



Contract Types: An Overview of the Legal Requirements and Issues

Kate M. Manuel
Legislative Attorney

August 24, 2010

Congressional Research Service

7-5700

www.crs.gov

R41168

Report Documentation Page				Form Approved OMB No. 0704-0188	
Public reporting burden for the collection of information is estimated to average 1 hour per response, including the time for reviewing instructions, searching existing data sources, gathering and maintaining the data needed, and completing and reviewing the collection of information. Send comments regarding this burden estimate or any other aspect of this collection of information, including suggestions for reducing this burden, to Washington Headquarters Services, Directorate for Information Operations and Reports, 1215 Jefferson Davis Highway, Suite 1204, Arlington VA 22202-4302. Respondents should be aware that notwithstanding any other provision of law, no person shall be subject to a penalty for failing to comply with a collection of information if it does not display a currently valid OMB control number.					
1. REPORT DATE 24 AUG 2010		2. REPORT TYPE		3. DATES COVERED 00-00-2010 to 00-00-2010	
4. TITLE AND SUBTITLE Contract Types: An Overview of the Legal Requirements and Issues				5a. CONTRACT NUMBER	
				5b. GRANT NUMBER	
				5c. PROGRAM ELEMENT NUMBER	
6. AUTHOR(S)				5d. PROJECT NUMBER	
				5e. TASK NUMBER	
				5f. WORK UNIT NUMBER	
7. PERFORMING ORGANIZATION NAME(S) AND ADDRESS(ES) Congressional Research Service, Library of Congress, 101 Independence Ave., SE, Washington, DC, 20540-7500				8. PERFORMING ORGANIZATION REPORT NUMBER	
9. SPONSORING/MONITORING AGENCY NAME(S) AND ADDRESS(ES)				10. SPONSOR/MONITOR'S ACRONYM(S)	
				11. SPONSOR/MONITOR'S REPORT NUMBER(S)	
12. DISTRIBUTION/AVAILABILITY STATEMENT Approved for public release; distribution unlimited					
13. SUPPLEMENTARY NOTES					
14. ABSTRACT					
15. SUBJECT TERMS					
16. SECURITY CLASSIFICATION OF:			17. LIMITATION OF ABSTRACT Same as Report (SAR)	18. NUMBER OF PAGES 29	19a. NAME OF RESPONSIBLE PERSON
a. REPORT unclassified	b. ABSTRACT unclassified	c. THIS PAGE unclassified			

Summary

Federal procurement contracts are commonly divided into two main types—fixed-price and cost-reimbursement—that primarily differ as to whether the government or the contractor assumes the risk of increases in performance costs (e.g., wages, materials). With a fixed-price contract, the contractor assumes this risk because it agrees to provide goods or services to the government for a certain price established at the time of contracting. If the performance costs exceed this price, the contractor generally cannot, absent a price adjustment clause, recover more money from the government. Rather, it must perform the contract at a loss, or default on the contract. In contrast, with a cost-reimbursement contract, the government assumes the risk of increases in performance costs because it agrees to repay the contractor for the allowable costs of performing certain work up to a total cost specified in the contract. Additionally, under certain types of cost-reimbursement contracts, the contractor may be entitled to profit in the form of fixed fees or incentive or award fees. Contracts can also be divided into other types, including incentive contracts, letter contracts, indefinite-delivery/indefinite-quantity (ID/IQ) contracts, and time-and-materials (T&M) contracts. Particular contracts can display features of various types (e.g., pricing on both fixed-price and cost-reimbursement bases for different line items) and can often be of multiple types (e.g., an ID/IQ T&M letter contract). Determining the type of a particular contract is a question of law, and contract language stating that a contract is of a certain type is not dispositive.

The use of certain contract types is prohibited or required in certain circumstances: (1) cost-plus-a-percentage-of-cost contracts are absolutely prohibited; (2) cost-reimbursement contracts cannot be used to acquire commercial items; and (3) contracts resulting from sealed bidding must be firm-fixed-price or fixed-price with an economic price adjustment. Outside of these restrictions, however, selection of the contract type for a particular procurement is generally within the contracting officer's discretion. The contracting officer generally decides on the contract type prior to issuing a solicitation. However, particularly in negotiated procurements, selection of the contract type can be “a matter for negotiation” between the procuring activity and the contractor.

Current congressional and public interest in contract types is, in part, an outgrowth of the reported increase in the use of cost-reimbursement contracts during the George W. Bush Administration and the Obama Administration's proposal to reduce by at least 10% the funds obligated by “high risk-contracting authorities,” such as cost-reimbursement, time-and-materials, and labor-hour contracts, in FY2010. The Department of Defense's (DOD's) budget request for FY2011 similarly proposed a 17% reduction in the use of time-and-materials and labor-hour contracts. Additionally, the Office of Management and Budget (OMB) has called for agencies to include “specific actions and goals” to reduce their reliance on cost-reimbursement and time-and-materials contracts in their FY2012 budget submissions. This call is part of a broader proposal to cut agencies' discretionary spending by 5%, among other things.

The 111th Congress has enacted or proposed several bills that address use of various types of contracts, including P.L. 111-5, P.L. 111-23, P.L. 111-84, P.L. 111-118, H.R. 1665, H.R. 2269, H.R. 3619, H.R. 4983, H.R. 5013, H.R. 5136, S. 920, S. 1194, S. 2901, S. 2971, S. 3454, S. 3455, S. 3607, S. 3611, and S. 3676.

Contents

Introduction	5
Selecting the Contract Type.....	5
Types of Contracts	7
Contracts Under Part 16 of the FAR	9
Fixed-Price Contracts.....	9
Cost-Reimbursement Contracts	12
Incentive Contracts	14
Time-and-Materials and Labor-Hour Contracts.....	15
Indefinite-Delivery Contracts.....	17
Other Agreements Under Part 16 of the FAR	19
Letter Contracts	19
Agreements.....	21
Recently Enacted and Proposed Legislation.....	21
Executive Branch Initiatives.....	23
Obama Memorandum of March 4, 2009.....	23
OMB Memorandum of July 29, 2009.....	24
OMB Memorandum of October 27, 2009.....	24
Effectiveness of These Initiatives Presently Unknown.....	26

Tables

Table 1. Types of Fixed-Price Contracts	9
Table 2. Types of Cost-Reimbursement Contracts.....	12
Table 3. OMB Guidance on “Appropriate Use and Oversight” of Contract Types.....	25

Appendixes

Appendix. Chronology of Developments Regarding Contract Types, 107 th -110 th Congresses.....	27
--	----

Contacts

Author Contact Information	30
Acknowledgments	30

Introduction

This report provides an overview of the various contract types (e.g., fixed-price, cost-reimbursement) used in federal procurement and the legal requirements and issues pertaining to each. Current congressional and public interest in contract types is, in part, an outgrowth of the reported increase in the use of cost-reimbursement contracts during the George W. Bush Administration¹ and the Obama Administration's proposal to reduce by at least 10% the funds obligated by "high risk-contracting authorities," such as cost-reimbursement, time-and-materials, and labor-hour contracts, in FY2010.² The Department of Defense's (DOD's) budget request for FY2011 similarly proposes a 17% reduction in the use of time-and-materials and labor-hour contracts.³ Additionally, the Office of Management and Budget (OMB) has called for agencies to include "specific actions and goals" to reduce their reliance on cost-reimbursement and time-and-materials contracts in their FY2012 budget submissions.⁴ This call is part of a broader proposal to cut agencies' discretionary spending by 5%, among other things.

Selecting the Contract Type

The use of certain contract types may be prohibited or required, at least in certain circumstances. Cost-plus-a-percentage-of-cost contracts, under which the government reimburses contractors' costs and pays them a percentage of these costs as an allowance for profit, are absolutely prohibited,⁵ and agency prime contracts must generally prohibit cost-plus-a-percentage-of-cost

¹ In FY2008, 60% of federal contract dollars (\$315.7 billion) was reportedly obligated through fixed-price contracts; 25% (\$135.4 billion) through cost-reimbursement contracts; and 5% (\$27.5 billion) through time-and-materials and labor-hour contracts). See Contract Data for FY2008 Show Continued Reliance on Cost-Reimbursement Contracts, *Fed. Cont. Daily*, Apr. 6, 2009. The amount obligated through cost-reimbursement contracts has increased since FY2000, although the extent of this increase is unclear. See *id.* (reporting that only \$71 billion was obligated by cost-reimbursement contracts in 2000); Grant Thornton, 14th Annual Government Contractor Industry Highlights Book 8 (2009), available at http://www.grantthornton.com/staticfiles/GTCom/files/Industries/Government%20contractor/14th_Gov_Con_Highlights_011409small.pdf (noting that cost-reimbursement contracts represented 28% of federal contracts in its 11th survey, 39% in its 12th survey, 40% in its 13th survey, and 45% in the current survey); Center for Strategic and International Studies, Defense Industrial Initiatives Group, *Structure and Dynamics of the U.S. Federal Professional Services Industrial Base, 1995-2007* 16 (2009) (suggesting that the dollar amount obligated through fixed-price contracts has declined faster than usage of fixed-price contracts per se).

² Executive Office of the President, Office of Management and Budget, Improving Government Acquisition, July 29, 2009, at 2, available at http://www.whitehouse.gov/omb/assets/memoranda_fy2009/m-09-25.pdf.

³ See, e.g., Geoffrey Emeigh, DOD Requests \$548.9 B for FY2011, Aims to Reduce T&M/LH Contracts by 17 Percent, *Fed. Cont. Daily*, Feb. 2, 2010. The Panel on Contracting Integrity's 2009 report to Congress also included among its FY2010 goals studying DOD's letter contracts for possible abuse, reviewing use of time-and-materials and labor-hour contracts, and possibly developing doctrine for the selection of contract types for research and development. Dep't of Defense, Office of the Under Secretary of Defense for Acquisition, Technology & Logistics, Panel on Contracting Integrity 2009 Report to Congress, available at http://www.acq.osd.mil/dpap/cpic/cp/docs/Panel_on_Contracting_Integrity_2009_to_Congress.pdf.

⁴ Exec. Office of the President, Office of Mgmt. & Budget, Fiscal Year 2012 Budget Guidance, June 8, 2010, available at http://www.whitehouse.gov/sites/default/files/omb/assets/memoranda_2010/m10-19.pdf. DOD has reportedly placed similar emphasis on using the "proper" contract type for particular procurements and phasing out time-and-materials and single-award indefinite-delivery/indefinite-quantity contracts in its efforts to increase its warfighting capabilities by 2 to 3% annually without increasing spending. See Jeff Kinney, Carter Tells Defense Industry Officials DOD Must Receive More Value for Its Money, 94 *Fed. Cont. Rep.* 5 (July 6, 2010).

⁵ P.L. 81-152, § 304(b), 63 Stat. 395 (June 30, 1949) (codified, as amended, at 41 U.S.C. § 254(b)) (procurements of (continued...))

subcontracts.⁶ The use of cost-reimbursement contracts to acquire commercial items is similarly prohibited.⁷ Contracts for commercial items must instead be firm-fixed-price or fixed-price with economic price adjustment contracts,⁸ or of other types (e.g., time-and-materials, ID/IQ) that price goods or services on a firm-fixed-price or fixed-price-with-an-economic-price-adjustment basis.⁹ Contracts that result from sealed bidding must also be firm-fixed-price or fixed-price with an economic price adjustment.¹⁰

Aside from these restrictions, however, selection of the contract type for a particular procurement is generally within the contracting officer's discretion.¹¹ The contracting officer generally decides

(...continued)

civilian agencies); P.L. 84-508, § 2306(a), 70A Stat. 130 (May 9, 1956) (codified, as amended, at 10 U.S.C. § 2306(a)) (procurements of defense agencies); 48 C.F.R. § 16.102(c). Despite this prohibition, agencies sometimes inadvertently enter cost-plus-a-percentage-of-cost contracts, which are void because they are unlawful. *See, e.g.,* Urban Data Sys., Inc. v. United States, 699 F.2d 1147 (Fed. Cir. 1983), *aff'd* Urban Data Sys., Inc., GSBGA 5545, 81-2 BCA ¶ 15,254 (1981) (finding that two contracts whose price adjustment clauses provided for item or unit prices to be audited after performance, with the contract prices adjusted by 5 to 10% based upon the audit findings, constituted cost-plus-a-percentage-of-cost systems of contracting).

⁶ 48 C.F.R. § 16.102(c). The clause prohibiting cost-plus-a-percentage-of-cost subcontracts may be excluded only when the prime contract is a firm-fixed-price contract. *Id.*

⁷ 48 C.F.R. § 16.301-3(b). For purposes of federal procurements, a “commercial item” is

... [a]ny item, other than real property, that is of a type customarily used by the general public or by non-governmental entities for purposes other than governmental purposes, and (i) [h]as been sold, leased, or licensed to the general public; or (ii) [h]as been offered for sale, lease, or license to the general public ... [including] installation services, maintenance services, repair services, training services, and other services if (i) [s]uch services are procured for support of [a commercial item], regardless of whether such services are provided by the same source or at the same time as the item; and (ii) [t]he source of such services provides similar services contemporaneously to the general public under terms and conditions similar to those offered to the Federal Government; [or] ... [s]ervices of a type offered and sold competitively in substantial quantities in the commercial marketplace based on established catalog or market prices for specific tasks performed or specific outcomes to be achieved and use standard commercial terms and conditions. 48 C.F.R. § 2.101.

