



Contract Types



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Learning Objectives

- **Overview of basic contract types**
- **Recognize contract characteristics**
- **Understand contract incentives**
- **Determining “best” contract**



“NEW?” FP Policy

- **President Obama, “it is the policy of the federal government that executive agencies shall not engage in non-competitive contracts except in those circumstances where their use can be fully justified and where appropriate safeguards have been put in place to protect the taxpayer. In addition, there shall be a preference for fixed price contracts. Cost reimbursement contracts shall be used only when circumstances do not allow for a fixed-price type contract,” (White House Memorandum, March 4, 2009).**
- **OMB memo 29 Jul 2009 called for reducing by 10% the use of noncompetitive contracts, cost reimbursement contracts, time and materials contracts and labor hours contracts in FY 2010.**
- **BBPI use FFP or FPIF with 50/50 share ratio.**
- **BBPI 2.0 use appropriate contract type, 3.0 FPIF**



FAR Policy

- **Federal Acquisition Regulation (FAR) Part 16.103(a)** says that “negotiating contract type and negotiating prices are closely related and should be considered together. The objective is to negotiate a contract type and price (or estimated cost and fee) that will result in reasonable contractor risk and provide the contractor with the greatest incentive for efficient and economical performance.”
- **FAR 6.101 Policy.** Requires that with certain exceptions “the contracting officer shall promote and provide for full and open competition...”



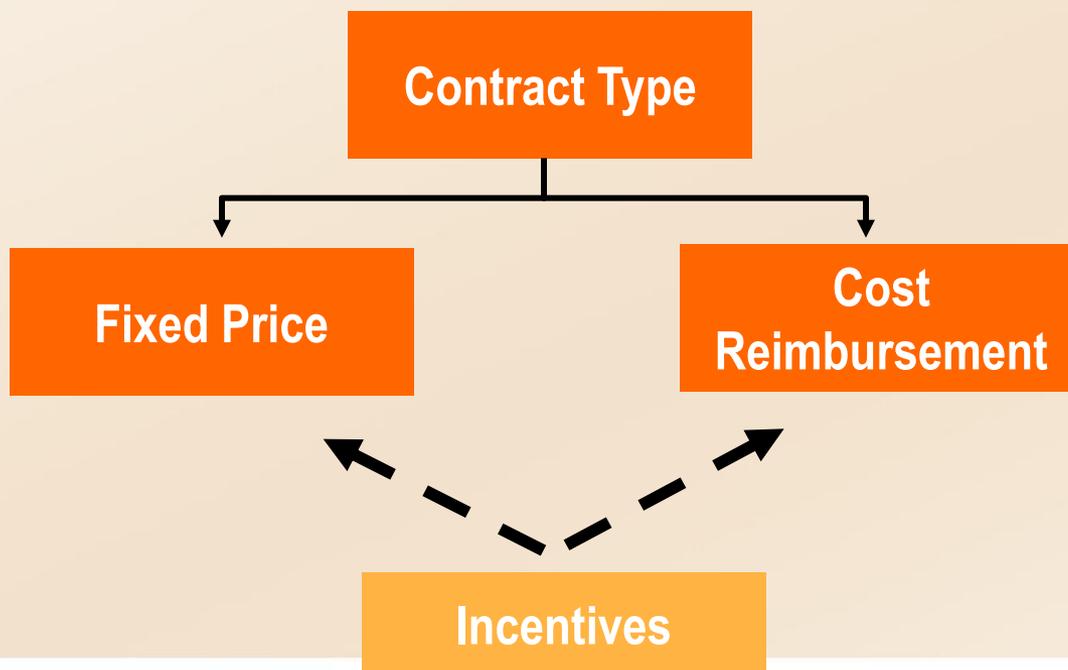
Contract Types - Characteristics

	<u>Cost</u>	<u>Fixed Price</u>
Promise	Best Effort or completion	Deliver
Risk to Contractor	Low	High
Risk to Government	High	Low (but ?)
Cash Flow	Cost Incurred	On Delivery
<u>Progress Payments</u>	----	Yes
<u>Performance Based Payments</u>	----	Preferred
Administration	High	Low
Fee/Profit	Periodic	On Delivery



Understanding Contract Categories

- There are two primary categories of contracts
 - Fixed price
 - Cost Reimbursement
- Incentives are an integral part of performance based contracts and can be used in either type of contract





A Primer on Contract Types



How is a Price calculated in a Fixed Price Contract ?

