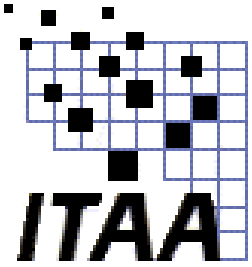

RECOMMENDATIONS OF THE INFORMATION TECHNOLOGY ASSOCIATION OF AMERICA

PRESENTED TO

THE ACQUISITION ADVISORY PANEL

The Information Technology Association of America ("ITAA") is pleased to submit its recommendations to the Section 1423 Acquisition Advisory Panel (the "Panel") established pursuant to Section 1423 of the Service Acquisition Reform Act ("SARA"). The Panel's statutory charter is to review acquisition laws, regulations, and government-wide acquisition policies and recommend changes to Congress and to the President with a view toward ensuring the effective and appropriate use of commercial practices and performance-based contracting in Federal Government procurements. With this statutory charter, the Panel is presented with an exceptional opportunity to recommend the removal of significant obstacles that currently hinder the Government's access to the full range of commercial goods, services, and related technologies. This opportunity is especially keen with respect to the Government's acquisition of services. The major procurement reforms of the 1990s focused mainly on the acquisition of goods. With the acquisition of services now amounting to more than $189 billion per year, it is critically important that the laws and policies applicable to services be carefully reviewed and improved.

This paper presents ITAA's recommendations on how the law should be changed or clarified regarding four specific areas that have received significant attention in recent years. Specifically--

1. ITAA recommends that the statutory definition of "commercial item" be revised so that commercial services are treated on par with commercial supplies. The current statutory and regulatory definitions of "commercial item" are confusing, mix price reasonableness issues with definitional issues, and sometimes prevent the use of commercial terms on acquisitions involving truly commercial services. (Section I below.)

2. ITAA recommends that the restrictions on agencies' use of commercial terms on time-and-materials ("T&M") contracts and orders be addressed so that these types of contracts and orders may be used where appropriate; that is, when the scope of

work cannot be defined with reasonable definitiveness up front, the volume of work is expected to fluctuate significantly, or firm-fixed-price terms otherwise would pose a significant risk to the contractor (resulting in higher prices to the Government to account for contingencies). Further, we recommend that the FAR be clarified to resolve the current confusion concerning the appropriate method of billing subcontract labor under T&M prime contracts. The regulations should reflect a default rule stating that subcontract labor shall be billed at the rates set out in the prime contract, regardless of the rates at which a subcontractor bills the prime contractor, so long as the prime contractor provides the Government with a reasonable measure of insight into the prime contractor's use of subcontractors. Subcontract labor should not be considered a "pass through" cost for the many reasons detailed below. (Section II below.)

3. We urge the FAR Councils and General Services Administration ("GSA") to confirm in regulation that post-award "defective-pricing" audits are proscribed for all commercial acquisitions. This audit authority is inconsistent with law, contrary to customary commercial practice, significantly increases contract administration costs for those contractors subject to audit, and unnecessarily breeds disputes between contractors and the Government that could be avoided through use of the Government's existing pre-award audit authority. ITAA strongly disagrees with the recent comments on this issue by the GSA Office of Inspector General. (Section III below).

4. Finally, ITAA urges the FAR Councils to finalize the proposed rule issued on January 15, 2004 to add the Trade Agreements Act and the Buy American Act to the list of laws inapplicable to commercially available off-the-shelf acquisitions. In addition, we believe that there should be a statutory exemption for the broader category, "commercial items." The application of these laws pose complexity, burden, and compliance challenges to suppliers of commercial items while restricting the Government's ability to access some of the latest, state-of-the-art, global technologies.

These recommendations are based on the extensive experience that ITAA's members have providing information-technology goods and services to the commercial and Government markets. ITAA strongly believes that, if acted upon, the recommendations will result in increased access by the Government to latest and best technologies and increased efficiency in the Federal procurement system.

ITAA provides global public policy, business networking, and national leadership to promote the continued rapid growth of the IT industry. ITAA consists of over 400 corporate members throughout the U.S. and a global network of 50 countries' IT associations. The Association plays the leading role in issues of IT industry concern, including information security, taxes and finance policy, digital intellectual property protection, telecommunications competition, workforce and education, immigration, online privacy and consumer protection, government IT procurement, human resources and e-commerce policy. ITAA members range

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I. The Definition of "Commercial Item" Should be Improved to Better Enable the Acquisition of Commercial Services.

