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**Department of
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**48 CFR Parts 2, 10, 12, 16, and 52
Federal Acquisition Regulation; Additional
Commercial Contract Types; Proposed
Rule**

DEPARTMENT OF DEFENSE**GENERAL SERVICES
ADMINISTRATION****NATIONAL AERONAUTICS AND
SPACE ADMINISTRATION****48 CFR Parts 2, 10, 12, 16, and 52**

[FAR Case 2003–027]

RIN 9000–AK07

**Federal Acquisition Regulation;
Additional Commercial Contract Types**

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

ACTION: Advance notice of proposed rulemaking and notice of public meeting.

SUMMARY: The Civilian Agency Acquisition Council and the Defense Acquisition Regulations Council (Councils) are issuing this advance notice of proposed rulemaking (ANPR) to solicit comments that can be used to assist in the implementation of section 1432 of the National Defense Authorization Act for Fiscal Year 2004 (Public Law 108–136) in the Federal Acquisition Regulation (FAR). Section 1432 amends section 8002(d) of the Federal Acquisition Streamlining Act (FASA) to expressly authorize the use of time-and-materials (T&M) and labor-hour (LH) contracts for the procurement of commercial services. Implementation of section 8002(d) will require certain revisions to the FAR's current commercial item policies and associated clauses to ensure they effectively address the risks associated with T&M and LH contracting. Current policies were designed only to support purchases through firm-fixed price contracts and fixed-price contracts with economic price adjustments.

DATES: *Comment Date:* Interested parties should submit comments in writing on the ANPR to the address below on or before November 19, 2004, to be considered in the formulation of any proposed or interim rule.

The Councils, in collaboration with OFPP, invite interested parties from both the private and public sector to provide comments on the effective use of T&M and LH contracts for the acquisition of commercial items and suggestions for implementing the specific requirements of section 8002(d). Comments are especially welcome on the specific issues discussed in the "Supplementary Information" section of this notice. See, in particular, the two

sets of questions posed under "Solicitation of Public Comment" and the draft regulatory language provided under "Regulatory Amendments Under Consideration."

Public Meeting: A public meeting will be held on October 19, 2004, from 10:00 a.m. to 4:30 p.m. EST, in the GS Building Auditorium, 1800 F Street, NW, Washington, DC, 20405, to facilitate an open dialogue between the Government and interested parties on the implementation of section 8002(d). Interested parties are encouraged to attend and engage in discussions regarding the questions and draft provisions contained in this ANPR. 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 October 1, 2004. Interested parties may register and submit their input electronically at: <http://www.acq.osd.mil/dpap/dars/coming.htm>. Attendees are encouraged but not required to register for the public meeting, to ensure adequate room accommodations. Interested parties may also offer additional questions for discussion at the public meeting.

Directions to the meeting can be found at the Web site. Participants are encouraged to check the Web site prior to the public meeting to ensure the location has not changed as a result of a large number of registrants.

The public meeting is physically accessible to people with disabilities. Request for sign language interpretation or other auxiliary aids should be directed to Mr. Gerald Zaffos (202–208–6091) at least 5 days prior to the meeting.

ADDRESSES: *Written comments.* Submit comments identified by ANPR, 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.

- Mail: ANPR.2003-027@gsa.gov. Include ANPR, FAR case 2003–027, in the subject line of the message.

- Fax: 202–501–4067.

- Mail: General Services Administration, Regulatory Secretariat (VR), 1800 F Street, NW, Room 4035, ATTN: Laurie Duarte, Washington, DC 20405.

Instructions: Please submit comments only and cite ANPR, 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 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. Gerald Zaffos, Procurement Analyst, at (202) 208–6091. Please cite ANPR, FAR case 2003–027.