Contractor calculates the cost of material, labor, overhead, general and administrative (G&A) costs and profit

Contractor bears the risk of performing all required actions at the fixed price they propose

Government pays contract price

How is the total Cost determined in a cost reimbursement contract?

Contractor estimates total labor, material costs, overheads, G&A costs and Fee

Contractor provides "best effort" to perform all required actions, but bears less performance risk than in a fixed price arrangement.

Risk for government is that task may not be completed before funding is exhausted



Today's Environment

- **Contract Costs exceeding estimates**
- **Performance Management Problems**
- **Declining Resources**
- **Political constraints**



Choosing Contract Type

- **Choosing the best contract type for a particular acquisition is a critical decision that requires careful analysis and due diligence on the part of the government contracting officer.**
- **The guidance at FAR 16.202-2 says that “A firm fixed price contract is suitable for acquiring commercial items or for acquiring other supplies or services on the basis of reasonably definite functional or detailed specifications when the contracting officer can establish fair and reasonable prices at the outset...”**
- **Generally, this means price history and/or experience provides a solid basis for estimating the cost.**



Contract Types, cont.

- **Defense Federal Acquisition Regulation Supplement (DFARS) 235.006(ii)(A) states, “Do not award a fixed-price type contract for a development program unless (1) The level of program risk permits realistic pricing; (2) The use of a fixed price contract permits an equitable and sensible allocation of risk between the Government and the contractor; and (3) A written determination that these criteria have been met”**
- **FAR 16.301-2 says Cost-reimbursement contracts are suitable for use only when the agency can’t define the requirement or uncertainties involved in contract performance do not permit costs to be estimated with sufficient accuracy to use any type of fixed price contract.**



Contract Types, cont.

- **FAR 16.601 Time and materials contracts**
- **Limitations. A time and materials contract can only be used if-**
 - **The contracting officer prepares a determination that no other contract type is suitable.**
 - **Must be signed by the KO prior to execution of the base period.**
 - **Must be signed by the HCA if more than 3 years**
 - **Must include a ceiling price**



Contract Types, cont.

- **Labor hours contracts** are a variation of time and materials contract but no materials are supplied by the contractor. (16.602)
- **Letter contracts** (16.603) are written preliminary contract instruments that can be used when work must start immediately and HCA or designee determines in writing no other contract is suitable. Also called undefinitized contract actions or UCA's.



Contract Incentives

- FAR 16.4 addresses incentive contracts
- The 2 major types of incentives are Formula and Award Fee
- They are appropriate to use when FFP is not
- The 3 formula-type incentives are cost, performance and delivery/schedule
- You can use more than 1 incentive in a contract, but

