DEPARTMENT OF DEFENSE

GENERAL SERVICES ADMINISTRATION

NATIONAL AERONAUTICS AND SPACE ADMINISTRATION

48 CFR Parts 2, 10, 12, 16, 44, and 52

[FAR Case 2003–027]

RIN 9000–AK07

Federal Acquisition Regulation; Additional Contract Types

AGENCIES: Department of Defense (DoD), General Services Administration (GSA), and National Aeronautics and Space Administration (NASA).

ACTION: Proposed rule.

SUMMARY: The Civilian Agency Acquisition Council and the Defense Acquisition Regulations Council (Councils) are proposing to amend the Federal Acquisition Regulation (FAR) to implement section 1432 of the National Defense Authorization Act for Fiscal Year 2004. Title XIV of the Act, referred to as the Services Acquisition Reform Act of 2003 (SARA), amended section 8002(d) of the Federal Acquisition Streamlining Act of 1994 (FASA) to expressly authorize the use of time-and-materials (T&M) and labor-hour (LH) contracts for certain categories of commercial services under specified conditions.

DATES: Interested parties should submit written comments to the FAR Secretariat on or before November 25, 2005, to be considered in the formulation of a final rule.

Public Meeting: A public meeting will be held on Tuesday, October 18, 2005, from 9 a.m. to 4 p.m. Eastern Time, in the GS Building Auditorium, 1800 F Street NW, Washington, DC 20405, to facilitate an open dialogue between the Government and parties interested in the implementation of section 8002(d). Because they are so closely related, the public meeting will also cover proposed rule, FAR case 2004–015, Payment Under Time-and-Materials and Labor-Hour Contracts. FAR case 2004–015 is published as the next item following this publication. Interested parties are encouraged to attend and engage in discussions regarding these proposed rules.

To facilitate discussions at the public meeting, interested parties are encouraged to provide written comments on issues they would like addressed at the public meeting no later than Tuesday, October 11, 2005. Interested parties may register and submit their input electronically at *http://www.acq.osd.mil/dpap/dars/index.htm*. Attendees are encouraged, but not required, to register for the public meeting, to ensure adequate accommodations.

Directions to the meeting can be found at the Web site. Participants are encouraged to check with the Web site prior to the public meeting to ensure the location has not been changed as a result of a large number of registrants. The public meeting is physically accessible to people with disabilities. Requests for sign language interpretation or other auxiliary aids should be directed to Mr. Jeremy Olson at 202–501–3221 at least 5 days prior to the meeting.

ADDRESSES: Submit comments identified by FAR case 2003–027 by any of the following methods:

- Federal eRulemaking Portal: *http://www.regulations.gov*. Follow the instructions for submitting comments.
- Agency Web Site: *http://www.acqnet.gov/far/ProposedRules/proposed.htm*. Click on the FAR case number to submit comments.
- E-mail: *farcase.2003–027@gsa.gov*. Include FAR case 2003–027 in the subject line of the message.
- Fax: 202–501–4067.
- Mail: General Services Administration, Regulatory Secretariat (VIR), 1800 F Street, NW, Room 4035, ATTN: Laurieann Duarte, Washington, DC 20405.

Instructions: Please submit comments only and cite FAR case 2003–027 in all correspondence related to this case. All comments received will be posted without change to *http://www.acqnet.gov/far/ProposedRules/proposed.htm*, including any personal and/or business confidential information provided.

FOR FURTHER INFORMATION CONTACT: The FAR Secretariat at (202) 501–4755 for information pertaining to status or publication schedules. For clarification of content, contact Mr. Jeremy Olson at (202) 501–3221. Please cite FAR case 2003–027.

SUPPLEMENTARY INFORMATION:

A. Background

Section 8002(d) limits use of T&M and LH contracts to the following categories of commercial services:

- Commercial services procured for support of a commercial item, as described in 41 U.S.C. 403(12)(E); and
- Any other category of commercial services that is designated by the Administrator of OFPP on the basis that—

1. The commercial services in such category are of a type of commercial services that are commonly sold to the general public through use of T&M or LH contracts; and

2. It would be in the best interests of the Federal Government to authorize use of T&M or LH contracts for purchase of the commercial services in such category.

In furtherance of its statutory responsibilities, OFPP worked in coordination with the Councils on a series of questions for the Advance notice of proposed rulemaking and notice of public meeting published in the **Federal Register** on September 20, 2004 (69 FR 56316), to obtain information describing how T&M and LH contracts are used commercially. In particular, the questions elicited information on the types of services that are commonly acquired on this basis and the circumstances under which these arrangements are used. Interested parties offered a variety of written observations in response to these questions. The public comments are discussed in greater detail below. In addition, a number of interested parties provided oral comments during a public meeting that was held on October 19, 2004, to facilitate an open dialogue with Government procurement policy officials.

OFPP and several members of the Acquisition Strategy Team also received an oral briefing from the Government Accountability Office (GAO) on a survey the GAO conducted late last year to determine how often commercial companies use T&M and LH contracts in their commercial practices, either as a buyer or a provider. The GAO received 23 responses to its survey. Some of the responses came from Fortune 500 companies. Although responses were limited, the GAO indicated that they represented buying practices from a relatively wide range of industries, including: airline, automotive and truck manufacturers, automotive and truck parts, business services, communications equipment, computer hardware, computer services, electric utilities, insurance, major drugs (pharmaceutical), money center bank, non-profit financial services, oil and gas, regional bank, retail (grocery and technology), scientific and technical instruments, and semiconductor.

OFPP made three main findings from these inputs. First, commercial services are commonly sold on a T&M and LH basis in the marketplace when requirements are not sufficiently well understood to complete a well-defined scope of work and when risk can be managed by maintaining surveillance of costs and contractor performance. Second, these same services are also

generally offered on a fixed-price basis. Third, a few types of services are sold predominantly on a T&M and LH basis-specifically, emergency repair services.

Based on these findings, OFPP recommended to the Councils that the proposed rule allow an agency to purchase any commercial service on a T&M or LH basis if it has completed a determination and findings (D&F) containing sufficient facts and rationale to justify that a firm-fixed pricing arrangement is not suitable. OFPP stated that this conclusion is consistent with the statutory requirement in 8002(d) that contracting officers must execute a D&F that establishes that no contract type other than a T&M and LH contract is suitable before pursuing one of these arrangements. The agency would also need to comply with the other limitations set forth in 8002(d)-*i.e.*, the service is acquired under a contract awarded using competitive procedures, the contract or order includes a ceiling price that the contractor exceeds at its own risk, and any subsequent change in the ceiling price is authorized only upon a determination, documented in the contract file, that it is in the best interest of the procuring agency to change the ceiling price.

With respect to the contents of the D–F, OFPP advised the Councils that the rationale supporting use of a T&M or LH contract for commercial services should establish that it is not possible at the time of placing the contract or order to accurately estimate the extent or duration of the work or to anticipate costs with any reasonable degree of certainty. As noted in the findings above, this condition typically appears to exist in circumstances where the private sector commonly turns to T&M and LH contracting. And, this condition always appears to exist for services that are predominantly purchased on a T&M and LH basis, such as emergency repair services-*i.e.*, emergency repair services, by their very nature, are difficult to capture in a well-defined scope of work and therefore are not generally conducive to purchase on a fixed-price basis. In addition, if the need is of a recurring nature and is being acquired through a contract extension or renewal, OFPP expects, consistent with FAR 7.104(h), that the D&F reflect why knowledge gained from the prior acquisition could not be used to further refine requirements and acquisition strategies in a manner that would enable purchase on a fixed-price basis. OFPP believes that these steps will help ensure that T&M and LH contracts are used only when in the best interests of the government, as envisioned by section 8002(d)(3)(B)(ii).

Finally, the Councils invite the public to provide additional comment that might further inform OFPP's findings and conclusions. Respondents are encouraged to include citations, as appropriate, to relevant sources of information that may be used to substantiate the basis for the response provided.

The Councils have shaped the proposed rule to reflect OFPP's recommendations.

Comments were received from 23 respondents in response to the ANPR. The Councils considered all of the comments and recommendations in developing the proposed rule. The Councils made the following changes to the rule as a result of the public comments and Council deliberations:

1. REVISED FAR 12.207(b) to be consistent with OFPP's determination not to develop a list of commercial services that are commonly sold to the general public on a T&M basis.

2. REVISED FAR 12.207(b)(3) to be consistent with the requirements for noncommercial T&M/LH contracts and to emphasize that requirements should be structured so as to ''maximize the use of fixed price contracts'' to be consistent with the statutory language.

3. REVISED FAR 12.301(b)(3) to prohibit tailoring of the consent to subcontract provisions in paragraph (u) of Alternate I of the FAR clause at 52.212–4 (except to require individual orders to be addressed individually under indefinite delivery contracts) because the Councils believe tailored subcontract provisions may not adequately protect the Government.

4. REVISED FAR 44.303 to specify that only firm-fixed price or fixed-price with economic price adjustment contracts awarded for commercial items under FAR Part 12 are excluded from Contractor Purchasing System Reviews (CPSR) to assure that the CPSR includes commercial T&M/LH contracts thereby providing contractors the flexibility to award commercial T&M/LH subcontracts without the otherwise required subcontract consent.

5. DELETED the language in paragraph (a) of the FAR clause at 52.212–4 that allowed the Government to require the contractor to ensure future performance conforms to contract requirements because the Councils believe that this language is unnecessary since the Government already has this right through the use of a cure notice and ADD language to clarify that the Government may seek either ''an equitable price adjustment'' or ''adequate consideration'' for acceptance on nonconforming supplies or services.

6. *Alternate I to FAR clause 52.212–4*—

a. REVISED paragraph (a) to allow contractors to be paid for reperformance, without profit, up to the ceiling price to be consistent with the provisions for noncommercial T&M contracts, *i.e.*, paragraphs (c) through (k) of the FAR clause at 52.246–6, Inspection—Time-and-Material and Labor-Hour. However, since contracting officers will not necessarily know the portion of profit in the labor rates for these competitive awards, the Councils revised paragraph (a)(4) of the clause to require contracting officers to identify the portion of profit in the ''hourly rate'' and included a 10 percent default if not otherwise specified in the clause. The Councils note that 10 percent default is arbitrary and not necessarily representative of the actual portion of profit in the labor rates; however, the Councils believe it is advisable to establish a default for instances where contracting officers fail to provide a specific decrement.

b. RELOCATED definitions previously located in paragraph (u) to paragraph (e) to be consistent with the new format of the basis clause and ADDED a new definition for ''materials'' to recognize that the term has different meaning for T&M contracts, *i.e.*, materials include other direct and indirect costs.

c. DELETED the requirement in paragraph (i)(1)(i)(A) that only permitted reimbursement of fractional hours if the contract specifically authorized fractional hours because the Councils believe contractors should be paid for fractional hours on a prorated basis.

d. REVISED paragraph (i)(1)(i)(B) to specify that contractors shall substantiate subcontractor hours reimbursed at the hourly rate in the schedule when requested by the contracting officer and to specify the payment records that may be requested to substantiate the labor.

e. REVISED the material cost provisions at paragraph (i)(1)(ii) to—

1. Permit payment at the contractor's established catalog or market price for materials that meet the definition of a commercial item.

2. Permit reimbursement of subcontract costs at the hourly rate specified in the schedule in certain situations.

3. Delete the requirement to take all discounts, rebates, allowances, etc. to be more consistent with commercial practices. However, when the contractor receives the benefit of such discounts, rebates, or allowances, the Government must receive appropriate credit.

4. Eliminate the ''most favored customer'' requirement to be consistent with the allowability provision for material costs at 31.205–26(f).

5. Add provisions to permit reimbursement of other direct costs on a cost basis only to the extent such costs are listed in the contract clause so the Government will know the ''types of costs'' a contractor might subsequently bill as other direct costs.

6. Add provisions for reimbursement of indirect costs at a fixed amount to the extent such reimbursement are listed in the contract clause to permit reimbursement without imposing the requirements of FAR Part 31.

f. REVISED the access to records provisions at paragraph (4) to allow the Government to review records of employee qualifications and changed terminology from ''records of distribution of labor'' versus ''labor distribution reports'' to be more consistent with commercial practices.

g. ELIMINATED the requirements at paragraph (i)(5) for Assignment of Refunds, Rebates and Credits because the Councils believe the applicable credits are adequately covered in paragraph (i)(1)(ii).

h. REVISED paragraph (u)(8), to clarify that payment of subcontract costs incurred prior to the date of any required subcontract consent will only be reimbursed if the contracting officer subsequently provides the consent.

Disposition of Public Comments

1. *Types of Commercial Services Sold on a T&M/LH Basis*.

a. *Predominately Sold on T&M or LH Basis*. One commenter said that T&M contracts are predominately used when the work effort to complete is extremely difficult or impossible to determine at the time the contract is executed and when the customer does not have a complete definition of the final or expected result. Another commenter said commercial T&M/LH contracts are appropriate when it is not possible for the buyer/seller to estimate accurately the resources required for performing and neither party can assume the financial risks for performance. Another commenter said the commercial marketplace regularly acquires support on a fixed rate per day or hours basis. In addition, various commenters identified the following specific services as a type of commercial service predominately sold on a T&M or LH basis:

1. Emergency Response.
2. Repairs.
3. Information Technology.
4. Professional.
5. System Integration.
6. Program Management.
7. Software Development.
8. Facilities.
9. Legal.
10. Accounting and Auditing.
11. Cleaning.
12. Consulting.
13. Business Advisory.
14. Financial Management.
15. Project Management.
16. Training.
17. Certain building trades (e.g., painters).
18. Quality Assurance.
19. Moving.
20. Installation.
21. Support.
22. Engineering.
23. Wind Tunnels.
24. Troubleshooting.
25. Miscellaneous Testing.
26. Pilot.

b. *Rarely Sold on a T&M or LH Basis*. One commenter said T&M/LH contracts are rarely used when the extent of the work effort to complete is clearly understood and definable, *i.e.*, the customer is able to clearly and accurately define the work.

c. *Commonly Sold as Both T&M/LH and Fixed Price*. One commenter said commonly sold commercial T&M/LH services can also be sold as fixed-price, under different circumstances, and that the customer's ability to specify required services/needs should be the basis for determining the use of commercial T&M/LH contracts. Another commenter said professional architectural and engineering design services, and consulting services are commonly sold on both a T&M/LH and fixed price basis.

