July 15, 2003

FSS Acquisition Letter FX-02-1
Supplement No. 1

MEMORANDUM FOR ALL FSS ACQUISITION ACTIVITIES
(FX DISTRIBUTION LIST)

VA NATIONAL ACQUISITION CENTER
FEDERAL SUPPLY SCHEDULE SERVICE

FROM: PATRICIA M. MEAD
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SUBJECT: Economic Price Adjustments for Contracts That Are Not Based on Commercial Catalogs or Price Lists

1. **Purpose**. This Supplement reinstates and extends the expiration date of FSS Acquisition Letter (AL) FC-02-1.

2. **Applicability**. This supplement applies to the Federal Supply Service and the VA National Acquisition Center for all appropriate Federal Supply Schedule Program solicitations and contracts as follows:

- solicitations that are anticipated to receive offers that will not be based on commercial catalogs or price lists, and

- awarded contracts where pricing is not based on commercial catalogs or price lists.

3. **Effective Date**. This supplement is effective upon signature.

4. **Expiration Date**. FC-02-1 expires one year from the effective date of this supplement, unless otherwise extended or canceled.

5. **Reference to Regulations**. The procedures in FC-02-1 will be included in Chapter 38 of the Supply Operations Handbook, FSS P. 2901.2A.

January 3, 2002

FSS ACQUISITION LETTER FC-02-1

MEMORANDUM FOR ALL FSS ACQUISITION ACTIVITIES
(FC DISTRIBUTION LIST)

VA NATIONAL ACQUISITION CENTER
FEDERAL SUPPLY SCHEDULE SERVICES

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SUBECT: Economic Price Adjustments For Contracts That Are Not Based on Commercial Catalogs or Price Lists

SEARCH ENGINE - HOW TO FIND ANSWERS TO ACQUISITION LETTER 02-1

SECTION 1. GENERAL INFORMATION ABOUT ACQUISITION LETTER 02-1

SECTION 2. DETERMINING ECONOMIC PRICE ADJUSTMENT MECHANISMS

SECTION 3. THE REQUIREMENT FOR AN EPA

SECTION 1. GENERAL INFORMATION ABOUT ACQUISITION LETTER 02-1

1-1 Does Acquisition Letter 02-1 apply to me?

If you are . . .	*And you . . .*	*Then . . .*
The Federal Supply Service and the VA National Acquisition Center	*Contract under the Federal Supply Schedule Program*	*Acquisition Letter FC-02-1 applies to all appropriate MAS solicitations that are anticipated to receive some offers that will not be based on commercial catalogs or price lists.*

1-2 What is the purpose of Acquisition Letter 02-1?

This Acquisition Letter establishes the processes and procedures to use for adjusting prices for Federal Supply Schedule contracts consistent with commercial practices where prices are not based on commercial catalogs or pricelists **AND** market research demonstrates that inclusion of such alternate economic price adjustment (EPA) provisions is beneficial. This policy will be consolidated into Chapter 38, Federal Supply Schedule Contracting, of the FSS Handbook P2901.2A. The procedures in this Acquisition Letter are consistent with the requirements of FAR Part 12, Acquisition of Commercial Items; FAR Subpart 8.4, Federal Supply Schedules; FAR Subpart 16.203, Fixed-price contracts with economic price adjustment (EPA); GSAM 516.203-4 and 538.270 as applicable.

1-3 When does this Acquisition Letter go into effect?

This acquisition letter is effective upon signature. FSS does not require you to implement it until 10 days after its signature date, but strongly encourages you to implement it before then. It will be effective for one year, unless extended.

1-4 Why are new policies and procedures needed for economic price adjustments?

The current GSAR clause for multiple award schedule (MAS) contracts (552.216-70, Alternate I) sets forth the EPA procedures for services and products based on commercial catalogs or price lists. This clause has proved inadequate where prices are **not** based on commercial catalogs or price lists. As such, acquisition centers have relied on fixed price contracts or a variety of EPA approaches that may not reflect the commercial practice for adjusting pricing in the industry.

SECTION 2. DETERMINING ECONOMIC PRICE ADJUSTMENT MECHANISMS

2-1 What are the objectives of selecting the right EPA mechanism?

The objectives of selecting an appropriate price adjustment mechanism are to ensure that the Government receives quality goods and services at fair and reasonable prices; the contractor accepts reasonable cost risks; commercial practices are maintained; and contract administration is minimized.

2-2 What are typical EPA mechanisms?