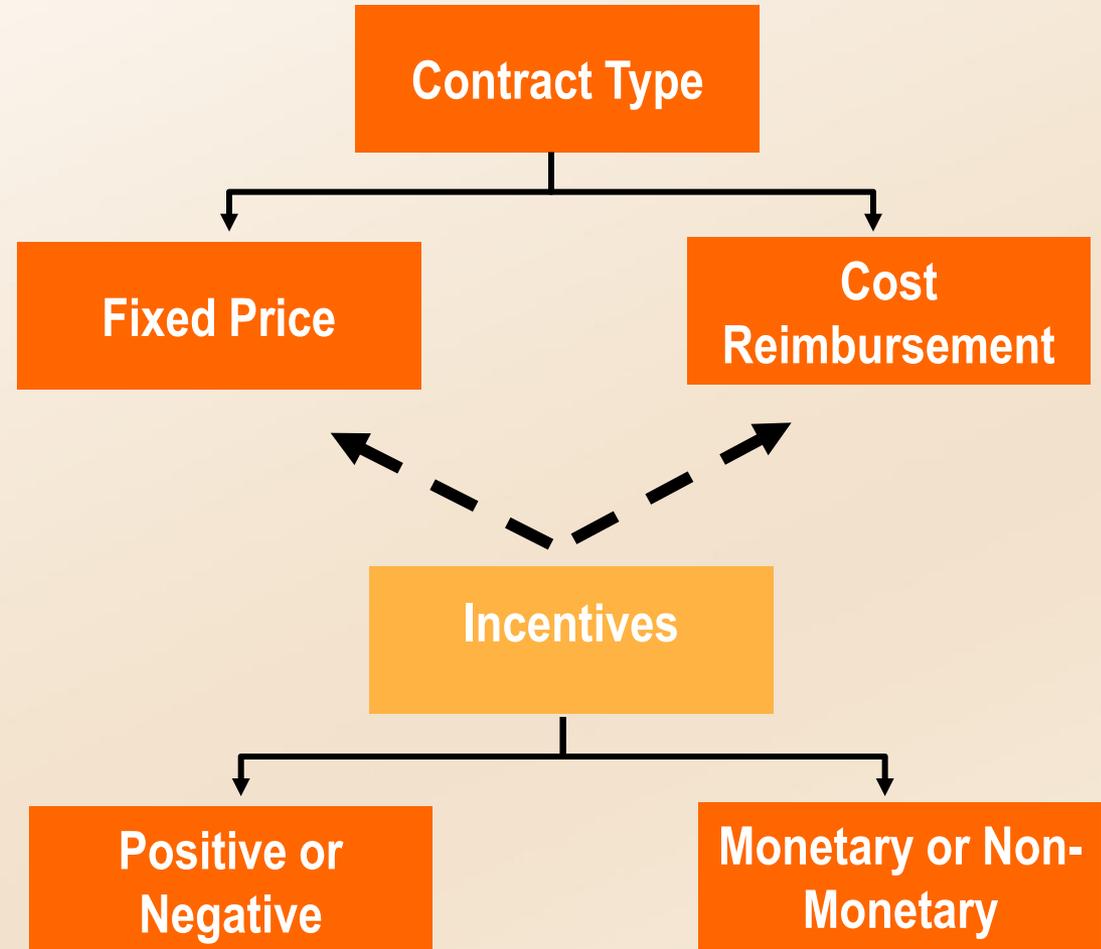


Contract Incentives, con't

- Cost is a mandatory incentive and no other incentive can be used without also using a cost incentive (16.402-1).
- Multiple Incentive(s) in the contract should motivate the contractor to achieve outstanding results in all incentive areas.

Understanding Incentives

- Incentives can be positive or negative. In addition, they can be monetary or non-monetary
- The goal is to motivate a contractor to achieve higher performance levels that benefit your organization





Monetary Incentives

- **Two contract types which entail monetary incentives**
 - **Award Fee**
 - **Incentive Fee**
- **Incentive Fee contracts contain objectively measurable performance criteria**
 - **Incentive is earned when measurable criteria is met**
 - **Cost, schedule and performance may be incentivized, but cost must always be**
- **Award Fee contracts contain a separate award fee pool used to motivate performance**
 - **Requires an award fee plan that described the performance areas to be incentivized**
 - **Relies on subjective measures**
 - **Administratively burdensome**
- **Another monetary “incentive” commonly found in PBA contracts is a deduction for not meeting PWS performance standards**



Contract Incentives, cont.

- **But be careful what you incentivize**
 - **A properly structured incentive arrangement should motivate the contractor to strive for excellence, and**
 - **Compel tradeoff decisions consistent with the Governments overall objectives**
 - **However, if everything is important then???**
 - **Also avoid conflict between cost control and quality**



Contract Incentives, cont.

- **Award Fee incentives are in disfavor (GAO-06-409T) High award fees routinely paid by DoD**
- **DPAP Memo 24 Apr 2007, It is the policy of the Department of Defense that objective criteria will be utilized whenever possible to measure contract performance.**
- **If a CPAF is used HCA must determine that objective criteria do not exist.**