Response: The Councils appreciate the public input and has fully considered it in formulating the types of services that are appropriate for commercial T&M/LH contracts.

2. *Appropriate Use*.

a. One commenter said the Government should conduct a thorough review of actual commercial buying practices to substantiate that T&M/LH contracts are used in the private sector rather than assuming and asserting that the use of T&M/LH contracts are a standard commercial practice.

Response: The FAR rule implements the statute that authorizes the use of T&M contracts for commercial services. The Councils note that the ANPR requested information from the public to better ensure that the implementation applies only to services that are commonly sold on a commercial basis as required by the statute. The Councils believe the public's input and the statute provide a sufficient basis for developing appropriate FAR coverage.

b. One commenter said the language at FAR 12.207(b)(3)(iii) that minimizes the use of T&M and LH contracts to the *maximum* extent practicable comes close to defeating the purpose of the original legislation. The commenter also said that the rule does not convey Congress's intent because the SARA legislation required maximum use of fixed price contracts and the ANPR indicates that the D&F is to demonstrate that a Government requirement is described in such a way as to *minimize* the use of T&M and LH contracts.

Response: The Councils recognize that the language should focus on maximizing fixed price contracts for commercial items. Therefore, the Councils revised the rule to establish the requirement in a way that will maximize the use of fixed price contracts, *e.g.*, by limiting the value or length of the current T&M/LH contracts or orders.

c. One commenter questioned the need to restrict commercial T&M and LH contracts to competitive circumstances because there may be situations where sufficient controls are in place to acquire services using procedures other than competition.

Response: Section 1423 of Public Law 108–136 stipulates commercial T&M and LH contracts must be made on a competitive basis.

d. One commenter recommended that the Councils clarify that the fair opportunity requirements of FAR 16.505 apply to commercial task order T&M contracts.

Response: The provisions at FAR 16.505 apply to commercial task order T&M contracts. Nothing in this rule requires that each task order be subject to full and open competition.

e. One commenter said the FAR Council solicited responses at the public meeting regarding whether commercial services task orders awarded on a noncompetitive basis should be eligible to be awarded under T&M/LH vehicles. The commenter has legal and policy objections to sole-source procurements being awarded under T&M/LH vehicles since SARA extended only to competitive procurements.

Response: The Councils acknowledge noncompetitive contract awards were discussed at the public meeting; however, noncompetitive awards were only discussed to obtain input on what constitutes competition. As stated in the ANPR and the rule, the awards must be made on a competitive basis.

f. One commenter said that use of competition and a ceiling does not adequately protect the Government from abuse because competition is an ''illusionary protection'' as

demonstrated by the General Services' schedules and task orders under IDIQs since ''in practice, they are mostly awarded on a sole source basis.''

Response: The commenter is concerned about compliance with the rule rather than promulgation of the rule itself. The rule requires use of competition in accordance with the statutory requirement for use of T&M contracts for commercial services. The commenter did not state that true competition is a problem, but merely assumes that such competition will not be obtained, *i.e.*, procuring components will not comply with the FAR requirements. Issues regarding compliance with the FAR are beyond the scope of the Councils; however, the Councils note that the assumption in promulgating the FAR is that it will be properly applied.

g. One commenter recommended eliminating the phrase ''of a type'' in FAR 12.207(b)(2)(ii)(A) since it cannot be uniformly defined and is confusing. The commenter believes eliminating the phrase will ensure that the services being purchased are truly commercial and not just a stretch of someone's imagination.

Response: The term ''of a type'' is part of the regulatory definition of a commercial item and also part of the statutory requirement that provides for use of T&M contracts for commercial items. Therefore, the Councils believe it is not appropriate to eliminate this phrase from this rule or FAR.

h. One commenter said the rule should limit services bought on T&M and LH contracts under FAR Part 12 to those that are truly commercial in nature and commonly sold in the commercial markets and restrict the use of commercial item T&M/LH contracts for requirements with large material components.

Response: The rule restricts the use to commercial services that are commonly sold to the general public through use of a T&M/LH contract. The Councils agree a commercial T&M/LH contract may not be the most suitable contract type when material costs are a significant cost of the acquisition. However, the Councils believe imposing strict limits on the material component would unnecessarily restrict the contracting officer's flexibility and discretion when responding to a specific requirement. The Councils note that the rule adopts the same procedures for noncommercial T&M contracts in FAR Subpart 16.6.

i. One commenter said the definition of what qualifies as a commercial service should be broad in scope and recommended requiring an affirmative determination by the contracting officer instead of developing a comprehensive list. Another commenter recommended adding the type(s) of service to a general list of subject areas to be considered when choosing a T&M or LH contract but not adding examples (consulting, training, etc.) because doing so might result in premature decisions for T&M or LH applicability. Another commenter recommended using broad categories, such as Federal supply codes or three-digit NAICS, so as not to limit implementation of public law because there are innumerable services that could be procured on a T&M/LH basis. Conversely, one commenter recommended adding a clear definition of commercial service with concrete examples. Another commenter said SARA requires OFPP to formulate a list of services typically sold on a T&M/LH basis commercially and that the list is needed because some contracting officers may be limited in their ability to properly determine whether the service could be bought on a T&M/LH basis. Another commenter said the rule should not go beyond the statutory language in describing the type of service(s) that may be procured under T&M contracts. Another commenter said the rule is incomplete because the rule authorizes use of T&M/LH contracts to acquire any other category of commercial services identified by OFPP but the rule does not identify where the OFPP determination will be posted or how it will be communicated to agencies.

Response: The Council note that many of the attendees at the public meeting expressed the view that a comprehensive list of commercial services would be overly restrictive and impractical. The Councils agree that developing and maintaining a comprehensive list is not practical or feasible because many services may be sold on both a T&M/LH and fixed price basis depending on the circumstances of the acquisition. Further, the Councils note that the ANPR did not identify a location for the ''OFPP determination'' because the Councils intended to revise the rule when OFPP made its determination. As OFPP has now made its determination, the Councils revised the rule to reflect that determination, *i.e.*, the rule allows agencies to purchase any commercial service on a T&M/LH basis when the agency has completed a D&F containing sufficient facts and rationale to justify that a FFP arrangement is not suitable.

j. One commenter said the term ''predominantly'' should not be used in lieu of the term ''commonly'' since they have distinctively different meanings.

Response: The **Federal Register** notice requested input on T&M services ''predominately'' and ''commonly'' sold on a T&M/LH basis to obtain additional insight into the use of T&M contracts for commercial services. The Councils agree the terms have different meaning and notes that the term ''predominately'' is not used in the provisions discussed in the ANPR or the rule.

k. One commenter suggested adding the ''type of work'' or ''type of skills needed'' to the list of considerations for deciding whether other contract types authorized by FAR 12.207 are suitable instead of limiting the determination to situations where it is not possible at the time of award to estimate accurately the extent or duration of work stating many times the Government's requirements quickly evolve after award. Another commenter said the rule should not adopt the rule in the GSA Multiple Award Schedule because T&M and LH contracts are advantageous to the Government since profit is defined and limited. Another commenter recommended revising the coverage at FAR 12.207(b)(3)(ii)(A) for when a T&M/LH contract is suitable by inserting either the word ''some'' or ''certain'' in front of the word ''costs'' at the beginning of the fifth line to specify that only ''some'' or ''certain'' costs cannot be anticipated with a reasonable degree or certainty since contracting officers are required to determine that the contract award amount is fair and reasonable. Three commenters said the situations when T&M/LH contracts can be used should be the same for commercial and noncommercial acquisitions.

Response: The ANPR language at FAR 12.207(b)(3)(ii)(B) that would have allowed use of commercial T&M/LH contracts when the work is sufficiently understood to allow for fixed pricing was intended to clarify that there were only two pricing arrangements for commercial items, fixed price (*i.e.*, firm-fixed price and fixed price with economic price adjustment) and T&M/LH. The Councils agree the situations for appropriate use of commercial T&M/LH contracts should be the same as the situations that permit noncommercial T&M/LH contracts. As the additional language appears to have caused confusion, the Councils eliminated the requirements at FAR 12.207(b)(3)(ii)(B). The rule is now identical to the requirements to FAR Subpart 16.6 (noncommercial) and MAS special ordering procedures which restrict T&M contracts to situations where it is not possible at the time of placing the contract to estimate accurately the extent or duration of the work to

anticipate costs with any reasonable degree of confidence.

l. Two commenters said the Government should not assume that T&M contracts can only be used when the entire effort is T&M since contracts that are predominately firm-fixed price can also include T&M items.

Response: Neither the FAR, nor this rule, preclude the use of ''hybrid'' contracts, *i.e.*, contracts with mixed contract types. Therefore, additional authority is not needed. However, the Councils note that contracting officers must adequately document why no other contract type is suitable for the T&M portion of the contract in the supporting D&F.

m. One commenter said offerors should be allowed the flexibility to propose both fixed price and T&M solutions and that the contracting officer could analyze and decide which offer is most cost effective and advantageous to the Government.

Response: The Councils believe contracting officers will conduct adequate market research to determine the appropriate contract type and notes that T&M contracts are only authorized when no other contract type is suitable. The solicitation must identify the anticipated contract type so offerors will know the terms and conditions that apply to the solicitation and can price their offers accordingly. Additionally, the solicitation must specify the evaluation factors that will be used to determine the successful offeror so that all offerors are on equal footing since evaluation factors, like proposed prices, vary depending on the contract type. The Councils note that existing FAR provisions allow contracting officers to solicit alternate proposals.

n. One commenter noted that T&M contracts represent more risk to the buyer than firm fixed price contracts and said differences in Federal and State court interpretations of critical performance aspects, especially the ability of the buyer to enforce firm deliverables and warranties, may explain why the rule limits the use of T&M or LH contracts to when ''no other contract type is suitable.'' The commenter said that Federal courts have often found that the buyer cannot enforce firm deliverables or warranties under T&M and LH contracts, which makes these contract types inherently risky for the Government. Conversely, State courts, applying the principles of the Uniform Commercial Code, typically do not make distinctions between T&M/LH and FFP contracts in regard to the buyer's rights to firm deliverables and warranties. The commenter further recognized that a continued bias in favor of fixed price contracts for acquisition of commercial services under FAR Part 12 is in order. However, the commenter recommended that the Councils fully understand the important distinctions made by the Courts before implementing the rule.

Response: The Councils agree that T&M contracts comprise the highest contract type risk to the Government. As such, they should only be used when no other contract type is suitable. The Councils recognize there are Court opinions regarding deliverables and warranties. However, the issue of deliverables and warranties does not factor into the decision to use a T&M contract. The key factor in deciding to use a T&M contract is the ability to accurately estimate the extent or duration of the work or anticipate costs with any reasonable degree of certainty.

o. One commenter said there is a clear separation between projects that are obviously suited for FFP (defined scope development or implementation) and those suited for T&M (design consulting services, quality assurance, security, auditing, etc.) and that there is little chance that the rule would drive contracts away from FFP.

Response: Since commercial T&M contracts are not currently authorized by the FAR, the Councils are unable to determine whether the rule will ''drive contracts away from FFP.'' In accordance with the rule, T&M/LH contracts are only authorized when the contracting officer determines that no other contract type is suitable which should assure that the rule does not ''drive contracts away from FFP''.

p. One commenter said contracting officers should be provided guidance on sources and specific instructions for conducting market research to evaluate options and rationale for not using fixed-prices for delivery of services.

Response: The discussion of market research is included in FAR Part 10, Market Research. The FAR does not provide specific instructions or sources for conducting market research since this will vary with different types of acquisitions. Such specific instructions and sources are more appropriately contained in agency training materials and guidance.

q. One commenter said the rule should be revised to emphasize that market research is performed to establish why T&M is the appropriate contract type for a particular requirement. Another commenter said the market research procedures in FAR Part 10 will be an effective way to determine whether it is feasible to purchase services on a fixed-price basis or a T&M/ LH basis. Another commenter said market research should be limited to a determination of whether the desired services are commercial which could result in solicitation of both fixed-price and T&M contracts. Another commenter noted that contracting officers should rely on market analysis to identify services typically sold commercially since market analysis, coupled with documentation that the scope or duration of work is not sufficiently clear, should be sufficient to establish that a fixed-price contract is not suitable.

Response: The Councils agree market research is an effective way to determine whether purchases can be made on a T&M/LH or FFP basis and notes that the ANPR and the proposed rule require agencies to determine commercial practices, including contract type, during market research. The Councils do not believe additional coverage is needed.

r. One commenter recommended revising FAR Parts 7 and 37 to require Government personnel to evaluate the existing requirements and market conditions and adapt the strategy needed to address them.

Response: Government personnel are required to conduct market research, which includes evaluating the existing requirements and market conditions, to determine the most suitable approach to acquiring, distributing, and supporting the needed supplies or services. The Councils do not believe additional coverage is needed.

s. One commenter recommended that the Councils amend Part 12 to exclude applied research since established catalog or market prices cannot exist because the primary objective of this type of research is to advance scientific knowledge not yet existing in the marketplace. The commenter noted that the Deputy Inspector General for Auditing had previously identified the inappropriate use of FAR Part 12 in procurement of applied research in Report No. D2001–051, ''Use of Federal Acquisition Regulation (FAR) Part 12 Contracts for Applied Research,'' dated February 15, 2001.