The most significant statutory and regulatory Federal procurement reform efforts of the past decade focused on commercial item acquisitions with the aim of providing the Government with access to the latest commercial technologies in a timely and cost-effective manner. Although the early focus of the reform efforts was on the procurement of commercial ***goods***, today the Government spends more money on ***services*** than it does on goods, and the indication is that this trend will continue. Unfortunately, with respect to services, both the statutory and regulatory definitions of "commercial item" are confusing, mix price reasonableness issues with definitional issues, and otherwise pose obstacles to the acquisition of commercial services. Accordingly, ITAA submits that the statutory and FAR definitions of "commercial item" 1/ should be revised to address these concerns.

Dating as far back as 1972, when the Commission on Government Procurement recommended that the Government take advantage of solutions offered in the commercial market, the Government has encouraged procuring agencies to recognize the efficiency and cost savings available through the acquisition of commercial goods and services. 2/ This encouragement in part took the form of a specific statutory preference for commercial items with the passage of the Federal Acquisition Streamlining Act of 1994 ("FASA"). Two years later, the Clinger-Cohen Act of 1996 ("Clinger-Cohen Act") further encouraged the participation of commercial companies in the Government market by creating a commercial item exception to the requirement for the submission of certified cost or pricing data otherwise required by the Truth in Negotiations Act ("TINA"). However, the reforms reflected in FASA and the Clinger-Cohen Act as they pertain to the definition of "commercial items" were focused mainly on the acquisition of supplies as opposed to services.

ITAA's primary concern with the definition of "commercial item" is how that definition applies to stand-alone services (*i.e.*, subsection (6) of the FAR definition). The language as included in FAR 2.101 provides the following "sub-definition" regarding stand-alone services:

1/ 41 U.S.C. § 403 (2004); FAR § 2.101.

2/ *See Report of the Commission on Government Procurement*, vol. 2, pt. D, "Acquisition of Commercial Products" (Dec. 1972), excerpted in House Comm. On Armed Services, 100th Cong. Sess., Defense Acquisition: Major U.S. Commission Reports (1949-1988) at16-17 (Comm. Print No. 26, 1988); *see also* Exec. Order No. 12352, Federal Procurement Reforms, 3 CFR § 137 (1982) (directing federal agencies to establish criteria for expanding the acquisition of "available" goods and services); Deficit Reduction Act of 1984, Pub. L. 98-369, tit. VII, Dir. "B", §§ 2711, 2721, 98 Stat. at 1185, 1186 (amending 41 U.S.C. §§ 253 (a)(1)(A); 10 U.S.C. § 2301(a)) (Competition in Contracting Act of 1994 mandated the use of commercial products "whenever practicable.").

> (6) Services 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 outcomes to be achieved and under standard commercial terms and conditions. This does not include services that are sold based on hourly rates without an established catalog or market price for a specific service performed or a specific outcome to be achieved.

The terms "catalog price" and "market price" are separately defined.

The sub-definition for stand-alone commercial services has long been a source of confusion in the acquisition community. *See* Ralph C. Nash and John Cibinic, *Postcript IV: Defining Commercial Services*, 14 No. 8 Nash & Cibinic Rep. ¶ 39 ("One of the continuing puzzlements in the Government contracting process is the interpretation of the definition of stand-alone services . . ."). Although there are many issues embedded within this definition, we will concentrate on only a few.

First, the requirement that the services be sold "competitively" in the commercial marketplace should have no bearing on whether the service is "commercial." For example, if a supplier provides a unique service on a non-competitive basis to several private entities because competition is non-existent, the fact that competition does not exist for the service does not change the fact that the service is sold in the commercial market and, therefore, would commonly be thought of as "commercial." This issue demonstrates one of several ways in which the current definition for stand-alone services mixes price reasonableness issues with what characteristics define commercial services. In our view, whether a service is sold competitively or non-competitively in the commercial market might be relevant only to an agency's price reasonableness determination in those situations where the agency procures the service without competition and requires commercial pricing data to substantiate price reasonableness. This aspect of the definition is better left for the FAR procedures dealing with price reasonableness determinations. *See, e.g.,* FAR 12.209 (entitled ("Determination of Price Reasonableness"); FAR 15.403-3 ("Requiring Information Other than Cost or Pricing Data").