There are two types of EPA mechanisms: Fixed price and market indicators. Different industry segments will have different methods of adjusting prices.

2-3 What are fixed price EPA mechanisms?

There are two fixed price EPA mechanisms: Full term and negotiated escalation rates.

2-4 How do full term EPAs work?

For full term EPAs an offeror projects future increases and spreads them over the full term of the contract. For example, an offeror offers widget services commercially at $90 today anticipating 3.3% increase per year for 20 years. The average price over the 20-year period would be $125. The offeror proposes to provide widgets to the Government for the full term of the contract at $125. Although this method may be proposed, full term prices are not acceptable. Full term EPAs pose a high risk to the Government in that prices during the early years of the contract are high (impacting the ability of the contractor to sell items), and during the later years, the prices are too low (potentially jeopardizing performance).

2-5 How do negotiated escalation rate EPAs work?

An offeror projects future increases for each year (or each base year) of the contract by proposing an escalator to be applied to the price at a certain point in time, resulting in a fixed unit price for each year (or each base year) of the contract. For example, an offeror offers widget services commercially at $90 today and proposes to provide them to the Government for the full term of the contract at an escalation rate of xx% per year. The award document cites paragraph (b)1 of the Economic Price Adjustment clause, I-FSS-969, (Attachment 1) as applicable to this contract.

2-6 Can the rate of escalation vary among items offered?

Yes.

2-7 How do I determine the reasonableness of the proposed negotiated escalation rate?

When evaluating the reasonableness of proposed escalation rates, the offeror must be able to demonstrate what its practices regarding escalations have been over a period of time. This can include providing copies of contracts, invoices, agreements, or cost or pricing data that is not certified. There are also various sources that provide (for a fee) economic and forecasting information that can be useful in evaluating escalation rates (Attachment 2). Please note, it is appropriate to consider both a review of the offeror's commercial practice and any source data in determining an appropriate rate of escalation. For example, it is not reasonable to insist that the Data Resources, Inc. escalation rate of 4% be adhered to when the offeror can demonstrate a different rate of escalation.

2-8 How do you administer the negotiated escalation rate EPA?

This type of price adjustment is straight forward. As specified in paragraph (b)1 of the Economic Price Adjustment clause, I-FSS-969, it requires no contract modification to effectuate the price increase because the rate is established in the contract. Normally, price changes become effective on the anniversary date of the contract, although other dates may be negotiated based on the offeror's commercial practice for revising its price.

2-9 What kind of risk does the use of negotiated escalation rates pose to the Government?

Negotiated escalation rate EPAs pose a small risk to the Government in that escalation rates are difficult to project for long-term contracts because of unknown future market conditions. When using this type of EPA, it is important to conduct regular reviews (at a minimum, at each option period) to ensure the prices continue to be fair and reasonable.

2-10 What are market indicator EPA mechanisms?

This is where a contractor's price increases are tied to a market indicator, such as an index or salary survey. For example, a contractor offers widget services commercially at $90 today and proposes to provide them to the Government for the full term of the contract, but tie price increases to the Economic Research Institute's annual salary survey. Market indicators may be a commercial survey discovered during market research or a Government index. This method is described in paragraph (b)(2) of the Economic Price Adjustment clause, I-FSS-969. A sample listing of indicators is included as Attachment 2.

2-11 How do I determine the reasonableness of the proposed market indicator?

When evaluating the reasonableness of the proposed market indicator, it should be relevant to the service or product solicited, have an established history, be published regularly, and have reasonable assurance that it will continue to be available in the future. The indicators and how they will be applied are negotiable and must be determined prior to award. For example, a broad based market indicator, such as issued by the Bureau of Labor Statistics, can be applied uniformly to all categories, if the contractor routinely applies across the board wage increases. If a contractor's wage changes vary by skills, the EPA should be based on specific matched categories.

As provided for in the new EPA clause, if the designated market indicator is no longer published or is determined unreliable by the Government, the contractor and the Government will agree on a substitute market indicator.

2-12 How do you administer the market indicator EPA?

