

# *Chapter 6*

## **Types of Contracts**



*2014 Contract Attorneys Deskbook*

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## **CHAPTER 6**

### **TYPES OF CONTRACTS**

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## **CHAPTER 6**

### **TYPES OF CONTRACTS**

#### **I. OBJECTIVES**

Following this block of instruction, the student should:

1. Understand the common contract types by structure.
2. Know the factors that a contracting officer must consider in selecting a contract type.
3. Understand the fundamental differences between fixed-price and cost-reimbursement contracts.
4. Recognize a Cost-Plus-Percentage-of-Cost contract and understand it is a prohibited contract type.

#### **II. GENERAL INFORMATION**

- A. Why Types? A wide selection of contract types is available to the government in order to provide needed flexibility in acquiring the large variety and volume of supplies and services required by agencies. FAR 16.101(a). Contract types vary according to:
  1. The degree and timing of the responsibility assumed by the contractor for the costs of performance; FAR 16.101(a)(1) and
  2. The amount and nature of the profit incentive offered to the contractor for achieving or exceeding specified standards or goals. FAR 16.101(a)(2).
- B. Categories. Contract Types can be categorized by Structure and also by Price.
  1. When categorized by structure, there are basic contracts with or without option years, indefinite delivery contract structures, letter contracts and basic ordering or purchasing agreements (covered in the simplified acquisition instruction).
  2. When categorized by price, there are two basic types of contracts: Fixed-Price Contract Types and Cost Reimbursement Contract Types. FAR 16.101(b). The selection of contract type's price structure will allocate risk to either the government or the contractor. Firm fixed price contracts allocate to the contractor the full responsibility for the

performance costs and resulting profit (or loss). Cost contracts allocate minimal responsibility for the contractor to control costs. For more discussion, see figure 10 on page 61 and the discussion on selection of contract types.

- C. Disputes. In determining which type of contract was entered into by the parties, the court is not bound by the name or label given to a contract. Rather, it must look beyond the first page of the contract to determine what were the legal rights for which the parties bargained, and only then characterize the contract. *Crown Laundry & Dry Cleaners, Inc. v. United States*, 29 Fed. Cl. 506, 515 (1993).

### III. CONTRACT TYPES – CATEGORIZED BY STRUCTURE.

#### A. Base Contract + Option Periods.



1. Base Contract. Most contracts are awarded with a base contract period and one or more option periods. A common structure is a one fiscal year base contract with four one-fiscal-year options where each option may be unilaterally exercised at the government’s option during a specified period of time.
2. Definition of an Option. FAR 17.201. A unilateral right in a contract by which, for a specified time, the Government may elect to purchase additional supplies or services called for by the contract, or may elect to extend the term of the contract.
3. Total Contract Period.
  - a. Generally, a contract, including all options, may not exceed five years. See [FAR 17.204\(e\)](#). See also [10 U.S.C. § 2306b](#) and [FAR Subpart 17.1](#) (limiting multi-year contracts); [10 U.S.C. § 2306c](#) and [FAR 17.204\(e\)](#) (limiting certain service Ks); [41 U.S.C. § 6707\(d\)](#) and [FAR 22.1002-1](#) (limiting contracts falling under the SCA to 5 years in length); see also [Delco Elec. Corp., B-244559](#), Oct. 29, 1991, 91-2 CPD ¶ 391 (use of options with delivery dates seven and half years later does not violate FAR 17.204(e), because the five year limit applies to five years’ requirements in a supply contract);

Freightliner, ASBCA No. 42982, 94-1 BCA ¶ 26,538 (option valid if exercised within five years of award).

- b. Variable option periods do not restrict competition. Madison Servs., Inc., B-278962, Apr. 17, 1998, 98-1 CPD ¶ 113 (Navy's option clause that allowed the Navy to vary the length of the option period from one to twelve months did not unduly restrict competition).
- c. The contract shall state the period within which the option may be exercised. The period may extend beyond the contract completion date for service contracts. The contract shall specify limits on the purchase of additional supplies or services, or the overall duration of the term of the contract.
- d. Use of Options. [FAR 17.202](#).
  - (1) The Government can use options in contracts awarded under sealed bidding and negotiated procedures when in the Government's interest.
  - (2) Inclusion of an option is normally not in the Government's interest when:
    - (a) The foreseeable requirements involve:
      - (i) Minimum economic quantities; and
      - (ii) Delivery requirements far enough into the future to permit competitive acquisition, production, and delivery.
    - (b) An indefinite quantity or requirements contract would be more appropriate than a contract with options. However, this does not preclude the use of an ID/IQ or requirements contract with options.
  - (3) The contracting officer shall not employ options if:
    - (a) The contractor will incur undue risks; e.g., the price or availability of necessary materials or labor is not reasonably foreseeable;
    - (b) Market prices for the supplies or services involved are likely to change substantially; or

- (c) The option represents known firm requirements for which funds are available unless—
    - (i) The basic quantity is a learning or testing quantity; and
    - (ii) Competition for the option is impracticable once the initial contract is awarded.
- e. Evaluation of options. Normally offers for option quantities or periods are included in the solicitation and evaluated when awarding the basic contract. [FAR 17.206\(a\)](#). The total price of the contract includes all the option periods.
  - (1) If the option was not evaluated during the basic contract, it may not be exercised without an approved exception to full and open competition under the Competition in Contracting Act (CICA). See Major Contracting Services, Inc., Comp. Gen. B-401472, Sept. 14, 2009.
  - (2) An agency may only exclude options from evaluation if it would not be in the best interest of the government and this determination is approved at a level above the contracting officer. [FAR 17.206\(b\)](#).
- f. Contract Extensions.
  - (1) If an option is not evaluated as part of the initial competition, exercise of the option amounts to a “contract extension beyond the scope of the contract, and therefore effectively constitutes a new procurement” which is subject to the CICA’s competition requirements. Major Contracting Services, Inc, B-401472, 14 Sept 2009.
  - (2) “Bridge Contracts.” Often a “bridge” contract involves a contract extension for a period of time while a follow-on contract is being competed. These “bridge” contracts are subject to CICA’s competition requirements. By statute, failure to adequately plan for a procurement in advance is not a proper justification for a competition exception. [41 USC § 3304\(e\)\(5\)\(A\)](#); VSE Corp.; Johnson Controls World Serv., Inc., 2005 CPD ¶ 103; Techno-Sciences, Inc., B-257686, 31 Oct. 1994; Laidlaw Environmental Services (GS), B-249452, 23 Nov. 1992.

g. Exercising Options.

- (1) Exception from competition. The exercise of an option permits an agency to satisfy current needs for goods and services without going back through full competitive procedures. *Banknote Corp. of America, Inc.*, Comp. Gen B-250151, Dec. 14, 1992. Thus, the government must comply with applicable statutes and regulations before exercising an option. *Golden West Ref. Co.*, EBCA No. C-9208134, 94-3 BCA ¶ 27,184 (option exercise invalid because statute required award to bidder under a new procurement); *New England Tank Indus. of N.H., Inc.*, ASBCA No. 26474, 90-2 BCA ¶ 22,892 (option exercise invalid because of agency's failure to follow DOD regulation by improperly obligating stock funds); see [FAR 17.207](#).
- (2) The Contracting Officer may exercise an option only after determining that:
  - (a) Funds are available;<sup>1</sup>
  - (b) The requirement fills an existing need;
  - (c) The exercise of the option is the most advantageous method of fulfilling the Government's need, price and other factors considered;<sup>2</sup> and
  - (d) The option was synopsized in accordance with Part 5 unless exempted under that Part (ie. Option was part of the original solicitation that was competed under CICA).
- (3) To determine whether it is appropriate to exercise the option instead of re-competing the need, the Contracting Officer shall make the determination to exercise the option on the basis of one of the following:
  - (a) A new solicitation fails to produce a better price or more advantageous offer.

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<sup>1</sup> Failure to determine that funds are available does not render an option exercise ineffective, because it relates to an internal matter and does not create rights for contractors. See *United Food Servs., Inc.*, ASBCA No. 43711, 93-1 BCA ¶ 25,462 (holding valid the exercise of a one-year option subject to availability of funds).

<sup>2</sup> The determination of other factors should take into account the Government's need for continuity of operations and potential costs of disrupting operations. [FAR 17.207\(e\)](#).

- (b) An informal analysis of the market indicates the option is more advantageous.
  - (c) The time between contract award and exercise of the option is so short that the option is most advantageous.
- (4) The government must exercise the option according to its terms.
- (a) The government may not include new terms in the option without meeting CICA requirements. See 4737 Connor Co., L.L.C. v. United States, 2003 U.S. App. LEXIS 3289 (Fed. Cir. 2003) (option exercise was invalid where the Government added a termination provision not present in the base period of the contract at the time of exercise of the option); VARO, Inc., ASBCA No. 47945, 47946, 96-1 BCA ¶ 28,161 (inclusion of eight additional contract clauses in option exercise invalidated the option).
  - (b) The government must follow the option mechanics in the contract to include timing of notice. See Lockheed Martin Corp. v. Walker, 149 F.3d 1377 (Fed. Cir. 1998) (Government wrongfully exercised options out of sequence); The Boeing Co., ASBCA No. 37579, 90-3 BCA ¶ 23,202 (Navy failed to exercise the option within the 60 days allowed in the contract and the board invalidated the option); and White Sands Construction, Inc., ASBCA Nos. 51875, 54029 (Apr. 16, 2004) (Exercise improper when preliminary notice of intent to exercise mailed on last day available and contractor received it after the deadline). Compare The Cessna Aircraft Co. v. Dalton, 126 F.3d 1442 (Fed. Cir. 1997) (exercise of option on 1 Oct. proper).
- (5) If a contractor contends that an option was exercised improperly, and performs, it may be entitled to an equitable adjustment. See Lockheed Martin IR Imaging Sys., Inc. v. West, 108 F.3d 319 (1997) (partial exercise of an option was held to be a constructive change to the contract).

(6) The government has the discretion to decide whether to exercise an option.

(a) Decision not to exercise.

(i) The decision not to exercise an option is generally not a protestable issue since it involves a matter of contract administration. See Young-Robinson Assoc., Inc., B-242229, Mar. 22, 1991, 91-1 CPD ¶ 319 (contractor cannot protest agency's failure to exercise an option because it is a matter of contract administration); but see Mine Safety Appliances Co., B-238597.2, July 5, 1990, 69 Comp. Gen. 562, 90-2 CPD ¶ 11 (GAO reviewed option exercise which was, in effect, a source selection between parallel development contracts).

(ii) A contractor may file a claim under the Disputes clause, but must establish that the Government abused its discretion or acted in bad faith. See Kirk/Marsland Adver., Inc., ASBCA No. 51075, 99-2 ¶ 30,439 (summary judgment to Government); Pennyrile Plumbing, Inc., ASBCA Nos. 44555, 47086, 96-1 BCA ¶ 28,044 (no bad faith or abuse of discretion).

(b) The decision to exercise an option is subject to protest. See Alice Roofing & Sheet Metal Works, Inc., B-283153, Oct. 13, 1999, 99-2 CPD ¶ 70 (protest denied where agency reasonably determined that option exercise was most advantageous means of satisfying needs).

B. **Indefinite Delivery Type Contracts** – Three Types. FAR Subpart 16.5. FAR 16.501-2(a) recognizes three types of indefinite delivery contracts: definite-quantity contracts, requirements contracts, and indefinite-quantity/indefinite delivery contracts. All three types permit Government stocks to be maintained at minimum levels, and permit direct shipment to users.

1. **Terminology.** [FAR 16.501-1](#).

- a. Delivery order contract. A contract for supplies that does not procure or specify a firm quantity of supplies (other than a minimum or maximum quantity) and that provides for the issuance of orders for the delivery of supplies during the period of the contract.
  - b. Task order contract. A contract for services that does not procure or specify a firm quantity of services (other than a minimum or maximum quantity) and that provides for the issuance of orders for the performance of tasks during the period of the contract.
2. **Definite-Quantity/Indefinite-Delivery Contracts.** [FAR 16.502](#); [FAR 52.216-20](#). The quantity and price are specified for a fixed period. The government issues delivery orders that specify the delivery date and location.
3. **Requirements Contracts.** [FAR 16.503](#); [FAR 52.216-21](#).
- a. The government promises to order all of its requirements, if any, from the contractor, and the contractor promises to fill all requirements. See Sea-Land Serv., Inc., B-266238, Feb. 8, 1996, 96-1 CPD ¶ 49 (solicitation for requirements contract which contained a “Limitation of Government Liability” clause purporting to allow the government to order services elsewhere rendered contract illusory for lack of consideration).
  - b. The Government breaches the contract when it purchases its requirements from another source. Datalect Computer Servs. Inc. v. United States, 56 Fed. Cl. 178 (2003) (finding agency breached its requirements contract covering computer maintenance services where agency later obtained extended warranty from equipment manufacturer covering same items); Torncello v. United States, 681 F.2d 756 (Ct. Cl. 1982) (Navy diverted rodent pest control services); T&M Distributors, Inc., ASBCA No. 51279, 01-2 BCA ¶ 31,442 (finding that Ft. Carson breached its requirements contract covering the operation of an auto parts store when certain tenant units elected to order their parts from cheaper suppliers).
  - c. The Government may also breach the contract if it performs the contracted-for work in-house. C&S Park Serv., Inc., ENGBCA Nos. 3624, 3625, 78-1 BCA ¶ 13,134 (failure to order mowing services in a timely fashion combined with use of government employees to perform mowing services entitled contractor to equitable adjustment under changes clause). The Government deferral or backlogging of its orders such that it does not order

its actual requirements from a contractor is also a breach of a requirements contract. R&W Flammann GmbH, ASBCA Nos. 53204, 53205, 02-2 BCA ¶ 32,044.

