



# CONTRACT LAW DIVISION

Office of the Assistant General Counsel for Finance & Litigation

## A LAWYER'S VIEW OF FIXED PRICE EPA'S

Office of the Assistant General Counsel for Finance & Litigation



### Fixed Priced Contracts with Economic Price Adjustment (The Beauty and the Beast)

by Ed Seymour

So, you want to do a firm fixed priced contract with economic price adjustment (FFP/EPA) to get a good deal for Uncle Sam in an uncertain market. After all, the FAR encourages the use of fixed price contracts of whatever type before one considers the use of a cost-reimbursement contract. The beauty of this idea is clear, the fixed price contract. The beast unfortunately is also clear, the Economic Price Adjustment.

#### The Trap

FAR § 16.203-1 describes the three types of FFP/EPA. (a) adjustments based upon established prices (b) adjustments based upon actual costs of labor or materials, and (c) *adjustments based on cost indexes of labor or material*. The first two are addressed in FAR §16.203-2, Application and have standard FAR clauses to be included in the contract. These two types of FFP/EPA cause little problem for the Contracting Officer, as increases or decreases payable under the contract are based on real prices or costs which can be readily identified. FAR §16.203-2 is silent however, and no standard FAR clause is provided for adjustments based on cost indexes of labor or materials. The only help provided by the FAR is some general advice hidden in the §16.203-4(d) Contract Clauses and it does not address the major trap which exists for the Contracting Officer. The index chosen must approximately track the economic changes effecting the contract. This simple statement of the obvious can cause major problems later, because there are lots of indexes, the choice of which may not be obvious.

#### The Stage is Set

On September 29, 1982, a Contracting Officer for the U.S. Army awarded a FFP/EPA to obtain 600 gallon tank and pump units for the transportation of vehicle fuels. The contract included adjustments based upon the Bureau of Labor Statistics (BLS) index for "Machinery and Equipment, Code 11." To the Contracting Officer, the BLS index chosen appeared to be the correct choice, since it covered the type of items being procured. However, one small detail was overlooked. It seems that over half of the material used to construct the tank and pump units was aluminum. Unfortunately, the price of aluminum increased 40% during the initial period of the contract, an increase not reflected in the BLS index for machinery and equipment.

#### Act I: The Drama Unfolds

As one might imagine, the contractor submitted a claim for cost increases that were actually being experienced, regardless of the BLS index. The Contracting Officer replied that the contractor entered the contract of its own free will, that it knew ahead of time which BLS index was contained therein, and that while the choice of index was reasonable, the risks that it would not precisely track the costs experienced had to be born by the contractor. Claim denied. Have a nice day!

Being a bit peeved, the contractor complains to the U.S. Claims Court that the Contracting Officer is being unfair as the BLS index in the contract does not correctly reflect the economic facts that were actually being experienced. The court decides that since the contractor entered this contract freely and on full notice of its terms, no injustice has been unleashed upon the contractor. The Contracting Officer is right.

#### Act II: Not so Fast

Now the contractor is really angry! Asserting error of law and mistake, the contractor appeals to the U.S. Court of Appeals for the Federal Circuit. The contractor again doggedly argues that the contract's BLS index does not reflect the economic facts that were actually being experienced. The Government confidently asserts that the index chosen is reasonable even if it is not absolutely accurate, and that the contractor entered the contract freely and on full notice of its terms. The court after full consideration of the issues says: Government, you lose! You have a regulatory obligation to pick an index that will achieve the purpose the index is supposed to serve. This regulatory obligation was violated, since the index did not approximate the cost growth actually experienced by the contractor. *Beta Systems, Inc. v. United States*, 838 F. 2d 1179 (Fed. Cir. 1988). Government, have a nice day!

#### Finale/Curtain

Contracting officers should get as many facts as possible about the product or services to be procured and try to pick/construct the best index to reflect the product or service when issuing a fixed-price contract with an EPA based on cost indexes.



**From the Editor-** LCDR Seymour is an attorney in the Contract Law Division and provides legal advice to several NOAA offices including the NEXRAD program.

Comments, criticisms, and suggestions for future topics are welcome. - Call Jerry Walz at FTS 377-1122