This definition is controversial, in part because it includes the phrase “of a type” when referring to services as well as goods, while the statutory definition of commercial services on which it is based does not. *Compare id.* (regulatory definition of “commercial services”) with 41 U.S.C. § 403(12)(F) (statutory definition of “commercial services”). *See, e.g.,* Report of the Acquisition Advisory Panel to the Office of Federal Procurement Policy and the United States Congress 95-96 (2007), available at https://www.acquisition.gov/comp/aap/24102_GSA.pdf.

⁸ 48 C.F.R. § 16.201.

⁹ The Services Acquisition Reform Act (SARA) of 2003 explicitly authorized agencies to use time-and-materials and labor-hour contracts to acquire commercial items. *See* P.L. 108-136, § 1432, 117 Stat. 1672 (Nov. 24, 2003). Before SARA was enacted, the FAR prohibited the use of contracts that were not fixed-price to acquire commercial items. *See* 48 C.F.R. § 12.207 (2002) (“Agencies shall use firm-fixed-price contracts or fixed-price contracts with economic price adjustment for the acquisition of commercial items.... Use of any other contract type to acquire commercial items is prohibited.”).

¹⁰ 48 C.F.R. § 16.102(a). Sealed bidding is one of two main source-selection methods used by the federal government. In sealed bidding, the procuring activity awards the contract to the lowest-priced, qualified, responsible bidder without conducting negotiations with the bidders. This is in contrast to the other main source-selection method, negotiated procurement, wherein the procuring activity bargains with offerors after receiving proposals, and awards the contract to the offeror whose proposal rates most highly on evaluation criteria that include, but are not limited to, cost or price. In the case of negotiated procurements, any type or combination of types of contracts allowed under Subpart 16 of the FAR may be used. 48 C.F.R. § 16.102(b).

¹¹ *See, e.g.,* Am. Tel. & Tel. Co. v. United States, 307 F.3d 1374, 1379 (Fed. Cir. 2002) (“[T]he regulations entrust the contracting officer with especially great discretion, extending even to his application of procurement regulations.”); Master Sec., Inc., Comp. Gen. Dec. B-232263 (Nov. 7, 1988) (denying a protest that alleged the contracting officer’s proposed use of a firm-fixed-price contract for three years of work was improper because it would impose an inordinate (continued...))

on the contract type prior to issuing a solicitation. This decision is made after considering a range of factors including the degree of price competition in the procurement, the type and complexity of the requirements, the urgency of the requirements, the period of performance or length of the production run, and the history of the acquisition.¹² These factors can cut in various ways in any given procurement. For example, while the requirements might be simple enough for a fixed-price contract, the procuring activity's need for them might be urgent, a circumstance which can justify use of cost-reimbursement contracts. However, particularly in negotiated procurements, selection of the contract type can be "a matter for negotiation" between the procuring activity and the contractor.¹³ Most reports by the Government Accountability Office or agency inspectors general discussing agencies' use of particular types of contracts allege not that the type used was *unlawful* but that it was *imprudent* because it left the government vulnerable to paying too much, especially if agency oversight of contractor performance was inadequate.¹⁴

Provided they do not unilaterally modify particular contracts, procuring activities may generally change the type of contract used in the course of an acquisition program, a series of contracts for recurring requirements, or a single long-term contract, so as to shift more risk to the contractor as the uncertainties associated with the procurement are reduced.¹⁵

Types of Contracts

Federal procurement contracts are commonly divided into two main types—fixed-price and cost-reimbursement—that primarily differ as to whether the government or the contractor bears the risk of increases in performance costs (e.g., wages, materials). With a fixed-price contract, the contractor agrees to supply certain goods or services to the government at a predetermined price. This means that, absent a price adjustment clause in the contract, the contractor assumes the risk that the performance costs will exceed the contract price.¹⁶ In contrast, with a cost-reimbursement contract, the government agrees to pay certain costs that the contractor incurs in providing the goods or services. While payment may only be made for costs allowed under the contract up to a

(...continued)

risk of high labor costs on the contractor).

¹² 48 C.F.R. § 16.104(a)-(k).

¹³ 48 C.F.R. § 16.103(a). A "procuring activity" is any component of an executive agency with significant acquisition functions that is designated as such by the head of the agency. 48 C.F.R. § 2.101.

¹⁴ See, e.g., Treasury Inspector General for Tax Administration, *Current Practices Might Be Preventing Use of the Most Advantageous Contractual Methods to Acquire Goods and Services*, Feb. 10, 2009, at 2-3, *available at* <http://www.treas.gov/tigta/auditreports/2009reports/200910037fr.html> (reporting that 33 of 40 contracts reviewed were cost-reimbursement, time-and-materials, or labor-hour, but finding that the contracts were not improper based on the associated statements of works); Gov't Accountability Office, *Troubled Asset Relief Program: Additional Actions Needed to Better Ensure Integrity, Accountability, & Transparency*, GAO-90-161, Dec. 2008, at 36-37, *available at* <http://www.gao.gov/new.items/d09161.pdf> (noting extensive use of time-and-materials contracts and suggesting that there needs to be close government supervision to ensure that costs are contained).

¹⁵ See, e.g., 48 C.F.R. § 16.103(c); Gov't Accountability Office, *Troubled Asset Relief Program: Status of Efforts to Address Transparency and Accountability Issues*, GAO-09-417T, Feb. 24, 2009, at 3 & 10, *available at* <http://www.gao.gov/new.items/d09296.pdf> (recommending that agencies shift toward fixed-price contracts as program requirements are better defined).

¹⁶ See, e.g., *Cleveland Telecomm. Corp. v. United States*, 39 Fed. Cl. 649 (1997) (contractor not entitled to reimbursement for unforeseen premium wage payments); *D.W. Clark, Inc., ASBCA 45562*, 94-3 BCA ¶ 27,132 (1994) (contractor solely responsible for increases in material costs absent an economic price adjustment clause in the contract).

total cost specified in the contract,¹⁷ the government assumes the risk that performance costs will increase over the term of the contract. While shifting as much risk as possible from the government to the contractor might seem like a good idea,¹⁸ the FAR instructs contracting officers to use contract types that result in “reasonable contractor risks,”¹⁹ in part because contractors who are forced to assume excessive risk may cease to be available as contracting partners for the government.²⁰ Contracts can also be divided into other types, including incentive contracts, letter contracts, indefinite-delivery/indefinite-quantity (ID/IQ) contracts, and time-and-materials (T&M) contracts. Particular contracts can display features of various types (e.g., pricing on both fixed-price and cost-reimbursement bases for different line items) and can often be of multiple types (e.g., an ID/IQ T&M letter contract).²¹

This report focuses on the “contract types” included in Part 16 of the Federal Acquisition Regulation (FAR). Some of these types are legally binding contracts; others are agreements that, while not themselves legally binding, spell out terms and conditions of future binding contracts. The report does not discuss other “types” in terms of which federal procurement contracts can also be described (e.g., performance-based, share-in-savings, interagency, multiyear).²² The report also does not directly address orders or options because they are not types of contracts.²³

Determining the type of a particular contract is a question of law,²⁴ and contract language stating that a contract is of a certain type is not dispositive.²⁵

¹⁷ 48 C.F.R. § 52.216-7 (allowable costs and payment); 48 C.F.R. § 52.232-20(a) (limitation on costs).

¹⁸ See, e.g., Firm-Fixed-Price Contract Awards Require Discipline on DOD’s Part, Comptroller Says, *Fed. Cont. Daily*, Mar. 20, 2009 (quoting some who would place all risk of cost overruns on the contractors).

¹⁹ 48 C.F.R. § 16.103(a).

²⁰ See, e.g., John Cibinic, Jr. & Ralph C. Nash, Jr., *Formation of Government Contracts* 1080 (3d ed. 1998).

²¹ See, e.g., J.A. Jones Constr. Co., ASBCA 43344, 96-2 BCA ¶ 28,517 (1996) (contract displaying elements of firm-fixed price and cost-sharing contracts); Ben Bain, DHS Procurement Office Eyes Contract Hybrids, *Wash. Tech.*, Dec. 3, 2009, available at <http://washingtontechnology.com/Articles/2009/12/07/WEEK—DHS-contracting-eagle.aspx>. A “hybrid contract” is one that displays features of multiple types.

²² The report also does not discuss task order/delivery order (TO/DO) contracts or multiple-award task-order contracts (MATOCs) as distinct types. As the FAR explains, requirements contracts and ID/IQ contracts can also be described as TO/DO contracts. 48 C.F.R. § 16.501-2(a). Similarly, any type of indefinite-delivery contract could be a MATOC. 48 C.F.R. § 16.500(a).

²³ An order is a request for delivery of goods or provision of services issued to a vendor currently holding a contract. The work under the order must be within the scope of the contract under which the order is issued, or the procuring activity must solicit a new contract. An option is a unilateral right in a contract under which the government may, for a specified period, purchase additional supplies or services, or otherwise extend the contract. Federal contracts are generally for one year but can potentially be extended to five years through agencies’ use of options. 48 C.F.R. § 17.204(e).

²⁴ See, e.g., Coastal Gov’t Servs., Inc., ASBCA 49625, 97-1 BCA ¶ 28,888 (1997) (“The determination of the contract type is a matter of law, ... and we are not bound either by what the contract is called or by the label attached to it by the parties.”).

²⁵ See, e.g., LSI Serv. Corp. v. United States, 422 F.2d 1334 (Ct. Cl. 1970) (finding that a contract titled “Cost Reimbursement Contract” was a fixed-price contract because it contained a clause limiting the maximum total cost, including the contractor’s fee, to a stated amount); Franklin Co., ASBCA 9750, 65-1 BCA ¶ 4,767 (1965), *aff’d* Franklin Co. v. United States, 381 F.2d 416 (Ct. Cl. 1967) (finding that the contracts in question were not requirements contracts, despite being designated as such, because they provided for the supply of the same kind of services in the same place, and there cannot be two simultaneous requirements contracts for the same services in the same place).

Contracts Under Part 16 of the FAR

Fixed-Price Contracts

The various types of fixed-price contracts, described in **Table 1**, provide for the contractor to receive a specified (i.e., fixed) price for supplying certain goods or services to the government. With some types of fixed-price contracts, the price is fixed without the possibility of change, absent modifications by the government or defective performance by the contractor, at the time of contracting (e.g., firm-fixed-price contracts). With others, the price is fixed at the time of contracting but could later change depending upon changes in circumstances (e.g., fixed-price contracts with economic price adjustments,²⁶ fixed price contracts with prospective price redetermination, fixed-ceiling price contracts with retroactive price redetermination²⁷). The extent of possible changes in price is sometimes restricted at the time of contracting (e.g., fixed-ceiling-price contracts with retroactive price redetermination). At other times, it may be left open (e.g., fixed-price contracts with economic price adjustments). Fixed-price contracts are generally for the provision of specified quantities of goods or services. However, some provide a specified fee in return for the contractor's expending a specified level of effort, regardless of whether particular objectives are realized (e.g., firm-fixed-price, level-of-effort term contracts).

Table 1. Types of Fixed-Price Contracts

Type	Description	Use	Conditions on Use
Firm-fixed-price contracts	Contractor agrees to provide supplies or services to the procuring activity for a specified price	Used when acquiring commercial items or other goods and services when there are reasonably definite specifications, and fair and reasonable prices can be established at the outset	n/a
Fixed-price contracts with economic price adjustments ^a	Contractor agrees to provide supplies or services to the procuring activity for a specified price that could be adjusted if certain economic conditions change during performance of the contract	Used when the stability of market or labor conditions throughout the period of performance is uncertain, and contingencies otherwise included in the contract price can be identified and separately addressed in the contract	Contracting officer must determine that a price adjustment clause is necessary to protect the contractor or government against significant fluctuations in costs or provide for price adjustments in the event of changes in the contractor's established prices

²⁶ Contracting officers have substantial discretion in determining whether to include an economic price adjustment clause in a fixed-price contract, and their determinations about whether to include such a clause generally will not be reversed by judicial or administrative tribunals. *See, e.g.,* B&P Refuse Disposal, Inc., Comp. Gen. Dec. B-253661 (Sept. 16, 1993); Master Security, Inc., Comp. Gen. Dec. B-232262 (Nov. 30, 1988); Sentinel Elecs., Inc., Comp. Gen. Dec. B-212770 (Dec. 20, 1983).

²⁷ Some commentators have suggested that fixed-price contracts with retroactive price redetermination are really cost-plus-a-percentage-of-cost contracts because profit is computed based on a percentage of the costs after performance. *See, e.g.,* 2-19 Gov't Cont.: L., Admin. & Proc. § 19.40. The courts, however, have historically rejected this argument on the grounds that Congress explicitly prohibited cost-plus-a-percentage-of-cost contracts but has permitted fixed-price contracts with retroactive price redetermination. *See Nat'l Elec. Labs., Inc. v. United States*, 180 F. Supp. 337, 340 (Ct. Cl. 1960) ("There probably is some difference but not enough, we think, to justify us in treating the latter [retroactive] type of price provisions as illegal.").