- d. Contractors may receive lost profits as a measure of damages when the Government purchases supplies or services from an outside source. See T&M Distributors, Inc., ASBCA No. 51279, 01-2 BCA ¶ 31,442; Carroll Auto., ASBCA No. 50993, 98-2 BCA ¶ 29,864.
- e. The Government cannot escape liability for the breach of a requirements contract by retroactively asserting constructive termination for convenience. T&M Distributors, Inc., ASBCA No. 51279, 01-2 BCA ¶ 31,442; Carroll Auto., ASBCA No. 50993, 98-2 BCA ¶ 29,864 (Government invoked constructive Termination for Convenience (T4C) theory two years after contract performance); Torncello v. United States, 231 Ct. Cl. 20, 681 F.2d 756 (Ct. Cl. 1982).
- f. A requirements contract must contain [FAR 52.216-21](#). If the Government inadvertently or intentionally omits this clause, a court or board will examine other intrinsic / extrinsic evidence to determine whether it is a requirements contract. See, e.g., Centurion Elecs. Serv., ASBCA No. 51956, 03-1 BCA ¶ 32,097 (holding that a contract to do all repairs on automated data processing equipment and associated network equipment at Fort Leavenworth was a requirements contract despite omission of requisite clause).
- g. The Contracting Officer shall state a realistic estimated total quantity in the solicitation and resulting contract. The estimate is not a representation to an offeror or contractor that the estimated quantity will be required or ordered, or that conditions affecting requirements will be stable or normal. The estimate may be obtained from records of previous requirements and consumption, or by other means, and should be based on the most current information available. [FAR 16.503\(a\)\(1\)](#). The estimate is not a guarantee or a warranty of a specific quantity. Shader Contractors, Inc. v. United States, 149 Ct. Cl. 535, 276 F.2d 1, 7 (Ct. Cl. 1960).
- h. There is no need to create or search for additional information. Medart v. Austin, 967 F.2d 579 (Fed. Cir. 1992) (court refused to impose a higher standard than imposed by regulations in finding reasonable the use of prior year's requirements as estimate). The standard is for the government to base its estimates on "all relevant information that is reasonably

available to it.” Womack v. United States, 182 Ct. Cl 399, 401, 389 F.2d 793, 801 (1968).

- i. The estimates can be based on personal experience as long as it is reasonable. National Salvage & Service Corp., ASBCA No. 53750 (Jun. 18, 2004).
- j. The GAO will sustain a protest if a solicitation contains flawed estimates. Beldon Roofing & Remodeling Co., B-277651, Nov. 7, 1997, CPD 97-2 ¶ 131 (recommending cancellation of invitation for bids (IFB) where solicitation failed to provide realistic quantity estimates).
- k. Failure to use available data or calculate the estimates with due care may also entitle the contractor to additional compensation. See Hi-Shear Tech. Corp. v. United States, 53 Fed. Cl. 420 (2002) (noting the government “is not free to carelessly guess at its needs” and that it must calculate its estimates based upon “all relevant information that is reasonably available to it.”); S.P.L. Spare Parts Logistics, Inc., ASBCA Nos. 51118, 51384, 02-2 BCA ¶ 31,982; Crown Laundry & Dry Cleaners v. United States, 29 Fed. Cl. 506 (1993) (finding the government was negligent where estimates were exaggerated and not based on historical data); and Contract Mgmt., Inc., ASBCA No. 44885, 95-2 BCA ¶ 27,886 (granting relief under the Changes clause where Government failed to revise estimates between solicitation and award to reflect funding shortfalls).
- l. Contractors are generally not entitled to lost profits for negligent estimates. Recovery is generally limited to reliance damages and a price adjustment. See Rumsfeld, v. Applied Companies, Inc., 325 F.3d 1329 (Fed. Cir. 2003), and Everett Plywood v. United States, 190 Ct. Cl. 80, 419 F.2d 425 (Ct. Cl. 1969) (contractor entitled to adjustment of the contract price applied to the volume of timber actually cut). The purpose of a damages award is to put the non-breaching party in as good a position as it would have been but for the breach. S.P.L. Spare Parts Logistics, Inc., ASBCA Nos. 54435, 54360, 06-1 BCA ¶ 33,135.
- m. A negligent estimate that was too low may result in a constructive change to the contract. Chemical Technology v. United States, 227 Ct. Cl. 120, 645 F.2d 934 (1981).
- n. The only limitation on the Government’s freedom to vary its requirements after contract award is that it be done in good faith.

- (1) The Government acts in good faith if it has a valid business reason for varying its requirements, other than dissatisfaction with the contract. Technical Assistance Int'l, Inc. v. United States, 150 F.3d 1369 (Fed. Cir. 1998) (no breach or constructive change where Government diminished need for vehicle maintenance and repair work by increasing rate at which it added new vehicles into the installation fleet); Shear Tech. Corp. v. United States, 53 Fed. Cl. 420 (2002); Maggie's Landscaping, Inc., ASBCA Nos. 52462, 52463 (June 2, 2004) (Government had valid reasons to reduce orders, to include dry and wet conditions).
- (2) "Bad faith" includes actions "motivated solely by a reassessment of the balance of the advantages and disadvantages under the contract" such that the buyer decreases its requirements to avoid its obligations under the contract. Technical Assistance Int'l, Inc. v. United States, 150 F.3d 1369, 1372 (Fed. Cir. 1998) (citing Empire Gas Corp. v. Am. Bakeries Co., 840 F. 2d 1333, 1341 (7<sup>th</sup> Cir. 1988)).
- (3) The Government is not liable for acts of God that cause a reduction in requirements. Sentinel Protective Servs., Inc., ASBCA No. 23560, 81-2 BCA ¶ 15,194 (drought reduced need for grass cutting).

Limits on use of Requirements Contracts for Advisory and Assistance Services (CAAS).<sup>3</sup> 10 U.S.C. § 2304b(e)(2); [FAR 16.503\(d\)](#). Activities may not issue solicitations for requirements contracts for advisory and assistance services in excess of three years and \$10 million, including all options, unless the contracting officer determines in writing that the use of the multiple award procedures is impracticable. See para. III.E.9b, *infra*.

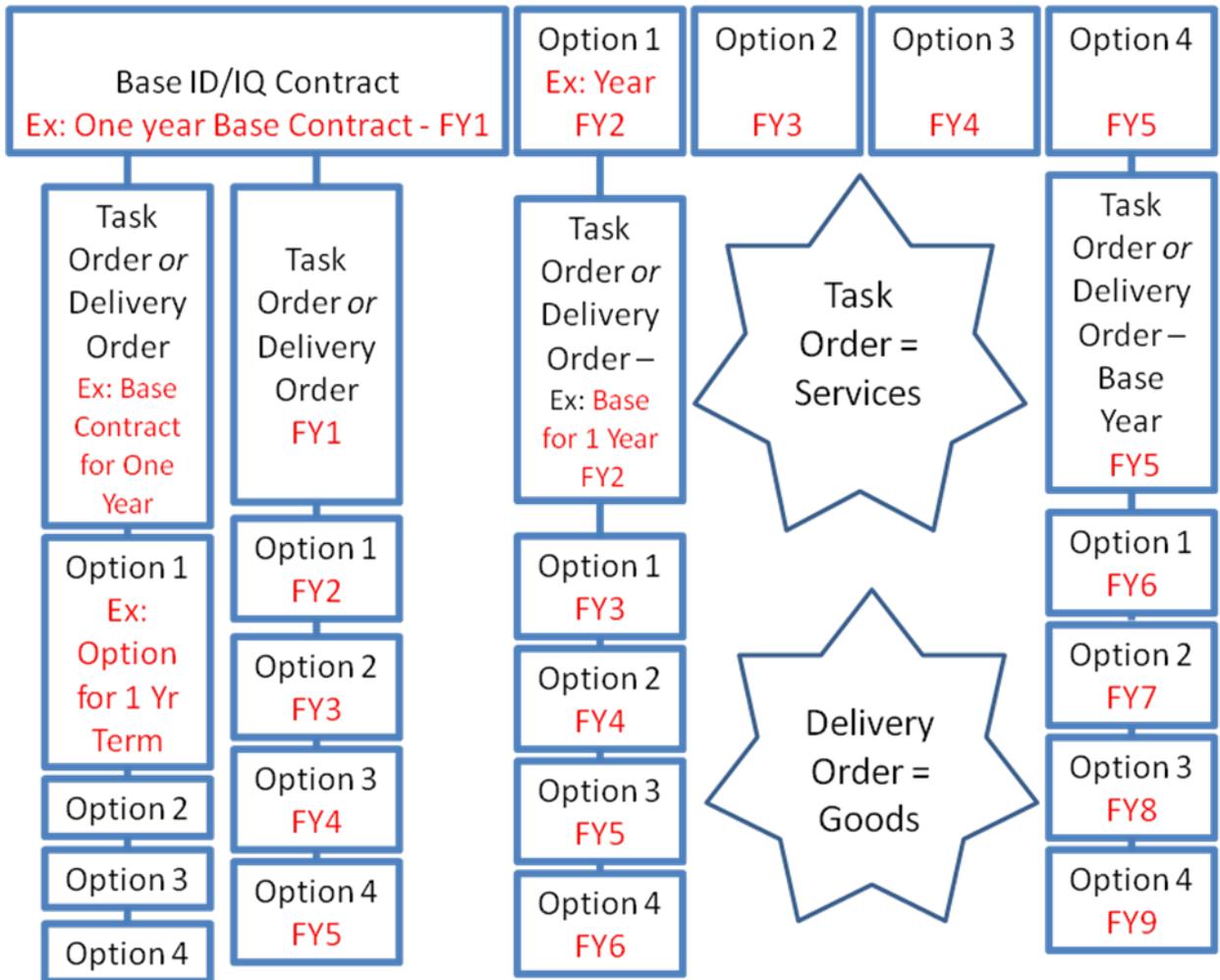
4. **Indefinite-Quantity/Indefinite-Delivery Contracts (also called ID/IQ or Minimum Quantity Contracts).** [FAR 16.504](#).

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<sup>3</sup> "Advisory and assistance services" means those services provided under contract by nongovernmental sources to support or improve: organizational policy development; decision making; management and administration; program and/or program management and administration; or R&D activities. It can also mean the furnishing of professional advice or assistance rendered to improve the effectiveness of Federal management processes or procedures (including those of an engineering or technical nature). All advisory and assistance services are classified as: Management and professional support services; Studies, analyses and evaluations; or Engineering and technical services. [FAR 2.101](#). See also [DOD Directive 4205.2, Acquiring And Managing Contracted Advisory And Assistance Services \(CAAS\) \(10 Feb. 92\)](#); as well as [AR 5-14, Management of Contracted Advisory and Assistance Services \(15 Jan. 93\)](#).

- a. Generally.
  - (1) Indefinite or variable quantity contracts permit flexibility in both quantities and delivery schedules.
  - (2) These contracts permit ordering of supplies or services after requirements materialize.
  - (3) An indefinite quantity contract must be either a requirements or an ID/IQ contract. See *Satellite Servs., Inc.*, B-280945, B-280945.2, B-280945.3, Dec. 4, 1998, 98-2 CPD ¶ 125 (solicitation flawed where it neither guaranteed a minimum quantity nor operated as a requirements contract).
- b. An ID/IQ contract shall require the Government to order and the contractor to furnish at least a stated minimum quantity of supplies or services. In addition, if ordered, the contractor shall furnish any additional quantities, not to exceed the stated maximum. [FAR 16.504\(a\)](#).

Example of an ID/IQ Contract Structure



- c. Application. Contracting officers may use an ID/IQ contract when the Government cannot predetermine, above a specified minimum, the precise quantities of supplies or services that the Government will require during the contract period, and it is inadvisable for the Government to commit itself for more than a minimum quantity. The contracting officer should use an indefinite quantity contract only when a recurring need is anticipated. [FAR 16.504\(b\)](#).
- d. In order for the contract to be binding, the minimum quantity in the contract must be more than a nominal quantity. [FAR 16.504\(a\)\(2\)](#). See CW Government Travel, Inc., B-295530 (\$2500 minimum adequate when it represented several hundred transactions in travel services); Wade Howell, d.b.a. Howell Constr. v. United States, 51 Fed. Cl. 516 (2002); Aalco Forwarding, Inc., et. al., B-277241.15, Mar. 11, 1998, 98-1 CPD ¶ 87 (\$25,000 minimum for moving and storage services); Sea-Land Serv. Inc., B-278404.2 Feb. 9, 1998, 98-1 CPD ¶ 47 (after considering the acquisition as a whole, found guarantee of one “FEU”<sup>4</sup> per contract carrier was adequate consideration to bind the parties). If the contract contains option year(s), only the base period of performance must contain a non-nominal minimum to constitute adequate consideration. Varilease Technology Group, Inc. v. United States, 289 F.3d 795 (Fed. Cir. 2002)
- e. The contractor is entitled to receive only the guaranteed minimum. Travel Centre v. Barram, 236 F.3d 1316 (Fed. Cir. 2001) (holding that agency met contract minimum so “its less than ideal contracting tactics fail to constitute a breach”); Crown Laundry & Dry Cleaners, Inc., ASBCA No. 39982, 90-3 BCA ¶ 22,993; but see Community Consulting Int’l., ASBCA No. 53489, 02-2 BCA ¶31,940 (granting summary judgment on a breach of contract claim despite the government satisfying the minimum requirement). The corrected quantum must account for the amount the contractor would have spent to perform the unordered work. Bannum, Inc., DOTBCA 4452, 06-1 BCA ¶ 33,228.
- f. The government may not retroactively use the Termination for Convenience clause to avoid damages for its failure to order

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<sup>4</sup> Meaning Forty-Foot Equivalent Unit, an FEU is an industry term for cargo volumes measuring 8 feet high, 8 feet wide, and 40 feet deep.

the minimum quantity. Compare Maxima Corp. v. United States, 847 F.2d 1549 (Fed. Cir. 1988) (termination many months after contract completion where minimum not ordered was invalid), and PHP Healthcare Corp., ASBCA No. 39207, 91-1 BCA ¶ 23,647 (contracting officer may not terminate an indefinite-quantity contract for convenience after end of contract term), with Hermes Consolidated, Inc. d/b/a Wyoming Refining Co., ASBCA Nos. 52308, 52309, 2002 ASBCA LEXIS 11 (partial T4C with eight days left in ordering period proper) and Montana Ref. Co., ASBCA No. 50515, 00-1 BCA ¶ 30,694 (partial T4C proper when Government reduced quantity estimate for jet fuel eight months into a twelve month contract).

