

# DHG

DIXON HUGHES GOODMAN LLP

# Commercial Item Pricing & Challenges in the Current Environment

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**PUBLIC  
CONTRACTING  
INSTITUTE**

**Trending Cost & Pricing Issues  
Webinar Series**



# Instructor



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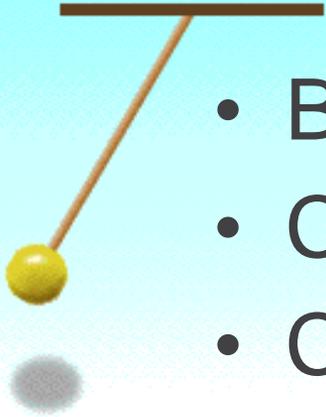
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# The Cost and Price Analysis Series

- May 18 - Part I: Price Analysis and Fair and Reasonable Pricing
- **June 15-27 - Part II: Commercial Item Pricing and Challenges in the Current Environment**
- September 21 - Part III: Direct and Indirect Costs and a Little Thing Called G&A!
- October 19 - Part IV: Profit – Yes, contractors are allowed to have some!?
- November 16 – Part V - Cost Analysis and Cost Realism and Their Expanding Roles in Contract Pricing
- December 21 - Part VI: Defective Pricing – Hazards & Defenses

# CIDs – A recap



- Benefits of commercial items
- Commercial Item – 8 Elements
- Challenges to the CID
- Market Research
- CID is not clearly defined in regulation
- Documentation is critical
- Opening the Aperture



Large Aperture  
*f/2*



Medium Aperture  
*f/8*



Small Aperture  
*f/22*

# Commercial Item Pricing – Part Deux

- The determination of fair and reasonable pricing for the commercial item or service is probably the most challenging task for the contracting officer today. One of the principle challenges recognized today, is identifying and evaluating a price for a commercial item or service to be fair and reasonable.
- This virtual class will prepare buyers and sellers to maximize efficiency with analysis tools and techniques that are provided in guidance available to federal oversight officials.
- The instructor will review current guidance available, industry best practices and current, relevant examples to help fill the knowledge gap and close the loop on commercial item pricing.

# Learning Objectives

- Upon completion of this session the participant should know:
  - Price analysis tools and techniques to support fair and reasonable commercial item price determinations
  - Guidelines available in several agencies to support to price analysis process for commercial items
  - Additional layers of approvals placed on procurement officials when using commercial pricing
  - Recent trends and developments affecting the ability of the contracting officer to award commercial item contracts



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# Commercial Item Pricing

# Adequate pricing

- The key to adequately pricing products and services is market research:
  - Prices can be influenced by a variety of non-cost factors
  - MR generally produces information can be relied upon
- Requires the adoption of business practices common in the commercial sector to determine what prices are fair and reasonable.
- Competitive forces of the marketplace generally yield more favorable pricing of commercial products and services.
- The price analysis process should be fairly simple and not overly burdensome.
- Having a good understanding of what is being bought and knowing how to assess its value from a customer view point is more important than determining the vendor's incurred costs for the commercial product or service.

# Skills Required – Diligence and Common Sense

- Consider buying a TV set for your personal use, at a minimum:
  - You would want to know comparable prices in the marketplace
  - You would not request a breakdown of the costs for the labor, overhead, materials, G&A or transportation
  - Consider your personal needs and budget constraints
  - Hone in on a price range - focus on non-price factors such as product features, performance or reliability, warranty, brand name or company reputation, and other quality considerations, in addition to price.
- In determining which TV set represents the best value selection, you usually balance the non-price or quality factors with relevant pricing information you obtained in your research of other competitive brand name TV sets
- After having evaluated all factors, you select a particular brand-name TV set that represents the best value, given the alternatives considered, and you proceed with the purchase

# Market Leverage and Market Research

- Market Leverage—The Key to Reasonable Prices and Best Value Decisions
  - How well you know the Government needs?
  - How well you know the commercial marketplace?
  - How well you use market leverage?
- Pricing Information Obtained from Market Research
  - CO may rely on this information to determine expected pricing
  - Expectation is that the competitive forces of the marketplace generally yield more favorable pricing of commercial products and services
  - Market research should continue throughout the entire acquisition process, up to and including the conclusion of negotiations

# Sources of Commercial Pricing Information

- Supplier catalogs
- Electronic Internet search engines
- Government “electronic malls”
- Data readily available from market research
- Data available from Government purchasing/engineering activities
- Analogies—comparative pricing information for similar items
- Parametric analyses
- Advice from Government pricing and audit personnel
- Company historical records
- Industry association databases

# Market Research Questions

- The following slides list some factors that affect commercial pricing
  - No single, magical checklist exists
  - Critical thinking needed for more unique or specialized acquisitions
  - The questions can serve as a primer for the acquisition team
  - Questions are not all inclusive

# Market Research Questions

## Research Factor

## Be Able to Answer Questions Such As...

Pricing History

What information is available concerning past prices paid for the service or item of supply and about changes in the supply item or service or market since then?