Second, the requirement that the terms under which the service is offered be based on "established catalog or market prices" is vague, has very little, if anything, to do with whether a service is commercial in nature, and is otherwise too restrictive. It has been well chronicled by Professors Nash and Cibinic, as well as others, that what is required to meet the definition of "market price" is a source of significant confusion. *See id.* Moreover, the definition fails to reflect that many types of professional services, including professional IT-related services, are sold in the commercial marketplace using other than an "established catalog" price, which is at least partly a reflection of the fact that services often need to be tailored somewhat from one project to the next. More importantly, however, whether a service provider maintains a catalog price for a particular service or can establish a "market price" is wholly unrelated to whether the work to be performed is sold in the commercial market; that is, whether the service is a commercial service. As is the case with the competitiveness issue addressed above, the heart of the issue pertaining to "established catalog or market prices" is a price reasonableness issue that

might become relevant if the services are procured when competition for Government procurement is lacking. Even with respect to price reasonableness, where the Government does conduct a competition (including a competition using Federal Supply Schedule procedures), and receives competitive offers for services of a type sold in the commercial market, what significance is it whether or not there are "established catalog or market prices"? The competition ensures that the Government gets fair and reasonable pricing. Only where such competition is lacking on a competitive procurement might factors such as "established catalog or market prices" become relevant. Either way, however, such issues have no bearing on whether a service is commercial in nature. 3/

The requirement that stand-alone services must be based on "established catalog" or "market prices" to qualify as a commercial item appears to be based on a combination of two factors. First, when the Section 800 Panel recommended the original definition of "commercial item" in the early 1990s, the Panel indicated it had insufficient data to assess what obstacles existed regarding the procurement of stand-alone commercial services. Therefore, the Panel chose not to address the issue. *See Postscript: Defining Commercial Services*, Nash & Cibinic Report, July 1997. Second, the language appears to be the result of Congress mimicking the language already existing in the Truth in Negotiations Act ("TINA"). In 1996, however, the Clinger-Cohen Act removed the offensive "established catalog" or "market price" language from TINA so as to exempt all "commercial items" from the Government-unique requirements of TINA. That same language, however, still applies to the definition for stand-alone commercial services, the result being that Government-unique laws and requirements apply to the acquisition of commercial stand-alone services if it cannot be shown that the prices for those services are based on an established catalog or market price.

Finally, the last sentence of the definition adds to the confusion. The last sentence provides that the definition of commercial item "does not include services that are sold based on hourly rates without an established catalog or market price for a specific service performed or a specific outcome to be achieved." ITAA and its members read this sentence as requiring an established catalog or market price for hourly rates when the service is being sold based on an hourly rate. Some commentators have suggested, however, that this language might be read to preclude all stand-alone services based on hourly rates from the definition of "commercial item." Such an interpretation would now be contrary to the provisions of the Service Acquisition Reform Act 4/ that expressly allow the use (with strings attached) of time-and-materials and labor hour pricing terms in commercial item acquisitions.

To address these issues, ITAA recommends the adoption of a new definition of "commercial item" that places stand-alone commercial services on par with commercial supplies.

3/ *See* 11 No. 7 Nash & Cibinic Rep. ¶ 34 ("There is no rational reason for using these pricing-related terms as criteria for determining whether the procurement procedures and terms and conditions permitted for other commercial items would be permitted for stand-alone services.").

4/ National Defense Authorization Act for Fiscal Year 2004, Pub. L. 108-136, tit. XIV, §§ 1432, 1433, 117 Stat. 1392, 1672 (amending 41 U.S.C. §§ 264 note, 403)).

