994, the government enacted FASA, which dramatically changed the government's procurement philosophy. A key provision in FASA is the government's stated preference for the purchase of commercial items because the purchase of proven commercial items can:

- Reduce the need for government funded research and development.
- Minimize acquisition lead-time.
- Reduce the need for:
 - detailed design specifications; and
 - expensive product testing.

FASA further encourages government agencies to ensure that requirements are defined so that commercial items may be procured to fulfill agency requirements.

REVISED FEDERAL ACQUISITION REGULATION PART 12

In 1995, the Federal Acquisition Regulation (FAR) council implemented FASA by revising FAR Part 12 to:

- Contain policies and procedures applicable only to commercial items.
- Create acquisition policies that more closely resemble the commercial marketplace.
- Identify exemptions from government contracting laws and regulations for commercial item contracts.

Among other things, FAR Part 12 requires government agencies to:

- Conduct market research to determine if commercial items are available to satisfy the agency's requirements.
- Buy commercial items when they are available to meet the agency's needs.
- Require prime contractors and subcontractors at all tiers to incorporate, to the maximum extent practicable, commercial items as components of items supplied to the government.

(48 C.F.R. § 12.101(a), (b) and (c).)

WHAT QUALIFIES AS A COMMERCIAL ITEM?

The definition of a commercial item is broad and addresses goods and services differently. It also covers the combination of goods and services that are customarily combined and sold in combination to the general public (48 C.F.R. § 2.101(4)).

DEFINITION OF COMMERCIAL ITEM GOOD

Section 2.101 of the FAR defines a commercial item good as:

- Any item:
 - other than real property (land);
 - **of a type** customarily used for nongovernmental purposes; or
 - that has been either sold, leased or licensed (or offered for sale, lease or license) to the general public.
- (48 C.F.R. § 2.101(1).)
- Any item that evolved from an item described in Section 2.101(1) of the FAR through advances in technology or performance and is not yet available in the commercial marketplace, but will be in time to satisfy the delivery requirements under a government solicitation (48 C.F.R. § 2.101(2)).
- Any item that would be considered a commercial item as defined in Section 2.101(1) or (2) of the FAR but for:
 - modifications of a type customarily available in the commercial marketplace; or
 - minor modifications not customarily available in the commercial marketplace made to meet federal government requirements.
- (48 C.F.R. § 2.101(3).)

A commercial item good includes any item that is commercially available off-the-shelf (COTS). A COTS item is any supply item, including construction material, that is:

- A commercial item as defined in Section 2.101(1) of the FAR.

- Sold in substantial quantities in the commercial marketplace.
- Offered to the federal government, under a contract or subcontract at any tier, without modification, in the same form as it is sold in the commercial marketplace.

(48 C.F.R. § 2.101.)

However, while a COTS item is a commercial item, an item does not need to be a COTS item to be considered a commercial item.

DEFINITION OF COMMERCIAL ITEM SERVICE

A commercial item service is:

- Any service:
 - **of a type** offered and sold competitively in substantial quantities in the commercial marketplace;
 - based on established catalog or market prices;
 - for specific tasks performed or specific tasks to be achieved; and
 - under standard commercial terms and conditions.
- (48 C.F.R. § 2.101(6).)
- A service procured in support of a commercial item good if the supplier provides similar services at the same time to the general public under terms and conditions similar to those offered to the federal government, including the following support services:
 - installation;
 - maintenance;
 - repair; and
 - training.
- (48 C.F.R. § 2.101(5).)

While goods can qualify as commercial items regardless of how they are priced, services other than those under Section 2.101(5) of the FAR must have established catalog or market prices to qualify as commercial items.

"OF A TYPE" SIGNIFICANTLY BROADENS THE DEFINITION OF COMMERCIAL ITEM

It is significant that for both goods and services, to qualify as a commercial item, a contractor need only demonstrate that the goods or services offered to the government are of a type offered for sale or sold to the general public. This **does not** require a contractor to show either:

- The identical item is offered or sold to the general public.
- The contractor itself offers or sells the item to the general public.

The FAR does not, however, clearly define the point at which the differences between the commercial product and the product offered to the government are so significant to breach the of a type standard.

COMMERCIAL ITEM PRICING

To get FAR Part 12 preferential treatment, the FAR requires commercial item contracts to be either:

- Firm-fixed-price.
- Fixed price with economic price adjustment based on:
 - established prices; or
 - cost indexes of labor or material.