Have there been historic differences between prices paid by the Government vis-à-vis other buyers? Why?

Competitive Conditions

How many sellers are in the market?

How many buyers?

Are other companies expected to enter the market?

Demand Levels

What is the relationship of the quantity the Government intends to buy vis-à-vis the quantities that others buy?

Will the planned volume justify a lower-than-market price as a result of the seller's increased economies of scale?

Will the planned volume be so large as to drive the sellers to or beyond full capacity, resulting in unanticipated inflation?

Is the procurement for items at the leading edge of market demand (i.e., market demand is increasing), or at the back end (i.e., demand for the item is dropping)?

Trends in Supply and Demand

Will demand be higher or lower at the time of award than now?

Will supply capacity keep pace with demand?

# More Market Research Questions . . .

<u>Research Factor</u>	<u>Be Able to Answer Questions Such As...</u>
Pattern of Demand	<p>Is there a cyclical pattern to supply and demand?</p> <p>Would allowing delivery to be made at a later date result in lower prices than an immediate award? Or would it be better to stock up now at today's prices (if there is a bona fide need)?</p>
Other Market Forces Expected to Affect Contract Price	<p>What forces might drive up prices in the near future? Strikes? Labor shortages? Subcontractor bottlenecks? Energy shortages? Other raw material shortages? Legislative action?</p> <p>What forces might lead the Government to expect lower prices in the future? Rising unemployment? Industry downturn?</p>
Pricing Strategies & Incentives	<p>What are the pricing strategies of firms in the commercial market?</p> <p>What discounts are available for quantity buys?</p> <p>What types of incentives are used by firms in the commercial market?</p>
Sources of Supplies or Services	<p>Which firms in the market are the most likely to submit offers to a Government solicitation?</p> <p>Which are the least likely, and why?</p>
Supply or Service Characteristics	<p>What features distinguish one service or item of supply from another?</p> <p>Which commercial supplies or services match most closely the Government requirements document (as it currently reads in the purchase request)?</p> <p>What is the apparent trade-off between features and price?</p>

# A few more . . .

<u>Research Factor</u>	<u>Be Able to Answer Questions Such As...</u>
Delivery/ Performance Terms	What are the current distribution channels? What are current transportation costs (if available and applicable)?
Ownership Costs	What are the commercial lead-times? What are the commercial warranty terms and conditions (if any)? What are the historical repair costs for each item? What are the historical maintenance costs for each item? What are the lifecycle costs (possible energy cost, costs of oil, toner, paper requirements, gasoline, electricity, etc.)?
Contract Terms and Conditions	What terms and conditions are used in commercial transactions for the supply item or service? What terms and conditions have been used in other Government acquisitions of the supply item or service? What type of contract is generally used in commercial transactions for the supply item or service? What type of contract is generally used in commercial transactions for the supply item or service in other Government acquisitions?
Problems	What has been the historical default rate by firms performing similar contracts? What performance problems have typically been encountered? Have similar acquisitions been characterized by claims or cost overruns?
Overall Value	What is the relationship between price and the overall value to the Government?



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# Price Analysis

# Pricing Policy – FAR 15.402

Purchase supplies and services from responsible sources at fair and reasonable prices:

- Obtain data other than certified cost or pricing data as necessary to establish a fair and reasonable price
- Generally use the following order of preference in determining the type of data required:
  - Adequate price competition - No Additional Data
  - Data other than certified cost or pricing data such as data related to prices (e.g., established catalog or market prices, sales to non-governmental and governmental entities), relying:
    - First on data available within the Government;
    - Second, on data obtained from sources other than the offeror; and
    - If necessary, on data obtained from the offeror.
    - When obtaining data from the offeror is necessary, unless an exception under 15.403-1(b)(1) or (2) applies, such data submitted by the offeror shall include, at a minimum, appropriate data on the prices at which the same or similar items have been sold previously, adequate for evaluating the reasonableness of the price.
- Cost data to the extent necessary for the contracting officer to determine a fair and reasonable price