Response: Applied research is a service that is performed on a T&M/LH basis in the commercial marketplace. The acquired scientific knowledge is the result of the research services.

t. One commenter said contracting officer should be given discretion in making an award on the basis of an overall evaluation of the proposal, which presumably includes rates, technical approach to performing the work, price, etc., and that price alone should not be the deciding factor.

Response: The Councils agree that price alone is not necessarily the sole or key factor in making an award. However, the rule does not need to be changed since FAR Part 12 already requires the contracting officer to use the provisions in FAR 15.101 and 15.304, which provide criteria to be used in making the award. The criteria states that the relative importance of price will vary with different types of acquisitions.

u. One commenter believes award fees and performance or delivery incentives fees provisions at FAR 12.207(d) should only be used in contracts for commercial services when use of such fees are consistent with commercial practices.

Response: The Councils see no reason to limit the use of award fees and performance or delivery incentives to be consistent with commercial practices. The Government uses award fees and incentives to motivate contractor efforts that might not otherwise be emphasized in order to meet specific acquisition objectives. While the use of award fees and incentives may not be customary in all commercial industries, the Councils believe similar incentives are generally used in the commercial marketplace when appropriate.

v. One commenter encouraged the ''abandonment of CPFF contracts for commercial services in favor of T&M'' and urged approval of the rule.

Response: Cost type commercial contracts are prohibited by statute.

w. One commenter at the public meeting said the rule should apply only at the prime contract level since the commercial sector does not compete awards at the subcontract level.

Response: The rule does not change how commercial contractors price subcontracts. As always, commercial contractors can use T&M contracts. However, the Councils believe commercial contractors often award subcontracts on a competitive basis.

x. One commenter at the public meeting asked how contracting officers determine what is ''in scope'' for the purpose of issuing change orders since T&M contracts do not always specify an outcome.

Response: The procedures for determining what is ''in scope'' for commercial T&M contracts are the same as those used for noncommercial T&M contracts. While T&M contracts do not always specify an outcome, they do specify the contract requirements. Determining whether the change is ''in scope'' or ''out of scope'' will be based on the requirements in the contract. The Councils note that work is within the scope of the contract if it is regarded as having been fairly and reasonably within the contemplation of the parties when the contract was entered into.

y. One commenter at the Public Meeting asked if fixed-price contracts with prospective price redetermination contracts could serve the same purpose for many contracts that are awarded on a T&M basis.

Response: Fixed-price contracts with prospective price redeterminations may be used in acquisitions of quantity production or services when it is possible to negotiate a fair and reasonable firm fixed price for an initial period, but not for subsequent periods of contract performance (see FAR 16.205–2). Conversely, a T&M contract can only be used when it is not possible at the time of placing the contract to estimate accurately the extent or duration of the work or to anticipate costs with any reasonable degree of confidence (see FAR 16.601(b)). The appropriate contract type will be based on the specific circumstances of the acquisition.

3. *Determination and Finding (D&F).*

a. One commenter said the requirement for a D&F for every CLIN or order would be unduly burdensome to contracting officers and instead recommended revising the acquisition planning process and associated documentation requirements to address the possibility or probability for using T&M and LH based on the analysis of the requirement and market research. Another commenter said a D&F is needed for each task order. Another commenter said that the rule could be drafted to make it less onerous for developing and approving D&Fs and that the requirement for a D&F for each order when the IDIQ contract provides for both FP and T&M orders would be redundant and wasteful and that it is not necessary to require approval one level above the contracting officer for a D&F for an IDIQ authorizing only T&M and LH contracts. Another commenter said separate D&Fs should be issued for each task order under an IDIQ contract when all task orders will be issued as T&M/LH. Another commenter said a D&F should be executed by the contracting officer only as currently required under the FAR, *i.e.*, a D&F should not be required for each order.

Response: The Councils note that there is no requirement for a D&F for each CLIN and that there is no requirement for a D&F for fixed price orders. The Councils acknowledge that the proposed rule contains additional requirements for commercial T&M/LH IDIQ D&Fs than those required for noncommercial T&M/LH IDIQ D&Fs. While the Councils recognize these additional requirements may be more burdensome, the Councils believe the additional requirements are needed to encourage the preference for the use of fixed price contracts for commercial items as required by the statute.

b. One commenter said the rule should make clear that a D&F will not be required prior to issuing a solicitation inviting both fixed price and T&M/LH proposals and that a D&F should only be required if the ultimate award is T&M or LH. Three commenters recommended setting a D&F threshold to limit the burden for small dollar acquisitions.

Response: FAR 12.207(b)(1) only requires a D&F before award. It does not require a D&F before issuance of a solicitation. The Councils also note that statute requires a D&F for T&M/LH contracts regardless of the dollar amount.

c. One commenter suggested adding a requirement for the D&F to address the specific reasons why a FFP contract was eliminated instead of allowing high-level generalities as explanations. The commenter also said the D&F should explain the boundaries of the requirement so the performance risk to the Government is reduced or the contract value or contract length is limited. Another commenter recommended changing the word suitable to a phrase more like ''a determination and findings (D&F) that the use of commercial items is not suitable if it is not used''.

Response: The content of a D&F is addressed in the rule at FAR 12.207(b). The rule requires that ''each D&F shall contain sufficient facts and rationale to justify that no other contract type authorized by this part is suitable.'' The Councils believe the rule provides adequate guidance to contracting officers as to the required content of the D&F. Sufficient facts and rationale include any necessary information regarding contract value and length. The D&F required by the statute and the rule relate to contract type only and not the determination of whether ''use of commercial items is not suitable.''

d. One commenter said the D&F process appears to be adequate and appropriate but the commenter recommended adding a requirement to analyze the need to definitively control the profit level when determining whether a fixed price contract is appropriate.

Response: The ''need to definitively control the profit level'' is not a criterion for determining whether a fixed price contract is suitable. T&M/LH contracts are only used ''when it is not possible at the time of placing the

contract to estimate accurately the extent or duration of the work or to anticipate costs with any reasonable degree of confidence.''

e. One commenter recommended adding a requirement to FAR 12.207(b)(1) for the contracting officer to obtain higher-level D&F approval before taking any actions to extend or renew the contract beyond five years because the Deputy Inspector General for Auditing has previously identified problems with service contracts such as T&M/LH contracts that have been extended or renewed for 10, 20, and even 30 years with no attempt to use available historical information to transform the T&M/LH contract to FFP.

Response: The Councils believe current FAR provisions adequately cover the commenter's recommendations. Actions to extend the contract or order beyond the limits established in FAR 17.204(e) require approval in accordance with agency procedures. In addition, FAR 7.103(r) requires that agency heads ensure that knowledge gained on prior acquisitions is used to further refine requirements and acquisition strategies. Furthermore, the rule requires that actions be taken to maximize the use of fixed price contracts, including limiting the contract length for T&M/LH contracts.

4. *Payment.*

a. One commenter asked the Councils to consider revising the last sentence of FAR 52.212–4, Alternate I (a)(i)(B) (sic, paragraph (i)(1)(i)(B)) from ''or other substantiation *specified in the contract*'' to ''or other substantiation *required by the contracting officer*'' because the commenter believes that the specific type of substantiation necessary may not be apparent until after award.

Response: The Councils do not believe it would be prudent to leave the contract terms open to the unilateral discretion of the contracting officer. The Councils believe it is imperative for commercial contractors to know what will be required to receive reimbursement. Leaving the contract terms open-ended will discourage competition and possibly lead to disputes. Should the parties agree after contract performance has begun that additional or alternative substantiation is needed, the contract can be appropriately modified.

b. One commenter said payment of partial hours should not be dependent on specific language allowing payment and recommended payment for work performed unless the contract specifically provides otherwise.

Response: The Councils agree that partial hours should be paid on a pro-rated basis and revised the rule to provide for payment of partial hours on a pro-rata basis.

c. One commenter said the Government's unilateral right to dispute a payment and withhold money under the Overpayments/Underpayments portion of the clause is inconsistent with commercial practices and that disputes should be subject to the Contracts Disputes procedures.

Response: The Councils believe that the rule is consistent with commercial practices since commercial companies withhold payments when the supplier does not comply with the terms of the contract. The Councils note that the Overpayments/Underpayments provisions protect both the Government and contractors and those contractors have full rights under the disputes clause of the contract to file claims and recover monies, including applicable interest.

d. One commenter said the payment clause on withholds for non-commercial T&M contracts at FAR clause 52.232–7 is not appropriate for commercial T&M contracts and the proposed payment provisions in paragraph (i) of the proposed alternate clause are acceptable.

Response: The Councils agree that withhold provisions at FAR clause 52.232–7 are not necessary for commercial T&M contracts and notes that the rule, like the ANPR, does not include the withhold provisions.

e. One commenter said it is common for a contractor to subcontract for labor categories when the contractor does not have the labor category identified in the contract and questioned what the contractor will be permitted to bill and what the Government will be required to pay the contractor for subcontract labor, *i.e.*, schedule rates or actual costs. The commenter also said clear guidance is needed on how to treat subcontract labor costs for both commercial and non-commercial T&M/LH contracts. Another commenter said the common commercial practice is to negotiate and pay vendors one hourly rate per labor category regardless of whether the work is performed by the prime or subcontractor employees, *i.e.*, ''blended rates'' which include subcontract rates.

Response: The Councils believe that the contract should clearly address how the contractor will be reimbursed for subcontract costs and revised the rule to provide for reimbursement of subcontractor costs at actual cost unless the contract specifies that the subcontract cost are reimbursable at the hourly rates prescribed in the schedule.

5. *Ceiling Price.*

a. One commenter said the not-to-exceed (NTE) requirements of the proposed rule and continued auditing of labor rates and internal costs by DCAA make long-standing fears about T&M contracts unrealistic.

Response: T&M contracts will continue to comprise the highest contract type risk to the Government since they provide the least incentive for contractors to perform efficiently and economically. The NTE ceiling for commercial T&M contracts, like the ceiling for non-commercial T&M contracts, simply limits the Government's risk. The Councils note that, like non-commercial T&M contracts, labor hours and not labor rates are subject to Government audit after contract award. The Councils further note that the Government's audit rights under the rule are limited to verification of labor hours and employee qualifications (when reimbursed on an actual cost basis), direct material, subcontract, and other direct costs.

b. One commenter said the ceiling prices may be established with the expectation of completion even if the contractor exceeds the ceiling price. Another commenter said the provision will encourage contractors to perform services on the Government's ''promise'' to extend ceiling prices thereby creating additional disputes and controversies. The same commenter also said that the Government should increase the ceiling price on a timely basis because the commenter believes the provisions that allow contractors to be paid after the fact for services provided prior to the obligation of money may violate the Anti-Deficiency Act (ADA).

Response: The provisions in the rule for commercial T&M contracts, like those for non-commercial T&M contracts, clearly state that the Government is not obligated to pay, and the contractor is not obligated to perform, after the ceiling price is reached. The Councils recognize that some contractors have continued to perform on noncommercial T&M contracts beyond the established ceiling based on a Government employee's belief that the ceiling price will be increased and agrees that this practice has led to many disputes and controversies. The Councils agree that the Government should increase the ceiling price on a timely basis when the Government intends to continue performance beyond the existing ceiling price and notes this is why contractors are required to notify the Government when they expect to exceed 85 percent of the ceiling price. The ADA prohibits the Government from taking any action to obligate the Government prior to obligating sufficient funds to the contract. The Councils further agree that

these provisions may result in a contractor being paid after the fact for services provided prior to the obligation of additional funds to increase the ceiling. However, since the Government has no obligation to pay for services rendered after the ceiling is reached and before additional monies are obligated, there is no ADA violation. After additional funds are obligated, the issue is allowability.

c. One commenter said requiring the contractor to track and report costs against a NTE value is inconsistent with commercial practices and that changes to its business systems to accommodate these government-unique requirements would not likely be justified since commercial customers do not need a ceiling price or notification of 85 percent of the NTE. The commenter said that the incentive to deliver high-quality support services at a reasonable price in the commercial marketplace is to retain a competitive advantage and maintain a reputation for responsive, high quality customer support. Another commenter said the provisions requiring notification to the Government when contractors believe they may exceed 85 percent of the ceiling price or that the total price to the Government will be substantially greater or less than the ceiling price in the contract makes the commercial provider responsible for Government management of the contract and requires systems and reports that are inconsistent with commercial practices. The commenter said this is a shift of responsibility and costs without justification and that commercial contractors are at risk since breach of this provision can result in non-payment for services rendered. Another commenter recommended not requiring ceiling prices when contracting under emergency procurement procedures.

Response: The Councils recognize there may be unique situations in the commercial marketplace where commercial companies agree to open ended commitments; however, statute prohibits the Government from doing so. As discussed in b above, the Government is prohibited from taking any action that obligates the Government prior to obligating sufficient funds to the contract. The same is true even for emergency procurements. The Councils note that these provisions also protect contractors from nonpayment for services rendered by ensuring sufficient funds are available if the contracting officer determines the ceiling price should be increased. Unless notified by the contractor, the Government will have no way of knowing when the contractor will exceed the ceiling since the Government does not know the price for work performed and not billed or the price of work planned to be performed in the current period. While systems and reports will vary between commercial providers, the Councils believe commercial providers generally track and measure performance against negotiated contract values and can therefore report projected expenditures and cumulative services rendered.

d. Another commenter said the ceiling price should equal the available funds since the total contract costs cannot be reasonably determined with any degree of confidence.

Response: The ceiling price is required by statute. While establishing a ceiling price is not an exact science, the ceiling represents the Government's best estimate of the contract price. If the estimated price increases during contract performance, the contracting officer will only obligate additional funds when it is in the Government's best interest to do so.

