Session Content

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Public Awareness
Basic Contract Types
Contract Types by Obligation of the Parties
Contract Types by Risks to the Parties
More on Types and Special Factors
Hybrids
Questions
Background
In the beginning, all contracts were Fixed Price

World War I introduced the concept of “teardown and repair” contracts
- A Fixed Price order to “tear down” a piece of failed equipment and diagnose the problem (and prepare a repair proposal)
- A Time & Materials order (parts and labor) to make the repair
- Still in use today at your friendly, local auto repair shop except the diagnosis is usually done “on spec”

World War II introduced the concept of cost reimbursable contracts
- No time for definitive specs
U.S. Government forays into Research & Development (such as Project MoHole) further developed the cost-reimbursable concept

- Courts held that Government should accept both performance and cost risk when there is high level of uncertainty
- DOD continued to experiment with Fixed Price R&D periodically
  - Last significant FP R&D contract was $5B contract for the Navy A-12
  - Contract terminated for default in 1991
  - Promptly converted to T for C
  - The last lawsuits arising out of the termination claims were settled in 2011
Politicians LOVE “Fixed Price” contracts – good press
  - Results in extreme preference for FFP in legislation and regulation
  - Makes life VERY difficult for program managers

Politicians love to pound podiums and demonize “Cost Plus” contracts and the contractors who hold them
  - Results in initiatives to reduce or “wipe out” cost plus contracting
  - No real effect on procurement processes to date

Politicians ignore “T&M” contracts because neither they nor the public know what they are or how they work
  - In all of Congress, there are probably less than a dozen legislators that could accurately describe the characteristics of the three basic contract types
Public Awareness

You’re kidding, right?
In the Press, the basic contract types are:

- “No Bid” (sole source – whether appropriate or not)
  - In the visual media, speaking the phrase apparently requires a distasteful look to go with it
    - The implication is one of malfeasance on the part of the awarding agency
  - Wasteful (anything other than fixed price)
  - Fixed Price (referred to in glowing terms)
Contracts on the Web

Federal Obligations on Contracts – GFYs 2007 – 2011*

<table>
<thead>
<tr>
<th></th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
<th>2011</th>
<th>5 Yr Growth</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fixed Price</td>
<td>$272,540</td>
<td>$320,036</td>
<td>$301,036</td>
<td>$336,609</td>
<td>$331,852</td>
<td>21.8%</td>
</tr>
<tr>
<td>Cost-Reimbursable</td>
<td>$137,797</td>
<td>$142,928</td>
<td>$151,961</td>
<td>$161,762</td>
<td>$165,262</td>
<td>19.9%</td>
</tr>
<tr>
<td>T&amp;M/LH</td>
<td>$26,191</td>
<td>$28,582</td>
<td>$28,898</td>
<td>$28,910</td>
<td>$25,445</td>
<td>-2.8%</td>
</tr>
<tr>
<td>Other</td>
<td>$32,389</td>
<td>$50,064</td>
<td>$58,599</td>
<td>$11,294</td>
<td>$14,187</td>
<td>-56.2%</td>
</tr>
<tr>
<td>All Amounts in $ Million</td>
<td>$468,916</td>
<td>$541,610</td>
<td>$540,494</td>
<td>$538,575</td>
<td>$536,747</td>
<td>14.5%</td>
</tr>
</tbody>
</table>

*Data from USASpending.gov
Basic Contract Types
3 Basic Contract Types:

- Fixed Price (also called Firm Fixed Price (FFP))
- Time and Material/Labor Hour (T&M/LH)
- Cost Reimbursement (also called “Cost Plus” type contracts)

Many variations and combinations:

- Fixed price labor with cost-reimbursable ODCs (the successor to T&M)
- Fixed price contract with time as the unit of measure
- Fixed price services with a Level of Effort
- Cost-type labor with fixed price options for products
- Etc.
- Etc.
Usage of the Types

FFP

- Requirements are known and can be described with precision
- Cost of performance can be predicted with a reasonable degree of certainty

T&M/LH

- Requirements poorly described or subject to frequent or unpredictable change
- Cost of performance can be predicted with a reasonable degree of certainty

Cost Plus

- Requirements or ability to perform are uncertain
- Costs cannot be predicted with any degree of certainty
Performance Risk
- Can this SOW even be done? Are we sure?
- Is the schedule realistic?
- If it can’t be done or the schedule is impossible, who takes the hit?

Cost Risks
- Do we know what this will cost?
- Are there factors beyond the control of either party?
- If we’re wrong, who takes the hit?

The Contract Risk Spectrum
The variables in the equation

- Can the job be done?
- How long will it take?
- What will it cost?

In R&D (and most services)

- Only two of the variables can be known
- Pick any two and the other one must be unknown (think Time & Materials)
- More than one variable MAY be unknown (think Cost Plus)

If all three variables are known with some degree of certainty…

- Contracts should be (and probably will be) Fixed Price
- Risk should be minimal and the Government will want the risk that does exist to be born by the contractor
Contract Types by Obligation
## Obligations of the Parties

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<thead>
<tr>
<th>Contract Type</th>
<th>Contract Form</th>
<th>Contractor Obligations</th>
<th>Government Obligations</th>
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<td>Firm Fixed Price</td>
<td>Completion</td>
<td>To deliver goods or services (Performance-based contract)</td>
<td>To pay promptly on delivery, inspection, acceptance and presentation of a proper invoice</td>
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<td>Cost Reimbursable</td>
<td>Completion</td>
<td>To provide the contractor's &quot;best efforts&quot; in pursuit of the objectives stated in the SOW</td>
<td>To reimburse the contractor's total cost of performance subject to the allowability and allocability rules of FAR and CAS and the restrictions of the contract clauses</td>
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<td><strong>Time and Materials</strong></td>
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Why no completion type T&M?

