

## Ch 1 - Conduct Market Research for Price Analysis

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### **1.0 Chapter Introduction**

*Presolicitation Market Research.* In Government acquisition, market research requires collecting and analyzing information about capabilities within the market to satisfy Government needs. Market research policies and procedures should be designed to arrive at the most suitable approach to acquiring, distributing, and supporting supplies and services. The personnel involved must ensure that legitimate needs are identified and trade-offs evaluated to acquire items which meet those needs.

To get the supplies and services that will best meet the needs of the Government, the Government members of the Acquisition Team must understand the true needs of the Government and know what is available in the marketplace. Market research should be an on-going process for every member of the Acquisition Team, but there are three points where effective market research is particularly important:

- The purchase request should reflect the results of market research conducted by the requester. The requester should consider input from other Government members of the Acquisition Team, especially from the user (if different than the requester) and Government technical personnel. Contracting personnel should support and encourage requester market research efforts whenever possible. For example, the catalogs and price lists available in the contracting office may be invaluable to the requester's market research effort. Contracting personnel should not take the responsibility for developing the requirements documents and should remind other members of the Team not to disclose source selection information outside channels authorized by the agency head (see [FAR 3.104](#)).
- Before soliciting offers for acquisitions with an estimated value in excess of the simplified acquisition threshold, you must conduct market research to assure that together the requirements documents and the contract business terms form the most suitable approach to acquiring, distributing, and supporting supplies and services. This research may be a one-time analysis or part of your on-going effort to know and understand the marketplace for the items that you routinely procure. As you perform your market research, you may question the requirements documents, but you must never change those documents without authorization from the requester.
- Before soliciting offers for acquisitions with an estimated value less than the simplified acquisition threshold, you should perform market research whenever adequate information is not available and the circumstances justify its cost.

*Information for Market Research.* When conducting market research, you should not request potential sources to submit more than the minimum information necessary. Most firms will gladly support Government market research as long as the result will benefit the firm. Most will provide complete information about how the products that they can provide will meet Government requirements. However, they are unlikely to provide information about problems with their products or about other products that could better meet the Government's needs at a lower total cost.

Generally, information on a particular product or industry is available from many sources other than potential offerors. These sources include:

- Knowledgeable individuals in Government and industry;
- The results of recent market research undertaken to meet similar or identical requirements;
- Government data bases that provide information relevant to agency acquisitions;
- Interactive, on-line communication among industry, acquisition personnel, and customers;
- Source lists of similar items obtained from other contracting activities or agencies, trade associations or other sources; or
- Catalogs and other generally available product literature published by manufacturers, distributors, and dealers or available on-line.

*Market Research Results* Use the results of market research to:

- Determine if there are sources capable of satisfying the agency's requirements;
- Determine if commercial items or, to the extent commercial items are not available, nondevelopmental items are available that:
  - Meet the agency's requirements;
  - Could be modified to meet the agency's requirements; or
  - Could meet the agency's requirements if those requirements were modified to a reasonable extent.
- Determine the extent to which commercial items or nondevelopmental items could be incorporated at the component level;
- Determine the practices of firms engaged in producing, distributing, and supporting commercial items, such as terms for warranties, buyer financing, maintenance, and packaging and marking; and
- Ensure maximum practicable use of recovered materials and promote energy conservation and efficiency.

*Market Research and Contract Pricing.* [FAR Part 10](#) requires that you use the results of market research in developing Government requirements and determining how you will satisfy those requirements. This research is required because the decisions made in the presolicitation phase of

the acquisition process will be key factors in defining what the Government receives and the price that the Government will pay. For example, contracting decisions that:

- Increase contractor performance costs will normally increase contract price.
- Lower contractor performance costs will normally reduce contract price.
- Limit competition will normally increase contract price.
- Facilitate competition will normally reduce contract price.
- Increase contractor risk will normally increase contract price.
- Limit contractor risk will normally decrease contract price.

The better you understand the marketplace the better you will be able to make decisions that will enable you to meet the needs of the Government at a reasonable price.

This same understanding of the marketplace will enable you to develop a better estimate of a reasonable price for a contract that meets the needs of the Government. Your preliminary price estimate and the factors that affect contract price will be key inputs to the acquisition planning process. For example, the method of contracting and required contract terms and conditions both depend on your estimate of contract price. In addition, your preliminary estimate of contract price will become a key input to your final determination of contract price reasonableness.

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## **1.1 Reviewing The Purchase Request And Related Market Research**

When determining how much reliance you can place on the Independent Government Estimate in making contracting decisions, you must evaluate the depth and quality of the analysis involved in developing the estimate. As a minimum, you should consider the following five areas:

- 1.1.1 - [How Was The Estimate Made?](#)
- 1.1.2 - [What Assumptions Were Made?](#)

- 1.1.3 - [What Information And Tools Were Used?](#)
- 1.1.4 - [Where Was The Information Obtained?](#)
- 1.1.5 - [How Did Previous Estimates Compare With Prices Paid?](#)

*Purchase Request.* The purchase request is the document that formally transmits the requirement to the contracting office. It is the purchase request that typically first combines the Government requirements document with the Independent Government Estimate of contract price. Normally, the purchase request will also include an assurance that funds are available or will be available to fund the acquisition of the required supplies or services.

*Independent Government Estimate ([FAR 15.404-1\(b\)\(2\)\(v\)](#)).* As the name implies, the Independent Government Estimate must be developed independently by the Government. Independent development is vital because this estimate normally provides your first indication of a reasonable contract price and it is also one of the bases that you should consider in contract price analysis. The estimate development process may be automated or manual, but the best estimates reflect the requester's market research.

*Reviewing Requester Market Research.* [FAR Part 10](#) requires market research before developing new requirements documents for an acquisition. Logically, this responsibility falls on the requester. The quality of the requester's Independent Government Estimate usually depends on the quality of the requester's market research. Because of the importance of the Independent Government Estimate to your selection of appropriate acquisition techniques and eventually your decision on price reasonableness, you should review the estimates carefully, before initiating further procurement action.

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### **1.1.1 How Was The Estimate Made?**

*Estimate Preparation.* To judge the reliability of a Government estimate, you must know how the estimate was made. Purchase requests may be prepared by an automated system or manually by the requester or an estimating specialist.

- Automated Purchase Request Estimates

- Estimates for purchase requests prepared by an automated system are developed following an algorithm that has been programmed into the system. The most common algorithm is to set the unit price estimate equal to the last unit price paid.
  - Estimates prepared by automated systems rarely take changes in the market situation into account. Even such basic factors as changes in price related to changes in quantity are not considered. For example, assume that the requirement is for 5,000 generators. If the last acquisition was for a single generator, the estimated unit price for each of the 5,000 generators would be the same as the price for a single generator.
  - When you make acquisitions based on automated purchase requests, you must learn what market factors (if any) are considered in preparing the request. Factors not considered in estimate development should be special areas of emphasis in your market research. Once you understand the algorithm for developing the automated estimate, you should remain alert to possible changes in that algorithm.
  - Manual Purchase Request Estimates
    - Estimates for manual purchase requests are typically prepared by the individual preparing the purchase request. Different organizations, and different individuals within the same organization, may have different methods of developing the Government estimate.
    - Estimates should reflect any market changes identified during market research. Unfortunately, many do not. Instead manual estimates, like automated estimates, are often based on the last unit price paid with no consideration of changes in the market situation.
    - You must determine how each individual estimate was developed so that the other questions concerning reliability can be examined. This also provides a general insight into the amount of time devoted by the requester to market research.
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### 1.1.2 What Assumptions Were Made?

Every estimate involves assumptions. Knowing and understanding those assumptions can give you an insight into the estimator's understanding of reliable estimate development.

*Analysis of Assumptions* In many cases, user/technical/program personnel are not familiar with relevant cost factors and market forces that affect contract pricing. As a result, assumptions and estimates may not be accurate.

If the rationale used to develop the estimate is not clear or does not seem reasonable, ask questions! **IN PRICING, THERE ARE NO DUMB QUESTIONS!** If you do not know, ask! By asking questions about the Independent Government Estimate and accompanying documentation, you can identify assumptions that are not consistent with market realities and work with the requester to improve the estimate before the contracting process begins.

**Estimate Example 1:** The requester used the last price paid for an item to estimate the price for the same item 10 years later.

- **Assumptions** The requester has assumed that the last price paid was reasonable, and that the market situation has not changed in 10 years.
- **Analysis** Over a few days or weeks, it may be reasonable to assume that the price has not changed if quantity, delivery, and other factors have not changed. But in this case the last purchase was made 10 years ago? Normally, it is not reasonable to assume that the price has not changed in 10 years. Once you identify the assumptions used in estimate development, you can evaluate them and adjust for any that do not appear consistent with market realities.

**Estimate Example 2:** The requester estimated the price of 100 warehouse trucks with 3 cubic foot capacity based on the price paid for 2 cubic foot units acquired during the last month.

- **Assumptions.** The requester has assumed that the recent price was reasonable, and that the unit price is not affected by changes in unit capacity.
- **Analysis.** The assumption that unit price will not be affected by the unit's capacity may or may not be

reasonable. However, the great difference in capacity should lead you to subject this assumption to closer scrutiny during your market research.

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### 1.1.3 What Information And Analysis Were Used?

It is important to determine what the requester knows about the item or service being requested and what type of analysis was used in estimate development.

*Market Research Information.* The **most successful estimators** know their item. Before they make an estimate, they collect information on the product and the market for that product. Their market research may be a one-time effort or part of an on-going process that is an integral part of their normal job.

The **most reliable estimates** are prepared by estimators who have performed detailed market research and can answer "yes" to the following questions that apply to a particular purchase request:

- Did the estimator perform a detailed analysis of the Government requirements documents?
- Is the estimator familiar with the market for the item, including:
  - Last price paid?
  - General market price changes?
  - Current commercial market price?
  - Quantity price breaks?
  - Possible substitutes?

*Estimating Analysis.* Market information alone is usually not enough. The estimator must be able to **apply** appropriate analysis to estimate development. Reasoned analysis provides a much more supportable estimate than one that is simply based on estimator judgment and experience. The strongest estimates are usually the result of a reasoned analysis supported by the use of appropriate quantitative techniques.

**Reasoned Analysis.** A reasoned analysis is an analysis that sets forth the known information and clearly explains how it was used in estimate development. This analysis may or may not be supported by the use of quantitative techniques.



**Quantitative Techniques.** When appropriate, adjustments should be made using accepted quantitative techniques. For example, index numbers can be used to quantify price changes and adjust historical pricing data.

*Estimate Support Comparison.* Estimates supported by words such as "professional judgment," but no factual data, are typically of little value. Estimates based on good information and the application of appropriate quantitative techniques or reasoned analysis will generally be more accurate and easier to support throughout the acquisition process. For example, in an analysis of changes in technology, which of the following techniques would be more useful in price estimation?

**Professional Judgment.** "Based on my 20 years of experience as a Project Engineer and my knowledge of the product, I estimate the price of this unit at \$585,000."

**Reasoned Analysis.** "We are requesting new high sensitivity replacement units. A year ago, a product could not be produced with this level of sensitivity to high frequency sound. Today, units with similar sensitivity improvements are available at a 30 percent higher price than the less sensitive units they replaced. Therefore the estimated price for this unit, \$585,000, is 30 percent higher than the \$450,000 price last paid for the less sensitive unit that it will replace."

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#### 1.1.4 Where Was The Information Obtained?

The breadth and depth of the requester's market information will have a substantial impact on the quality of the estimate. Learn what you can about the sources of information used by the requester in estimate development, because some sources of information are better than others. Knowing the sources of information will make it easier for you to evaluate the reliability of the estimate.

*Estimate Information Sources.* Many estimators rely exclusively on historical prices as their base for estimate development. Historical prices are an excellent source of information on the price at some point in the past but market conditions and Government requirements change over time. Past prices for a similar item may have been based on

detailed Government specifications while the current requirement is based on products commonly traded in the commercial market place. In that situation, historical prices may not provide a viable price estimate.

Encourage requesters to provide source data with their estimates. Information, such as a vendor catalog or portion thereof, will provide an excellent starting point for your market research.

*Product Analysis.* If the requirement is unique and there is no price history available, the estimator must develop a price estimate by some other form of analysis. One option is for the requester to develop an estimate based on an evaluation of the material and labor required to produce the product. When such estimates are required, the more current the data used to develop the cost estimate, the more reliance you can place on the estimate.

*Misleading Information.* Many data sources, such as stock lists, can present information that is difficult to use in price estimating. The price information is usually not current and there is typically little information about its source. Prices may be historical prices from an unknown point in the past or even averages of historical prices. It is typically difficult or impossible to adjust these prices for changes in the market situation. As a result, you must be particularly careful when using such data as a base for estimated development.

*Emphasize Estimator Independence.* While use of vendor catalogs and other methods of market research should be encouraged, estimators MUST BE DISCOURAGED FROM CONTACTING VENDORS FOR SPECIFIC QUOTATIONS. This is particularly true in sole source situations, where the Independent Government Estimate may be a primary basis for determining price reasonableness. If both the estimate and the proposal come from the offeror, there is no independent measure of price reasonableness.

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#### **1.1.5 How Did Previous Estimates Compare With Prices Paid?**

An examination of the Independent Government Estimate should include an examination of the estimator's track record. Just as past vendor performance is an indicator of

future contract performance, the quality of past estimator performance is an indicator of the quality of the current estimate.

*Comparison with Prices Paid.* In evaluating estimates, ask: "Have the estimator's past estimates been close to contract prices determined fair and reasonable through analysis using other price analysis techniques?"

If the answer is yes, greater reliance can be placed on current estimates developed using similar techniques.

If the answer is no, less reliance should be placed on these estimates.

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## **1.2 - Considering Contract Pricing In Your Market Research**

The Independent Government Estimate is only one preliminary estimate of contract price. As a minimum, your research, should consider the following data sources:

- 1.2.1 - [Historical Pricing Data For Market Research](#)
- 1.2.2 - [Published Data For Market Research](#)
- 1.2.3 - [Market Research Data From Buyers And Other Experts](#)
- 1.2.4 - [Market Research Data From Prospective Offerors](#)
- 1.2.5 - [Market Research Data From Other Sources](#)

*Factors to Consider in Researching the Market.* Each time you conduct market research the process will be different because of differences in Government requirements, market conditions, and other factors. The following table identifies research factors and outlines the type of questions that you should be able to answer when you complete your market research. Not all of the questions identified in the table will be valid for every acquisition. For some acquisitions, you will have many specialized questions that are not covered in the following table. However, the research factors identified and the related questions provide a good framework for your market research.

**Pricing Factors to Consider in Market Research**  
**Research Factor You Should Be Able to Answer Questions**  
**Such As...**

- Pricing History
- What information is available concerning past prices paid for the product and changes in the product or market since then?
  - Have there been historic differences between prices paid by the Government vis-à-vis other buyers? Why?
- Current Competitive Conditions
- How many sellers are in the market?
  - How many buyers?
- Current Overall Level of Demand
- What is the relationship of the quantity we intend to buy vis-à-vis the quantities that others buy?
  - Will our volume justify a lower than market price due to the seller's increased economies of scale?
  - Will our volume be so large as to drive the sellers to or beyond full capacity, resulting in unanticipated inflation?
- Trends in Supply and Demand
- Will demand be higher or lower at the time of award than now?
  - Will supply capacity keep pace with demand?
- Pattern of Demand
- Is there a cyclical pattern to supply and demand?
  - Would awarding six months from now result in lower prices than an immediate award?
  - Or would it be better to stock up now at today's prices?
- Other Market Forces Expected to Affect Contract Price
- What forces might drive up prices in the near future? Strikes? Labor shortages? Subcontractor bottlenecks? Energy shortages? Other raw material shortages?
  - What forces might lead us to expect lower prices in the

future?

Pricing  
Strategies

- What are the pricing strategies of firms in the market?
- What are the implications for expected prices?

Sources of  
Supplies or  
Services

- Which firms in the market are the most likely to submit offers to a Government solicitation?
- Which are the least likely and why?

Product  
Characteristics

- What features distinguish one product from another?
- Which commercial products match most closely with the Government requirements document (as it currently reads in the purchase request).
- What is the apparent tradeoff between features and price?

Delivery/  
Performance  
Terms

- What are the current distribution channels?
- What are current transportation costs (if available and applicable)?
- What are the commercial lead-times?

Ownership Costs

- What are the commercial warranty terms and conditions (if any)?
- What are the historical repair costs for each product?
- What are the historical maintenance costs for each product?

Contract Terms  
and Conditions

- What terms and conditions are used in commercial transactions?
- What terms and conditions have been used in other Government acquisitions?
- What type of contract is generally used in commercial

transactions? Government  
acquisitions?

Problems

- What has been the historical default rate by firms performing similar contracts?
- What performance problems have typically been encountered?
- Have similar acquisitions been characterized by claims or cost overruns?

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### 1.2.1 Historical Pricing Data For Market Research

Prior to contracting, [FAR 7.103\(1\)](#) requires the contracting officer to review:

- The acquisition history of the supplies and services; and
- A description of the supplies, including, when necessary for adequate description, a picture, drawing, diagram, or other graphic representation.

One of the reasons for this requirement is to ensure that prior prices are considered in estimating the proper price of the current acquisition. However, you must also remember that information from Government historical price data bases provides a picture of what happened in the past. You must integrate this information with information from other market research to enhance the accuracy of your price estimate.

*Sources of Acquisition Histories.* Acquisition histories can be found in many sources. Typically, the best sources are contract files, computerized acquisition data files, and manual item records.

**Contract Files.** Usually, the best source of information on past pricing decisions is the original file of the contract action. Detailed information, and the rationale used to determine price reasonableness should be available in the file.

**Computerized Acquisition Data Files.** Computers provide immediate access to the data considered most important to purchase decision making. While computer data files may not be as complete as purchase files, they do provide key data in a form that can be used by the buyer in a timely fashion.

**Manual Item Records.** Manual item records typically provide data similar to that contained in computerized acquisition data files.

*Researching Historical Acquisition Pricing Information.* Historical prices are an excellent source of market information. Research of historical market information can tell you a lot about the acquisition situation for the product at some point or points in the past. For that information to be useful, you must be able to determine what the market situation was in the past and how it has changed since then. The following table presents research elements that you should consider in your examination of historical acquisition information and questions that you should consider in your research.

#### **Historical Acquisition Data for Pricing**

<b>Research Element</b>	<b>You Should Be Able to Answer Questions Such As...</b>
Trends in Supply and Demand	<ul style="list-style-type: none"><li>• When did past acquisitions take place?</li><li>• Is there any indication of prevailing market conditions at that time?</li></ul>
Pattern of Demand	<ul style="list-style-type: none"><li>• What quantities were solicited for each acquisition?</li><li>• What quantities were acquired?</li></ul>
Trends in Prices	<ul style="list-style-type: none"><li>• What was the contract price?</li><li>• How did the unsuccessful offers compare with the successful offer?</li></ul>
Start-up Costs and Pricing Strategy	<ul style="list-style-type: none"><li>• Did the contract price include one-time engineering, tooling, or other start-up costs?</li><li>• Should future contracts include similar or related costs?</li><li>• Were necessary start-up costs paid</li></ul>

for in a manner separate from the price for the item or service?

Sources of  
Supplies or  
Services

- How many sources were solicited for the prior acquisition?
- What specific sources were solicited?
- How many sources offered bids or proposals?
- What specific sources offered bids or proposals?

Product  
Characteristics

- Are there any significant differences between the Government requirements documents for the prior contract and the current requirements?

Delivery/  
Performance  
Terms

- What was the delivery or performance period in days, weeks, months, or years?
- In what month(s) were the supplies to be delivered or the service to be performed?
- Did the vendor meet the delivery targets?
- What was the FOB point?
- Was premium transportation required for timely delivery?

Ownership Costs

- What costs of ownership were associated with the acquisition?

Acquisition  
Method

- What acquisition method was employed for past acquisitions?

Contract Terms  
and  
Conditions

- What were the general terms of past contracts?
- Are there any significant differences between terms of the last contract (e.g., packing requirements, type of contract, and the like) and those recommended for this acquisition?

Problems

- What problems (if any) were



encountered during contract performance?

### 1.2.2 Published Data For Market Research

This subsection presents examples of several types of published information that you can use in developing your preliminary estimates of contract price.

- 1.2.2.1 - [Manufacturer And Dealer Catalogs](#)
- 1.2.2.2 - [Product Brochures And Promotional Material](#)
- 1.2.2.3 - [Trade Journals](#)
- 1.2.2.4 - [Government Or Independent Testing](#)
- 1.2.2.5 - [Source Identification Publications](#)
- 1.2.2.6 - [Federal Supply Schedules \(FSS\)](#)
- 1.2.2.7 - [Government Economic Data](#)
- 1.2.2.8 - [Non-Government Economic Data](#)

*Typical Data Available by Source.* The table below summarizes the sources of pricing related data and typical data available for each source.

**Typical Data Available by Source**

Source	Product Specs.	Product Picture	Pricing Info.	Order Quantity Req. Info.	Delivery Data	Source Location	Warranty and Guarantee Info.	Index
Catalogs	Yes	Often	Yes	Yes	Yes	Yes	Rarely	I
Product Brochures	Yes	Often	Often	Often	Often	Yes	Yes	I
Trade Journals	Yes	Often	Rarely	Rarely	Rarely	Often	Often	I
Advertisement	Yes	Often	Often	No	No	Often	Often	Y
Product Eval's	Yes	Rarely	Rarely	No	No	No	No	Y
Articles								
Source ID Pubs	No	Rarely	No	No	No	Yes	No	I
Yellow Pages	Yes	Yes	No	No	No	Yes	No	I

Thomas  
Register

Govt or  
Independent  
Testing

Yes No No No No No No

Qualified  
Products  
Lists

Yes No No No No No No

Underwriters  
Laboratory

Federal  
Supply  
Schedules

Yes Often Yes Yes Yes Yes Often

Govt Economic  
Data

No No No No No No No

Non-Govt.  
Economic Data

No No Some Do No No No No

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### 1.2.2.1 Manufacturer And Dealer Catalogs

Catalogs are familiar sources of data that can be found in both department stores and mail order houses. The manufacturer and dealer catalogs used in Government purchasing resemble these catalogs in the type of information they provide. Typical data you can find in manufacturer and dealer catalogs include:

- Product descriptions
- Pictures
- Prices and quantity discounts
- Minimum order requirements
- Delivery data
- Points of contact for quotes and orders

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### 1.2.2.2 Product Brochures And Promotional Material

Brochures and promotional material provide much greater detail about specific products than would normally be included in a catalog with several thousand other products.

While details on pricing and delivery are often included, this information may be excluded in order to provide greater latitude in negotiating the terms of sale.

The following are typical data you can find in product brochures and promotional material:

- Detailed specifications
- Pictures
- Available service guarantees and products
- Points of contact for quotes and orders
- Pricing information
- Delivery data

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### 1.2.2.3 Trade Journals

Trade journals provide a variety of information from different sources, including advertisements, product evaluations, and independent articles.

*Trade Journal Data Sources.*

**Advertisements** typically consist of product descriptions, often with pictures and comparisons with competitor's products. Sources to consult for additional information may also be identified.

**Product evaluations** provide independent information to members of the trade who may be considering the purchase of that product or a similar one. Evaluations usually deal with technical capabilities, but often include information on source locations, pricing, and warranties.

**Articles** about the trade may indirectly provide an independent analysis of product capabilities. Successes or failures in using particular products or services serve as evaluations of their quality.

The table below gives an overview of typical data you can find in trade Journals.

<b>Data Source</b>	<b>Typical Data</b>
Advertisements for Products Used in the	<ul style="list-style-type: none"><li>• General product descriptions</li><li>• Pictures</li><li>• Comparisons with competitive</li></ul>

Trade	<ul style="list-style-type: none"> <li>products</li> <li>List prices</li> </ul>
Independent Product Evaluations	<ul style="list-style-type: none"> <li>Strengths and weaknesses of products</li> <li>Warranty or guarantee provisions</li> <li>Comparisons with competitive products</li> <li>Pricing information</li> </ul>
Articles	<ul style="list-style-type: none"> <li>Application of existing products to problem solving</li> <li>Strengths and weaknesses of products in problem solving</li> </ul>

#### 1.2.2.4 - Government Or Independent Testing

Product testing by Government or independent laboratories can provide essential product data. The data can be used to determine if a product meets minimum requirements and to identify and compare similar products.

*Qualified Products Lists* ([FAR 9.201](#) and [9.202\(c\)](#)). The results of Government testing often means inclusion on a **Qualified Products List (QPL)**. A QPL is a list of products which have been examined, tested, and have satisfied all applicable Government product qualification requirements. When a QPL applies to a particular product, all potential offerors must either be on the list or demonstrate to the satisfaction of the contracting officer that their product meets or can meet QPL standards before the date set for contract award. You can also use QPLs to identify potential sources for similar products.

*Underwriters Laboratory.* The best known independent testing laboratory is [Underwriters Laboratory \(UL\)](#). Testing and approval by UL is essential for a wide variety of electrical products.

The table below gives an overview of typical data you can obtain from product standards and testing laboratories.

Data Source	Typical Data
Qualified Products	Results of product tests to

Lists	Government requirements
<a href="#">Underwriters Laboratory (UL)</a>	Results of tests of electrical products to UL commercial standards

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#### **1.2.2.5 Source Identification Publications**

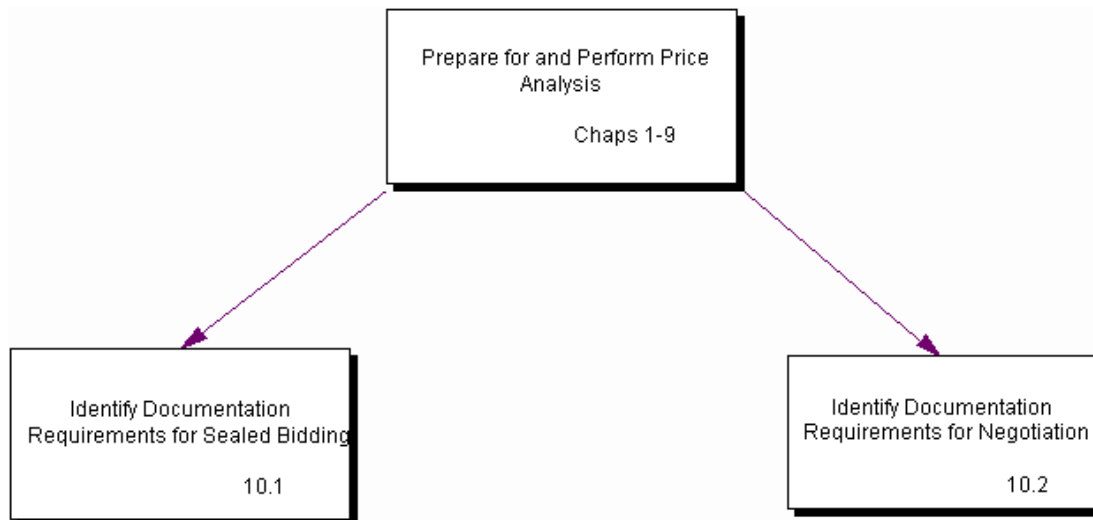
There are thousands of publications designed to assist you in locating possible sources of product information. The most widely accepted of these are the Yellow Page and the [Thomas Register of American Manufacturers](#).

## Ch 10 -Documenting Pricing Actions

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    - 10.1.1 - [Record All Bids](#)
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    - 10.1.4 - [Identify The Basis For Considering The Award Price Reasonable](#)
  - 10.2 - [Documenting Actions In Negotiations](#)
- 

### 10.0 Introduction

*Documentation in the Pricing Process.* Documentation is the final activity in contract pricing process. The figure below demonstrates that you must identify the appropriate documentation for the method of contracting that you are using.



*Need for Good Documentation.* Good documentation is essential to good contracting. As time goes on, you forget times, dates, persons involved, and other elements that are important in all aspects of contracting and pricing in particular.

While fresh in your mind, you should document:

- Events;
- Actions; and
- Decisions.

*Problems from Poor Documentation.* Lack of good documentation can create serious problems. Since you will not always be available to explain what you did, or why, other contracting personnel will not know what happened, or about any special circumstances that may have affected your decisions. If your files lack proper documentation:

- Other contracting personnel may take the time to accomplish an action or make a decision that you have already completed. These actions or decisions may conflict with yours.
- Legal advisors and management review teams may question your action or lack of action because they do not have all of the relevant information.
- You will find that the lack of documentation is generally treated as a lack of action. If it is not documented, it never happened.