Prior to the completion of the negotiation, the contracting officer and the offeror should "dry run" the EPA using previously published numbers from the designated indicator. If both the CO and the offeror arrive at the same adjustment, you can be assured there is a meeting of minds on how the EPA will operate. The calculation of the dry run and the contractor's agreement should be documented in the contract file. This exercise will save significant administrative effort during the term of the contract. The use of market indicators requires more administration and requires a bilateral contract modification to adjust prices. Adjustments to the contract price are governed by changes to the agreed-upon indicator at set periods of time. The market indicator chosen will govern the frequency of adjustments, subject to any limitations set forth in the Economic Price Adjustment clause paragraph (d) . In addition, the contractor bears the burden of tracking the indicator providing additional supporting information as required by the Economic Price Adjustment clause paragraph (e) and notifying acquisition personnel of changes.

2-13 What kind of risk does the use of market indicators pose to the Government?

Market indicator EPAs pose a small risk to the Government in that the chosen indicator could be discontinued or unsuitable, or the prices could fluctuate erratically (e.g., the price of precious metals). When using this type of EPA, it is important to conduct regular reviews to ensure the prices continue to be fair and reasonable.

2-14 How do I determine the appropriate EPA mechanism to use?

Market research is key in determining which price adjustment method (or combination of price adjustment methods) is appropriate for the services and products solicited. Contracting officers should consider the actual practices offerors use in establishing their commercial pricing as well as results of the market research conducted in determining the EPA. Helpful sources are provided in Attachment 2. Acquisition personnel are instructed to conduct market research to determine the EPA practices for the services and products solicited. As part of the acquisition planning process, guidelines can be prepared for the schedule based on this research. Contracting Officers must tailor the EPA clause to meet the commercial practices of each offeror. In accordance with GSAM 516.203-4(c), the contracting director must approve each tailored EPA clause.

2-15 So which EPA clause should I use?

For those services and products that **ARE** based on commercial catalogs or price lists, continue to use GSAR 552.216-70, Alternate 1.

For those services and products that are not based on commercial catalogs or price lists, Attachment 1 contains a new EPA clause that can be used in all appropriate solicitations and contracts where prices are not based on commercial catalogs or pricelists **AND** market research demonstrates that inclusion of such alternate EPA provisions is beneficial. All applicable solicitations should be refreshed; offers in-house, but not awarded, should include the new EPA clause. Applicable contracts may be modified bilaterally at no cost.

For some solicitations and contracts, it may be necessary to use **BOTH** clauses while FSS pursues a revision to the GSAM. For example, you may have a professional services contract with a line item for other direct costs for various products—adjustments to the labor portion could be based on a negotiated escalation rate, while adjustments to the other direct costs could be based on a producer price index. Where this is the case, the Contracting Officer must clearly identify which items are controlled by which EPA clause in the award documentation and in the award letter to the Contractor.

SECTION 3. THE REQUIREMENT FOR AN EPA

3-1 Must I include an EPA?

Yes. When awarding Federal Supply Schedule contracts, the pricing, and a method for adjusting the price, must be established for each contract and option year. All Schedule contracts must be priced.

SECTION 4. SPECIAL CIRCUMSTANCES

4-1 With longer term contracts and our desire to have competitive prices and contractor participation, is there any other way to adjust contract prices?

Yes. It is appropriate to consider market conditions as a special circumstance that may warrant price relief due to unusual occurrences in the market. This may necessitate providing price adjustment relief apart from the two other price adjustment methods discussed in paragraph (b) of the Economic Price Adjustment clause, I-FSS-969.). Where a contractor's price increases are tied to verifiable changes in market conditions impacting the industry and the specific services under contract and the contractor requests relief, the Contracting Officer may offer relief under paragraph (c) of the Economic Price Adjustment clause. In determining whether or not to exercise the authority of paragraph (c), the Contracting Officer must review evidence of market changes in determining whether relief should be granted. This includes, but is not limited to, current experiences reported and demonstrated by the contractor, evidence in trade publications, and/or unusual changes in market indices. The change in market conditions should be beyond those that could reasonably be anticipated by the contractor at the time of the negotiations. The circumstances surrounding Y2K is one example of an unusual occurrence in market conditions. Another more recent example is biochemical detection/protection services: these examples of spikes in the market place have a direct impact on market prices and may warrant price adjustment relief. Prior to allowing for relief authorized by paragraph (c), the Contracting Officer must receive approval from the contracting director.

4-2 How do you administer price adjustments based on special circumstances?

The contractor will request a price adjustment based on demonstrated changes in market conditions. Price adjustments based on special circumstances require the Contracting Officer to review the request and examine how the market has impacted the particular industry as a whole. Any adjustment requires a bilateral contract modification.

SECTION 5. EPA – THE FACTS

5-1 What kind of impact does the EPA have on negotiations?