SUPPLEMENTARY INFORMATION:**A. Background**

Title XIV of the National Defense Authorization Act for Fiscal Year 2004 (Public Law 108–136), referred to as the Services Acquisition Reform Act (SARA), includes a provision, section 1432, which expressly authorizes the use of T&M and LH contracts for the procurement of commercial services. Section 1432 amends section 8002(d) (41 U.S.C. 264 note) of FASA. As amended, section 8002(d) places certain conditions on the use of T&M and LH contracts for purchases of commercial services under FAR Part 12, namely: (1) The purchase must be made on a competitive basis; (2) The service must fall within certain categories as prescribed by section 8002(d); (3) The contracting officer must execute a determination and findings (D&F) that no other contract type is suitable; and (4) The contracting officer must include a ceiling price that the contractor exceeds at its own risk and that may be changed only upon a determination documented in the contract file that the change is in the best interest of the procuring agency. The Councils are issuing this ANPR to seek the public's input for how best to implement the requirements and authorities of section 8002(d).

This ANPR is not intended to affect the special ordering procedures issued by the GSA pursuant to FAR 8.402 for the procurement of services under the Multiple Award Schedules (MAS) Program. MAS policies regarding the placement of orders on a T&M and LH basis will be conformed to the FAR when FAR coverage is finalized.

B. Solicitation of Public Comment

The Councils, along with OFPP, wish to ensure that T&M and LH contracting is used only when conditions warrant and that the terms and conditions incorporated into resulting T&M and LH contracts adequately protect the parties' respective interests based on the risk each party is being asked to bear. The

following discussion is intended to facilitate input that can assist the Councils in successfully achieving these goals as they develop regulations to implement section 8002(d).

1. *Suitability of T&M and LH*

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

a. Commercial services procured for support of a commercial item, as described in 41 U.S.C. 403(12)(E); and

b. Any other category of commercial services that is designated by the Administrator of OFPP on the basis that—

(i) 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

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

2. In furtherance of its responsibility under section 8002(d), OFPP seeks to better understand how T&M and LH contracts are used commercially and when their use is in the best interest of the Government. OFPP has developed questions to obtain this information and requested that the Councils pose them as part of this ANPR.

Accordingly, the Councils invite the public to provide comments addressing the appropriate use of T&M and LH contracting in commercial item acquisitions and especially welcome feedback to the following questions: (In commenting, please include citations, as appropriate, to relevant sources of information that may be used to substantiate the basis for the response provided.)

a. What, if any, types of commercial services are sold to the general public predominantly on a T&M or LH basis?

b. What types of commercial services are rarely, if ever, sold to the general public on a T&M or LH basis?

c. What types of commercial services are commonly sold to the general public through both a T&M or LH and fixed-price basis?

d. What conditions typically exist when services are commonly sold to the general public through the use of T&M or LH contracts?

e. Should this rule adopt the same policy set forth in the FAR for non-commercial items and in GSA's special ordering procedures for acquiring commercial services under the Multiple Award Schedules (MAS) (see <http://www.gsa.gov>; click on "GSA Schedules") that restricts T&M and LH 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 or to anticipate costs with any reasonable degree of confidence? Why or why not?

f. What steps should a contracting officer be required to take to establish that a fixed-price contract is not suitable? (Since use of cost-type contracts is prohibited under FAR Part 12, a contracting officer would not be expected to address why a cost-type contract was not suitable prior to using a T&M and LH contract for a commercial item acquisition.)

OFPP intends to share the public's feedback with the advisory panel that is being established pursuant to section 1423 of SARA to review commercial practices and other acquisition-related issues.

3. *Terms and conditions.* The current FAR clauses prescribed for the acquisition of commercial items were designed to support firm-fixed price contracts and fixed-price contracts with economic price adjustments. In shaping these clauses, the FAR drafters gave little thought to the risk involved when using flexibly priced contracts. For this reason, the Councils are reviewing these clauses to determine where refinements might be needed to more appropriately reflect the relationship that is created between the Government and a contractor under a T&M or LH contract.