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## **10.1 Documenting Actions In Sealed Bidding**

- 10.1.1 [Record All Bids](#)
- 10.1.2 [Record The Reason For Rejection Of Bids](#)
- 10.1.3 [Record How Any Ties Were Broken](#)
- 10.1.4 [Identify The Basis For Considering The Award Price Reasonable](#)

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### **10.1.1 Record All Bids**

*Introduction* ([FAR 14.403\(a\)](#)). As soon as practicable after opening, the bid opening officer must assure that all bids are accurately recorded and certified.

*Forms to Be Completed* ([FAR 14.403\(a\)](#) and [14.403\(c\)](#)). Except for the Defense Center, in the acquisition of natural gas, petroleum or coal, and the Defense , in the acquisition of perishable subsistence items, bids must be recorded on one of the following forms:

- Standard Form (SF) 1409, [Abstract of Offers](#) (Note--PDF format).
- Optional Form (OF) 1419, [Abstract of Offers](#) -- Construction (Note--PDF Format).
- An automated equivalent to one of the above forms.

Agencies and contracting offices may establish additional documentation requirements.

*Acquisitions with Numerous Bid Items* ([FAR 14.403\(a\)](#)). In situations where bid items are too numerous to warrant complete recording of all bids, you may limit abstract entries for individual bids to the item numbers and bid prices. In preparing these forms, use the extra columns of the SF 1409 or OP 1419 to record the information that the contracting office deems necessary. If needed, the following forms can be used:

- SF 1410, [Abstract of Offers](#) (Note--PDF Format) -- Continuation, with the SF 1409.
- OF 1419A, [Abstract of Offers](#) -- Construction, Continuation Sheet, with the OF 1419.

*Make Abstracts Available for Public Inspection* ([FAR 14.403\(b\)](#) and [24.2](#)). You must make abstracts of offers for unclassified acquisitions available for public inspection. However, publicly displayed abstracts must not contain:

- Information on any failure to meet minimum standards or responsibility.
- Information on apparent collusion of bidders.
- Other notations properly exempt from disclosure to the public in accordance with agency regulations implementing FAR 24.2, Freedom of Information Act.

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### **10.1.2 Record The Reason For Rejection Of Bids**

*Introduction.* An individual bid may be rejected or an entire solicitation canceled for pricing related reasons. Whenever such action is taken, you must clearly document the facts leading to the decision, as well as the decision itself.

*Documenting a Suspected Mistake in Bid* ([FAR 14.404-2\(f\)](#) and [14.407-1](#)). Any bid may be rejected if the contracting



officer determines in writing that the price is unreasonable. Unreasonableness of price includes the total price of the bid, as well as the prices of individual items.

Typically, the rejection of an individual bid because of unreasonable pricing begins with an alleged or suspected mistake in bid. Whenever you suspect a mistake in bid, you must call the bidders attention to the suspected mistake and request the bidder to verify the bid in writing.

Documentation of the verification process SHOULD include:

- A record of the request for verification. If the request is made orally, the key points of the conversation must be documented in the contract file. If the request is made in writing, retain a copy in the contract file.
- Also retain a copy of the offeror's written response in the contract file.

*Documenting Rejection of an Unfair Bid* (FAR [14.407-3\(g\)\(5\)](#))(Pamfilis Painting, Inc., CGEN B-237968, April 3, 1990).

. If the bidder fails or refuses to furnish evidence to support the mistake in bid, consider the bid as submitted, unless the contracting officer determines that one of the following situations exists:

- The amount of the bid is so far out of line with the amounts of other bids received, the agency estimate, or the amount determined reasonable by the contracting officer, as to reasonably justify the conclusion that accepting the bid would be unfair to the bidder or to other bona fide bidders.
- There are indications of error so clear as to reasonably justify the conclusion that acceptance of the bid would be unfair to the bidder or to other bona fide bidders.

Documentation concerning rejection of an unfair bid MUST include a record of all attempts made to obtain the information required and the action taken with respect to the bid.

Documentation SHOULD also include:

- Evidence supporting the determination that the bid is "far out of line" with other bids or the agency estimate or other indications that the bid is unfair to the bidder or other bona fide bidders.
- A clear determination that one or both of the FAR [14.407-3\(g\)\(5\)](#) situations exist.
- A copy of the bidder notification of bid rejection.

The following quote, concerning a protest by Pamfilis Painting, Inc., demonstrates the importance of clear "unfair bid" documentation.

A contracting officer's decision to reject an apparently mistaken bid under the authority of the Federal Acquisition Regulation 14.407-3(g)(5) **is subject to question only where it is shown to be unreasonable....** Moreover, an obviously erroneous bid may not be accepted even if it is verified by the bidder. The contracting officer's decision to reject Pamfilis's bid was reasonable. **The record demonstrates that there is a significant disparity in Pamfilis's bid and the government estimate for many elements of work which creates reasonable doubt that the protester understood the scope of work required by the IFB. ... the record indicates that the Navy questioned** whether Pamfilis's bid included the costs associated with (1) the specialty painting required in the solicitation, i.e., railing and trim painting, metal and fence painting; (2) demolition, (3) quality assurance, and (4) utilities, water, scaffolding and tools. While Pamfilis denies any mistake in its bid and continues to maintain that its total bid price is reasonable and includes all costs reasonably associated with all items of work to be performed, **the protester has not furnished any probative evidence to support its bid calculations. As noted above, Pamfilis was repeatedly asked to furnish its original work papers which Pamfilis has failed to provide.** In view thereof, and in view of the disparities between Pamfilis's bid and the government estimate, the contracting officer reasonably rejected Pamfilis's bid as mistaken." (emphasis added)

*Documenting Rejection of an Unbalanced Bid* ([FAR 14.404-2\(g\)](#) and [15.404-1\(g\)](#)). Any bid may be rejected if the prices

for line items or subline items are unbalanced and there is a high probability that award to that bidder will:

- Increase contract performance risk; or
- Result in payment of unreasonably high prices.

Documentation SHOULD include:

- The price analysis used to identify the unbalanced bid.
- A clear determination that the unbalanced pricing will:
  - Increase contract performance risk; or
  - Result in payment of unreasonably high prices.
- A copy of the bidder notification of bid rejection.

*Documenting Invitation Cancellation for Pricing Related Reasons ([FAR 14.404-1\(c\)](#))*. As you learned earlier in the text, five of eleven reasons for canceling an IFB after bid opening are directly related to pricing decisions. The relevant subparagraphs of FAR 14.404-1(c) are:

(4) The invitation did not provide for consideration of all factors of cost to the Government, such as cost of transporting Government-furnished property to bidders' plants.

(5) Bids received indicate that the needs of the Government can be satisfied by a less expensive article differing from that for which the bids were invited.

(6) All otherwise acceptable bids received are unreasonable prices, or only one bid received and the contracting officer cannot determine the reasonableness of the bid price.

(7) The bids were not independently arrived at in open competition, were collusive, or were submitted in bad faith.

(9) A cost comparison as prescribed in OMB Circular A-76 and Subpart 7.3 shows that performance by the Government is more economical.

Documentation MUST include a written determination by the agency head, or designee, that one of the situations identified above exists and presents a compelling reason for canceling the .

Documentation SHOULD also include:

- All the findings that led to the decision - including, in the case of unreasonable prices - data supporting the contracting officer's conclusion that all bids received are unreasonable (e.g., in comparison to commercial prices, historical prices, the Independent Government Estimate, et. al.).
- The specific reason for the cancellation, including the authorizing FAR reference.
- A copy of the notification of bid rejection and invitation cancellation.

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### **10.1.3 Record How Any Ties Were Broken**

*Introduction* ([FAR 14.408-6\(a\)](#) and [14.408-6\(b\)](#)). When two or more bids are equal in ALL respects, contract must be awarded in the following order of priority:

1. Small business concerns that are also labor surplus area concerns.
1. Other small business concerns.
2. Other business concerns.
3. If two or more bidders remain tied, the tie must be broken by a drawing by lot limited to the tied bidders. If time permits, the bidders involved must be given the opportunity to attend the drawing. The drawing must be witnessed by at least three persons.

*Tie Breaking Documentation* ([FAR 14.408-6\(](#) and [14.408-](#)). You MUST include in the documentation:

- A written agreement that the contractor will perform, or cause to be performed, the contract in accordance with the circumstances justifying the priority used to break the tie or select bids for a drawing by lot.
- A record of how the tie was broken. The record should consider the order of priority of tie breaking

criteria and the offerors eliminated by each criterion.

- If applicable, the names and addresses of at least three individuals who witnessed the drawing by lot and the person who supervised the drawing.

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#### **10.1.4 Identify The Basis For Considering The Award Price Reasonable**

*Introduction* ([FAR 14.408-2](#)). You must determine that the prices offered are reasonable before making a contract award. In each case, the determination must consider all relevant circumstances. Take particular care in cases where only a single bid is received.

*Document in the Contract File* ([FAR 14.103-2](#), [14.408-2\(a\)](#), [14.408-7\(a\)](#), and [FAR 14.408-7\(b\)](#)).

Whenever you award a contract, you MUST document the following in the contract file:

- Compliance with FAR 14.103-2, including FAR 14.103-2(d), which requires that award be made to the responsible bidder whose bid is responsive to the terms of the IFB and is most advantageous to the Government, considering only price and price-related factors included in the IFB.
- That the accepted bid was the lowest bid received, or list all lower bids with reasons for their rejection in sufficient detail to justify the award. If bids are rejected for price-related reasons, include details, or reference to details, of the price analysis supporting the rejection decision.

By awarding the contract, you, as the contracting officer, demonstrate an affirmative decision that the price is reasonable.

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#### **10.2 Documenting Actions In Negotiations**

*Introduction.* Requirements for documentation of negotiations vary with the dollars involved. In this

section you will learn about documentation of both simplified acquisitions and other contracts.

*Micro-Purchase Documentation* ([FAR 13.202](#)). The administrative cost of verifying the reasonableness of the price of purchases at or below the micro-purchase threshold may more than offset potential savings from detecting overpricing. Action to verify price is only required when you:

- Suspect or have information to indicate that the price may not be reasonable (e.g., comparison with previous prices or personal knowledge).
- Purchase an item for which no comparable pricing information is readily available (e.g., a supply or service that is not the same as or similar to other supplies or services that you have recently purchased on a competitive basis).

Since there is no requirement for price analysis, no pricing documentation is required unless you must take action to verify price reasonableness. Award demonstrates an affirmative decision that the price is reasonable. When you must take action to verify price reasonableness, documentation should be sufficient to establish price reasonableness. If you award to other than the low quoter, you must explain your award decision.

*Other Simplified Acquisition Documentation* ([FAR 13.106-3](#)). Other simplified acquisitions require a determination that the price is reasonable:

- Whenever possible, base your determination on comparisons with competitive quotations or offers.
- If you only receive one quote, include a statement of price reasonableness in the contract file. The statement may be based on:
  - Market research;
  - Comparison of the proposed price with prices found reasonable on previous purchases;
  - Current price lists, catalogs, or advertisements;
  - A comparison with similar items in a related industry
  - Value analysis;
  - Personal knowledge of the item being purchased;
  - Comparison to an Independent Government Estimate;or

- o Any other reasonable basis.

Your documentation must also include:

- All quotes
  - o If an oral solicitation is used, include an informal record of the suppliers contacted, oral price quotations, and other terms and conditions.
  - o If a written solicitation is used, include an abstract or notes to show prices, delivery, references to printed price lists used, the vendor or vendors contacted, and other pertinent data.
- If you do not have adequate price competition, describe the analysis used to determine price reasonableness.
- If you only solicit one source, explain the absence of competition, unless the contract is for utility services available from only one source.
- When you consider criteria other than price-related factors in selecting the supplier, document the rationale used in making your final award decision. Be sure to explain the role that price analysis played in your decision.

*Pre negotiation Documentation for Other Than Simplified Acquisitions* ([FAR 15.406-1\(b\)](#) and [15.406-3\(a\)](#)).

Contracting officers must establish pre negotiation objectives before the negotiation of any pricing action. The scope and depth of the analysis supporting the objectives should be directly related to the dollar value, importance, and complexity of the pricing action.

In many contracting activities, contracting officers prepare written **pre negotiation memoranda** to document these pre negotiation objectives. Whether you work for such an activity or not, you should draft the following elements of the Price Negotiation Memorandum (PNM) **before** negotiations:  
1

- Purpose of the negotiation (new contract, final pricing, etc.)
- Description of the acquisition, including appropriate identifying numbers (e.g., RFP number).
- If the offeror was not required to submit cost or pricing data to support a price negotiation over the

cost or pricing data threshold, the exception used and the basis for using it.

- A summary of the contractor's proposal, field pricing and internal analyses, and the Government prenegotiation objective. Carefully summarize the reasons for any pertinent variances.
- Summarize of the most significant facts or considerations controlling the establishment of the prenegotiation price objective.
- Summarize and quantify any significant effect that direction from Congress, other agencies, or higher-level officials (i.e., officials who would not normally exercise authority during the contract award and review process) has had on the contract action.

<sup>1</sup> Note: Additional information is required if you used cost analysis in preparing your negotiation objectives.

*Additional Documentation for Other Than Simplified Acquisitions.* In preparing your prenegotiation documentation, you should also document any important aspects of the acquisition situation that could reasonably affect your pricing decision:

- Describe the items or services being purchased.
- Indicate the quantities being purchased.
- Identify the unit prices proposed and negotiated.
- Identify the place of contract performance.
- Describe the delivery schedule or period of performance.
- State whether there is a difference between the proposed delivery schedule and the objective schedule.
- State whether there have been any previous buys of similar products; if so, identify:
  - When.
  - How many were acquired.
  - Schedule/production rate.
  - Contract type.
  - Unit prices or total prices, including both target and final prices, if applicable.
- Identify whether Government-furnished material will be provided as a result of the contract, and if so, its estimated dollar value.
- Describe any unique aspects of the contract action.
- Describe any outside influences or time pressures associated with the procurement, for example, procurement priority and funding limitations, etc.



*Documentation of Actions Taken To Address Unreasonable Prices.* Describe all actions taken if a contractor insists on a price or demands a profit or fee that the contracting officer considers unreasonable (see FAR 15.405(d)). The documentation should describe:

- efforts to identify, or to determine the feasibility of developing, an alternative source;
- actions taken at a level above the contracting officer to address a contractor's refusal to agree to a reasonable price;
- circumstances that compel the government to agree to a price, or a profit or fee, that the contracting officer considers unreasonable, as well as actions taken to prevent a recurrence of those circumstances; and,

actions taken to ensure that unreasonable prices are not used in making future price comparisons, or as the basis for determining any other prices to be fair and reasonable.

## Ch 2 - Maximize Price Competition

- 2.0 - [Chapter Introduction](#)
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- 

### **2.0 - Chapter Introduction**

*Acquisition strategy.* In this chapter, we will examine the effect of numerous acquisition decisions on competition and contract pricing. The sections of this chapter, provide answers to the following three questions:

- How can solicitation Schedules (e.g., Part I of the UCF) be improved to yield more effective price competition?
- How can business terms and conditions (e.g., Parts II - IV of the UCF) be improved to yield more effective price competition?
- How can the methods of publicizing the buy be tailored to yield more effective price competition?

*Why promote competition?* The Government policy regarding competition is stated in [FAR 6.101\(b\)](#):

Contracting officers shall provide for full and open competition through the use of competitive procedure(s) . . . that are best suited to the circumstances of the contract action and consistent with the need to fulfill the Government's needs efficiently.

Competition is important to contract pricing in three ways:

- Competition is widely acknowledged as the best way to encourage firms to offer a quality product at a reasonable price.
- Competitive prices are one of the best bases to use in evaluating the reasonableness of an offered price.
- Adequate price competition is the most common basis for excepting offerors from the requirement to submit cost or pricing data.

*What does "Maximizing Price Competition" mean?* To maximize price competition, you must:

- Attract competitive offers from the best vendors (in terms of their track records for pricing, quality, timeliness, and integrity), and
- Obtain reasonably-priced offers, in part because the solicitation:
  - Reflects the Government's **actual minimum need** and
  - Prospective contract provisions **balance the cost risk** associated with satisfying that need.

*Key acquisition team members.* Efforts to maximize competition require a detailed analysis of Government requirements. To be effective this analysis must involve affected members of the Acquisition Team. Member participation will vary from acquisition to acquisition, but most often contracting personnel and one or more of the following team members will be involved:

- Users-key source of information on the real needs of the Government;
- Requirement Managers-key decision makers;
- Suppliers-information source in market research and analysis; and

- Contracting Personnel-responsible for the effectiveness of the acquisition decision.

*Potential impediments to competition.* In various acquisition situations, you may use many different formats to organize a solicitation or contract. Regardless of the format, there are potential impediments to competition.

### **Potential Impediments to Price Competition**

<b>Solicitation Element</b>	<b>Potential Impediments</b>
Supplies or Services and Prices Requirements Documents	<ul style="list-style-type: none"> <li>• Failure to consolidate requirements</li> <li>• Use of vague or ambiguous terms</li> <li>• Excessive (i.e., gold plated) or impractical requirements</li> <li>• Use of design specifications when performance specifications are feasible</li> <li>• Brand-name specifications</li> <li>• Brand-name-or-equal specifications that admit few, if any, equals</li> <li>• Use of Government-unique specifications for commercial or commercial-type deliverables</li> <li>• Biased specifications (i.e., specifications geared to the unique features of a single product or of premium priced products)</li> </ul>
Packaging and Marking	<ul style="list-style-type: none"> <li>• Noncommercial requirements</li> <li>• Excessive requirements</li> <li>• Biased requirements</li> </ul>
Inspection and Acceptance	<ul style="list-style-type: none"> <li>• Noncommercial requirements</li> <li>• Excessive requirements</li> <li>• Biased requirements</li> </ul>
Deliveries or Performance	<ul style="list-style-type: none"> <li>• Noncommercial terms</li> <li>• Delivery requirements not in tune with market cycles (e.g., requirements for "out-of-season" deliveries.)</li> <li>• Excessively tight deadlines</li> </ul>
Contract Administration	<ul style="list-style-type: none"> <li>• Noncommercial requirements</li> </ul>

- Data
  - Excessive requirements
- Special Contract Requirements
  - Noncommercial requirements
  - Excessive requirements
- Contract Clauses
  - Noncommercial terms and conditions
  - Excessive requirements (e.g., an excessively long warranty period, relative to commercial warranties)
  - Use of the wrong type of contract, given risks inherent in the work
  - Failure to use terms and conditions that could encourage competition
- Instructions, Conditions, and Notices to Offerors
  - Noncommercial requirements
  - Excessive requirements
- Evaluation for Award
  - Price given too little weight relative to technical factors
  - Biased evaluation factors (e.g., geared to unique features of a single product or of premium priced products)

## 2.1 - Improving The Schedule

*Section Introduction.* Solicitations and contracts must include the product or service requirements that the contractor is expected to meet. These requirements should be specified in a manner designed to promote full and open competition and should only include restrictive provisions or conditions that are necessary to satisfy the minimum needs of the Government (see [FAR 11.002\(a\)\(1\)](#)).

This section covers the following strategies for improving purchase descriptions and related terms (i.e., Part I of the UCF-Schedule) to obtain more effective price competition:

- 2.1.1 - [Consolidate Requirements](#)
- 2.1.2 - [Describe Government Needs To Promote Competition](#)
- 2.1.3 - [Review Requirements Documents](#)
- 2.1.4 - [Use And Maintain Requirements Documents](#)

- 2.1.5 - [Acquire Other Than New Material](#)
  - 2.1.6 - [Consider Delivery Or Performance Schedules](#)
  - 2.1.7 - [Use Liquidated Damages](#)
  - 2.1.8 - [Use Variation In Quantity](#)
  - 2.1.9 - [Pursue Restrictive Requirement Relief](#)
- 

### 2.1.1 - Consolidate Requirements

*Introduction.* Federal agencies are required to procure supplies in quantities that will:

- Result in the total cost and unit cost most advantageous to the Government, where practicable ([FAR 7.202](#)).
  - Total cost is the sum of allowable direct and indirect costs allocable to the contract, incurred or to be incurred, less any allocable credits, plus any allocable facilities capital cost of money ([FAR 31.201-1](#)).
  - Unit cost is the cost to complete any unit identified in the contract.
- Not exceed the reasonable quantity expected to be required by the agency.

In contracting, the general assumption is that larger quantities will attract greater competition and result in lower prices. However, most inventory management systems do not consider the effect of larger quantities on price. Price is considered to be fixed regardless of the quantity purchased. Because inventory management systems typically do not consider the benefits of requirement consolidation, contracting personnel must often take primary responsibility for coordinating consolidation efforts.

*Consolidation decision.* As you review the Government requirements and prepare the schedules of supplies or services, consider the following:

#### Consolidation Decision

If you can answer "YES" to the following questions...	AND...	Then...
Is the contracting office likely to receive more purchase requests for this item or service during the	Quantity and delivery requirements are firm and full	Consolidate purchase requests into a single definite

coming year?	funding is currently available.	delivery contract.
Can we reasonably estimate total organization requirements for the coming year?	Quantity or timing of requirements is not firm or full funding is not currently available.	Consolidate purchase requests into a single indefinite delivery contract.
Can this requirement be combined with other known requirements to reduce the total cost to the Government?		

*Consolidate purchase requests.* If you expect to receive purchase requests from a number of different activities for the same end item, encourage those activities to submit their purchase requests at roughly the same time. Then award a single contract for the aggregate quantity in the purchase requests.

Consider polling the requiring activities by phone if you suspect that a number of requiring activities will need the same end item. You might also consider "riding" the contract of another agency that needs the same end items (see [FAR 17.502](#)).

*Place economic order quantities.* The major drawback to consolidating requirements is that you may acquire a warehouse full of supplies that are not immediately needed. The Government incurs a daily cost for storing unused supplies—a cost that may over time outweigh any price breaks from having purchased in bulk. Therefore, when deciding the quantity to acquire at any one time, you should minimize the **total** cost of both:

- Buying the supplies; **and**
- Storing the supplies.

This means balancing per unit prices against per unit storage costs, taking into account how many units are likely to be drawn from inventory each month. The "Economic Order Quantity" is the quantity that represents the best balance of acquisition and storage costs—this is the quantity that ideally you should award at any one time.

If inventory managers are available, work with them to determine the economic order quantity. You can also solicit

information from offerors relevant to determining the economic order quantity.

*Use indefinite delivery contracts.* **Indefinite-delivery contracts** give the Government greater flexibility and buying power by combining requirements over an extended period of time with limited obligation regarding the exact time of delivery. They establish limits on the Government's obligation under the contract and provide flexibility in scheduling deliveries to minimize the costs to the Government for holding and managing inventory.

*Types of indefinite-delivery contracts* ([FAR 16.501](#)). There are three principal types of indefinite-delivery contracts:

- Definite Quantity
- Indefinite Quantity
- Requirements

Indefinite quantity and requirements contracts are further divided into delivery order and task order contracts.

- A **delivery order contract** is an indefinite quantity or requirements contract for supplies.
- A **task order contract** is an indefinite quantity or requirements contract for services.

*Indefinite-quantity contract* (See [FAR 16.504](#)). An indefinite-quantity contract (either delivery order or task order) provides for an indefinite quantity of purchases within limits established in the contract. At the time that the contract is awarded, the Government is only obligated to acquire a stated minimum quantity (or dollar value) during the term of the contract. Delivery orders or task orders may be placed as needed until the maximum quantity (or dollar value) stated in the contract is reached.

If the indefinite quantity contract is not for advisory and assistance services, give the maximum practicable preference to making multiple awards under a single solicitation. For advisory and assistance contracts that will not exceed three years and \$10,000,000 (including all options) you may (but you are not required to) give preference to making multiple awards. If the indefinite-quantity contract for advisory and assistance services exceeds three years and \$10,000,000 (including all options), you must make multiple awards unless only one



offer is received or a written determination to make a single award is made in accordance with FAR 16.504(c).

**Example of situation for use:** Suppose an organization needs specialized engineering support. The exact amount of support is not known at the beginning of the year, but the requiring activity can estimate minimum and maximum requirement limits. Here, an indefinite-quantity contract provides a useful contracting and pricing tool.

*Requirements contract* (See [FAR 16.503](#)). A **requirements contract** (either delivery order or task order) requires the contractor to fill all actual purchase needs for specific requirements at an agreed-to price. The contract must include a realistic estimate of the Government's requirements during the contract period. However, the Government is obligated to order only its actual requirements.

**Example of situation for use:** Suppose the organization requires a standard commercial item. The exact quantity is not known at the beginning of the year and it is not possible to clearly estimate a minimum and a maximum quantity for the year. However, it is possible to develop an estimate of quantity needs. A requirements contract will permit the organization to contract for needs that may develop based on the estimated quantity.

*Comparison of contract types.* The following table compares the Government pricing leverage for the three indefinite-delivery contract types and a definite-quantity definite-delivery contract:

<b>Contract Type and Pricing Leverage</b>	
<b>Contract Type</b>	<b>Pricing Leverage Ranking</b>
Definite-Quantity- Definite-Delivery	First, if the entire quantity is known and contracted for at one time.
	Last, if individual small orders are required.
Definite-Quantity- Indefinite-Delivery	Second

Indefinite-Quantity- Third  
Indefinite-Delivery or  
Requirements

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### **2.1.2 Describe Government Needs To Promote Competition**

*Need description objectives.* [FAR 11.002\(a\)](#) requires that agencies describe Government needs in a manner designed to:

- Promote full and open competition, with due regard to the nature of the supplies or services to be acquired; and
- Only include restrictive provisions or conditions to the extent necessary to satisfy the minimum needs of the agency or as authorized by law.

*Contracting officer responsibility.* Normally, you will not be ultimately responsible for describing Government needs. That will normally be the responsibility of technical experts and the requiring activity. However, as a member of the Acquisition Team, you are responsible for sharing your acquisition knowledge in an attempt to meet the needs of the Government.

*Points to consider in describing requirements* (See [FAR 11.002\(a\)\(2\)](#)). To promote full and open competition to the maximum extent possible, the Acquisition Team must:

- State supply or service requirements in terms of:
  - Functions to be performed;
  - Performance required; or
  - Essential physical characteristics;
- Define requirements in terms that enable and encourage offerors to supply commercial items, or modified commercial items, or, to the extent that commercial items suitable to meet the agency's needs are not available, nondevelopmental items;
- Provide offerors of commercial items and nondevelopmental items an opportunity to compete in any acquisition to fill such requirements;
- Require prime contractors and subcontractors at all tiers to incorporate commercial items or nondevelopmental items as components of items supplied to the agency; and
- Modify requirements in appropriate cases to ensure that the requirements can be met by commercial items

or, to the extent that commercial items suitable to meet the agency's needs are not available, nondevelopmental items.

*Comparing functional, performance, and design requirements.* As indicated above, there are three basic ways to define a requirement: function, performance, and design requirements. A specific Government need could be described using just one of the three ways, but most needs are described using some combination of the three. Still, a particular requirement is normally classified as the type of requirement it most resembles, even though it also contains the elements of other types of requirements.

### Comparing Requirements

Requirement Type	States requirement in terms of...	Considerations for use...
Functional	Functions to be performed. For example, a container for serving water to individuals.	<ul style="list-style-type: none"> <li>• When needs are complex and innovation is desirable, they permit the greatest competition.</li> <li>• HOWEVER, requirements that permit a wide variety of approaches can also increase the difficulty of determining price reasonableness, because competitive prices may no longer be useful bases for price analysis (e.g., a 10-ounce pewter cup vs. a 4-ounce paper cup).</li> </ul>
Performance	Performance required. For example, a serving container capable of holding eight ounces of water for a period of two hours.	<ul style="list-style-type: none"> <li>• May make it possible for you to obtain competition and innovation on specialized requirements.</li> <li>• HOWEVER, as with functional requirements, performance requirements that permit a wide variety of approaches can also limit the usefulness of competitive prices as a base for price analysis (e.g., an 8-ounce pewter</li> </ul>

cup vs. an 8-ounce paper cup).