Type	Description	Use	Conditions on Use
Fixed-price contract with prospective price redetermination	Contractor receives a firm fixed price for a specified initial period of performance, with the price for later periods revised in an equitable manner based on variables agreed upon by the parties ^b	Used to acquire quantity production or services when it is possible to negotiate a fair and reasonable price for the initial period but not for later ones	Negotiations have shown firm-fixed-price and incentive contracts are not suitable; contractor's accounting system is adequate; accounting system can be made to conform to the price periods; there is reasonable assurance redetermination will take place as scheduled
Fixed-ceiling-price contracts with retroactive price redetermination	Contractor receives no more than a fixed ceiling price that was agreed upon when the contract was formed; determination of actual price occurs after the contract is performed based on variables previously agreed upon	Used for research and development contracts whose anticipated value is less than \$100,000 when other fixed-price contracts cannot be used	Contractor's accounting system is adequate for price redetermination; there is reasonable assurance redetermination will take place as scheduled; the head of procuring activity approves use of this contract
Firm-fixed-price, level-of-effort term contracts	Contractor receives a fixed amount for providing a certain level of effort over a certain period of time on work that "can only be stated in general terms"	Used for research and development contracts whose anticipated value is less than \$100,000; generally yields a report describing the R&D results	Required level of effort is identified, agreed upon in advance; there is reasonable assurance that the intended result cannot be achieved by expending less effort

Source: Congressional Research Service, based on Subpart 16.2 of the FAR.

- a. Economic price adjustment clauses themselves can be of three types, depending upon whether the adjustment is made based upon (1) established prices, (2) the actual costs of labor or material, or (3) indexes of labor or material. 48 C.F.R. § 16.203-1(a).
- b. The initial performance period must be the longest possible period allowing for a "fair and reasonable firm fixed price," and the later performance periods must be a minimum of 12 months. 48 C.F.R. § 16.205-2(a).

Fixed-price contracts are generally favored by policy makers because the contractor, not the government, assumes the risk of increases in performance costs.²⁸ The government's liability is typically limited to the contract price, so long as the contract does not have a price adjustment clause and the government has not actually or constructively modified the contract.²⁹ If the costs of labor or materials increase during performance of the contract, the contractor must absorb these costs, even if doing so means choosing between performing the contract at a loss and breaching the contract. Additionally, the government can generally rely on the contractor to finance performance under a fixed-price contract.³⁰ Unless the government agrees to provide financing in the form of progress payments, it pays only for completed or delivered work.³¹ With

²⁸ See, e.g., Formation of Government Contracts, *supra* note 20, at 1061.

²⁹ See, e.g., McDonnell Douglas Corp. v. United States, 37 Fed. Cl. 295 (1997) (when the government orders changes, the contractor is no longer required to deliver at the contract price, regardless of increases in performance costs, so long as the increases resulted from the government's changes); Martin-Copeland Co., ASBCA 26551, 83-2 BCA ¶ 16,752 (1983) (contractor not entitled to relief when the price of gold increased by 350% because it had assumed the risk that the price would not increase beyond the 10% provided for in the price adjustment clause).

³⁰ See, e.g., Formation of Government Contracts, *supra* note 20, at 1061.

³¹ *Id.* Progress payments made on the basis of percentage of completion to construction contractors and architect-engineers are considered invoice payments. 48 C.F.R. § 32.903. Progress payments made on the basis of performance milestones are considered financing payments. 48 C.F.R. §§ 32.503-8—32.503.9. Any other progress payments based (continued...)

cost-reimbursement contracts, in contrast, the contractor needs to provide only a minimal amount of financing because its costs are reimbursed on a regular basis.³² Further, fixed-price contracts are generally simpler for the government to administer because there is typically no need to audit the contractor's books or determine whether particular costs are allowable under the contract.³³ Rather, the government can pay the agreed-upon price upon acceptance of the goods or services or as otherwise scheduled under the contract.³⁴

Fixed-price contracts are not without their drawbacks, however, as some commentators have noted.³⁵ Regardless of the type of fixed-price contract used, the government runs the risk of overpaying for goods and services, especially if it overestimates its requirements.³⁶ It is not entitled to a price reduction if the contractor's actual costs are less than anticipated,³⁷ and certain payments may be recoverable under cost-reimbursement contracts but not under fixed-price contracts.³⁸ With firm-fixed-price contracts, in particular, the government could also (1) pay higher prices than would have been paid under cost-reimbursement contracts;³⁹ (2) have to convert the contract to another type to obtain completion of performance;⁴⁰ or (3) defend lawsuits filed by contractors attempting to recover increases in performance costs by alleging that the government constructively modified the contract.⁴¹ Similarly, with fixed-price contracts with economic price adjustment clauses, the government could be vulnerable to "significant and unanticipated price increases," especially if the clauses do not adequately protect the government's interests.⁴² However, refusal to use economic price adjustment clauses where

(...continued)

on costs are "unusual" and may be made only in exceptional cases. 48 C.F.R. §§ 32.501-1—32.501-2.

³² See, e.g., *Formation of Government Contracts*, *supra* note 20, at 1061.

³³ See, e.g., 2-19 Gov't Cont.: L., Admin. & Proc. § 19.20 (2009).

³⁴ Acceptance occurs when an authorized representative of the government assumes ownership of identified supplies tendered or approves specific services rendered as partial or complete performance of the contract. See 48 C.F.R. § 46.101.

³⁵ See, e.g., *Formation of Government Contracts*, *supra* note 20, at 1080.

³⁶ *North Chicago Disposal Co.*, ASBCA 25535, 82-1 BCA ¶ 15,488 (1981) (government could not recover when it contracted for removal of "wet garbage" from galleys at the Great Lakes Naval Base and then did not use the service because the galley personnel were unaware of it and disposed of the garbage in-house); *Rolligon Corp.*, ASBCA 8812, 65-2 BCA ¶ 15,488 (1965) (government liable for the full contract price when it leased two experimental vehicles from the contractor for a one-year testing-and-evaluation period and then discontinued testing after one month).

³⁷ *Penker Constr. Co. v. United States*, 96 Ct. Cl. 1 (1942) (government could not deduct payments from a fixed-price contract when the number of yards of materials excavated was less than the government had estimated it would be).

³⁸ *Gould, Inc.*, ASBCA 46759, 97-2 BCA ¶ 29,254 (1997), *reaff'd on recons.* 98-1 BCA ¶ 29,469 (1998) (when the contractor over-funded pension accounts because of incorrect actuarial assumptions, the government was entitled to a credit on costs billed to cost-recovery contracts, but not on costs billed to firm-fixed-price contracts).

³⁹ See, e.g., *Commission on Army Acquisition and Program Management in Expeditionary Operations, Urgent Reform Required: Army Expeditionary Contracting* 38 (2007) (reporting that contractors had to price firm-fixed-price contracts higher in order to cover possible risks of performing in war zones).

⁴⁰ See, e.g., *General Dynamics Corp. v. United States*, 671 F.2d 474 (Ct. Cl. 1982) (government converting a firm-fixed-price contract into a cost-reimbursement contract in order to obtain completion of the work); *Ball Bros. Research Group*, NASABCA 1277-6, 80-2 BCA ¶ 14,562 (1980) (same).

⁴¹ See, e.g., *McDonnell Douglas Corp. v. United States*, 37 Fed. Cl. 295 (1997) (when the government orders changes, the contractor is no longer required to deliver at the contract price, regardless of increases in performance costs, so long as the increases resulted from the government's changes). In one case, Northrop Grumman reportedly sued to recover \$14 million due to alleged modifications to the fixed-price portions of a \$26 million contract to develop a prototype communications system. See, e.g., *Northrop Grumman May Sue for Overrun on \$26 Million Prototype Contract*, COFC Rules, 70 Fed. Cont. Rep. 417 (Oct. 26, 1998).

⁴² Office of the Under Secretary of Defense, Acquisition, Technology & Logistics, *Follow-on Actions in Response to* (continued...)

significant economic fluctuations are possible could result in the government paying higher prices because fewer contractors will compete for such contracts.⁴³

Cost-Reimbursement Contracts

The various cost-reimbursement contracts, described in **Table 2**, provide for the government to pay the contractor, at a minimum, allowable costs incurred in performing the contract up to a total cost specified in the contract. As used here, “costs” do not necessarily include all expenses that the contractor incurred in performing the contract. Rather, costs are expenses that are allocable to the contract and reimbursable by the government under the terms of the contract.⁴⁴ The types of cost-reimbursement contracts differ in whether the contractor recovers only costs (e.g., cost contracts, cost-sharing contracts) or whether there is some allowance for profit (e.g., cost-plus-fixed-fee contracts, cost-plus-a-percentage-of-cost contracts). Some contracts are with vendors that are nonprofits (e.g., cost contracts) or that at least are not expecting to profit from the contract (e.g., cost-sharing contracts). Others are with contractors who anticipate making a profit (cost-plus-fixed-fee contracts). Cost-plus-a-percentage-of-cost contracts are absolutely prohibited,⁴⁵ and no cost-reimbursement contract may be used to acquire commercial items.⁴⁶

Table 2. Types of Cost-Reimbursement Contracts

Type	Description	Use
Cost contracts	Contractor reimbursed for allowable costs up to a specified total cost; no allowance for profit	Used for research and development projects, especially those involving nonprofits (e.g., colleges and universities)
Cost-sharing contracts	Contractor is reimbursed for some allowable costs; pays the other costs itself	Used when the contractor expects “substantial compensating benefits” (e.g., commercializing the results of R&D)
Cost-plus-fixed-fee contracts	Contractor is reimbursed for allowable costs up to the specified total cost and receives a negotiated fixed fee for its efforts ^a	Used when other contract types cannot be used (e.g., requirements for research, study or preliminary exploration involving a level of effort that is presently unknown, or development or testing under circumstances where the use of a cost-plus-incentive-fee contract is impractical)
Cost-plus-a-percentage-of-cost contracts	Contractor is reimbursed for its costs and receives a certain percentage of these costs as an allowance for profit	Absolutely prohibited, even as a subcontract under most types of federal prime contracts

Source: Congressional Research Service, based on Subpart 16.3 of the FAR.

(...continued)

OIG Report Notification: “Effect of Payments into Boeing Pension Funds on Economic Price Adjustment Clauses in DoD Contracts,” Sept. 9, 2009, *available at* <http://www.acq.osd.mil/dpap/policy/policyvault/USA005087-09-DPAP.pdf> (reporting \$1.9 billion in price increases on contracts for the C-17 Globemaster aircraft, F/A-18 E/F Super Hornet aircraft, and AH-64D Apache Longbow helicopter).

⁴³ See, e.g., Formation of Government Contracts, *supra* note 20, at 1083.

⁴⁴ 48 C.F.R. § 31.201-2 (allowable costs); 48 C.F.R. § 31.201-4 (allocable costs). This means that “costs” can vary by contract, making it impossible to discuss, in the abstract, which costs may properly be reimbursed.

⁴⁵ See *supra* notes 5-6 and accompanying text.

⁴⁶ 48 C.F.R. § 16.301-3(b).

- a. The fixed fee is independent of actual costs and is adjusted only if the procuring activity changes the work to be performed under the contract. 48 C.F.R. § 16.306(a).

As commentators have noted, cost-reimbursement contracts can be “high risk” for the government because the contractor has little incentive to keep the performance costs down given that the government will ultimately pay these costs.⁴⁷ These risks are even greater when the contractor is assured of not only recovery of its costs, but also profit based on a percentage of the costs (i.e., cost-plus-a-percentage-of-cost contracts).⁴⁸ Cost-reimbursement contracts also impose certain administrative demands upon procuring activities that are generally not present with fixed-price contracts. Among other things, procuring activities must (1) ensure that the contractor’s accounting system is adequate for determining the costs applicable to the contract and (2) conduct “appropriate ... surveillance” of the contractor during performance.⁴⁹ Further, cost-reimbursement contracts can give rise to disputes between the parties over whether particular costs are allowable under or allocable to the contract.⁵⁰

However, the alleged risks of cost-reimbursement contracts can be lessened with effective government oversight of contractor performance,⁵¹ and the contracts themselves contain certain protections for the government. Key among these protections are limitations on allowable costs and total costs.⁵² The government is only required to reimburse the contractor for costs that are allowable under and allocable to the contract, and the maximum total cost that the government must potentially reimburse is fixed at the time of contracting. Under the terms of the contract, the contractor must notify the government when costs approach or exceed this total. The government then has the right—but not the obligation—to approve additional costs.⁵³ If the government approves additional costs, the contractor must continue working until the funds are spent or performance is completed. However, if the government does not approve the additional costs, the contractor is expected to cease performance. If it does not cease performance, it generally cannot recover any further costs from the government.⁵⁴ Cost-plus-fixed-fee contracts are also subject to limitations on the amount of the fixed fee, which generally cannot exceed 10% of the estimated cost (6% for architectural and engineering work; 15% for experimental, research or development work).⁵⁵

⁴⁷ See, e.g., Improving Government Acquisition, *supra* note 2.

⁴⁸ *Muschany v. United States*, 324 U.S. 49, 61-62 (1944) (“The evil of such contracts is that the profit of the other party to the contract increases in proportion to that other party’s costs expended in the performance.”).

⁴⁹ 48 C.F.R. § 16.301-3.

⁵⁰ See, e.g., 2-19 Gov’t Cont.: L., Admin. & Proc. § 19.20.

⁵¹ See, e.g., Geoffrey Emeigh, DOD Acquisition Experts Chime in on SASC Weapon Systems Acquisition Reform Agenda, *Fed. Cont. Daily*, Mar. 4, 2009 (quoting Jacques Gansler, former Under Secretary of Defense for Acquisition, Technology & Logistics, as stating that the government has not been using cost-type contracts as effectively as it could).