The current definition causes confusion and otherwise poses an unnecessary obstacle to the Government's acquisition of commercial services. ITAA recommends the following revisions to FAR § 2.101, with a corresponding revision to the statutory definition:

Commercial item means—

(1) Any item, including any supply or service, other than real property, that is of a type customarily used by the general public or by non-Governmental entities for the purposes other than Governmental purposes, and—

(i) Has been sold, leased, or licensed to the general public; or

(ii) Has been offered for sale, lease, or license to the general public;

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(5) Installation~~ services, maintenance services, repair services, training services, and other services if~~

~~(i) Such services are procured for support of an item referred to in paragraph (1), (2), (3), or (4) of this definition, regardless of whether such services are provided by the same source or at the same time as the item; and~~

~~(ii) The source of such services provides similar services contemporaneously to the general public under terms and conditions similar to those offered to the Federal Government~~;

(6) Services~~ 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 outcomes to be achieved and under standard commercial terms and conditions. This does not include services that are sold based on hourly rates without an established catalog or market price for a specific service performed or a specific outcome to be achieved. For purposes of these services~~

~~(i) Catalog price means 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; and~~

~~(ii) Market prices means 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 offerors.~~

These revisions are simple and straightforward, and place commercial services on the same footing as any other commercial item. Stand-alone services that clearly are commercial should not be subject to Government-unique rules and requirements that have long been inapplicable to other types of commercial acquisitions. *See generally* FAR Subpart 12.5 ("Applicability of Certain Laws to the Acquisition of Commercial Items"). Put simply, if a

service is of a type offered in the commercial marketplace and, thus, establishing a credible basis for demonstrating market acceptance, then the service should qualify as a "commercial item." Issues such as "established catalog or market prices" should be addressed only in the context of whether pricing is fair and reasonable where competition is lacking for a Federal procurement. *See* 14 No. 8 Nash & Cibinic Rep. ¶ 39 ("We…believe that the difficult FAR definition [of stand-alone commercial services] may be impeding the full use of the commercial item procedures for procuring services."). 5/ The taxpayers' interests are protected as this is already specifically provided for in FAR 15.403-3, which states that, when adequate price competition is absent (and the prices are not set by law), "the contracting officer must require that the information submitted by the offeror include, at a minimum, appropriate information on the prices at which the same item or similar items have previously been sold, adequate for determining the reasonableness of the price." *See also* FAR 12.209, "Determination of Price Reasonableness" (stating that the contracting officer must establish price reasonableness in accordance with 13.106-3, 14.408-2, or subpart 15.4).

II. Reforms are Needed to Remove Obstacles Confronted by Commercial Firms Performing Time-and-Materials Work.

A. Greater Flexibility Should Be Provided to Agencies to Use Time-and-Materials Contracts.

Time-and-material contracts and orders (T&M contracts) are widely used in the commercial marketplace due to the substantial benefits that they can provide to the customer. For example, T&M contracts are often used on projects where the scope of work cannot be defined with any reasonable degree of certainty upfront or otherwise would pose too great a risk for firm-fixed priced bidding. T&M contracts also enable service providers to ramp up or down quickly when the volume of work is expected to fluctuate significantly. Importantly, T&M contracts enable the customer to obtain competition and receive price offers without large pricing contingencies when firm-fixed pricing poses too great a risk. These same benefits make T&M contracts valuable in the context of Government procurements.

The procurement laws and regulations, however, significantly restrict the ability of procuring agencies to use T&M contracts. For example, the FAR Part 12 pricing provisions still do not provide for T&M contracting. Also, FAR 16.601(c)(1) requires contracting officers to execute a determination and finding that no other contract type is suitable to the acquisition before using a T&M contract. The Service Acquisition Reform Act ("SARA"), which was enacted in Title IV of the National Defense Authorization Act for Fiscal year 2004, Pub. L. No. 108-136, now makes it clear that T&M contracts may be used in commercial item acquisitions, but only with certain significant strings attached. Specifically, SARA requires that the T&M

5/ The definition also should reflect that the reference to "governmental" pertains only to the Federal Government, and, accordingly, that sales to state and local government be considered as commercial sales. There seems to be no valid reason for distinguishing state and local government from other non-Federal Government consumers.

contract be issued on a competitive basis, that the service be of a type prescribed by the Administrator of the Office of Federal Procurement Policy, and that the contracting officer first prepare a determination and finding that no other contract type is suitable. These restrictions, as well as the underlying bases offered for them by critics of T&M contracts, are too restrictive and fail to appropriately reflect the benefits that T&M contracts can provide to the Government.