Negotiated EPAs should have a direct impact on the prices and discounts negotiated, whatever the EPA used. If the pricing risk the contractor is willing to undertake for the Government is greater than the risk taken for the most favored customer, credit should be allowed for that difference in accordance with GSAM 538.270 (c)(7). If during the course of the contract, the contractor proposes a change in price adjustment methods, the contracting officer should require appropriate consideration for any lowering of the contractor's risk.

5-2 What about options?

When exercising an option to extend a Schedule contract, the Contracting Officer shall review the EPA provisions in the contract to determine if the EPA is still reasonable and valid and in the Government's best interests. It is reasonable to re-negotiate and modify the EPA provisions as necessary.

5-3 What about EPA ceilings?

As part of acquisition planning, the ceiling should be established in the solicitation based on market research and conditions relevant to the industry being solicited. The current ceiling on any EPA provision negotiated is normally 10% (reference GSAR 552.216-70, Alternate I). **These same provisions will apply to the new EPA clause**. This ceiling can be increased ***provided*** that the contractor requests that the ceiling be raised **AND** analysis of current market conditions reveals that most suppliers of similar supplies or services are affected **AND** the contracting director approves it. If the price ceiling is raised, the contract must be bilaterally modified to reflect the revised ceiling.

5-4 What about price reductions?

All MAS contracts remain subject to contract clauses GSAR 552.238-75, "Price Reductions"; and 552.215-72, "Price Adjustment -- Failure to Provide Accurate Information." In the event the application of an economic price adjustment results in a price less favorable to the Government than the price relationship established during negotiation between the MAS price and the price to the designated customer, the Government will maintain the price relationship to the designated customer.

5-5 Can price increases be applied retroactively?

No.

5-6 What is the impact of price increases to orders placed by customers?

The EPA will not affect the price of orders placed prior to the effective date of the EPA.

5-7 Should clause I-FSS-966 (Dec 1987) still be used in MAS solicitations?

No. I-FSS-966, MULTIPLE AWARD SCHEDULE PRICE REDUCTION AND ECONOMIC PRICE ADJUSTMENT CLAUSE (DEC 1987) has become obsolete. If this clause remains in any solicitation or contract, it should be removed with the implementation of this acquisition letter.

SECTION 6. CONCLUSION

6-1 What do I need to do to solicitations or contracts?

Attachment 1 contains a new clause that should be added to MAS solicitations and contracts, if appropriate, at the next scheduled refresh. Contracts may be modified, as appropriate. The clause will be added to the FSS Clause Manual.

6-2 Where can I go for additional help?

The MAS Helpdesk is not just for customers and industry to use—it's for you as well. You can reach us at (703) 305-6566 or email at MASHelpdesk@gsa.gov. The FSS Acquisition Management Center will work with you to get answers quickly whenever possible.

ATTACHMENT 1

I-FSS-969 ECONOMIC PRICE ADJUSTMENT-FSS MULTIPLE AWARD SCHEDULE (JAN 2002)

Price adjustments include price increases and price decreases. Adjustments will be considered as follows:

(a) Contractors shall submit price decreases anytime during the contract period in which they occur. Price decreases will be handled in accordance with the provisions of the Price Reduction Clause.

(b) There are two types of economic price adjustments (EPAs) possible under the Multiple Award Schedules (MAS) program for contracts not based on commercial catalogs or price lists as described below. Price adjustments may be effective on or after the first 12 months of the contract period on the following basis:

(1) **Adjustments based on escalation rates negotiated prior to contract award**. Normally, when escalation rates are negotiated, they result in a fixed price for the term of the contract. No separate contract modification will be provided when increases are based on negotiated escalation rates. Price increases will be effective on the 12-month anniversary date of the contract effective date, subject to paragraph (f), below.

(2) **Adjustments based on an agreed-upon market indicator prior to award**. The market indicator, as used in this clause, means the originally released public index, public survey or other public, based market indicator. The market indicator shall be the originally released index, survey or market indicator, not seasonally adjusted, published by the [to be negotiated], and made available at [to be identified]. Any price adjustment shall be based on the percentage change in the designated (i.e. indicator identification and date) market indicator from the initial award to the latest available as of the anniversary date of the contract effective date, subject to paragraph (e), below. If the market indicator is discontinued or deemed no longer available or reliable by the Government, the Government and the Contractor will mutually agree to a substitute. The contract modification reflecting the price adjustment will be effective upon approval by the Contracting Officer, subject to paragraph (g), below. The adjusted prices shall apply to orders issued to the Contractor on or after the effective date of the contract modification.