As part of their review, the Councils are considering the provisions that have been traditionally incorporated into T&M and LH contracts pursuant to FAR Subpart 16.6. In considering changes, the Councils recognize that the provisions and clauses established and prescribed by Subpart 12.3 are meant to address, to the maximum extent practicable, commercial market practices for a wide range of potential Government acquisitions of commercial items.

To assist in this effort, the Councils invite the public, and especially small business, to provide comment on industry practices, including terms and conditions, relating to commercial use of T&M and LH contracts. Comments are especially welcome in response to the following questions: (In commenting, please include citations, as appropriate, to relevant sources of information that may be used to substantiate the basis for the response provided.)

a. What type of surveillance is conducted under T&M and LH commercial contracts (e.g., quality control and inspections)?

b. What responsibility should the contractor bear for correction of non-conforming services under T&M and LH commercial contracts (e.g., who should

bear the cost of correction or re-performance)? Does the burden of responsibility depend on whether the Government has accepted the service?

c. What oversight is used to ensure work is being properly charged under T&M and LH contracts (e.g., what type of information is required to substantiate payment requests)?

d. Is consent to subcontract required for subcontracts not identified in the original proposal?

e. How are material handling or subcontract administration rates charged under T&M commercial contracts? If material handling or subcontract administration rates are reimbursed based on actual rates, how can this be done without application of FAR Subpart 31.2?

f. What is the impact if Cost Accounting Standards apply to these contracts?

g. How often and under what circumstances does the customer provide property on a T&M or LH contract? How is the property managed and controlled?

C. Regulatory Amendments Under Consideration

The Councils are considering amendments to commercial items policies in FAR Part 12 and associated clauses in FAR Part 52 to ensure the effective use of T&M and LH contracts consistent with the parameters established in section 8002(d). Changes are also being considered for FAR Parts 2, 10, and 16.

Although the Councils have not yet agreed upon proposed FAR amendments, their preliminary thinking on regulatory implementation as of the publication of this ANPR is set forth below. The specific shape of a proposed or interim rule will not be decided until after the public's input has been considered. (For example, this language does not attempt to identify categories of services, since, as explained above, additional information will be needed to assist OFPP in making this determination.) The public is welcome to comment on these preliminary changes as part of their comments in response to this notice and at the public meeting. The main changes that would be made by this draft proposal are described below:

1. *Determination and findings (D&F).* Section 8002(d) requires the contracting officer to execute a D&F that no other contract type is suitable before proceeding with a purchase on a T&M or LH basis. The FAR has long relied on contracting officers to execute this type of D&F to protect the Government's interests when using a T&M or LH

contract for the purchase of non-commercial items. The D&F helps to ensure that contracting officers give sufficient consideration to fixed-price arrangements that will frequently represent a more appropriate allocation of risk. This point is underscored by the Conference Report (House Report 108-354) (<http://Thomas.loc.gov/>) accompanying SARA. The Conferees make clear that the option to use T&M and LH contracts was not intended to supplant the statutory preference for performance-based fixed-price task orders established by section 821 of the Defense Authorization Act for FY 2001 (Public Law 106-398). The Conferees state that "a performance-based contract or task order that contains firm-fixed prices for the specific tasks to be performed remains the preferred option for the acquisition of either commercial or non-commercial items." See H. Rept. 108-354 at p. 777.

The Councils and OFPP generally would expect to find that services are likely to be sold on both a T&M or LH and fixed-price basis in many instances. In these cases, determining whether fixed-price contracts are unsuitable may be more a function of the specific circumstances surrounding the acquisition than the specific nature of the service being acquired.