⁵² 48 C.F.R. § 52.216-7 (allowable costs and payment); 48 C.F.R. § 52.232-20(a) (limitation on costs).

⁵³ See, e.g., *Eyler Assocs.*, ASBCA 16804, 75-1 BCA ¶ 11,320 (1975) (contracting officer has substantial discretion in determining whether to fund an overrun); *ARINC Research Corp.*, ASBCA 15861, 72-2 BCA ¶ 9,721 (1972) (same).

⁵⁴ However, in certain circumstances, the government’s failure to fund a cost overrun could constitute an abuse of discretion. See, e.g., *Gen. Elec. Co. v. United States*, 440 F.2d 420 (Ct. Cl. 1971) (government abused its discretion in failing to fund a cost overrun when the circumstances were such that the contractor could not have known of the overrun).

⁵⁵ 48 C.F.R. § 15.404-4(c)(4)(i). The FAR authorizes payment of this fixed fee either (1) upon completion and delivery of a specified end product or (2) after the contractor has worked at a specified level of effort for an agreed upon period of time. 48 C.F.R. § 16.306(d)(1)-(2). Payment upon completion is preferred and must be used “whenever the work ... can be defined well enough to permit development of estimates within which the contractor can be expected to (continued...) ”

Incentive Contracts

The various types of incentive contracts—fixed-price incentive contracts, cost-plus-incentive-fee contracts, and cost-plus-award-fee contracts—are often characterized as occupying a “middle ground” between fixed-price and cost-reimbursement contracts because the parties share the risk by basing the contractor’s profits, in part, on the cost or quality of its performance.⁵⁶ The various types of incentive contracts are alike in that they provide for the contractor to get (1) a specified base fee and (2) the opportunity to earn additional fees (i.e., incentive or award fees) based upon its performance in meeting cost, schedule, or technical goals under the contract.⁵⁷ They differ in the basis upon which the additional fee is determined and, in the case of incentive-fee contracts, the circumstances in which they can be used.

With cost-plus-award-fee contracts, the award fee is entirely separate from the base fee⁵⁸ and is determined based on the procuring activity’s subjective evaluation of the contractor’s performance.⁵⁹ Such determinations are generally final and are not subject to the “disputes clause” of the contract, which otherwise permits the contractor to contest certain matters with the government.⁶⁰ However, in *Burnside-Ott Aviation Training Center v. Dalton*, the U.S. Court of Appeals for the Federal Circuit held that such unilateral determinations by the government are subject to dispute when they are arbitrary and capricious.⁶¹

With fixed-price incentive contracts and cost-plus-incentive-fee contracts, in contrast, the incentive fee is determined based upon formulaic adjustments of the base fee.⁶² The formula for *fixed-price incentive contracts* focuses upon “the relationship of total final negotiated cost to total target cost”⁶³ and can include either (1) the target cost, the target profit, and the price ceiling, in the case of firm-target incentives⁶⁴ or (2) the initial target cost, the initial target profit, the ceiling price, and the initial profit adjustment formula that is used at an agreed-upon point during performance to establish the target profit, in the case of successive-target incentives.⁶⁵ The formula for *cost-plus-incentive-fee contracts* focuses upon “the relationship of total allowable

(...continued)

complete the work.” 48 C.F.R. § 16.306(d)(3). Payment based upon work at a specific level of effort for an agreed upon period of time may be used only when the contract requires the contractor “to provide a specific level of effort within a definite time period.” 48 C.F.R. § 16.306(d)(4).

⁵⁶ See, e.g., Formation of Government Contracts, *supra* note 20, at 1061.

⁵⁷ Because exclusive focus upon meeting delivery or technical performance goals can result in excessive costs, any contract including delivery or technical performance goals must also include cost goals. 48 C.F.R. § 16.403(a); 48 C.F.R. § 16.405-1(a); 48 C.F.R. § 16.405-2.

⁵⁸ 48 C.F.R. § 16.405-2.

⁵⁹ 48 C.F.R. § 16.401(e)(2). The FAR requires that cost-plus-award-fee contracts include award-fee plans, specifying the procedures that the procuring activity will use when evaluating the contractor’s performance to determine award fees. 48 C.F.R. § 16.401(e)(3). Among other things, these plans provide for “evaluation period(s) to be conducted at stated intervals during the contract period ... so that the contractor will periodically be informed of the quality of its performance and the areas in which improvement is expected.” *Id.*

⁶⁰ 41 U.S.C. §§ 601-613 (codification of the Contract Disputes Act); 48 C.F.R. § 52.233-1 (standard disputes clause).

⁶¹ 107 F.3d 854 (Fed. Cir. 1997), *aff’d* Burnside-Ott Aviation Training Center, ASBCA 43184, 96-1 BCA ¶ 28,102 (1996). See also *Textron Defense Sys., A Div. of AVCO Corp.*, ASBCA 47352, 47950, 96-2 BCA ¶ 28,332 (1996).

⁶² 48 C.F.R. § 16.403(a); 48 C.F.R. § 16.405-1(a).

⁶³ 48 C.F.R. § 16.403(a).

⁶⁴ 48 C.F.R. § 16.403-1(a).

⁶⁵ 48 C.F.R. § 16.403-2(a)(1).

costs to total target cost”⁶⁶ and includes the target cost, the target fee, the minimum fee, and the maximum fee as components.⁶⁷ The FAR contemplates that cost-plus-incentive-fee contracts will be used more narrowly than fixed-price incentive contracts (i.e., for research and development projects).⁶⁸

Contractors who fail to meet incentive-related goals often also fail to meet other terms of the contract, which could carry different penalties. For example, failure to meet a technical performance goal could constitute failure to meet a specification requirement. However, the penalty for the former is a reduction in profits or fees, while the penalties for the latter could involve rejection of the work by the contracting officer, requirements to redo the work so that it meets the specifications, or termination for default. Most contracts reportedly do not make clear that the government is not entitled to a “double remedy” in these situations,⁶⁹ but courts and boards of contract appeals sometimes construe the contract to such an effect.⁷⁰

Time-and-Materials and Labor-Hour Contracts

In a time-and-materials contract, the contractor is paid a fixed hourly rate⁷¹ for direct labor expended during the contract’s performance (e.g., wages, overhead, general and administrative expenses, profit⁷²), as well as the actual cost of materials.⁷³ The materials covered by a time-and-materials contract can include direct materials, subcontracts for supplies or incidental services, other direct costs, and applicable indirect costs.⁷⁴ However, the FAR specifies that material handling costs, which include “all appropriate indirect costs allocated to direct materials,” may be part of the materials cost only if they are not part of the labor-hourly rate.⁷⁵ It imposes this requirement to ensure that material handling costs are not “paid twice” in a way that could result in a prohibited cost-plus-percentage-of-cost system of contracting.⁷⁶ A labor-hour contract is

⁶⁶ 48 C.F.R. § 16.405-1(a).

⁶⁷ *Id.*

⁶⁸ The FAR states that cost-plus-incentive-fee contracts are “appropriate” for “services or development and test programs.” 48 C.F.R. § 16.405-1(b)(1). Additionally, cost-plus-incentive-fee contracts, like other cost-reimbursement contracts, cannot be used to acquire commercial items. 48 C.F.R. § 301-3(b).

⁶⁹ Formation of Government Contracts, *supra* note 20, at 1145.

⁷⁰ See, e.g., North Am. Aviation, Inc., ASBCA 11603, 68-1 BCA ¶ 6,998 (1968); Gen. Precision, Inc., ASBCA 11071, 66-2 BCA ¶ 5,904 (1966).

⁷¹ The FAR defines “hourly rate” as “the rate(s) prescribed in the contract for payment for labor that meets the labor category qualification of a labor category specified in the contract that are – (1) [p]erformed by the contractor; (2) [p]erformed by the subcontractors; or (3) [t]ransferred between divisions, subsidiaries, or affiliates of the contractor under a common control.” 48 C.F.R. § 16.601(a). See 48 C.F.R. § 16.601(c)(2) for the detailed requirements for fixed hourly rates.

⁷² 48 C.F.R. § 16.601(c)(2)(i).

⁷³ 48 C.F.R. § 16.601(b).

⁷⁴ 48 C.F.R. § 16.601(a). “Direct materials” are “those materials that enter directly into the end product, or that are used or consumed directly in connection with the furnishing of the end product or service.” *Id.*

⁷⁵ 48 C.F.R. § 16.601(c)(3).

⁷⁶ See, e.g., Gen. Eng’g & Mach. Works v. O’Keefe, 991 F.2d 775 (Fed. Cir. 1993) (affirming a board holding that recovery of a separate material handling charge and inclusion of material handling costs in the hourly rate of a time-and-materials contract violated the prohibition on cost-plus-a-percentage-of-cost contracts because it allowed a “double recovery”).

similar to a time-and-materials contract, except the contractor supplies only direct labor, not materials.⁷⁷

Subpart 16 of the FAR addresses procuring activities' use of time-and-materials and labor-hour contracts in general. It authorizes agencies to use such contracts only when

- the parties cannot accurately estimate the extent or duration of the contract's work, or reasonably estimate the costs of the contract, at the time of contracting;⁷⁸
- the contracting officer prepares a determination and findings (D&F) that "no other contract is suitable";⁷⁹ and
- the contract includes a ceiling price that the contractor exceeds at its own risk.⁸⁰

Subpart 12 of the FAR imposes additional requirements upon use of time-and-materials and labor-hours contracts to acquire commercial services.⁸¹ Under Subpart 12, agencies may use time-and-materials and labor-hour contracts to acquire commercial services only under contracts or orders that were "competitively" awarded.⁸² Additionally, under Subpart 12, D&Fs must not only conclude that "no other contract is suitable" but must also: (1) include a description of the market research that was conducted to reach this conclusion; (2) establish that it is not possible at the time of contracting or ordering to accurately estimate the extent or duration of the work or anticipate the costs; (3) establish that the requirement has been structured to maximize use of firm-fixed-price or fixed-price with economic price adjustment contracts in future acquisitions for the same requirements (e.g., limiting the length of the contract); and (4) describe plans to maximize the use of firm-fixed-price or fixed-price with economic price adjustment contracts in future acquisitions.⁸³

⁷⁷ 48 C.F.R. § 16.602.

⁷⁸ 48 C.F.R. § 16.601(c).

⁷⁹ 48 C.F.R. § 16.601(d)(1)(i). Additionally, the head of the contracting activity must approve the D&F "prior to the execution of the base period when the base period plus any option periods exceeds three years." 48 C.F.R. § 16.601(d)(1)(ii).

⁸⁰ 48 C.F.R. § 16.601(d)(1). The contractor must document any subsequent changes in the ceiling price. 48 C.F.R. § 16.601(d)(2).

⁸¹ There is, however, presently some uncertainty as to whether purchases under the Federal Supply Schedules, which list commercial items, are subject to the requirements of Subpart 12 or just those of Subpart 16. The General Services Administration reportedly has taken the position that the Federal Supply Schedules are not subject to Subpart 12 because the Federal Acquisition Streamlining Act (FASA) of 1994, not the Services Acquisition Reform Act (SARA) of 2003, authorized use of time-and-materials and labor-hour contracts under the Federal Supply Schedules, and SARA, not FASA, is the basis for the requirements in Subpart 12. See Gov't Accountability Office, Contract Management: Minimal Compliance with New Safeguards for Time-and-Materials Contracts for Commercial Services and Safeguards Have Not Been Applied to GSA Schedules Program, GAO-09-579, June 24, 2009, available at <http://www.gao.gov/new.items/d09579.pdf>.

⁸² 48 C.F.R. § 12.207(b)(1)(i). For purposes of Subpart 12.2, this means (1) contracts awarded using competitive procedures or procedures for other than full and open competition, provided that the procuring activity received offers from two or more responsible offerors, or (2) orders issued under a multiple-award ID/IQ using the "fair opportunity" procedures described below. 48 C.F.R. § 12.207(b)(1)(i)(A)-(C). See *infra* note 104 and accompanying text for more information on the "fair opportunity" procedures.

⁸³ 48 C.F.R. § 12.207(b)(2)(i)-(iv). Subpart 12 similarly limits agencies' authority to use ID/IQ contracts to acquire commercial services. See 48 C.F.R. § 12.207(c).

Indefinite-Delivery Contracts

The three types of indefinite-delivery contracts—definite-quantity, requirements, and indefinite-delivery/indefinite-quantity (ID/IQ) contracts—are alike in that they provide for the contractor to deliver goods or services to the procuring activity at future dates unspecified at the time of contracting. They differ in the quantity of goods or services that the procuring activity must order and, thus, in the circumstances in which they are generally used. Definite-quantity contracts provide for the procuring activity to order a fixed quantity of goods or services from the contractor over the term of the contract.⁸⁴ Such contracts are used when the procuring activity knows that it will require a specific quantity of goods or services that are regularly available or will be available after a short lead time.⁸⁵ Requirements contracts, in contrast, provide for the procuring activity to order all its “requirements” for goods or services of the type provided for in the contract from the contractor during the term of the contract.⁸⁶ If the procuring activity has no requirements for these goods or services, it generally “owes” the contractor no orders.⁸⁷ However, if the procuring activity has requirements and purchases them from another vendor⁸⁸ or, in some cases, develops additional in-house capabilities to perform the work,⁸⁹ it could potentially terminate the contract for convenience or even breach it.⁹⁰ Requirements contracts are used when

⁸⁴ 48 C.F.R. § 16.501-2(b)(1).