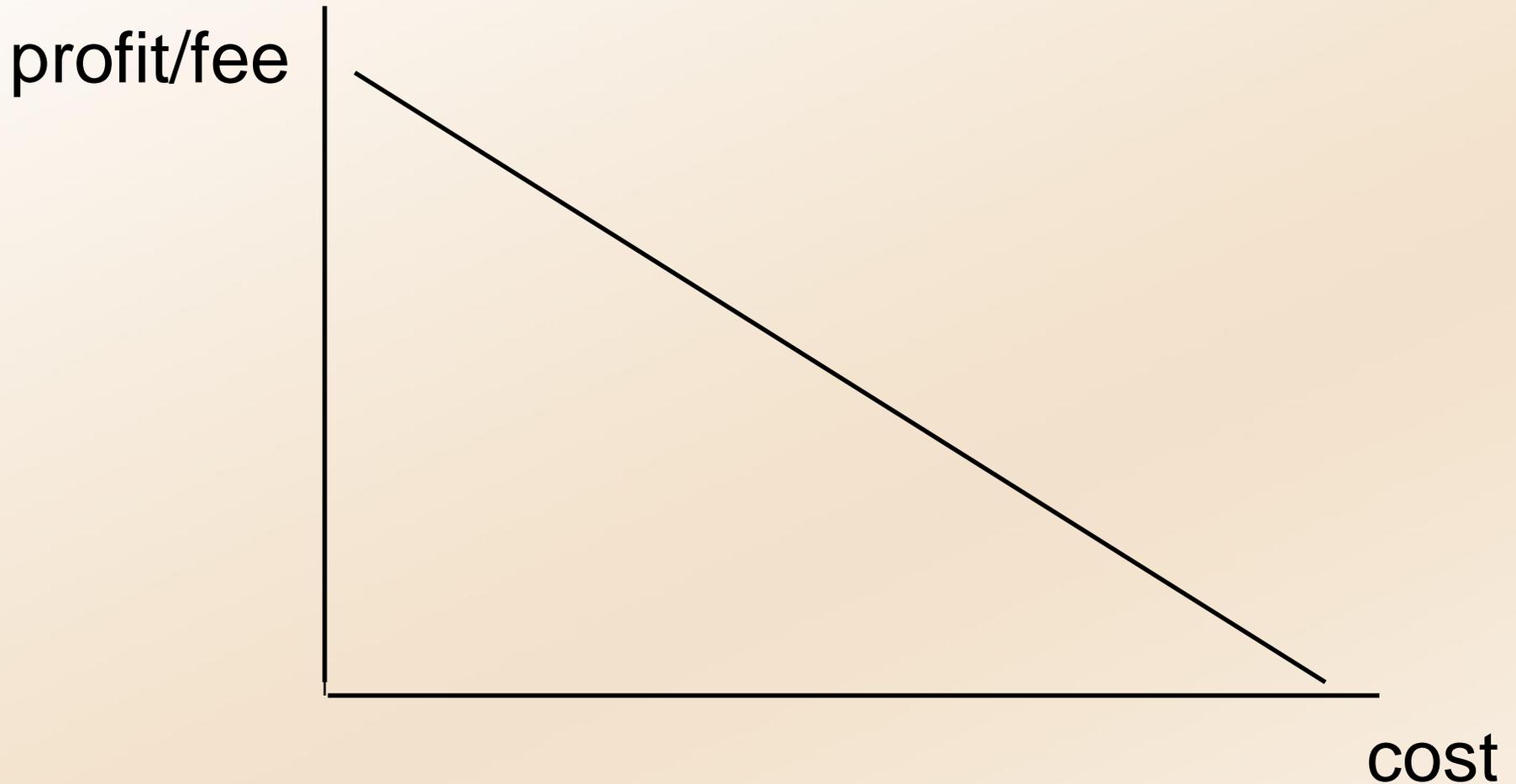


Contract Incentives, cont.

- **Multiple incentives can be used (i.e. CPI/AF, FP/AF, etc.)**
- **Types of incentive contracts:**
 - **FPIF, FPIS, FPAF**
 - **CPFF, CPIF, CPAF, (No CPPC)**
 - **Multiple Incentives**
 - **Disincentives, can be used but can't be punitive**
 - **But, what about FFP?**