6. *Advance Consent for Overtime*. One commenter said the advance consent for payment of overtime is inconsistent with commercial practice and that commercial customers expect repair teams to work as necessary to complete repairs expeditiously. Another commenter believes that commercial standards should be utilized for overtime payment because requiring the contracting officer to approve overtime may delay the project and end up costing the Government more than results from contracting officer approval.

Response: The Councils believe the consent is needed to ensure overtime is only used when the Government agrees the additional costs of overtime are justified and necessary to meet the Government's objective. The clause provides the flexibility for the contracting officer to authorize overtime at the time of contract award if deemed necessary to meet essential delivery and performance schedules; make up for delays beyond the Contractor's control; or to eliminate extended production bottlenecks or project delays.

7. *Materials Costs*.

a. *Material Handling*. One commenter recommended using loaded rates or a fixed charge to allow contractors to recover material handling and subcontract administration costs without imposing the requirements of FAR Part 31. Another commenter said reimbursing contractors for material handling does not violate the cost plus a percentage of cost prohibition imposed by Congress because the material handling costs are not a ''fee'' of the type Congress prohibited. Another commenter said instead of using a percentage markup, which raises cost plus percentage of cost contracting concerns, the rule should permit the contractor to charge the Government a fixed fee for providing material that will compensate the contractor for its indirect costs. Another commenter said since the work is being awarded competitively, the rule should allow contractors to mark up their subcontractor's T&M or LH service rates as long as the amount of the mark-up is fully disclosed to the government and the total rate, including the mark-up, does not exceed the contractor's own rate for the same service thereby avoiding the application of Part 31 and concerns over cost-plus-percentage-of-cost contracting. Another commenter said material handling and subcontract administration costs are normally marked up a percentage rate as mutually agreed to and negotiated by the contractor and client. Two other commenters said customers are charged the catalog price that includes material handling charge. One commenter said basing material handling or subcontract administration fees on actual costs is rare in the commercial marketplace. Another commenter said that many commercial contractors do not add a separate material handling fee or subcontract administration costs on top of their fully burdened labor rates. Another commenter said payment of separate indirect rates for material and subcontracts should not be allowed for commercial purchases. Another commenter said contractors that are otherwise CAS covered will have to allocate the indirect cost for the direct materials on FAR Part 12 T&M contracts to those contracts even though the contractor will not be paid for the indirect costs and will suffer an overall loss. Another commenter concurred with the ANPR's proposed prohibition on mark-ups on materials costs.

Response: The comments reflect a varying set of commercial practices for material handling and subcontract administration costs. The Councils believe it is important to provide as much flexibility as possible without violating the cost plus percentage of cost prohibition. The Councils believe use of a fixed rate violates the cost plus percentage of cost contract prohibition. Therefore, the rule does not permit application of a fixed rate. The Councils believe use of a fixed amount may be appropriate and revised the rule accordingly. However, the fixed amounts for indirect costs should exclude any amounts already included in the schedule labor rates. Finally, the

Councils note that while the ANPR did not permit direct reimbursement for material handling, nothing in the ANPR or rule prevents contractors from including material handling in the fully burdened labor rates.

b. *Most Favored Customer Terms*. One commenter cautioned against use of the mandated ''most favorable customer'' terms for materials the contractor sells rather than purchasing from outside vendors. Another commenter said the ''most favored customer'' price clauses pose numerous compliance risks to industry and are inconsistent with commercial practices. The commenter said it cannot ensure that the catalog price for a part is no higher than the market price or the ''most favored customer'' price.

Response: The Councils note ''most favored customer'' pricing is consistent with the provisions for noncommercial T&M/LH contracts but not consistent with the general allowability provisions for material costs at FAR 31.205–26(f) and that the Councils are currently considering changes to the provisions for noncommercial T&M contracts. The Councils believe the provisions at FAR 31.205–27(e) are more appropriate for commercial contracts and revised the rule to permit reimbursement at the catalog or market price when the materials furnished by the contractor meet the definition of a commercial item at FAR 2.101. In addition, the Councils note that the ANPR failed to address interdivisional transfers. The Councils also revised the rule to specify the procedures for interdivisional transfers on commercial T&M/LH contracts consistent with the provisions of FAR 31.205–26(e).

c. *Most Advantageous Pricing*. One commenter said requiring ''most advantageous prices'' for purchases of material from outside vendors is inconsistent with commercial practices and the Government's own ''best value'' requirement. The commenter believes Government auditors will interpret ''most advantageous'' to mean lowest price when there are sound business reasons to procure from other than lowest price. The commenter said when prices are set by the initial competition, no further Government action should be taken. Further, the commenter said if the Government is concerned about product pricing, the Government should furnish the materials to the contractor so the Government, and not the contractor, will incur the unnecessary costs and risks associated with the proposed standards of most advantageous prices.

Response: The Councils believe the rule is consistent with commercial practices and the Government's ''best value'' determination because the rule, like commercial practice and the best value determinations, considers factors other than lowest price, *i.e.*, prompt delivery and quality materials. Since the rule specifically identifies factors other than lowest price, the Councils believe Government auditors will properly consider these other factors. In addition, the Councils agree additional Government action would not be needed if the material prices were set by the initial competition; however, the material price for commercial T&M contracts are not set at time of contract award. Instead, the Government reimburses contractors based on actual costs or catalog or market prices for the materials furnished by the contractors. Finally, the Councils do not believe contractors will incur additional costs or risks to buy materials at the most advantageous price because the Councils believe commercial companies already consider the price, quality, and availability before acquiring materials. The rule requires the contractor to obtain materials at the most advantageous prices ''to the extent able.''

d. *Refunds*. One commenter said requiring contractors to give the Government credit for cash and trade discounts, rebates, scrap, commissions, and other amounts that have accrued to the benefit of the contractor is inconsistent with commercial practices. The commenter also said commercial companies apply commercial pricing standards for its labor and spares catalog pricing for materials. Another commenter said the Government is arbitrarily establishing a method of pricing materials that is inconsistent with commercial practices and requires accounting of ''rebates, refunds and discounts that are received or accrued to the contractor.'' The commenter believes this tracking is unjustified, would be very costly, and ultimately result in many disputes that in turn would be costly for both Government and commercial services contractors for audits, disputes and legal fees. The commenter recommended that the Government rely on competition as means to determine the price is fair and reasonable. Another commenter said that if a contracting officer is responsible for enforcing this requirement of giving the Government credit for all discounts and rebates, it may be advisable to consider allowing the CO to require supporting information from the contractor. Another commenter recommends that these contracts include refund or price reduction clauses allowing the Government to recoup any overages identified through surveillance of the contract.

Response: The Councils recognize that reducing the price of materials for any possible applicable credits may not be customary in the commercial marketplace. The Councils note that the credits only apply when the Government reimburses the contractor at his actual costs, which, if such credits are received, are reduced accordingly. However, to be more consistent with commercial practices, the Councils revised the rule to limit the requirements to credits received by or accrued to the contractor.

e. *General*. One commenter said limiting the ''allowable material costs'' to actual costs focused on ''costs'' rather than ''price'' which is fundamentally inconsistent with commercial practices.

Response: While reimbursement for actual costs may be inconsistent with commercial practices, the Councils believe payment of the actual cost is necessary to protect the Government when the material being sold to the Government does not meet the definition of a commercial item at FAR 2.101. The Councils note when the material is a commercial item, the rule provides that the contractor will be paid on the basis of an established catalog or market price.

8. *Consent to Subcontract*.

a. Several commenters said the consent to subcontract requirements should not apply to commercial contracts because they are inconsistent with commercial practice. One commenter said that the consent to subcontract requirement is generally limited and does not apply when a prime contractor requires subcontracting to an affiliate. Two commenters said the consent to subcontract is necessary and agreed with the proposed language in paragraph (u) of Alternate I at FAR clause 52.212–4. Another commenter said the normal practice is that the contractor is not allowed to assign any portion of its responsibilities or rights under the contract without first obtaining the written approval of the client. Two commenters said the subcontract consent requirement is contrary to the FASA's intended purpose of simplifying commercial item contracting. Another commenter said the requirement will add administrative effort and costs with no value added to contractors and little benefit to the Government. Another commenter said that once an authorized determination has been made to allow a T&M contract type, further authorizations for T&M should not be required for subcontracts

under an approved overall contract. The commenter said it should be presumed that the approval of T&M for the prime contract flows to all subcontracts under it. Another commenter said since commercial contractors are not likely to have government-approved purchasing systems, the contractors would be subject to the proposed subcontract consent provisions which is not practicable in commercial contracts and is not a commercial practice. Another commenter said the costs outweigh benefits when the choice is to either create/maintain approved purchasing system or delay performance pending Government approval. The same commenter also said a fair & reasonable determination can be made at contract award because use of T&M is limited to contracts awarded through competition.

Response: When contractors add or substitute subcontractors after award, the basis for the best value determination used to award the contract may have been altered. Therefore, the Government must have the right to approve changes in subcontractors to maintain best value. As indicated by some of the comments, some commercial companies reserve the right to approve or deny changes in subcontractors. In fact, one commenter stated ''the normal practice is that the contractor is not allowed to assign any portion of its responsibilities or rights under the contract without first obtaining the written approval of the client.'' The Councils do not believe subcontract consent will add significant administrative effort but will protect the Government from potential subcontractor substitution issues.

b. One commenter recommended revising the proposed paragraph at FAR 12.216 as follows because all contractors should be required to get the contracting officer's consent prior to using foreign subcontractors to prevent contractors from negotiating labor hours and rates based upon its local workforce and subsequently subcontracting with a foreign contractor with much lower rates.

(1) Add the following after the second sentence in proposed FAR 12.216:

Any subcontract with a foreign company when the work will be physically performed outside the United States or Canada requires the contracting officer's consent.

(2) Add the following phrase at the end of the proposed last sentence:

. . . except for subcontracts with a foreign companies as described above.

(3) Add the following new coverage to the proposed FAR clause at 52.212–4, Alternate I (u), to enact the revised requirements discussed above:

(2) The Contractor must obtain the contracting officer's written consent for any subcontract with a foreign company when the work will be performed outside the United States or Canada.

Response: Such provisions are not provided for non-commercial T&M contracts. The Councils do not believe it is advisable to add more stringent requirements for commercial T&M contracts than are used for non-commercial T&M contracts. The Councils are not aware of any problems in this area under existing T&M contracts.

c. One commenter said the rule should (as the ANPR proposes) require contractors to obtain the contracting officer's consent to subcontract. The Government should know what entity is providing services on a T&M or LH basis. However, the requirement to obtain consent to subcontract should apply only to charges that are directly charged to the contract, as opposed to overhead expenses and general and administrative expenses. Many commercial companies have corporate-wide agreements with vendors to perform those functions.

Response: The Councils agree that the consent to subcontract applies only to costs that are directly charged to the contract and does not apply to overhead expenses and G&A expenses. The provisions in the proposed rule are the same as the consent to subcontract requirements for non-commercial T&M contracts. Therefore, there is no need to provide additional language.

d. One commenter assumed that the clause at FAR 52.212–4, Alt. I, paragraph (u) can be tailored to conform to commercial practices in the industry as provided under FAR 12.302(b) and recommends acknowledging such in the final rule.

Response: The tailoring provisions at FAR 12.302 do not apply to the proposed FAR clause at 52.212–4, Alternate I, paragraph (u), because the Councils believe tailored subcontract provisions may not adequately protect the Government's interests. While some commercial companies may allow assignment of rights and responsibilities under the contract without the approval of the client, the Councils do not believe commercial industries, as a whole, generally allow unknown or unapproved changes to the contract. The Councils believe the Government should retain the right to approve such changes to protect the Government's interest in achieving best value. The Councils revised FAR 12.301(b)(3) to clarify that the Alternate clause is not subject to the tailoring authorities of FAR 12.302.

9. *Contractor Purchasing System Reviews (CPSR).* One commenter said imposing CPSRs requirements on commercial T&M or LH contracts would stop many small businesses and small disadvantaged businesses from providing commercial services since these businesses may not need, nor have, the sophisticated infrastructure required to successfully complete a CPSR.

Response: The rule does not impose a CPSR requirement but simply recognizes that contractors with approved purchasing systems require less oversight because the contractor's overall system provides adequate controls and procedures to protect the Government.

10. *Other Direct Costs (ODC).* One commenter said ODC may include travel, software license fees, software subscription fees, and other categories of other direct costs outside the normal definition of materials and subcontracts. The commenter suggested not defining the elements of ODC so that these other types of other direct costs could be proposed and evaluated. Another commenter asked whether travel would be considered ''materials'' under a T&M contract or be perceived as a cost reimbursement item requiring non-commercial procedures. Another commenter noted that the ANPR appears to only allow materials costs and subcontract costs to be charged as ODC. The commenter suggested limiting the definition of materials costs to preclude direct charging of intangible types of costs and force vendors to include such costs in their loaded labor rates.

Response: The Councils believe that it is important to provide as much flexibility as possible. However, it is also imperative that the contract clearly articulates what costs are reimbursable outside of the fixed hourly labor rate(s) set forth in the contract. To clarify the issue, the Councils revised the rule to allow reimbursement of ODC based on actual costs for the types of ODC specified in the contract thereby allowing flexibility to negotiate reimbursable ODC on a case-by-case basis.

11. *Government Property.*

One commenter said customers do not normally furnish property for commercial T&M or LH airplane repair contracts. Another commenter said customer provided property is not the ''norm'', but if property is supplied, the owner's standard procedures should apply. Another commenter said GFP should be listed in the contract and tracked by the agency's property management process. Another commenter said the proposed Alternate I to the FAR clause at 52.212–4 should

also contain a provision requiring any property or equipment submitted for reimbursement under the contract as ODC to be designated as Government property and treated accordingly. Another commenter said this does not occur often on professional A&E services contracts. When it does, it normally is in the form of Project Record Documents for existing facilities that the customer wishes to remodel or modify. Such Project Record Documents are managed and controlled by our staff as if they were our own. Upon completion of the contract, such documents are returned to the customer in their original condition. They can be either in hard copy or electronic medium.