⁸⁵ 48 C.F.R. § 16.502(b).

⁸⁶ 48 C.F.R. § 16.503(a) (“A requirements contract provides for filling all actual purchase requirements of designated Government activities for supplies or services during a specified contract period.”).

⁸⁷ See, e.g., *G.T. Folge & Co. v. United States*, 135 F.2d 117 (4th Cir. 1943) (government not liable for failure to order if it has no requirements for the goods or services). Any estimates of quantity contained in the solicitation or the contract are nonbinding. See, e.g., *Franklin Co. v. United States*, 381 F.2d 416 (Ct. Cl. 1967) (government not obligated to furnish work orders up to the estimated amount); *Kasehagen Sec. Servs., Inc., ASBCA 25629*, 86-2 BCA ¶ 18,797 (1986) (contractor must fill orders above the estimate). However, the government could potentially be liable to the contractor if the estimate was negligently prepared. See, e.g., *Alert Care Ambulance Serv., VACAB 2844*, 90-3 BCA ¶ 22,945 (1990) (government failed to exercise due care in preparing the estimates because it did not consider historical data regarding prior years’ requirements); *Pied Piper Ice Cream, Inc., ASBCA 20605*, 76-2 BCA ¶ 12,148 (1976) (same). If feasible, the contract should specify a maximum quantity of goods or services, orders in excess of which the contractor is generally not required to meet. 48 C.F.R. § 16.503(a)(2).

⁸⁸ See, e.g., *Rumsfeld v. Applied Cos., Inc.*, 325 F.3d 1328, 1339 (Fed. Cir. 2003) (“[T]he government breaches a requirements contract when it has requirements for contract items or services, but diverts business from the contractor and does not use the contractor to satisfy those requirements.”); *Ready-Mix Concrete Co. Ltd. v. United States*, 158 F. Supp. 571 (Ct. Cl. 1958) (contractor entitled to an equitable adjustment if the government purchases the needed supplies or services from any other source during the contract period).

⁸⁹ Contract language stating that the contractor is entitled to supply those items “required to be purchased by the government” will generally be construed to allow the procuring activity to develop additional in-house capacity during the term of the contract. See, e.g., *Export Packing & Crating Co., Inc., ASBCA 16133*, 73-2 BCA ¶ 10,066 (1973); *Applied Painting & Decorating Co., ASBCA 15919*, 73-2 BCA ¶ 10,358 (1973). However, language stating that the contractor is entitled to supply items “in excess of the quantities which the activity may itself furnish with its own capabilities” generally will not be so construed because it is read as referring to the procuring activity’s capabilities at the time of contracting. See, e.g., *Kozak Micro Sys., Inc., GSBCA 10519*, 91-1 BCA ¶ 23,342 (1991) (“Where the contract demands that the contractor provide all the required supplies or services of a named Government activity ‘in excess of the quantities which the activity may itself furnish with its own capabilities,’ the document is understood to refer to the capabilities in existence at the time the contract is awarded. The government may not develop and use additional capabilities to eliminate a part of work that the contractor raised every expectation of receiving, and thereby prevent the contractor from recovering its costs.”); *Maya Transit Co., ASBCA 20186*, 75-2 BCA ¶ 11,552 (1975) (government not permitted to reorder its budget priorities and redistribute its capabilities to assume more bus routes for its own drivers when the contract provided for the contractor to furnish bus services “in excess of the quantities which the activity may itself furnish within its own capabilities”).

⁹⁰ Courts often treat governmental failures to comply with the terms of procurement contracts as constructive terminations of the contract. See, e.g., *Nesbitt v. United States*, 543 F.2d 583 (Ct. Cl. 1965); *Integrity Mgmt. Int’l, Inc.*, (continued...)

the government anticipates recurring requirements but cannot predetermine the precise quantities needed.⁹¹ ID/IQ contracts are also used when the government anticipates recurring needs but cannot specify the quantity needed.⁹² However, an ID/IQ contract does not entitle the contractor to fill all the procuring activity's requirements for certain goods or services. Rather, the contractor is assured of orders for only the "minimum quantity" of goods or services specified in the contract.⁹³ This quantity must be a "more than nominal amount,"⁹⁴ but recent recommendations by the Government Accountability Office suggest that \$500 can be used as the guaranteed minimum, regardless of the maximum ordering limitations or total contract value, in the absence of reliable historical data suggesting otherwise.⁹⁵

Under indefinite-delivery contracts, the procuring activity issues task or delivery orders to the contractor when it requires supplies or services, a process which is generally not subject to the Competition in Contracting Act. However, Congress has imposed certain competition requirements upon agencies issuing orders under requirements and ID/IQ contracts, in particular. The Federal Acquisition Streamlining Act (FASA) of 1994 established a "preference" for multiple-award contracts by requiring agencies to use them, instead of single-award contracts, "to the maximum extent possible."⁹⁶ A multiple-award contract is one held by several vendors, all of whom can receive orders under it, while a single-award contract is one held by one vendor, who is the only vendor who can receive orders under it.⁹⁷ This preference applies to ID/IQ contracts⁹⁸ and, potentially, to requirements contracts.⁹⁹ FASA also requires agencies using multiple-award

(...continued)

ASBCA 18289, 75-1 BCA ¶ 11,235 (1975). However, they will generally not convert failure to order under a requirements contract into a termination for convenience when the failure was in bad faith or based on circumstances known to the government at the time of contracting. *See, e.g.,* *Torncello v. United States*, 681 F.2d 756 (Fed. Cl. 1982) (termination based on the contractor's prices, which were known to the government at the time of contracting); *Kalvar Corp. v. United States*, 543 F.2d 1298 (Ct. Cl. 1976) (termination in bad faith).

⁹¹ 48 C.F.R. § 16.503(b)(1).

⁹² 48 C.F.R. § 16.504(b).

⁹³ *See, e.g.,* 48 C.F.R. § 16.504(a)(1); Peter J. Brandon, AGBCA 91-186-1, 92-1 BCA ¶ 24,648 (1991). Provided the minimum quantity is ordered, the government is not liable for ordering similar goods and services from other contractors; failing to order any estimated quantities, even if those estimates were negligently prepared; or any costs that the contractor incurs due to lack of orders. *See, e.g.,* *Bliss Co. v. United States*, 74 Ct. Cl. 14 (1932) (government not liable for losses due to the contractor's plant being idled for lack of orders); *Crown Laundry & Dry Cleaners*, ASBCA 39982, 90-3 BCA ¶ 22,993 (1990) ("[W]e do not examine the reasonableness of the estimates in indefinite quantity contracts."); *Alta Constr. Co., PSCBA 1395*, 87-2 BCA ¶ 19,720 (1987) (government's awarding work orders to a competitor of the contractor does not give rise to a breach of contract claim). An ID/IQ contract may also contain a maximum quantity, orders in excess of which the contractor generally need not fill. 48 C.F.R. § 16.504(a)(3).

⁹⁴ *Goldwasser v. United States*, 325 F.2d 722 (Ct. Cl. 1963) (contract with a minimum quantity of \$100 compared to estimated price of \$40,000 "would have been a one-sided bargain, bordering upon lack of mutuality"); *Tennessee Soap Co. v. United States*, 126 F. Supp. 439 (Ct. Cl. 1954) (a \$10 minimum order was nominal and thus insufficient).

⁹⁵ Library of Congress, Comp. Gen. Dec. B-318046 (July 7, 2009).

⁹⁶ P.L. 103-355, § 1004, 108 Stat. 3249-54 (Oct. 13, 1994) (codified at 10 U.S.C. § 2304a(d)(3)) (procurements of defense agencies); *id.* at § 1054, 108 Stat. 3261-65 (codified at 41 U.S.C. § 253h(d)(3)) (procurements of civilian agencies).

⁹⁷ A single-award ID/IQ contract differs from a requirements contract in that the procuring activity has not committed to purchasing all its requirements for particular goods and services from that contractor and is free to contract with other vendors for the same goods and services.

⁹⁸ *See, e.g.,* 48 C.F.R. § 16.500(a) ("This subpart prescribes policies and procedures for making awards of indefinite-delivery contracts and establishes a preference for making multiple awards of indefinite-quantity contracts.").

⁹⁹ *See, e.g.,* Formation of Government Contracts, *supra* note 20, at 1191 (raising the question of whether single-award requirements contracts violate FASA). *See also* *Nations, Inc.*, Comp. Gen. Dec. B-272455 (Nov. 5, 1996) (finding such (continued...))

contracts to provide contractors “a fair opportunity to be considered” when issuing task or delivery orders in excess of \$3,000 unless certain conditions apply.¹⁰⁰ The National Defense Authorization Act for FY2008 (NDAA ‘08) and regulations promulgated under its authority further strengthened the competition requirements for orders under requirements and ID/IQ contracts by prohibiting agencies from using single-award contracts whose anticipated value exceeds \$100 million, including options, unless the agency head makes certain determinations in writing.¹⁰¹ The NDAA ‘08 also defined what constitutes a “fair opportunity to be considered” for orders in excess of \$5 million under multiple-award contracts.¹⁰² Also, in the interests of promoting competition, agencies are likewise prohibited from awarding requirements contracts for “advisory and assistance services”¹⁰³ in excess of three years and \$11.5 million, including options, unless certain conditions are met.¹⁰⁴

Other Agreements Under Part 16 of the FAR

Letter Contracts

There are times when an agency’s need for a contractor’s goods or services is so pressing that the agency cannot wait for the execution of a formal (i.e., definitized) contract. However, contractors

(...continued)

a violation when the procuring activity proposed to issue a single requirements contract whose anticipated value was over \$10 million).

¹⁰⁰ 10 U.S.C. § 2304c(b)(1)-(4); 41 U.S.C. § 253j(b)(1). For an agency to issue an order without providing contractors “a fair opportunity to be considered,” the following conditions must be satisfied: (1) the agency’s need for the goods or services is of “unusual urgency;” (2) only one contractor is capable of providing the goods or services; (3) the order should be issued on a sole-source basis in the interests of economy and efficiency because it is “a logical follow-on” to an order issued on a competitive basis; or (4) the order must be placed with a particular contractor to satisfy a minimum guarantee under an ID/IQ.

¹⁰¹ P.L. 110-181, § 843, 122 Stat. 236-39 (Oct. 14, 2008). Before using a single-award contract, the agency head must find that (1) the orders expected under the contract are “so integrally related” that only a single source can reasonably perform them; (2) the contract provides for only firm-fixed-price orders for goods or services whose prices are established in the contract; (3) only one source is qualified and capable of performing the work at a reasonable price; or (4) because of exceptional circumstances, it is “necessary in the public interest” to award the contract to a single source. *Id.* Agency heads must notify also Congress within 30 days after making a determination to award a single-award contract in excess of \$100 million. P.L. 110-181 applies to the requirements and ID/IQ contracts of both defense and civilian agencies. An earlier law had imposed similar restrictions on DOD’s requirements and ID/IQ contracts, but this provision was subsequently repealed because it was redundant. See National Defense Authorization Act for FY2009, P.L. 110-417, § 863(f), 122 Stat. 4548 (Oct. 14, 2008) (repealing defense-specific requirements); National Defense Authorization Act for FY2002, P.L. 107-107, § 803, 115 Stat. 1179 (Dec. 28, 2001) (establishing defense-specific requirements).

¹⁰² P.L. 110-181, § 843. Under the NDAA, for contractors to have a fair opportunity to be considered, agencies must provide them with (1) a notice of the task or delivery order that includes a clear statement of the agency’s requirements; (2) a reasonable period of time to provide a proposal in response to the notice; (3) disclosure of the significant factors and subfactors that the agency expects to consider in evaluating proposals and their relative importance; (4) a written statement documenting the basis for the award and the relative importance of quality and price or cost factors, if the award is to be made on a best-value basis; and (5) an opportunity for post-award debriefing. *Id.*

¹⁰³ As used here, “advisory and assistance services” include “those services provided under contract by nongovernmental sources to support or improve: organizational policy development; decision-making; management and administration; program and/or project management and administration; or R&D activities.” 48 C.F.R. § 2.101.

¹⁰⁴ Before issuing a solicitation for such a contract, the contracting officer or other designated official must determine in writing that the services are “so unique or highly specialized that it is not practicable to make multiple awards.” 48 C.F.R. § 16.503(d)(1)-(2).

recognize that performing in the absence of a legal commitment binding the government to compensate them is risky and could result in their “being called a mere volunteer and ... recover[ing] nothing.”¹⁰⁵ As a result, the government developed letter contracts (also known as undefinitized contracts).¹⁰⁶ These are temporary contracts intended to “authorize immediate commencement of ... work” prior to the execution of the final contract.¹⁰⁷ Letter contracts typically state that a formal contract will be executed at a later date and incorporate certain terms and conditions by reference.¹⁰⁸ When letter contracts are used, they are subject to numerous requirements,¹⁰⁹ including a requirement that the contract cannot “[c]ommit the Government to a definitive contract in excess of the funds available at the time the letter contract is executed.”¹¹⁰ In the event that a definitive contract cannot be negotiated because of failure to reach agreement as to price or fee after reasonable efforts, the contractor must proceed with the work, and the contracting officer may determine a reasonable price or fee with the approval of the head of the procuring activity.¹¹¹

Courts may or may not consider letter contracts to be legally binding, depending upon the language contained in the contracts. If, for example, the document contains a clear and unconditional acceptance of the offer, then the government will generally be found to have been bound as of the date it was issued.¹¹² However, if the government’s acceptance is conditioned upon execution of a formal contract, the document will generally be found not to be legally binding.¹¹³

Letter contracts are of particular concern to Congress because of the potential for agencies to commit themselves to spending in excess of appropriations.¹¹⁴ Because letter contracts only contain general terms, many terms and conditions, including price, often have not been negotiated

¹⁰⁵ 2-19 Gov’t Cont.: L., Admin. & Proc. § 19.160 [1]. *See also* *Baltimore & Ohio R.R. v. United States*, 261 U.S. 592 (1923).