- |        |   |   |
|--------|---|---|
| Design | Essential physical characteristics. For example, a 303 stainless cup, with specified diameter and height. | <ul style="list-style-type: none"><li>• Requirements consistent with the designs and production methods common in the appropriate industry can be effective in obtaining price competition and uniform products.</li><li>• Unique or out of date requirements can restrict competition and increase prices.</li><li>• Competitive prices typically provide a good base for price analysis.</li><li>• HOWEVER, if the design requirement is unique or out of date, all the prices offered may be unreasonable.</li></ul> |
|--------|---|---|

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### 2.1.3 Review Requirements Documents

*General Order of Precedence.* The Acquisition Team may select from existing requirements documents, modify or combine existing requirements documents, or create new requirements documents to meet agency needs, as long as the Team's selection is consistent with the following order of precedence (see [FAR 11.101\(a\)](#)):

- Documents mandated for use by law.
- Performance-oriented documents.
- Detailed design-oriented documents.
- Standards, specifications and related publications issued by the Government outside the Defense or Federal series for the non-repetitive acquisition of items.

*Environmentally Preferable Material.* The Acquisition Team should prepare product descriptions to make maximum practical use of recovered material and other materials that are environmentally preferable (see [FAR 11.101\(b\)](#)).

**Recovered materials** ([FAR 23.402](#)) are waste materials and by-products which have been recovered or diverted from solid waste including post-consumer material. However, recovered materials do not include those materials and by-products generated from, and commonly reused within, an original manufacturing process. The Environmental Protection Agency has developed a list of designated items that are or can be made with recovered materials in [40 CFR Chapter 1, Subchapter I](#). For example, paper and paper products have been designated as items that can be produced with recovered materials.

An **environmentally preferable** ([FAR 23.703](#)) material is an item that has a lesser negative effect on human health or the environment when compared with competing products that serve the same purpose. This comparison should be made using principles recommended in guidance issued by the EPA and may consider raw materials acquisition, production, manufacturing, packaging, distribution, reuse, operation, maintenance, or disposal of the product.

*Standardization Programs.* The Acquisition Team must select existing requirements documents or develop new requirements documents that meet the needs of the agency in accordance with applicable standardization programs (see [FAR 11.102](#)).

*Product Market Acceptance* ([FAR11.103](#)). There may be situations where the agency needs to assure that existing commercial or nondevelopmental products will meet the needs of the Government. For example, the agency may require an item that has a demonstrated reliability, performance, or product support record in a specified environment. In such situations, the agency head may require offerors to demonstrate that the items offered:

- Either:
  - Have achieved commercial market acceptance; **OR**
  - Have been satisfactorily supplied to an agency under current or recent contracts for the same or similar requirements; **AND**
- Otherwise meet the item description, specifications, or other criteria prescribed in the public notice and solicitation.

If the agency head determines that offerors must demonstrate market acceptance, develop solicitation

criteria that the Acquisition Team can use to evaluate product market acceptance. Ensure that the criteria:

- Reflect the minimum need of the Government;
- Relate to an item's performance and intended use, not an offeror's capability;
- Are supported by market research;
- Include consideration of items supplied satisfactorily under recent or current Government contracts, for the same or similar items; and
- Consider the entire relevant commercial market, including small business concerns.

**Do not make market acceptance the sole criterion** that you use to determine whether an item meets Government requirements. You should also conduct related market research to evaluate the item's acceptability. Whenever you have questions concerning an item's acceptability, you should involve other appropriate members of the Acquisition Team in the evaluation process.

Whenever you use commercial market acceptance as an evaluation criterion, document your rationale in the contract file. In your documentation, describe the circumstances that justify the use of commercial market acceptance criteria, and support the specific criteria being used.

*Items Peculiar to One Manufacturer* ([FAR 6.302-1\(c\)](#) and [11.104](#)). An acquisition that uses a brand-name description or other purchase description to specify a particular brand-name product, or feature of a product, peculiar to one manufacturer does not provide for full and open competition regardless of the number sources solicited. For that reason, you must not use such descriptions unless:

- The particular brand-name, product, or feature is essential to the Government's requirements, and market research indicates other companies' similar products, or products lacking the particular feature, do not meet, or cannot be modified to meet, the agency's minimum needs; and
- The authority to contract without providing for full and open competition is supported by the justifications and approvals required under [FAR 6.302-1](#).

*Content of Brand-Name-Or-Equal Purchase Descriptions.* [FAR 11.104\(b\)](#) requires that each brand-name-or-equal purchase description include, in addition to the brand name, a general description of those salient physical, functional, or performance characteristics of the brand name item that an "equal" item must meet to be acceptable for award.

**Example of Problems That Can Develop:** In 1991, the General Accounting Office (GAO) reported (GAO/NSIAD 91-53) that solicitations giving only part numbers as item descriptions may be unnecessarily restricting competition. All solicitations questioned by the report required offerors to submit technical data, on both the brand-name item identified in the solicitation and any alternative product offered, so that the Government could determine whether the offered item met Government needs. However, the solicitations usually did not identify descriptive information available in the buying center on the items being solicited.

Several prospective sources indicated that they could not identify the items required, because only part numbers were provided. Providing even incomplete data to prospective offerors should be beneficial to the Government by helping to increase competition.

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#### **2.1.4 - Use And Maintain Requirements Documents**

*Identifying Applicable Specifications and Related Documents* ([FAR 11.201](#)). Any requirements documents used in a solicitation or contract must be clearly identified to avoid any confusion about the Government's requirements.

- **Identify Federal or Military specifications.** If you cite requirements documents listed in the [General Services Administration \(GSA\) Index of Federal Specifications, Standards and Commercial Item Descriptions](#), the [DoD Index of Specifications and Standards \(DoDISS\)](#), or other agency index, identify each document's approval date and the dates of any applicable amendments and revisions. Do not use general identification references, such as "the issue in effect on the date of the solicitation." Do not furnish the cited requirements documents with the solicitation, except when:

- The requirements document must be furnished with the solicitation to enable prospective contractors to make a competent evaluation of the solicitation;
  - You believe that it would be impracticable for prospective contractors to obtain the documents in a reasonable time to respond to the solicitation; or
  - A prospective contractor requests a copy of a Government promulgated requirements document.
- 
- **Identify other pertinent documents.** Clearly identify any pertinent documents not listed in the GSA Index of Federal Specifications, Standards and Commercial Item Descriptions or DoDISS. When you use such documents, either furnish them with the solicitation or provide specific instructions on how prospective offerors can obtain or examine such documents.
- 
- **Assure that any necessary references to other documents are clear.** Make sure that any references made in requirements documents to other documents:
    - Are restricted to documents, or appropriate portions of documents, that apply to the acquisition;
    - Cite the extent of their applicability;
    - Do not conflict with other documents and provisions of the solicitation; and
    - Identify all applicable first tier references.
- 
- **Assure that interested parties know where to obtain Federal and Military specifications.**
    - The GSA Index of Federal Specifications, Standards and Commercial Item Descriptions may be purchased from the General Services Administration, Federal Supply Service Bureau, Specification Section, Suite 8100, 470 L'Enfant Plaza, SW, Washington, DC 20407, telephone (202) 619-8925.
    - The DoDISS may be purchased from the Standardization Documents Desk, Building 4, Section D, 700 Robbins Avenue, Philadelphia, PA 19111-5094, telephone (215) 697-2667/2179 .



- **Assure that interested parties know where to obtain nongovernment standards adopted by the Government.** Interested parties may generally obtain them from the GSA Specification Section or the DoD Standardization Documents Desk those nongovernment (voluntary) standards adopted for use by Federal or Defense activities. Standards not available from these sources may be obtained from Government libraries, activities subscribing to document handling services or the organization responsible for the preparation, publication or maintenance of the standard.

*Identifying the Need for Changes* ([FAR 11.203](#)). Standardization documents are maintained to assure that requirements for items used across the Government are uniform. However, products available in the commercial market and the needs of the Government change over time.

As part of your market research, communicate with customers to determine how well the requirements document reflects the customer's needs. If the customer indicates that the requirements do not meet customer needs, obtain suggestions for corrective action.

Whenever practicable, you may provide affected industry an opportunity to comment on the requirements documents. If industry sources recommend changes, obtain comments from the appropriate members of the Acquisition Team before taking any action to modify requirements documents.

*Modifying Standardization Documents* ([FAR 11.202](#)). Whenever you determine that Government standardization documents should be changed:

- Submit any recommended changes for standardization documents listed in the GSA Index of Federal Specifications, Standards and Commercial Item Descriptions, to the General Services Administration, Federal Supply Service, Office of Acquisition, Washington, DC 20406.
- Submit any recommendations for changes to standardization documents listed in the DoDISS to the cognizant preparing activity.

When you cite an existing standardization document but modify it to meet agency needs, follow the guidance provided in the appropriate standardization reference.

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### **2.1.5 - Consider Acquiring Other Than New Material**

*Introduction.* Your market research may identify situations where it would be advantageous to the Government to acquire items that are not new (e.g., rebuilt items), former Government surplus property, or residual inventory. Such items may be available at a fraction of the price of new material. You must consider the best interests of the Government in deciding whether to solicit offers based on providing such items.

*Contracting Officer Authorization.* Do not permit a contractor to provide other than new material, former Government surplus property, or residual inventory unless the contractor has obtained the appropriate contracting officer authorizations required by [FAR 52.211-5](#), Material Requirements clause.

*Considering Authorization Requests.* Allow offers of other than new material, former Government surplus property, or residual inventory unless you determine that such materials are unacceptable. As you make your determination, consider the following:

- Requirements of law or regulation;
- Safety of persons or property; and
- Contract performance requirements.

When you are acquiring commercial items, you should consider the customary practice in the industry for the item being acquired. For example, in many industries it is common practice to use rebuilt parts because of the savings over the purchase of new parts. In other industries, safety and performance considerations make the use of new components essential.

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### **2.1.6 - Consider Delivery Or Performance Schedules**

*Introduction.* The time of delivery or performance is an essential contract element and must be clearly stated in solicitations and contracts. Assure that delivery or performance schedules ([FAR 11.401\(a\)](#)) are realistic and meet the requirements of the acquisition. Remember that unreasonably tight or difficult to attain schedules:

- Tend to restrict competition;
- Are inconsistent with small business policies; and
- May result in higher prices.

*Consider Market Norms.* In 1990, GAO examined inventory and contracting practices at two Government buying centers (GAO/NSIAD 90-124). GAO found that, in most cases, buyers made no effort to match delivery schedules to market norms. Instead, buyers awarded contracts based on quotes to deliver on the date specified by the organizations' automated inventory system. Since little was known about market delivery norms, there was no reason to question the specified delivery schedule. Buyers assumed that suppliers would deliver according to the contract schedule.

The data collected by GAO do not support that assumption. GAO examiners reviewed 109 purchases of 57 supply items. They found that:

- 1 purchase (0.9%) was delivered exactly on time
- 58 purchases (53.2%) were delivered an average of 51 days late
- 50 purchases (45.9%) were delivered an average of 61 days early

At these buying centers, failure to consider market norms may have had a substantial impact on competition, prices, and other acquisition costs.

- Many prospective competitors who recognized that the required delivery schedule did not provide sufficient time for production and delivery, may have been unreasonably excluded from the competition.
- Some firms may have had an unfair competitive advantage because they knew that the Government would accept less-than-agreed-to delivery.
- The Government likely paid unnecessarily high prices because of the limited competition and unenforced delivery schedules.

- Items delivered late may have caused inventory shortages or other operational delays.
- Items delivered early may have increased Government inventory holding costs.

*Supply/Service Schedule Factors to Consider* ([FAR 11.402\(a\)](#)) Consider the following factors when establishing delivery schedules for supplies or services:

- Urgency of need;
- Industry practices;
- Market conditions;
- Transportation time;
- Production time;
- Capabilities of small business concerns;
- Administrative lead time for obtaining and evaluating offers -- contractor delivery should not be curtailed because of Government delays in contract award;
- Time required for contractors to comply with any conditions precedent to contract performance; and
- Time required for the Government to perform its contract obligations -- such as delivering Government-Furnished Property.

*Construction Schedule Factors to Consider* ([FAR 11.402\(b\)](#)) In developing a schedule for construction projects, you must consider such factors as:

- Nature and complexity of the project;
- Construction seasons involved;
- Required completion date;
- Availability of materials and equipment;
- Capacity of contractors to perform;
- Use of multiple completion dates (e.g., a separate completion date for separable items of work).

*Selecting Appropriate Method of Expressing Schedule* ([FAR 11.403\(a\)](#)) Consider different ways of expressing delivery or performance schedules and select the one that seems most appropriate for your acquisition situation. Common methods of expressing contract delivery or performance requirements include specific:

- **Calendar dates;**
- **Time periods from a contract date** (e.g., from the date of contract award, from date of acceptance by the

Government, or from the effective date of the contract);

- **Time periods from the date of receipt of contract notice** by the contractor (e.g., notice of award or notice of acceptance by the Government);
  - **Time period for delivery after receipt by the contractor of each individual order** under the contract (e.g., orders under indefinite delivery contracts and GSA schedules).
- 

### **2.1.7 - Consider Liquidated Damages**

*Introduction.* In Government contracting, a liquidated damages clause is a stipulation by the Government and contractor to a sum of money to be recovered by the Government in the event the contractor fails to meet a specified contract delivery or performance requirement. Liquidated damages are normally assessed at a daily rate for each day of delay in meeting the delivery or performance requirement. A liquidated damages clause may be used in any type of contract, but such clauses are most commonly used in construction contracts.

*Deciding Whether to Use Liquidated Damages* ([FAR 11.502](#) and [DFARS 211.504](#)). In some agencies, use of a liquidated damages clause may be mandatory in certain contracting situations, For example, the Department of Defense requires the use of liquidated damages in all construction contracts over \$500,000.

If the use of a liquidated damages clause is not specifically required by your agency, you should only use liquidated damages when you can answer "YES" to both of the following questions:

- Will the Government reasonably expect to suffer damage if the delivery or performance is delinquent?
- Would the extent or amount of such damage be difficult or impossible to ascertain?

As you decide whether to include a liquidated damages clause in the contract, consider the probable effect on contract pricing, competition, and contract administration:

- Concern among prospective offerors about the cost risk associated with liquidated damages may increase contract prices and decrease competition. A tight delivery schedule will increase offeror concern. If the risk of timely performance is substantial, consider using positive performance incentives rather than liquidated damages.
- The cost/difficulty of contract administration will likely increase if the contractor perceives that timely performance is unlikely or impossible. Numerous claims may result as the contractor attempts to use Government action or inaction to justify its failure to meet the contract schedule.

*Estimating a Reasonable Rate* ([FAR 11.502\(b\)](#), [11.503\(b\)](#), and [11.503\(c\)](#)). Whenever you use liquidated damages, you must calculate the rate on a case-by-case basis, based on an estimate of actual damage to the Government if the contractor does not perform on time. Assure that the rate is reasonable because a rate fixed without any reference to probable actual damages may be held to be a penalty, and therefore unenforceable.

If a liquidated damages clause is used in a construction contract, the contract should identify a daily rate for the assessment of liquidated damages. As a minimum, the rate should cover the estimated cost of inspection and superintendence for each day of delay in contract completion. Whenever the Government will suffer other specific losses due to the failure of the contractor to complete the work on time, the rate should also include an amount to cover those losses. Examples of specific losses include the:

- Cost of substitute facilities;
- Rental of buildings and/or equipment; or
- Continued payment of quarters allowances.

Usually, a single liquidated damages rate (e.g., \$500 per day) is used from the date of contractually required delivery/performance until the contractor actually delivers or the contract is terminated. However, the probable damage to the Government may not follow a linear pattern.

- If appropriate to reflect probable damages to the Government, you may develop two or more incremental

rates which provide for a declining rate assessment as the delinquency continues.

- You may also include an overall maximum dollar amount or period of time, or both, during which liquidated damages may be assessed, to ensure that the result is not an unreasonable assessment of liquidated damages.
- 

### **2.1.8 - Consider Variation In Quantity**

*Introduction* ([FAR 11.701\(a\)](#)). As part of your market research, you should evaluate the market use of variation in quantity clauses for the item(s) you are acquiring. In particular, you should consider possible variations in quantity for fixed-price supply contracts, service contracts that involve the furnishing of supplies, and unit-priced construction contracts.

*Reasonable Variation for Supplies* ([FAR 11.701\(a\) and \(b\)](#) and [52.211-16](#)). When you are preparing a solicitation for a fixed-price supply contract or service contract that involves the furnishing of supplies, you can insert the FAR Variation in Quantity clause to provide for accepting a quantity that is greater than the quantity called for in the contract, a quantity that is less than the quantity called for in the contract, or both, as long as the variation is caused by conditions of loading, shipping, packing, or by allowances in manufacturing processes.

In the solicitation, you must describe the acceptable plus or minus variation as a percentage of a specific quantity of items.

- Base the percentage(s) that you assign on your market research of the items and industry involved.
  - Tailor the plus and minus variation percentages to the item and industry involved -- do not use a standard or usual variation that you apply in all circumstances.
  - Neither variation percentage should be larger than necessary to afford a contractor reasonable protection.
  - Neither the plus or minus variation percentage shall exceed 10 percent.
  - Either variation percentage could be as small as zero.

- If you allow both a plus and a minus variation, the plus percentage and the minus percentages can be different (e.g., plus 10 percent and minus 5 percent).
- Carefully determine which quantity or quantities will be subject to the variation. Possibilities include:
  - The total contract quantity,
  - A particular item (e.g., Item 1 only),
  - Each quantity specified in the delivery schedule,
  - Total item quantities for each destination, or
  - Total quantity of each item without regard to destination.

*Delivery of Excess Supplies* ([FAR 11.701\(c\)](#) and [52.211-17](#)). You are preparing a solicitation for a fixed-price supply contract and you are concerned that the contractor may deliver more than the quantity specified in the contract (including any allowable variation in quantity)? You know that delivery of even a small quantity of excess items will result in unnecessary administrative cost to the Government, because Government personnel will have to determine and manage the disposition of the excess supplies. What action can you take to protect the Government?

You can insert the FAR Delivery of Excess Quantities clause, into the solicitation/contract. That clause provides that:

- Excess quantities of items totaling up to \$250 in value may be retained by the Government without compensating the contractor.
- Excess quantities of items totaling \$250 in value may, at the Government's option, be either returned at the contractor's expense or retained and paid for at the contract unit price.

*Reasonable Variation for Construction* ([FAR 11.702](#) and [52.211-18](#)). When you are preparing a solicitation for a fixed-price construction contract that will authorize a variation in the estimated quantity of unit-priced items (e.g., feet of road paving), you must insert the FAR Variation in Estimated Quantity clause. Under this clause:

- When the actual quantity of a unit-priced item varies more than 15 percent above or below the estimated quantity, either the contracting officer or the



contractor can demand an equitable adjustment in the contract price. The equitable adjustment must be based upon any increase or decrease in costs due solely to variation above 115 percent or below 85 percent of the estimated quantity.

- If a quantity variation causes an increase in the time necessary for contract completion, the contractor may request an extension of time.

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### **2.1.9 - Pursue Restrictive Requirement Relief**

*Introduction.* Improving Government requirements documents to increase competition requires responsible and effective management at all levels. The effort is not limited to contracting and requirements management activities, but must extend to all members of the Acquisition Team.

*Analysis.* Typically, you must work closely with other Acquisition Team members to analyze the:

- User's real needs
- Current product requirements
- Products available in the commercial market
- Real restrictions that prevent the use of commercial products

*Improving Communications.* Effective communications are essential. Acquisition Team members must communicate effectively with each other as well as with top management in the department or agency.

The objectives and benefits of pursuing restrictive requirement relief must be communicated to everyone involved.

Any effort to eliminate restrictive requirements must have top management support. Top management can communicate its support by establishing an effective monitoring system—using the inspectors general, internal audit, or other groups. Monitors should periodically evaluate whether managers at all levels are taking an active and positive approach to eliminating restrictive requirements, increasing competition, and increasing the use of commercial and nondevelopmental items.

*Effective Communication System.* The table below provides an overview of the communication process necessary to eliminate restrictive requirements, and the key Acquisition Team members involved.

<b>Effective Communication</b>		
<b>Personnel</b>	<b>Communicating With...</b>	<b>Communicating About...</b>
Users	<ul style="list-style-type: none"> <li>• Requirements Managers</li> <li>• Contracting Personnel</li> </ul>	<ul style="list-style-type: none"> <li>• Adequacy of current specifications in communicating the user's minimum needs.</li> <li>• Current product capabilities.</li> <li>• Current product failures and deficiencies.</li> <li>• Suggestions for improvement and corrective action.</li> </ul>
Requirements Managers	<ul style="list-style-type: none"> <li>• Users</li> <li>• Contracting Personnel</li> </ul>	<ul style="list-style-type: none"> <li>• Satisfaction of user needs with current products.</li> <li>• Satisfaction of user needs by less expensive commercial products.</li> <li>• Tailoring of mandatory requirements documents to assure identification of the minimum Government needs.</li> <li>• Justification for other than commercial items or services.</li> </ul>
Suppliers	<ul style="list-style-type: none"> <li>• Users</li> <li>• Requirements Managers</li> </ul>	<ul style="list-style-type: none"> <li>• The industry:               <ul style="list-style-type: none"> <li>◦ Business practices in sales and distribution.</li> <li>◦ Production capacity.</li> </ul> </li> </ul>

- o Packaging and preservation practices.
  - Commercial products available to satisfy user needs.
  - Commercial product quality practices.
  - Commercial product support.
- 
- |                          |   |   |
|--------------------------|---|---|
| Contracting<br>Personnel | <ul style="list-style-type: none"> <li>• Users</li> <li>• Requirements Managers</li> <li>• Suppliers</li> </ul> | <ul style="list-style-type: none"> <li>• Restrictive requirements.</li> <li>• Provision of commercial market information to users and requirements managers.</li> <li>• Analysis of competitive conditions in the market.</li> <li>• Communicating Government requirements to suppliers in a way that maximizes competition.</li> </ul> |
|--------------------------|---|---|

*Catalyst for Action.* </&NBSP;&NBSP;YOU p Government.< the of needs minimum meet to standards, or specifications voluntary commercial descriptions, purchase Standards, and Specifications Federal modified ability about uncertainties are there where situations be may However, prices. reduce quality, improve items, nondevelopmental use increase competition, can encouragement, support management strong with Team, Acquisition Ideally, action. for catalyst forceful a as serve required also>

**Situation 1:** Two potential suppliers assure you that their commercial products will "do the job just as well as the product specified by Federal Specifications, and save the Government at least 15 percent." The user and the

requirements manager say that "the commercial products may work" but they are "not sure of the possible long-term effects on safety." They feel that, "we should stick with the product we know."

**Situation 2:** You have a brand-name request for copy paper. Technical personnel certify that only the brand-name can meet Government needs. Suppliers of other copy papers indicate that their brands are "as good as the requested paper in all important respects and will save the Government at least 25 percent." Users and the requirements manager still maintain that "the brand-name paper is the only brand that does not jam under prevalent high-humidity conditions."

***What should the contracting officer do?***

In both the situations above, technical personnel have evaluated the commercial products and have rejected them, and it appears that the contracting officer's job is done. However, [FAR 11.002\(a\)\(1\)\(ii\)](#) requires that you:

Only include restrictive provisions or conditions to the extent necessary to satisfy the minimum needs of the agency or as authorized by law.

In both situations, it appears that some suppliers are being unreasonably excluded from the competition. The Government may be paying for more than it needs at prices much higher than necessary. In addition, the rejected potential suppliers may protest exclusion from any future contract actions.

As a contracting officer, you should continue to ask questions to make sure that you get the correct answer about the true agency requirements. There are no "dumb questions" in contracting, except those that are never asked!

***Action Support. To whom should the contracting officer raise questions?***

Ideally, you should work with concerned members of the Acquisition Team to raise questions about unnecessarily restrictive requirements to higher authority within the agency. In the case of a Government specification item, you should raise the question to the authority responsible for the specification. If other members of the Acquisition Team refuse to question requirements that appear to be unnecessarily restrictive, you, as the contracting officer, should raise questions to higher technical authority through contracting channels.

Whether you act alone or with the Team to question requirements, the ultimate answer might be to accept or to reject the proposed alternatives. Regardless of the answer, you have fulfilled the responsibility of pursuing all actions necessary to ensure effective contracting. You have also formed the basis for a broad Government position on the answer. If potential suppliers do protest, no one will wonder why you did not ask the question earlier.

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## **2.2 - Improving Business Terms And Conditions**

*Section Introduction.* This section covers the following strategies for selecting clauses and provisions for the solicitation to maximize price competition:

- [2.2.1 - Base The Contract Type On Risk Analysis](#)
- [2.2.2 - Review Applicability Of Socioeconomic Requirements](#)
- [2.2.3 - Match Payment And Finance Terms To Market Conditions](#)
- [2.2.4 - Furnish Government Property](#)
- [2.2.5 - Consider Warranty Requirements](#)
- [2.2.6 - Optimize Price/Technical Tradeoffs](#)

### **2.2.1 - Base The Contract Type On Risk Analysis**

*Introduction.* The selection of contract type can have a significant effect on both competition and contract price.

*Two Contract Categories.* Most contract types fit into one of two categories:

- Fixed-Price; or
- Cost-Reimbursement.

The biggest difference between the two is the assignment of risk.

In **fixed-price contracts**, the contractor is required to deliver the product specified and there is a maximum limit on the amount of money the Government must pay.

In **cost-reimbursement contracts**, the contract is required to deliver a "best effort" to provide the specified product. All allowable costs must be reimbursed, regardless of delivery, up to the level specified in the contract.

*Risk, Contract Type, and Price.* Analysis of the risk inherent in the contracting situation is the key element in the selection of an appropriate contract type. The relationship between risk, contract type, and price can be demonstrated by the following examples.

**Examples:**

- Selection of a fixed-price contract when the risks are beyond the contractor's control, as in many development contracts, will increase price and reduce competition.
- Selection of a cost-reimbursement contract when the risks are well within the contractor's control, as in most production contracts, will reduce the contractor's motivation to control costs.

*Commercial Items (FAR 16.201).* When acquiring commercial items, you are limited to using either a firm fixed-price (FFP) or fixed-price with economic price adjustment (FPEPA).

*Major Types of Contracts.* The table below presents a comparison of the major contract types.

**Comparison of Major Types of Contracts**

	<b>Firm Fixed-Price (FFP)</b>	<b>Indefinite Delivery (ID)</b>	<b>Fixed-Price Economic Price Adjustment (FPEPA)</b>
Principal Risk to Be Mitigated	Costs of performance can be estimated with a high degree of confidence. Thus, the contractor assumes	At time of award, delivery requirements are not certain.	Market prices required labor materials are to be highly uncertain over the life

	the risk.		contract.
Use When	<ul style="list-style-type: none"> <li>o The requirement is well-defined.</li> <li>o Commercial item</li> <li>o Contractors are experienced in meeting it.</li> <li>o Market conditions are stable.</li> <li>o Financial risks are otherwise insignificant.</li> </ul>	<p><b>Definite Quantity:</b> The required quantity is known and funded at the time of award.</p> <p><b>Indefinite Quantity:</b> The minimum quantity required is known and funded at award.</p> <p><b>Requirements:</b> No commitment on quantity is possible at award.</p>	<ul style="list-style-type: none"> <li>o Comm item</li> <li>o The prices at are sever and signi</li> <li>o The stems fro industry-contingen beyond th contracto control.</li> <li>o The at risk o the administr burdens o FPEPA.</li> </ul>
Elements	Firm fixed-price for each line item or one or more groupings of line items.	<ul style="list-style-type: none"> <li>o Performance period.</li> <li>o Ordering activities and delivery points.</li> <li>o Maximum or minimum limit (if any) on each order.</li> <li>o Extent of each party's obligation on quantity.</li> </ul>	<p>A fixed-price, ceiling on upw adjustment, an formula for ad the price up o based on:</p> <ul style="list-style-type: none"> <li>o Esta prices.</li> <li>o Actu costs of labor or materials</li> <li>o Labo material indices.</li> </ul>
Contractor Is Obligated To	Provide an acceptable deliverable at the time, place, and price specified in the contract.	Provide acceptable deliverables at the time and place specified in each order at the per unit price, within any ordering limits established by the contract.	Provide an acc deliverable at time and place specified in t contract at th adjusted price

Contractor Incentive	Generally realizes an additional dollar of profit for every dollar that costs are reduced.	Incentive will depend on the pricing arrangement.	Generally real additional dol profit for eve dollar that co reduced.
A Typical Application	Commercial supplies and services.	Long-term contracts for commercial supplies or support services.	Long-term cont for commercial supplies durin period of high inflation.
Principal Limitations	Generally not appropriate for R&D. Firm fixed-price level of effort contract may be used for R&D if agreement can be reached on effort required at a price £ \$100,000.	May use any appropriate cost or pricing arrangement that complies with FAR Part 16. Multiple awards preferred for most indefinite quantity contract items. Single award required for requirements contract items.	Must be justif
In FAR Parts <a href="#">16</a> , <a href="#">32</a> , <a href="#">35</a> , and <a href="#">52</a>			
Variants	Firm Fixed-Price Level of Effort	Definite quantity, indefinite quantity requirements.	