- g. The contractor must prove the damages suffered when the Government fails to order the minimum quantity. The standard rule of damages is to place the contractor in as good a position as it would have been had it performed the contract. White v. Delta Contr. Int'l, Inc., 285 F.3d 1040, 43 (Fed. Cir. 2002) (noting that “the general rule is that damages for breach of contract shall place the wronged party in as good a position as it would have been in, had the breaching party fully performed its obligation”); PHP Healthcare Corp., ASBCA No. 39207, 91-1 BCA ¶ 23,647 (holding the contractor was not entitled to receive the difference between the guaranteed minimum and requiring the parties to determine an appropriate quantum); AJT Assocs., Inc., ASBCA No. 50240, 97-1 BCA ¶ 28,823 (holding the contractor was only entitled to lost profits on unordered minimum quantity).
- h. The contract statement of work cannot be so broad as to be inconsistent with statutory authority for task order contracts and the requirements of the Competition in Contracting Act. See Valenzuela Eng'g, Inc., B-277979, Jan. 26, 1998, 98-1 CPD ¶ 51 (statement of work for operation and maintenance services at any government facility in the world deemed impermissibly broad).
- i. [FAR 16.506\(a\)\(4\) and 16.506 \(f\) & \(6\)](#) set forth several requirements for indefinite-quantity solicitations and contracts, including the use of [FAR 52.216-27](#), Single or Multiple Awards, and [FAR 52.216-28](#), Multiple Awards for Advisory and Assistance Services.
- j. Statutory Limitation on Awarding Sole-Source ID/IQ's: Section 843 of the 2008 NDAA limited DoD's ability to award large, sole-source ID/IQ contracts. Section 843 modified Title

10 by prohibiting the award of any ID/IQ estimated to exceed \$100 million (including options), unless the head of the agency determines, in writing, that:

- (1) the task or delivery orders expected under the contract are so integrally related that only a single source can reasonably perform the work;
- (2) the contract provides only for firm, fixed price task orders or delivery orders for— products for which unit prices are established in the contract, or services for which prices are established in the contract for the specific tasks to be performed;
- (3) only one source is qualified and capable of performing the work at a reasonable price to the government; or
- (4) because of exceptional circumstances, it is necessary in the public interest to award the contract to a single source.
- (5) Finally, the head of the agency must notify Congress within 30 days after any written determination authorizing the award of an ID/IQ estimated to exceed \$100 million.

k. Policy Preference for Multiple-Award ID/IQs: [FAR 16.504\(c\)\(1\)\(i\)](#) establishes a preference for making multiple awards of indefinite-quantity contracts under a single solicitation for similar supplies or services. See Nations, Inc., B-272455, Nov. 5, 1996, 96-2 CPD ¶ 170 (GAO ruled that the government must make multiple awards in CAAS indefinite delivery/indefinite quantity type of contracts). The contracting officer must document the decision whether or not to make multiple awards in the acquisition plan or contract file.

- (1) A contracting officer must give preference to giving multiple awards for ID/IQs, unless one or more of the conditions specified in [FAR 16.504\(c\)\(1\)\(ii\)\(B\)](#) are present:
  - (a) Only one contractor is capable of providing performance at the level of quality required because the supplies or services are unique or highly specialized;
  - (b) Based on the contracting officer's knowledge of the market, more favorable terms and

conditions, including pricing, will be provided if a single award is made;

- (c) The cost of administration of multiple contracts may outweigh any potential benefits from making multiple awards;
  - (d) The tasks likely to be ordered are so integrally related that only a single contractor can reasonably perform the work;
  - (e) The total estimated value of the contract is less than the simplified acquisition threshold; or
  - (f) Multiple awards would not be in the best interests of the government.
- (2) For advisory and assistance services contracts exceeding three years and \$12.5 million, including all options, the contracting officer must make multiple awards unless ([FAR 16.504\(c\)\(2\)](#)):
- (a) The contracting officer or other official designated by the head of the agency makes a written determination as part of acquisition planning that multiple awards are not practicable because only one contractor can reasonably perform the work because either the scope of work is unique or highly specialized or the tasks so integrally related. Compare Nations, Inc., B-272455, Nov. 5, 1996, 96-2 CPD ¶ 170 (ruling that Army's failure to execute D&F justifying single award rendered RFP defective) with Cubic Applications, Inc., v. United States, 37 Fed. Cl. 345 (1997) (Cubic not entitled to equity where it failed to raise multiple award issue prior to award);
  - (b) The contracting officer or other official designated by the head of the agency determines in writing, after the evaluation of offers, that only one offeror is capable of providing the services required at the level of quality required; or
  - (c) Only one offer is received; or

- (d) The contracting officer or other official designated by the head of the agency determines that the advisory and assistance services are incidental and not a significant component of the contract.

l. Ordering periods. DFARS 217.204.

- (1) The ordering period for a task or delivery order contract may be up to five years. DFARS 217.204(e)(i)(A).
- (2) Options or modifications may extend a contract, not to exceed ten years unless
  - (a) The head of the agency determines in writing that exceptional circumstances require a longer period.
  - (b) DoD must submit a report to Congress concerning any approved extensions. DFARS 217.204(e)(i)(B) & (C) and (ii).
  - (c) These limitations do not apply to:
    - (i) Contracts awarded under other statutory authority.
    - (ii) Advisory and assistance service task order contracts.
    - (iii) Definite quantity contracts.
    - (iv) GSA schedule contracts.
    - (v) Multi-agency contracts awarded by other than NASA, DoD, or the Coast Guard.
  - (d) Approval is needed from the senior procurement executive before issuing any order if performance is expected to extend more than one-year beyond the authorized limit. DFARS 217.204(e)(iv).

m. Placing Orders. [FAR 16.505](#).

- (1) [FAR 16.505\(a\)](#) sets out the general requirements for orders under delivery or task order contracts. A

separate synopsis under [FAR 5.201](#) is not required for orders.

- (2) Orders under multiple award contracts. [FAR 16.505\(b\)](#).
  - (a) Fair Opportunity to be Considered. Each awardee must be given a “fair opportunity to be considered for each order in excess of \$3,000.” FAR 16.505(b)(1)(i). See also Nations, Inc., B-272455, Nov. 5, 1996, 96-2 CPD ¶ 170.
  - (b) Fair Opportunity to be Considered for ID/IQ Orders of \$5,000,000 or less. The KO has broad discretion in developing order placement procedures that will satisfy the requirement to provide each contractor a “fair opportunity to be considered.” The KO should use streamlined procedures, including oral presentations. Additionally, the KO need not contact each of the multiple ID/IQ awardees before selecting an order awardee, if the KO has the information necessary to ensure that all ID/IQ awardees have a fair opportunity to compete for each order. FAR 16.16.505(b)(1)(ii).
  - (c) Fair Opportunity to be Considered for ID/IQ Orders exceeding \$5,000,000. Section 843 of the FY 2008 NDAA modified 10 U.S.C. § 2304c to require enhanced competition for orders in excess of \$5,000,000. In essence, orders exceeding \$5,000,000 must be “competed” among the ID/IQ awardees. KO’s do not satisfy the requirement to provide a fair opportunity be considered unless the KO provides each ID/IQ awardee:
    - (i) a notice of the task or delivery order that includes a clear statement of the agency’s requirements;
    - (ii) a reasonable period of time to provide a proposal in response to the notice;
    - (iii) disclosure of the significant factors and subfactors, including cost or price, that the agency expects to consider in

evaluating such proposals and their relative importance;

- (iv) in the case of an order award that is to be made on a best value basis, a written statement documenting the basis for the award and the relative importance of quality and price or cost factors; and
  - (v) an opportunity for a post award debriefing consistent with the requirements of 10 U.S.C. 2305(b)(5). The post award debriefing requirements of 10 U.S.C. 2305(b)(4) are currently implemented in FAR 15.506, Postaward Debriefing of Offerors.
- (d) Exceptions to the Requirement to provide a Fair Opportunity to be Considered. Awardees need not be given a fair opportunity to be considered for an order if: there is an urgent need; there is only one capable source, the order is a logical follow-on to a previously placed order, or the order is necessary to satisfy a minimum guarantee. [FAR 16.505\(b\)\(2\)](#).
- (e) [DFARS 208.404-70](#) requires that any order off of a Federal Supply Schedule (FSS) in excess of \$100,000 be made on a competitive basis. The Contracting Officer must either: issue the notice to as many schedule holders as practicable, consistent with market research appropriate to the circumstances, to reasonably ensure that proposals will be received from at least 3 sources that offer the required work; or contact all schedule holders that offer the required work by informing them of the opportunity for award.
- (f) [DFARS 216.505-70](#) requires any task order in excess of \$150,000 placed under a non-FSS multiple award contract (MAC) also be made on a competitive basis. All awardees that offer the required work must be provide a copy of the description of work, the basis upon which the contracting officer will make the selection, and given the opportunity to submit a proposal.

- (g) The contract may specify maximum or minimum quantities that may be ordered under each task or delivery order. [FAR 16.504\(a\)\(3\)](#). However, individual orders need not be of some minimum amount to be binding. See *C.W. Over and Sons, Inc.*, B-274365, Dec. 6, 1996, 96-2 CPD ¶ 223 (individual delivery orders need not exceed some minimum amount to be binding).
  - (h) Any sole source order under the FSS or MAC requires approval consistent with the approval levels in FAR 6.304. *See* Memorandum, Director, Defense Procurement and Acquisition Policy, to Senior Procurement Executives & Directors of Defense Agencies, subject: Approval Levels for Sole Source Orders Under FSS and MACs (13 Sep. 04). *See also*, Chapter 5, Contract Attorneys Course Deskbook.
- n. Protests concerning task orders. The issuance of a task or delivery order is generally not protestable.<sup>5</sup> Exceptions include:
- (1) Task orders whose value exceeds \$10,000,000. See 10 U.S.C. § 2304c (sunset of bid protest jurisdiction eliminated for DOD.) But see 41 U.S.C. § 4106(f)(1) (suspending bid protest jurisdiction on 30 September 2016) .
  - (2) Where an agency conducts a downselection (selection of one of multiple contractors for continued performance). See *Electro-Voice, Inc.*, B-278319, B-278319.2, Jan. 15, 1998, 98-1 CPD ¶ 23.
  - (3) Where an agency conducts a competition among ID/IQ contractors and arrives at its source selection using negotiated procurement procedures. CourtSmart

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<sup>5</sup> "[A] protest is not authorized in connection with the issuance or proposed issuance of a task or delivery order except for a protest on the ground that the order increases the scope, period, or maximum value of the contract under which the order is issued." [10 U.S.C. § 2304c\(e\)](#). See also [4 C.F.R. § 21.5\(a\)](#) (providing that the administration of an existing contract is within the purview of the contracting agency, and is an invalid basis for a GAO protest). *But see *Group Seven Associates, LLC v. United States*, COFC No. 05-867C (Oct. 13, 2005)* (looking at the merits and denying the protest, although noting that jurisdiction was "doubtful.")

Digital Sys., Inc., B-292995.2, B-292995.3, Feb. 13, 2004; COMARK Fed. Sys., B-278343, B-178343.2, Jan. 20, 1998.

- (4) A competition is held between an ID/IQ contractor (or BPA holder) and another vendor. AudioCARE Sys., B-283985, Jan. 31, 2000, 2000 CPD ¶ 24.
- (5) The order exceeds the contract's scope of work. See Anteon Corp., B-293523, B-293523.2, Mar. 29, 2004, 2004 CPD ¶ 51; Symplicity Corp., B-291902, Apr. 29, 2003 (purchase order improper when it included items not part of the vendor's Federal Supply Schedule contract); Makro Janitorial Servs., Inc., B-282690, Aug. 18, 1999, 99-2 CPD ¶ 39 (task order for housekeeping services beyond scope of preventive maintenance contract).
- (6) The protest challenges the transfer to an ID/IQ contract the acquisition of services that had been previously set aside for small businesses. LBM, Inc., B-290682, Sep. 18, 2002, 2002 CPD ¶ 157.
- (7) The FAR requires the head of an agency to designate a Task and Delivery Order Ombudsman to review complaints from contractors and ensure they are afforded a fair opportunity to be considered for orders. The ombudsman must be a senior agency official independent of the contracting officer and may be the agency's competition advocate. FAR 16.505(b)(5).

**Discussion Problem:** Redstone Arsenal awarded a contract to Hanley's Dirty Laundry, Inc. for laundry services at the installation. The contract contained the standard indefinite quantity clause, however, it did not set forth a guaranteed minimum quantity. At the end of the first year of performance, the government had ordered only half of the contract's estimated quantity. Hanley's filed a claim for the increased unit costs attributable to performing less work than it had anticipated. The Arsenal prepared the estimated quantities for the contract by obtaining estimated monthly usage rates from serviced activities and multiplying by twelve. These estimates were two years old at the time the Arsenal awarded the contract but no attempt was made to update them. In addition, the Arsenal had more recent historical data available but failed to use it. Hanley's argued that the government was liable due to a defective estimate. The government argued that the contract was an indefinite quantity contract, therefore, there was no liability for a defective estimate.

Is the government liable?

C. **LETTER CONTRACTS.** [FAR 16.603](#).

1. Use. Letter contracts are used when the Government's interests demand that the contractor be given a binding commitment so that work can start immediately, and negotiating a definitive contract is not possible in sufficient time to meet the requirement. Letter contracts are also known as **Undefinitized Contract Actions** (UCA).
2. Approval for Use. The head of the contracting activity (HCA) or designee must determine in writing that no other contract is suitable. [FAR 16.603-3](#); [DFARS 217.7404-1](#). Approved letter contracts must include a not-to-exceed (NTE) price.
3. Definitization. The parties must definitize the contract (agree upon contractual terms, specifications, and price) by the earlier of the end of the 180 day period after the date of the letter contract, or the date on which the amount of funds obligated under the contractual action is equal to more than 50 percent of the negotiated overall ceiling price for the contractual action.<sup>6</sup> [10 U.S.C. § 2326](#); [DFARS 217.7404-3](#).
4. The maximum liability of the Government shall be the estimated amount necessary to cover the contractor's requirements for funds before definitization, but shall not exceed 50 percent of the estimated cost of the definitive contract unless approved in advance by the official who authorized the letter contract. [10 U.S.C. § 2326\(b\)\(2\)](#); [FAR 16.603-2\(d\)](#); [DFARS 217.7404-4](#).
5. Restrictions: Letter contracts shall not
  - a. Commit the Government to a definitive contract in excess of funds available at the time of contract.
  - b. Be entered into without competition when required.
  - c. Be amended to satisfy a new requirement unless that requirement is inseparable from the existing letter contract. [FAR 16-603-3](#).
6. Liability for failure to definitize? See *Sys. Mgmt. Am. Corp.*, ASBCA Nos. 45704, 49607, 52644, 00-2 BCA ¶ 31,112 (finding the Assistant Secretary of the Navy unreasonably refused to approve a proposed definitization of option prices for a small disadvantaged business's supply contract).

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<sup>6</sup> [FAR 16.603-2\(c\)](#) provides for definitization within 180 days after date of the letter contract or before completion of 40 percent of the work to be performed, whichever occurs first.

7. The Air Force has added a Mandatory Procedure tracking UCAs and definitization schedules. Any failure to definitize within one year must be reported to the Deputy Assistant Secretary of the Air Force for Contracting. AFFARS MP5317.7404-3.