Response: As with any acquisition, the need to furnish Government property will depend on the nature of the requirements, e.g. military equipment repair. However, when property is furnished, the contract must include the appropriate Part 45 property clauses. The Councils note that the Councils are revising Part 45 and the associated clauses to reflect accepted industry practices for property management. Finally, the Councils note documents, such as project record documents, are not considered Government property under FAR Part 45.

12. *Government Oversight*.

a. One commenter recommended that the Government hold the prime contractor accountable for proper record keeping and invoicing and not require copies of a commercial subcontracting agreement and subcontractor invoices because the Government has no privity with the subcontractors. The commenter believes requesting such information is clearly inappropriate and that the Government has no need to routinely obtain and review subcontractor's documentation since the Government presumably evaluated and accepted the prime's proposal. Another commenter asserted that subcontract costs should be the responsibility of the prime for competitive procurements and there should be no Government involvement.

Response: The Councils agree that the Government generally will not need access to the subcontractor's books and records. The Councils believe there are two possible scenarios regarding subcontract costs. The first scenario is where the contract provides for subcontract costs to be reimbursed at actual costs to the prime contractor. In this case, the Government would need to verify that the prime contractor has actually made the payments in the ordinary course of business and that such payments were made in accordance with the subcontract agreement (the Government would not need access to the subcontractor books and records, only to a copy of the subcontract agreement maintained by the prime contractor and verification to the prime contractors records that payment was made). The second is where the contract provides for the subcontract costs to be reimbursed at the prime contract fixed hourly labor rates. In this case, the Government needs to have some assurance that the prime contractor has verified the hours worked by the subcontractor. To address this situation, the Councils have revised the rule to require that subcontractor hours be substantiated by actual payment, individual timecards, employee qualifications, or other substantiation specified in the contract.

b. One commenter said the proposed Alternate I to FAR clause 52.212–4 creates issues related to the governments audit rights such as whether the government has the right to interview contractor employees about work they have performed. Another commenter said access to contractor employees is not consistent with commercial practices and should not be permitted.

Response: The rule permits, but does not require, contracting officers to have access to contractor employees. While such access may not be a standard commercial practice, the Councils believe employee interviews may be necessary in some cases to verify the hours claimed by the contractor.

c. One commenter advocates including protections, above those currently required in commercial items purchases, for commercial services bought on a T&M/LH basis. The commenter suggested a provision which would authorize the CO to request substantiation for hourly rates charged under the task orders stating that such a provision would allow for substantiation of hours worked, access to original timecards, timekeeping procedures, labor distribution reports, and assigned employees. The commenter also said documents such as employees' resumes or other personnel records of employees, to verify that employees have the contractually required qualifications and experience, should be made available for Government review. The commenter also suggested identifying labor distribution reports as ''records of distribution of labor'' to avoid confusion at contractors that do not maintain formal reports, but do maintain records relating to their distribution of labor.

Response: The Councils believe that access to employee timecards, labor distributions, and the ability to interview the employees should provide sufficient information to verify the validity of hours claimed on the contract. However, the Councils believe that there may also be a need to assess employee qualifications to verify that the employee meets the qualifications of the labor category to which he/she has been charged. Therefore, the Councils revised the rule to also provide access to records that substantiate employee qualifications. In addition, the Councils revised the rule to say ''records of distribution of labor'' versus ''labor distribution reports'' to be more consistent with commercial practices.

d. One commenter said that additional controls and oversights are used in the commercial marketplace since T&M/LH contracts do represent more risk to the buyer, e.g., verification of labor hours performed versus billed, labor categories utilized versus billed, and adequate accounting systems so the buyer could validate costs billed. The commenter also said that existing oversight methods and controls for Federal non-commercial T&M/LH contracts are a good basis for crafting the methods and controls to apply to Part 12 T&M/LH contracts and that the proposed rule appears to have carefully examined those terms and conditions that should be applied to the new authority under FAR Part 12. Another commenter said that allowing contracting officers to negotiate access to other types of documents on task orders, where circumstances merit such access, is warranted. Another commenter said that access to commercial contractor records or audit rights is uncommon, limited in scope or nonexistent and that surveillance, if any, was generally limited to verification of hours or expenses billed. Another commenter said in the commercial marketplace, the contractor is responsible for providing sufficient information to support billings for hours charged, materials used, and subcontracts performed.

Response: The Councils believe that the ANPR carefully considered existing requirements for T&M contracts as well as differences between the commercial marketplace and non-commercial contracts. The Councils believe the rule provides the proper balance between the need to verify compliance with contract terms and the need to minimize access contractor records.

e. Two commenters said the payment provision in the FAR clause at 52.212–4 and the proposed alternate provisions are inconsistent with commercial practices. One of the commenters also said commercial companies do not

provide access to time cards, actual material or subcontract costs, employees or employee time cards and that this access would not be provided to the Government and that oversight is not used to ensure work is being properly charged. Another commenter said it is a customary commercial practice for the seller to grant limited access to records and limited audit rights, *i.e.*, time sheets, invoices, expense reimbursement receipts, etc. This commenter and another commenter said the Government should not have access to contractor employees. Another commenter said it is normal practice for the client to request copies of time cards, along with detailed invoices outlining which individual performed the services, the amount of time that individual spent on those services during the period of the invoice. In addition, the time card would have the respective supervisor approval indicating that the time was properly recorded. The clients also normally require that they have the ability to audit the contractor's records if they so choose.

Response: The Councils believe the Government must have some assurance that the number of hours claimed by the contractor accurately reflects the time spent by the appropriate labor category performing work on the contract and that the amounts paid to the contractor based on actual costs accurately reflect the actual costs paid by the contractor for materials, subcontracts, and other direct costs. Some commenters said their commercial companies do require access to time cards, actual material, and subcontract costs as a condition for T&M contracting. The Councils believe that the rule minimizes access to records to only those documents that are necessary to verify compliance with the contract terms. The Councils do not believe it is appropriate for the Government to simply accept the submitted hours and material/subcontract costs as valid without some type of verification.

f. One commenter noted that the ANPR failed to include sufficient oversight mechanisms to protect the taxpayers' interests. The commenter recommended establishing periodic audits and reporting requirements on the use of D&F in commercial T&M/LH contracts, and requiring approval of the D&F by the head of the contracting authority. Further, the commenter recommended that the Government have access to the contractor books and records; FAR clause 52.215–2, Audit and Records—Negotiation, should be included in all T&M/LH contracts; and contracts should be subject to the cost principles found in FAR Part 31, Contract Cost Principles and Procedures. Another commenter is not opposed to T&M and LH contracts, but opposes the proposed rule because it does not make them subject to full oversight and audit provisions.

Response: The FAR does not provide for periodic audits of contracting officer decisions. The frequency and scope of such audits are under the purview of the agency Inspector General, not the FAR Council. In regards to the application of FAR Part 31, the Councils do not believe such access is necessary because the proposed rule does not provide for reimbursement of indirect costs using actual indirect cost rates. In addition, the rule does provide access to those records necessary to verify those costs that are reimbursed on an actual basis. There is no benefit to extending such access to include all records that are normally accessible for non-commercial contracts. In fact, extending such access would essentially nullify the concept of a commercial contract.

g. One commenter believes substantiation of invoices should be based on commercial practices, rather than relying upon a time card system, ''as presumably identified'' in the DCAA manual. This commenter also believes this is inconsistent with commercial practices regarding audits of cost by requiring timecards pursuant to Government procedures and that SARA does not authorize this extension of Government rights to provide auditors with ''free range with disrupting employees and subcontractor relationships.'' Another commenter asserts that the ''Proposed rule does not include any of the protections that are in the commercial market.'' This commenter believes these ''contract vehicles are high risk and do not include adequate cost controls.''

Response: While these commenters refer to using commercial practices for protection (*e.g.*, for substantiation of invoices), neither commenter provides a description of what that protection is, *i.e.*, how does the commercial customer know the hours or actual costs are a proper reflection of the amounts actually incurred? The Councils believe there must be some verification, and believes that the proposed rule provides the minimum access to records needed to perform that verification. The Councils do not believe that SARA requires the Government to make payments based on actual hours and/or actual costs incurred without some form of verification. The Councils note some commenters said requiring access to time cards, invoices, and subcontract agreements is a standard commercial practice for T&M contracting.

h. One commenter believes that quality assurance is not sufficient to protect taxpayers and that post award audits are necessary. The commenter also expressed concern that currently paragraph (e) of FAR clause 52.232–7 allows for contracting officer requests for audit prior to final payment and that this may contradict other provisions for commercial audits that are not subject to post award audits. Additionally, the commenter said there may be a conflict between 41 U.S.C. 254d(a)(1) and 10 U.S.C. 2313(a) (which allows post award audits) and the FAR provision (which does not expressly allow audits for commercial items). The commenter believes that if a post award audit provision is not included, the contracting officer should be required to provide written justification why one was not included. Further, the commenter said the audit should occur when the contractor notifies the Government that the costs will exceed 85 percent of ceiling. The commenter recommended a price reduction clause to recoup overages identified in audit.

Response: Post-award audits for commercial items are necessary for T&M contracts. The contract clause requires the contractor to substantiate the labor hours and material, subcontract, and other direct costs. The rule provides the necessary access to records to verify compliance with these contract terms.

i. One commenter said the ANPR's suggestion of describing the types of information that may be audited to verify material and subcontract costs (rather than merely repeating the vague ''substantiating material'' description) makes sense. The commenter also said government access to the contractor's employees to verify hours charged is unnecessary, inconsistent with commercial practices, and substantially broader than the Government's rights under the existing T&M payment clause. In the absence of indicia of fraud or other wrongdoing, timecards should be sufficient evidence of hours actually worked. Given the time and expense associated with conducting interviews, the government would likely interview employees only when there was a basis to investigate alleged wrongdoing. In those circumstances, the government could obtain information through subpoenas; a contract clause is therefore unnecessary.

Response: According to some commenters, requiring access to contractor employees is a standard commercial practice for T&M contracting. In addition, the proposed provisions for access to contractor

employees are no broader than what is currently provided for under non-commercial T&M contracts. The relevant access to records provision for current T&M contracts is not the T&M payment clause, but instead is the clause at FAR 52.215–2, Audit and Records—Negotiation, which provides the Government with access to contractor employees. The Government should not have to allege wrongdoing to interview contractor employees when their labor hours are included on invoices submitted to the Government.

j. Commenters at the public meeting said commercial companies do not keep payment records three years after contract completion.

Response: The requirement at paragraph (d)(2) of FAR clause 52.212–5 for contractors to maintain the payment records three years after contract completion is a statutory requirement that provides for Comptroller General examination of records under contracts for commercial items.

13. *Nonconforming.*

a. One commenter said it may be extremely difficult for the Government to enforce the defects language after the contractor invoices and the Government accepts the labor, as opposed to accepting the tangible products generated by the labor, because the Government will have a difficult time proving, after the fact, that the labor was defective or otherwise unacceptable unless the Government can prove fraudulent timekeeping practices or sloth on the part of the contractor or its employees can be proven. The commenter also said if the contractor provides the correct mix of labor skills and the service is provided in accordance with the statement of work, the contractor should bear no burden for corrections and that it would be hard to reject or prove the services were non-conforming after payment since the Government evaluates, interviews, and approves contractor personnel. Another commenter said it is reasonable to expect the contractor to be responsible for the correction of any non-conforming contract requirement, if it is determined to be the fault of the contractor.

Response: The Councils agree that it may be difficult to prove services are nonconforming on a commercial T&M/LH contract after the contractor has invoiced the Government and the Government has accepted and paid for the labor. The Councils note the current FAR coverage, while previously applicable only to commercial FFP contracts, provides post acceptance remedies for nonconforming services. The rule simply adds additional remedies to address situations when reperformance will not correct the defect or is not possible to reperform.

b. One commenter recommended replacing the word ''may'' with ''should'' in the third and sixth lines of paragraph (a) at FAR clause 52.212–4 because Government officials should be encouraged to seek consideration for nonconforming services and should be required to ensure that the contractor's future performance conforms to the contract requirements. The commenter also recommended revising proposed paragraph 52.212–4, Alternate I (a), to include the word ''should'' instead of ''may'' in the seventh, twelfth, and fifteenth lines for the same reasons.

Response: The use of the term ''may'' is consistent with the existing terminology for commercial FFP contracts, *i.e.*, paragraph (a) at FAR clause 52.212–4, which states the ''Government may require repair or replacement of nonconforming supplies or reperformance of nonconforming services at no increase in contract price.'' The Government should seek consideration when appropriate. However, the Councils believe the term ''may'' provides the contracting officer sufficient latitude to exercise their judgment while managing the contract. The Councils did, however, revise the rule to clarify that the Government may seek either ''an equitable price adjustment or adequate'' consideration and deleted the language that allowed the Government to require the contractor to ensure future performance conforms to contract requirements because the Councils believe that this language is unnecessary since the Government already has this right through the use of a cure notice.

c. One commenter said commercial T&M agreements include a warranty and a disclaimer of any other remedies as permitted under the UCC. Another commenter said seeking consideration for acceptance of nonconforming supplies or services is a right of the Government under common law so there is no need to include such a provision in the clause.