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**Comparison of Major Types of Contracts**

	<b><i>Fixed-Price Award Fee (FPAF)</i></b>	<b><i>Fixed-Price Prospective Redetermination (FPPR)</i></b>	<b><i>Fixed-Price Incentive (FPI)</i></b>
Principal Risk to Be Mitigated	Acceptance criteria are inherently judgmental, with a corresponding risk that the end user will not be fully satisfied.	Costs of performance can be estimated with confidence only for the first year of performance.	Labor or material requirements for work are moderately uncertain. Hence, the Government assumes part of the risk.
Use When	<a href="#">Judgmental standards can be fairly applied.</a> <sup>2</sup> The potential fee is large enough to both:	The Government needs a firm commitment from the contractor to deliver the supplies or services during subsequent years.	Ceiling price can be established that covers the most probable risks inherent in the nature of the work. The proposed profi



The dollars at risksharing formula

- o Provide a meaningful incentive.
  - o Justify the administrative burdens of an FPAF.
- o outweigh the administrative burdens of an FPRP.
- o would motivate the contractor to control costs and meet other objectives.

Elements

- o A firm fixed-price
  - o Fee pool
  - o Standards for evaluating performance.
  - o [Criteria for determining a "fee" based on performance against the standards.](#)<sup>2</sup>
- o Fixed price for the first period.
  - o Proposed subsequent periods (at least 12 months apart).
  - o Timetable for pricing the next period(s).
- o Ceiling price
  - o Target cost
  - o Target profit
  - o Delivery quality, and/or other performance targets (optional)
  - o Ratio for adjusting profit based on actual costs and/or performance.

Contractor Is Obligated To

Perform at the time, place, and the price fixed in the contract.

Provide acceptable deliverables at the time and place specified in the contract at the price established for each period.

Provide an acceptable deliverable at the time and place specified in the contract, at or below the ceiling price.

Contractor Incentive (*Other Than Maximizing Goodwill*)<sup>1</sup>

Generally realizes an additional dollar of profit for every dollar that costs are reduced; earns an additional fee for satisfying the performance standards.

For the period of performance, realizes an additional dollar of profit for every dollar that costs are reduced.

Realizes a higher profit by completing the work below the ceiling price and/or by meeting objective performance targets.

Principal Limitations In FAR Parts <a href="#">16</a> , <a href="#">32</a> , <a href="#">35</a> , and <a href="#">52</a>	Must be negotiated. Contractor must have an adequate accounting system that supports the pricing periods. Prompt redeterminations.	Must be negotiated. Contractor must have an adequate accounting system. Targets must be supported by the cost data.	Must be justified. Must be negotiated. Contractor must have an adequate accounting system. Targets must be supported by the cost data.
Variants	Retroactive Redetermination.	Firm or Successive Targets.	

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**Comparison of Major Types of Contracts**

	<i>Cost-Plus-Fixed-Fee (CPFF)</i>	<i>Cost-Plus-Incentive-Fee (CPIF)</i>	<i>Cost-Plus-Award-Fee (CPAF)</i>
Principal Risk to Be Mitigated	Labor hours, labor mix, and/or other things) necessary to perform are speculative. Hence, the Government assumes the risks inherent in the contract, benefiting if the actual cost is lower than the expected cost; losing if the work cannot be completed within the expected cost of performance. Some type contracts include procedures for raising or lowering the fee as an incentive for the contractor to perform at lower cost and/or attain performance goals.	Labor hours, labor mix, and/or material requirements (among other things) necessary to perform are highly uncertain and speculative. Hence, the Government assumes the risks inherent in the contract, benefiting if the actual cost is lower than the expected cost; losing if the work cannot be completed within the expected cost of performance. Some type contracts include procedures for raising or lowering the fee as an incentive for the contractor to perform at lower cost and/or attain performance goals.	Labor hours, labor mix, and/or material requirements (among other things) necessary to perform are highly uncertain and speculative. Hence, the Government assumes the risks inherent in the contract, benefiting if the actual cost is lower than the expected cost; losing if the work cannot be completed within the expected cost of performance. Some type contracts include procedures for raising or lowering the fee as an incentive for the contractor to perform at lower cost and/or attain performance goals.
Use When	Formulas relating fee to performance (e.g. to actual costs) would be unworkable or of marginal utility.	Objective relationship can be established between the fee and such performance measures as actual costs, delivery dates, performance benchmarks, and the like.	Objective incentive targets are not feasible for critical aspects of performance. <a href="#">Judgmental standards can be fairly applied.</a> <sup>2</sup> Potential fee would provide meaningful incentive.
Elements	<ul style="list-style-type: none"> <li>o Estimated cost</li> <li>o A fixed fee</li> </ul>	<ul style="list-style-type: none"> <li>o Target cost</li> <li>o Performance targets (optional)</li> <li>o Minimum, maximum, and target fee</li> <li>o Ratio for adjusting fee based on actual costs and/or</li> </ul>	<ul style="list-style-type: none"> <li>o Estimated cost</li> <li>o Standard for evaluating performance</li> <li>o Base and maximum fee</li> <li>o <a href="#">"Procedural fee" based on performance</a></li> </ul>

performance

against the standards<sup>2</sup>

Contractor Is Obligated To Make a good faith effort to meet the Government's needs within the estimated cost in the Schedule.

Contractor Incentive (Other Than Maximizing Goodwill)<sup>1</sup> Realizes a higher rate of return (i.e., fee divided by total cost) as total cost decreases.<sup>3</sup> Realizes a higher fee by completing the work at a lower cost and/or by meeting other objective performance targets.

A Typical Application Research study. Research and development of the prototype for a major system. Large scale research study.

Principal Limitation In FAR Parts 16, 32, 35, and 52 Variants The contractor must have an adequate accounting system. Government must exercise surveillance during performance ensure use of efficient methods and cost controls. Must be negotiated. Must be justified. Statutory and regulatory limits on the fees that may be negotiated. Must include applicable FAR Limitation of Cost clause. Completion or Term.

**Comparison of Major Types of Contracts**

**Cost or Cost Sharing (C/CS)**

**Time & Materials (T&M)**

Principal Risk to Be Mitigated Labor hours, labor mix, and/or material requirements (among other things) necessary to perform are highly uncertain and speculative. Hence, the Government assumes the risks inherent in the contract, benefiting if the actual cost is lower than the expected cost; losing if the work cannot be completed within the expected cost of performance.

Use When

- o The contractor expects substantial compensating benefits for absorbing part of the costs and/or foregoing fee, or
- o The vendor is a nonprofit entity.

Hourly labor rates can be firmly defined at contract award but hours required to complete the required task cannot.

Elements

- o Estimated cost
- o Ceiling price

- o If cost sharing, agreement on the Government's share of the cost
- o No fee
- o Per hour labor rate that also covers overhead and profit
- o Provisions for reimbursing direct material costs plus material handling cost

Contractor Is Obligated To Make a good faith effort to meet the Government's needs within the estimated cost in the Schedule.

Make a good faith effort to meet the Government's needs within the "ceiling price."

Contractor Incentive (*Other Than Maximizing Goodwill*)<sup>1</sup> Cost sharing shares the cost of providing a deliverable of mutual benefit.

Fixed rate and flexible hours to perform a task with unknown elements.

A Typical Application Joint research with educational institutions.

Emergency repairs to heating plants and aircraft engines.

Principal Limitations In FAR Parts [16](#), [32](#), [35](#), and [52](#) The contractor must have an adequate accounting system. The Government must exercise surveillance during performance to ensure use of efficient methods and cost controls. Must be negotiated. Must be justified. Must include the applicable FAR Limitation of Cost clause.

Contracting officer must determine in writing that no other contract type is suitable. Labor rate must be negotiated and justified. The Government must exercise appropriate surveillance to ensure efficient performance. Contract must include a ceiling price.

Variants

Labor Hour

**Notes to tables:**

Note 1 - Goodwill being the value of the name, reputation, location and other intangible assets of a firm.

Note 2 - Performance is evaluated by an Award Fee Panel with fee determined by a Fee Determining Official. Fee determinations are not subject to contract disputes provisions.

Note 3 - The CPFF contract is commonly used in situations where the Government is more interested in technical excellence than cost control. However, you must be aware that higher cost does not necessarily equal technical excellence. Contractors may attempt to shift unnecessary resources to CPFF contracts to control costs on other contracts.

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### 2.2.2 - Review Applicability Of Socioeconomic Requirements

*Introduction.* The Government has established socioeconomic programs to achieve national social and economic goals, but these programs can also limit potential sources. As you implement these programs, always consider the probable effect on competition and contract pricing.

*Consider Small Business Program Effects.* The single most important socioeconomic program affecting competition is the small business program. The following table summarizes four elements of the program related to mandatory sources. Particularly notice the situations where you should question the various requirements that limit competition or produce prices that are not fair and reasonable.

<b>Sourcing Requirement</b>	<b>Question When...</b>
<b>Total Small Business Set-Aside</b> ( <a href="#">FAR 19.502-2(a)</a> ) An acquisition must be reserved for exclusive participation by small business when there is a reasonable expectation that the requirements can be met by small business.	There is a reasonable expectation that: <ul style="list-style-type: none"><li>o Offers WILL NOT be obtained from at least two responsible small business concerns (The two concerns must offer products from different small business concerns unless the requirement is waived by SBA.) OR THAT</li><li>o Award(s) WILL NOT be made at fair market</li></ul>

prices.

**Partial Small Business Set-Aside ([FAR 19.502-3](#))**

A portion of the acquisition is reserved for participation by small business when a total set-aside is not appropriate and the requirement is severable into two or more economic lots.

**HUBZone Set-Aside ([FAR 19.13](#))**

An acquisition exceeding the simplified acquisition threshold must be set-aside for HUBZone small business concerns when there is a reasonable expectation that:

- o Offers will be received from two or more HUBZone small business concerns; and
- o Award will be made at a fair and reasonable price.

There is a reasonable expectation that ONLY two firms (one large and one small) with performance capability will respond to the solicitation.

There is a not reasonable expectation that:

- o Offers will be received from two or more HUBZone small business concerns; and
- o Award will be made at a fair and reasonable price.

**Very Small Business Set-Aside ([FAR 19.9](#))**

If a contracting office is located in a designated Small Business Administration district is acquiring supplies or contracts for other than supplies will be performed in a designated district, the contracting officer must set aside requirements estimated to be greater than \$2,500 but not greater than \$50,000 for for very small business concerns as long as competitive offers are expected from two or more offerors that meet set-aside requirements.

There is no reasonable expectation that offers will be received from two or more acceptable offerors that are competitive in terms of market prices, quality, and delivery.

**8(a) Program ([FAR 19.8](#))**  
 Contracts may be awarded to the Small Business Administration (SBA) for performance by eligible 8(a) firms. The SBA subcontracts may be awarded on a non-competitive or competitive basis.

There is a reasonable expectation that the contract price will exceed a fair market price. The negotiated contract price and estimate of a fair market price are subject to the concurrence of the SBA.

*Consider Effects of Other Mandatory Source Programs.*

There are a number of other socioeconomic programs that limit the sources that you can consider for a particular acquisition. The three most important programs are considered in the following table. Again notice the situations where you should question the various requirements that limit competition.

<b>Mandatory Sources</b>	
<b>Socioeconomic Sourcing Requirements</b>	<b>Question when the price of the required source exceeds open market prices</b>
<b>Federal Prison Industries (FPI) or UNICOR</b> Mandatory source for supplies of the classes listed in the Schedule of Products Made in Federal Penal and Correctional Institutions. <a href="#">FAR 8.6</a>	The contracting officer may refer the matter to the cognizant product division identified in the Schedule or to the FPI Washington office for resolution.
<b>Committee for Purchase from the Blind and Other Severely Handicapped</b> Mandatory source for supplies and services identified in the Procurement List. <a href="#">FAR 8.7</a>	Ordering offices may make recommendations to the Committee at any time for price revisions.

**2.2.3 - Match Payment And Finance Terms To Market Conditions**

*Introduction.* Under cost-reimbursement contracts, contractors are typically reimbursed for costs incurred on a monthly basis. Under fixed-price contracts, payment is made in a lump sum at contract completion unless other

financing terms are provided for in the contract. Sometimes, you can attract a greater level of competition and lower-priced offers by providing financing. However the costs of extending such financing must be considered.

*Contractor Financing.* Requiring contractors to fund the entire contract may severely limit competition, particularly with large contracts and long performance periods. Any firm that does submit an offer will probably offer a higher price to cover the cost of working capital. Recognizing the potential effects of required contractor funding on competition and pricing, you may want to consider other financial terms.

However, there are negative aspects to Government funding. Government funds are not free. The Government must also pay interest on borrowed capital. In addition, when the Government provides working capital support, the contractor has both the funds and the product. In the event of contractor default or bankruptcy, the Government may lose both the product and the funds.

*Simplified Acquisition Financing.* Unless agency regulations otherwise permit, you must not provide contract financing for purchases made under the authority of FAR Part 13 (see [FAR 32.003](#)).

*Customary and Unusual Financing.* Financing methods can be divided in several different ways. As you make financing decisions, the most basic division is into customary and unusual financing methods ([FAR 32.001](#)).

- **Customary contract financing** is financing deemed by your agency to be routinely available for fixed-price contracts. Most customary contract financing arrangements should be available for your use without specific reviews or approvals by higher management ([FAR 32.113](#)).
- **Unusual contract financing** is financing not deemed to be customary contract financing by your agency. Unusual contract financing is financing that is legal and proper under applicable laws, but your agency has not authorized you to use it without specific reviews or approvals by higher management ([FAR 32.114](#)).

*Customary Financing Methods for Non-Commercial Items.* The following table outlines customary methods for financing



non-commercial items in accordance with FAR Part 32 and agency regulations:

**Customary Financing Methods for Non-Commercial Items**

Financing of...	Description	Requirement for Use
Shipbuilding, or ship conversion, alteration, or repair using progress payments based on a percentage or stage of completion ( <a href="#">FAR 32.113(a)</a> )	Progress payments are based on the stage or percentage of completion.	Use in accordance with agency guidance.
Construction or architect-engineer services using progress payments based on a percentage or stage of completion ( <a href="#">FAR 32.103</a> and <a href="#">FAR 32.113(b)</a> )	Progress payments are based on the stage or percentage of completion. Up to 10 percent of the progress payment may be withheld if progress is not satisfactory during any payment period.	Mandatory for construction contracts and architect-engineer contracts.
Supplies or services awarded under sealed bidding, competitive negotiation, or sole-source negotiation, using progress payments	Payments are made based on costs incurred as work progresses. Payments may be customary or unusual. The customary rates for large and small business are found in FAR 32.501-1.	Customary progress payments may be included when the contract exceeds minimum dollar amounts, first deliveries will not be made for a substantial time after work begins, and there will be performance expenditures prior to

based on costs.

([FAR 32.113\(c\)](#) and [FAR 32.501-1](#))

Supplies or services awarded under a sole-source acquisition, through performance-based payments (Do not combine performance-based payments in with progress payments based on cost). ([FAR 32.10](#))

Performance-based payments can be based on a single item or the entire contract. Terms must include:

- o Performance-based payments.
- o Performance-based finance amount.
- o Procedures for multiple appropriations (if applicable).
- o Procedures for liquidating finance payments.

delivery.

Performance-based payments preferred over progress payments when practical.

Performance-based payments require:

- o Agreement with contractor on performance-based payment terms.
- o Definitized fixed-price contract.
- o Contract does not provide for other methods of financing except advance payments and guaranteed loans when authorized.

Supplies or services through advance payments ([FAR 32.4](#))

Advances of money to a contractor before, in anticipation of, and for the purpose of complete performance under one or more contracts.

Advance payments are the least preferred method of contracting and should not be authorized if other types of financing are reasonably available. May be used only when statutory requirements and standards are met.

Supplies or services through

Guarantees are made by Federal Reserve Banks to enable contractors

- o Annual maximums for guarantees set

guaranteed  
loans  
([FAR 32.3](#))

to obtain financing  
from private sources  
under national defense  
contracts for supplies  
or services.

by Congress.  
o Contractors  
apply through  
the Federal  
Reserve Bank.  
Loan approval  
requires a  
Certificate of  
Eligibility  
prepared by the  
contracting  
officer  
considering FAR  
requirements.

Supplies or  
services  
through any  
appropriate  
combination  
of advance  
payments,  
guaranteed  
loans, and  
either  
performance-  
based  
payments or  
progress  
payments (but  
not both)  
([FAR  
32.113\(g\)](#))

Any combination of  
these financing  
methods can be used  
long as performance-  
based payments and  
progress payments are  
not used together on  
the same contract.

The requirements  
outlined in the  
as blocks above for each  
type of payment  
considered for  
combination apply  
here.

*Circumstances for Financing Commercial Items.* In some  
markets, commercial buyers commonly provide contract  
financing. You may include appropriate financing terms in  
contracts for commercial purchases when doing so will be in  
the best interest of the Government (see [FAR 32.202-1](#)).

Specifically, you may use commercial interim payments  
and commercial advance payments when the following  
conditions are met:

- The contract item financed is a commercial supply or  
service;

- The contract price exceeds the simplified acquisition threshold in FAR Part 13;
- You determine that it is appropriate or customary in the commercial marketplace to make financing payments for the item;
- This form of contract financing is in the best interest of the Government;
- You obtain adequate security to protect the Government from financial loss;
- Prior to any performance of work under the contract, the aggregate of commercial advance payments shall not exceed 15 percent of the contract price;
- You award the contract on the basis of competitive procedures or, if only one offer is solicited, adequate consideration is obtained (based on the time value of the additional financing to be provided) if the financing is expected to be substantially more advantageous to the offeror than the offeror's normal method of customer financing; and
- You obtain concurrence from the payment office concerning liquidation provisions when required.

*Customary Financing Methods.* The following table outlines customary commercial methods for contract financing in accordance with [FAR Part 32](#) and agency regulations:

**Customary Financing Methods for Commercial Items**

<b>Financing Method</b>	<b>Description</b>	<b>Special Considerations</b>
Commercial advance payments ( <a href="#">FAR 32.202-2</a> )	Payments made before the performance of any work under the contract.	Aggregate of payments shall not exceed 15 percent of the contract price. Payments are not subject to the requirements covering advance payment for non-commercial items.
Commercial interim payments ( <a href="#">FAR 32.202-2</a> )	Payments made to the contractor after some work has been done, but before the item is delivered.	Includes all payments that are not advance payments or delivery payments.

Do not automatically include financing in commercial item contracts. Consider customary commercial financing arrangements as part of your market research. In particular, consider:

- The extent to which other buyers provide contract financing for purchases in that market;
- The overall level of financing normally provided;
- The amount or percentages of any payments equivalent to advance payments;
- The basis for any payments equivalent to commercial interim payments as well as the frequency, and amounts of percentages; and
- Methods of liquidation of contract financing payments and any special or unusual payment terms applicable to delivery payments.

#### 2.2.4 - Furnish Government Property

*Introduction.* Government-furnished property can be used in several ways to encourage competition and assure overall price reasonableness.

*Description.* The term **property** includes facilities, material, special tooling, special test equipment, and agency peculiar property. Different types of property can be used to affect competition and pricing.

*Overview of Government Property.* The table below provides an overview of the various types of Government property and how each type can be used to affect competition and pricing.

<b>Furnishing Government Property</b>		
<b>Type of Property</b>	<b>Definition</b>	<b>Competition and Pricing Considerations</b>
Facilities ( <a href="#">FAR 45.302</a> )	Plant equipment and real property for production, maintenance, research, or testing furnished as Government facilities under situations identified in FAR 45.302.	Making facilities available can significantly increase competition for major production efforts, while eliminating the need for duplicative investment by competitors.

Material ( <a href="#">FAR 45.301</a> )	Property that may be incorporated into or attached to a deliverable end item or that may be consumed or expended in performing a contract. It includes assemblies, components, parts, raw and processed materials, and small tools and supplies that may be consumed in normal use in performing a contract.	Providing Government material can enhance competition in several situations. Breakout of key components can increase competition and reduce component prices. Furnishing proprietary components can increase effective competition on larger systems.
Special Tooling ( <a href="#">FAR 45.101</a> )	Jigs, dies, fixtures, molds, patterns, taps, gauges, other equipment and manufacturing aids, components of these, all items, and replacement of these items, which are of such specialized nature that, without substantial modification, or alterations, their use is limited to the development or production of particular supplies or parts thereof, or to particular services. It does not include material, special test equipment, facilities (except foundations and similar improvements necessary for installing special tooling), general or special machine tools, or similar capital items.	Government provision of special tooling increases competition by reducing the need for investment that can only be used on one contract or project. Government ownership and right to move tooling limit producer ability to obtain a lock on the competition because of unique tooling capacity.
Special Test Equipment ( <a href="#">FAR 45.101</a> )	Single or multipurpose integrated test units engineered, designed, fabricated, or modified to accomplish special	Like special tooling, Government provision of special test equipment increases competition by reducing the need for

purpose testing in performing a contract. It consists of items or assemblies of equipment including standard or general purpose items or components that are interconnected and interdependent so as to become a new functional entity for special testing purposes. It does not include material, special tooling, facilities (except foundations and similar improvements necessary for installing special test equipment), and plant equipment items used for general plant testing purposes.

investment that can only be used on one contract or project. Government ownership and right to move test equipment limit producer ability to obtain a lock on the competition because of unique tooling capacity.

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### **2.2.5 - Consider Warranty Requirements**

*Introduction.* A warranty is a promise or affirmation given by a contractor to the Government regarding the nature, usefulness, or condition of the supplies, or performance of services furnished under a contract (see [FAR 46.701](#) and [46.702](#)).

The principal purposes of a warranty in a Government contract are to:

- Delineate the rights and obligations of the contractor and the Government for defective work.
- Foster quality performance.

*Commercial Warranties.* Take advantage of commercial warranties (including extended warranties, where appropriate and in the Government's best interests) offered by the contractor for the repair and replacement of commercial items ([FAR 46.709](#)).

In solicitations for commercial items, require offerors to offer the Government at least the same warranty terms,

including offers of extended warranties, offered to the general public in customary commercial practice. You may specify minimum warranty terms, such as minimum duration, appropriate for the Government's intended use of the item.

- Assure that any express warranty the Government intends to rely upon meets the needs of the Government. Analyze any commercial warranty to determine if--
- - The warranty is adequate to protect the needs of the Government (e.g., items covered by the warranty and length of warranty);
  - The terms allow the Government effective postaward administration of the warranty; and
  - The warranty is cost-effective.
- In some markets, customary commercial practice may exclude or limit the implied warranties contained in the Government contract terms and conditions for commercial contracts. In such cases, ensure that the express warranty provides for the repair or replacement of defective items discovered within a reasonable period of time after acceptance.
- Include express warranties in the contract by addendum.

*Use of Other Warranties.* Warranties generally are not mandatory. Use must be approved in accordance with agency procedures. In determining whether a warranty is appropriate, you must consider the:

- Nature and use of the supplies or services;
- Warranty cost including contractor charges and the cost of Government enforcement and administration;
- Government's ability to administer and enforce the warranty;
- Customary trade practice; and
- Reductions in the cost of Government contract quality assurance.

([FAR 46.703 and 46.704](#))

*Effect of Warranty on Competition and Pricing.* By agreeing to a warranty, contractors accept the risk of deferred liability. That acceptance of risk has associated costs. Contractors unwilling to accept that risk will drop



from the competition. Others may increase their price to compensate for the risk.

Before you include a warranty provision in a solicitation, you must evaluate the benefits of the warranty against the effect on competition and price. To do that, you must understand the relationship between warranty requirements, competition, price, the nature of the product, and trade practice. Warranty requirements that are unreasonable, given the nature of the product, will reduce competition and increase price. Requirements which significantly exceed trade practice will reduce competition and increase price.

*Control Warranty Costs.* Work with the requiring activity to identify and eliminate warranty requirements that are not in the best interest of the Government. In your analysis, consider the following guidelines:

- For commercial items, use commercial rather than Government-unique warranties.
- For non-commercial items, tailor warranty requirements to mirror existing trade practices.
- When a Government-unique warranty is required, solicit the warranty as a separately priced line item, which the Government may or may not exercise.
- If you are unsure about the benefits of an extended warranty, solicit offerors on the extended warranty as a separately priced option (especially for distant future years).

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### **2.2.6 - Optimize Price/Technical Trade-Offs**

*Technical Factors that Can Reduce Competition.* The factors already considered in this chapter have the greatest effect on competition and contract price. There are, however, many other technical and business factors that can reduce competition and increase prices. These include:

- Security requirements;
- Payment provisions that increase contractor investment;
- Packaging requirements that require survival under extreme conditions;

- Unclear instructions, certifications, and notices to bidders/offerors;
- Unclear source selection criteria; and
- Conflicting and restrictive general contract clauses.

*Technical Factors and Price.* Technical factors could invite offerors to submit higher prices as the tradeoff for a technically superior offer. Key questions to ask regarding proposed technical evaluation factors:

- Will the technical evaluation factor unnecessarily force the acquisition into a higher-priced market segment?
- Will the technical factor constructively amend the specifications to require more than the Government's actual minimum needs?
- Given the likely effect on contract price, is the factor truly necessary to minimize the technical or business risks inherent in the contract requirements?
- Will use of the technical factor likely result in a "greater value" for the taxpayer?

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### **2.3 - Publicizing The Acquisition**

*Introduction.* Publicizing the contract action is one of the most important considerations in maximizing competition. If the solicitation never gets into the hands of potential offerors, competition cannot occur.

As you decide how to publicize the buy, consider the potential effect on competition and contract price. If you can obtain dozens of competitive offers through a notice in the Commerce Business Daily (CBD), you probably do not need to be too concerned about more aggressive means of publicizing the buy. However, if the CBD notice is not likely to reach the strongest competitors, select the method of publicizing most likely to reach them.

As you publicize the buy, remember to allow enough time to receive requests for the solicitation. Of course you must also allow enough time after the solicitation is issued for firms to prepare appropriate offers.

*Methods of Publicizing the Buy.* The following table presents a variety of different methods for publicizing an

acquisition buy and situations where the method can provide the most useful results in increasing competition.

Method Of Publicizing	Description	Situations For Use
Posting a Notice in the Contracting Office ( <a href="#">FAR 5.101</a> )	An unclassified notice of the solicitation or a copy of the solicitation.  Primary purpose is to reach local sources willing to visit the contracting office at least once a week.  Especially useful in providing notice of requirements to local small business.	Unless exempt under FAR 5.101(a)(2)(ii) (e.g., oral or FACNET solicitation), notice is required for all contract actions over \$10,000 but not over \$25,000.  Posting for actions over \$25,000 is useful and may be required by your agency.
<a href="#">Commerce Business Daily (CBD)</a> Synopsis of Proposed Contract Actions ( <a href="#">FAR 5.201 and 5.207</a> )	A synopsis of upcoming acquisitions following the format in FAR 5.207. Primary purposes are to improve small business access to acquisition information and enhance competition by identifying contracting and subcontracting opportunities.  Designed to reach interested national and international sources. Especially useful in providing notice of larger requirements that will attract distant sources.	Required for all nonexempt supply and service contract actions over \$25,000.
<a href="#">Commerce Business Daily (CBD)</a> Synopsis	A synopsis of contract awards following the format	Required for all nonexempt supply and service purchase

of Contract Awards ( <a href="#">FAR 5.207</a> and <a href="#">5.301</a> )	in FAR 5.207.	actions over \$25,000 subject to Trade Agreements Act, or likely to result in any subcontracts.
Handouts ( <a href="#">FAR 5.101(b)(1)</a> )	Listings or synopses of proposed contracts published periodically, normally once a week.	Particularly useful when the you want to bring unique requirements to the attention of local sources.
	May be posted much like notices required for contracting offices or in other locations convenient for local sources.	By providing the information in a usable format, handouts make collecting information easier for potential sources and may increase competition.
Assisting Trade Association Dissemination ( <a href="#">FAR 5.101(b)(2)</a> )	Handouts or similar publications may be distributed to local trade associations with a membership potentially interested in contracting to provide required goods and services.	Particularly useful when you want to bring unique requirements to the attention of firms in the trade that may never have considered Government business.
Federal Acquisition Computer Network (FACNET) or Another Means of Access Through the Single Governmentwide Point of Entry ( <a href="#">FAR 5.101(b)(1)</a> )	FACNET or another point of entry designated by the Administrator of the Office of Federal Procurement Policy that allows the private sector to electronically access governmentwide opportunities Governmentwide.	Use electronic commerce whenever practicable or cost-effective.
Announcements to Mass Media Without Cost	Announcements can be made in the form of news releases to	Particularly useful when you want to reach firms that may

([FAR](#)  
[5.101\(b\)\(1\)](#))

newspapers,  
magazines, or other  
mass media without  
cost.

never have considered  
Government business

Announcements may  
even emphasize the  
public service that  
will be performed by  
firms competing to  
meet Government  
requirements.