(48 C.F.R. § 12.207(a).)

In limited circumstances, a contractor may receive a time-and-materials or a labor-hour commercial item contract, but various higher level government approvals are required for these contracts (48 C.F.R. § 12.207(b)). For both commercial item goods and services, before issuing a commercial item prime contract or subcontract, the government or higher-tiered contractor must use a price analysis to determine whether the contractor's price is fair and reasonable. However, this price analysis **does not** involve an examination of the contractor's separate cost elements or proposed profit used to develop the firm-fixed-price (48 C.F.R. § 15.403-3(c)). For more information see Box, Price Analysis for Commercial Item Contracts.

COMMERCIAL ITEM PRIME CONTRACTS AND SUBCONTRACTS: REQUIRED CONTRACT CLAUSES

Commercial item prime contractors and subcontractors are only required to accept a small set of FAR and agency supplement clauses in their contracts. Most federal agencies have their own FAR supplements. For example, the Department of Defense FAR Supplement (DFARS) applies to sales to the Department of Defense (DoD).

FAR Subpart 12.5 provides a laundry list of laws that:

- Are not applicable to prime contracts for the acquisition of commercial items.
- Are not applicable to subcontracts, at any tier, for the acquisition of commercial items.
- Have been amended to eliminate or modify their applicability to either prime contracts or subcontracts for the acquisition of commercial items.

(48 C.F.R. §§ 12.500 and 12.503-12.505.)

REQUIRED CONTRACT CLAUSES FOR PRIME CONTRACTS AND SOLICITATIONS

Commercial item prime contracts and solicitations must incorporate only the following four primary FAR clauses:

- **FAR Clause 52.212-1, Instructions to Offerors.** Provides a single, streamlined set of instructions to be used when soliciting offers for commercial items (48 C.F.R. § 12.301(b)(1)).
- **FAR Clause 52.212-3, Offeror Representations and Certifications.** Provides a single, consolidated list of representations and certifications for the acquisition of commercial items (48 C.F.R. § 12.301(b)(2)).
- **FAR Clause 52.212-4, Contract Terms and Conditions.** Includes terms and conditions which are, to the maximum extent practicable, consistent with customary commercial practices (48 C.F.R. § 12.301(b)(3)). Contractors may:
 - request to have some of these terms and conditions tailored to adapt to the market conditions for a particular transaction (for example, the warranty, risk of loss, and termination clauses) (48 C.F.R. § 12.302(a)); and
 - suggest additional terms that are consistent with that particular industry (48 C.F.R. § 12.302(c)).
- Seven out of the 22 paragraphs of this clause implement statutory requirements and therefore cannot be tailored, including the paragraphs on assignments, disputes, payment, invoice,

unauthorized obligations and two paragraphs on legally mandated compliance matters (48 C.F.R. § 12.302(b)).

- **FAR Clause 52.212-5, Contract Terms and Conditions Required to Implement Statutes or Executive Orders.** Incorporates by reference only those paragraphs required to implement provisions of law or executive orders applicable to the acquisition of commercial items (48 C.F.R. § 12.301(b)(4)). FAR Clause 52.212-5 has a check-the-box format, for which contracting officers must check off only those clauses that apply to the prime contract and contractors are only required to comply with the clauses that have been checked off.

REQUIRED CONTRACT CLAUSES FOR COMMERCIAL ITEM SUBCONTRACTS

Even if a higher-tiered contractor has a non-commercial item prime contract, the higher-tiered contractor can and is encouraged to issue commercial item subcontracts to the maximum extent practicable (48 C.F.R. §§ 44.402(a) and 52.244-6(b)). The required clauses for commercial item subcontracts issued under commercial item prime contracts are listed in Section 52.212-5(e) of the FAR. The required clauses for commercial item subcontracts issued under non-commercial item prime contracts are listed in Section 52.244-6(c) of the FAR.

The lists of clauses in Sections 52.212-5(e) and 52.244-6(c) of the FAR:

- Are significantly shorter than those required for non-commercial item subcontracts.
- Permit the higher-tiered contractor to include in the commercial item subcontract additional clauses necessary to satisfy its contractual obligations (for example, a changes clause, a stop work order clause and a termination for convenience clause).

UNIQUE GOVERNMENT CONTRACTING REQUIREMENTS THAT STILL APPLY

Even commercial item contractors must comply with a limited number of federal government-unique requirements that apply to all government contractors, including:

- Those aimed at achieving the government's socioeconomic policies (see Equal Employment Opportunity Contract Clauses).
- Import and export restrictions and anti-corruption regulations (see Additional Requirements).