The primary argument of critics of T&M contracts is that T&M contracts do not provide sufficient motivation for contractors to perform efficiently. But this argument is undercut by the reality that contractors are subject to significant built-in incentives to perform T&M (as well as other) contracts in a high-quality, efficient manner. For example:

- Inefficient performance of a T&M contract will result in a poor past performance rating. A strong past performance record is vital to a contractor's efforts to secure future work because past performance is a mandatory evaluation factor on which contract awards are based. 6/
- A contractor could be subject to termination if it fails to perform commensurate with the standard of performance specified in the contract. For example, FAR 52.232-7, Payments under Time-and-Materials and Labor-Hour Contracts, requires the contractor to use its ***best efforts*** to perform the work specified in the contract within the ceiling price. Failure to abide by this term could subject the contractor to a default termination, a drastic sanction that can be accompanied by significant liability.
- Failing to perform efficiently and effectively makes it less likely that an agency will exercise contract options or award follow-on work to the contractor.

In ITAA's view, critics of T&M contracting unreasonably discount the above factors that serve to motivate the performance of T&M contracts in a cost efficient and effective manner. Any perceived misuse or misapplication of T&M contracts has more to do with lack of appropriate training of procurement officials—which is an issue that exists regardless of contract type—than it does the inherent nature of T&M contracts.

ITAA recommends that (i) pursuant to SARA the Administrator of OFPP make it clear that T&M contracts may be used for any service as long as the service is commercial in nature and circumstances exist that otherwise justify the use of a T&M contract (*i.e.,* it is not possible to define the scope of work with reasonable definitiveness upfront or firm-fixed priced terms would pose a significant risk to bidding contractors); (ii) FAR Part 12 be revised to indicate that T&M contracts are permitted for commercial item acquisitions; and (iii) the statutes be revised to permit use of T&M contracting on other than a competitive basis as long as such use satisfies the Competition in Contracting Act. Points (i) and (ii) can easily be addressed as part of the pending FAR cases addressing T&M contracts.

6/ For commercial item acquisitions, the FAR mandates evaluation of past performance. FAR § 12.206.

B. For T&M Contracts, Subcontracted Work Should Be Reimbursed at the Prime Contractor's Labor Rates, Unless the Contract Specifically Provides Otherwise.

Recently, several Government agencies took the drastic step of withholding payment from contractors on the basis that the prime contractor's subcontracted labor should have been invoiced to the Government at the rates the subcontractor bills the prime contractor—in effect a "pass-through"—rather than at the rates listed in the prime contract. In ITAA's view, these withholdings were based on an improper interpretation of the contract terms, specifically the pricing schedule and FAR Clause 52.232-7 included within the contracts. Moreover, the withholdings were inconsistent with FAR 16.601(a)(1), which specifically provides for the payment of direct labor hours as specified fixed hourly rates. In addition, the withholdings were premised on a misconception of the fundamental nature of T&M contracts, which are much more akin to fixed-price than cost reimbursement contracts with respect to the labor rates charged to the Government. ITAA is concerned that unless this issue is appropriately addressed there may be a chilling effect on the desire of some service providers to compete for federal work where T&M contracts are employed.

ITAA suggests that the billing of subcontracted labor under T&M contracts be addressed in the two FAR cases currently pending that deal with T&M contracts. Specifically, the FAR Councils should clarify that the default standard for billing subcontracted labor—at least as to commercial item contracts—should be that the Government will be billed at the prime contract rates (whether a "blended" rate or otherwise) as opposed to a pass-through approach that would require that such labor be billed at the prime contractor's cost *(i.e.*, the rate the subcontractor bills the prime contractor).