For these reasons, the preliminary draft would require contracting officers to describe the market research they have undertaken to evaluate contract options and the rationale for concluding, based on this research, that fixed-prices for the delivery of completed tasks is unsuitable under the circumstances. The preliminary draft would require the contracting officer to prepare a D&F that establishes either (1) that it is not possible at the time of placing the contract to accurately estimate the extent or duration of the work or to anticipate costs with any reasonable degree of certainty or, (2) if work is sufficiently understood to allow for pricing on a fixed-price basis, that fixed pricing would unnecessarily inflate the Government's costs or impose unreasonable risk on the contractor. The preliminary draft encourages indefinite-delivery contracts that provide for orders to be issued on a T&M or LH basis, to also provide for orders to be issued on a fixed-price basis. In this situation, a D&F is executed for each T&M or LH order. If it is not practicable to provide for both contract types, then the D&F is executed for the contract and additionally must explain why providing for an alternative fixed-price structure is not practicable.

2. *Terms and conditions.* The Councils are considering an alternate to

the standard clause used in commercial contracts, set forth at FAR clause 52.212-4, for incorporation into T&M and LH contracts for commercial services. This alternative clause would make the following modifications to FAR clause 52.212-4:

- *Inspection/acceptance.* Paragraph (a) of FAR clause 52.212-4 provides that the Government may require repair or replacement of nonconforming supplies or reperformance of nonconforming services at no increase in price. The Councils anticipate, based on their initial review of commercial contracts, that the requirement at paragraph (a) of FAR clause 52.212-4 for reperformance of nonconforming services is consistent with commercial practice. However, the Councils also determined that, regardless of whether a fixed-price contract or a T&M or LH contract is used, reperformance may not correct defects or may not be possible. In these cases, the Councils believe that the Government should be able to invoke other remedies, such as requiring action by the contractor to ensure that future performance conforms to contract requirements or acceptance of nonconforming supplies or services with appropriate consideration. Accordingly, this clarification is included in a draft revision to paragraph (a) of the basic terms and conditions clause at 52.212-4 and an alternate that would be used for T&M and LH contracts.

- *Payment.* The payment provision at paragraph (i) of FAR clause 52.212-4 provides that payment shall be made for items accepted. Generally, FAR 15.403-1(b)(3) exempts contracts for commercial items from the submission of cost or pricing data, and 15.209(b)(1)(iii) exempts contracts for commercial items from applicability of 52.215-2, Audits and Records-Negotiations. As a result of section 1432 of SARA, these same exceptions would generally apply to T&M and LH contracts used for the acquisition of certain commercial services. However, there are some unique aspects of T&M and LH contracts that may require Government review. These reviews would be limited to review of the labor hours, the actual material costs, and actual subcontract costs. The Councils are, therefore, considering an alternate clause that would provide a special payment provision for T&M and LH contracts. The language of the alternate clause is generally derived from FAR 52.232-7, the payment clause currently used for non-commercial acquisitions on T&M and LH contracts, but has been modified to incorporate commercial buying practices. The proposed

alternate payment provision requires the contractor to provide access to employees and their timecards, labor distributions, and material and subcontract invoices. The alternate payment provision does not provide for the withholding and retention of payments subject to final audit. Since the proposal does not provide for reimbursement of actual indirect rates (e.g., a material handling or subcontract administration rate), the proposal does not require application of FAR Part 31.

In addition, paragraphs (b)(1) and (b)(4)(iii) of FAR clause 52.232-7 allow for the reimbursement of reasonable and allocable material handling costs and/or subcontract administration costs arising from the handling of materials and/or the administration of subcontracts (provided these indirect costs are not included in the loaded hourly rate). As a result, T&M and LH contracts for non-commercial items are generally subject to the provisions of FAR Part 31 and the negotiation of final indirect rates. Since commercial item contracts are not subject to FAR Part 31 and final indirect rates, the Councils have discussed the possibility of using a predetermined rate not subject to any audit and adjustment. However, concerns were raised that this would violate the prohibition on cost plus a percentage of cost (CPPC) contracting if the factor is any amount greater than the actual overhead rate the contractor incurs. As a result, the alternate payment provision provides for payment of the direct costs of material or subcontracts only and does not allow for the application and payment of separate indirect rates for materials and subcontracts.

Finally, the alternate clause applies the Prompt Payment Act to T&M and LH contracts, thus maintaining the application of the Act to commercial items acquisitions.