#### IV. CONTRACT TYPES - CATEGORIZED BY PRICE

##### A. Fixed-Price Contracts. [FAR Subpart 16.2](#).

1. General. Fixed Price (FP) contracts provide for a firm price, or in appropriate cases, an adjustable price. FAR 16.201. Fixed-price contracts that provide for an adjustable price may include a ceiling price, a target price (including a target cost), or both. The most common types of fixed price contracts include: Firm, Fixed Price (FFP), Fixed Price with Economic Price Adjustment (EPA), Fixed Price with Award Fee, and Fixed Price Incentive Fee (FPIF) contracts.
2. Use. Use of a FP contract is normally inappropriate for research and development work, and has been limited by DOD Appropriations Acts. See FAR 35.006 (c) (the use of cost-reimbursement contracts is usually appropriate for R&D contracts); but see *American Tel. and Tel. Co. v. United States*, 48 Fed. Cl. 156 (2000) (upholding completed FP contract for developmental contract despite stated prohibition contained in FY 1987 Appropriations Act).
3. **Firm-Fixed-Price Contracts (FFP)**. FAR 16.202.
  - a. A FFP contract is not subject to any adjustment on the basis of the contractor's cost experience on the contract. It provides maximum incentive for the contractor to control costs, perform effectively, and impose a minimum administrative burden on the contracting parties. FAR 16.202-1. (See Figure 1, page 3). The contractor promises to perform at a fixed-price, and bears the responsibility for increased costs of performance. The contractor also accepts the benefit of decreased costs associated with the items to be delivered under the contract. Appeals of *New Era Contract Sales, Inc.*, ASBCA Nos. 56661, 56662, 56663, April 4, 2011 (failure of subcontractor to honor previously quoted prices does not excuse prime contractor); *Chevron U.S.A., Inc.*, ASBCA No. 32323, 90-1 BCA ¶ 22,602 (the risk of increased performance costs in a fixed-price contract is on the contractor absent a clause stating otherwise).
  - b. An FFP is appropriate for use when acquiring commercial items or for acquiring other supplies or services on the basis of reasonably definite functional or detailed specifications when

the contracting officer can establish fair and reasonable prices at the outset, such as when:

- (1) There is adequate price competition;
  - (2) There are reasonable price comparisons with prior purchases of the same or similar supplies or services made on a competitive basis or supported by valid cost or pricing data;
  - (3) Available cost or pricing information permits realistic estimates of the probable costs of performance; or
  - (4) Performance uncertainties can be identified and reasonable estimates of their cost impact can be made, and the contractor is willing to accept a firm fixed price representing assumption of the risks involved.
- FAR 16.202-2.

Figure 1

**Fixed Price = \$50**



| <b>If in performing the contract, the contractor incurs costs of:</b> | <b>Then the contractor is entitled to the following amount of money:</b> |
|---|--|
| <b>\$50</b>   | \$50   |
| <b>\$40</b>   | \$50   |
| <b>\$80</b>   | \$50   |
| <b>\$10</b>   | \$50   |

**Discussion Problem:** The NAVAIR Aviation Supply Office (ASO) awarded a firm-fixed-price contract for 9,397 aluminum height adapters to Joe’s Aluminum Manufacturing Corp. Shortly after contract award, the price of aluminum rose drastically. Joe’s refused to continue performance unless the government granted a price increase to cover aluminum costs. The ASO terminated the contract for default and Joe’s appealed the termination to the ASBCA.

Should the ASO have granted the price increase? Why or why not?

4. **Fixed-Price Contracts with Economic Price Adjustment (FP w/ EPA).** [FAR 16.203](#); [FAR 52.216-2](#); [FAR 52.216-3](#); and [FAR 52.216-4](#).
- a. Provides for upward and downward revision of the stated contract price upon the occurrence of specified contingencies. See Transportes Especiales de Automoviles, S.A. (T.E.A.S.A.), ASBCA No. 43851, 93-2 B.C.A. 25,745 (stating that “EPA provisions in government contracts serve an important purpose, protecting both parties from certain specified contingencies.”); MAPCO Alaska Petroleum v. United States, 27 Fed. Cl. 405 (1992) (indicating the potential price revision serves the further salutary purpose of minimizing the need for contingencies in offers and, therefore, reducing offer prices).
  - b. May be used when the contracting officer determines:
    - (1) there is serious doubt concerning the stability of market or labor conditions that will exist during an extended period of contract performance, and
    - (2) contingencies that would otherwise be included in the contract price can be identified and covered separately in the contract. [FAR 16.203-2](#).
  - c. Methods of adjustment for economic price adjustment clauses. [FAR 16.203-1](#).
    - (1) Cost indexes of labor or material (not shown). The standards or indexes are specifically identified in the contract. There is no standard FAR clause prescribed when using this method. The DFARS provides extensive guidelines for use of indexes. See [DFARS 216.203-4\(d\)](#).
    - (2) Based on published or otherwise established prices of specific items or the contract end items (not shown). Adjustments should normally be restricted to industry-wide contingencies. See [FAR 52.216-2](#) (standard supplies) and [FAR 52.216-3](#) (semi standard supplies); [DFARS 216.203-4](#) (indicating one should ordinarily only use EPA clauses when contract exceeds simplified acquisition threshold and delivery will not be completed within six months of contract award). The CAFC recently held that market-based EPA clauses are permitted under the FAR. Tesoro Hawaii Corp., et. al v. United States, 405 F.3d 1339 (2005).

- (3) Actual costs of labor or material (see Figure 2, page 31). Price adjustments should be limited to contingencies beyond the contractor's control. The contractor is to provide notice to the contracting officer within 60 days of an increase or decrease, or any additional period designated in writing by the contracting officer. Prior to final delivery of all contract line items, there shall be no adjustment for any change in the rates of pay for labor (including fringe benefits) or unit prices for material that would not result in a net change of at least 3% of the then-current contract price. [FAR 52.216-4\(c\)\(3\)](#). The aggregate of the increases in any contract unit price made under the clause shall not exceed 10 percent of the original unit price; there is no limitation on the amount of decreases. [FAR 52.216-4\(c\)\(4\)](#).
- (4) EPA clauses must be constructed to provide the contractor with the protection envisioned by regulation. Courts and boards may reform EPA clauses to conform to regulations. See Beta Sys., Inc. v. United States, 838 F.2d 1179 (Fed. Cir. 1988) (reformation appropriate where chosen index failed to achieve purpose of EPA clause); Craft Mach. Works, Inc., ASBCA No. 35167, 90-3 BCA ¶ 23,095 (EPA clause did not provide contractor with inflationary adjustment from a base period paralleling the beginning of the contract, as contemplated by regulations).

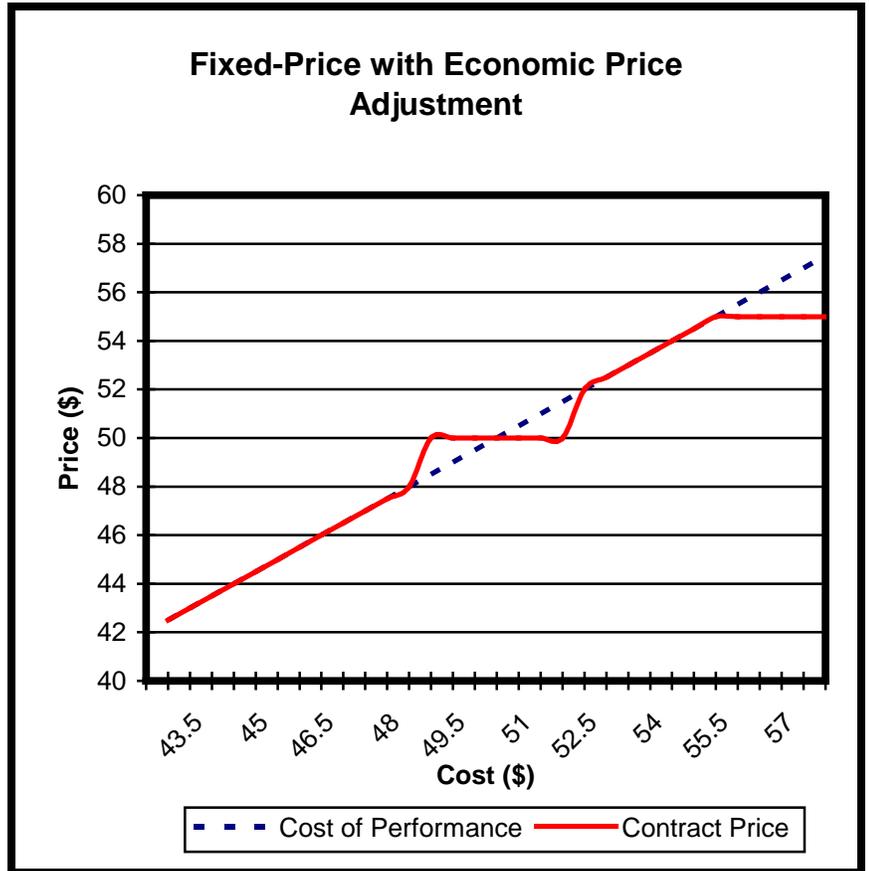
Figure 2

**Fixed Price = \$50**

**An EPA will be made if qualifying costs exceed 3% of the contract price.**

**By contract clause, the maximum upward adjustment is capped at 10% of the contract price.**

**A downward EPA will be made if costs are 3% to 100% lower than the contract price. There is no cap on downward EPA.**



| If due to price fluctuations recognized by the EPA clause, the contractor incurs costs of: | Then the contractor is entitled to the following amount of money: | Explanation   |
|--|---|---|
| <b>\$43</b>  | $\$50 - \text{EPA } \$7 = \$43.00$                                | There is no cap on economic price adjustments that reduce the contract price. Here, the reduced cost of performance qualifies for an adjustment and the government should pay the Ktr only \$43.00.   |
| <b>\$47</b>  | $\$50 - \text{EPA } \$3 = \$47.00$                                | Ktr receives less than the full fixed price because the reduction in costs has exceeded 3% of the contract price. Here, 3% of \$50.00 is \$1.50. The cost of performance is less than \$48.50 so this contract qualifies for a \$3 contract adjustment. The government should pay the Ktr only \$47.00. |
| <b>\$49</b>  | \$50  | Ktr receives the full Fixed Price because the reduction in costs has not exceeded 3% of the contract price. Here, 3% of \$50.00 is \$1.50, so the cost of performance must be below \$48.50 to qualify for an adjustment.   |
| <b>\$50</b>  | \$50  | Ktr receives the Fixed Price but has not qualified for any adjustment.  |
| <b>\$51</b>  | \$50  | Ktr receives the Fixed Price with no Adjustment because the increase in costs has not exceeded 3% of the contract price. Here, 3% of \$50.00 is \$1.50, so the increase in cost must exceed \$51.50 before an adjustment is made to the contract price.   |
| <b>\$53</b>  | $\$50 + \text{EPA } \$3 = \$53.00$                                | Ktr receives an Adjustment because the increase in costs has exceeded 3% of the contract price. The Ktr receives an additional \$3.00 as an Economic Price Adjustment (EPA).  |
| <b>\$55</b>  | $\$50 + \text{EPA } \$5 = \$55.00$                                | Costs have exceeded 3% of the contract price but have not exceeded the ceiling price on the contract, so the Ktr receives an EPA for the full amount of its costs.  |
| <b>\$56</b>  | $\$50 + \text{EPA Ceiling } \$5 = \$55$                           | Costs have exceeded 3% of the contract price and the 10% contract ceiling price of \$55.00. Ktr is limited to an EPA of \$5.00 because that is the K ceiling.   |

- (5) Alternatively, a party may be entitled to fair market value, or *quantum valebant* recovery. Gold Line Ref., Ltd. v. United States, 54 Fed. Cl. 285 (2002) (quantum valebant relief OR reformation of clause to further parties' intent "to adjust prices in accordance with the FAR); Barrett Ref. Corp. v. United States, 242 F.3d 1055 (Fed. Cir. 2001).
- (6) A contractor may waive its entitlement to an adjustment by not submitting its request within the time specified in the contract. Bataco Indus., 29 Fed. Cl. 318 (1993) (contractor filed requests more than one year after EPA clause deadlines).

5. **Fixed-Price Contracts with Award Fees.** [FAR 16.404.](#)

- a. Award Fee contracts are a type of incentive contract. With this type of contract, the contractor receives a negotiated fixed price (which includes normal profit) for satisfactory contract performance. Award fee (if any) will be paid in addition to that fixed price (see Figure 3, page 37). Unlike the Cost-Reimbursement with Award Fee type (see section II.B.3), there is no base fee.
- b. This type of contract should be used when the government wants to motivate a contractor and other incentives cannot be used because the contractor's performance cannot be measured objectively.
- c. Determination and Finding (D&F). FAR 16.401(d). A determination and finding, signed by the head of the contracting activity, is required. The D&F must justify that the use of this type of contract is in the best interests of the government. It must address all of the following suitability items:
  - (1) The work to be performed is such that it is neither feasible nor effective to devise predetermined objective incentive targets applicable to cost, schedule, and technical performance;
  - (2) The likelihood of meeting acquisition objectives will be enhanced by using a contract that effectively motivates the contractor toward exceptional performance and provides the government with the flexibility to evaluate both actual performance and the conditions under which it was achieved; and

- (3) Any additional administrative effort and cost required to monitor and evaluate performance are justified by the expected benefits as documented by a risk and cost benefit analysis to be included in the D&F. FAR 16.401(e).
- d. The contract must provide for periodic evaluation of the contractor's performance against an award fee plan. The Air Force Award Fee Guide, which can be found at <http://www.safaq.hq.af.mil/contracting/toolkit/part16/acrobat/award-feeguide.pdf> and the National Aeronautics And Space Administration Award Fee Contracting Guide, available at <http://www.hq.nasa.gov/office/procurement/regs/afguidee.html> both contain helpful guidance on setting up award fee evaluation plans.
- e. Funding Limitations: On 17 October 2006, the President enacted the 2007 National Defense Authorization Act (NDAA); Section 814 of the 2007 NDAA required the Secretary of Defense to issue guidance for the appropriate use of award fees in all DoD acquisitions.<sup>7</sup>
- f. In 24 April 2007, the Director, Defense Procurement and Acquisition Policy issued the required guidance on the proper use of award fees and the DoD award fee criteria.<sup>8</sup> The required DoD award fee criteria is reflected in the chart below:

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<sup>7</sup> John Warner National Defense Authorization Act, 2007, Pub. L. No. 109-364, 120 Stat. 2083, Sec. 814 (Oct. 17, 2006).