First, the "pass-through" approach advocated by some within the Government is contrary to customary commercial practice. Service providers offer their services in the commercial market at a price, whether at a firm-fixed price, T&M, labor hour, or some other basis. It would be rare for most types of commercial services for a prime contractor to offer to provide subcontracted labor as a pass-through cost to its commercial customers. The important point is that the service provider is responsible for the project, regardless of whether the service provider uses subcontracted labor, and the service provider should control its own offered pricing. Quite reasonably, prime contractors expect to earn an appropriate fee to reflect the responsibility as a prime contractor, especially including

- overhead costs associated with capital assets used by the subcontractor;
- the costs of managing contracts and the subcontractors hired to perform services or provide goods under those contracts;
- the costs of determining rates and expenses and the cost of accounting, recordkeeping and documentation for tracking and reporting purposes; and
- the cost of risk assumed by the prime contractor in guaranteeing the quality of work performed by the subcontractor to the government customer, including the risk of liability should the subcontractor's performance be nonconforming.

Second, the pass-through approach would harm the Government's ability to obtain the best overall solutions. Prime contractors would have less incentive to put together a team of contractors best capable of delivering the required solution. If a pass-through approach is adopted, the prime contractor will have a significant monetary incentive ***not*** to subcontract work. Also, the resulting decrease in subcontracting opportunities will negatively impact small businesses, which often do not possess the resources necessary to assume a prime contractor role. Any decrease in participation by small businesses will harm the Government's ability to access the innovative solutions reflected in many small business offerings.

Third, an argument advanced by some in favor of a pass-through approach is that any other approach would result in the prime contractor potentially earning a financial "windfall" on the "delta" between the prime contract and subcontractor labor rates. This argument, however, fails to consider the costs of managing subcontracted effort referenced above or that the prime contract rates may reflect an anticipation that some of the labor will be subcontracted, with the result being a blended rate reflecting the anticipated subcontractor labor rates. The windfall argument also fails to reflect that, regardless of whether the proposed labor rates are blended rates, the reasonableness of the proposed labor rates are determined through competition and other price evaluation techniques prescribed by the FAR to ensure that the pricing is fair and reasonable. Commercial time and material contracts are required by law to be awarded only after a competition is conducted. If contractors were achieving excessive profits from such contracts, competitive forces would quickly eliminate any such excessive profits.

Finally, another argument advanced by some advocating a pass-through approach is that procuring agencies have insufficient insight into a prime contractor's planned subcontract approach. This concern, however, is easily addressed in acquisitions by simply requiring the prime contractor in major acquisitions (perhaps defined to include acquisitions in excess of the simplified acquisition threshold) to list its major subcontractors so that the use of the named subcontractors may be evaluated as part of the source-selection evaluation purposes and to provide notice during contract performance of any change in subcontractors. The notifications regarding subcontractors, however, are performance and management issues, and is not a pricing issue. The price of all labor, including any subcontracted labor, should be the price offered by the prime contractor.

For these reasons, ITAA submits that the FAR should be clarified to reflect a default rule stating that subcontract labor shall be billed at the prime contract rates and not as a pass through cost.

III. Post-Award "Defective Pricing" Audits are Prohibited by Statute and Are Unnecessary.

The Federal Acquisition Regulation and the General Services Administration's supplement thereto should be clarified to explicitly state that post-award audits of pre-award pricing information (the so-called "defective pricing audits") are strictly prohibited in commercial item acquisitions. The GSA issued a notice of advance rulemaking ("ANPR") on April 12, 2005 requesting comments on whether GSA's contract provisions should permit post-award audits of contractor's pre-award pricing, sales, or other data that formed the basis for the contract award.

ITAA's position on this issue is well known, yet we are compelled once again to voice our strong objection to the prospect that such post-award audits might be imposed. Congress via the Clinger-Cohen Act expressed its opposition to this type of post-award audit of a commercial item contractor's pre-award information, and such audits are contrary to customary commercial practice. The administrative burden and risk of liability connected with these audits would discourage participation in the Federal market by commercial contractors.

In addition to exempting commercial item procurements from TINA, the Clinger-Cohen Act reflects Congress's intent that defective pricing audits be inapplicable to commercial item contracts. The House Report that accompanied the Act provided:

> The National Defense Authorization Act for Fiscal Year 1996 (Public Law 104-06) eliminated certain rights by the government to audit information to be supplied by commercial suppliers in lieu of certified cost or pricing data. In taking this action, Congress clearly and willfully did not intend that this statutory change permit federal agencies to subsequently determine through agency supplements to the Federal Acquisition Regulation whether and to what extent post award audit access is appropriate on commercial item contracts.