- *Termination for convenience.* The current termination language in paragraph (l) of FAR clause 52.212-4 and the corresponding guidance at 12.403(d) do not currently reflect how a contractor would be paid under a terminated commercial T&M and LH contract. Rather than paying the contractor based on a "percentage of contract price reflecting the percentage of the work performed prior to notice of termination," the alternate clause would pay the contractor for the number of direct labor hours expended before the effective date of termination multiplied by the hourly rate(s) in the contract schedule, plus reasonable charges directly related to the termination.

- *Subcontracts.* Currently, FAR Part 12 does not address subcontracts *i.e.*, there is no guidance addressing issues

such as consent to subcontracts and advanced notification requirements). However, the Councils believe that the additional risks associated with T&M and LH contracting require surveillance, including insight into subcontracts. A new FAR section 12.216 and paragraph (u) for the alternate clause are being considered that would require the contractor to obtain the contracting officer's consent prior to awarding certain subcontracts. Similar to FAR 52.244-2, the subcontracts clause used for non-commercial acquisitions involving either T&M or LH contracts, paragraph (u) of the alternate clause would establish standard conditions under which consent is required, and would permit the contracting officer to designate or exempt additional specific subcontracts or categories of subcontracts for consent. The contracting officer would be required to consider the risk, complexity and dollar value of anticipated subcontracts when determining the consent requirements.

3. *Application of Cost Accounting Standards (CAS)*. FAR 12.214 states that CAS does not apply to contracts and subcontracts for the acquisition of commercial items when these contracts and subcontracts are firm-fixed price or fixed-price with economic price adjustment, provided that the price adjustment is not based on actual costs incurred. This FAR provision is based on a CAS exemption that was promulgated by the Cost Accounting Standards Board (CAS Board) after the enactment of the Clinger-Cohen Act (Public Law 104-106) pursuant to its authorities in section 26 of the Office of Federal Procurement Policy Act (OFPP Act) in general and section 26(f)(2)(B)(i) of the OFPP Act in particular (41 U.S.C. 422(f)(2)(B)(i)). The scope of the CAS exemption parallels the scope of contract types currently authorized by FAR 12.207.

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.

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

Government procurement.

Dated: September 13, 2004.

Laura Auletta,

Director, Contract Policy Division.

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

1. The authority citation for 48 CFR parts 2, 10, 12, 16, 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 of the introductory text of paragraph (6).

PART 10—MARKET RESEARCH

10.001 [Amended]

3. Amend section 10.001 in paragraph (a)(3)(iv) by adding "type of contract," before the word "terms".

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 in a category of commercial service identified in paragraph (b)(2) of this section;

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

(iii) The contracting officer—

(A) Executes a determination and findings (D&F) for the contract, in accordance with paragraph (b)(3) 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) The following categories of services may be purchased using a time-and-materials or labor-hour contract:

(i) Commercial services procured for support of a commercial item as defined in paragraph (5) of the "commercial item" definition at 2.101.

(ii) Any other category of commercial services that is identified by the Administrator of the Office of Federal Procurement Policy (OFPP) on the basis that—

(A) The commercial services in such category are of a type of commercial services that are commonly sold to the general public through use of time-and-materials or labor-hour contracts; and

(B) It would be in the best interests of the Federal Government to authorize use of time-and-materials or labor-hour contracts for purchases of the commercial services in such category.

(3) Each D&F required by (b)(1)(iii)(A) shall contain sufficient facts and rationale to justify that no other contract type authorized by this part is suitable. At a minimum, the D&F shall—

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

(ii)(A) 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; or

(B) If work is sufficiently understood to allow for pricing on a fixed-price basis, explain why fixed pricing would unnecessarily inflate the Government's costs or impose unreasonable risk on the contractor; and

(iii) Establish that the requirement has been structured to minimize the use of T&M and LH contracts to the maximum extent practicable (e.g., by limiting the value or length of the contract or order).