# How Much Data?

- Obtain the type and quantity of data necessary to establish a fair and reasonable price, but not more data than is necessary.
- Requesting unnecessary data can lead to increased proposal preparation costs, generally extend acquisition lead time, and consume additional contractor and Government resources.
- Use techniques such as, but not limited to, price analysis, cost analysis, and/or cost realism analysis to establish a fair and reasonable price.
- If a fair and reasonable price cannot be established by the CO from the analyses of the data obtained or submitted to date, the CO shall require the submission of additional data sufficient for the CO to support the determination of the fair and reasonable price

# Price Analysis

- Contracting officers must ensure that commercial items—like any other supplies or services bought for the Government—are purchased at fair and reasonable prices.
- Price analysis, as supported by market research, is the preferred method for determining whether prices paid for commercial items are fair and reasonable.
- When using price analysis, the focus is on examining and evaluating a proposed price without evaluating its separate costs elements or profit.

# 15.403-3(c) – Commercial Items

- At a minimum, the contracting officer must use price analysis to determine whether the price is fair and reasonable
- The fact that a price is included in a catalog does not, in and of itself, make it fair and reasonable.
- If the contracting officer cannot determine whether an offered price is fair and reasonable, even after obtaining additional data from sources other than the offeror, then the contracting officer shall require the offeror to submit data other than certified cost or pricing data to support further analysis. This data may include:
  - history of sales to non-governmental and governmental entities,
  - cost data, or
  - any other information the contracting officer requires to determine the price is fair and reasonable.
  - Unless an exception applies, the CO shall require that the data submitted by the offeror include, at a minimum, appropriate data on the prices at which the same item or similar items have previously been sold, adequate for determining the reasonableness of the price.
  - For services that are not offered and sold competitively in substantial quantities in the commercial marketplace, but are of a type offered and sold competitively in substantial quantities in the commercial marketplace, see 15.403-1(c)(3)(ii).

# Limitations Relating to Commercial Items

- The contracting officer shall limit requests for sales data relating to commercial items to data for the same or similar items during a relevant time period.
- The contracting officer shall, to the maximum extent practicable, limit the scope of the request for data relating to commercial items to include only data that are in the form regularly maintained by the offeror as part of its commercial operations.
- The Government must not disclose outside the Government data obtained relating to commercial items that is exempt from disclosure under 24.202(a) or the Freedom of Information Act (5 U.S.C. 552(b)).



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# Price Analysis

# Techniques

- Comparison of Proposed Prices – BEST!
- Trade-off Process
- Low Price Technically Acceptable
- Comparison with Competitive Published Price Lists, Published Market Prices of Commodities, Similar Indexes, and Discount or Rebate Arrangements
- Comparison of Proposed Prices with Prices Obtained Through Market Research for the Same or Similar Items
- Analysis of Data Other than CCPD
- Value Analysis

# Full & Open Competition

OFFEROR	PRICE	MEETS GOVERNMENT'S REQUIREMENT?
OFFEROR 1	\$120,000	YES
OFFEROR 2	\$145,000	YES
OFFEROR 3	\$135,000	YES
OFFEROR 4	\$155,000	YES
OFFEROR 5	\$125,000	YES

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OFFEROR 1	\$120,000	YES
OFFEROR 2	\$145,000	YES
OFFEROR 3	\$135,000	YES
OFFEROR 4	\$155,000	YES
OFFEROR 5	\$125,000	YES

In the example, five offerors submitted quotes and all are deemed technically acceptable. In evaluating simply on price, the CO can make award to Offeror 1. In this example, competition has driven down the price and all offerors satisfy the Government's requirement.

# Tradeoff Process

OFFEROR	PRICE	ADJECTIVAL RATING
OFFEROR 1	\$120,000	UNSATISFACTORY
OFFEROR 2	\$170,000	EXCELLENT
OFFEROR 3	\$175,000	VERY GOOD
OFFEROR 4	\$172,000	GOOD
OFFEROR 5	\$125,000	MARGINAL

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OFFEROR 5	\$125,000	MARGINAL

In the example, the two lowest price offerors, Offerors 1 and 5 received either unsatisfactory or marginal ratings respectively, after evaluation of final proposal revisions. It is in the CO's best interest to award to Offeror 2. Although higher, priced Offeror 2 received an excellent rating which, after a thorough tradeoff process analysis, was determined to be well worth the additional cost. Since the offered prices vary significantly, it could mean that Offerors 1 and 5 do not understand the requirements.