EQUAL EMPLOYMENT OPPORTUNITY CONTRACT CLAUSES

Federal government contractors must promote equal opportunity as required by the Equal Employment Opportunity (EEO) contract clauses if the contractor receives more than \$10,000 per year in government contract awards. The EEO contract clauses implement:

- Executive Order 11246 (September 24, 1965) and its implementing regulations.
- The Vietnam Era Veterans' Readjustment Assistance Act of 1972 (38 U.S.C. § 4211 and 4212), the Veterans Employment Opportunities Act of 1998 (Public Law 105-339), the Jobs for Veterans Act (Public Law 107-288), Executive Order 11701 (January 24, 1973) and their implementing regulations.
- Section 503 of the Rehabilitation Act of 1973 (29 U.S.C. § 793), Executive Order 11758 (January 15, 1974) and their implementing regulations.

The Department of Labor monitors and enforces contractors' compliance with these contract clauses through its Office of Federal Contract Compliance Programs (OFCCP). These contract clauses impose obligations on government contractors that deviate from the practices of an ordinary commercial contractor. These include, but are not limited to:

- Requiring contractors to file annual compliance reports.
- Requiring contractors to create an Affirmative Action Program, if the contractor:
 - has 50 or more employees; and
 - a prime contract or subcontract of \$50,000 or more (or bills of lading that can be expected to total \$50,000 or more in a 12-month period).
- (41 C.F.R. § 60-2.1.)
- Permitting the OFCCP to audit the contractor's personnel records.
- Regulating how a contractor posts employment opportunities.

ADDITIONAL REQUIREMENTS

In addition to the EEO contract clauses, commercial item contractors must also comply with:

- All applicable import and export restrictions (for more information on export laws, see [Complying with US Export Regulations Checklist \(1-520-0908\)](#) and [Practice Notes, Export Regulation Laws: Overview \(1-521-6990\)](#) and [Export Regulation: US Antiboycott Laws \(3-509-2210\)](#)).
- Restrictions on recruiting and hiring former government employees.
- The Anti-Kickback Act of 1986 (41 U.S.C. § 51).
- Lobbying restrictions.
- Prohibitions on human trafficking.
- In some instances, laws that impose a preference for domestic sources or materials.
- If the contract exceeds \$5.5 million and has a period of performance longer than 120 days, a requirement to have a written code of business ethics and conduct (FAR Clause 52.203-13). Even if not required, contractors should consider implementing such a code and a compliance program as a best practice for government contractors.
- A requirement for prime contractors and first-tier subcontractors to report the names and total compensation of the five most highly compensated executives for the contractor's preceding fiscal year, if:
 - the contractor receives 80% or more of its annual gross revenues from federal contracts, subcontracts, loans, grants, subgrants, and cooperative agreements;
 - the contractor receives \$25 million or more in annual gross revenues from federal contracts, subcontracts, loans, grants, subgrants, and cooperative agreements; and
 - the public does not already have access to this information through SEC or IRS reports.
- (48 C.F.R. §§ 4.1400 - 4.1403 and FAR Clause 52.204-10.)

FRAUD ENFORCEMENT MECHANISMS

All government contractors are subject to the federal government's procurement fraud enforcement mechanisms, which come in a

variety of forms. The government can prosecute procurement fraud under several criminal and civil statutes, including:

- **The False Statements Act.** The government uses this statute most frequently to address all categories of procurement fraud (18 U.S.C. § 1001). It prohibits lying (knowingly and willfully making a false statement) to the government. A statement made under this act may be:
 - oral;
 - written;
 - sworn; or
 - unsworn.
- **The Civil False Claims Act.** This act:
 - provides for treble damages and penalties for the submission of false claims by either a prime contractor or subcontractor to any federal agency or entity using federal funds to pay these claims;
 - authorizes private citizens with evidence of fraud against the government to file lawsuits in their own name (on behalf of themselves and the government) and then keep a significant share of the government's recovery (a qui tam action) (31 U.S.C. § 3730). Qui tam actions are often brought by disgruntled current or former employees who are aware of the company's business practices in performing its government contracts. Whistleblowers (referred to as relators) often are rewarded with 15% to 25% of the total recovery from the company (31 U.S.C. § 3730); and
 - protects employees from retaliation by their employers.
- (31 U.S.C. §§ 3729-3733.)