¹⁰⁶ 2-19 Gov’t Cont.: L., Admin. & Proc. § 19.160 [1].

¹⁰⁷ *Id.*; 48 C.F.R. § 16.603-1.

¹⁰⁸ *See* *Briggs & Turivas v. United States*, 83 Ct. Cl. 664 (1936). The FAR requires contracting officers to include within the letter contract the standard contract clauses for the type of contract that is contemplated by the letter contract. 48 C.F.R. § 16.603-4(a).

¹⁰⁹ *See* 48 C.F.R. §§ 16.603-2—16.603-3.

¹¹⁰ 48 C.F.R. § 16.603(a)-(b).

¹¹¹ 48 C.F.R. § 16.603-2(c). The contractor is required to continue work under the standard contract clause found at 48 C.F.R. § 52.216-25. However, because of the lack of detailed terms in the letter contract, litigation can result if the letter is not converted into a detailed contract. *See, e.g., Chrysler Corp., ASBCA 4749, 60-2 BCA ¶ 2,669* (1960).

¹¹² *See, e.g., Secretary of Navy, Comp. Gen. Dec. B-22324* (Dec. 15, 1941). So long as the letter is sufficiently clear that the contractor can proceed with the work and the government can make substantial payments on the account, courts will generally hold that a contract was created and therefore allow a contractor to sue, despite the absence of a formal contract. *Bass & Assocs. v. United States*, 205 F.2d 1386 (Ct. Cl. 1974). However, the FAR requires that contractors satisfy three requirements to recover pre-contract costs: (1) the costs must be incurred prior to definitization; (2) the costs must have been incurred directly pursuant to negotiations with the procuring activity; and (3) the costs would have been allowable if incurred after definitization. *See Integrated Logistics Support Sys. v. United States*, 47 Fed. Cl. 248, 256 (2000). The Government’s maximum liability for pre-contract costs is “the estimated amount necessary to cover the contractor’s requirements for funds before definitization” but cannot exceed 50% of the estimated costs of the definitized contract unless approved in advance by the authorizing official. *See, e.g., General Servs. Admin.*, 33 Comp. Gen. 291 (1954).

¹¹³ *See, e.g., Secretary of Commerce, Comp. Gen. Dec. B-21873* (Dec. 22, 1941).

¹¹⁴ For example, Congress has passed significant restrictions on the use of letter contracts in defense procurements. *See* 10 U.S.C. § 2326.

and agreed upon.¹¹⁵ As a result, the cost of the definite contract cannot easily be predicted. Additionally, the Comptroller General once expressed concern that letter contracts may violate the prohibition upon cost-plus-a-percentage-of-cost contracts when the definitive contract is not executed until the work is finished.¹¹⁶ However, letter contracts are now generally accepted.

Agreements

Although they are included in Part 16 of the FAR, the two types of agreements—basic agreements and basic ordering agreements—are not contracts.¹¹⁷ Rather, they are written instruments of understanding, negotiated between procuring activities and contractors, that contain terms applicable to future contracts¹¹⁸ or orders¹¹⁹ between the parties. Basic agreements and basic order agreements are used in different circumstances. Basic agreements are used when the procuring activity anticipates awarding a “substantial number” of contracts to a contractor with whom it has experienced “significant recurring negotiating problems;”¹²⁰ while basic ordering agreements are used when the procuring activity anticipates acquiring a substantial, but presently unknown, quantities of goods or services.¹²¹ However, the two types of agreements are alike in that they must be reviewed annually before the anniversary of their effective dates.¹²² Additionally, their terms may be changed only by modifications of the agreement, not by any contracts incorporating the agreement or orders issued under it.¹²³

Recently Enacted and Proposed Legislation

Like its recent predecessors (see **Appendix**), the 111th Congress has enacted several statutes that promote use of fixed-price contracts or limit use of other types of contracts. The American Recovery and Reinvestment Act (ARRA) of 2009 required that “[t]o the maximum extent possible, contracts funded under this Act shall be awarded as fixed-price contracts through the use of competitive procedures.”¹²⁴ The Weapon Systems Acquisition Reform Act of 2009 did not

¹¹⁵ 2-19 Gov’t Cont.: L., Admin. & Proc. § 19.160 [1].

¹¹⁶ See General Servs. Admin., 33 Comp. Gen. 291 (1954).

¹¹⁷ 48 C.F.R. § 16.702(a) (basic agreement); 48 C.F.R. § 16.703(a) (basic ordering agreement). However, an agreement could potentially be a contract when consideration and mutuality of assent are present. See, e.g., *Almar Indus. Inc. v. United States*, 16 Cl. Ct. 243 (1989); 2-19 Gov’t Cont.: L., Admin. & Proc. § 19.170.

¹¹⁸ See 48 C.F.R. § 16.702(b)(1) (basic agreements). These terms must include (1) the clauses required for negotiated contracts by statute, executive order, and the FAR and (2) any other clauses prescribed by the FAR or agency regulations that the parties agree to include. *Id.*

¹¹⁹ See 48 C.F.R. § 16.703(c)(1) (basic ordering agreements). These terms must (1) describe the method for determining prices to be paid to the contractor for supplies or services; (2) include delivery terms or conditions, or specify how they will be determined; (3) list one or more procuring activities authorized to issue orders under the agreement; (4) specify the point at which an order becomes a binding contract (e.g., issuance, acceptance); (5) provide that failure to reach agreement on price for any order issued before price is established is a dispute under the “disputes clause;” and (6) include any special data required when “fast payment” procedures will apply to orders. *Id.*

¹²⁰ 48 C.F.R. § 16.702(a).

¹²¹ 48 C.F.R. § 16.703(b).

¹²² 48 C.F.R. § 16.702(b)(3) (basic agreements); 48 C.F.R. § 16.703(c)(2) (basic ordering agreements).

¹²³ *Id.*

¹²⁴ P.L. 111-5, § 1554, 123 Stat. 302 (Feb. 17, 2009). ARRA further required that agencies post a summary of each contract that is not fixed-price or competitively awarded on Recovery.gov (<http://www.recovery.gov>). *Id.*

itself directly address the types of contracts used in major defense acquisition programs,¹²⁵ but its sponsors reportedly characterized the act as “push[ing]” DOD to award more fixed-price contracts for weapon systems by “eliminating” certain risks inherent in such programs.¹²⁶ The National Defense Authorization Act for FY2010 similarly expressed the sense of Congress that the Navy can undertake other measures to acquire new ships and maintain the current fleet with greater efficiency, including increased use of fixed-price contracts.¹²⁷ This act also required the Secretary of Defense to revise the Defense Federal Acquisition Regulation Supplement to ensure that it reflects all applicable limitations on reimbursement of costs and payment of profits or fees with respect to costs incurred prior to definitization of letter contracts.¹²⁸ Additionally, the Department of Defense Appropriations Act, 2010,¹²⁹ continued the prohibition on obligating more than 35% of the funds appropriated under the act for environmental remediation under ID/IQ contracts valued at \$130 million or higher that had appeared in prior appropriations acts.¹³⁰

The 111th Congress is also considering additional legislation targeting the types of contracts used by federal agencies. Many bills would promote the use of firm-fixed-price contracts, or limit the use of other types of contracts, either in general or in particular circumstances. For example, the Implementing Management for Performance and Related Reforms to Obtain Value in Every Acquisition Act of 2010 (H.R. 5013) would require the Secretary of Defense to ensure that contracts for the acquisition of military-purpose nondevelopmental items are firm-fixed-price,¹³¹ while the Intelligence Authorization Act for FY2010 (S. 3611) would require the Director of National Intelligence to conduct and submit to the congressional intelligence committees an initial vulnerability assessment for each major system and significant items of supply prior to obligating funds for contracts in excess of \$40 million that are not firm-fixed-price.¹³² Other bills

¹²⁵ P.L. 111-23, 123 Stat. 1704 (May 22, 2009). A major defense acquisition program is any program that (1) will exceed \$300 million for research, development, testing, and evaluation, or \$1.8 billion for total procurement, or (2) is designated as such by the Secretary of Defense. 10 U.S.C. § 2430.

¹²⁶ See, e.g., *Weapon Systems Acquisition Reform Bill to Back Fixed-Cost Awards, Alter Nunn-McCurdy Related Terms*, *Fed. Cont. Daily*, Feb. 25, 2009 (quoting Senator Carl Levin).

¹²⁷ P.L. 111-84, § 1021, 123 Stat. 2444 (Oct. 23, 2009).

¹²⁸ *Id.*, at § 812, 123 Stat. 2406. This includes, but is not limited to, the requirements in Section 809 of the National Defense Authorization Act for FY2008 (P.L. 110-181) and 48 C.F.R. § 52-216.26.

¹²⁹ P.L. 111-118, § 8098, 123 Stat. 3450 (Dec. 19, 2009).

¹³⁰ See, e.g., Consolidated Security, Disaster Assistance & Continuing Appropriations Act, 2009, P.L. 110-329, § 8103, 122 Stat. 3644 (Sept. 30, 2008); Department of Defense Appropriations Act, 2008, P.L. 110-116, § 8110, 121 Stat. 1339 (Nov. 13, 2007); Department of Defense, Emergency Supplemental Appropriations to Address Hurricanes in the Gulf of Mexico, and Pandemic Influenza Act, 2006, P.L. 109-148, § 8051, 119 Stat. 2709 (Dec. 30, 2005).

¹³¹ H.R. 5013, § 108.

¹³² S. 3611, § 321. See also Gulf Coast Civil Works Act, H.R. 2269, § 2 (limiting use of cost-reimbursement contracts in certain construction projects); Improving Management for Performance and Related Reforms to Obtain Value in Every Acquisition Act of 2010, H.R. 5013, § 408 (establishing an “acquisition savings program” that targets ID/IQ contracts); National Defense Authorization Act for FY2011, H.R. 5136, § 408 (same); *id.* at § 832 (requiring contractors submitting proposals for energy-savings contracts to use firm-fixed-price contracts); Information Technology (IT) Investment Oversight Enhancement and Waste Prevention Act, S. 920, § 4 (requiring that agencies whose information technology investment projects vary at least 40% from their original baselines in terms of cost, schedule, or performance examine use of firm-fixed-price contracts for certain requirements); Coast Guard Authorization Act for FY2010 and 2011, S. 1194, § 502 (limiting the Coast Guard’s authority to enter into letter contracts); Coast Guard Acquisition Reform Act of 2009, H.R. 1665, § 207 (same); Coast Guard Authorization Act of 2010, H.R. 3619, § 527 (same); National Defense Authorization Act for FY2011, S. 3454, § 841 (establishing certain requirements for the “business systems” of contractors holding cost-reimbursement, incentive, time-and-materials, and labor-hour contracts); Department of Defense Authorization Act for FY2011, S. 3455, § 841 (same); *id.* at § 511 (including capabilities acquired under firm-fixed-price contracts among those eligible for the new acquisition process for the rapid fielding of capabilities in response to urgent operational needs).

would limit agencies' authority to award fees under incentive contracts by, for example, prohibiting the award of fees when contractors engage in undesirable conduct (e.g., jeopardizing the health or safety of government personnel)¹³³ or fail to engage in desired conduct (e.g., reporting information into databases on Afghanistan and Iraq contracts).¹³⁴ Yet other bills would require additional training (e.g., on formation and administration of cost-reimbursement, time-and-materials, and ID/IQ contracts),¹³⁵ or reporting (e.g., requiring that information on the amount and nature of the "profit incentive" offered to contractors for achieving or exceeding specified goals under incentive contracts be reported on USASpending.gov).¹³⁶ However, in one case, the proposed legislation (S. 3676) would remove an existing restriction on the use of a specific contract type by exempting the U.S. Agency for International Development from compliance with the "fair opportunity" procedures when issuing an order under an ID/IQ to a small or disadvantaged business.¹³⁷

Executive Branch Initiatives

Agencies arguably began paying more attention to contract types toward the end of the George W. Bush Administration (see **Appendix**). For example, on September 29, 2008, the Department of Defense announced that it would conduct peer reviews of certain service contracts,¹³⁸ a process that includes an evaluation of whether the "[a]ppropriate contract type" was used.¹³⁹ However, this attention increased during the Obama Administration, in part because use of fixed-price contracts is one of the key components of President Obama's proposals to reform government contracting.