<sup>8</sup> See Appendix A: DPAP Memo on Proper Use of Award Fee Contracts and Award Fee Provisions.

| <b><u>Rating</u></b> | <b><u>Definition of Rating</u></b>   | <b><u>Award Fee</u></b> |
|----------------------|--|-------------------------|
| Unsatisfactory       | Contractor had failed to meet the basic (minimum essential) requirements of the contract.  | 0%                      |
| Satisfactory         | Contractor has met the basic (minimum essential) requirements of the contract.   | No Greater than 50%     |
| Good                 | Contractor has met the basic (minimum essential) requirements of the contract, and has met at least 50% of the award fee criteria established in the award fee plan. | 50% - 75%               |
| Excellent            | Contractor has met the basic (minimum essential) requirements of the contract, and has met at least 75% of the award fee criteria established in the award fee plan. | 75% - 90%               |
| Outstanding          | Contractor has met the basic (minimum essential) requirements of the contract, and has met at least 90% of the award fee criteria established in the award fee plan. | 90% - 100%              |

- g. Section 8117 of the 2008 DoD Appropriations Act, enacted by the President on 13 November 2007, contained the funding limitation that “[n]one of the funds appropriated or otherwise made available by this Act may be obligated or expended to provide award fees to any defense contractor contrary to the provisions of section 814 of the National Defense Authorization Act, Fiscal Year 2007 (Public Law 109-364).”
- h. As a result of Sec. 8117, any obligations or expenditures for DoD contract award fees that do not conform with the DoD award fee criteria are not only policy violations, but likely per se (uncorrectable) Antideficiency Act violations as well.
- i. FAR Policy Requirements. The following conditions must be present before a fixed price contract with award fee may be used:

  - (1) The administrative costs of conducting award-fee evaluations are not expected to exceed the expected benefits;
  - (2) Procedures have been established for conducting the award-fee evaluation;
  - (3) The award-fee board has been established; and
  - (4) An individual above the level of the contracting officer approved the fixed-price-award-fee incentive.

**Figure 3**

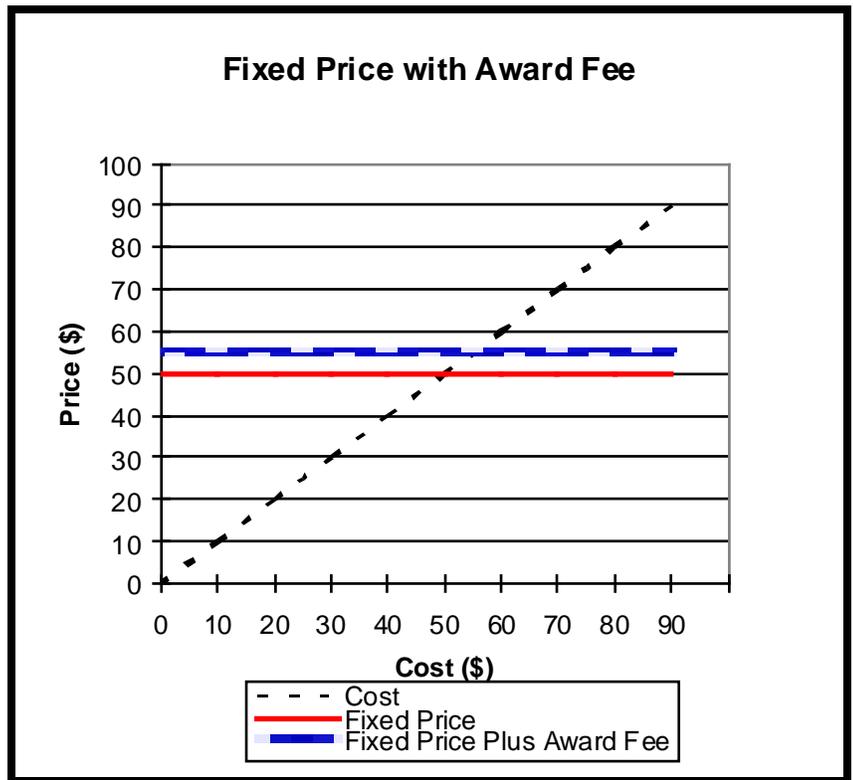
**Fixed Price = \$50**

**Potential Award Fee = \$5**

**Total Price for this contract will be between \$50 and \$55.**

**The Maximum that the Ktr can earn is \$55.00. (\$50.00 Fixed Price plus 100% of the \$5 Award Fee).**

**The Minimum the Ktr can earn is \$50.00, which is the fixed price of the K.**



| <b>If in performing the contract, the contractor incurs costs of:</b> | <b>Then the contractor is entitled to the following amount of money:</b> |
|---|--|
| <b>\$50</b>   | \$50 plus % of the award fee   |
| <b>\$40</b>   | \$50 plus % of the award fee   |
| <b>\$80</b>   | \$50 plus % of the award fee   |
| <b>If in performing the contract, the contractor performs:</b>        | <b>Then the contractor is entitled to the following amount of money:</b> |
| <b>Outstanding (90-100% of the \$5 Award Fee)</b>                     | \$54.50 - \$55.00  |
| <b>Excellent (75-90% of the \$5 Award Fee)</b>                        | \$53.75 - \$54.50  |
| <b>Good (50-75% of the \$5 Award Fee)</b>                             | \$52.50 - \$53.75  |
| <b>Satisfactory (No greater than 50% of the \$5 Award Fee)</b>        | \$50 - \$52.50   |
| <b>Unsatisfactory (0% of the \$5 Award Fee)</b>                       | \$50   |

6. **Fixed-Price Incentive (FPI) Contracts** (see Figure 4, page 40). [FAR 16.204](#); [FAR 16.403](#); [FAR 52.216-16](#); and [FAR 52.216-17](#). A FPI contract provides for adjusting profit and establishing the final contract price by application of a formula based on the relationship of final negotiated total cost to the total target cost. The final price is subject to a price ceiling that is negotiated at the outset of the contract. Because the profit varies inversely the cost, this contract type provides a positive, calculable profit incentive for the contractor to control costs. FAR 16.403-1(a).
- a. The contractor must complete a specified amount of work for a fixed-price. The contractor can increase its profit through cost-reduction measures.
  - b. The government and the contractor agree in advance on a firm target cost, target profit, and profit adjustment formula.
  - c. Use the FPI contract only when:
    - (1) A FFP contract is not suitable;
    - (2) The supplies or services being acquired and other circumstances of the acquisition are such that the contractor's assumption of a degree of cost responsibility will provide a positive profit incentive for effective cost control and performance; and
  - d. If the contract also includes incentives on technical performance and/or delivery, the performance requirements provide a reasonable opportunity for the incentives to have a meaningful impact on the contractor's management of the work. FAR 16.403. Individual line items may have separate incentive provisions. [DFARS 216.403\(b\)\(3\)](#).
  - e. The parties may use either FPI (firm target) or FPI (successive targets). [FAR 16.403\(a\)](#).
    - (1) FPI (firm target) specifies a target cost, a target profit, a price ceiling, and a profit adjustment formula. FAR 16.403-1; FAR 52.216-16.
    - (2) FPI (successive targets) specifies an initial target cost, an initial target profit, an initial profit adjustment formula, the production point at which the firm target cost and profit will be negotiated, and a ceiling price. FAR 16.403-2; FAR 52.216-17.

- f. Terms of Art with Firm Target Incentive Contracts: The following elements are negotiated at the outset.
- (1) Target Cost: The parties negotiate at the outset a firm target cost of performance for the acquisition that is fair and reasonable.
  - (2) Target Profit: The parties negotiate at the outset a firm target profit for the acquisition that is fair and reasonable.
  - (3) Profit Adjustment Formula: A formula, established at the outset, that will provide a fair and reasonable incentive for the contractor to assume an appropriate share of the risk. When the contractor completes performance, the parties determine what the final cost of performance was. Then, the final price is determined by applying the established formula. When the final cost to the contractor is less than the target cost, application of the formula results in a final profit greater than the target profit. When the final cost to the contractor is more than target cost, application of the formula results in a final profit less than the target profit, even a net loss. FAR 16.403-1(a).
  - (4) Price Ceiling (but not a profit ceiling or floor): The Ceiling Price is established at the outset, and it combines both cost and profit. It is the maximum price that the government may pay to the contractor, except for any adjustment under other contract clauses (like the changes clause). If the final negotiated cost exceeds the price ceiling, the contractor absorbs the difference as a loss. FAR 16.403-1(a). Because this is a hard figure, the FPIC should be used when the parties can accurately estimate the cost of performance. Generally negotiated as a percentage of target costs, normal ceiling prices range from 115 to 135% of Target Cost. If ceiling prices are as high as 150% of the target cost, then a Cost-Plus-Incentive-Fee contract may be more appropriate. See Formation of Government Contracts, 3rd Edition, John Cibinic and Ralph Nash, p. 1132, 1998.

**Figure 4**

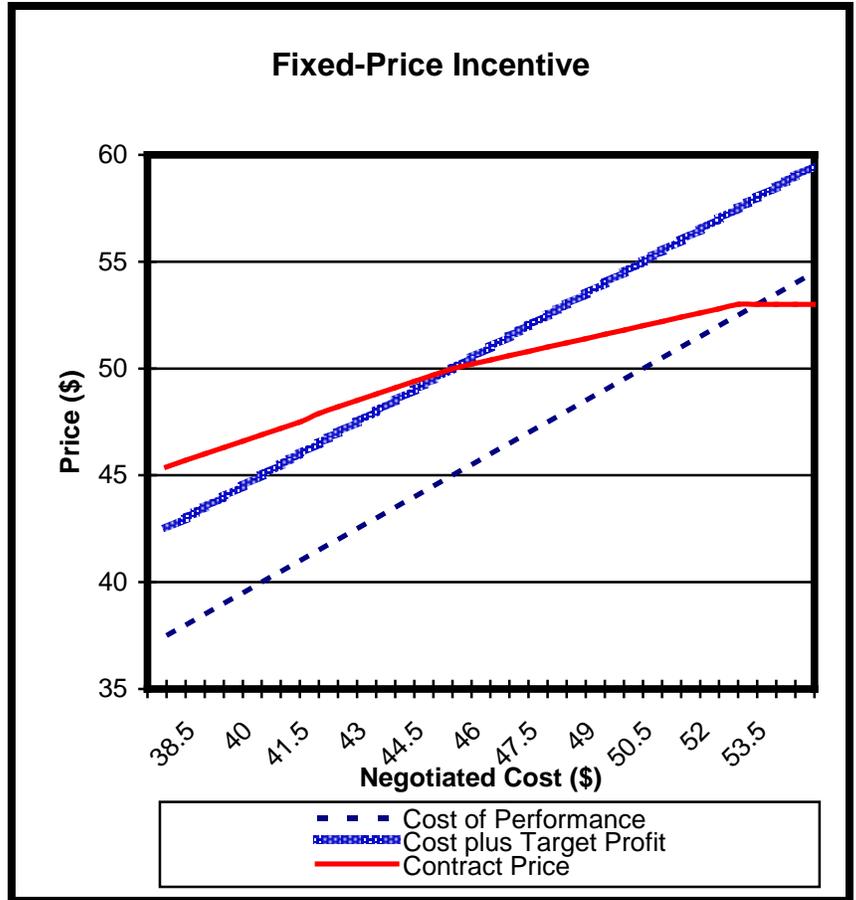
**Target Cost (TC) = \$45**  
**Target Profit (TP) = \$ 5**  
**Target Price = \$50**

**Ceiling Price (CP) = \$53**

**Price Adj (PA) Formula:**  
**60/40 split**

**Cost Overrun:** The Ktr is paid for only 60% of its actual costs (AC) that exceed the target cost.

**Cost Underrun:** If Ktr costs are less than the target cost, the difference is computed. The Ktr receives 40% of the difference, plus the target profit.



| If in performing the contract, the Ktr incurs costs: | Then the Ktr is entitled to the following amount of money: | Explanation   |
|--|--|---|
| \$45.00  | \$50.00  | Ktr TC \$45 + \$5 TP = \$50   |
| \$47.50  | \$51.00  | 60% of the \$2.50 AC overrun = \$1.50<br>\$45 TC + 1.5 Ktr share = 46.5 + \$5 TP = \$51.50  |
| \$50.00  | \$52.00  | 60% PA of the \$5 cost overrun = \$3.00<br>\$45 TC + \$3 Ktr share = \$48 + \$5 TP = \$52.00  |
| \$52.50  | \$53.00  | 60% PA of the \$7.5 cost overrun = \$4.50<br>\$45 TC + \$4.5 Ktr share = \$49.5 + \$5 TP = \$54.50 but Ktr only receives the \$53.00 ceiling price. |
| \$55.00  | \$53.00  | Ktr costs exceed ceiling price, which is the max the Ktr can receive. Ktr is operating at a loss.   |
| \$42.50  | \$48.50  | \$45.00 TC - \$42.50 AC = \$2.50 X 40% PA = \$1.00<br>Ktr receives \$42.50 + \$1 PA = \$43.50 + \$5TP = \$48.50                                     |
| \$40.00  | \$47   | \$45 TC - \$40 AC = \$5 X 40% PA = \$2<br>Ktr receives \$40 AC + \$2 PA = \$42 + \$5 TP = \$47  |
| \$37.50  | \$45.50  | \$45 TC - \$37.5AC = \$7.5 X 40% PA = 3<br>Ktr receives \$37.5 AC + \$3 PA = \$40.5 + \$5 TP = \$45.50  |

B. Cost-Reimbursement Contracts. [FAR Subpart 16.3](#).

1. Cost-Reimbursement contracts provide for payment of allowable incurred costs to the extent prescribed in the contract, establish an estimate of total cost for the purpose of obligating funds, and establish a ceiling that the contractor may not exceed (except at its own risk) without the contracting officer's approval. [FAR 16.301-1](#).
  - a. Application. Use when uncertainties involved in contract performance do not permit costs to be estimated with sufficient accuracy to use any type of fixed-price contract. [FAR 16.301-2](#).
  - b. The government pays the contractor's allowable costs plus a fee (often erroneously called profit) as prescribed in the contract.
  - c. To be allowable, a cost must be reasonable, allocable, properly accounted for, and not specifically disallowed. [FAR 31.201-2](#).
  - d. The decision to use a cost-type contract is within the contracting officer's discretion. Crimson Enters., B-243193, June 10, 1991, 91-1 CPD ¶ 557 (decision to use cost-type contract reasonable considering uncertainty over requirements causing multiple changes).
  - e. The government bears that majority of cost or performance risk. In a cost-reimbursement type contract, a contractor is only required to use its "best efforts" to perform. A contractor will be reimbursed its allowable costs, regardless of how well it performs the contractor. General Dynamics Corp. v. United States, 671 F.2d 474, 480-81 (Ct. Cl. 1982), McDonnell Douglas Corp. v. United States, 27 Fed. Cl. 295, 299 (1997) (noting that ". . .the focus of a cost-reimbursement contract is contractor input, not output.")
  - f. Limitations on Cost-Type Contracts. [FAR 16.301-3](#).
    - (1) The contractor must have an adequate cost accounting system. FAR 16.301-3. See CrystaComm, Inc., ASBCA No. 37177, 90-2 BCA ¶ 22,692 (contractor failed to establish required cost accounting system).
    - (2) The Government must exercise appropriate surveillance to provide reasonable assurance that efficient methods and effective cost controls are used.
    - (3) May not be used for acquisition of commercial items.