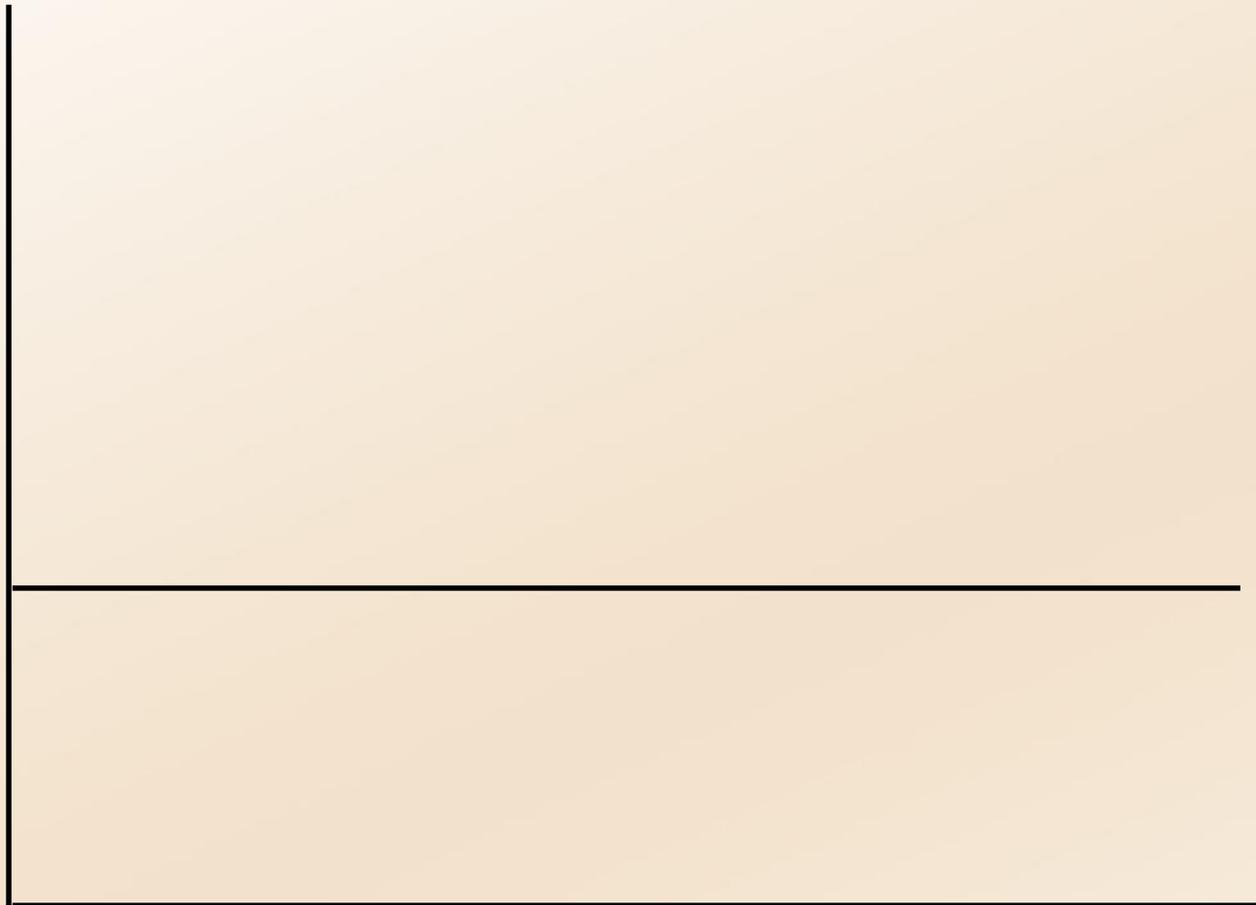
FIRM FIXED PRICE





COST PLUS FIXED FEE

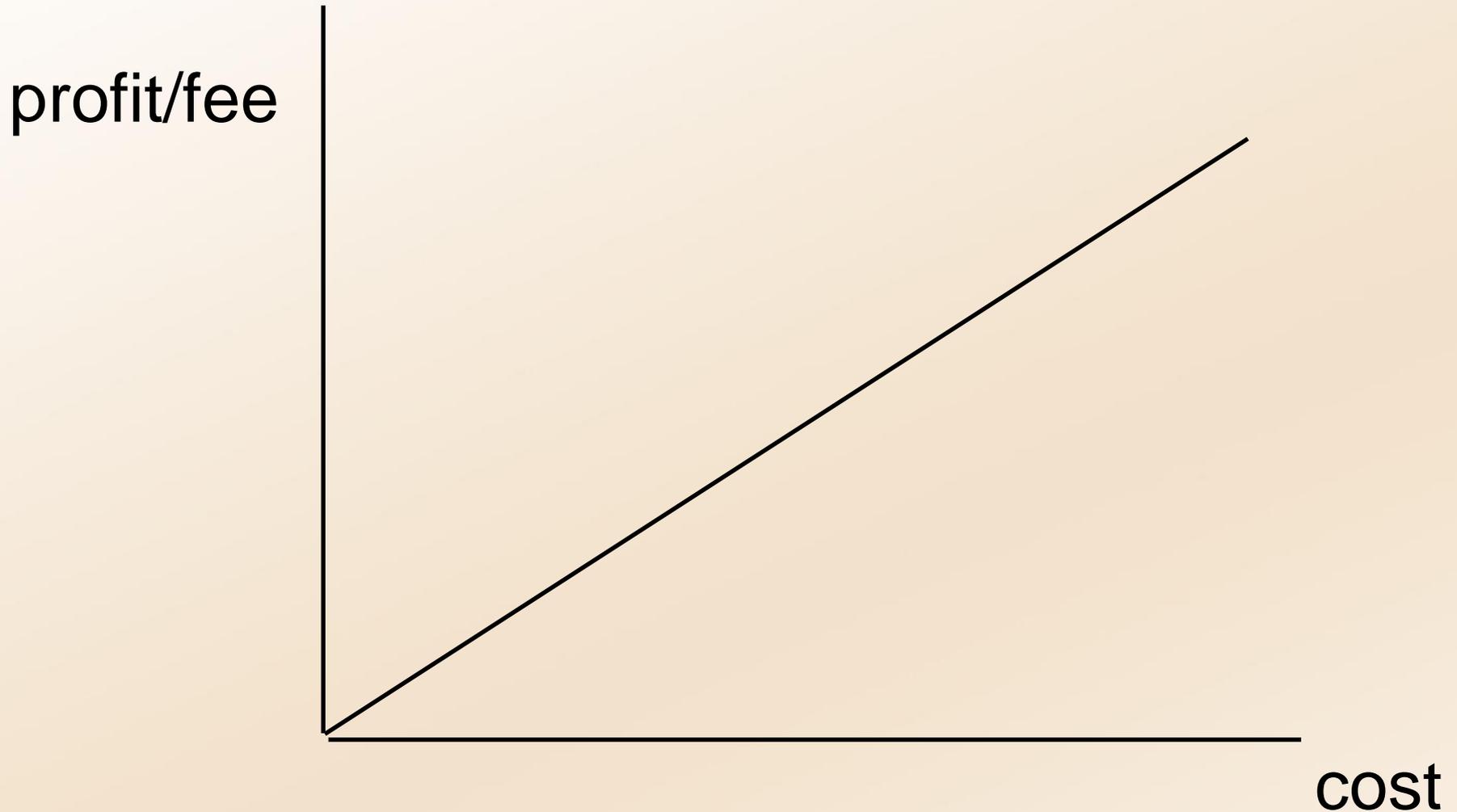
profit/fee



cost