Response: Remedies, including warranty provisions, vary by industry, service and products. The FAR routinely includes rights covered under common law in contract clauses to ensure all parties are cognizant of their rights and responsibilities.

d. One commenter said the requirement for contractors to repair or replace rejected supplies or reperform rejected services at no cost to the Government imposes more contract risk on the contractor than the non-commercial clause which does not require repair or reperformance at no cost to the Government, essentially imposing a fixed-price level of risks. The commenter further said combining a ceiling price that contractors exceed at their own risk and a requirement that the contractor use ''best efforts'' to perform within the ceiling price may result in contractors interpreting the clause to requirement to mean accomplish a certain result, *i.e.*, ''performance of the work specified in the Schedule'' within a specified dollar amount, *i.e.*, the ceiling price. The commenter recommended allowing contracting officers, where appropriate, to compensate contractors for reperformance or repair of deficient services or supplies up to the ceiling price, but not including profit, to be consistent with the non-commercial clause and to more accurately reflect standard commercial practices. Two commenters also recommended that replacement of nonconforming supplies or re-performance should be at no increase in contract price, allowing the contractor to re-perform up to the agreed upon ceiling price. Another commenter said the proposed rule establishes a contractor-friendly threshold because the contractor is agreeing to use its best efforts to perform work and T&M contracts pay for time or money spent, not milestones reached or work completed. Commenter states this is main difference between commercial practices and proposed rule.

Response: The Councils agree that contractors are generally only required to use ''best efforts'' to accomplish the desired results within the established ceiling price on both commercial and non-commercial T&M contracts as opposed to FFP contracts which requires contractors to accomplish stated results within the fixed price. The non-commercial T&M/LH clause does allow contractor to be paid for reperformance, without profit, up to the ceiling price (or the ceiling price as increased by the Government) unless the contractor fails to proceed with reasonable promptness to reperform within the ceiling price (or the ceiling price as increased by the Government), in which case, the Government may charge the contractor reperformance costs or terminate the contract for default. Additionally, the noncommercial clause only allows the Government to require the contractor to remedy without reimbursement in very limited situations such as fraud and willful misconduct. Since contractors are only required to use ''best efforts'' within the established ceiling price for

T&M and LH contracts, the Councils agree contractors should be paid for reperformance, without profit, up to the ceiling price. The Councils revised the proposed rule to be consistent with the provisions for noncommercial T&M contracts at FAR clause 52.246–6. However, since contracting officers will not necessarily know the proposed profit in competitive awards, the Councils revised the noncommercial T&M provisions to require contracting officers to specify a profit decrement in paragraph (a)(4) of the clause. Unless otherwise specified by the contracting officer, the labor rates will be reduced by 10 percent to exclude profit.

e. Another commenter said that its commercial contracts include normal commercial warranties that cover workmanship and materials. Under these provisions, a buyer can make a warranty claim and, if deemed valid, the servicing company would re-perform the work at no charge. Another commenter said surveillance/QC/Inspections for T&M and LH commercial contracts versus those of commercial FP contracts do not vary. Contractors are responsible for performance to minimum stated levels of completion and quality. Reviews of performance by the customer are the same regardless of the type of contract executed.

Response: When the commercial warranties adequately cover workmanship and materials, there is generally no need to include additional requirements addressing non-conforming supplies or services. In other instances, commercial warranties may not exist or may not adequately address the contract requirements. In such cases, the Government needs provisions to address non-conforming supplies and services. As such, the rule provides remedies for non-conforming supplies and services that are consistent with those provided for under non-commercial contracts.

14. *Termination*.

a. One commenter recommended revising FAR 12.403 to specify the amounts recoverable upon termination for convenience of a T&M or LH contract for commercial services because the ANPR did not adequately address a contractor's need to recover material costs in a termination for convenience.

Response: As provided in FAR 12.403(d)(ii), which also applies to commercial FFP contracts, contractors can recover ''any charges the contractor can demonstrate directly resulted from the termination.'' While material costs are not specifically addressed in this coverage, a contractor would recover the costs if the contractor is able to demonstrate the costs were incurred in support of the contract and the costs are otherwise allowable in accordance with the proposed language at paragraph (i)(1)(ii) of FAR clause 52.212–7.

b. One commenter said the concept of termination for convenience is inconsistent with commercial practices and would be considered a breach of contract, with damages, in the commercial marketplace. The commenter also said amount of damages would be negotiated or established in a lawsuit and would not be limited to reasonable charges the contractor can demonstrate to the satisfaction of the Government using its standard record keeping system. Another commenter said few, if any, commercial T&M contracts include right of immediate termination as is proposed. Further, the commenter said the Government should compensate for additional costs beyond hours worked as is provided for in FAR 12.403(d)(ii) and that the termination clause should mirror those used in the commercial marketplace which generally require 30 to 90 days termination notice with no cap on compensation.''

Response: The Councils recognize that terminations for convenience are not standard commercial practice. However, to protect the public's interest, the Government must retain the right to terminate a contract when the product or service is no longer needed or funds are not available. The Councils note the FAR already contains the provisions for terminating commercial contracts at the Government's convenience. The proposed rule simply provides the basis for calculating labor costs on a terminated commercial T&M/LH contract.

15. *CAS Applicability*.

a. One commenter said CAS coverage needs to be extended to commercial contracts when the contractor is already CAS covered. Another commenter said many commercial companies do not require employees to record all time worked and that these companies' labor charging systems will not be tied to a CAS compliant accounting system. The commenter said requiring commercial companies to comply with CAS flies in the face of commercial item reform. Another commenter stated that CAS should continue to apply to all T&M/LH contracts to protect taxpayers' interests by ensuring consistent accounting treatment, proper allocation of costs to contracts, and preparation of reliable cost estimates. Another commenter said application of CAS is unnecessary and would have adverse consequences. This commenter noted that commercial contractors that sell exclusively in the commercial marketplace most likely do not have accounting systems configured to comply with CAS and may decline to perform commercial services for the government on a T&M or LH basis. Accordingly, CAS rules should be amended to exempt commercial services purchased under T&M or LH contracts from its coverage. Another commenter said they see no particular difference between the contract types as to the applicability of CAS. Another commenter said commercial systems are set up to support commercial transactions, not to comply with CAS clauses in Government contracts. Thus, this commenter asserted, such clauses would not be acceptable. One commenter stated CAS should not apply to commercial item acquisitions and that the CAS Board did not fully implement FARA since FARA exempted all contract for commercial items from CAS requirements. Another commenter said that if CAS applies to commercial T&M/LH contracts, the government will effectively eliminate most commercial contractors from competition for these types of contracts. Another commenter said that CAS should not apply and all that should be required from contractors is an adequate accounting system for recording hours and material purchases.

Response: Revisions to CAS requirements is beyond the scope of this case. The Councils will forward the comments to the CAS Board for the Board's consideration.

b. One commenter said that the ''Councils'' infer that they (the Councils) have some authority to amend or interpret CAS, as evidenced by the Councils soliciting public comments based on the assumption that CAS will not apply to commercial T&M/LH contracts.

Response: The **Federal Register** notice is very clear that any actions regarding the Cost Accounting Standards would need to be taken by the CAS Board. In paragraph (3) of Section C, Regulatory Amendments under Consideration, the Notice states the following:

> The need for potential amendments to the current CAS exemption for commercial items is being considered. Temporary waivers are subject to approval by the CAS Board. Permanent exemptions are subject to the regulatory promulgation process and are codified in 48 CFR Chapter 99. No changes to FAR 12.214 are reflected in the draft amendment that is being published with this notice. However, FAR 12.214 will be revised to reflect any actions that are taken by the CAS Board. Any public comments addressing CAS will be provided to the CAS Board for consideration.

16. *General Comments*.

a. One commenter said the Councils were too restrictive when they implemented Section 8002(d) of FASA (Pub. L. 103–355) because there is no statutory prohibition against the use of T&M/LH contracts. The commenter requested the Councils to take this opportunity to revisit this question and amend the FAR to permit use of T&M/LH contracts to acquire any commercial item.

Response: Congress was well aware of the FAR requirements that limit the available contract types for commercial items when it drafted Section 1432 of the National Defense Authorization Act for Fiscal Year 2004. If Congress disagreed with the Council implementation of FASA, the Councils believe Congress would have expanded Section 1432 to specifically authorize T&M/LH contracts for commercial items. The Councils do not believe it is appropriate to expand contract types for commercial items without specific statutory authority.

b. One commenter questioned why the minutes posted by the Councils from the Public Meeting did not include the detailed questions and answers discussed at the Public Meeting. Specifically, the commenter was concerned that the minutes failed to recognize the discussion on how to conduct market research to determine if the service was sold in the commercial marketplace using T&M or LH contracts.

Response: The purpose of the public meeting was to allow the public to provide input on the effective use of T&M and LH contracts for the acquisition of commercial items and suggestions for implementing the provisions of the SARA legislation for the Council's consideration. While the Councils did record and post the general topics that were discussed at the meeting, the Councils did not record or post the detailed discussions from the meeting. The ANPR and the proposed rule contain provisions that require the contracting officer to consider various customary practices, including contract type, when conducting market research. Detailed instructions for how to conduct market research are not contained in the FAR because the instructions would vary based on the unique aspects of the acquisition. More specific instructions are appropriately contained in agency training materials.

c. One commenter said that the proposed rulemaking should be designated as a major rule under the Congressional Review Act and economically significant under Executive Order 12866. The commenter also states that the assessment of benefits, costs and reasonable alternatives should be conducted assuming applicability and inapplicability of Cost Accounting Standards (CAS) and reviewed by Agency attorneys, economists, engineers and scientists.

Response: As required in the regulatory process, OMB's Office of Information Regulatory Affairs reviewed the rule to ensure the requirements of Executive Order 12866 were fully met.

d. One commenter noted that the ANPR failed to eliminate what the commenter considers the current illegal use of commercial T&M/LH contracts by GSA by declaring commercial T&M/LH contracts executed in violation of FAR 12.207 null and void.

Response: The rule implements Section 1432 of Public Law 108–136. Questions over legality of actions agencies may have taken prior to this authority are beyond the scope and authority of the Councils.

e. One commenter said the FAR Council has exceeded its statutory authority under SARA by adding clauses and requirements that are not consistent with the requirements of Section 8002 of Public Law 103–355 which limit the contract clauses, to the maximum extent practicable, to those required to implement provisions of law or executive orders or those determined to be consistent with standard commercial practice.

Response: The Councils believe it limited the contract clauses to the ''maximum extent practicable'' to those required to implement the SARA legislation for commercial T&M and LH contracts. The Councils acknowledge it added a limited number of provisions not specifically mandated by the SARA legislation (such as consent to subcontract); however, the Councils believe that the provisions are needed to protect the Government and are, to the maximum extent practicable, consistent with commercial practice. FASA acknowledges that additional contract clauses may be required by including the phrase ''to the maximum extent practicable.''

f. One commenter identified industry best practices of close communication and cooperation between buyer and seller, using a project management team that is well versed in the types of services involved, and establishing Forward Pricing Rate Agreements with firms frequently contracted with for T&M/LH to reduce the time and effort involved in contract formation and administration.

Response: The Councils thank the commenter for the identified best practices. The Councils agree close communication, cooperation, and knowledge of the type of services are necessary for any successful procurement. The Councils note, however, that commercial T&M and LH contracts will be awarded using competitive procedures and establishing forward pricing rate agreements is not necessary and contrary to competitive procedures.

g. One commenter requested that the Councils consider customary commercial pricing concepts for acquiring commercial services to be consistent with the tenets of FAR Part 12 and existing statutes. FAR Part 12 encourages the consideration of commercial practices when acquiring commercial services. As an example, the commenter identified GSA's recent multi-channel contact center contract, which involved acquiring commercial telecommunication services on a price per unit or price per minute basis.

Response: The rule does not prohibit the use of a wide variety of commercial pricing practices including the example given by the commenter.

h. Two commenters recommended that the final rule explicitly state that the rule only applies to contracts executed on or after the effective date of the rule. In addition, one of the commenters said the rule should not apply to task orders under IDIQ commercial contracts in existence at the time of the rule's effective date unless mutually agreed to in writing by all parties.

Response: The standard FAR conventions at FAR 1.108(d) apply. As the rule does not specify otherwise, the FAR changes apply to solicitations issued after the effective date of the change. However, the Councils note the FAR allows contracting officers to make changes in existing contracts with appropriate considerations and mutual consent of the parties.

This is not a significant regulatory action and, therefore, was not subject to review under Section 6(b) of Executive Order 12866, Regulatory Planning and Review, dated September 30, 1993. This rule is not a major rule under 5 U.S.C. 804.

B. Regulatory Flexibility Act

The changes may have a significant economic impact on a substantial number of small entities within the meaning of the Regulatory Flexibility Act, 5 U.S.C. 601, *et seq.*, because small entities that have not bid on non-commercial T&M/LH contracts in the past may be induced to bid on commercial T&M/LH contracts. An Initial Regulatory Flexibility Analysis (IRFA) has been prepared. The analysis is summarized as follows:

Initial Regulatory Flexibility Analysis

1. Description of the reasons why action by the agency is being considered. This proposed rule would revise the Federal Acquisition Regulation to allow contracting officers to award Time and Material and Labor Hour (T&M/LH) contracts when procuring commercial items. The proposed rule is required by Section 1432 of the National Defense Authorization Act for Fiscal Year 2004 (Pub. L. 108–136).

2. Succinct statement of the objectives of, and legal basis for, the proposed rule. This proposed rule implements Section 1432 of the National Defense Authorization Act for Fiscal Year 2004 (Pub. L. 108–136), which authorized the use of Time and Material or Labor Hour (T&M or LH) contracts for commercial services acquired in support of a commercial item, and any other category of services that is designated by the Administrator of OFPP as being of a type commonly sold to the general public on a T&M or LH basis, and would be in the best interest of the Government to acquire such services on a T&M or LH basis.

3. Description of, and, where feasible, estimate of the number of small entities to which the proposed rule will apply. The changes may have a significant economic impact on a substantial number of small entities within the meaning of the Regulatory Flexibility Act, 5 U.S.C. 601, *et seq.*, because the use of commercial practices will allow additional small businesses that do not maintain records that are adequate for cost reimbursement contracting to compete for commercial T&M/LH contracts. At this time, there is no way to predict the number of procurements that will be awarded using commercial T&M/LH contracts, nor is there a method available to estimate the number of small entities that may be influenced by this change to begin competing for these types of contracts.