- (4) Cost ceilings are imposed through the Limitation of Cost clause, [FAR 52.232-20](#) (if the contract is fully funded); or the Limitation of Funds clause, [FAR 52.232-22](#) (if the contract is incrementally funded).
- (5) When the contractor has reason to believe it is approaching the estimated cost of the contract or the limit of funds allotted, it must give the contracting officer written notice.
- (6) [FAR 32.704](#) provides that a contracting officer must, upon receipt of notice, promptly obtain funding and programming information pertinent to the contract and inform the contractor in writing that:
  - (a) Additional funds have been allotted, or the estimated cost has been increased, in a specified amount; or
  - (b) The contract is not to be further funded and the contractor should submit a proposal for the adjustment of fee, if any, based on the percentage of work completed in relation to the total work called for under the contract; or
  - (c) The contract is to be terminated; or
  - (d) The Government is considering whether to allot additional funds or increase the estimated cost, the contractor is entitled to stop work when the funding or cost limit is reached, and any work beyond the funding or cost limit will be at the contractor's risk.
- (7) The contractor may not recover costs above the ceiling unless the contracting officer authorizes the contractor to exceed the ceiling. [JJM Sys., Inc.](#), ASBCA No. 51152, 03-1 BCA ¶ 32,192; [Titan Corp. v. West](#), 129 F.3d 1479 (Fed. Cir. 1997); [Advanced Materials, Inc.](#), 108 F.3d 307 (Fed. Cir. 1997). Exceptions to this rule include:
  - (a) The overrun was unforeseeable. [Johnson Controls World Servs, Inc. v. United States](#), 48 Fed. Cl. 479 (2001); [RMI, Inc. v. United States](#), 800 F.2d 246 (Fed. Cir. 1986) (burden is on contractor to show overrun was not reasonably foreseeable during time of contract

performance); F2 Assoc., Inc., ASBCA No. 52397, 01-2 BCA ¶ 31,530. To establish that the cost overrun was unforeseeable, the contractor must establish that it maintained an adequate accounting system. SMS Agoura Sys., Inc., ASBCA No. 50451, 97-2 BCA ¶ 29,203 (contractor foreclosed from arguing unforeseen cost overrun by prior decision).

- (b) Estoppel. Am. Elec. Labs., Inc. v. United States, 774 F.2d 1110 (Fed. Cir. 1985) (partial estoppel where Government induced continued performance through representations of additional availability of funds); Advanced Materials, Inc., 108 F.3d 307 (Fed. Cir. 1997) (unsuccessfully asserted); F2 Assoc., Inc., ASBCA No. 52397, 01-2 BCA ¶ 31,530 (unsuccessfully asserted).

2. Statutory Prohibition Against Cost-Plus-Percentage-of-Cost (CPPC) Contracts.

- a. The cost-plus-percentage-of-cost system of contracting is prohibited. 10 U.S.C. § 2306(a); 41 U.S.C. § 254(b); FAR 16.102(c).
- b. Identifying cost-plus-percentage-of-cost. In general, any contractual provision is prohibited that assures the Contractor of greater profits if it incurs greater costs. The criteria used to identify a proscribed CPPC system, as enumerated by the court in Urban Data Sys., Inc. v. United States, 699 F.2d 1147 (Fed. Cir. 1983) (adopting criteria developed by the Comptroller General at 55 Comp. Gen. 554, 562 (1975)), are:
  - (1) Payment is on a predetermined percentage rate;
  - (2) The percentage rate is applied to actual performance costs (as opposed to estimated or target performance costs determined at the outset);
  - (3) The Contractor's entitlement is uncertain at the time of award; and
  - (4) The Contractor's entitlement increases commensurately with increased performance costs. See also Alisa Corp., AGBCA No. 84-193-1, 94-2 BCA ¶ 26,952 (finding contractor was entitled to quantum valebant

basis of recovery where contract was determined to be an illegal CPPC contract).

- c. Compare The Dep't of Labor-Request for Advance Decision, B-211213, Apr. 21, 1983, 62 Comp. Gen. 337, 83-1 CPD ¶ 429 (finding the contract was a prohibited CPPC) with Tero Tek Int'l, Inc., B-228548, Feb. 10, 1988, 88-1 CPD ¶ 132 (determining the travel entitlement was not uncertain so therefore CPPC was not present).
  - d. Contract modifications. If the government directs the contractor to perform additional work not covered within the scope of the original contract, the contractor is entitled to additional fee. This scenario does not fall within the statutory prohibition on CPPC contracts. Digicon Corp., GSBCA No. 14257-COM, 98-2 BCA ¶ 29,988.
3. **Cost Contracts.** [FAR 16.302](#); [FAR 52.216-11](#). The contractor receives its allowable costs but no fee (see Figure 5, page 45) may be appropriate for research and development work, particularly with nonprofit educational institutions or other nonprofit organizations, and for facilities contracts.

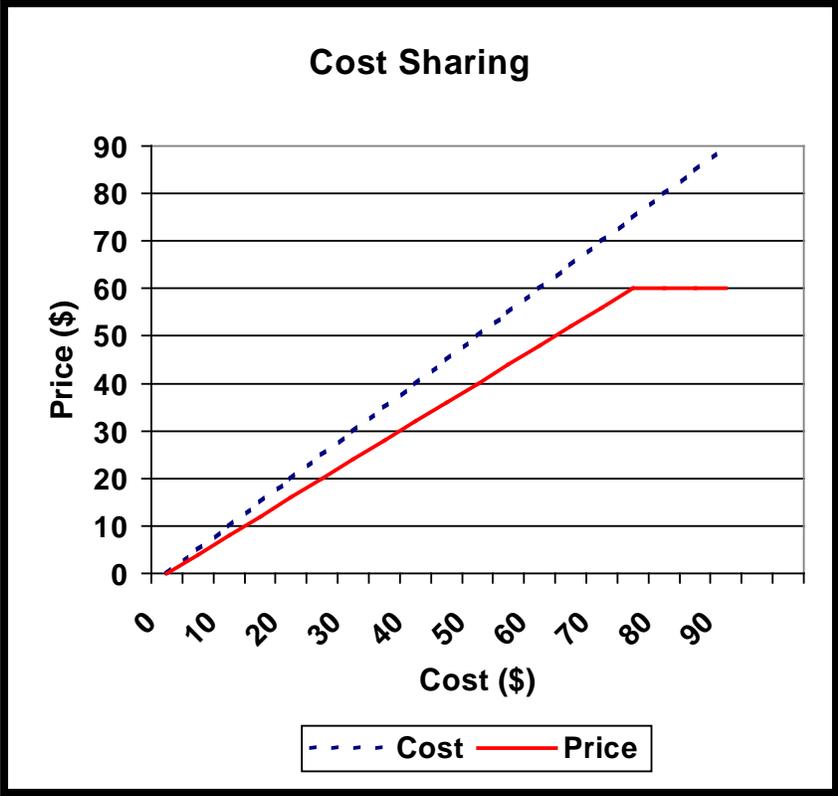
Figure 5



| <b>If in performing the contract, the contractor incurs costs of:</b> | <b>Then the contractor is entitled to the following amount of money:</b> |
|---|--|
| \$50  | \$50   |
| \$60  | \$60   |
| \$30  | \$30   |
| \$100   | \$100  |

4. Cost-Sharing Contracts. [FAR 16.303](#); [FAR 52.216-12](#).
- The contractor is reimbursed only for an agreed-upon portion of its allowable cost (see Figure 6 below).
  - Normally used where the contractor will receive substantial benefit from the effort.

**FIGURE 6.**  
**Contractor is paid 80% of negotiated costs.**  
**Cost Ceiling = \$60**



a)

| <b>If in performing the contract, the contractor incurs costs of:</b> | <b>Then the contractor is entitled to the following amount of money:</b> |
|---|--|
| <b>\$50</b>   | \$40   |
| <b>\$60</b>   | \$48   |
| <b>\$70</b>   | \$56   |
| <b>\$80</b>   | \$60 (cost ceiling)  |

5. **Cost-Plus-Fixed-Fee (CPFF) Contracts** (see Figure 7, page 49). [FAR 16.306](#); [FAR 52.216-8](#).
- a. **Definition.** The contract price is the contractor's allowable costs, plus a fixed fee that is negotiated and set prior to award. The fixed fee does not vary with actual costs, but may be adjusted as a result of changes in the work to be performed under the contract. FAR 16.306(a).
  - b. **Use.** This contract type permits contracting for efforts that might otherwise present too great a risk to contractors, but it provides the contractor only a minimum incentive to control costs. FAR 16.306(a). Often used for research or preliminary exploration or study when the level of effort is unknown or for development and test contracts where it is impractical to use a cost-plus-incentive-fee contract.
  - c. **Limitation on Maximum Fee for CPFF contracts.** [10 U.S.C. § 2306\(d\)](#); [41 U.S.C. § 3905](#); [FAR 15.404-4\(c\)\(4\)](#).
    - (1) Maximum fee limitations are based on the estimated cost at the time of award, not on the actual costs incurred.
    - (2) Research and development contracts: the maximum fee is a specific amount no greater than 15% of estimated costs at the time of award.
    - (3) For contracts other than R&D contracts, the maximum fee is a specific amount no greater than 10% of estimated costs at the time of award.
    - (4) In architect-engineer (A-E) contracts, the contract price (cost plus fee) for the A-E services may not exceed 6% of the estimated project cost. Hengel Assocs., P.C., VABCA No. 3921, 94-3 BCA ¶ 27,080.
  - d. **Forms.** A CPFF contract may take one of two forms: Completion or Term.
    - (1) The completion form describes the scope of work by stating a definite goal or target with a specific end product. The fixed fee is payable upon completion and delivery of the specified end product.
    - (2) The term form describes the scope of work in general terms and obligates the contractor to devote a specified level of effort for a stated time period. Under a term

form, the fixed fee is payable at the expiration of the agreed-upon period if performance is satisfactory. FAR 16.306(d).

**Discussion Problem:** The US Army Intelligence and Security Command (INSCOM) issued a solicitation for a new computer system for its headquarters building at Fort Belvoir. The solicitation required offerors to assemble a system from commercial-off-the-shelf (COTS) components that would meet the agency's needs. The solicitation provided for the award of a firm-fixed price contract. Several days after issuing the solicitation, INSCOM received a letter from a potential offeror who was unhappy with the proposed contract type. This contractor stated that, although the system would be built from COT components, there was a significant cost risk for the awardee attempting to design a system that would perform as INSCOM required. The contractor suggested that INSCOM award a cost-plus-fixed-fee (CPFF) contract. Additionally, the contractor suggested that INSCOM structure the contract so that the awardee would be paid all of its incurred costs and that the fixed fee be set at 10% of actual costs.

How should INSCOM respond?

**Estimated Cost @  
 Time of Award =  
 \$50**  
  
**Fixed Fee = \$5**  
  
**Cost Ceiling = \$75**

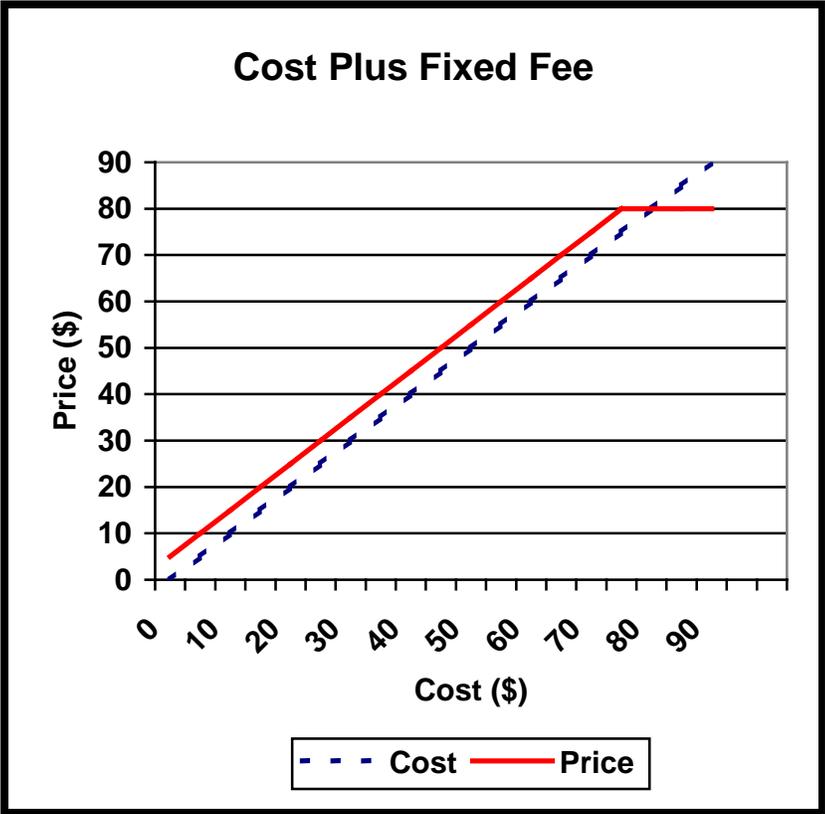


Figure 7

| If in performing the contract, the contractor incurs costs of: | Then the contractor is entitled to the following amount of money: |
|--|---|
| <b>\$50</b>  | \$50 + \$5 Fixed Fee = \$55                                       |
| <b>\$40</b>  | \$40 + \$5 Fixed Fee = \$45                                       |
| <b>\$70</b>  | \$70 + \$5 Fixed Fee = \$75                                       |
| <b>\$80</b>  | \$75 cost ceiling + \$5 Fixed Fee = \$80                          |
| <b>\$90</b>  | \$75 cost ceiling + \$5 Fixed Fee = \$80                          |

6. **Cost-Plus-Award-Fee (CPAF) Contracts.** [FAR 16.305](#) and [FAR 16.405-2](#).