COST PLUS % OF COST



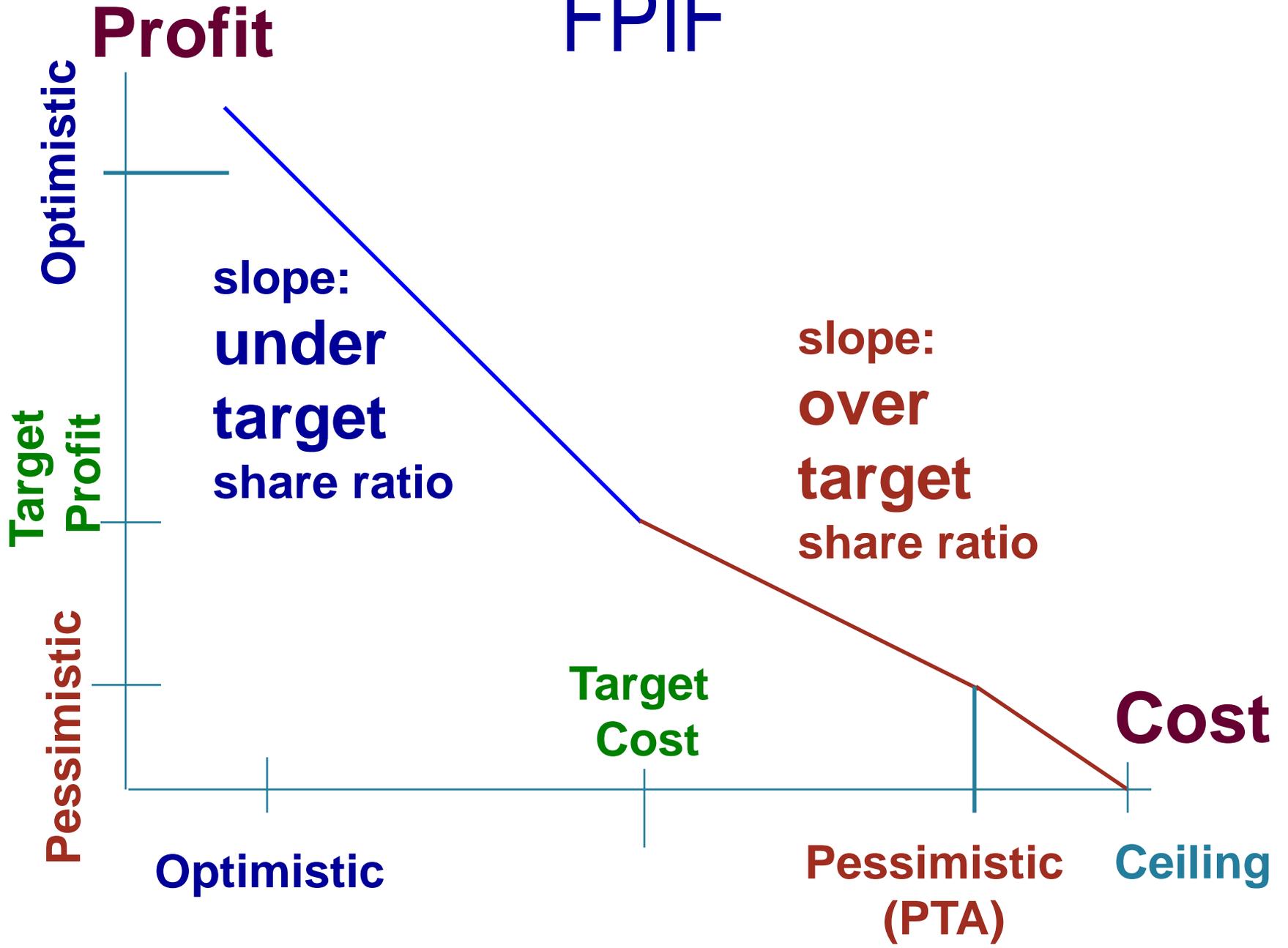


FPIF Contract Arrangement

- **Target Cost = \$**
- **Target Profit = \$**
- **Target Price = \$**