Does “reimburse the total cost of performance” mean everything, no matter what?
Contract Types by Risk
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<td></td>
<td></td>
<td>Performance</td>
<td>Cost</td>
</tr>
<tr>
<td>Firm Fixed Price</td>
<td>Completion</td>
<td>Very High</td>
<td>Very High</td>
</tr>
<tr>
<td></td>
<td>Level of Effort</td>
<td>Very Low</td>
<td>Moderately Low</td>
</tr>
<tr>
<td>Fixed Price Incentive</td>
<td>Completion</td>
<td>High</td>
<td>High</td>
</tr>
<tr>
<td>Time &amp; Materials</td>
<td>Level of Effort</td>
<td>Very Low</td>
<td>Moderately Low</td>
</tr>
<tr>
<td>Cost Plus Fixed Fee</td>
<td>Completion</td>
<td>Very Low</td>
<td>Very Low</td>
</tr>
<tr>
<td></td>
<td>Level of Effort</td>
<td>Very Low</td>
<td>Very Low</td>
</tr>
<tr>
<td>Cost Plus Incentive Fee</td>
<td>Completion</td>
<td>Very Low</td>
<td>Low</td>
</tr>
<tr>
<td></td>
<td>Level of Effort (?)</td>
<td>Very Low</td>
<td>Low</td>
</tr>
<tr>
<td>Cost Plus Award Fee</td>
<td>Completion</td>
<td>Very Low</td>
<td>Low</td>
</tr>
<tr>
<td></td>
<td>Level of Effort</td>
<td>Very Low</td>
<td>Low</td>
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More on Contract Types
Factors in Selecting Types

- Competition
- Price analysis when competition not present
- Cost analysis when price analysis impractical or impossible
- Complexity of the requirement
- History and frequency
- Segregation or fragmentation
- Urgency
- Laziness or incompetence
Firm Fixed Price contracts are not subject to any adjustment based on cost of performance.

Firm Fixed Price places all cost risk and full responsibility for the resulting profit or loss on the contractor.

The Contractor is (theoretically) responsible for delivering the required product or service no matter how long it takes or how much it costs.

**SPECIAL FACTORS**

Failure to deliver (default) can expose the contractor to risk of “excess procurement costs”
Firm Fixed Price contracts with Economic Price Adjustment (EPA) provisions can be adjusted up or down based on contingencies.

EPA adjustments are of three general types:

- Adjustments based on established prices
- Adjustments based on actual costs of labor or material
- Adjustments based on cost indexes of labor or material

EPA adjustments are typically small and within a very narrow range.
Other Fixed Price Variants

- Fixed Price Contracts with Prospective Price Redetermination
  - Contains points at which the price of FUTURE deliverables can be adjusted
- Fixed Price Contracts with Retroactive Price Redetermination
  - Contains points at which the price of goods or services already delivered can be adjusted
- Firm Fixed Price Level of Effort Term Contract
Cost-reimbursable contracts provide for payment of allowable costs up to a funds ceiling.

Funding cannot be exceeded (Limitation of Funds Clause)

SPECIAL FACTORS

Cost reimbursable contracts contain the “Allowable Cost and Payment” clause which establishes the requirement for an annual Incurred Cost Submission.
Cost reimbursable variants

- Cost Plus Fixed Fee: Fee is fixed at inception of contract
- Cost-No Fee Contracts: No fee permitted
- Cost-Sharing Contract: No fee and only agreed upon portion of allowable costs are reimbursed
- Cost Plus Incentive Fee Contract: Fee is adjusted based on formula of total allowable costs to total target costs
- Cost Plus Award Fee Contract: Fee based on judgmental evaluation by the Government
A T&M contract provides for services on the basis of—

- Direct labor hours at specified fixed hourly rates that include wages, overhead, general and administrative expenses, and profit; and

- Actual cost for non-labor items:
  - Materials (usually supplies), Subcontracts and Other Direct Costs (travel, computer usage charges, etc.)

**SPECIAL FACTORS**

T&M contracts ALSO contain the “Allowable Cost and Payment” clause which establishes the requirement for an annual Incurred Cost Submission.
A labor-hour contract is a variant of the T&M contract, differing only in that materials are not supplied by the contractor.
The “New” Hybrids
The current administration has a declared preference for fixed price contracts

Government agencies (DOD in particular) have been “pushing” fixed price contracts for at least the last ten years

The result…

- More fixed price contracts
- More contracts *classified* as fixed price
- Hybrid contracts with features of multiple contract types, but *labeled* as fixed price
New contracts with fixed price labor and cost reimbursable materials and ODCs

- Labor often billed as a unit of time
- Sometimes billed by position filled and unit of time
- Sometimes billed by position with unit of time as hours

Materials and ODCs estimate or ceiling often much larger than fixed price for the labor
These hybrid contracts should and usually do contain the Allowable Cost and Payment clause and trigger the requirement for an Incurred Cost Submission.

DCAA considers the fixed price labor hybrids (with cost reimbursable materials and ODCs) to be cost-type contracts with one or more fixed price line items or features.

They are looking for them in ICS schedules and rejecting the submission when hybrid “improperly classified”

Difficult to detect and often missed initially.
Questions and Discussion
Call to Action / Contact Us

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