(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. In such contracts, the contracting officer shall execute the D&F required by paragraph (b)(3) of this section at the order level, 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)(3) 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.

(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 Subcontracts.

When a time-and-materials or labor-hour contract is awarded pursuant to 12.207(b), Alternate I to 52.212-4 is used. Alternate I includes a subcontract consent provision, which requires the contractor to obtain the contracting officer's consent prior to awarding certain subcontracts. The contracting officer must identify, in an addendum to the clause, subcontracts evaluated during negotiation, any other subcontracts requiring consent, and any exceptions to the standard consent requirements when a contractor does not have an approved purchasing system. The contracting officer shall consider the risk, complexity, and dollar value of anticipated subcontracts when determining the consent requirements.

7. Amend section 12.301 in paragraph (b)(3) by adding a new second sentence to read as follows:

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

* * * * *

(b) * * *

(3) * * * Use this clause with its Alternate I when a time-and-materials or

labor-hour contract will be awarded.

* * *

8. Amend section 12.403 in paragraph (d)(1) by revising paragraph (d)(1)(i); redesignating paragraph (d)(1)(ii) as (d)(1)(iii); and adding a new paragraph (d)(1)(ii) to read as follows:

12.403 Termination.

* * * * *

(d) * * *

(1) * * *

(i) 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

(ii) 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 to the end of the introductory text of paragraph (b) to read as follows:

16.601 Time-and-materials contracts.

* * * * *

(b) * * * 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 to 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 52—SOLICITATION PROVISIONS AND CONTRACT CLAUSES

11. Amend section 52.212-4 by revising the date of the clause; adding a new fourth sentence to the introductory text of paragraph (a) of the clause; and adding Alternate I to read as follows:

52.212-4 Contract Terms and Conditions—Commercial Items.

* * * * *

CONTRACT TERMS AND CONDITIONS—COMMERCIAL ITEMS (DATE)

(a) * * * If repair/replacement or reperformance will not correct the defects or is not possible, the Government may require the Contractor to ensure that future performance conforms to contract requirements and may seek 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), (i), and (l) for those in the basic clause and add the following paragraph (u) to the basic clause:

(a) *Inspection/Acceptance.* The Contractor shall only tender for acceptance those items that conform to the requirements of this contract. The Government reserves the right to inspect or test any supplies or services that have been tendered for acceptance. The Government may require repair or replacement of nonconforming supplies or reperformance of nonconforming services at no increase in the cost to the Government. If reperformance will not correct the defects or is not possible, the Government may require the Contractor to ensure that future performance conforms to contract requirements and may seek consideration for acceptance of nonconforming supplies or services. The Government must exercise its post-acceptance rights—

(1) Within a reasonable time after the defect was discovered or should have been discovered; and

(2) Before any substantial change occurs in the condition of the item, unless the change is due to the defect in the item.

* * * * *

(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.* (A) 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 if specified in the contract.

(B) Invoices may be submitted once each month (or at more frequent intervals, if approved by the Contracting Officer) to the Contracting Officer or designee. When requested by the Contracting Officer, the Contractor shall substantiate invoices by evidence of individual daily job timecards or other substantiation specified in the contract.

(C) 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 overtime work is approved in advance by the Contracting Officer, 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 costs.* (A) Allowable costs of materials are limited to the actual cost of direct materials (less any rebates, refunds or discounts received by or accrued to the

contractor). When requested by the Contracting Officer, the Contractor shall substantiate any claimed materials costs by evidence of invoices and payment of those invoices. Direct materials, as used in this clause, are those materials that enter directly into the end product, or that are used or consumed directly in connection with the furnishing of the end product or service.

(B) The Government will reimburse the Contractor for the cost of direct materials provided such costs are consistent with paragraph (i)(1)(ii)(C) and the Contractor—

(1) Has made payments of cash, checks, or other forms of payment for the direct materials costs; or

(2) Will make these payments determined due—

(i) In accordance with the terms and conditions of an agreement or invoice; and

(ii) Ordinarily within 30 days of the submission of the Contractor's payment request to the Government.