- **Ceiling Price = \$**
- **Share ratios: overrun 50/50; under run 50/50**

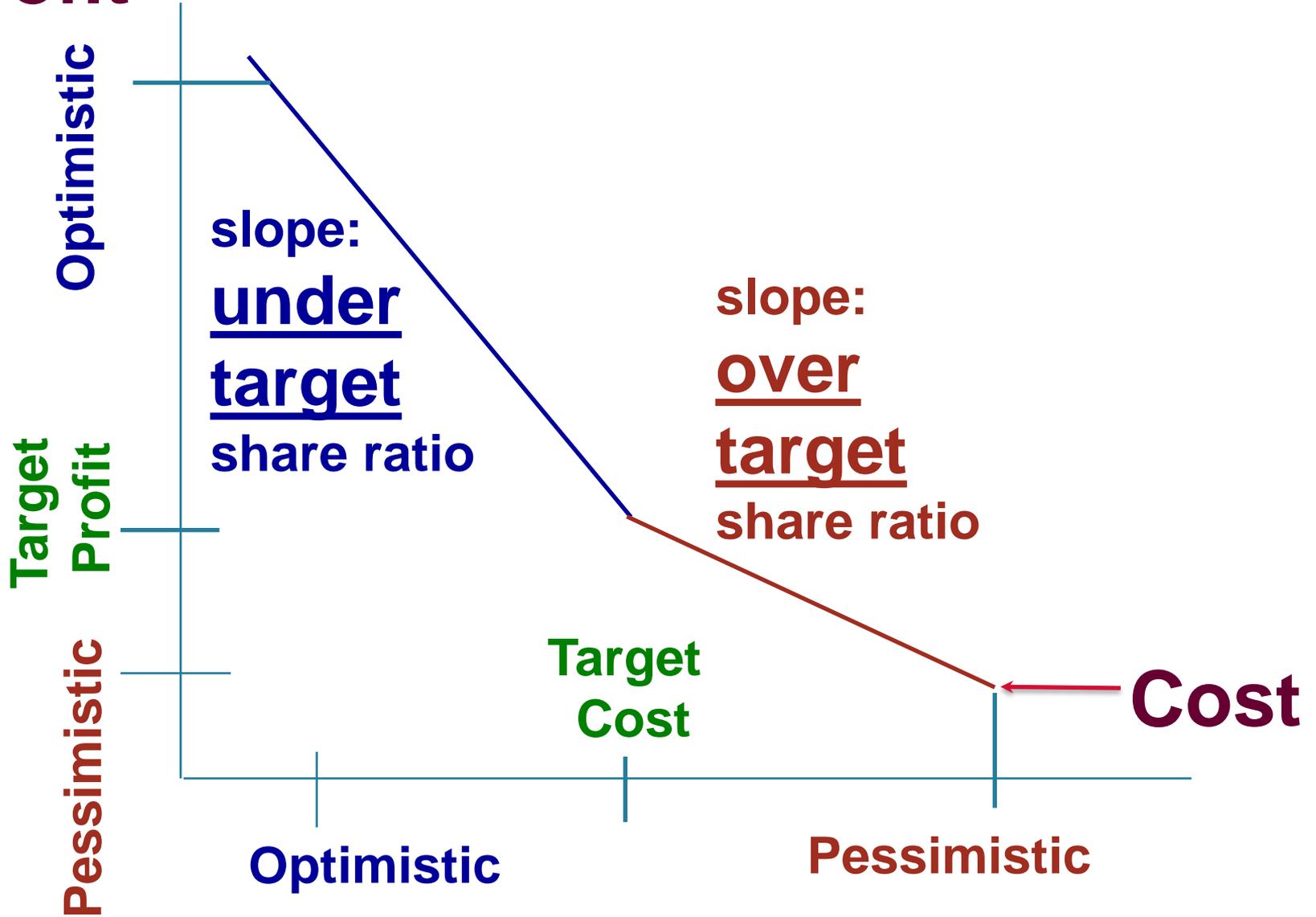
(Negotiated with contractor)