Announcements may be  
made about any  
significant proposed  
purchase, but larger  
requirements and  
traditionally non-  
competitive  
requirements will  
likely be considered  
the most newsworthy.

Paid  
Advertisements  
([FAR](#)  
[5.101\(b\)\(4\)](#))

Paid advertisements  
can be tailored to  
get the exact message  
the Government wants  
to send to businesses  
in the identified  
target area, whether  
or not the business  
is specifically  
trying to identify  
Government  
requirements.

Use only when you  
anticipate that you  
cannot otherwise  
obtain effective  
competition.

You may use a single  
newspaper or several  
newspapers in a  
region.

Do not place any  
advertisements  
proposed contracts in  
a newspaper published  
and printed in the  
District of Columbia  
(DC) unless supplies  
or services will be  
furnished or labor  
performed in DC or  
adjoining counties of  
Maryland and  
Virginia.

You may place orders  
for paid advertising  
directly with the  
media or through an  
advertising agency.

Prior to using paid  
newspaper  
advertisements, you  
must obtain approval  
from the agency head  
or designee.

## Ch 3 - Price-Related Information From Offerors

- 3.0 - [Chapter Introduction](#)
- 3.1 - [Cost or Pricing Data](#)
- 3.2 - [Cost or Pricing Data Exceptions](#)
  - 3.2.1 - [Adequate Price Competition Exception](#)
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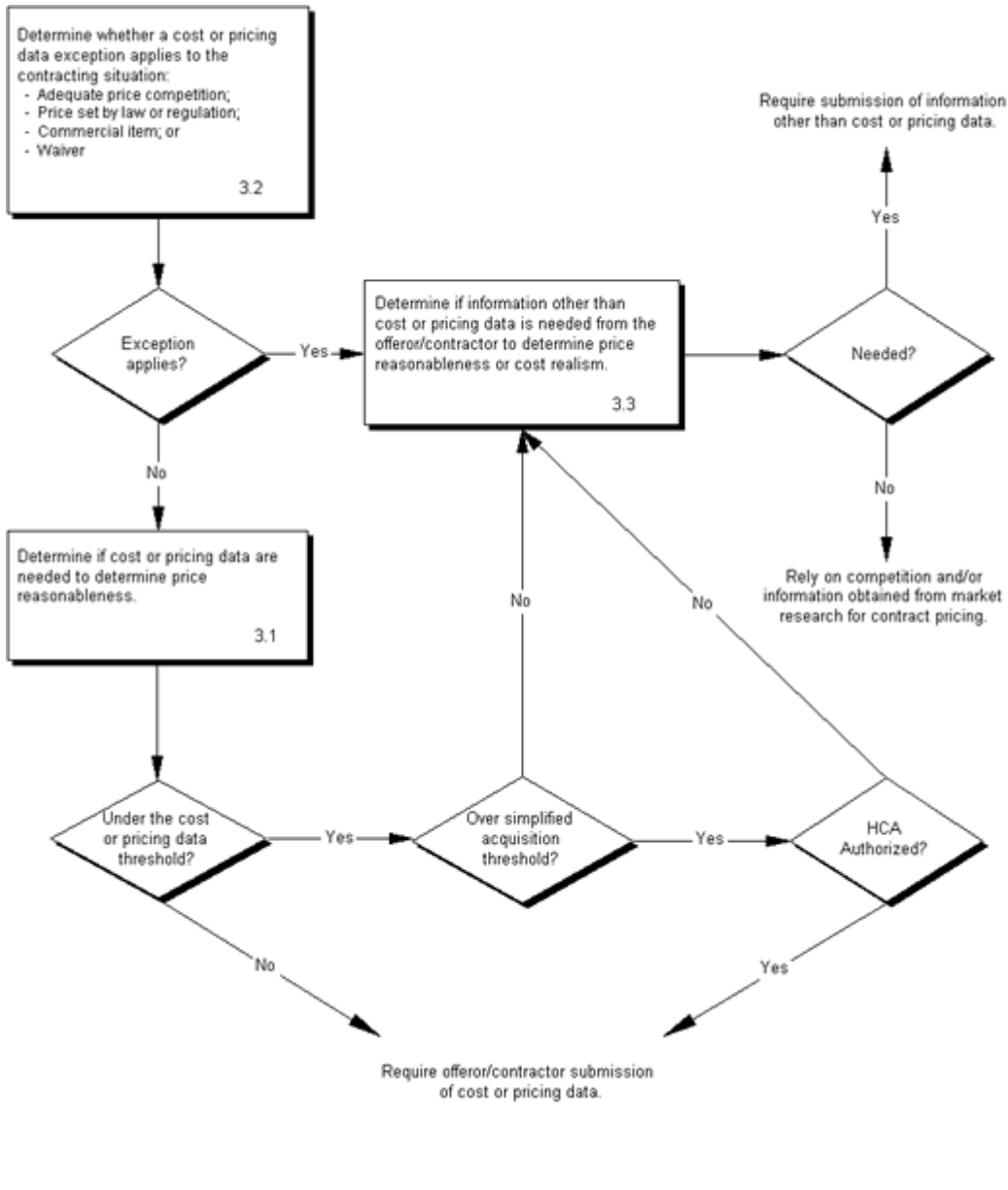
### 3.0 - Chapter Introduction

This chapter covers the steps you will take to determine what data will be needed from offerors to support the pricing decision.

The policies described in this chapter for obtaining and evaluating cost or pricing data or information other than cost or pricing data from offerors **apply only to acquisition by negotiation**.

NEVER require offerors to submit cost or pricing data or information other than cost or pricing data with sealed bids. For sealed bidding, you may only require bidders to submit original worksheets and other data used in bid preparation when there is an alleged mistake in bid ([FAR 14.407-3\(g\)\(2\)](#)).

*Flow Chart of the Decision Process.* This flow chart outlines the decision process that you should follow to determine what (if any) information to require from offerors/contractors.



Cost or Pricing Data ([FAR 15.401](#)).

Cost or pricing data:

- Are all facts that, as of the date of price agreement or, if applicable, another date agreed upon between the parties that is as close as practicable to the date of agreement on price, prudent buyers and sellers would reasonably expect to affect price negotiations significantly.
- Require certification as accurate, complete, and current in accordance with ([FAR 15.406-2.](#))

- Are factual, not judgmental, and are therefore verifiable.
- Include the data that form the basis for the prospective offeror's judgment about future cost projections. The data do not indicate the accuracy of the prospective contractor's judgment.
- Are more than historical accounting data. They are all the facts that can be reasonably expected to contribute to the soundness of estimates of future costs and to the validity of determinations of costs already incurred.
- Include such factors as:
  - Vendor quotations;
  - Nonrecurring costs;
  - Information on changes in production methods and in production or purchasing volume;
  - Data supporting projections of business prospects and objectives and related operations costs;
  - Unit-cost trends such as those associated with labor efficiency;
  - Make-or-buy decisions;
  - Estimated resources to attain business goals; and
  - Information on management decisions that could have a significant bearing on costs.

*Information Other Than Cost or Pricing Data.*

Information other than cost or pricing data:

- Are any type of offeror information that are not required to be certified as accurate, complete, and current, in accordance with FAR 15.406-2, that are necessary to determine price reasonableness or cost realism.
- May include pricing, sales, or cost information.
- Includes all of data submitted that was to have been cost or pricing data but for which certification is not required after submission.

*Order of Preference for Information ([FAR 15.402](#)).* When conducting acquisition by negotiation, you should generally use the following order of preference in determining the type of information to obtain from an offeror:

- If price is based on adequate price competition, generally no additional information is required to determine price reasonableness.



- If you conclude that additional information is necessary to determine price reasonableness, to the maximum extent practicable, obtain the additional information from sources other than the offeror.
  - You may require offerors to submit information other than cost or pricing data to determine the cost realism of competing offers or to evaluate competitive approaches.
- If you need price information other than cost or pricing (e.g., established catalog or market prices) rely:
  - First, on information available within the Government;
  - Second, on information obtained from sources other than the offeror; and
  - If necessary, obtain information from the offeror.
- If you need cost information other than cost or pricing data, only require an offeror to submit the information needed to determine price reasonableness or cost realism.
- Use every means available to ascertain a fair and reasonable price prior to requiring an offeror to submit cost or pricing data.

*Solicitation Price-Related Information Requirements* ([FAR 15.403-5](#) and [15.408\(1\)](#)). You may require offerors to submit pricing-related information at any time prior to the close of negotiations. However, identifying all requirements in the solicitation will permit offerors to gather and document the required information during proposal preparation. If you require information after proposals are received, the contracting process must be delayed while the offeror gathers and documents the information required.

The solicitation must specify:

- Whether cost or pricing data are required;
- That, when cost or pricing data are required, the offeror may submit a request for exception from the requirement to submit cost or pricing data;
- Whether information other than cost or pricing data is required, if cost or pricing data are not necessary;
- Necessary preaward or post award access to the offeror's records;

- The format required for submission of cost or pricing data or information other than cost or pricing data (the FAR Table 15-2 format, a specified alternate format, or a format selected by the offeror).

*Price-Related Information Requirements After Receipt of Offers* ([FAR 15.403-4\(c\)](#)). Decisions on pricing-related information requirements continue after proposals are received:

- If offerors were required to submit cost or pricing data and:
    - An offeror submitted the data, but the contracting officer later finds that an exception applies, never require the offeror to certify that the data are accurate, complete, and current. Instead treat the data as information other than cost or pricing data.
    - No exception applies, but an offeror initially refuses to provide the required data, or the data provided are so deficient as to preclude adequate analysis and evaluation, the contracting officer must again attempt to obtain the data. If the offeror persists in refusing to provide the needed data, the contracting officer must withhold contract award or price adjustment and refer the contract action to higher authority, with details of the attempts made to resolve the matter and a statement on the practicality of obtaining the supplies or services from another source.
  - If offerors are not required to submit cost or pricing data and the contracting officer later determines that the data are necessary, require the offeror to submit the required data prior to the close of contract negotiations.
  - If the Government does not require submission of cost or pricing data or information other than cost or pricing data, but the contracting officer later determines that information other than cost or pricing data are needed from the offeror to determine price reasonableness, require the offeror to submit the necessary information prior to the close of contract negotiations.
-

### 3.1 - Cost or Pricing Data

*Decision Process for Requiring Cost or Pricing Data* ([FAR 15.402\(a\)\(3\)](#), [15.403-1\(b\)](#), and [FAR 15.403-4\(a\)](#)). [The Truth in Negotiations Act \(TINA\)](#) requires that you obtain cost or pricing data in specific contracting situations (described in this section). However, the Act also provides exceptions to that requirement (described in the next section). **Never** require an offeror to submit cost or pricing data unless the contracting officer concludes that none of the exceptions to the cost or pricing data requirement are appropriate.

Because you must consider the exceptions before requiring cost or pricing data, the decision to require cost or pricing data is the last determination in the flow chart presented at the beginning of this chapter. However, in the chapter, we present this section first to identify the general requirement from which contracting officers should consider possible exceptions.

*Situations Requiring Cost or Pricing Data* ([FAR 15.403-4\(a\)](#)). When no exception is appropriate, obtain cost or pricing data before accomplishing any of the following actions when the price is expected to exceed the cost or pricing data threshold:

- The award of any negotiated contract (except for undefinitized actions such as letter contracts).
- The award of a subcontract at any tier, if the contractor and each higher-tier subcontractor have been required to furnish cost or pricing data.
- The modification of any sealed bid or negotiated contract (whether or not cost or pricing data were initially required). This requirement also applies to subcontracts if the contractor and each higher-tier subcontract have been required to furnish cost or pricing data.
  - When deciding whether cost or pricing data are required, sum the value of related increases and decreases in contract requirements. For example, a \$150,000 modification resulting from a reduction of \$350,000 and an increase of \$200,000 is a \$550,000 price adjustment when determining the need for cost or pricing data.
  - Do not sum the value of unrelated and separately priced changes for which cost or pricing data

would not otherwise be required. Such changes may be included in the same contract modification for administrative convenience.

*New Contract Cost or Pricing Data Threshold* ([FAR 15.403-4\(a\)\(1\)](#)). For a new contract, the applicable cost or pricing data threshold is the threshold that is in effect on the date of agreement on price, or the date of award, whichever is later. The cost or pricing data threshold is currently \$500,000. This amount is subject to review and possible adjustment on October 1, 2000 and every five years thereafter.

*Subcontract And Modification Cost or Pricing Data Threshold.* For prime contract modifications, new subcontracts at any tier, and subcontract modifications, the applicable cost or pricing data threshold is established by the prime contract.

- For most contracts, the applicable cost or pricing data threshold is the current threshold on the date of agreement on price, or the date of award, whichever is later.
- Some older contracts specify a dollar threshold that does not automatically change as the current threshold changes. However, a specific dollar threshold can be updated using a bilateral contract modification.

*HCA-Approved Cost or Pricing Data Below the Threshold* ([FAR 2.101](#), [15.403-1](#), and [15.403-4\(a\)\(2\)](#)). The contracting officer may require cost or pricing data submission at or below the cost or pricing data threshold, but only if all three of the following requirements are met:

- The estimated value of the contract action exceeds the simplified acquisition threshold.
  - The simplified acquisition threshold for most noncommercial acquisitions is currently \$100,000.
  - For noncommercial contracts awarded and performed, or purchases to be made, outside the United States in support of contingency operations, the simplified acquisition threshold is \$200,000.
- No exception to obtaining cost or pricing data applies. (For example, never require cost or pricing data when contracting for a commercial item.)

- The head of the contracting activity (without power of delegation) authorizes the cost or pricing data requirement.
    - The head of the contracting activity must justify the cost or pricing data requirement.
    - File documentation must include a written finding that cost or pricing data are necessary to determine whether an offered price is fair and reasonable and the facts supporting that finding.
- 

### 3.2 - Cost Or Pricing Data Exceptions

*Section Introduction.* This section will present a brief review of points to consider in determining whether an exception applies to cost or pricing data requirements. Topics that will be covered include:

- [3.2.1 - Adequate Price Competition Exception](#)
- [3.2.2 - Price Set By Law Or Regulation Exception](#)
- [3.2.3 - Commercial Item Exception](#)
- [3.2.4 - Waiver Exception](#)

*General Guidelines on Exceptions ([FAR 15.403-4\(a\)](#)).* **Never** require cost or pricing data when an exception to cost or pricing data requirements applies. In determining whether a specific exception applies, consider the conditions for granting that exception and the special issues associated with granting that exception.

*Contract Options ([FAR 15.403-2\(a\)](#)).* **Never** require cost or pricing data when exercising an option at the price established at contract/subcontract award or initial contract/subcontract negotiation.

*Funding Adjustments ([FAR 15.403-2\(b\)](#)).* **Never** require cost or pricing data for proposals used solely for overrun funding or interim billing price adjustments.

*Actions at or Below the Cost or Pricing Data Threshold.*  
([FAR 15.403-4\(a\)\(2\)](#))

**Never** require cost or pricing data for contract or subcontract actions priced at or below the simplified acquisition threshold.

**Never** require cost or pricing data for other contract or subcontract actions priced at or below the cost or pricing data threshold **unless** the requirement is authorized by the head of the contracting activity without power of delegation.

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### **3.2.1 Adequate Price Competition Exception**

*Conditions for New Contract or Subcontract Exception* ([FAR 15.403-1\(b\)\(1\)](#) and [FAR 15.403-1\(c\)\(1\)](#)). Never require cost or pricing data when the contracting officer determines that the agreed-upon prices are based on adequate price competition. A price is based on adequate price competition if:

- Two or more responsible offerors, competing independently, submit priced offers responsive to the Government's expressed requirement and both of the following conditions are met:
  - Award will be made to the offeror whose proposal represents the best value to the Government where price is a substantial factor in the source selection;
  - There is no finding that the price of the otherwise successful offeror is unreasonable. Any finding that a proposed price is unreasonable must be supported by a statement of the facts and approved at a level above the contracting officer;
- There was a reasonable expectation, based on market research or other assessment, that two or more responsible offerors, competing independently, would submit priced offers responsive to the solicitation's expressed requirement, even though only one offer is received from a responsible, responsive offeror and both of the following requirements are met:
  - Based on the offer received, the contracting officer can reasonably conclude that the offer was submitted with the expectation of competition, e.g., circumstances indicate that:
  - The offeror believed that at least one other offeror was capable of submitting a meaningful, responsive offer; and

- o The offeror had no reason to believe that other potential offerors did not intend to submit an offer; and
  - o The determination that the proposed price is based on adequate price competition and is reasonable is approved at a level above the contracting officer; or
- Price analysis clearly demonstrates that the proposed price is reasonable in comparison with current or recent prices for the same or similar items, adjusted to reflect changes in market conditions, economic conditions, quantities, or terms and conditions under contracts that resulted from adequate price competition.

*Conditions for Modification Exception* ([FAR 52.215-21\(a\)\(ii\)](#)).

Never require cost or pricing data for a modification of a contract or subcontract for a commercial item if:

- The original contract or subcontract was granted an exception from cost or pricing data requirements because:
  - o The price agreed upon was based on adequate price competition or prices set by law or regulation, or
  - o The contract or subcontract was for a commercial item; and
- The modification would not change the contract or subcontract from a contract or subcontract for acquisition of a commercial item to a contract or subcontract for acquisition of an item other than a commercial item.

*Independence of Brand Name Offers in Competition* ([FAR 6.302-1\(c\)](#)). Brand-name acquisitions raise special concerns about independent competition. If the Government requirement specifies a particular brand name, product, or feature of a product, peculiar to one manufacturer you cannot have **full and open competition** regardless of the number of sources solicited. That is why brand name descriptions must be approved in accordance with FAR Part 6.

- o You may still be able to obtain **adequate price competition** among dealers if the acquisition involves

- value added by the offeror** so that the brand name item is a relatively small part of the total acquisition. Examples of situations where you may have adequate price competition include acquisitions where the brand name item:
- Is a component of a larger system being acquired by the Government;
  - Requires contractor modification for Government use;
  - Requires contractor testing to qualify for Government use; or
  - Requires unique packaging to meet the needs of the Government.
- However, if the item will simply flow through the contractor without any **value added**, it is **unlikely that you will have adequate price competition because the manufacturer will control the majority of the acquisition price**. Dealers may actively compete within their portion of the price, but the manufacturer's pricing policy to dealers will likely determine the winner. Dealers cannot price the product independently because all must ultimately rely on the same source for the item. Even though there may not be adequate price competition, the item may qualify for a commercial item exception.
  - Be especially careful when the manufacturer is one of the competitors. Since the manufacturer controls its pricing policy to dealers, the manufacturer can usually win the competition if it desires.

*Price as Substantial Factor in the Source Selection* (CGEN B-176217, December 14, 1972 and CGEN B-189884, March 29, 1979). To have adequate price competition, price must be a substantial factor in the contract award decision, but neither the FAR nor the law define what weight price must have to be considered a substantial factor.

- In general, the weight assigned must be large enough to cause offerors to seriously consider price in preparing their offers.
- The Comptroller General (CGEN) has found adequate price competition in cases where price was assigned a weight of only 20 percent in the award decision. However, price is usually assigned a weight that is higher than 20 percent.



*Recent Competition.* The FAR does not provide any guidelines on how recent competition must be to be considered as a basis for excepting an offeror from submitting cost or pricing data. The term "recent" must be judged subjectively.

- The price must be recent enough to use as a basis for determining price reasonableness.
- Normally, competition is considered recent if it took place within the last 12 months.
- However, be careful.
  - Before you except an offeror from submission of cost or pricing data based on recent competition, examine the market to see how market conditions have changed since the last competitive acquisition.
  - If the product market is extremely volatile, a price that is only a few months old may not be recent enough to use as a basis for determining price reasonableness.

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### **3.2.2 Price Set By Law Or Regulation Exception**

*Conditions for Exception* ([FAR 15.403-1\(b\)\(2\)](#), [15.403-1\(c\)\(2\)](#), and [52.215-21\(a\)\(1\)](#)). Never require cost or pricing data for a new contract, new subcontract, or a contract or subcontract modification when the contracting officer determines that the agreed-upon prices are based on prices set by law or regulation. Pronouncements in the form of periodic rulings, reviews, or similar actions of a governmental body, or embodied in the laws, are sufficient to set a price.

*Applicable Items.* To apply this exception, the price of the item that you are acquiring must be set by law or regulation. You are not permitted to use this exception for items similar to those priced by law or regulation.

*Request for Exception* ([FAR 52.215-20\(a\)\(1\)](#) and [52.215-21\(a\)\(1\)](#)). When a solicitation or contract clause requires submission of cost or pricing data, an offeror/contractor may request an exception using prices set by law or regulation. The request for exception must (as a minimum):

- Identify the law or regulation that establishes the price offered.
  - Include a copy of any periodic ruling, review, or similar action of a governmental body used to establish the offered price, unless it was previously submitted to the contracting office.
- 

### **3.2.3 Commercial Item Exception**

*Conditions for Exception* ([FAR 15.403-1\(b\)\(3\)](#), [15.403-1\(b\)\(5\)](#), and [15.403-1\(c\)\(3\)](#)). Never require cost or pricing data for a new contract, new subcontract, or contract or subcontract modification when you are acquiring a commercial item.

- Any acquisition for an item that meets the FAR definition of a commercial item is excepted from cost or pricing data requirements.
- Any contract modification that does not change the item from a commercial item to a noncommercial item is also excepted from cost or pricing data requirements.

*Commercial Item Identification* ([FAR 2.101](#)). A commercial item is:

1. Any item, other than real property, that is of a type customarily used for nongovernmental purposes and that has been sold, leased, or licensed to the general public; or, offered for sale, lease, or license to the general public;
2. Any item that evolved from an item described in Paragraph 1 through advances in technology or performance and that is not yet available in the commercial marketplace, but will be available in the commercial marketplace in time to satisfy the delivery requirements under a Government solicitation;
3. Any item that would satisfy a criterion expressed in Paragraphs 1 or 2 of this definition, but for:
  - Modifications of a type customarily available in the commercial marketplace; or
  - Minor modifications of a type not customarily available in the commercial marketplace made to meet Government requirements. A "minor" modification is any modification that does not significantly alter the nongovernmental function

or essential physical characteristics of an item or component, or change the purpose of a process. When you determine whether a modification is minor consider the value and size of the modification and the comparative value and size of the final product. Use dollar values and percentages as guideposts, but they are not conclusive evidence that a modification is minor;

4. Any combination of items meeting the requirements of Paragraphs 1, 2, 3, or 5 of this definition that are of a type customarily combined and sold in combination to the general public;
5. Installation services, maintenance services, repair services, training services, and other services if such services are procured for support of an item referred to in Paragraphs 1, 2, 3, or 4 above, and if the source of such services:
  - o Offers such services to the general public and the Government contemporaneously and under similar terms and conditions; and
  - o Offers to use the same work force for providing the Government with such services as the source uses for providing such services to the general public;
6. Services of a type offered and sold competitively in substantial quantities in the commercial marketplace based on established catalog or market prices for specific tasks performed under standard commercial terms and conditions. This does not include services that are sold based on hourly rates without an established catalog or market price for a specific service performed;
7. Any item, combination of items, or service referred to in Paragraphs 1 through 6, notwithstanding the fact that the item, combination of items, or service is transferred between or among separate divisions, subsidiaries, or affiliates of a contractor; or
8. A nondevelopmental item, if the procuring agency determines the item was developed exclusively at private expense and sold in substantial quantities, on a competitive basis, to multiple State and local governments.

*Nondevelopmental Item Identification* ([FAR 2.101](#)). A nondevelopmental item is:

1. Any previously developed item of supply used exclusively for governmental purposes by a Federal agency, a State or local government, or a foreign government with which the United States has a mutual defense cooperation agreement;
2. Any item described in Paragraph 1 of this definition that requires only minor modification or modifications of a type customarily available in the commercial marketplace in order to meet the requirements of the procuring department or agency; or
3. Any item of supply being produced that does not meet the requirements of Paragraph 1 or 2 solely because the item is not yet in use.

*Request for Exception* ([FAR 52.215-20\(a\)\(1\)](#) and [52.215-21\(a\)\(1\)](#)). When a solicitation or contract clause requires submission of cost or pricing data, a firm may request a commercial item exception. At a minimum, the request for exception must include information on prices at which the same or similar items have previously been sold in the commercial market that is adequate for evaluating the reasonableness of the current acquisition price.

- For catalog items, the firm should include:
  - A copy of or identification of the catalog and its date, or the appropriate pages for the offered items, or a statement that the catalog is on file in the buying office to which the proposal is being submitted;
  - A copy or description of current discount policies and price lists (published or unpublished) (e.g., wholesale, original equipment manufacturer, or reseller); or
  - An explanation of the basis of each offered price and its relationship to the established catalog price, including how the proposed price relates to the price of recent sales in quantities similar to the proposed quantities.
- For market-priced items, the firm should include:
  - The source and date or period of the market quotation or other basis for market price, the base amount, and applicable discounts; and
  - A description of the nature of the market.
- For items included on an active Federal Supply Service Multiple-Award Schedule contract, the firm should include proof that an exception has been granted for the schedule item.

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### **3.2.4 Waiver Exception**

*Conditions for Exception* ([FAR 15.403-1\(b\)\(4\)](#) and [15.403-1\(c\)\(4\)](#)). Never require cost or pricing data for a new contract, new subcontract, or contract or subcontract modification when the head of the contracting activity waives the requirement for cost or pricing data.

- The authorization for the waiver and the supporting rationale must be in writing.
- The head of the contracting activity (without power of delegation) may consider waiving the cost or pricing data requirement if the price can be determined to be fair and reasonable without submission of cost or pricing data.

*Special Issue for Waivers* ([FAR 15.403-1\(c\)\(4\)](#)). For all other exceptions to cost or pricing data requirements, granting the exception to a prime contractor or higher-tier subcontractor means that lower-tier subcontractors are also excepted from submitting cost or pricing data.

Under the waiver of cost or pricing data requirements, the contractor or higher-tier subcontractor to whom the waiver applies must be considered as having been required to submit cost or pricing data. Consequently, lower-tier subcontract actions that are expected to exceed the cost or pricing data threshold require the submission of cost or pricing data unless:

- An exception otherwise applies to the lower-tier subcontract; or
- The prime contract waiver specifically includes the subcontract and the rationale supporting the waiver for that subcontract.

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### **3.3 Information Other Than Cost Or Pricing Data**

*Policy on Requiring Information Other Than Cost or Pricing Data* ([FAR 15.403-3](#)). The contracting officer is responsible for obtaining information other than cost or pricing data to the extent necessary to determine price reasonableness or cost realism.

- Generally, you should not require firms to submit information other than cost or pricing data when there is adequate price competition.
  - If you need additional information to determine price reasonableness, to the maximum extent practicable, the contracting officer must obtain the necessary information from sources other than the offeror.
  - However, the contracting officer may require information other than cost or pricing data to determine the cost realism of competing offers or to evaluate competing approaches.
- Unless price reasonableness will be determined by adequate price competition or a price set by law or regulation, obtain (as a minimum) appropriate information on prices at which the same item or similar items have previously been sold that is adequate for determining price reasonableness.
- For commercial items:
  - Limit requests for sales information to data for the same or similar items during a relevant time period.
  - To the maximum extent practicable, limit the requirement to information in a form regularly maintained by the offeror in commercial operations.
- As specified in Section 808 of Public Law 105-261, an offeror who does not comply with a requirement to submit information that the contracting officer has deemed necessary to determine price reasonableness or cost realism is ineligible for award unless the Head of the Contracting Activity determines that it is in the best interest of the Government to make the award to that offeror, based on consideration of the following:
  - The effort made to obtain the data.
  - The need for the item or service.
  - Increased cost or significant harm to the Government if award is not made.
- Contractor refusals to submit requested information, and all actions taken by the contracting officer and at levels above the contracting officer to address those refusals, must be fully documented.