(C) 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) Take all cash and trade discounts, rebates, allowances, credits, salvage, commissions, and other benefits. When unable to take advantage of the benefits, the Contractor shall promptly notify the Contracting Officer and give the reasons. The Contractor shall 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. The Contractor shall not deduct from gross costs the benefits lost without fault or neglect on the part of the Contractor, or lost through fault of the Government.

(D) If the nature of the work to be performed requires the Contractor to furnish material that the Contractor regularly sells to the general public in the normal course of business, the price to be paid for such material, notwithstanding the other requirements of this paragraph (i)(1)(ii), shall be on the basis of an established catalog or list price, in effect when the material is furnished, less all applicable discounts to the Government, provided that in no event shall such price be in excess of the Contractor's sales price to its most favored customer for the same item in like quantity, or the current market price, whichever is lower.

(iii) *Subcontract costs.* The Government shall reimburse the Contractor for the actual costs of direct subcontract costs that are authorized under paragraph (u), Subcontracts, of this clause, provided the Contractor has made or will make payments determined due of cash, checks, or other forms of payment to the subcontractor—

(A) In accordance with the terms and conditions of the subcontract; and

(B) Ordinarily within 30 days of the submission of the Contractor's payment request to the Government.

(iv) *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, material costs, and subcontract 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 performing 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.

(v) *Ceiling price.* The Government shall 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 shall have notified the Contractor in writing that the ceiling price has been increased and shall have specified 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.

(2) *Access to records.* At any time before final payment under this contract the Contracting Officer (or authorized representative) shall 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) For labor hours, when the Contracting Officer has required timecards as substantiation for payment—

(A) The original timecards;

(B) The Contractor's timekeeping procedures;

(C) Contractor reports 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.

(ii) For material costs—

(A) Any invoices substantiating direct material costs; and

(B) Any documents supporting payment of those invoices.

(iii) For subcontract costs—

(A) The subcontract agreement;

(B) Any invoices submitted by the subcontractor; and

(C) Any documents supporting payment of those invoices.

(3) *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. Any such reduction shall be promptly paid by the Contractor within 30 days, unless the parties agree otherwise. Any such increases shall be paid by the Government within 30 days, unless the parties agree otherwise. Payment may be made by check or as adjustment to future invoices. 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 substantiating material, and upon compliance by the Contractor with all terms of this contract, any outstanding balances shall be paid within 30 days, unless the parties agree otherwise. The completion invoice, and substantiating material, 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.

(4) *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.

(5) *Refunds, rebates, and credits.* The Contractor agrees that any refunds, rebates, or credits (including any related interest) accruing to or received by the Contractor or any assignee, that arise under the materials or subcontracts portion of this contract and for which the Contractor has been paid for or is aware of at the time of submission of the completion invoice, shall be paid by the Contractor to the Government. 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, an assignment to the Government of such refunds, rebates, or credits (including any interest) in form and substance satisfactory to the Contracting Officer.

(6) *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.

(7) *Electronic Funds Transfer (EFT).* If the Government makes payment by EFT, see 52.212-5(b) for the appropriate EFT clause.

(8) *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 which 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, 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 which reasonably could have been avoided.

* * * * *

(u) *Subcontracts.*—(1) *Definitions.* 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.

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.

(2) 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.

(3) 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.

(4) 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)(2) or (u)(3) 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.

(5) 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)(2) or (u)(3) of this clause.

(6) 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.

(7) 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).

(8) 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.

(9) Paragraphs (u)(2) and (u)(3) of this clause do not apply to the subcontracts, which were agreed to during negotiations, as set forth in an addendum to this clause.

(10) If the Contractor enters into any subcontract that requires consent without obtaining such consent, the Government shall 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 the consent was obtained shall be at the sole discretion of the Government.

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