Government contractors can address all of these government requirements with an effective compliance program. Implementing appropriate policies and procedures to comply with these requirements has a minimal impact on the contractor's business practices compared to the efforts required to comply with traditional government contract requirements.

HOW COMMERCIAL ITEM CONTRACTS DIFFER FROM TRADITIONAL GOVERNMENT CONTRACTS

Even though commercial item contractors must comply with certain government requirements (see [Unique Government Contracting Requirements that Still Apply](#)), they are **exempt** from many of the traditional government contract requirements that increase administrative costs and risk, such as:

- The Truthful Cost or Pricing Data Statute (formerly known as the Truth in Negotiations Act (TINA)). TINA requires a contractor to disclose to the government all of its cost or pricing data as of the date of price agreement and certify that its disclosure is current, accurate, and complete (10 U.S.C. § 2306a and 41 U.S.C. § 3901). For more information on TINA, see [Practice Note, Federal Government Contracts: Overview: The Truthful Cost or Pricing Data Statute \(9-599-6946\)](#).
- Cost Accounting Standards and related audits. The federal government's Cost Accounting Standards (CAS) govern the measurement, timing and allocability of costs charged to certain negotiated government contracts. The CAS rules and regulations impose major accounting requirements on government contractors and require the negotiation of impacts of changes

to the contractor's cost accounting practices (48 C.F.R. §§ 9903.301- 9903.307). For more information on CAS, see Practice Note, *Federal Government Contracts: Overview: Cost Accounting Standards* (9-599-6946).

- Traditional government terms and conditions pertaining to intellectual property (see Intellectual Property Rights).
- Contract clauses allowing the federal government to unilaterally make changes to the contract (see Changes Clauses).

While exempt from the above requirements, commercial item contractors and subcontractors can contractually agree to be bound by them. They should therefore be vigilant in negotiating their government contracts to confirm that these requirements are not included.

INTELLECTUAL PROPERTY RIGHTS

The FAR greatly reduces the intellectual property rights the government obtains under a commercial item prime contract or subcontract, allowing the contractor to more easily retain important rights.

Non-Commercial Items

For non-commercial item prime contracts and subcontracts, the government receives rights in technical data and computer software delivered to the government which were developed using government funds (FAR Clause 52.227-14). In non-commercial item contracts, to limit the rights the government receives in both technical data and software, the contractor bears the burden of demonstrating that the technical data or computer software was developed exclusively at private expense. Further, the non-commercial item FAR technical data and computer software clauses require contractors to properly mark with restrictive legends the technical data and computer software delivered to the government in which the contractor wants to limit the government's rights.

The contractor's failure to properly mark the technical data or computer software delivered to the government can lead to the government's receipt of an unlimited rights license in this data or software, which permits the government to share it with the contractor's competitors (see *Bell Helicopter Textron*, ASBCA No. 21192, 85-2 BCA ¶ 18415 (1985)). However, the FAR recognizes that strict compliance with these provisions would discourage commercial item contractors from government procurement and contains provisions that significantly reduce the administrative burden.

Commercial Items

For commercial items, FAR Part 12 provides that:

- The government acquires technical data and the rights in that data customarily provided to the public with a commercial item or process (48 C.F.R. § 12.211). Therefore, the contractor is only obligated to grant the government its standard commercial license.
- A presumption that technical data delivered under a contract for commercial items was developed exclusively at private expense (48 C.F.R. § 12.211). This presumption:
 - does not apply to DoD acquisitions of major weapon systems or subsystems or components; and
 - still applies to DoD acquisitions of major weapon systems or subsystems or their components that qualify as COTS and some components of commercial items (DFARS § 227.7103-13).

Regarding computer software, the government acquires commercial computer software or documentation under licenses customarily provided to the public if these licenses:

- Are consistent with federal law.
- Satisfy the federal government's needs.

(48 C.F.R. § 12.212.)

The contractor is not required to provide the government with any other rights in the computer software or documentation unless mutually agreed between the contractor and the government.

For both technical data and computer software that receive commercial item treatment, the requirement that contractors properly mark with specific restrictive legends the technical data and computer software in which the contractor wants to limit the government's rights is eliminated.