House National Security Committee, Defense Authorization Act for FY 1997, House Report No. 104-563, 104th Congress 2nd Session, p. 324.

When GSA subsequently sought to impose an interim rule including the post-award audit language, the principal architects of the Clinger-Cohen Act, Senator Cohen and former Representatives Spence and Clinger, wrote to the Director of the Office of Management and Budget, and emphasized that:

> The Federal Acquisition Reform Act of 1996 … eliminated the authority of Federal agencies to perform post-award audits of suppliers of commercial items. ***The clear intent of Congress was that these audits would no longer be performed by Federal agencies.*** Congress clearly did not intend that this statutory change permit Federal agencies to subsequently determine through agency supplements to the Federal Acquisition Regulation whether and to what extent post award audit access is appropriate on commercial item contracts.

Congressional intent is clear on this issue—"the only remaining authority for the government to pursue post-award audits of contractor records regarding the purchase of commercial items is the G[overnment] Account[ability] Office." *Id.*

In addition, both the Federal Acquisition Streamlining Act and the FAR mandate that Federal agencies, to the maximum extent practicable, use only those terms and conditions that are required by law or that are customary in the commercial marketplace, and to revise practices and procedures not required by law so as to reduce impediments to the acquisition of commercial items. Post-award audits are neither required by law nor customary in the commercial marketplace. It would be extremely rare for a company in the commercial market to provide a

buyer with a contractual right to second guess the data that formed the basis of the bargain ***after contract execution***.

Furthermore, allowing a party, years later, to re-examine and second-guess the data that formed the basis of the bargain will without question lead to many disputes, and it would otherwise be unfair to the contractor. In its May 9, 2005 comments to the ANPR, the GSA Office of Inspector General (the "GSA OIG") stated that contractors' concerns regarding potential fraud liability were "greatly exaggerated." We beg to differ. The apparent purpose of "defective pricing" audits is to find problems in the contractor's pre-award pricing information provided to the Government. Thus, Government auditors are incentivized to question the contractor's submission and to identify problems. The potential burdens posed by this audit mentality would be exaggerated in the context of post-award audits. An auditor's post-hoc evaluation of the completeness, accuracy, or currency of the pre-award data would force contractors to spend substantial resources justifying the data that very often was submitted years earlier. Contractors would be faced with the very real risk of having to defend against allegations of fraud, demands to recoup funds expended, and damage to its reputation when its interpretation of its prior submissions is different than that of the auditors.

Importantly, there is ample opportunity to protect taxpayers' interests without imposing burdensome post-award audits, and that is through use of ***pre-award audits***. With pre-award audits, any perceived problems with a contractor's submission of pricing information can be resolved prior to the formation of a contract. In other words, the pre-award audit approach provides both the Government and the contractor a chance to fix any perceived problems prior to any alleged harm being incurred by the Government through the submission of pricing data that is allegedly less than accurate, complete, or current.

Interestingly, the GSA OIG in its May 9, 2005 comments argues that its office only has sufficient resources to conduct 70 pre-award audits for FY 2005. Yet, the GSA OIG argues that it should have the right to conduct post-award audits as a backstop for contracts that are not reviewed pre-award. If the GSA OIG does not have sufficient resources to perform pre-award audits—which the GSA OIG itself admits should be given priority—we question why it is asking for authority to perform burdensome post-award defective pricing audits, which would divert its resources from doing pre-award audits. The Government would be far better served if the GSA OIG focused its resources in performing pre-award audits.

This issue continues to be the source of significant concern to the contracting community. ITAA urges the Panel to recommend that the FAR be revised to reflect that post-award audits of pre-award information are inapplicable to commercial item acquisitions.

IV. Commercial Items Should be Exempt From the Buy American Act and Trade Agreements Act.

Commercial item acquisitions should be made exempt from the requirements of the Trade Agreements Act ("TAA") and Buy American Act ("BAA"). These domestic-content restrictions are posing a substantial burden for commercial item vendors, resulting in higher prices for the Government and limitations on the Government's access to the latest state-of-the-art

technologies. In ITAA's view, any perceived benefit derived by the Government, and specifically the U.S. Trade Representative, through use of TAA and BAA as bargaining chips when negotiating trade agreements has proven to be minimal, at best. The costs of these Government-unique rules significantly offset any perceived benefit.