*Price Information Other Than Cost or Pricing Data.* The contracting officer may require the offeror/contractor to provide price information other than cost or pricing data. Price information will be particularly important for commercial items purchased noncompetitively.

<b>Price Information Other Than Cost or Pricing Data</b>		
<b>Information Element</b>	<b>Consider Offerors/Contractors To...</b>	<b>Requiring Related Analysis Questions</b>
Catalog pricing	Identify any relevant offeror commercial catalog, its date, catalog prices, and related discounts. Also require the offeror/contractor to explain any differences between the offered price, the established catalog price, and price of recent sales in quantities similar to the proposed quantities.	Does the firm have a commercial catalog price? How do the prices for recent commercial sales compare with the catalog price? How does the price offered compare to the catalog price and the circumstances of the commercial sales?
Market pricing	Describe the nature of the relevant market and how that market affects the offered price including the source and date or period of any relevant market quotation or other basis for market price, the base market price, and applicable discounts or other price adjustments.	Is there a commercial market for the item? Is there an independent and verifiable record of the market price? How does the price offered compare to the market price and the circumstances of the commercial sales?
Other evidence	Provide evidence of prices charged other customers	Can the offeror provide evidence

prices charged	under similar circumstances. For example, the firm could provide copies of contracts with other customers to document the prices charged.	of the prices paid by commercial customers? Do commercial customers verify the prices paid?
		How does the price offered compare with the prices paid by other customers under similar circumstances?
Services normally provided	Describe the services provided by the offeror/contract to the firm's buying at the prices provided as bases for price analysis. Different firms and industries provide different levels of support services for their products, including product warranties, set-up, and financing.	What services are provided other customers? Based on services provided, should the Government price be different than the price charged commercial customers?
Normal order size	Document the normal order size for firms paying prices provided by the offeror/contractor as bases for price analysis. Prices may relate to the total size of each order, not just the price of the item involved. For example, an order could include 100 units of the item and nothing else, or the order could include 100 units of the item and thousands of units of other items. Presumably, the larger order should merit a lower price.	What was the total dollar value of orders with other customers? Based on the relative order size, should the Government price be different than the price charged other customers?
Annual Volume of	Document the sales volume to similar customers and	Under similar circumstances,



Sales to Similar Customers	the prices paid by those customers. For example, commercial firms often negotiate total volume discounts with major customers, over and above normal order quantity discounts. In comparing total volume of purchases, you should normally consider known acquisitions from all Government activities as a group.	does the firm sell at lower prices to firms with larger total annual purchases?  What prices are charged other customers with total annual purchases similar to that of the Government?
Lowest Price Charged Other Customers	Document the lowest prices recently charged other customers for the same or similar products. The Government procurement may not this most favored customer treatment, however this information will provide useful information on the lowest prices paid by any customer under any circumstances. What is recent will vary based on the type of item and the market. Generally, it will vary from three months to a year.	What is the lowest recent price paid for the same or similar product?  How do the circumstances of the Government procurement differ from the circumstances of the lowest priced sale?

*Cost Information Other Than Cost or Pricing Data.* You may require an offeror/contractor to provide cost information other than cost or pricing data to support your analysis of price reasonableness or cost realism. The table below examines five situations in which cost information other than cost or pricing data might be needed. Examples of the type of questions that cost information could help answer are also provided. Government technical and audit assistance may be required to analyze the cost information and answer related questions.

<b>Contracting Situation</b>	<b>Analysis Purpose</b>	<b>Analysis Questions</b>
You expect a single offer at or below the cost or pricing data threshold,	Support determination of price	Does the proposed price appear

and you do not expect to be able to determine price reasonableness using price analysis alone.

reasonableness reasonable based on its relationship with estimated costs?

You expect a single offer greater than the cost or pricing data threshold that will be excepted from cost or pricing data requirements, but you do not expect to be able to determine price reasonableness using price analysis alone.

You expect competitive offers, but because of technical differences, you do not expect to be able to determine price reasonableness using price analysis alone.

You find that there are too few sales of commercial item to use as a basis for price analysis and cost analysis is the only reasonable method for determining price reasonableness.

You expect competitive offers for a cost-reimbursement contract.

Cost realism analysis to determine probable final cost to the Government. Are proposed costs realistic for the work to be performed?

You expect competitive offers for a fixed-price contract, but new requirements may not be understood by all offerors.

Cost realism analysis to determine an offeror understands all contract requirements. Do proposed costs reflect a clear understanding of contract requirements?

You expect competitive offers for a fixed-price

Cost realism analysis to Are proposed costs consistent

contract, but you have concerns about the performance quality that will result from each offeror's proposal.

determine an offeror's ability to deliver proposed quality at the proposed price.

with the offeror's technical proposal?

You expect competitive offers for a fixed-price contract, but market analysis leads you to believe that some offerors may propose unrealistic prices that would jeopardize contract performance.

Cost realism analysis to determine an offeror's ability to meet all contract requirements at the proposed price.

Do proposed costs reflect a clear understanding of contract requirements?

*Information Requirement* ([FAR 15.403-3\(a\)](#), [15.408\(1\)](#), [15.408\(m\)](#), [52.215-20](#), and [52.215-21](#)).

The solicitation/contract must specify the information and the format required:

- Tailor the requirement to the information essential for your analysis (e.g., do not require cost information if price information is adequate).
- Permit the firm to select the format for submitting the information unless the contracting officer determines that use of a specific format is essential.
- Ensure that the information used to support price negotiations is sufficiently current to permit negotiation of a fair and reasonable price.
- Limit requests for updated offeror/contractor information to information that affects the adequacy of the proposal for negotiations (e.g., changes in price lists).
- Never require a certificate of current cost or pricing data for any information other than cost or pricing data.

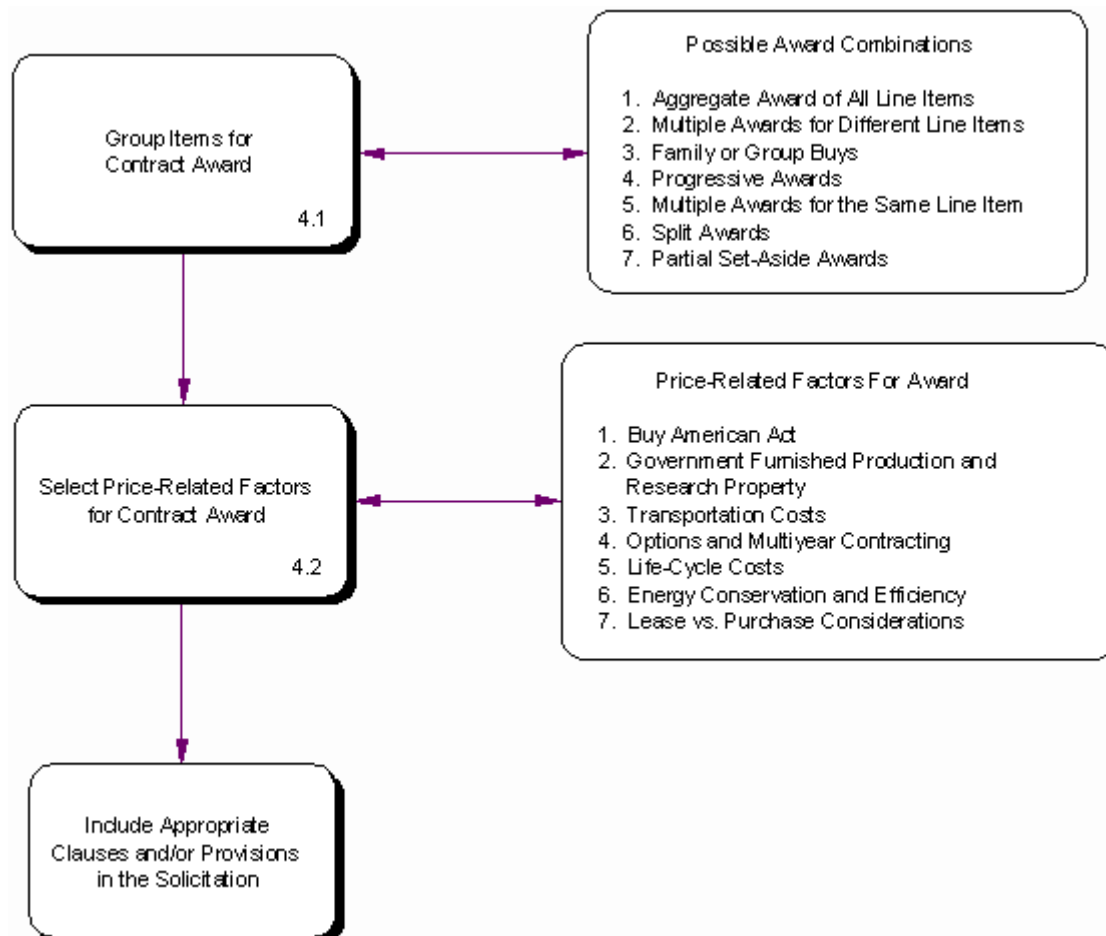
## Ch 4 - Identifying Possible Combinations for Award

- 4.0 - [Chapter Introduction](#)
- 4.1 - [Aggregate Award Of All Line Items To One Contractor](#)
- 4.2 - [Multiple Awards For Different Line Items](#)
- 4.3 - [Family Or Group Buys](#)
- 4.4 - [Progressive Awards For Portions Of Total Line Item Requirement](#)
- 4.5 - [Multiple Awards For The Same Line Item](#)
- 4.6 - [Split Awards](#)
- 4.7 - [Partial Set-Aside Awards](#)

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### 4.0 Chapter Introduction

*Criteria Development Process.* The figure below depicts the sequence of events or steps that you should follow in developing contract award criteria for contract pricing.



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*Identify Most Advantageous Award Strategy.* As you prepare any solicitation, you must clearly define the groupings and possible award combinations that will be considered in evaluating offers for contract award. When you solicit offers to provide one unit of a single product, only one firm can receive a contract award to provide that unit. However, as the number of different items and the number of units of each item increase, the number of award possibilities also increases. Theoretically, the award possibilities could become almost infinite.

There is no one method of grouping items for contract award that will always result in effective competition and reasonable prices. However, each method described in this chapter can improve competition and lower prices when used in the appropriate acquisition situation.

As you decide which method to use in a particular acquisition situation, consider both the product that you are acquiring and the potential offerors. Use market research to learn about the customary practices used by Government and industry.

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#### **4.1 Aggregate Award Of All Line Items To One Contractor**

*Aggregate Awards.* The table below presents descriptions and pricing considerations for making aggregate awards.

<b>Aggregate Awards</b>	
<b>Description</b>	<b>Use When...</b>
Award to the single responsible offeror whose offer provides the best value to the Government.	Award on an "all or none" basis would probably result in a total price that is lower than the sum of low offers from a line-item by line-item competition. This method would be especially appropriate when firms regularly sell the contract items as an integrated package to realize economies of scale that are not possible when selling each

component independently.

**For example:** Many firms offer computer systems that are cheaper than buying the separate components (e.g. disk drives, monitors, printers, etc.) one by one.

***Example of a Method of Award Provision:***

Award will be made in the aggregate for all items. The low aggregate offeror will be determined by multiplying the unit price submitted on each item by the quantity specified, and adding the resultant extensions. In order to qualify for an award, prices must be submitted on all items.

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**4.2 Multiple Awards For Different Line Items**

*Multiple Awards for Different Line Items* ([FAR 52.214-22](#) and [52.215-1\(f\)\(6\)](#)). The table below presents descriptions and pricing considerations for making multiple awards for different line items.

**Multiple Awards  
(Line Item by Line Item)**

<b>Description</b>	<b>Use When...</b>
Base award(s) on the line items or groups of line items that provide the lowest aggregate cost to the Government, including the assumed administrative costs for awarding and administering each contract.	Awarding line item by line item is likely to result in a lower total price than awarding on an aggregate "all or none" basis. This method would be especially appropriate if prospective offerors are likely to perceive no significant economies of scale from an aggregate award.

**For example:** Some firms may sell computer peripherals at much lower prices than are typically offered by computer manufacturers. However, such firms might

not be able to compete to provide the peripherals if the solicitation requires award based on the aggregate price for all line items (including the peripherals) that comprise a microcomputer system.

**Example 1 of a Method of Award Provision:**

The Government reserves the right to make multiple awards if, after considering the additional administrative costs, it is in the Government's best interest to do so

**Example 2 of a Method of Award Provision:**

In addition to other factors, bids will be evaluated on the basis of advantages and disadvantages to the Government that might result from making more than one award (multiple awards). It is assumed, for the purpose of evaluating bids, that \$500 would be the administrative cost to the Government for issuing and administering each contract awarded under this solicitation, and individual awards will be for the items or combinations of items that result in the lowest aggregate cost to the Government, including the assumed administrative cost.

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**4.3 Family Or Group Buys**

*Family or Group Buys* ([FAR 52.214-22](#) and [52.215-1\(f\)\(6\)](#)). The table below presents descriptions and pricing considerations for family or group buys.

<b>Family or Group Buys</b>	
<b>Description</b>	<b>Use When...</b>
Award for identified families, or groups, of line items that provide the lowest aggregate cost to the Government, including the assumed administrative costs of awarding each contract.	Offerors are likely to submit a total price for a group of line items that would be lower than the sum of their offers on the individual items. This method would be especially appropriate if offerors are likely to perceive significant

economies of scale from being awarded all line items in a particular group as a package.

**For example:** Firms that manufacture ink cartridges for printers also tend to manufacture ink cartridges for fax machines. Line items for different ink cartridges might be included in a single family of items.

***Example of a Method of Award Provision:***

Award will be made in the aggregate for each identified group of items. The low offeror for the group will be determined by multiplying the unit price submitted on each item in the group by the estimated quantity specified, and adding the resultant extensions. In order to qualify for an award on a group of items, an offeror must submit prices for each item within the group.

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**4.4 Progressive Awards For Portions Of Total Line Item Requirement**

*Progressive Awards.* The table below presents descriptions and pricing considerations for making progressive awards.

**Progressive Awards  
(Each Line Item)**

<b>Description</b>	<b>Use When...</b>
If the offeror with lowest evaluated unit price for a line item offers less than the total quantity required by the Government, award up to the quantity offered. Follow the same procedure with the next lowest evaluated unit price and continue until the entire line item requirement is awarded.	Some of the potential competitors do not have the capability to supply the entire quantity required by the Government, but might be in a position to offer the lowest price for some of the needed units.  <b>For example:</b> Some firms specialize in reconditioning laser printer cartridges and offer those cartridges at a



fraction of the price of new units. If such a firm did not have enough reconditioned cartridges to fill the entire requirement, a progressive award would allow the firm to compete for the quantities that it can supply -- with other firms competing for the balance of the requirement.

***Example of a Method of Award Provision:***

a) Award will be made on an item-by-item basis to the lowest responsive offerors up to their stated monthly quantity allocations. Awards to any offeror will not be made for quantities in excess of the firm's stated monthly quantity allocation.

b) If the low responsive offeror offers a monthly quantity allocation which, when multiplied by the number of months representing the contract period, totals less than the Government's estimated annual requirements, the Government may make progressive awards to the extent necessary to meet its estimated annual requirements. In such cases, awards will be made to the low responsive offeror up to that offeror's stated monthly quantity allocation, and then progressively to other offerors to the extent necessary to cover all Government requirements. Within the limits prescribed by the offeror, the Government will apply offeror's monthly quantity allocation to any items offered, as the Government's interests require.

c) If progressive awards are made, orders will be placed first with the contractor offering the lowest price on each item normally up to the contractor's monthly quantity allocation and then in the same manner, successively to other contractors. However, to avoid the placement of unduly small orders or the splitting of a single requirement between two contractors, the Government reserves the right to place orders with back-up contractors whenever the orders placed with lower priced contractors equal or exceeds 95 percent of their monthly quantity allocation for the item or group of items being ordered. In no case will orders be placed with any contractor in excess of its monthly quantity allocation.

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#### 4.5 Multiple Awards For The Same Line Item

*Multiple Awards for the Same Line Item* ([FAR 16.504\(c\)](#)).

The table below presents descriptions and pricing considerations for making multiple awards for the same line item under an indefinite quantity contract.

##### **Multiple Awards (Estimated Requirements for Individual Line Items)**

Description	Use When...
Make multiple awards for the same indefinite requirement in situations where multiple firms are capable of delivering similar, but not necessarily identical, products to meet the needs of the Government and provide alternatives for ordering offices. Ordering offices then have the choice of selecting the product and firm that best meet their needs.	<p>Appropriate to meet the needs of the Government. If you are using an indefinite quantity contract for:</p> <ul style="list-style-type: none"><li>• Supplies or services other than advisory and assistance services, give preference to making multiple awards, unless you determine that a single award is appropriate.</li><li>• Advisory and assistance services that will not exceed three years and \$10 million, including all options, you may give preference to making multiple awards.</li><li>• Advisory and assistance services that will exceed three years and \$10 million, you must give preference to making multiple awards, unless:</li><li>• The contracting officer, or other person designated by the agency head, determines in writing prior to solicitation that the services are so unique or highly specialized that it is not practical to award more than one</li></ul>

contract. This determination may also be appropriate when contract tasks are so integrally related that only a single contractor can reasonably perform the work, or

- The contracting officer, or other person designated by the agency head, determines in writing, after evaluation of offers, that only one offeror is capable of providing the services required, or
- You only receive one offer.

***Example 1 of a Method of Award Provision:***

The Government may elect to award a single delivery order contract or task order contract or to award multiple delivery order contracts or task order contracts for the same or similar supplies or services to two or more sources under this solicitation.

***Example 2 of a Method of Award Provision:***

The Government intends to award multiple contracts for the same or similar advisory and assistance services under this solicitation unless the Government determines, after evaluation of offers, that only one offeror is capable of providing the services at the level of quality required.

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#### **4.6 Split Awards**

*Split Awards* ([FAR 6.202](#)). The table below presents descriptions and pricing considerations for making split awards.

<b>Split Awards</b>	
<b>(Estimated Requirements for Individual Line Items)</b>	
<b>Description</b>	<b>Use When...</b>
Award of requirements for an	• Multiple sourcing is

individual line item may be split between two or more sources. The size of each portion of the split or a method for calculating the split should be established in the solicitation. Every possible effort should be made to assure that any amount awarded is an economic production quantity.

necessary to maintain competitive sources for a product that would otherwise be available only from one source. The split may be on a percentage share basis, with the most favorable offer receiving the largest percentage of the requirement; or

- Multiple source development will be facilitated at relatively low risk to the Government. For example, a partial set-aside is a form of split award.

***Example of Method of Award Provision:***

The Government intends to make split awards from this solicitation. Sixty percent of the total quantity will be awarded to the offeror that the Government determines to have submitted the proposal that offers the best value to the Government, considering primarily technical scores and secondarily, offered prices. Forty percent will be awarded to the remaining competitor provided that the technical evaluation determines that the technical proposal is acceptable and the offered prices are determined to be fair and reasonable.

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**4.7 Partial Set-Aside Awards**

*Partial Set-Aside Awards* ([FAR 19.502-3](#) and [52.219-7](#)). The table below presents descriptions and pricing considerations for making partial set-aside awards.

**Partial Set-Aside Awards**

<b>Description</b>	<b>Use When...</b>
A portion of the solicitation requirement is set-aside for small business. Any small business can submit an offer	All of the following are true: <ul style="list-style-type: none"><li>• A total set-aside is not</li></ul>

to provide the set-aside portion, the non-set-aside portion, or both.

Note: If a small business is awarded the non-set-aside portion of the requirement, do not attempt to negotiate a lower price with the firm for the set-aside portion. However, accept voluntary reductions.

appropriate.

- The requirement is severable into two or more economic purchase lots.
- One or more small business concerns is expected to have the technical competence and productive capacity to satisfy the set-aside portion of the requirement at a fair market price.
- The acquisition is not made under small purchase procedures.

Unless authorized by the head of the contracting activity, do not use a partial set-aside if there is a reasonable expectation that only two capable concerns (one large and one small) will respond.

***Method of Award Provision Requirements:***

The set-aside portion of the requirements must be specifically identified. Any acceptable method of award may be used to award the set-aside portion, including aggregate, line item by line item, or family buys. Solicitations must include [FAR 52.219-7](#), Notice of Partial Small Business Set-Aside.

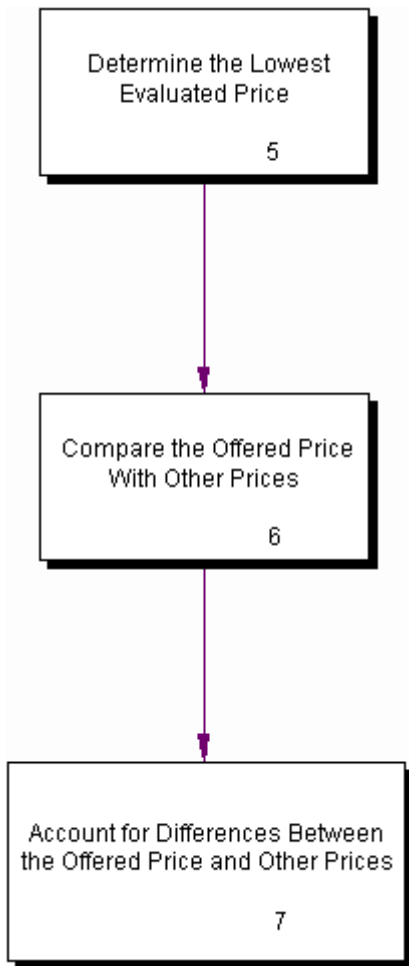
## Ch 5 - Identifying and Applying Price-Related Factors

- 5.0 - [Chapter Introduction](#)
  - 5.1 - [Assumed Administrative Cost Factors](#)
  - 5.2 - [Buy American Act Criteria](#)
    - - 5.2.1 [FAR Criteria](#)
    - - 5.2.2 [DFARS Criteria](#)
  - 5.3 - [Government Furnished Production And Research Property Factors](#)
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  - 5.9 - [Small Disadvantaged Business Price Evaluation Adjustment](#)
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### **5.0 Chapter Introduction**

*Procedural Steps.* The figure below shows where this chapter fits into the conduct of a price analysis.

### **Steps in Analyzing Prices (Chapters 5-7)**



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*Identify Price-Related Factors* ([FAR 14.201-5\(c\)](#) and [15.204-5\(e\)](#)). As you prepare any solicitation, you must identify the price-related factors to be considered in the contract award decision. **Assure that contract award criteria address all price-related factors that will have a significant and quantifiable effect on the total cost of the acquisition.** The price-related factors identified in this chapter are not meant to provide an exhaustive list of price-related factors that you could consider during offer evaluation. However, the chapter does address several key price-related factors that may be applicable to your contracting situation.

If you identify other price-related factors that may affect the total cost of a particular acquisition, you should consider those factors as you develop your contract award criteria.

Use *Price-Related Factors* ([FAR 14.201-6\(q\)](#) and [52.215-1\(f\)\(6\)](#)). Once you identify price-related criteria for offer evaluation, you must consider those criteria in offer evaluation. Generally, your evaluation should follow this 4-step procedure:

**Step 1.** Determine solicitation provisions.

**Step 2.** Determine total price offered.

**Step 3.** Evaluate award combinations.

**Step 4.** Make award decision.

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## **5.1 Assumed Administrative Cost Factors**

*When to Consider Administrative Cost Factors.* When multiple award of different line items in the solicitation is possible, you must consider the effect of different award combinations on the total cost to the Government. Since it will cost more to administer each additional contract, you must consider that cost in your evaluation.

*General Evaluation Requirements* ([FAR 14.201-6\(q\)](#), [52.214-22](#), and [52.215-1\(f\)\(6\)](#)).

### **Step 1. Determine Solicitation Provisions.**

In sealed bidding, if the contracting officer determines that making multiple awards might be economically advantageous to the Government, you must consider the costs of making multiple awards in offer evaluation. FAR prescribes an assumed administrative cost of \$500 for issuing and administering each contract.

When using negotiation procedures, other contract objectives may preclude consideration of the cost of multiple awards (e.g., multiple awards are preferred for most indefinite-quantity indefinite-delivery contracts). If consideration is appropriate, you could use the same \$500 cost estimate or a different reasonable estimate supported by a documented rationale.



## **Step 2. Determine Offered Price(s).**

Determine the price(s) in each offer for each item or group of items being considered for contract award.

## **Step 3. Evaluate Possible Award Combinations.**

In your evaluation of offers, consider the estimated administrative cost for each contract (e.g. \$500) when evaluating the possible award combinations. In relatively simple award situations, you might be able to determine the proper award decision without detailed calculations. In most situations, however, you must evaluate all possible award combinations. If the number of offerors is so large that evaluation of all possible methods of award would be prohibitive, you may exclude offerors that obviously have no chance of receiving the award. When determining which offerors do have a chance of receiving an award, consider the following:

- A successful offeror will NORMALLY be low on one or more items.
- If there are many offerors who are low on different items, it MAY BE POSSIBLE for a firm with offers close to the low offer on many items to win an award when the cost of contract administration is considered.

## **Step 4. Make Award Decision.**

Select the offers that provide the lowest evaluated prices.

*Evaluation Example* ([FAR 52.214-22](#)).

## **Step 1. Determine Solicitation Provisions.**

As an example of the evaluation process, consider an award under sealed bidding procedures. Assume that the invitation for bids states that award will be made to the responsive and responsible bidder with the lowest evaluated price and includes the following clause:

In addition to other factors, bids will be evaluated on the basis of advantages and disadvantages to the Government that might result from making more than one award (multiple awards). It is assumed, for the purposes of evaluating bids, that \$500 would be the administrative cost to the Government for issuing and administering each contract awarded under this solicitation, and individual awards will be for the items or combinations of items that result in the lowest aggregate cost to the Government, including the assumed administrative costs.

**Step 2. Determine Offered Price(s).**

In your evaluation of bids, consider the possible award combinations. Bids on the three different line items in the solicitation were received from two bidders. The extended line item totals, unit price multiplied by quantity, are shown in the table below.

Item	Bid 1	Bid 2
1	\$74,000	\$74,450
2	\$94,750	\$94,250
3	\$22,125	\$21,500

**Step 3. Evaluate Possible Award Combinations.**

Given the evaluation criteria and the bids, there are three possible methods of contract award:

- Multiple Awards
- Award All Items to Bidder 1
- Award All Items to Bidder 2

**Multiple Awards.** Awards to both Bidders 1 and 2. Looking at the bids without considering the \$500 evaluation factor, making multiple awards appears to be the logical decision. Following this procedure, the total evaluated price would be:

Item	Bidder 1 Award	Bidder 2 Award	Total Price
1	\$74,000		\$ 74,000
2		\$ 94,250	\$ 94,250
3		\$ 21,500	\$ 21,500
Admin. Cost	\$ 500	\$ 500	\$ 1,000

Evaluation Price	\$74,500	\$116,250	\$190,750
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**Award All Items to Bidder 1.** If all items were awarded to Bidder 1, the total evaluated price would be:

Item	Bidder 1 Award	Bidder 2 Award	Total Price
1	\$ 74,000		\$ 74,000
2	\$ 94,750		\$ 94,750
3	\$ 22,125		\$ 22,125
Admin. Cost	\$ 500		\$ 500
Evaluation Price	\$191,375		\$191,375

**Award All Items to Bidder 2.** If all items were awarded to Bidder 2, the total evaluated price would be:

Item	Bidder 1 Award	Bidder 2 Award	Total Price
1		\$ 74,450	\$ 74,450
2		\$ 94,250	\$ 94,250
3		\$ 21,500	\$ 21,500
Admin. Cost		\$ 500	\$ 500
Evaluation Price		\$190,700	\$190,700

**Step 4. Make Award Decision.**

In this case, your decision should be to award the entire requirement to Bidder 2, because that decision would result in the lowest aggregate evaluated price to the Government. Although multiple awards appears to offer the lowest total contract price, you can see that, when the assumed administrative cost was factored in, the total evaluated price is lowest if all items are awarded to Bidder 2.