FPIF



CPIF

Profit





Contract Types

- **At pessimistic cost CPIF becomes a CPFF**
- **No ceiling price**
- **Be careful when using for services because of cost – quality conflict**

- **Acquisition method will also influence selection of contract type**



Contracting Methods

- **Once requirement is identified acquisition planning begins and seeks to maximize competition and commercial items**
- **Before contracting consider required sources of supply, see FAR Part 8.**



Required Sources of Supply

Supplies

- (i) Agency inventories;
- (ii) Excess from other agencies;
- (iii) Federal Prison Industries, Inc.;
- (iv) Supplies which are on the Procurement List maintained by the Committee for Purchase From People Who Are Blind or Severely Disabled;
- (v) Wholesale supply sources, such as stock programs of the General Services Administration (GSA), the Defense Logistics Agency, the Department of Veterans Affairs, and military inventory control points;
- (vi) Mandatory Federal Supply Schedules;
- (vii) Optional use Federal Supply Schedules; and
- (viii) Commercial sources (including educational and nonprofit institutions).

Services

- (i) Services which are on the Procurement List maintained by the Committee for Purchase From People Who Are Blind or Severely Disabled;
- (ii) Mandatory Federal Supply Schedules;
- (iii) Optional use Federal Supply Schedules; and
- (iv) Federal Prison Industries, Inc., or commercial sources (including educational and nonprofit institutions)*.

*FAR 8.002



Contracting Methods

- FAR Part 12 Commercial Items
- Clear Preference for Commercial Items or NDI
- Certain Laws Not Applicable
- Limited Contract Types
 - Firm fixed-price (FFP)
 - Fixed-price/economic price adjustment (FP(EPA))
 - Time and Materials/Level of Effort (TM/LOE) (Requires D&F that no other contract type is suitable)



Contracting Methods

- **Micropurchases**
 - **<\$3,000**
 - **no competition necessary**
 - **the Government-wide commercial credit card - preferred method for purchase and payment**
- **Simplified Acquisition Procedures**
 - **\$3,000 - \$150,000**
 - **Electronic Commerce is preferred means**
 - **Reserved for small business**
 - **Can use for commercial item < \$6.5M or (\$12M contingency)**



Contracting Methods

“Acquisition managers shall take all necessary actions to promote a competitive environment” (DODD 5000.1)

“The program manager shall, throughout the acquisition process, promote full and open competition and sustain effective competition between alternative major system concepts and sources, as long as it is economically beneficial and practicable to do so.” (FAR 34.005-1)

“. . . contracting Officers shall promote & provide for full and open competition in soliciting offers and awarding Government contracts.” (FAR. 6.101)



Contracting Methods

- **Sealed Bidding (FAR Part 14)**
 - requirements are easily understood
 - expect competition
 - no discussion required
 - review responsiveness and responsibility
- **Contracting by Negotiation (FAR Part 15)**
 - competitive
 - non-competitive
 - opportunity for discussions
 - best value considerations
 - LPTA or Trade-off



Contracting Methods

Questions?