Obama Memorandum of March 4, 2009

On March 4, 2009, President Obama issued a memorandum on government contracting that identified use of cost-reimbursement contracts, along with noncompetitive contracts, as potentially inconsistent with obtaining the "best value" for taxpayers:

¹³³ National Defense Authorization Act for FY2011, S. 3454, § 843. S. 3454 would also limit award fees to private security contractors (PSCs) operating in areas of combat operations who fail to comply with regulations governing the conduct of PSCs. *Id.* at § 831. Similar provisions are included in S. 3455, the Department of Defense Authorization Act for FY2011. See S. 3455, §§ 842-843.

¹³⁴ National Defense Authorization Act for FY2011, § 852. See also Department of Homeland Security Appropriations Act, 2011, S. 3607, § 532 (requiring that all contracts entered into by the Department of Homeland Security that provide award fees link the fees to successful acquisition outcomes, as specified in terms of cost, schedule or performance); *id.*, § 552 (prohibiting the use of funds appropriated under the act to pay award or incentive fees to contractors whose work was judged below satisfactory or that does not meet the basic requirements of the contract).

¹³⁵ Acquisition Workforce Improvement Act of 2009, S. 2901, § 2 (establishing a government-wide acquisition management fellows program).

¹³⁶ Transparency in Government Act of 2010, H.R. 4983, § 501.

¹³⁷ Department of State, Foreign Operations, and Related Programs Appropriations Act, 2011, S. 3676, § 7034.

¹³⁸ Office of the Under Secretary of Defense, Acquisition, Technology & Logistics, Peer Reviews of Contracts for Supplies and Services, Sept. 28, 2008, *available at* <http://www.acq.osd.mil/dpap/policy/policyvault/USA000820-08-DPAP.pdf>.

¹³⁹ Office of the Under Secretary of Defense, Acquisition, Technology & Logistics, Review Criteria for the Acquisition of Services, Feb. 18, 2009, *available at* <http://www.acq.osd.mil/dpap/policy/policyvault/USA002735-08-DPAP.pdf>.

Excessive reliance by executive agencies on sole-source contracts (or contracts with a limited number of sources) and cost-reimbursement contracts creates a risk that taxpayer funds will be spent on contracts that are wasteful, inefficient, subject to misuse, or otherwise not well designed to serve the needs of the Federal Government or the interests of the American taxpayer.¹⁴⁰

The memorandum articulated a “preference for fixed-price type contracts,” with cost-reimbursement contracts used “only when circumstances do not allow the agency to define its requirements sufficiently to allow for a fixed-price type contract.”¹⁴¹ It also predicted that increased use of fixed-price contracts could save taxpayers “billions of dollars” a year¹⁴² and directed the Office of Management and Budget (OMB) to issue guidance on “the appropriate use and oversight of all contract types” by September 30, 2009.¹⁴³

OMB Memorandum of July 29, 2009

President Obama’s March 4, 2009 memorandum also called for OMB to issue guidance to assist agencies in “identify[ing] contracts that are wasteful, inefficient, or not otherwise likely to meet [their] needs.”¹⁴⁴ Although OMB was not required to address contract types when providing this guidance, it did so in its July 29, 2009, memorandum on “Improving Government Acquisition.” The July memorandum noted that cost-reimbursement and time-and-materials and labor-hour contracts “pose special risks of overspending” because “they provide no direct incentive to the contractor for cost control” and “are often used without an appropriate basis or sufficient management and oversight to limit taxpayer risk.”¹⁴⁵ The memorandum instructed agencies to “aim to reduce” by at least 10% the funds obligated by “high risk-contracting authorities,” such as cost-reimbursement, time-and-materials, and labor-hour contracts, in FY2010.¹⁴⁶ This 10% reduction is in addition to the requirement that agencies develop a plan to save 7% of “baseline” (FY2008) contract spending by the end of FY2011.¹⁴⁷

OMB Memorandum of October 27, 2009

On October 27, 2009, OMB issued the guidance on the appropriate use and oversight of various contract types called for in President Obama’s March 4, 2009, memorandum. The October memorandum provided a framework organized around three “key questions,” illustrated in **Table 3**, for selecting the best contract type for particular acquisitions and, if necessary, transitioning recurring or follow-on work to “lower-risk” contract types.¹⁴⁸ It reiterated that agencies are to

¹⁴⁰ The White House, Office of the Press Secretary, Government Contracting, Mar. 4, 2009, at ¶ 3, *available at* http://www.whitehouse.gov/the_press_office/Memorandum-for-the-Heads-of-Executive-Departments-and-Agencies-Subject-Government.

¹⁴¹ *Id.* at ¶ 8.

¹⁴² *Id.* at ¶ 2.

¹⁴³ *Id.* at ¶ 10.

¹⁴⁴ *Id.* at ¶ 8.

¹⁴⁵ Improving Government Acquisition, *supra* note 2, at 2.

¹⁴⁶ *Id.*

¹⁴⁷ *Id.* at 1. Agencies were to submit by November 2, 2009, plans to achieve 7% of baseline spending by FY2011 and reduce their use of “high risk” contract types. See OMB Official Defends Moves to Reform Federal Procurement System, *Fed. Cont. Daily*, Oct. 30, 2009.

¹⁴⁸ Executive Office of the President, Office of Management and Budget, Increasing Competition and Structuring (continued...)

reduce by at least 10% the funds obligated by new contracts that are cost-reimbursement, time-and-materials, or labor-hour contracts, among other things, in FY2010.¹⁴⁹ It also stated that the Office of Federal Procurement Policy (OFPP) within OMB will review agencies' progress vis-à-vis this target on a semiannual basis in FY2010 and require corrective action plans where necessary.¹⁵⁰ OFPP will set new targets for FY2011 and later years, as well as "work with agencies to identify best practices, new techniques and strategies, areas in need of additional guidance or policy, and measures and benchmarks."¹⁵¹

Table 3. OMB Guidance on "Appropriate Use and Oversight" of Contract Types

Key Question	Considerations
How is the agency choosing the best contract type for the acquisition?	- Determine the level of uncertainty - Use incentives to motivate lower costs with improved delivery or technical performance and discourage contractor inefficiency and waste
How is the agency mitigating the risk when cost-reimbursement or time-and-materials/labor-hour contracts are used?	- Ensure contractor costs are reasonable and the contractor is making progress in accordance with the contract's performance schedule (e.g., determine the contractor's accounting system is adequate, have in place appropriate government surveillance to provide reasonable assurance that efficient methods and effective costs controls are in place) - Link payment to performance on cost-plus-award-fee contracts (e.g., determine an award-fee contract is appropriate; tie fees to cost, timeliness, and the quality of the contractor's performance; follow prescribed standards for differentiating between levels of performance and the corresponding percentage of available award fee that can be earned; prohibit "roll over" of award fees and payment of award fees for unsatisfactory performance) - Determine the appropriateness of time-and-materials or labor-hour contracts in commercial acquisitions (i.e., ensure sufficient analysis underlies the decision, including an explanation of why a fixed-price contract is unsuitable) - Provide for the necessary skills and capacity in the acquisition workforce to award and manage a cost-type contract
How is the agency creating opportunities to transition to "lower risk" contracts?	- Use appropriate mechanisms, such as contract review boards, peer reviews, or contract type advocates to bring additional expertise to bear in determining the best contract type - Award contracts that allow the agency to choose between a fixed-price, cost-reimbursement, or time-and-materials or labor-hour basis for the payment of different contract requirements

Source: Congressional Research Service, based on "Increasing Competition and Structuring Contracts for the Best Results," http://www.whitehouse.gov/omb/assets/procurement_gov_contracting/increasing_competition_10272009.pdf.

(...continued)

Contracts for Best Results, Oct. 27, 2009, at Attachment, pp. 2-11, *available at* http://www.whitehouse.gov/omb/assets/procurement_gov_contracting/increasing_competition_10272009.pdf.

¹⁴⁹ *Id.* at 1.

¹⁵⁰ *Id.* at 2. In December 2009, OMB reported that agencies are generally "on track" to achieve this 10% reduction in FY2010. See Acquisition and Contracting Improvement Plans and Pilots: Saving Money and Improving Government, Dec. 2009, *available at* http://www.whitehouse.gov/omb/assets/reports/2009_acquisition_contracting_improvement.pdf.

¹⁵¹ *Id.*

Effectiveness of These Initiatives Presently Unknown

It remains to be seen how effective the Obama Administration's initiatives will be in curtailing use of cost-reimbursement and other allegedly "high risk" types of contracts.¹⁵² Some commentators expect agencies to award more fixed-price contracts, in keeping with President Obama's contracting agenda.¹⁵³ This view may be supported by certain recent, high-profile contract actions, such as the Air Force's proposal to award a fixed-price incentive contract for its KC-X aerial refueling tanker recapitalization program.¹⁵⁴ However, other commentators suggest that focusing upon contract types is unlikely to lead to the reforms necessary to improve federal contracting or make it more cost-effective.¹⁵⁵ The persistence of cost-reimbursement contracts under the ARRA may support this latter view. When enacting ARRA, Congress required that agencies use fixed-price contracts "[t]o the maximum extent possible."¹⁵⁶ However, as of February 2010, \$9.3 billion in ARRA funds had reportedly been obligated by non-fixed-price contracts, while \$11.1 billion had been obligated by fixed-price contracts.¹⁵⁷

¹⁵² Preliminary reports from OMB suggest that agencies' use of new cost-reimbursement, time-and-materials, and labor-hour contracts was lower in the first half of FY2010 than it was in the first half of FY2009. See Office of Mgmt. & Budget, Cutting Waste and Saving Money through Contracting Reform, July 7, 2010, *available at* http://www.whitehouse.gov/omb/assets/blog/Update_on_Contracting_Reforms.pdf. Additionally, many agencies have reportedly undertaken initiatives to improve their acquisition workforce's capability to manage "high risk" contract types. See Office of Mgmt. & Budget, Acquisition and Contracting Improvement Plans and Pilots: Saving Money and Improving Government, Dec. 2009, *available at* http://www.whitehouse.gov/sites/default/files/omb/assets/reports/2009_acquisition_contracting_improvement.pdf.

¹⁵³ See, e.g., Firm-Fixed Price Contract Awards Require Discipline on DOD's Part, Comptroller Says, *Fed. Cont. Daily*, Mar. 20, 2009.

¹⁵⁴ See, e.g., Northrop May Opt Out of Tanker Competition if DOD Does Not Modify Solicitation Language, *Fed. Cont. Daily*, Dec. 3, 2009.

¹⁵⁵ See, e.g., Steve Kelman & Steve Schooner, Achieving Effective Reform, *Fed. Times*, Apr. 13, 2009, at 23 ("Most contracting experts ... would put [the reforms proposed in Obama's March 4 memorandum] low on the priority list of the myriad targets of opportunity for improving the procurement system."); Matthew Weigelt, Contractors Wary of Procurement Proposals, *Wash. Tech.*, Mar. 27, 2009, *available at* <http://washingtontechnology.com/articles/2009/03/30/procurement-contract-reform.aspx> ("From what they heard, many information technology companies contracting with the government didn't consider Obama's proposed procurement reforms as anything approaching a sea change.... For instance, contracting regulations already favor fixed-price contracts as the safe and preferred method instead of cost-reimbursement and especially time-and-materials contracts. Many experts doubted that new guidance would improve on that."); New Nonprofit Organization Will Work to Promote Acquisition Reform, Innovation, *Fed. Cont. Daily*, Apr. 27, 2009 (quoting the newly formed Federal Acquisition and Reform Institute as expressing the view that the discussion needs to be "elevated" from "tactics, such as types of contracts, to a more strategic one").

¹⁵⁶ P.L. 111-5, § 1554, 123 Stat. 302.

¹⁵⁷ See, e.g., Deborah Billings, Obama Highlights Transparency of Recovery Act Implementation, 93 *Fed. Cont. Rep.* 133 (Feb. 23, 2010). See also Gov't Accountability Office, Recovery Act: Contract Oversight Activities of the Recovery Accountability and Transparency Board and Observations on Contract Spending in Selected States, GAO-10-216R, Nov. 30, 2009, at 7-8, *available at* <http://www.gao.gov/new.items/d10216r.pdf> (noting that, although state officials reported that 73% of federally funded contracts under ARRA were awarded using fixed-price contracts, some officials identified contracts as fixed-price when there was a fixed price per unit but the total quantities were undefined).