- a. The contractor receives its costs plus a fee consisting of a base amount (which may be zero) and an award amount based upon a judgmental evaluation by the Government sufficient to provide motivation for excellent contract performance (see Figure 8, page 54).

| <b><u>Rating</u></b> | <b><u>Definition of Rating</u></b>   | <b><u>Award Fee</u></b> |
|----------------------|--|-------------------------|
| Unsatisfactory       | Contractor had failed to meet the basic (minimum essential) requirements of the contract.  | 0%                      |
| Satisfactory         | Contractor has met the basic (minimum essential) requirements of the contract.   | No Greater than 50%     |
| Good                 | Contractor has met the basic (minimum essential) requirements of the contract, and has met at least 50% of the award fee criteria established in the award fee plan. | 50% - 75%               |
| Excellent            | Contractor has met the basic (minimum essential) requirements of the contract, and has met at least 75% of the award fee criteria established in the award fee plan. | 75% - 90%               |
| Outstanding          | Contractor has met the basic (minimum essential) requirements of the contract, and has met at least 90% of the award fee criteria established in the award fee plan. | 90% - 100%              |

- b. Determination and Finding (D&F). FAR 16.401(d). A determination and finding, signed by the head of the contracting activity, is required. The D&F must justify that the use of this type of contract is in the best interests of the government. It must address all of the following suitability items:
  - (1) The work to be performed is such that it is neither feasible nor effective to devise predetermined objective incentive targets applicable to cost, schedule, and technical performance;
  - (2) The likelihood of meeting acquisition objectives will be enhanced by using a contract that effectively motivates the contractor toward exceptional performance and provides the government with the flexibility to evaluate both actual performance and the conditions under which it was achieved; and
  - (3) Any additional administrative effort and cost required to monitor and evaluate performance are justified by the expected benefits as documented by a risk and cost benefit analysis to be included in the D&F. FAR 16.401(e).
- c. Funding Limitations: On 17 October 2006, the President enacted the 2007 National Defense Authorization Act (NDAA); Section 814 of the 2007 NDAA required the Secretary of Defense to issue guidance for the appropriate use of award fees in all DoD acquisitions.<sup>9</sup>
- d. On 24 April 2007, the Director, Defense Procurement and Acquisition Policy issued the required guidance on the proper use of award fees and the DoD award fee criteria.<sup>10</sup> The required DoD award fee criteria is reflected in the chart above:
- e. Section 8117 of the 2008 DoD Appropriations Act, enacted by the President on 13 November 2007, contained the funding limitation that “[n]one of the funds appropriated or otherwise made available by this Act may be obligated or expended to provide award fees to any defense contractor contrary to the provisions of section 814 of the National Defense Authorization Act, Fiscal Year 2007 (Public Law 109-364).”

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<sup>9</sup> John Warner National Defense Authorization Act, 2007, Pub. L. No. 109-364, 120 Stat. 2083, Sec. 814 (Oct. 17, 2006).

<sup>10</sup> See Appendix A: DPAP Memo on Proper Use of Award Fee Contracts and Award Fee Provisions.

- f. As a result of Sec. 8117, any obligations or expenditures for DoD contract award fees that do not conform with the DoD award fee criteria are not only policy violations, but also *per se* (uncorrectable) Antideficiency Act violations as well.
- g. Limitations on base fee. DOD contracts limit base fees to 3% of the estimated cost of the contract exclusive of fee. [DFARS 216.405-2\(c\)\(iii\)](#).
- h. Award fee. The DFARS lists sample performance evaluation criteria in a table that includes time of delivery, quality of work, and effectiveness in controlling and/or reducing costs. See [DFARS Part 216, Table 16-1](#). The [Air Force Award Fee Guide](#) (Mar. 02) and the [National Aeronautics And Space Administration Award Fee Contracting Guide](#) (Jun. 27, 01), discussed *supra* both contain helpful guidance on developing award fee evaluation plans.
- i. The FAR requires that an appropriate award-fee clause be inserted in solicitations and contracts when an award-fee contract is contemplated, and that the clause “[e]xpressly provide[s] that the award amount and the award-fee determination methodology are unilateral decisions made solely at the discretion of the government.” [FAR 16.406 \(e\)\(3\)](#). There is no such boilerplate clause in the FAR and therefore such a clause must be written manually. An award fee plan is included in the solicitation which describes the structure, evaluation methods, and timing of evaluations. Generally, award fee contracts require a fee-determining official, an award-fee board (typical members include the KO and a JA), and performance monitors (who evaluate technical areas and are not members of the board). See NASA and Air Force Award Fee Guides.
- j. Since the available award fee during the evaluation period must be earned, the contractor begins each evaluation period with 0% of the available award fee and works up to the evaluated fee for each evaluation period. [AFARS 5116.4052\(b\)\(2\)](#). If performance is deemed either unsatisfactory or marginal, no award fee is earned. [DFARS 216.405-2\(a\)\(i\)](#).
- k. A CPAF contract shall provide for evaluations at stated intervals during performance so the contractor will periodically be informed of the quality of its performance and the areas in which improvement is expected. [FAR 16.405-2\(b\)\(3\)](#).

- l. Unilateral changes to award-fee plans can be made before the start of an evaluation period with written notification by the KO. Changes to the plan during the evaluation plan can only be done through bilateral modifications. See Air Force Award Fee Guide.
  
- m. A contractor is entitled to unpaid award fee attributable to completed performance when the government terminates a cost-plus-award fee contract for convenience. Northrop Grumman Corp. v. Goldin, 136 F.3d 1479 (Fed. Cir. 1998).
  
- n. The award fee schedule determines when the award fee payments are made. The fee schedule does not need to be proportional to the work completed. Textron Defense Sys. v. Widnall, 143 F.3d 1465 (Fed. Cir. 1998) (end-loading award fee to later periods)

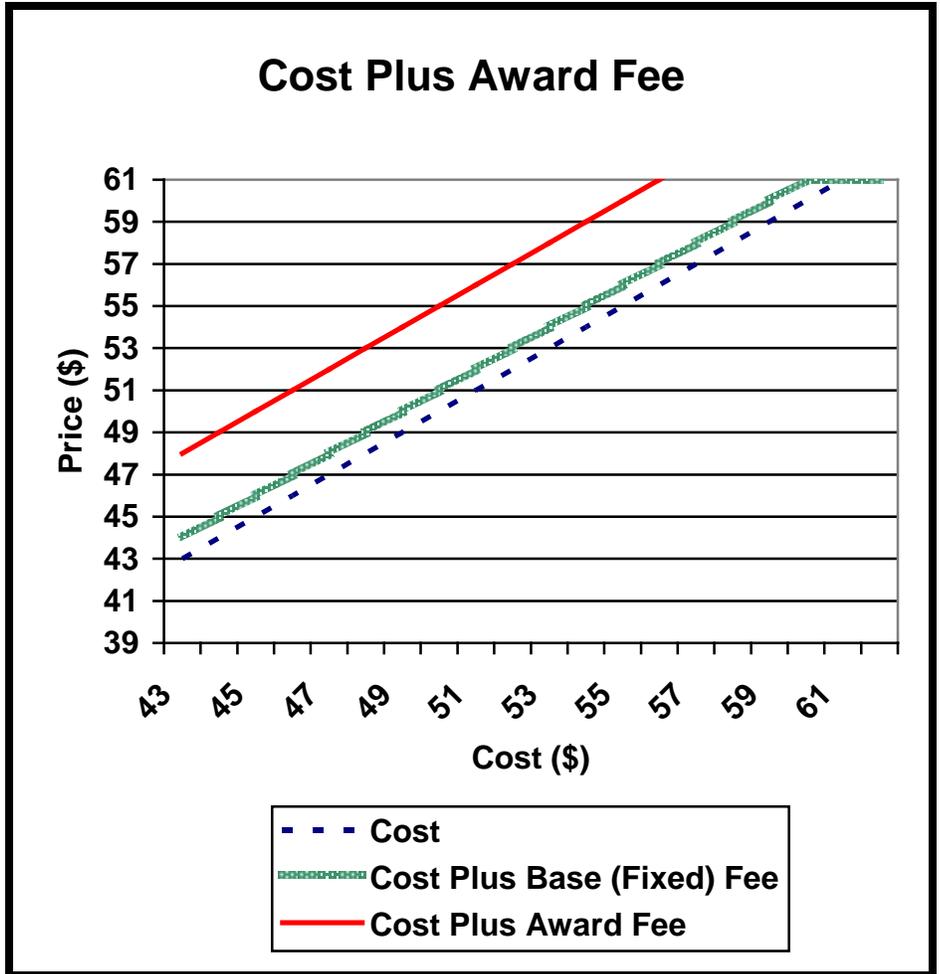
**FIGURE 8.**

**Estimated Cost @  
Time of Award =  
\$50**

**Base Fee = \$1**

**Award Fee = \$4**

**Cost Ceiling = \$60**



| <b>If in performing the contract, the contractor incurs costs of:</b>          | <b>Then the contractor is entitled to the following amount of money:</b> | <b>Notes</b>   |
|--|--|--|
| <b>\$50</b>  | \$51 + up to \$4 of award fee  |  |
| <b>\$55</b>  | \$56 + up to \$4 of award fee  |  |
| <b>\$57</b>  | \$58 + up to \$4 of award fee  | While \$60 is the cost ceiling, in cost contracts the cost ceiling is typically exclusive of any fee. (See FAR 52.232-20). |
| <b>\$60</b>  | \$60 + \$1 base fee + up to \$4 of the award fee                         | \$60 is the cost ceiling. See comment above.   |
| <b>\$68</b>  | \$60 + \$1 base fee + up to \$4 of the award fee                         |  |
| <b>If in performing the contract at \$50 in cost, the contractor performs:</b> | <b>Then the contractor is entitled to the following amount of money:</b> |  |
| <b>Outstanding (90-100%)</b>   | \$54.60-\$55   | \$1 Base Fee + 90-100% of the \$4 Award Fee  |
| <b>Excellent (75-90%)</b>  | \$54-\$54.60   | \$1 Base Fee + 75-90% of the \$4 Award Fee   |
| <b>Good (50-75%)</b>   | \$53-\$54  | \$1 Base Fee + 50-75% of the \$4 Award Fee   |
| <b>Satisfactory (No greater than 50%)</b>                                      | \$51-\$53  | \$1 Base Fee + no more than 50% of the \$4 Award Fee   |
| <b>Unsatisfactory (0%)</b>   | \$51   | \$1 Base Fee + None of the \$4 Award Fee   |

7. Cost-Plus-Incentive-Fee (CPIF) Contracts. [FAR 16.304](#); [FAR 16.405-1](#); and [FAR 52.216-10](#).
- a. The CPIF specifies a target cost, a target fee, minimum and maximum fees, and a fee adjustment formula (see Figure 9, page 57). After contract performance, the fee is determined in accordance with the formula. See *Bechtel Hanford, Inc., B-292288, et. al*, 2003 CPD ¶ 199.
  - b. A CPIF is appropriate for services or development and test programs. FAR 16.405-1. See *Northrop Grumman Corp. v. United States*, 41 Fed. Cl. 645 (1998) (Joint STARS contract).
  - c. The government may combine technical incentives with cost incentives. FAR 16.405-1(b)(2). The contract must have cost constraints to avoid rewarding a contractor for achieving incentives which outweigh the value to the government. FAR 16.402-4 (b).
  - d. If a contractor meets the contract criteria for achieving the maximum fee, the government must pay that fee despite minor problems with the contract. *North American Rockwell Corp., ASBCA No. 14329, 72-1 BCA ¶ 9207 (1971)* (Government could not award a zero fee due to minor discrepancies when contractor met the target weight for a fuel-tank, which was the sole incentive criteria).
  - e. A contractor is not entitled to a portion of the incentive fee upon termination of a CPIF contract for convenience. FAR 49.115 (b)(2).

**Target Cost (TC) = \$50**  
**Target Fee (TF) = \$5**

**Cost Ceiling (CC): \$60**  
**(120% TC)**

**Minimum Fee (MF) = \$2**  
**Maximum Fee (MxF) = \$7**

**Fee Adjustment (FA)**  
**formula: 50/50 split**

**Cost Overrun: The 50/50 FA formula decreases the \$5 TF until the Ktr is only receiving the \$2 MF. Also, the gov't will only pay actual costs up to the \$60.00 CC.**

**Cost Underrun: The 50/50 FA formula increases the \$5 TF until the Ktr tops out at the \$7 MxF.**

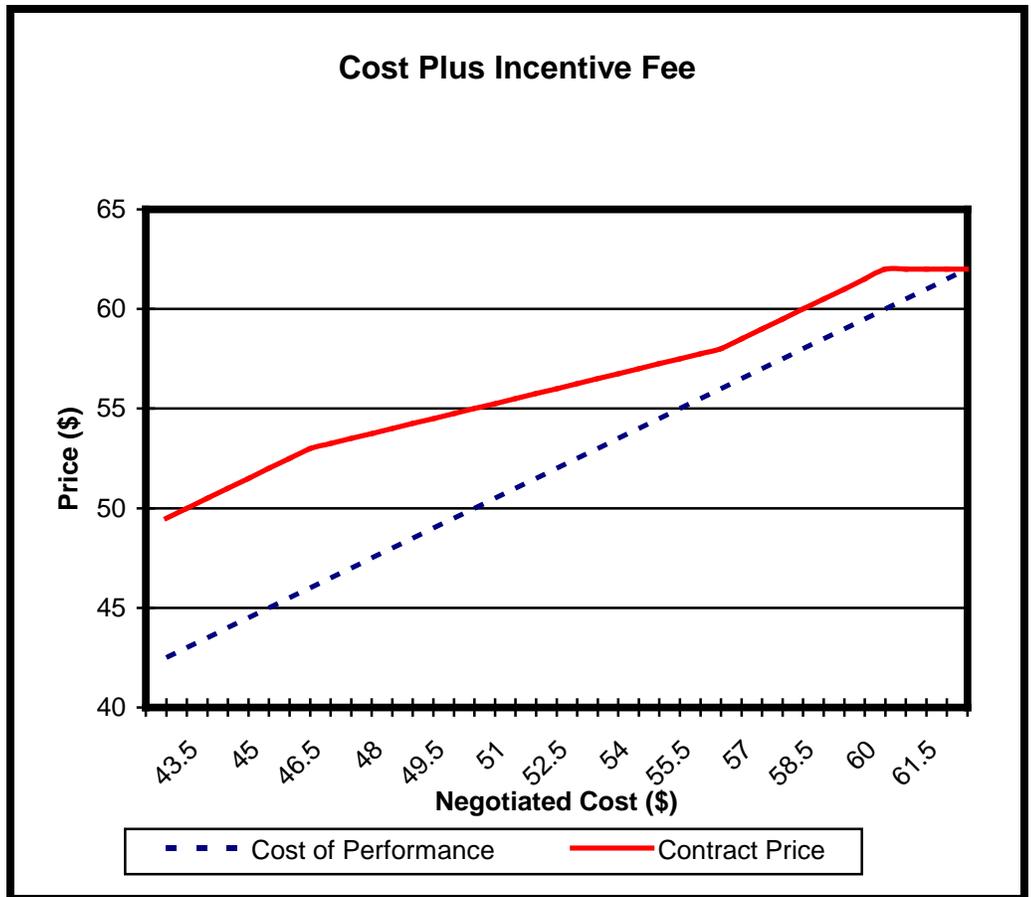


Figure 9

| If in performing the contract, the contractor incurs costs of: | Then the contractor is entitled to the following amount of money: | Notes/Explanation:  |
|--|---|---|
| \$50.00  | \$55.00   | TC \$50 + TF \$5 = \$55.00  |
| \$55.00  | \$57.50   | 50% of \$5 cost overrun = \$2.50 FA to TF<br>Actual Costs (AC) \$55 + TF \$5 - FA \$2.50 = \$57.50  |
| \$57.50  | \$59.50   | 50% of the \$7.50 cost overrun = \$3.75<br>TF \$5 - FA \$3.75 = \$1.25 which is lower than MF \$2<br>AC \$57.50 + MF \$2 = \$59.50            |
| \$60.00  | \$62.00   | 50% of the \$10 cost overrun = \$5 FA so Ktr = MF \$2<br>AC \$60 + MF \$2 = \$62  |
| \$62.00  | \$62.00   | 50% of the \$12 cost overrun = \$6 FA, so Ktr = \$2 MF<br>AC exceed Cost Ceiling (CC) so costs are limited to \$60<br>CC \$60 + MF \$2 = \$62 |
| \$47.50  | \$55.75   | 50% of the \$2.5 cost underrun = \$1.25 FA<br>AC \$47.50 + FA \$1.25 + TF \$5 = \$53.75   |
| \$45.00  | \$52.50   | 50% of the \$5 cost underrun = \$2.50 FA which would push the fee over the MxF \$7. So Ktr gets MxF \$7.00<br>AC \$45 + MxF \$7 = \$52.00     |