4. **Description of projected reporting, record keeping, and other compliance requirements of the proposed rule, including an estimate of the classes of small entities which will be subject to the requirement and the type of professional skills necessary for preparation of the report or record.** The rule would require contractors to maintain records to support invoices presented to the Government for payment. Such records would include original timecards, the contractor's timekeeping procedures, distribution of labor, invoices for material, and so forth. These are standard records maintained by any company, large or small, and the fact that the contract would require that these records be made available to the Government should not place any additional record keeping burden on the entity.

5. Identification, to the extent practicable, of all relevant Federal rules which may duplicate, overlap, or conflict with the proposed rule. There are no Federal rules that duplicate, overlap or conflict with the proposed rule.

6. Description of any significant alternatives to the proposed rule which accomplish the stated objectives of applicable statutes and which minimize any significant economic impact of the proposed rule on small entities. There are not any alternatives to publishing this proposed rule that will accomplish the stated objectives of Section 1432 of the National Defense Authorization Act for Fiscal Year 2004 (Pub. L. 108–136). The rule includes only FAR text revisions required to implement the statute cited herein.

The FAR Secretariat has submitted a copy of the IRFA to the Chief Counsel for Advocacy of the Small Business Administration. A copy of the IRFA may be obtained from the FAR Secretariat. The Councils will consider comments from small entities concerning the affected FAR parts 2, 10, 12, 16, 44, and 52, in accordance with 5 U.S.C. 610. Comments must be submitted separately and should cite 5 U.S.C. 601, *et seq.* (FAR case 2003–027), in correspondence.

C. Paperwork Reduction Act

The Paperwork Reduction Act does not apply because the proposed changes to the FAR do not impose information collection requirements that require the approval of the Office of Management and Budget under 44 U.S.C. 3501, *et seq.*

List of Subjects in 48 CFR Parts 2, 10, 12, 16, 44, and 52

Government procurement.

Dated: September 16, 2005.

Julia B. Wise,

Director, Contract Policy Division.

Therefore, DoD, GSA, and NASA propose amending 48 CFR parts 2, 10, 12, 16, 44, and 52 as set forth below:

1. The authority citation for 48 CFR parts 2, 10, 12, 16, 44, and 52 is revised to read as follows:

Authority: 40 U.S.C. 121(c); 10 U.S.C. chapter 137; and 42 U.S.C. 2473(c).

PART 2—DEFINITIONS OF WORDS AND TERMS

2.101 [Amended]

2. Amend section 2.101 in paragraph (b), in the definition ''Commercial item'', by removing the second sentence in the introductory text of paragraph (6).

PART 10—MARKET RESEARCH

10.001 [Amended]

3. Amend section 10.001 by removing from paragraph (a)(3)(iv) ''as terms'' and adding ''as type of contract, terms'' in its place.

4. Amend section 10.002 by revising paragraph (b)(1)(iii) to read as follows:

10.002 Procedures.

* * * * *

(b)* * *

(1)* * *

(iii) Customary practices, including warranty, buyer financing, discounts, contract type considering the nature and risk associated with the requirement, etc., under which commercial sales of the products or services are made;

* * * * *

PART 12—ACQUISITION OF COMMERCIAL ITEMS

5. Revise section 12.207 to read as follows:

12.207 Contract type.

(a) Except as provided in paragraph (b) of this section, agencies shall use firm-fixed-price contracts or fixed-price contracts with economic price adjustment for the acquisition of commercial items.

(b)(1) A time-and-materials contract or labor-hour contract (see Subpart 16.6) may be used for the acquisition of commercial services when—

(i) The service is acquired under a contract awarded using competitive procedures; and

(ii) The contracting officer—

(A) Executes a determination and findings (D&F) for the contract, in accordance with paragraph (b)(2) of this section (but see paragraph (c) of this section for indefinite-delivery contracts), that no other contract type authorized by this subpart is suitable;

(B) Includes a ceiling price in the contract or order that the contractor exceeds at its own risk; and

(C) Authorizes any subsequent change in the ceiling price only upon a determination, documented in the contract file, that it is in the best interest of the procuring agency to change the ceiling price.

(2) Each D&F required by paragraph (b)(1)(ii)(A) of this section shall contain sufficient facts and rationale to justify that no other contract type authorized by this subpart is suitable. At a minimum, the D&F shall—

(i) Include a description of the market research conducted (see 10.002(e));

(ii) Establish that it is not possible at the time of placing the contract or order to accurately estimate the extent or duration of the work or to anticipate costs with any reasonable degree of certainty; and

(iii) Establish that the requirement has been structured to maximize the use of fixed price contracts (e.g., by limiting the value or length of the Time and Material/Labor Hour contract or order) on future acquisitions for the same or similar requirements.

(c)(1) Indefinite-delivery contracts (see Subpart 16.5) may be used when—

(i) The prices are established based on a firm-fixed-price or fixed-price with economic price adjustment; or

(ii) Rates are established for commercial services acquired on a time-and-materials or labor-hour basis.

(2) When an indefinite-delivery contract is awarded with services priced on a time-and-materials or labor-hour basis, contracting officers shall, to the maximum extent practicable, also structure the contract to allow issuance of orders on a firm-fixed-price or fixed-price with economic price adjustment basis. For such contracts, the contracting officer shall execute the D&F required by paragraph (b)(2) of this section, for each order placed on a time-and-materials or labor-hour basis. Placement of orders shall be in accordance with Subpart 16.5.

(3) If an indefinite-delivery contract only allows for the issuance of orders on a time-and-materials or labor-hour basis, the D&F required by paragraph (b)(2) of this section shall be executed to support the basic contract and shall also explain why providing for an alternative firm-fixed-price or fixed-price with economic price adjustment pricing structure is not practicable. The D&F for this contract shall be approved one level above the contracting officer. Placement of orders shall be in accordance with Subpart 16.5.

(d) The contract types authorized by this subpart may be used in conjunction with an award fee and performance or delivery incentives when the award fee or incentive is based solely on factors other than cost (see 16.202–1 and 16.203–1).

(e) Use of any contract type other than those authorized by this subpart to acquire commercial items is prohibited.

6. Add section 12.216 to read as follows:

12.216 Subcontract consent.

(a) When a time and materials or labor hour contract is awarded pursuant to 12.207(b), Alternate I to the clause at 52.212–4 is used. Alternate I includes a subcontract consent provision that requires the contractor to obtain the contracting officer's consent prior to awarding certain subcontracts.

(b) When the contractor has an approved purchasing system, the contracting officer shall identify, in an addendum to the clause, those subcontracts that will require consent.

(c) When the contractor does not have an approved purchasing system, the contracting officer shall identify, in an addendum to the clause—

(1) Those subcontracts reviewed during proposal evaluation for which consent is not required after contract award;

(2) Those subcontracts for which consent is not required by the clause, but which the contracting officer has determined that an individual consent action is required to protect the Government; and

(3) Any other exceptions to the standard consent requirements.

(d) The contracting officer shall consider the risk, complexity and dollar value of anticipated subcontracts when determining the consent requirements.

7. Amend section 12.301 by revising paragraph (b)(3) to read as follows:

12.301 Solicitation provisions and contract clauses for the acquisition of commercial items.

* * * * *

(b)* * *

(3) The clause at 52.212–4, Contract Terms and Conditions—Commercial Items. This clause includes terms and conditions which are, to the maximum extent practicable, consistent with customary commercial practices and is incorporated in the solicitation and contract by reference (see Block 27, SF 1449). Use this clause with its Alternate I when a time and materials or labor hour contract will be awarded. The contracting officer may tailor this clause in accordance with 12.302, except that paragraph (u) of Alternate I may be tailored only for indefinite delivery contracts and only to indicate that subcontract consent requirements apply to individual orders and not the basic contract.

* * * * *

8. Amend section 12.403 by revising paragraph (d)(1)(i) to read as follows:

12.403 Termination.

* * * * *

(d)* * *

(1)* * *

(i)(A) The percentage of the contract price reflecting the percentage of the work performed prior to the notice of the termination for fixed price or fixed price with economic price adjustment contracts; or

(B) An amount for direct labor hours (as defined in the Schedule of the contract) determined by multiplying the number of direct labor hours expended before the effective date of termination by the hourly rate(s) in the Schedule; and

* * * * *

PART 16—TYPES OF CONTRACTS

9. Amend section 16.601 by adding a sentence at the end of the introductory text of paragraph (b) to read as follows:

16.601 Time-and-materials contracts.

* * * * *

(b) *Application.* * * * See 12.207(b) for the use of time-and-material contracts for certain commercial services.

* * * * *

10. Amend section 16.602 by adding a sentence at the end of the paragraph to read as follows:

16.602 Labor-hour contracts.

* * * See 12.207(b) for the use of labor hour contracts for certain commercial services.

PART 44—SUBCONTRACTING POLICIES AND PROCEDURES

11. Amend section 44.302 by revising the second sentence of paragraph (a) to read as follows:

44.302 Requirements.

(a)* * * If a contractor's sales to the Government (excluding competitively awarded firm-fixed-price and competitively awarded fixed-price with economic price adjustment contracts and firm-fixed price or fixed-price with economic price adjustment sales of commercial items pursuant to Part 12) are expected to exceed $25 million during the next 12 months, perform a review to determine if a CPSR is needed.* * *

* * * * *

12. Amend section 44.303 by revising the second sentence of the introductory paragraph to read as follows:

44.303 Extent of review.

* * * Unless segregation of subcontracts is impracticable, this evaluation shall not include subcontracts awarded by the contractor exclusively in support of Government contracts that are competitively awarded firm-fixed-price, competitively awarded fixed-price with economic price adjustment, or firm-fixed price or fixed-price with economic price adjustment awarded for commercial items pursuant to Part 12.* * *

* * * * *

PART 52—SOLICITATION PROVISIONS AND CONTRACT CLAUSES

13. Amend section 52.212–4 by—

a. Revising the date of the clause;

b. Adding a new fourth sentence to the introductory text of paragraph (a) of the clause; and

c. Adding Alternate I to read as follows:

52.212–4 Contract Terms and Conditions—Commercial Items.

* * * * *

CONTRACT TERMS AND CONDITIONS—COMMERCIAL ITEMS (DATE)

(a) *Inspection/Acceptance.** * * If repair/replacement or reperformance will not correct the defects or is not possible, the

Government may seek an equitable price reduction or adequate consideration for acceptance of nonconforming supplies or services.* * *

* * * * *

Alternate I (Date). When a time and materials or labor-hour contract is contemplated, substitute the following paragraphs (a), (e), (i) and (l) for those in the basic clause and add the following paragraph (u) to the basic clause.

(a) *Inspection/Acceptance.* (1) The Government has the right to inspect and test all materials furnished and services performed under this contract, to the extent practicable at all places and times, including the period of performance, and in any event before acceptance. The Government may also inspect the plant or plants of the Contractor or any subcontractor engaged in contract performance. The Government will perform inspections and tests in a manner that will not unduly delay the work.

(2) If the Government performs inspection or tests on the premises of the Contractor or a subcontractor, the Contractor shall furnish and shall require subcontractors to furnish all reasonable facilities and assistance for the safe and convenient performance of these duties.

(3) Unless otherwise specified in the contract, the Government will accept or reject services and materials at the place of delivery as promptly as practicable after delivery, and they will be presumed accepted 60 days after the date of delivery, unless accepted earlier.

(4) At any time during contract performance, but not later than 6 months (or such other time as may be specified in the contract) after acceptance of the services or materials last delivered under this contract, the Government may require the Contractor to replace or correct services or materials that at time of delivery failed to meet contract requirements. Except as otherwise specified in paragraph (a)(6) of this clause, the cost of replacement or correction shall be determined under paragraph (i) of this clause, but the ''hourly rate'' for labor hours incurred in the replacement or correction shall be reduced to exclude that portion of the rate attributable to profit. Unless otherwise specified below, the portion of the ''hourly rate'' attributable to profit shall be 10 percent. The Contractor shall not tender for acceptance materials and services required to be replaced or corrected without disclosing the former requirement for replacement or correction, and, when required, shall disclose the corrective action taken.

[*Insert portion of labor rate attributable to profit.*]

(5)(i) If the Contractor fails to proceed with reasonable promptness to perform required replacement or correction, and if the replacement or correction can be performed within the ceiling price (or the ceiling price as increased by the Government), the Government may—

(A) By contract or otherwise, perform the replacement or correction, charge to the Contractor any increased cost, or deduct such increased cost from any amounts paid or due under this contract; or

(B) Terminate this contract for cause.

(ii) Failure to agree to the amount of increased cost to be charged to the Contractor shall be a dispute under the Disputes clause of the contract.

(6) Notwithstanding paragraphs (a)(4) and (a)(5) of this clause, the Government may at any time require the Contractor to remedy by correction or replacement, without cost to the Government, any failure by the Contractor to comply with the requirements of this contract, if the failure is due to—

(i) Fraud, lack of good faith, or willful misconduct on the part of the Contractor's managerial personnel; or

(ii) The conduct of one or more of the Contractor's employees selected or retained by the Contractor after any of the Contractor's managerial personnel has reasonable grounds to believe that the employee is habitually careless or unqualified.

(7) This clause applies in the same manner and to the same extent to corrected or replacement materials or services as to materials and services originally delivered under this contract.

(8) The Contractor has no obligation or liability under this contract to correct or replace materials and services that at time of delivery do not meet contract requirements, except as provided in this clause or as may be otherwise specified in the contract.

(9) Unless otherwise specified in the contract, the Contractor's obligation to correct or replace Government-furnished property shall be governed by the clause pertaining to Government property.