**5.2 Buy American Act Criteria**

*In This Section.* The Independent Government Estimate is only one preliminary estimate of contract price. As a minimum, your research, should consider the data sources identified in this section.

- 5.2.1 [FAR Criteria](#)
- 5.2.2 [DFARS Criteria](#)

*Buy American Act Requirement* ([FAR 25.102](#) and [DFARS 225.102](#)). The Buy American Act requires that only domestic end products be acquired for public use, except articles, materials, and supplies-

- For use outside the United States;
- For which the cost would be unreasonable, as determined in accordance with FAR or agency guidance;
- For which the agency head determines that domestic preference would be inconsistent with the public interest;
- That are not mined, produced, or manufactured in the United States in sufficient and reasonably available commercial quantities, of a satisfactory quality; or
- Purchased specifically for commissary resale.

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### 5.2.1 FAR Criteria

*Applicability of FAR Guidance* ([FAR 25.105](#)). Apply FAR guidance in evaluating offers under the Buy American Act unless your agency prescribes different evaluation criteria. For example, the Defense Federal Acquisition Regulation Supplement (DFARS) prescribes procedures unique to the Department of Defense.

*Key Terms* ([FAR 25.101](#)). Consider the following definitions as you apply FAR Buy American Act criteria:

- **Components** -- articles, materials, and supplies incorporated directly into the end products.
- **Domestic end product** --
  - An unmanufactured end product mined or produced in the United States, or
  - An end product manufactured in the United States, if the cost of its components mined, produced, or manufactured in the United States exceeds 50 percent of the cost of all its components. The cost of each component includes transportation costs to the place of incorporation into the end product and any applicable duty (whether or not a duty-free entry certificate is issued). Components of foreign origin of the same class or

kind that are not mined, produced, or manufactured in the United States in sufficient and reasonably available commercial quantities of a satisfactory quality or which the agency head determines that domestic preference would be inconsistent with the public interest are treated as domestic. Scrap generated, collected, and prepared for processing in the United States is considered domestic.

- **Domestic offer** -- an offered price for a domestic end product, including priding to destination.
- **End product** -- articles, materials, and supplies to be acquired for public use under the contract.
- **Foreign end product** -- an end product other than a domestic end product.
- **Foreign offer** -- an offered price for a foreign end product, including transportation to destination and duty (whether or not a duty-free certificate is issued).

*General Buy American Act Implementation* ([FAR 52.225-1 and 52.225-3\(b\)](#)). To implement Buy American Act requirements, insert FAR Buy American Act--Supplies clause into any solicitation for supplies, or for services involving the furnishing of supplies, within the United States, unless the solicitation is restricted to domestic end products, the acquisition is made under the European Community Agreement or Trade Agreements Act, or another exception to the Buy American Act applies. This clause requires the contractor to deliver only domestic end products, except those:

- For use outside the United States;
- That the Government determines are not mined, produced, or manufactured in the United States in sufficient and reasonably available commercial quantities of a satisfactory quality;
- For which the agency determines that domestic preference would be inconsistent with the public interest; or
- For which the agency determines the cost to be unreasonable.

Note that the fourth exception allows you to award to a firm offering a foreign product if the cost of domestic end items is considered unreasonable. The FAR establishes criteria for determining the low evaluated offer when both

domestic and foreign end items have been offered in response to your solicitation.

When you insert the above clause into a solicitation, assure that you also insert the FAR Buy American Certificate. That provision requires offerors to identify any offered items that are not known domestic end products.

*Distinguishing Domestic from Nondomestic End Products* ([FAR 52.225-1](#)). How can you determine whether an offered product is domestic or foreign for the purposes of applying the FAR evaluation criteria? The FAR Buy American Certificate requires each offeror to identify any product being offered that is not a known domestic end product:

BUY AMERICAN CERTIFICATE (DEC 1989)

The offeror certifies that each end product, except those listed below, is a domestic end product (as defined in the clause entitled "Buy American Act-Supplies"), and that components of unknown origin are considered to have been mined, produced, or manufactured outside the United States.

*Excluded End Products Country of Origin:*

(List as necessary)

Offerors may obtain from the contracting officer lists of articles, materials, and supplies excepted from the Buy American Act.

(End of provision)

*Caveats* ([FAR 25.103](#), [25.102\(a\)](#), [25.108](#), [25.2](#), [25.400](#), [52.225-3](#), and [DFARS 225.105](#)).

There are several caveats that you must consider as you decide whether to use FAR Buy American Act criteria in offer evaluation:

- FAR Buy American Act guidance does not apply to all Federal departments and agencies. For example, the Department of Defense (DoD) and the National Aeronautics and Space Administration (NASA) have

determined that it is inconsistent with the public interest to apply the restrictions of the Buy American Act to their acquisitions of certain supplies mined, produced, or manufactured in certain foreign countries.

Federal departments and agencies (e.g., the DoD) have different criteria for determining when the cost of domestic end items should be considered unreasonable. Check your agency's FAR Supplement before applying the FAR criteria.

- Note that FAR Buy American Act--Supplies clause does not apply to acquisitions made under the Trade Agreements Act of 1979 and other trade agreements including the:
  - North American Free Trade Agreement (for Canadian and Mexican products);
  - Caribbean Basin Economic Recovery Act;
  - U.S. - Israeli Free Trade Area Agreement; or
  - Agreement on Civil Aircraft.
- The FAR contains a long list of articles, materials, and supplies that various agencies have determined are not mined, produced, or manufactured in the United States in sufficient and reasonably available commercial quantities of a satisfactory quality. That list is furnished for information only. Check your agency's FAR Supplement for guidance.
- The FAR contains still other exceptions and qualifications to the general FAR requirements.
- The policy on construction material is contained in FAR 25.2.

*General Evaluation Requirements* ([FAR 25.105](#)).

### **Step 1. Determine Solicitation Provisions.**

Decide whether to consider the FAR Buy American Act criteria in offer evaluation.

- Determine whether the FAR Buy American Act--Supplies clause was required for the acquisition and incorporated in the solicitation.
- If the clause was required, you must examine the Buy American Certificate submitted by each offeror to determine if any firm is offering a foreign product. If any offeror lists an Excluded End Product on the

Certificate, the Buy American Act criteria would apply **unless:**

- o The country of origin or the product is covered by one of the many exceptions to application of those criteria, or

No competing firm has offered a domestic product (i.e., an "unexcluded" end product) in response to your solicitation.

**Step 2. Determine Offered Price(s).**

Identify the price(s) in each offer for each item or group of items being considered for contract award. Identify the duty applicable to each foreign offer.

**Step 3. Evaluate Possible Award Combinations.**

Evaluate each item or group of items for which award may be made in accordance with solicitation contract award criteria.

- Unless the agency head determines otherwise, consider the offered price of a domestic end product unreasonable when the lowest acceptable domestic offer exceeds the lowest acceptable foreign offer, inclusive of duty, by:
  - o More than 6 percent, if the domestic offer is from a large business; or
  - o More than 12 percent, if the domestic offer is from a small business concern.
- If applying the 12-percent factor would result in an award of more than \$250,000 to a domestic concern, but applying the 6-percent factor would not, the agency head must decide whether award to the domestic concern would involve unreasonable cost.
- Never apply either the 6-percent or 12-percent factor to offers of:
  - o Israeli end products at or above \$50,000;
  - o Canadian end products above \$25,000; or
  - o Mexican end products above \$53,150.

**Step 4. Make Award Decision.**

Award to the offeror with the offer that provides the best value for the Government under the criteria



established in the solicitation. Settle ties in favor of domestic offers.

*Evaluation Example.*

**Step 1. Determine Solicitation Provisions.**

Assume that a solicitation states that award will be made to the responsible offeror with a technically acceptable offer and the lowest evaluated price. The Buy American Act applies to the acquisition, with no applicable exception to the Act for the acquisition or the end product.

Examining the Buy American Certificate in each offer, you discover that Offeror 2 and Offeror 3 left their respective certificates blank, meaning (presumably) that they are offering domestic end items. Offeror 1 states that the country of origin for its product is Greater Aquatica.

Since no exception applies to products from Aquatica, you must apply the FAR Buy American Act criteria.

**Step 2. Determine Offered Price(s).**

The table below lists the evaluated price of each offer. The price for the foreign end product includes all applicable duties.

<b>Offeror</b>	<b>End Product</b>	<b>Business Size</b>	<b>Offer</b>
1	Foreign	Small	\$168,000*
2	Domestic	Large	\$179,000
3	Domestic	Small	\$180,000

\* Item is not duty exempt. The price includes a \$1,900 duty.

**Step 3. Evaluate Possible Award Combinations.**

All offers are technically acceptable. Offeror 2 is a large business and Offeror 3 is a small business.

Since the foreign offer is low, you must use Buy American Act requirements to evaluate the low offer and the low domestic offer. Because the low domestic offeror is a

large business, you must use the 6-percent factor to adjust Offer 1 as follows:

<b>Offeror</b>	<b>Offer</b>	<b>Apply 6-Percent Factor</b>	<b>Evaluated Offer</b>
1	\$168,000	.06 x \$168,000 = \$10,080	\$178,080
2	\$179,000	N/A	\$179,000
3	\$180,000	N/A	N/A

#### **Step 4. Make Award Decision.**

Based on the evaluation above, you should award to Offeror 1, the offeror with the low evaluated price.

*Evaluation Example Note:* Offer 1 was not compared with Offer 3, because Offer 3 was not the low domestic offer.

If Offeror 1 had been in competition ONLY with Offeror 3, Offer 3 would have won the competition, because the adjustment factor would have been 12 percent for a small business.

If the offers had exceeded \$250,000 and applying the 12-percent factor would result in an award to a domestic concern but applying the 6-percent factor would not, the agency head would have to decide whether award to a domestic concern would involve an unreasonable cost.

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#### **5.2.2 DFARS Criteria**

*Applicability of DFARS Criteria* ([DFARS 225.105](#)). If your organization is subject to Defense Federal Acquisition Regulation Supplement (DFARS) guidance, use the DFARS procedures instead of the FAR procedures, to determine when the cost of a domestic end product is unreasonable under the Buy American Act.

*Key Terms* ([DFARS 225.000-70](#), [252.225-7001\(a\)](#), and [DFARS 252.225-7007\(a\)](#)). Consider the following definitions as you determine the applicability of DFARS Buy American Act criteria:

- **Defense equipment** -- any equipment, item of supply, component, or end product purchased by the DoD.
- **Domestic concern** -- a concern incorporated in the United States or an unincorporated concern having its principal place of business in the United States.
- **Domestic end product** --
  - An unmanufactured end product which has been mined or produced in the United States; or
  - An end product manufactured in the United States, if the cost of its qualifying country and its components which are mined, produced, or manufactured in the United States exceeds 50 percent of the cost of all its components. The cost of components includes transportation costs to the place of incorporation into the end product and any U.S. duty (whether or not a duty-free entry certificate is issued). Consider a component to have been mined, produced, or manufactured in the United States (regardless of its source in fact) if the end product in which it is incorporated is manufactured in the United States and the component is of a kind:
    - Determined to be not mined, produced, or manufactured in the United States in sufficient and reasonably available commercial quantities and of a satisfactory quality; or
    - Which the Secretary concerned determines would be inconsistent with the public interest to apply the restrictions of the Buy American Act.
- **Foreign concern** -- any concern other than a domestic concern.
- **Nondesignated country end product** -- any end product which is not a U.S. made end product or a designated country end product.
- **Nonqualifying country** -- a country other than the United States or a qualifying country.
- **Nonqualifying country end product** -- an end product which is neither a domestic nor qualifying country end product.
- **Nonqualifying country offer** -- an offer of a nonqualifying country end product, including the price of transportation to destination.
- **Qualifying country** -- a term used to describe certain countries with memoranda of understanding or international agreements with the United States.
- **Qualifying country component** -- an item mined, produced, or manufactured in a qualifying country.

- **Qualifying country end product** --
  - An unmanufactured end product mined or produced in a qualifying country; or
  - An end product manufactured in a qualifying country if the cost of the components mined, produced, or manufactured in the qualifying country and its components mined, produced, or manufactured in the United States exceed 50 percent of the cost of all its components.
- **Qualifying country offer** -- an offer of a qualifying country end product, including the price of transportation to destination.
- **Source** -- when restricted by such words as foreign, domestic, qualifying country, etc., refers to the actual manufacturer or producer of the end product or component.
- **U.S. made end product** -- an article that:
  - Is wholly the growth, product, or manufacture of the United States; or
  - In the case of an article that consists in whole or in part of materials from another country or instrumentality, has been substantially transformed in the United States into a new and different article of commerce with a name, character, or use distinct from that of the article or articles from which it was so transformed.

*Solicitation Requirement* ([FAR 6.302-3](#), [DFARS 225.109](#), and [DFARS 252.225-7000](#)). To implement Buy American Act requirements, insert DFARS Buy American Act and Balance of Payments Program clause into any solicitation for supplies, or for services involving the furnishing of supplies.

- Do not use the clause if an exception to the Buy American Act or Balance of Payments Program is known to apply or if you are using another clause related to trade agreements.
- You need not use the clause if nonqualifying country end products are ineligible for contract award, including end products restricted:
  - To domestic or domestic and qualifying country sources under Appropriations and Authorization Act restrictions;
  - To domestic and domestic and Canadian sources; and
  - Under industrial mobilization restrictions.

- You may use the clause if nonqualifying country end products are ineligible, but you anticipate a waiver of eligibility restrictions.

This clause:

- Advises offerors that a price offered for a nonqualifying country end product must include all applicable duties.
- Advises offerors that each nonqualifying country offer will be adjusted for evaluation by adding an amount equal to 50 percent of the offer, inclusive of duty.
- Requires the contractor to deliver "only domestic end products," unless its offer specified delivery of nondomestic end products. If an offeror that offers a qualifying country end product receives a contract, the firm must deliver a qualifying country end product or a domestic end product.

*Distinguishing Domestic from Nondomestic End Products* ([DFARS 252.225-7000](#)). How can you determine whether an offered end product is a domestic, qualifying country, or nonqualifying country for the purposes of applying the DFARS evaluation criteria? The DFARS Buy American Act-- Balance of Payments Program Certificate requires each offeror to identify any product being offered that is not a known domestic end product.

**BUY AMERICAN ACT-BALANCE OF PAYMENTS PROGRAM CERTIFICATE  
(DEC 1991)**

(a) Definition.

"Domestic and product," "qualifying country," "qualifying country end product," and "nonqualifying country end product" have the meanings given in the Buy American Act and Balance of Payments Program clause of this solicitation.

(b) Evaluation.

Offers will be evaluated by giving preference to domestic end products and qualifying country end products over nonqualifying country end products.

(c) Certifications.

(1) The Offeror certifies that-

(i) Each end product, except those listed in paragraphs (c)(2) or (3) or this clause. is a domestic end product; and

(ii) Components of unknown origin are considered to have been mined. produced. or manufactured outside the United States or a qualifying country.

(2) The Offeror certifies that the following end products are qualifying country end products:

Qualifying Country End Products

Line Item Number	Country of Origin
_____	_____

(List only qualifying country end products.)

(3) The Offeror certifies that the following end products are non-qualifying country end products:

Nonqualifying Country End Products

Line Item Number	Country of Origin (If known)
_____	_____

Caveats ([DFARS 225.102](#), [225.105](#), [225.872-1](#), and [252.225-7001](#)). There are several caveats that you must consider as you decide whether to use DFARS Buy American Act criteria in offer evaluation:

- DFARS procedures identify public interest exceptions to Buy American Act requirements.
  - The DoD has determined that it is inconsistent with the public interest to apply the restrictions of the Buy American Act to the acquisition of defense equipment which is mined, produced, or manufactured in countries identified as qualifying countries. These countries are excepted because of the provisions of a memorandum of understanding or other international agreement.
- The DoD has determined that individual acquisitions for products of four qualifying countries (Austria, Finland, Sweden, and Switzerland) may, on a purchase-by-purchase basis, be exempted from application of the Buy American Act.
- The Under Secretary of Defense (Acquisition and Technology) has determined that, for procurements subject to the Trade Agreements Act, it is inconsistent with the public interest to apply the Buy American Act to information technology products in Federal Supply Group 70 or 64 that are substantially transformed in the United States.
- Specific exceptions can be approved when the purposes of the Buy American Act are not served by applying its requirements in a particular acquisition situation.
- Consider requesting a public interest exception in appropriate situations. An exception may be appropriate:
  - If accepting the low domestic offer will involve substantial foreign expenditures, or accepting the low foreign offer will involve substantial domestic expenditures;
  - To ensure access to advanced state-of-the-art commercial technology; or
  - To maintain the same source of supply for spare and replacement parts for an end item that qualifies as an American good; or in order not to impair integration of the military and commercial industrial base.
  - A determination to grant a public interest exception must be made:

- At a level above the contracting officer for acquisitions valued at less than \$100,000;
  - By the head of the contracting activity for acquisitions valued at \$100,000 or more but less than \$1,000,000; or
  - By the agency head for acquisitions valued at \$1,000,000 or more.
- Except in certain identified situations, a determination that an article, material, or supply is not reasonably available is required where no domestic offer is received or when domestic offers are insufficient to meet the requirement and award is made to a nonqualifying country end product. The determination must be approved:
  - At a level above the contracting officer, for acquisitions estimated not to exceed \$25,000;
  - By the chief of the contracting office for acquisitions estimated not to exceed \$250,000;
  - By the head of the contracting activity (HCA) or immediate deputy for acquisitions estimated not to exceed \$2 million; or
  - By the head of the agency, or designee at a level no lower than an HCA for acquisitions estimated to exceed \$2 million.
- Scrap is domestic in origin if generated in, collected in, and prepared for processing in the United States.

*General Evaluation Requirements* ([DFARS 225.105](#), [225.872-1](#), [252.225-7000](#), and [DFARS 252.225-7001](#)).

### **Step 1. Determine Solicitation Provisions.**

Decide whether to consider the FAR Buy American Act criteria in proposal evaluation.

- Determine if the Buy American Act and Balance of Payments Program clause was required for the acquisition and incorporated in the solicitation.
- If the clause was required, examine the Buy American Certificate-Balance of Payments Program Certificate submitted by each offeror to determine if any firm is offering a foreign product and if any firm identifies a nonqualifying country end product on the Certificate.

### **Step 2. Determine Offered Price(s).**



Identify the price(s) in each offer for each item or group of items being considered for contract award. Identify the duty applicable to each foreign offer.

### **Step 3. Evaluate Possible Award Combinations.**

If the Act applies to the acquisition, add 50 percent to the price of the lowest offer of a product from a nonqualifying country. Qualifying country offers are specifically excluded from application of the requirements of the Buy American Act because of the provisions of memoranda of understanding or other international agreements.

As you evaluate nonqualifying country offers, consider the following:

- When a nonqualifying country offer includes more than one item, apply the 50-percent factor:
  - On an item-by-item basis; or
  - On a group basis, if the solicitation specifically provides for award on a group basis.
- When application of the factor would not result in the award of a domestic end product (e.g. when no domestic offers are received or when a qualifying country offer is lower than the domestic offers) evaluate nonqualifying country offers without the 50-percent factor.
- If duty is to be exempted through the inclusion of the FAR Duty-Free Entry clause, you must still evaluate the nonqualifying country offer inclusive of duty. If award is made on the nonqualifying country offer, award at the offered price minus the duty.
- If the evaluation procedures result in a tie between a nonqualifying country offer and a domestic offer, make award on the domestic offer.
- If an offer is for a U.S. made end product, domestically produced end product, product of a small business, but is not a domestic end product, treat the offer as a nonqualifying country offer.

### **Step 4. Make Award Decision.**

Award to the offeror with the lowest evaluated price, after application of the Buy American criteria in Step 3. Settle ties in favor of domestic offers.

Evaluation Example ([DFARS 252.225-7000](#)).

**Step 1. Determine Solicitation Provisions.**

Assume that the solicitation states that award will be made to the responsible offeror with a technically acceptable offer and the lowest evaluated price. The Buy American Act applies to this acquisition, with no applicable exception to the Act for the lens assembly or the end product.

You examine the Buy American--Balance of Payments Program Certificates submitted by Offeror 2 and Offeror 3 and find that they left their certificates blank, indicating that the items are domestic end products. Offeror 1 states that the country of origin for its product is Lower Aquatica (a nonqualifying country).

**Step 2. Determine Offered Price(s).**

The following table lists the evaluated price of each offer, after applying all other price-related factors in the RFP.

Offeror	End Product	Offer
1	Nonqualifying	\$168,000*
2	Domestic	\$179,000
3	Domestic	\$180,000

\* Item is not duty exempt. The price includes a \$1,000 duty.

**Step 3. Evaluate Possible Award Combinations.**

You have investigated and found that the Buy American Act applies to this acquisition. Use the Buy American criteria to evaluate offers as follows:

Offeror	Offer	Apply 50-Percent Factor	Evaluated Offer
1	\$168,000	$.50 \times \$168,000 = \$84,000$	\$252,000
2	\$179,000	N/A	\$179,000
3	\$180,000	N/A	\$180,000

#### Step 4. Make Award Decision.

Based on the evaluation above, you should select Offer (the low evaluated offer) for contract.

*Evaluation Example Note ([DFARS 225.872-1](#))*. Note that the decision would have been different if Offer 1 had been a product produced in a qualifying country, a country for which the DoD has determined it inconsistent with the public interest to apply the restrictions of the Buy American Act-Balance of Payment Program.

If Offer 1 had been a qualifying country offer, you would not apply the 50 percent adjustment factor. As a result, you would evaluate all offers without the adjustment factor:

Offeror	Offer	50-Percent Factor	Evaluated Offer
1	\$168,000	N/A	\$168,000
2	\$179,000	N/A	\$179,000
3	\$180,000	N/A	\$180,000

Without the adjustment factor, you select Offeror 1 for contract award.

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### 5.3 Government Furnished Production And Research Property Factors

This section examines the factors that you must consider when soliciting and evaluating offers that may involve Government furnished production and research property:

- 5.3.1 - [Eliminate Competitive Advantage](#)
- 5.3.2 - [Consider Costs And Savings To The Government](#)

*Government Production and Research Property ([FAR 45.301](#))*. The term "Government production and research property" means Government-owned facilities, Government-owned special test equipment, and special tooling to which the Government has title or has the right to acquire title.

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### 5.3.1 Eliminate Competitive Advantage

*Factors in Offer Evaluation* ([FAR 45.201](#)). When evaluating offers, you must make the maximum practical effort to:

- Eliminate any competitive advantage accruing to a contractor possessing Government furnished production and research property.
- Consider any costs or savings to the Government related to providing such property, regardless of any competitive advantage that may result.

*When to Consider as a Price-Related Factor* ([FAR 45.201](#) and [52.245-9](#)). To eliminate the competitive advantage that may result when an offeror offers to perform a contract with Government furnished production and research property, you can:

- **Adjust the offers of contractors proposing to use Government furnished production and research property.**
  - This is the **preferred method** for eliminating the competitive advantage. During offer evaluation, adjust any offers proposing the use of furnished production and research property using a factor equal to the rent that would be charged for use of the property under the requirements of the FAR Use and Charges clause. Only use the adjusted price in your evaluation. Do not include the adjustment in the price of any resulting contract award.
  - Do not adjust proposals using a rental equivalent factor when the contracting officer determines that using the factor would not affect the choice of contractor.
- **Charge the contractor rent for using Government furnished production and research property.** Only charge contractors rent **when adjustment of offers for offer evaluation is not practical.** Any offeror or subcontractor may use Government furnished production and research property after obtaining the written approval of the cognizant contracting officer. Charge rent in accordance with the provisions of the FAR Use and Charges clause.

*Solicitation Requirements* ([FAR 45.205](#)). When you anticipate that Government production and research property will be offered for use in a competitive acquisition, the solicitation:

- Should normally require the contractor to assume all costs related to making the property available for use (such as payment of all transportation or rehabilitation costs).
- The solicitation must describe offer evaluation procedures, including rental charges or equivalents to be evaluated, and require all offerors to submit with their offers the following information:
  - A list or description of all Government production and research property that the offeror or its subcontractors propose to use on a rent-free basis. The list must include property offered for use in the solicitation, as well as property already in possession of the offeror and its subcontractors under other contracts.
  - Identification of the facilities contract or other instrument under which property already in possession of the offeror and its subcontractors is held and written permission for its use from the cognizant contracting officer.
  - The dates during which the property will be available for use (including the first, last, and all intervening months) and, for any property that will be used concurrently in performing two or more contracts, the amounts of the respective uses in sufficient detail to support proration of the rent.
  - The amount of rent that would otherwise be charged, computed in accordance with FAR requirements.
- The solicitation must provide that using Government production and research property (other than as described and permitted in the solicitation) will not be authorized under the contract unless such use is approved in writing by the contracting officer with property cognizance, and either rent (calculated in accordance with the FAR Use and Charges clause) is charged, or the contract price is reduced by an equivalent amount.

*General Evaluation Requirements* ([FAR 45.205](#)).

**Step 1. Determine Solicitation Provisions.**

The solicitation must describe the evaluation procedures to be used, including the rental charges or equivalents to be evaluated, and information the offeror must submit with its offer.

**Step 2. Determine Offered Price(s).**

**Step 3. Evaluate Possible Award Combinations.**

Before you evaluate the pricing aspects of contractor use of Government production and research property on the contract, contact the contracting officer with property cognizance to confirm that the property is available for use on the contract. Follow the offer evaluation procedures set forth in the solicitation.

**Step 4. Make Award Decision.**

Whichever method you use, select the offer that provides the best value for the Government under the criteria established in the solicitation.

Determine the price(s) in each offer for each item or group of items being considered for contract award. Also identify what property each offeror is proposing to use on the contract and the estimated period of use.

*Evaluation Example* ([FAR 45.205](#) and [52.245-9](#)).

**Step 1. Determine Solicitation Provisions.**

Assume that the solicitation states that award will be made to the responsible offeror with a technically acceptable offer and the lowest evaluated price. It also includes the following provision:

For purposes of offer evaluation, any offer predicated on rent-free use of Government production and research property will be adjusted to eliminate possible competitive advantage. The adjustment will be made using a rental equipment adjustment factor equal to the allocable rent that would otherwise be charged for use of the Government property. Rent will

be computed in accordance with FAR 52.245-9, Use and Charges.

**Step 2. Determine Offered Price(s).**

Two offers were received in response to the solicitation.

Offeror	Offer
1	\$352,000
2	\$347,000

Only Offer 2 proposes rent-free use of GFP. It proposes rent-free use of one APEX Model 5209, Serial #14345089, machine tool, for a period of one month during production.

**Step 3. Evaluate Possible Award Combinations**

Contact the contracting officer responsible for the GFP to ensure that the proposed GFP will be available for use on your contract, as requested by the offeror.

Assume that the contracting officer with property cognizance further advises you that it is less than two years old and cost \$200,000. Using the FAR Use and Charges clause, you determine that a fair and reasonable rental cost is \$6,000.

Using the \$6,000 in evaluation, you find:

Offeror	Offer	GFP Rental Equivalent	Evaluated Price
1	\$352,000	N/A	\$352,000
2	\$347,000	\$6,000	\$353,000

**Step 4. Make Award Decision.**

Based on the evaluation above, you should award to Offeror 1. This will result in the lowest evaluated price to the Government.

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### **5.3.2 Consider Costs And Savings To The Government**

*When to Consider as a Price-Related Factor* ([FAR 45.201](#)).  
When evaluating offers, consider any other costs or savings to the Government that will result from providing production or research property, regardless of any competitive advantage that may result.

*Solicitation Requirements Related to Costs* ([FAR 45.202-3](#) and [45.205](#)). The solicitation:

- Should normally require the contractor to assume all costs related to making the property available for use (such as payment of all transportation or rehabilitation costs).
- Must describe these costs or savings will be considered in offer evaluation.
- Must specify any costs to the Government related to furnishing Government production and research property either as dollar amounts or as formulas.
  - Limit consideration to the cost of:
  - Reactivation from storage;
  - Rehabilitation and conversion; and
  - Making the property available on an f.o.b. basis.
  - If (under the terms of the solicitation) the contractor will bear the transportation cost of furnishing Government production and research property or the cost of making it suitable for use, do not use additional evaluation factors related to those costs.
- Specify the dollar amount of any savings to the Government related to contractor use of Government production and research property. Examples of such savings include any savings that result from avoiding the costs of deactivating tools and them in layaway, storage, or idle status.