CHANGES CLAUSES

Non-Commercial Items

Another traditional government contracting requirement is the government's ability to unilaterally direct changes to the contract in specified areas, within the general scope of the contract (FAR Clauses 52.243.1-4). If the government makes this change, the contractor must continue performing the contract as changed. If the contractor experiences an increase in the cost of performance or a delay in the schedule as a result of the change, the contractor:

- Can seek an equitable adjustment to either or both:
 - the contract price; or
 - the schedule.
- Must timely submit the necessary documents to support the equitable adjustment.
- Must perform the government-directed change, even if the contractor and the government have not agreed on the applicable equitable adjustment.
- Should negotiate and execute a contract modification for these changes.
- Can seek administrative relief under the disputes clause (FAR Clause 52.233-1), which, however, is often a lengthy and burdensome process, if an agreement with the government on the amount or scope of the equitable adjustment cannot be reached.

Commercial Items

For commercial items, however, FAR Part 12 provides that contract changes must be mutually agreed between the contractor and the government. Before accepting the change, the contractor can negotiate with the government regarding the impact of the change on the price, schedule, or both, and execute a bilateral contract modification accordingly. If it cannot agree with the government, the contractor can reject the change.

FINDING AND RESPONDING TO FEDERAL GOVERNMENT COMMERCIAL ITEM SOLICITATIONS

Suppliers can identify a commercial item solicitation or advocate for a federal agency to issue a commercial item solicitation in a variety of ways. For example, prospective government contractors can:

- **Find opportunities on the Federal Business Opportunities website.** The Federal Business Opportunities website enables contractors to search for solicitations and contract awards, for example, by:
 - agency;
 - item code; or
 - keyword.
- **Find opportunities and additional information on the Acquisition.Gov website.** The Acquisition.Gov website contains information not only on opportunities, but also aggregates information on available government contracting resources for contractors.
- **Network with US government officials.** Suppliers can network with federal government officials to:
 - understand government requirements;
 - market commercial goods and services; and
 - help shape future government needs.
- **Work with lobbyists.** Suppliers can hire lobbyists to meet with government officials and advocate on their behalf.
- **Ensure that the solicitation contemplates the award of a FAR Part 12 commercial item contract.** A contractor can enter into a variety of different types of contracts with the federal government. If the transaction involves commercial items, suppliers should ensure that the solicitation contemplates the award of a FAR Part 12 commercial item prime contract. If a solicitation is too restrictive, before the deadline to submit proposals, a prospective contractor can seek the re-solicitation of the goods or services on a commercial item basis and file a bid protest with:
 - the contracting government agency (see Practice Note, Government Contracts: Agency-Level Bid Protests ([2-561-9585](#)));
 - the US Government Accountability Office (see Practice Note, Government Contracts: GAO Bid Protests ([2-581-7651](#))); or
 - the Court of Federal Claims (see Practice Note, Government Contracts: COFC Bid Protests ([1-583-9427](#))).
- (48 C.F.R. §§ 33.101- 33.106.)

Before suppliers can submit proposals in response to government solicitations, they must fulfill a few administrative requirements, including:

- Registering in the System for Award Management (SAM).
- Filling out representations and certifications in SAM.

BENEFITS AND RISKS OF COMMERCIAL ITEM CONTRACTING

From a practical standpoint, taking advantage of FAR Part 12 makes sense for the government, prime contractors and subcontractors. Prime contractors potentially have a larger pool of suppliers willing to accept government subcontracts if they are more like commercial sales, and with fewer requirements, the costs are lower. Subcontractors benefit by having:

- Less onerous contract clauses.
- Reduced compliance risks.
- The ability to contract on more typical commercial terms.

The government, prime contractors and subcontractors all benefit from:

- Lower prices.
- Fewer compliance-related requirements.
- Reduced administrative costs.
- More supply sources.

That is not to say, however, that no risks exist in becoming a commercial item government contractor (see Unique Government Contracting Requirements that Still Apply). To mitigate these risks, government contractors can:

- Develop and implement an effective compliance program to avoid liability under the False Claims Act or violations of the False Statements Act.
- Take appropriate corrective action when they discover a real or potential violation.
- Limit their contracts with the government to commercial item contracts.

PRICE ANALYSIS FOR COMMERCIAL ITEM CONTRACTS

To award a commercial item contract, the federal government must conduct a price analysis to determine that the contract price is fair and reasonable. In a price analysis, the government must compare the contractor's proposed price to other information available to the government, such as:

- Other offers submitted in response to a solicitation.
- Previous prices for the same or similar items paid by:
 - the government; or
 - non-government customers.
- Published price lists.
- Independent government cost estimates.
- Prices obtained from market research.

(48 C.F.R. § 15.404-1(b).)

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