ITAA recommends that two actions be taken. First, the FAR Councils should finalize its January 15, 2004 proposed FAR rule regarding the implementation of Section 4203 of the Clinger-Cohen Act of 1996, 41 U.S.C. § 431. The Clinger-Cohen Act requires that the FAR list certain provisions of law that are inapplicable to contracts for acquisitions of commercially available off-the-shelf ("COTS") items. The January 15, 1004 notice of proposed rulemaking proposed the addition of the TAA (19 U.S.C. 2501, et seq. and 19 U.S.C. § 2512 et seq.) and the BAA, (41 U.S.C. 10a, et seq.) to the list of laws for which COTS acquisitions are exempt. ITAA supports the inclusion of the TAA and BAA on this list mandated by the Clinger-Cohen Act.

Second, ITAA recommends that Congress pass legislation exempting the broader category "commercial items" from application of TAA and BAA requirements. Such an exemption is in the best interest of the United States.

Importantly, the TAA and BAA place information technology and other U.S. companies at a distinct disadvantage in the worldwide commercial market. U.S. companies often must source products and components globally to remain cost competitive in the worldwide commercial market. In some cases the sourcing decision may be mandated by manufacturing or supply constraints. As a result, the TAA and BAA sometime cause a "catch-22" situation in that a contractor must choose between either being competitive in the worldwide commercial market or being competitive in the U.S. Government market, but not both. As a practical matter, because virtually all IT companies derive the vast majority of their revenues in the private sector, contractors typically choose to remain competitive in the commercial market and forego the potential Government sales when forced to make this choice. Because commercial IT companies tend to derive only three to ten percent of their total revenue from the Government market, their production decisions are driven primarily by the commercial market. The result, unfortunately, is that the Government may be denied access to state-of-the-art information technologies - including the latest and most powerful versions - which almost anyone else in the world may acquire.

The TAA and BAA also impose significant administrative burdens on contractors. For example, to comply with the TAA's "substantial transformation" test for determining the country of origin (only products from a limited set of countries designated under the WTO procurement agreement, NAFTA and the Caribbean Basin Initiative, as well as the U.S. itself, are eligible to be bid), contractors must monitor closely their own manufacturing processes and those of their suppliers, and determine precisely the point in which a product may be deemed "substantially transformed." This monitoring must continue even during contract performance, because contractor manufacturing and supply-chain decisions often change, based on changed circumstances in the global market that cannot be tailored to government-specific needs. Experience has shown that it is quite possible for a compliant product to be offered to the Government only to have the manufacturing location of the product subsequently shift to a

country not covered by the TAA, bringing the product out of compliance unless special steps are taken to maintain a second production line in a compliant country that is dedicated to production for Government customers. This is especially true for the many contracts that require deliveries over the course of several years. This situation is contrary to the entire philosophy of COTS and commercial item acquisition, which take as a main goal bringing to the Government the efficiency and effectiveness of the commercial marketplace. That cannot be accomplished when the rules dictate a Government-specific solution.

Adding to the burden posed by these laws is that the certifications that implement the TAA and BAA act as lightning rods for potential False Claims Act liability. This point is evident in the recent settlement between the Department of Justice and OfficeMax. Through the settlement, the Government and a qui tam relator received a significant monetary settlement worth several million dollars stemming from allegations that OfficeMax was noncompliant with the TAA. According to the allegations, such noncompliance violated the False Claims Act. Our concern is that innocent mistakes in judgment or administrative errors are ripe for allegations of fraud under the False Claims Act. This is especially the case with respect to the TAA and BAA.

In sum, the cost of complying with the TAA and BAA, as well as the associated risk of fraud allegations in the event of noncompliance, deters vendors from participating in the Government market and limits the Government's access to the latest and most powerful technologies.

V. Conclusion.

The Section 1423 Acquisition Advisory Panel has an excellent opportunity to facilitate positive change in the rules that apply to Federal procurement. ITAA urges the Panel to consider the recommendations set out in this paper. ITAA would be pleased to further discuss any of the issues addressed herein with the Panel.