# Low Price Technically Acceptable

OFFEROR	PRICE	TECHNICALLY ACCEPTABLE
OFFEROR 1	\$120,000	No
OFFEROR 2	\$170,000	YES
OFFEROR 3	\$175,000	YES
OFFEROR 4	\$172,000	YES
OFFEROR 5	\$125,000	No

# Low Price Technically Acceptable

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OFFEROR 2	\$170,000	YES
OFFEROR 3	\$175,000	YES
OFFEROR 4	\$172,000	YES
OFFEROR 5	\$125,000	No

In the example, Offerors 1 and 5 are not deemed technically acceptable. Although they offered the lowest prices, the CO should not make an award to either of them, since their product/service does not meet the requirements, needs and or standards. In this case, the CO should award to the lowest priced offeror that is technically acceptable, which is Offeror 2.

# Comparison with Competitive Published Price Lists, Published Market Prices of Commodities, Similar Indexes, and Discount or Rebate Arrangements

- Use price lists and other publicly available market data
- Compare to commercial item price lists maintained by the Government or other competitors
  - Understand the terms and conditions for the items being used for comparison and make adjustments, as necessary, to account for any differences
  - Refer to the Contract Pricing Reference Guides
  - Ensure any price lists, market data, and other published data are up-to-date and are published by a reliable source
- Comparison of Previously Proposed Prices
- Prices Set By Law Or Regulation
- Historical comparison
- Comparison to Independent Government Estimates (IGE)

# Comparison of Proposed Prices with Prices Obtained Through Market Research for the Same or Similar Items

- The importance of market research cannot be overstated
- Thorough market research prior to solicitation will produce a substantial amount of information that can be used to analyze proposed prices
- Market research will reveal:
  - the potential number of suppliers and buyers
  - demand for the product or service
  - availability of the product or service, and
  - a host of other factors that influence price.
- The amount of time and effort devoted to market research in the pre-solicitation phase will pay dividends when offers are received

# Analysis of Data Other than CCPD Provided by the Offeror

- The least preferred technique for analyzing proposed prices is to require the offeror to provide data other than certified cost or pricing data
- This technique should only be used when all other attempts to establish the reasonableness of a proposed price have failed
- A price breakdown is pricing information provided by the offeror.
- It could include:
  - sales history to other customers
  - proposal history, and
  - information other than cost or pricing data.
- Limitations relating to commercial items
  - Limit requests for sales data relating to commercial items to data for the same or similar items during a relevant time period
  - To the maximum extent practicable, limit the scope of the request for information relating to commercial items to include only information that is in the form regularly maintained by the offeror as part of its commercial operations
  - Must not disclose information obtained relating to commercial items that is exempt from disclosure under FOIA

# Value Analysis

- What does the product have to do?
- What does it cost now?
- What prices did the Government pay previously?
- What does it cost to operate and maintain?
- What other ways can the functioned be performed?
- What will these alternatives cost?
- Is it part of a larger system or product?
- What is the cost of the system or product?
- What is the affect on mission accomplishment without the availability?

# Last Resort . . .

- Cannot determine whether an offered price is fair and reasonable – The CO must require Data Other than CCPD to support further analysis
- When purchasing services that are not offered and sold competitively in substantial quantities in the commercial marketplace, but are of a type offered and sold competitively in substantial quantities in the commercial marketplace, they may be considered commercial items - **only if the CO determines in writing** that the offeror has submitted sufficient information to evaluate, through price analysis, the reasonableness of the price of such services.
  - In order to make this determination, the CO may request the offeror to submit prices paid for the same or similar commercial items under comparable terms and conditions by both Government and commercial customers; and
  - If the CO determines that the information is not sufficient to determine the reasonableness of price, other relevant information regarding the basis for price or cost, including information on labor costs, material costs and overhead rates may be requested



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# Current Events . . .

# Current Trends

- 2017 NDAA – Subtitle F
  - 10 Provisions relating to commercial items
- 2017 Drafts of Commercial Pricing Guides
  - Issued through DoD AT&L
  - Industry provided lengthy comments
- a revised rule . . . any day now ? ? ?



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**In Summary . . .**

# Summary

- GOAL - Fair and reasonable price
  - not lowest price
  - not a perfect price
- Good Market Research is critical
- Competition is encouraged
- Traditional price analysis tools are used
- Comparisons are good – Likely no perfect fit
- Keep your aperture open

# Thank you for participating . . .

- Join us on September 21 –

## **Part III: Direct and Indirect Costs and a Little Thing Called G&A!**