8. Time-and-Materials and Labor-Hour Contracts. [FAR Subpart 16.6](#).
  - a. Application. Use these contracts when it is not possible at contract award to estimate accurately or to anticipate with any reasonable degree of confidence the extent or duration of the work. [FAR 16.601\(b\)](#); [FAR 16.602](#).
  - b. Type. The FAR Council recently specified that T&M and LH contracts are neither fixed-price contracts nor cost-reimbursement contracts, but they constitute their own unique contract type. Federal Register, Vol. 77, No.1, Jan 2012.
  - c. Government Surveillance. Appropriate surveillance is required to assure that the contractor is using efficient methods to perform these contracts, which provide no positive profit incentive for a contractor to control costs or ensure labor efficiency. [FAR 16.601\(b\)\(1\)](#); [FAR 16.602](#). CACI, Inc. v. General Services Administration, GSBCA No. 15588, 03-1 BCA ¶ 32,106.
  - d. Limitation on use. The contracting officer must execute a D&F that no other contract type is suitable, and include a contract price ceiling. This includes Federal Supply Schedule contracts. [FAR 8.404\(h\)\(3\)\(i\)](#); [FAR 16.601\(c\)](#); [FAR 16.602](#).
  - e. Types.
    - (1) Time-and-materials (T&M) contracts. Provide for acquiring supplies or services on the basis of:
      - (a) Direct labor hours at specified fixed hourly rates that include wages, overhead, general and administrative expenses, and profit; and
      - (b) Materials at cost, including, if appropriate, material handling costs as part of material costs.
        - (i) Material handling costs shall include those costs that are clearly excluded from the labor-hour rate, and may include all appropriate indirect costs allocated to direct materials.
        - (ii) An optional pricing method described at [FAR 16.601\(b\)\(3\)](#) may be used when the contractor is providing material it sells regularly to the general public in the

ordinary course of business, and several other requirements are met.

- (c) Labor-hour contracts. Differs from T&M contracts only in that the contractor does not supply the materials. [FAR 16.602](#).

## C. Miscellaneous Contract Types

### 1. Level of Effort Contracts.

- a. Firm-fixed-price, level-of-effort term contract. [FAR 16.207](#). Government buys a level of effort for a certain period of time, i.e., a specific number of hours to be performed in a specific period. Suitable for investigation or study in a specific R&D area, typically where the contract price is \$100,000 or less.
- b. Cost-plus-fixed-fee-term form contract. [FAR 16.306\(d\)\(2\)](#). Similar to the firm-fixed-price level-of-effort contract except that the contract price equals the cost incurred plus a fee. The contractor is required to provide a specific level of effort over a specific period of time.

### 2. Award Term Contracts. Similar to award fee contracts, a contractor earns the right, upon a determination of exceptional performance, to have the contract's term or duration extended for an additional period of time. The contract's term can also be reduced for poor performance. There has been no guidance from the FAR on this type of contract. The Air Force Material Command issued an Award Fee & Award Term Guide, dated December 2002, which contains useful guidance.

- a. The process for earning additional periods is similar to award fees. Generally, a Term Determining Official, an Award Term Review Board, and Performance Monitors should be identified within the solicitation.
- b. A point ceiling (+100) and a floor (-100) will be set up to incentivize the contractor's performance. Performing to either threshold will either increase or decrease the term of the contract. For example, two Very Good evaluations (80 points for each) in a row would earn another year of performance. The 60 points would carry over to the next evaluation period.

## V. SELECTION OF CONTRACT TYPE

### A. Factors to Consider.

1. Regulatory Limitations.
  - a. Sealed Bid Procedures. Only firm-fixed-price contracts or fixed-price contracts with economic price adjustment may be used under sealed bid procedures. FAR 16.102(a) and FAR 14.104.
  - b. Contracting by Negotiation. Any contract type or combination of types described in the FAR may be selected for contracts negotiated under FAR Part 15. FAR 16.102(b).
  - c. Commercial items. Agencies must use firm-fixed-price contracts or fixed-price contracts with economic price adjustment to acquire commercial items. As long as the contract utilized is either a firm-fixed-price contract or fixed-price contract with economic price adjustment, however, it may also contain terms permitting indefinite delivery. FAR 12.207. Agencies may also utilize award fee or performance or delivery incentives when the award fee or incentive is based solely on factors other than cost. FAR 12.207; FAR 16.202-1; FAR 16.203-1.
2. Negotiation. Selecting the contract type is generally a matter for negotiation and requires the exercise of sound judgment. The objective is to negotiate a contract type and price (or estimated cost and fee) that will result in reasonable contractor risk and provide the contractor with the greatest incentive for efficient and economical performance. FAR 16.103(a). (See Figure 10, page 61).

3. Allocation of Risk. Certain contract types distribute the risk of a contract cost overrun differently. For example, a firm fixed price contract places the risk of a cost overrun solely on the contractor. While the level of effort contract type places more of the risk of a cost overrun on the government.

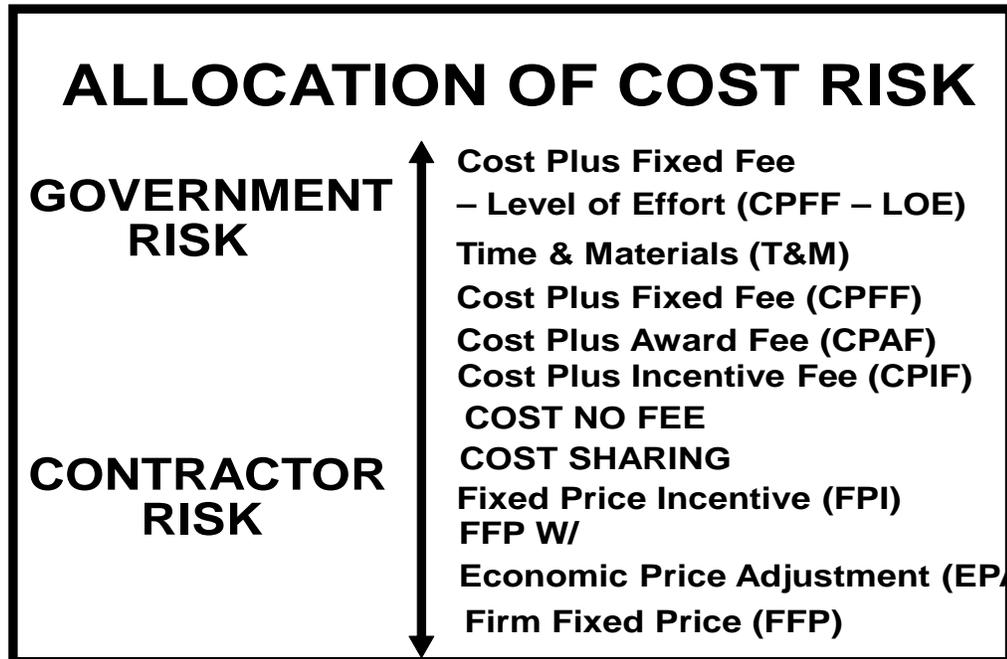
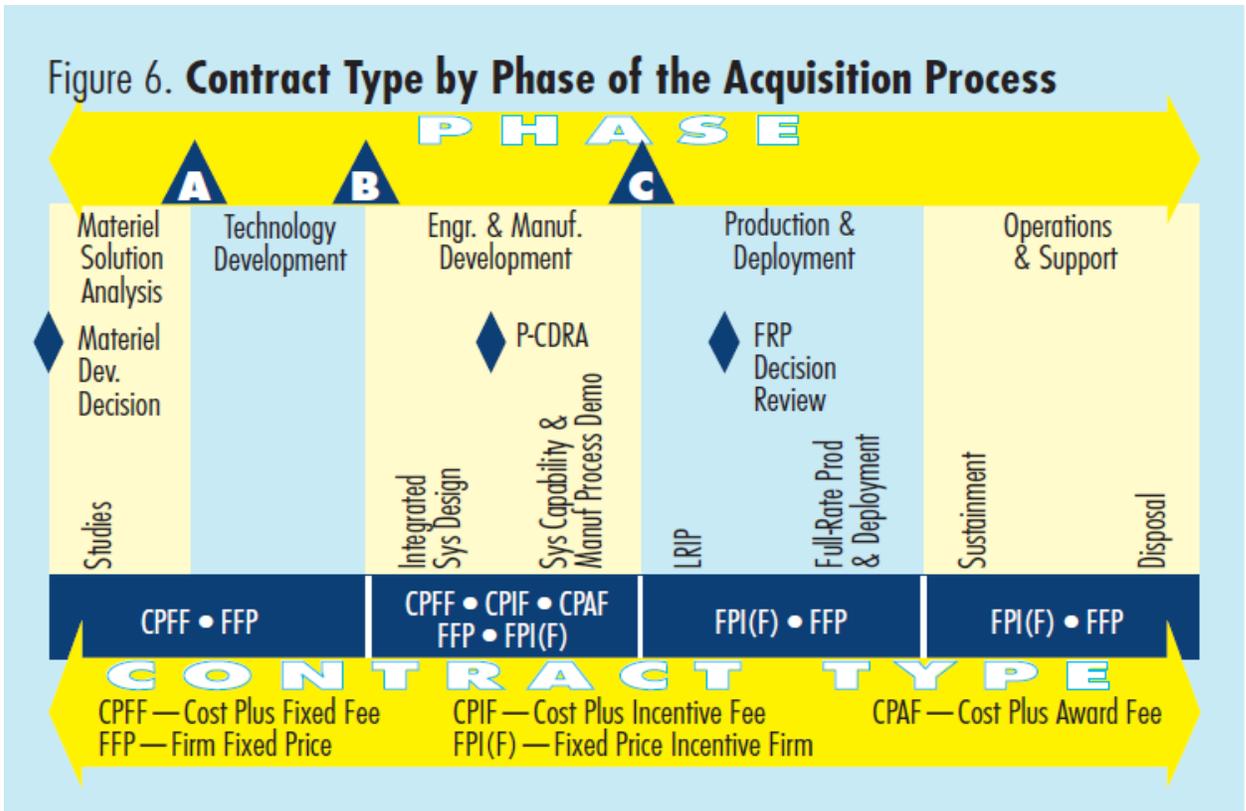


Figure 10

4. Discretion. Selection of a contract type is ultimately left to the reasonable discretion of the contracting officer. Diversified Tech. & Servs. of Virginia, Inc., B-282497, July 19, 1999, 99-2 CPD ¶ 16 (change from cost-reimbursement to fixed-price found reasonable).
  - a. There are numerous factors that the contracting officer should consider in selecting the contract type. [FAR 16.104](#).
    - (1) Availability of price competition.
    - (2) The accuracy of price or cost analysis.
    - (3) The type and complexity of the requirement.
    - (4) Urgency of the requirement.
    - (5) Period of performance or length of production run.
    - (6) Contractor's technical capability and financial responsibility.
    - (7) Adequacy of the contractor's accounting system.
    - (8) Concurrent contracts.
    - (9) Extent and nature of proposed subcontracting.
    - (10) Acquisition history.
  - b. In the course of an acquisition lifecycle, changing circumstances may make a different contract type appropriate. Contracting Officers should avoid protracted use of cost-reimbursement or time-and-materials contracts after experience provides a basis for firmer pricing. [FAR 16.103\(c\)](#).

- c. Common Contract Type by Phase of the Acquisition Process. For a more complete description of the acquisition process and Milestones A, B, and C, please see DODI 5000.02.



## VI. PERFORMANCE-BASED ACQUISITIONS FAR SUBPART 37.6

- A. Focuses on results rather than methods (i.e. “how the work it to be accomplished or how many work hours). [FAR 37.602\(b\)\(1\)](#). Performance-based contracts for services shall include:
1. A performance work statement (PWS)
  2. Measurable performance standards and a method of assessing performance against those standards
  3. Performance incentives when appropriate. FAR 37.601
  4. There are two ways to generate the PWS. Either the government creates the PWS or prepares a statement of objectives (SOO) from which the contractor generates the PWS along with its offer. The SOO does not become part of the contract. The minimum elements of the SOO are:
    - a. Purpose;
    - b. Scope or mission;
    - c. Period or place of performance;
    - d. Background;
    - e. Performance objectives; and
    - f. Any operating constraints. FAR 37.602 (c).
  5. Depends on quality assurance plans to measure and monitor performance prepared by either the government or submitted by the contractor. FAR 37.604.
  6. The ideal contract type is one that incorporates positive and/or negative performance incentives which correlate with the quality assurance plan. FPIF are useful types for performance-based contracts.
- B. Resources
1. FAR 16.4, DFARS 216.1, and DFARS PGI 216.4
  2. The DoD has a *Guidebook on Performance-Based Service Acquisitions* located at <http://www.acq.osd.mil/dpap/Docs/pbsaguide010201.pdf> . Another guide is the *Seven Steps to Performance-Based Service Acquisitions*, [http://www.acquisition.gov/comp/seven\\_steps/home.html](http://www.acquisition.gov/comp/seven_steps/home.html).

3. The DOD has established the Award and Incentive Fees Community of Practice under the Defense Acquisition University  
<https://acc.dau.mil/awardandincentivefees>.