(c) Nothwithstanding the two economic price adjustments discussed above, the Government recognizes the potential impact of unforeseeable major changes in market conditions. For those cases where such changes do occur, the contracting officer will review requests to make adjustments, subject to the Government's examination of industry-wide market conditions and the conditions in paragraph (d) and (e), below. If adjustments are accepted, the contract will be modified accordingly. The determination of whether or not extra-ordinary circumstances exist rests with the contracting officer. The determination of an appropriate mechanism of adjustment will be subject to negotiations.

(d) Conditions of Price change requests under paragraphs b(2) and c above.:

(1) No more than three increases will be considered during each succeeding 12-month period of the contract. (For succeeding contract periods of less than 12 months, up to three increases will be considered subject to the other conditions of subparagraph (b)).

(2) Increases are requested before the last 60 days of the contract period, including options.

(3) At least 30 days elapse between requested increases.

(4) In any contract period during which price increases will be considered, the aggregate of the increases during any 12-month period shall not exceed ____ percent (__%) of the contract unit price in effect at the end of the preceding 12-month period. The Government reserves the right to raise the ceiling when market conditions during the contract period support such a change.

(e) The following material shall be submitted with request for a price increase under paragraphs b(2) and c above:

(1) A copy of the index, survey or pricing indicator showing the price increase and the effective date.

(2) Commercial Sales Practice format, per contract clause 52.215-21 Alternate IV, demonstrating the relationship of the Contractor's commercial pricing practice to the adjusted pricing proposed or a certification that no change has occurred in the

data since completion of the initial negotiation or a subsequent submission.

(3) Any other documentation requested by the Contracting Officer to support the reasonableness of the price increase.

(f) The Government reserves the right to exercise one of the following options:

(1) Accept the Contractor's price increases as requested when all conditions of (b), (c), (d), and (e) of this clause are satisfied;

(2) Negotiate more favorable prices when the total increase requested is not supported; or,

(3) Decline the price increase when the request is not supported. The Contractor may remove the item(s) from contract involved pursuant to the Cancellation Clause of this contract.

(g) Effective Date of Increases: No price increase shall be effective until the Government receives the electronic file updates pursuant to GSAR 552.243-72, Modifications (Multiple Award Schedule).

(h) All MAS contracts remain subject to contract clauses GSAR 552.238-75, "Price Reductions"; and 552.215-72, "Price Adjustment -- Failure to Provide Accurate Information." In the event the application of an economic price adjustment results in a price less favorable to the Government than the price relationship established during negotiation between the MAS price and the price to the designated customer, the Government will maintain the price relationship to the designated customer.

ATTACHMENT 2

MARKET RESEARCH SOURCES

Extensive information on salaries for various labor categories is available from the Internet-below are a sampling of sites:

✓ The Economic Research Institute at www.erieri.com/sources.

✓ Salary surveys and relevant salary information at www.rileyguide.com, http://salarycenter.monster.com/, http://www.imercer.com/dataandsystems/home/default.asp, http://www.claytonwallis.com/onlrates.htm, http://www.wageweb.com, http://www.apegga.com/members/member_services/salary_survey99/salaries_index.htm, http://consulting.about.com/careers/consulting/msubsalary.htm?once=true&, http://www.healthcarejobstore.com/hb_cfmfiles/salary/index.cfm (for health care), and http://ebnonline.com/salary/1999charts.html.

✓ The Department of Labor at (http://stats.bls.gov/oes/oes_data.htm) or http://stats.bls.gov:80/datahome.htm, but keep in mind that the survey data published by DOL is often one or two or more years old because of the data collection, analysis and reporting process they use.

Market indicators that can be used for products include:

✓ Web site to jump to a variety of indices, including consumer price index, producer price index, manufacturing price index, employment index, health care, etc. http://cas.dri-wefa.com/econanalysis.cfm?service_id=303&siteid=guest&username=guest&password=guest

✓ Indices published by the Bureau of Labor Statistics at http://www.bls.gov/ppi/ that provide a wide range of information on various commodities and industries

Market Price Forecasts

✓ http://www.dri-wefa.com/splash.cfm, for Data Resources Inc.,
✓ http://www.claytonwallis.com/cxgeop.htm for Clayton-Wallis forecasts
✓ Individual state economic offices have long term wage projections, without employment category details