* * * * *

(e) *Definitions.* (1) The clause at FAR 52.202–1, Definitions, is incorporated herein by reference. As used in this clause—

Approved purchasing system means a Contractor's purchasing system that has been reviewed and approved in accordance with Part 44 of the Federal Acquisition Regulation (FAR).

Consent to subcontract means the Contracting Officer's written consent for the Contractor to enter into a particular subcontract.

Direct materials means 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.

Materials means—

(1) Direct materials, including supplies and services transferred between divisions, subsidiaries, or affiliates of the contractor under a common control;

(2) Subcontracts for supplies and services;

(3) Other direct costs (*e.g.*, travel, computer usage charges, etc.); or

(4) Indirect costs specifically provided for in this clause.

Subcontract means any contract, as defined in FAR Subpart 2.1, entered into by a subcontractor to furnish supplies or services for performance of the prime contract or a subcontract. It includes, but is not limited to, purchase orders, and changes and modifications to purchase orders.

* * * * *

(i) *Payments.* (1) *Services accepted.* Payment shall be made for services accepted by the Government that have been delivered to the delivery destination(s) set forth in this contract. The Government will pay the Contractor as follows upon the submission of commercial invoices approved by the Contracting Officer:

(i) *Hourly rate.* The amounts shall be computed by multiplying the appropriate hourly rates prescribed in the contract by the number of direct labor hours performed. Fractional parts of an hour shall be payable on a prorated basis. Invoices may be submitted once each month (or at more frequent intervals, if approved by the Contracting Officer) to the Contracting Officer or the Contracting Officer's representative. When requested by the Contracting Officer or the Contracting Officer's representative, the Contractor shall substantiate invoices (including any subcontractor hours reimbursed at the hourly rate in the schedule) by evidence of actual payment, individual daily job timecards, records that verify the employees meet the qualifications for the labor categories specified in the contract, or other substantiation specified in the contract. Unless the Schedule prescribes otherwise, the hourly rates in the Schedule shall not be varied by virtue of the Contractor having performed work on an overtime basis. If no overtime rates are provided in the Schedule and the Contracting Officer approves overtime work in advance, overtime rates shall be negotiated. Failure to agree upon these overtime rates shall be treated as a dispute under the Disputes clause of this contract. If the Schedule provides rates for overtime, the premium portion of those rates will be reimbursable only to the extent the overtime is approved by the Contracting Officer.

(ii) *Materials.* (A) If the Contractor furnishes its own materials that meet the definition of a commercial item at 2.101, the price to be paid for such materials shall be the Contractor's established catalog or the market price, adjusted to reflect the—

(*1*) Quantities being acquired; and

(*2*) Actual cost of any modifications necessary because of contract requirements.

(B) *Subcontracts.* (*1*) Unless the subcontractor is listed in paragraph (i)(1)(ii)(B)(*2*) of this clause, subcontract costs will be reimbursed at actual costs as specified in (i)(1)(ii)(C) of this clause.

(*2*) Provided the subcontract agreement requires the contractor to substantiate the subcontract hours and employee qualification, the contractor shall be reimbursed at the hourly rates prescribed in the schedule for the following subcontractors: [*Insert subcontractor name(s) or, if no subcontracts are to be reimbursed at the hourly rates prescribed in the schedule, ''None.'' If this is an indefinite delivery contract, the Contracting Officer may insert ''Each order must list separately the subcontractor(s) for that order or, if no subcontracts under that order are to be reimbursed at the hourly rates prescribed in the schedule, insert 'None'.''*]

(C) Except as provided for in paragraphs (i)(1)(ii)(A) and (B) of this clause, the Government will reimburse the Contractor the actual cost of materials (less any rebates, refunds, or discounts received by or accrued to the contractor) provided the Contractor—

(*1*) Has made payments for materials in accordance with the terms and conditions of the agreement or invoice; or

(*2*) Makes these payments within 30 days of the submission of the Contractor's payment request to the Government and such payment is in accordance with the terms and conditions of the agreement or invoice.

(D) To the extent able, the Contractor shall—

(*1*) Obtain materials at the most advantageous prices available with due regard to securing prompt delivery of satisfactory materials; and

(*2*) Give credit to the Government for cash and trade discounts, rebates, scrap, commissions, and other amounts that have accrued to the benefit of the Contractor, or would have accrued except for the fault or neglect of the Contractor.

(E) *Other Costs*. Unless listed below, other direct and indirect costs will not be reimbursed.

(*1*) *Other Direct Costs*. The Government will reimburse the Contractor on the basis of actual cost for the following, provided such costs comply with the requirements in paragraph (i)(1)(ii)(C) of this clause: [*Insert each element of other direct costs (e.g., travel, computer usage charges, etc.) Insert ''None'' if no reimbursement for other direct costs will be provided*.]

(*2*) *Indirect Costs (Material Handling, Subcontract Administration, etc.)*. The Government will reimburse the Contractor for indirect costs on a pro-rata basis over the period of contract performance at the following fixed price: [*Insert a fixed amount for the indirect costs and payment schedule. Insert ''$0'' if no fixed price reimbursement for indirect costs will be provided*.]

(2) *Total cost*. It is estimated that the total cost to the Government for the performance of this contract shall not exceed the ceiling price set forth in the Schedule and the Contractor agrees to use its best efforts to perform the work specified in the Schedule and all obligations under this contract within such ceiling price. If at any time the Contractor has reason to believe that the hourly rate payments and material costs that will accrue in performing this contract in the next succeeding 30 days, if added to all other payments and costs previously accrued, will exceed 85 percent of the ceiling price in the Schedule, the Contractor shall notify the Contracting Officer giving a revised estimate of the total price to the Government for performing this contract with supporting reasons and documentation. If at any time during the performance of this contract the Contractor has reason to believe that the total price to the Government for performing this contract will be substantially greater or less than the then stated ceiling price, the Contractor shall so notify the Contracting Officer, giving a revised estimate of the total price for performing this contract, with supporting reasons and documentation. If at any time during performing this contract, the Government has reason to believe that the work to be required in performing this contract will be substantially greater or less than the stated ceiling price, the Contracting Officer will so advise the Contractor, giving the then revised estimate of the total amount of effort to be required under the contract.

(3) *Ceiling price*. The Government will not be obligated to pay the Contractor any amount in excess of the ceiling price in the Schedule, and the Contractor shall not be obligated to continue performance if to do so would exceed the ceiling price set forth in the Schedule, unless and until the Contracting Officer notifies the Contractor in writing that the ceiling price has been increased and specifies in the notice a revised ceiling that shall constitute the ceiling price for performance under this contract. When and to the extent that the ceiling price set forth in the Schedule has been increased, any hours expended and material costs incurred by the Contractor in excess of the ceiling price before the increase shall be allowable to the same extent as if the hours expended and material costs had been incurred after the increase in the ceiling price.

(4) *Access to records*. At any time before final payment under this contract, the Contracting Officer (or authorized representative) will have access to the following (access shall be limited to the listing below unless otherwise agreed to by the Contractor and the Contracting Officer):

(i) Records that verify the employees whose time has been included in any invoice meet the qualifications for the labor categories specified in the contract;

(ii) For labor hours (including any subcontractor hours reimbursed at the hourly rate in the schedule), when timecards are required as substantiation for payment—

(A) The original timecards;

(B) The Contractor's timekeeping procedures;

(C) Contractor records that show the distribution of labor between jobs or contracts; and

(D) Employees whose time has been included in any invoice for the purpose of verifying that these employees have worked the hours shown on the invoices.

(iii) For material and subcontract costs that are reimbursed on the basis of actual cost—

(A) Any invoices or subcontract agreements substantiating material costs; and

(B) Any documents supporting payment of those invoices.

(5) *Overpayments/Underpayments*. (i) Each payment previously made shall be subject to reduction to the extent of amounts, on preceding invoices, that are found by the Contracting Officer not to have been properly payable and shall also be subject to reduction for overpayments or to increase for underpayments. The Contractor shall promptly pay any such reduction within 30 days unless the parties agree otherwise. The Government within 30 days will pay any such increases, unless the parties agree otherwise. Payment will be made by check. If the Contractor becomes aware of a duplicate invoice payment or that the Government has otherwise overpaid on an invoice payment, the Contractor shall immediately notify the Contracting Officer and request instructions for disposition of the overpayment.

(ii) Upon receipt and approval of the invoice designated by the Contractor as the ''completion invoice'' and supporting documentation, and upon compliance by the Contractor with all terms of this contract, any outstanding balances will be paid within 30 days unless the parties agree otherwise. The completion invoice, and supporting documentation, shall be submitted by the Contractor as promptly as practicable following completion of the work under this contract, but in no event later than 1 year (or such longer period as the Contracting Officer may approve in writing) from the date of completion.

(6) *Release of claims*. The Contractor, and each assignee under an assignment entered into under this contract and in effect at the time of final payment under this contract, shall execute and deliver, at the time of and as a condition precedent to final payment under this contract, a release discharging the Government, its officers, agents, and employees of and from all liabilities, obligations, and claims arising out of or under this contract, subject only to the following exceptions:

(i) Specified claims in stated amounts, or in estimated amounts if the amounts are not susceptible to exact statement by the Contractor.

(ii) Claims, together with reasonable incidental expenses, based upon the liabilities of the Contractor to third parties arising out of performing this contract, that are not known to the Contractor on the date of the execution of the release, and of which the Contractor gives notice in writing to the Contracting Officer not more than 6 years after the date of the release or the date of any notice to the Contractor that the Government is prepared to make final payment, whichever is earlier.

(iii) Claims for reimbursement of costs (other than expenses of the Contractor by reason of its indemnification of the Government against patent liability), including reasonable incidental expenses, incurred by the Contractor under the terms of this contract relating to patents.

(7) *Prompt payment*. The Government will make payment in accordance with the Prompt Payment Act (31 U.S.C. 3903) and prompt payment regulations at 5 CFR part 1315.

(8) *Electronic Funds Transfer (EFT)*. If the Government makes payment by EFT, see paragraph (b) of the FAR clause at 52.212–5 for the appropriate EFT clause.

(9) *Discount*. In connection with any discount offered for early payment, time shall be computed from the date of the invoice. For the purpose of computing the discount earned, payment shall be considered to have been made on the date that appears on the payment check or the specified payment date if an electronic funds transfer payment is made.

* * * * *

(l) *Termination for the Government's convenience*. The Government reserves the right to terminate this contract, or any part hereof, for its sole convenience. In the event of such termination, the Contractor shall immediately stop all work hereunder and shall immediately cause any and all of its suppliers and subcontractors to cease work. Subject to the terms of this contract, the Contractor shall be paid an amount for direct labor hours (as defined in the Schedule of the contract) determined by multiplying the number of direct labor hours expended

before the effective date of termination by the hourly rate(s) in the contract, less any hourly rate payments already made to the Contractor plus reasonable charges the Contractor can demonstrate to the satisfaction of the Government using its standard record keeping system that have resulted from the termination. The Contractor shall not be required to comply with the cost accounting standards or contract cost principles for this purpose. This paragraph does not give the Government any right to audit the Contractor's records. The Contractor shall not be paid for any work performed or costs incurred that reasonably could have been avoided.

* * * * *

(u) *Subcontracts.* (1) If the Contractor has an approved purchasing system, the Contractor shall obtain the Contracting Officer's written consent only before placing subcontracts identified in an addendum to this clause.

(2) If the Contractor does not have an approved purchasing system, consent to subcontract is required for any subcontract that—

(i) Is of the cost-reimbursement, time-and-materials, or labor-hour type; or

(ii) Is fixed-price and exceeds—

(A) For a contract awarded by the Department of Defense, the Coast Guard, or the National Aeronautics and Space Administration, the greater of the simplified acquisition threshold or 5 percent of the total estimated cost of the contract; or

(B) For a contract awarded by a civilian agency other than the Coast Guard and the National Aeronautics and Space Administration, either the simplified acquisition threshold or 5 percent of the total estimated cost of the contract.

(iii) Exceptions to this requirement may be as specified by the Contracting Officer in an addendum to this clause.

(3) The Contractor shall notify the Contracting Officer reasonably in advance of placing any subcontract or modification thereof for which consent is required under paragraph (u)(1) or (u)(2) of this clause, including the following information:

(i) A description of the supplies or services to be subcontracted.

(ii) Identification of the type of subcontract to be used.

(iii) Identification of the proposed subcontractor.

(iv) Extent of competition or basis for determining price reasonableness.

(v) The proposed subcontract amount.

(vi) If a time-and-materials or labor-hour subcontract, a list of the labor categories, corresponding labor rates and estimated hours.

(4) The Contractor is not required to notify the Contracting Officer in advance of entering into any subcontract for which consent is not required under paragraph (u)(1) or (u)(2) of this clause.

(5) Unless the consent or approval specifically provides otherwise, neither consent by the Contracting Officer to any subcontract nor approval of the Contractor's purchasing system shall constitute a determination—

(i) Of the acceptability of any subcontract terms or conditions; or

(ii) Relieve the Contractor of any responsibility for performing this contract.

(6) No subcontract or modification thereof placed under this contract shall provide for payment on a cost-plus-a-percentage-of-cost basis, and any fee payable under cost-reimbursement type subcontracts shall not exceed the fee limitations in FAR 15.404–4(c)(4)(i).

(7) The Contractor shall give the Contracting Officer immediate written notice of any action or suit filed and prompt notice of any claim made against the Contractor by any subcontractor or vendor that, in the opinion of the Contractor, may result in litigation related in any way to this contract, with respect to which the Contractor may be entitled to reimbursement from the Government.

(8) If the contractor enters into any subcontract that requires consent without obtaining such consent, the Government will not be liable for any costs incurred under that subcontract prior to the date the contractor obtains the required consent. Any payment of subcontract costs incurred prior to the date of the consent will be reimbursed only if the Contracting Officer subsequently provides the consent required by paragraph (u) of this clause.

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