Appendix. Chronology of Developments Regarding Contract Types, 107th-110th Congresses

- Dec. 28, 2001 National Defense Authorization Act for FY2002 (P.L. 107-107, §§ 802-803¹⁵⁸) set as an “objective” for DOD to achieve savings in expenditures for services by using “appropriate” competition of task orders under service contracts. Also required DOD to award orders in excess of \$100,000 issued under multiple-award contracts on a competitive basis¹⁵⁹ unless certain circumstances apply.¹⁶⁰
- Nov. 24, 2003 National Defense Authorization Act for FY2004 (P.L. 108-163, §§ 847 and 1432) made firm-fixed-price or fixed-price with economic price adjustment contracts or subcontracts for certain weapons-related prototype projects valued at less than \$50 million eligible for a pilot program for follow-on contracting for the production of items or processes. Also authorized use of time-and materials or labor-hour contracts to purchase commercial services that are (1) commonly sold to the general public through such contracts and (2) purchased on a competitive basis.
- Jan. 6, 2006 National Defense Authorization Act (P.L. 109-163, § 817) established a joint training program on contingency contracting, including the appropriate use of letter contracts, ID/IQ task orders, and letter contracts.
- July 11, 2006 Coast Guard & Maritime Transportation Act of 2006 (P.L. 109-241, § 205) authorized the use of “one-step turn-key selection procedures” in contracting for construction projects. Such procedures are “used for the selection of a contractor on the basis of price and other evaluation criteria to perform, in accordance with the provisions of a firm fixed-price contract, both the design and construction of a facility.”
- Oct. 4, 2006 Department of Homeland Security Appropriations Act, 2007 (P.L. 109-295, § 692) generally prohibited contractors holding cost-reimbursement contracts or task or delivery orders for disaster or emergency response or recovery valued at over \$100,000 from subcontracting more than 65% of the cost of the contract or order.¹⁶¹
- Oct. 17, 2006 John Warner National Defense Authorization Act for FY2007 (P.L. 109-364) required the Departments of Defense and State and the U.S. Agency for International Development to identify the types of contracts used in Iraq and Afghanistan (§ 854).¹⁶² Also required various entities to perform “comprehensive and detailed cost analyses” of the Joint Strike Fighter engine program covering, among other things, an alternative under which the programs executes a one-time firm-fixed price contract for a selected propulsion system for the lifecycle of the aircraft following the Initial Service Release of the propulsion system in FY2008 (§ 211). Authorized the Milestone Decision Authority for a major defense acquisition program to approve use of a cost-type contract for a development program only upon a written determination that (1) the program is so complex and technically challenging that it would not be practicable to reduce program risk to a level that would permit use of a fixed-price contract and (2) the complexity and technical challenge of the program is

¹⁵⁸ Section 803 was repealed by the National Defense Authorization Act for FY2009 because it was “redundant” after Congress imposed identical restrictions on all agencies. See P.L. 110-417, § 863(f), 122 Stat. 4548 (Oct. 14, 2008).

¹⁵⁹ For purposes of Section 803, an award is made on a competitive basis if it is made pursuant to procedures that: (1) require that fair notice of the intent to make a purchase is provided to all contractors offering such services under the contract and (2) afford all contractors responding to that notice a fair opportunity to make an offer and have that offer considered. However, notice may be provided to fewer than all contractors offering the service so long as notice is provided to “as many contractors as is practicable.” If notice is not provided to all contractors, a purchase may not be made unless either (1) offers were received from at least three qualified contractors or (2) the contracting officer determines in writing that no additional qualified contractors could be identified despite reasonable efforts to do so.

¹⁶⁰ A purchase need not be made on a competitive basis if the contracting officer waives this requirement based upon a determination, justified in writing, that (1) the agency’s need for the requirements is of “unusual urgency;” (2) only one contractor is capable of providing the goods or services at the required “level of quality;” (3) the order should be issued on a sole-source basis in the interests of economy and efficiency because it is a “logical follow-on” to an order that was competitively issued; or (4) the order must be placed with a particular contractor to satisfy a minimum guarantee.

¹⁶¹ This prohibition does not apply if the Secretary of Homeland Security determines that it is “not feasible or practicable.”

¹⁶² A similar requirement was later included in the National Defense Authorization Act for FY2008. See P.L. 110-181, § 861(b), 122 Stat. 253 (Jan. 28, 2008).

- not the result of a failure to meet the requirements established in 10 U.S.C. 2366a (§ 818).¹⁶³ Exempted firm-fixed price contracts, subcontracts, or task or delivery orders awarded on the basis of adequate price competition or for the acquisition of commercial items from the regulatory provisions proscribing pass-through charges on DOD contracts that are “excessive” in relation to the cost of work performed by the contractor or subcontractor (§ 852). Required the Secretary of Defense to issue guidance on the linking of award and incentive fees to acquisition outcomes (§ 814).¹⁶⁴
- May 25, 2007 U.S. Troop Readiness, Veterans’ Care, Katrina Recovery & Iraq Accountability Appropriations Act, 2007 (P.L. 110-28, § 6402) prohibited obligation of certain funds appropriated for the Integrated Deepwater Systems program until the House and Senate Appropriations committees receive and approve a plan for expenditure that contains “very limited ID/IQ contracts” and explains the need for any ID/IQ contracts.¹⁶⁵
- Dec. 4, 2007 The Office of Federal Procurement Policy issued a memorandum¹⁶⁶ calling on top federal acquisition officials to (1) review their agencies’ policies on incentive fee contracting to ensure that the fees paid to contractors are linked to acquisition outcomes; (2) ensure that incentive fees are not earned if the contractor’s performance is judged to be below satisfactory or does not meet the basic contract requirements; (3) examine incentive fee contracts as part of the program management review process for agency internal audits; (4) conduct risk-benefit analyses to determine whether to use incentive fee contracts and (5) develop guidance indicating that rollover of unearned fees is “not preferred.”
- Jan. 28, 2008 National Defense Authorization Act for FY2008 (P.L. 110-181, §§ 805 and 809) restricted DOD’s use of time-and-materials and labor-hour contracts for commercial item acquisitions to (1) services procured for support of a commercial item; (2) emergency repair services; or (3) other services to the extent that the agency head approves certain determinations in writing.¹⁶⁷ Also required that the Defense Federal Acquisition Regulation Supplement (DFARS) be amended to include certain requirements pertaining to the use of letter contracts.¹⁶⁸
- Mar. 20, 2008 DOD issued a memorandum reminding senior contracting officials that time-and-materials contracts “are the least preferred contract type.”¹⁶⁹

(...continued)

¹⁶³ Section 818 repeals Section 807 of the National Defense Authorization Act for FY1989, which prohibited the use of firm-fixed-price contracts in excess of \$10 million for the development of major systems or subsystems unless the Secretary of Defense determined in writing that the program risk had been reduced to the extent that realistic pricing can occur and the contract type permits an “equitable and sensible” allocation of risk between the contracting parties. See P.L. 100-456, § 807, 102 Stat. 2011 (Sept. 29, 1988).

¹⁶⁴ Among other things, this guidance must (1) ensure all that new contracts using award fees link fees to program cost, schedule, and performance outcomes; (2) identify circumstances in which contractor performance may be judged “excellent” or “superior” and the percentage of the available award fee that the contractor should be paid for such performance; (3) establish standards for determining what percentage of an award fee, if any, should be paid for performance judged “acceptable,” “expected,” “good,” or “satisfactory;” (4) ensure no award fee is paid to contractors for performance that is less than satisfactory or does not meet basic contract requirements; and (5) provide “specific direction” on any circumstances in which award fees not earned during one award fee period may be rolled over to subsequent award fee periods.

¹⁶⁵ Identical language was later included in the Consolidated Appropriations Act, 2008. P.L. 110-161, 121 Stat. 2055 (Dec. 26, 2007).

¹⁶⁶ Executive Office of the President, Office of Management and Budget, *Appropriate Use of Incentive Contracts*, available at http://www.whitehouse.gov/omb/procurement/memo/incentive_contracts_120407.pdf.

¹⁶⁷ These determinations must find (1) that the services to be acquired are commercial services; (2) the offeror of the services has submitted sufficient information under 41 U.S.C. § 403(12)(F)(b); (3) similar services are commonly sold to the general public through the use of time-and-materials or labor-hour contracts; and (4) the use of a time-and-materials or labor-hour contract is in the best interest of the government.

¹⁶⁸ These requirements must include, at a minimum, the circumstances in which it is appropriate to use letter contracts; approval requirements for use of letter contracts; procedures for ensuring that timelines for definitization are met; procedures for ensuring compliance with limitations on the obligation of funds pursuant to letter contracts; procedures for ensuring compliance with limitations on profits or fees with respect to costs incurred prior to definitization; and reporting requirements for letter contracts that fail to meet timelines or comply with limitations on obligation of funds or profits or fees.

¹⁶⁹ Office of the Under Secretary of Defense, Acquisition, Technology & Logistics, *Proper Use of Time-and-Materials* (continued...)

- Apr. 23, 2008 DOD proposes a rule¹⁷⁰ that would require certain determinations and findings for non-commercial time-and-materials contracts, including (1) “sufficient facts and rationale to justify that no other contract type is suitable;” (2) a description of the market research conducted; (3) information establishing that it is not possible at the time of placing the contract or order to estimate with accuracy the extent or duration of the work to be performed or to anticipate the costs with any reasonable degree of accuracy; (4) information establishing that the requirement has been structured to minimize the use of time-and-materials requirements; and (5) a description of the actions planned to minimize the use of time-and-materials contracts on future acquisitions for the same requirements. Rule would also require that contracting officers structure ID/IQ contracts that authorize time-and-materials orders to also authorize orders on other bases, to the maximum extent practicable and execute determinations and findings for each order placed on a time-and-materials basis, if the contract allows other types of orders, or for the underlying contract, if it authorizes only time-and-materials orders.
- July 14, 2008 DOD issued memorandum¹⁷¹ reminding contracting officers that they are to prepare quality assurance plans along with the statement of work or objectives when using time-and-materials or labor-hour contracts and noting that the contracting officer’s representative’s surveillance functions should correspond with the dollar value and complexity of the contract.
- Oct. 14, 2008 Duncan Hunter National Defense Authorization Act for FY2009 (P.L. 110-417) subjected non-defense agencies to the competition requirements pertaining to the issuance of orders in excess of \$100,000 under multiple-award ID/IQ contracts that defense agencies had been subject to under the National Defense Authorization Act for FY2002, as well as required public notice of all sole-source orders placed against a multiple-award contract except in cases involving “extraordinary circumstances” or classified orders (§ 863). Required that the FAR be amended to include certain guidance on the use of cost-reimbursement contracts¹⁷² and required the inspectors general of certain agencies¹⁷³ and the Director of OMB to produce reports regarding use of cost-reimbursement contracts and, in the case of OMB, task and delivery orders (§ 864).¹⁷⁴ Imposed limitations on tiering of subcontractors on cost-reimbursement contracts or task or delivery orders issued by non-defense agencies¹⁷⁵ in order to “ensure that neither a contractor nor a subcontractor receives indirect costs or profit on work performed by a lower-tier subcontractor to which the higher-tier contractor or subcontractor adds no, or negligible, value” (§ 866).¹⁷⁶ Also required that the FAR be amended to provide non-defense agencies with guidance on the appropriate use of award and incentive fees like that required for defense agencies under the John Warner National Defense Authorization Act for FY2007 (§ 867).¹⁷⁷

(...continued)

Contract Types, Mar. 20, 2008, *available at* <http://www.acq.osd.mil/dpap/policy/policyvault/2008-0173-DPAP.pdf>.

¹⁷⁰ Dep’t of Defense, DFARS Case 2007-D021: Limitations on DoD Non-Commercial Time-and-Materials Contracts, 73 Fed. Reg. 21891 (Apr. 23, 2008). The final rule was promulgated on November 24, 2008. *See* 73 Fed. Reg. 70912.

¹⁷¹ Office of the Under Secretary of Defense, Acquisition, Technology & Logistics, Management of Contractor Performance under Time & Material and Labor Hour Contracts for Services, July 14, 2008, *available at* <http://www.acq.osd.mil/dpap/policy/policyvault/2008-0320-DPAP.pdf>.

¹⁷² This guidance must include, at a minimum, (1) when and under what circumstances cost-reimbursement contracts are appropriate; (2) the acquisition plan findings necessary to support the decision to use a cost-reimbursement contract; and (3) the acquisition workforce resources necessary to award and manage cost-reimbursement contracts.

¹⁷³ This reporting requirement applies only to agencies that awarded contracts or issued orders totaling at least \$1 billion in the prior fiscal year. For these agencies, the inspectors general are to report on the results of their view of the agency’s compliance with the new FAR provisions in their next semiannual report.

¹⁷⁴ OMB is to submit an annual report to Congress on the total number and value of contracts awarded during the covered fiscal year, the total number and value of cost-reimbursement contracts and orders issued during that year; and an assessment of the effectiveness of the new FAR provisions in ensuring appropriate use of cost-reimbursement contracts.

¹⁷⁵ Section 866 explicitly provided that defense agencies are to remain subject to the limitations on tiering of subcontractors contained in Section 852 of the John Warner National Defense Authorization Act of Fiscal Year 2007, P.L. 109-364, 120 Stat. 2340.

¹⁷⁶ This provision does not apply to charges for indirect costs or profit based on the direct costs of managing lower-tier subcontracts.

¹⁷⁷ Among other things, this guidance must (1) ensure that all new contracts using award fees link such fees to (continued...)

Author Contact Information

Kate M. Manuel
Legislative Attorney
kmanuel@crs.loc.gov, 7-4477

Acknowledgments

CRS Legislative Attorney Carol J. Toland contributed to an earlier version of this report.

(...continued)

acquisition outcomes; (2) establish standards for identifying the appropriate level of officials authorized to approve the use of award and incentive fees in new contracts; (3) identify circumstances in which contractor performance may be judged “excellent” or “superior” and the percentage of the award fee that the contractor should be paid for such performance; (4) establish standards for determining the percentage of the available award fee, if any, which contractors should be paid for performance that is judged to be “acceptable,” “average,” “expected,” “good,” or “satisfactory;” (5) ensure that no award fee may be paid for contractor performance that is judged to be below satisfactory performance or performance that does not meet the basic requirements of the contract; (6) provide “specific direction” on any circumstances in which it may be appropriate to roll over award fees that are not earned in one award fee period to subsequent award fee periods; and (7) include performance measures to evaluate the effectiveness of award and incentive fees as a tool for improving contractor performance and achieving desired program outcomes.