*General Evaluation Requirements* ([FAR 45.202-3](#)).

#### **Step 1. Determine Solicitation Provisions.**

The solicitation must specify savings that will be considered in offer evaluation as dollar values. Costs must be stated using dollar values or formulas. Do not provide for any adjustment to consider costs that will be borne by the contractor.



**Step 2. Determine Offered Price(s).**

Determine the price(s) in each offer for each item or group of items being considered for contract award. Review each offer to determine whether it specifies use of the identified property.

**Step 3. Evaluate Possible Award Combinations.**

In offer evaluation, identify the costs and savings in each offer related to Government production and research property. Use the costs and savings specified in the solicitation.

**Step 4. Make Award Decision.**

Make award to the firm whose offer is most advantageous to the Government under the terms of the solicitation. Include consideration of the costs and savings to the Government that result from the use of the Government production and research property.

*Evaluation Example ([FAR 45.202-3](#)).*

**Step 1. Determine Solicitation Provisions.**

Assume that the solicitation states that award will be made to the responsible offeror with a technically acceptable offer and the lowest evaluated price. It also includes the provision below. The amount of \$9,000 represents the cost of deactivating and placing the tools in storage and maintaining them there for the period of the contract. A complete list of the tools involved is included elsewhere in solicitation.

In addition to any other proposal adjustments, \$9,000 will be deducted from any offers proposing to use the GFP identified in Solicitation Paragraph L-XX. The \$9,000 represents the costs that the Government will avoid if the identified GFP is not placed in storage.

**Step 2. Determine Offered Price(s).**

You have received two offers. Both propose use of the tooling described in the solicitation. Offer 1 includes the estimated costs of relocating the tooling from the plant of Offeror 2. Offer 2 does not propose relocation costs because the tooling is already located at the offeror's plant.

Offeror	Offer
1	\$364,000
2	\$370,000

**Step 3. Evaluate Possible Award Combinations.**

Both offers propose use of the tooling described in the solicitation. As a result, the \$9,000 savings identified in the solicitation will be deducted from the price offered by each of the offerors. No additional adjustment is required to consider the cost to the Government related to relocating the equipment. The relocation cost is included in Offer 1 and there is no relocation cost associated with Offer 2, because the property is already located at Offeror 2's facility.

Offeror	Offer	Government Savings	Offer Evaluation
1	\$364,000	\$9,000	\$355,000
2	\$370,000	\$9,000	\$361,000

**Step 4. Make Award Decision.**

In your evaluation, you should deduct \$9,000 from both offers. As a result, there would be no change in the dollar difference between the two offers. You should award to Offeror 1.

**5.4 Transportation Costs**

*When to Consider as a Price-Related Factor* ([FAR 47.301](#), [47.301-1](#), and [47.301-2](#)). When transportation costs are not included in item purchase price, you must consider them as part of any supply contract award decision. Your objective is to ensure that acquisitions are made on the basis most advantageous to the Government, and that supplies arrive in good order, in good condition, on time, at the required place.

Work with your agency transportation officer during solicitation and evaluation of offers to ensure that all necessary transportation factors are considered, including transportation costs.

*F.o.b. Definition* ([FAR 47.001](#)). The term **free on board (f.o.b.)** is used in conjunction with a physical point to determine:

- The responsibility and basis for payment of freight charges; and
- Unless otherwise agreed to, the point at which title for goods passes to the buyer or consignee.

**For example:** Contracts with "**f.o.b. origin**" generally require the Government to pick up the deliverable at the contractor's warehouse, with the Government responsible for shipping costs from the warehouse. In contrast, "**f.o.b. destination**" contracts generally requires the contractor -- at the contractor's expense -- to ship the contract item to a Government loading dock.

Usually, the f.o.b. point is either the place of shipment origin or final shipment destination but it can be anywhere in between. For example, the f.o.b. point could be an airport or dock where the shipment will be consolidated with other items for transport to a final destination.

*Solicitation Requirements* ([FAR 47.304-1](#), [47.303](#), [47.305-1](#), [52.247-45](#), [52.247-46](#), [52.247-47](#), [52.247-49](#), [52.247-50](#), and [52.247-51](#)). As you prepare each supply solicitation, the contracting officer must generally determine the contract f.o.b. terms on the basis of lowest overall cost. The solicitation must:

- Specify whether offerors must submit offers based on:
  - F.o.b. origin;
  - F.o.b. destination;

- Both f.o.b. origin and f.o.b. destination; or
  - Either f.o.b. origin or f.o.b. destination at the discretion of the offeror.
- Include the appropriate clauses to describe the packing, marking, and other delivery terms for the f.o.b. point selected (e.g., f.o.b. origin; f.o.b. origin, contractor's facility; f.o.b. origin, freight allowed; or f.o.b. destination).
- Requirement that the offeror furnish the Government as much of the following data as is applicable to the particular acquisition:
  - Modes of transportation and, if rail transportation is used, names of rail carriers serving the offeror's facility.
  - The number of railroad cars, motor trucks, or other conveyances that can be loaded per day.
  - Type of packaging (e.g., box, carton, crate, drum, bundle, skids) and when applicable, package number from the governing freight classification.
  - Number of units packed in one container.
  - Guaranteed maximum shipping weight; cubic measurement; and length, width, and height of each container.
  - Minimum size of each shipment.
  - Number of containers or units that can be loaded in a car, truck, or other conveyance of the size normally used (specify type and size) for the commodity.
  - Description of material in terms of the governing freight classification or tariff (or Government rate tender) under which lowest freight rates are applicable.
  - Benefits available to the Government under transit arrangements made by the offeror.
  - Other information related to the f.o.b. point selected.
- Must describe how offers will be evaluated for contract award, such as:
  - F.o.b. Origin and/or F.o.b. Destination Evaluation;
  - Evaluation -- F.o.b. Origin;
  - Shipping Point(s) Used in Evaluation of F.o.b. Origin Offers;
  - Destination Unknown;
  - Evaluation of Export Offers; or
  - No Evaluation of Transportation Costs.

General Evaluation Requirements ([FAR 47.304-1](#), [47.304-1\(a\)](#), [47.304-1\(b\)](#), and [47.306](#)).

### **Step 1. Determine Solicitation Provisions.**

The solicitation must specify the acceptable f.o.b. terms and the basis for offer evaluation.

- If the solicitation requires that all offerors be made **f.o.b. destination**, transportation must be included in the offered. No further consideration of transportation costs is required.
- When offers are quoted **f.o.b. origin**, consider the following factors along with purchase price when evaluating prices:
  - The cost of transportation from the offeror's designated point of origin to the destination defined in the solicitation. The Government normally uses land transportation rates in proposal evaluation.
  - When provided for in the solicitation, proposed cost-reimbursable differentials based on possible routing conditions. These contingencies may be included by offerors to compensate for an unfavorable routing condition. Evaluation is based on the routing conditions anticipated at the time of award.
- When offers may be quoted **either f.o.b. origin or f.o.b. destination**, your evaluation of:
  - F.o.b. destination offers will not require adjustment to consider the cost of transportation.
  - F.o.b. origin offers must consider the factors described above.

### **Step 2: Determine Offered Price(s).**

Determine the price(s) in each offer for each item or group of items being considered for contract award. You must also examine each offer to identify the f.o.b. terms and to determine whether the offered terms comply with solicitation requirements.

### **Step 3. Evaluate Possible Award Combinations.**

Evaluate offers using the specific criteria set forth in the solicitation. In evaluating transportation costs

- You must use the lowest available freight rates and related accessorial and incidental charges that are:
  - In effect on, or become effective before, the expected date of initial shipment; and
  - On file or published on the date of bid opening or due date for offers.
- If rates or related charges become available after the bid opening or the due date of offers, do not use them in evaluation unless they cover transportation for which no applicable rates were in effect at the time of bid opening or the due date of offers. ([FAR 47.306-2](#))

*Evaluation Example* ([FAR 47.305-2](#), [47.306-2](#), and [52.247-45](#)).

**Step 1. Determine Solicitation Provisions.**

Assume that the solicitation states that award will be made to the responsible offeror with a technically acceptable offer and the lowest evaluated price. It also includes the following provision:

Offers are invited on the basis of both f.o.b. origin and f.o.b. destination, and the Government will award on the basis the contracting officer determines to be most advantageous to the Government. An offer on the basis of f.o.b. origin only or f.o.b. destination only is acceptable, but will be evaluated only on the basis submitted.

**Step 2. Determine Offered Price(s).**

Three offers were received. One offers the item f.o.b. destination. The others offer the item f.o.b. origin.

Offeror	F.O.B. Point	Offer
1	Origin	\$435,000
2	Destination	\$450,000
3	Origin	\$436,000

### Step 3. Evaluate Possible Award Combinations.

From the cognizant transportation officer, you obtain information on the lowest available transportation cost and incidental charges. Specific shipping costs are shown below, for each offer:

Offeror	F.O.B. Point	Offer	Transportation Cost	Evaluated Price
1	Origin	\$435,000	\$2,600	\$437,600
2	Destination	\$450,000	N/A	\$450,000
3	Origin	\$436,000	\$1,500	\$437,500

### Step 4. Make the Award.

Make award to the offeror with the lowest evaluated price, Offeror 3.

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## 5.5 Options And Multi-Year Contracting

This section examines the factors that you must consider when soliciting and evaluating offers involving options and multi-year contracting.

- 5.5.1 - [Options](#)
- 5.5.2 - [Multi-Year Contracting](#)

*Longer-Term Business Relationships.* Contracts are normally written to acquire supplies and services in support of identified requirements. Funded contracts include funds approved by Congress for the current year.

Options and multi-year contracting are two methods of establishing longer-term relationships with contractors. Either of these techniques may be used in sealed bidding or negotiation.

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### 5.5.1 Options

*Contract Options* ([FAR 17.201](#) and [17.207](#)). Options are unilateral rights prescribed in a contract, which, for a specified time, permit the Government to elect to purchase additional supplies or services called for in the contract or to elect to extend the term of the contract.

The Government is under no obligation to exercise any options prescribed in a particular contract. Options may be exercised at award or at a later time as prescribed in the contract. Options are funded when exercised using funds available at that time.

*When to Include Contract Options* ([FAR 17.202\(d\)](#)). For either sealed bidding or negotiation, the contracting officer:

- Should include options in solicitations and contracts when it is in the Government's interest.
- Should normally not include options when:
  - The foreseeable requirements involve:
  - Minimum economic quantities (i.e., quantities large enough to permit startup costs recovery and the production of required supplies at a reasonable price); and
  - Delivery requirements far enough into the future to permit competitive acquisition, production, and delivery.
  - An indefinite quantity or requirements contract would be more appropriate than a contract with options. However, this does not preclude the use of an indefinite quantity contract or requirements contract with options.
- Must not include options if:
  - The contractor will incur undue risks (e.g., the price or availability of necessary materials or labor is not reasonably foreseeable);
  - Market prices for the supplies or services involved are likely to change substantially; or
  - The option represents known firm requirements for which funds are available unless:
  - The basic quantity is a learning or testing quantity; and
  - Competition for the option is impracticable once the initial contract is awarded.
- May include options in service contracts if there is an anticipated need for a similar service beyond the



first contract period. The contracting officer's decision to include options should consider the:

- o Government need for continuity in contractor operations; and
- o Potential cost of support disruption.

*Solicitation Requirements (FAR 17.203)*. When you expect that the contract(s) will include an option clause, include the clause and the related evaluation provision in the contract solicitation. Solicitations containing an option clause:

- Must:
  - o State the basis of evaluation, either exclusive or inclusive of the option;
  - o Inform offerors that the Government may exercise the option at time of award (when appropriate).
  - o State that offerors may offer varying prices for options, depending on the quantities actually ordered and the dates (when appropriate).
  - o Specify the price at which the Government will evaluate the option (e.g., highest option price offered or option price for specified requirements), whenever:
  - o Offerors may offer varying prices for options, depending on the quantities actually ordered and the dates when ordered; and
  - o The Government may exercise an option at the time of award.
  - o When the solicitation requires that option price(s) not exceed those of the initial requirement:
  - o Specify that the Government will accept an offer containing an option price higher than the base price only if the acceptance does not prejudice any other offeror; and
  - o Limit option quantities for additional supplies to not more than 50 percent of the initial quantity of the same contract line item. In unusual circumstances, an authorized person at a level above the contracting officer may approve a greater percentage of quantity.
- Should normally not limit option prices. If prices will be considered in the evaluation for contract award, never limit option prices.
- May (in unusual circumstances) require that options be offered at prices no higher than those for the initial

requirement (e.g., when the option cannot be evaluated for contract award or future competition for the option is impracticable).

*Evaluation* ([FAR 17.206](#)).

**Step 1. Determine Solicitation Provisions.**

The solicitation must specify the option requirements and how option offers will be evaluated. Based on the evaluation provisions, your evaluation must either include or exclude option offers in your evaluation.

**Step 2: Determine Offered Price(s).**

Determine the price(s) in each offer for each item or group of items being considered for contract award. Also identify the price for any option that will be considered in evaluating offers for contract award.

**Step 3. Evaluate Possible Award Combinations.**

Evaluate offers using the specific criteria set forth in the solicitation.

**Step 4. Make Award Decision.**

Award to the firm whose offer provides the best value to the Government under the terms of the solicitation.

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**5.5.2 Multi-Year Contracting**

*Multi-Year Contracting* ([FAR 17.103](#), [17.104](#), and [17.105-1\(d\)](#)). Multi-year contracting is a special contracting method used to acquire known requirements in quantities and total cost not exceeding planned requirements for up to five years (unless otherwise authorized by statute).

This contracting method can be employed even though the total contract funds ultimately to be obligated are not available at the time of contract award. However, if funds are not appropriated to support the succeeding year's requirements, the agency must cancel the contract. The multi-year contract may provide for a cancellation payment

to be made to the contractor if appropriations are not made.

The key difference between a multi-year contract and a multiple year contract is that the multi-year contract buys more than one year's requirement without establishing and having to exercise an option for each program year after the first.

*When to Use Multi-Year Contracting* ([FAR 17.103](#) and [17.105-1](#)). Multi-year contracting may be used for the acquisition of either supplies or services.

In the DoD, NASA, and the Coast Guard, the agency head may enter into a multi-year contract for supplies if the agency head expects that:

- A multi-year contract will result in substantial savings over the estimated cost of carrying out the program using annual contracts;
- The minimum production rate, procurement rate, and total quantities purchased are expected to remain substantially unchanged during the contemplated contract period;
- The design for the supplies to be acquired is stable and the associated technical risks are not excessive;
- Contract funding will be requested at a level that will avoid contract cancellation throughout the contemplated contract period; and

The estimates of both the contract cost and the cost avoidance related to multi-year contracting are realistic.

In other agencies, the contracting officer may enter into a multi-year contract if the head of the contracting activity determines that:

- The need for the supplies or services is reasonably firm and continuing over the contract period; and
- A multi-year contract will serve the best interests of the United States by encouraging full and open competition or promoting economy in administration, performance, and operation of agency programs.

In practice, multi-year contracting is rarely used by any agency other than the Department of Defense.

*Reasons for Using Multi-Year Contracting* ([FAR 17.105-2](#)).  
Reasons for multi-year contracting include:

- Lower costs;
- Enhanced standardization;
- Reduced administrative burden;
- Substantial continuity of production or performance (avoiding annual startup costs, preproduction testing costs, make-ready expenses, and phaseout costs);
- Contractor work forces stabilization;
- Avoidance of the need to establish quality control techniques and procedures for a new contractor each year;
- Broadened competitive base with opportunity for participation by firms not otherwise willing or able to compete for lesser quantities, particularly in cases involving high startup costs; and
- Increased incentives to contractors to improve productivity through investment in capital facilities, equipment, and advanced technology.

*Congressional Notification* ([FAR 17.108](#)). For the DoD, NASA, and Coast Guard, a multi-year contract which includes cancellation ceiling in excess of \$100 million may not be awarded until the agency head gives written notification of the proposed contract and the proposed contract cancellation ceiling to the committees on armed services and appropriations of the House of Representatives and Senate.

For other agencies, a multi-year contract which includes a cancellation ceiling in excess of \$10 million may not be awarded until the agency head gives written notification of the proposed contract and of the proposed cancellation ceiling to the appropriate agency oversight committees and the committees on appropriations of the House of Representatives and the Senate.

The contract may not be awarded until the thirty-first day after the required notification date.

*Solicitation Requirements* ([FAR 17.106-2](#)). Solicitations for multi-year contracts must identify all the factors that will be considered in offer evaluation, including:

- Requirements by item of supply or service for the:
  - First program year; and

- Each program year of the multi-year contact.
- Criteria for comparing the lowest evaluated offer for the first program year requirements to the lowest evaluated offer on the multi-year requirements.
- A provision that permits the Government to only consider offers for the first-year requirement , if the Government determines before award that only those requirements are needed.
- A provision specifying a separate cancellation ceiling (on a percentage or dollar basis) and applicable dates for each program year subject to cancellation.
- A statement that award will not be made on less than the first year program requirements.
- If Government administrative costs of annual contracting will be considered in offer evaluation, they must be reasonably estimated and stated in the solicitation.

Never use the cancellation ceiling as an offer evaluation factor.

*General Evaluation Requirements.*

**Step 1. Determine Solicitation Provisions.**

The solicitation must identify all the factors related to multi-year contracting that will be considered in offer evaluation. Because the factors can be complex and vary substantially from contract to contract, you should take special care to assure that you understand all factors before you begin offer evaluation.

**Step 2: Determine Offered Price(s).**

Determine the price(s) for each offer for the first program year and each program year of the multi-year contact.

**Step 3. Evaluate Possible Award Combinations.**

Evaluate offers using the specific factors set forth in the solicitation, including criteria for comparing the lowest evaluated offer for the first program year requirements to the lowest evaluated offer on the multi-year requirements.

**Step 4. Make Award Decision.**

Award to the firm whose offer provides the best value to the Government under the terms of the solicitation.

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## **5.6 Life-Cycle Costs**

*Life-Cycle Cost* ([FAR 7.101](#)). Life-cycle cost is the total cost to the Government of acquiring, operating, supporting, and (if applicable) disposing of the items being acquired.

- Acquisition costs are all costs, including contract costs, associated with acquiring an item for Government use. For complex items, several contracts may be required and costs may involve research and development as well as production, delivery, and installation of the item.
- Operating and support costs are all costs, including contract costs, associated with equipment, supplies, and services needed to operate and maintain an operational system.
- Disposal costs are all costs, including contract costs, associated with removing equipment from service and disposing of it. Evaluations that consider life-cycle cost should also consider any significant salvage or resale value at the time of disposal.

*When to Consider as a Price-Related Factor.* Consider life-cycle cost in acquisition planning whenever the costs of item of system operation, support, and disposal are significant in comparison with the cost of acquisition. Consideration is particularly important when you expect that offers will include items that have substantially different operation, support, and disposal costs.

Source selection consideration can be appropriate for an item as simple as an automobile tire or as complex as a major weapon system. For more complex systems, planning should also address:

- Factors with a significant effect on life-cycle cost results, and implement tradeoff studies to evaluate alternative actions which could reduce costs related to those factors.
- Life-cycle costs in product design.
- Contract commitments (when appropriate) that will affect control of life-cycle cost results.

Follow-on efforts subsequent to purchase to further reduce life-cycle cost.

*Solicitation Requirements.* If you intend to consider life-cycle costs in offer evaluation, the solicitation must:

- Advise prospective offerors how life-cycle costs will be considered in making the contract award decision.
  - Award may be made based on lowest evaluated cost, including life-cycle costs, or life-cycle costs may be considered as a factor in an award decision that also considers other characteristics of the item or system.
  - When life-cycle costs continue over a period of years, solicitations will often provide for adjustments to consider one or more of the following:
    - Time value of money.
    - Cost uncertainty.
    - Inflation.
- Require offerors to estimate key elements of life-cycle cost. To estimate preparation, the solicitation must provide relevant information (e.g., projected item usage, operating environment, and the operating period that will be considered in offer evaluation).
- Require offerors to provide relevant cost estimates along with appropriate information to support life-cycle cost estimates.
  - Estimate requirements typically include elements such as:
    - Average unit price, including (when appropriate) recurring and nonrecurring production costs;
    - Unit operating and support costs (e.g., manpower, energy, and parts requirements);
    - Unit disposal costs (e.g., the cost of removing equipment from the Government facility);
    - Unit salvage or residual value.
    - Related information should provide estimate support (e.g., test or operational data).

*General Evaluation Requirements.*

### **Step 1. Determine Solicitation Provisions.**

When life-cycle costs will be considered as a price-related factor in offer evaluation, the solicitation must identify life-cycle cost estimate requirements, the

information needed to support those estimates, and how those estimates will be considered in making the contract award decision.

### **Step 2: Determine Offered Price(s).**

Determine the price(s) for each offer. Also identify and evaluate life-cycle cost estimates required for offer analysis. Ask questions such as the following:

- *Is the estimating methodology reasonable and supported by the information provided?*
- *Are the costs realistic when compared with other known information, including past cost performance?*
- *Is the estimate complete in its consideration of all identified cost elements?*

### **Step 3. Evaluate Possible Award Combinations.**

Evaluate offers using the specific criteria set forth in the solicitation, including any adjustments for:

- Time value of money;
- Cost uncertainty; or
- Inflation.

### **Step 4. Make Award Decision.**

Award to the firm whose offer provides the best value to the Government under the terms of the solicitation.

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## **5.7 Energy Conservation And Efficiency Factors**

*When to Consider as a Price-Related Factor ([FAR 23.203](#)).* The cost of energy is an important cost of operating many items and systems. Accordingly, agencies must consider energy efficiency in the procurement of products and services. In particular:

- Acquisition team members must consider energy conservation and efficiency data along with estimated cost and other relevant factors in the preparation of plans, drawings, specifications, and other product descriptions.



Contracting officers should consider energy efficiency as a price related factor when the results would be meaningful, practical, and consistent with agency programs and needs. Consideration will be typically be most meaningful when you are contracting for items or systems that consume substantial amounts of energy.

*Solicitation Requirements* ([FAR 23.202](#)). When you intend to consider energy efficiency as price-related factor in offer evaluation, the solicitation:

- Must advise prospective offerors how energy efficiency will be considered in making the contract award decision.
  - Award may be made based on lowest evaluated cost, including energy cost, or energy cost may be considered as a factor in an award decision that also considers other technical characteristics of the item or system.
  - When energy costs continue over a period of years, solicitations will often provide for adjustments to consider one or more of the following:
    - Time value of money.
    - Cost uncertainty.
    - Inflation.
- Should (when applicable) advise prospective offerors about energy efficiency standards that prescribe a minimum level of energy efficiency for covered contract items.
- Should (when applicable) require offerors to provide product information from the energy use and efficiency labels that provide information on covered contract items (e.g., central air conditioners, clothes dryers, clothes washers, freezers, and room air conditioners).

*General Evaluation Requirements* ([FAR 23.203](#)).

### **Step 1. Determine Solicitation Provisions.**

When energy cost will be considered as a price-related factor in offer evaluation, the solicitation must identify any cost information required from each offeror and state how energy costs will be considered in making the contract award decision.

### **Step 2. Determine Offered Price(s).**

Determine the price(s) in each offer for each item or group of items being considered for contract award. Also assure that the offer contains the information required by the solicitation to evaluate energy-related factors in price analysis.

### **Step 3. Evaluate Possible Award Combinations.**

Evaluate offers using the specific criteria set forth in the solicitation, including any adjustments for:

- Time value of money;
- Cost uncertainty; or
- Inflation.

### **Step 4. Make Award Decision.**

Award to the firm whose offer provides the best value to the Government under the terms of the solicitation.

*Evaluation Example.*

### **Step 1. Determine Solicitation Provisions.**

Assume that you are acquiring 1,000 hot water heaters with a 50 gallon capacity. Because of extreme hard water conditions in area water systems, technical personnel estimate useful life at five years.

The solicitation states that award will be made to the responsible offeror with a technically acceptable offer and the lowest evaluated price. It also includes the following provision:

Award will be made to the firm whose offer will provide the lowest total discounted cost of acquisition and ownership to the Government during the first five years of operation, considering price and energy cost. Estimates of energy cost will be based on the energy use and efficiency label provided by the manufacturer under 42 U.S.C. 6296

### **Step 2. Determine Offered Price(s).**

You received two offers. The prices shown below are for 1,000 units. Annual energy costs are total estimated costs for the 1,000 units. Energy costs are based on the projected hours of operation and the energy use and efficiency label figures provided by each offeror and are calculated as follows:

Offeror	Offer	Annual Energy Cost
1	\$360,000	\$560,000
2	\$370,000	\$520,000

**Step 3. Evaluate Possible Award Combinations.**

As stated in the solicitation provision, expenditures and receipts must be "discounted." In terms of your analysis, discounting refers to the financial concept of the time value of money. Under that concept, the net present value of a dollar paid (received) today is more than the net present value of dollar paid (received) at any future time, because the holder of the money can collect interest.

Net present value, will depend on the amount of the payment (receipt), the discount (interest) rate, and the time when the payment (receipt) will take place. For example:

- If you must pay one dollar today, the net present value of the payment is one dollar;

If you must pay one dollar one year from now and the discount (interest) rate is 10 percent, the net present value is \$.90909. In other words, \$.90909 invested at 10 percent interest will be worth approximately \$1.00 at the end of one year.

Net present value analysis allows you to consider the time value of money in comparing alternatives with different expenditures/receipts at different points in time. Using net present value analysis, financial experts in your organization have calculated that the net present value of an annual energy cost for five years is the annual

cost multiplied by 3.97581. The net present value of an annual cost of \$1.00 for five years would be \$3.97581 (\$1 x 3.97581). The net present value of \$100 for five years would be \$397.581 (\$100 x 3.97581). The net present value of \$1,000 would be \$3,957.81 (\$1,000 x 3.97581).

In accordance with the solicitation provision, evaluate the offers by summing proposed price and net present value of the 5-year energy cost. Note that the energy cost for one year is greater than the price of the heaters.

Offeror	Offer	Net Present Value of 5-Year Energy Cost	Evaluated Price
1	\$360,000	\$560,000 x 3.97581 = \$2,226,453.60	\$2,586,453.60
2	\$370,00	\$520,000 x 3.97581 = \$2,067,421.20	\$2,437,421.20

**Step 4. Make Award Decision.**

Make award to the offeror with the lowest evaluated price, including consideration of annual energy-related costs for five years. In this case, Offeror 2 should receive the contract award.

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**5.8 Lease Vs. Purchase Factors**

*Lease vs. Purchase Decision* ([FAR 7.401](#)). Agencies should consider whether to lease or purchase equipment based on a case-by-case evaluation of comparative costs and other factors.

- As a minimum, the acquisition team should consider the following factors:
  - Estimated length of time that the equipment will be used and the extent of use during that period;

- Financial and operating advantages of alternative types of equipment;
- Cumulative rental payments for the estimated period of use;
- Net purchase price;
- Transportation and installation costs;
- Maintenance and other service costs; and
- Potential obsolescence of the equipment because of imminent technological improvements.
- In addition, the acquisition team should consider the following factors (as appropriate) depending on the type, cost, complexity, and estimated period of equipment use:
  - Availability of purchase options;
  - Potential for use of the equipment by other agencies after its use by the acquiring agency;
  - Trade-in or salvage value;
  - Imputed interest; and
  - Availability of a servicing capability, especially for highly complex equipment.

*When to Purchase ([FAR 7.402\(a\)](#))*. Generally, the purchase method is appropriate if the equipment will be used beyond the point at which cumulative leasing costs exceed purchase costs. The acquisition team should not rule out equipment purchase, in favor of leasing, merely because future technological advances might make the selected equipment less desirable.

*When to Lease ([FAR 7.402\(b\)\(2\)](#))*. The lease method is appropriate when it is advantageous to the Government. The lease method may also serve as an interim measure when the circumstances:

- Require immediate equipment use to meet program or system goals; but
- Do not currently support acquisition by purchase.

*When to Consider as a Price-Related Factor*. Generally the lease vs. purchase decision is not made as part of an evaluation of competitive offers. Rather, it is made based on data collected especially for that purpose.

However, there are situations in which it may make sense to solicit such competition. For example, if equipment requires a unique maintenance capability, you might solicit competition to determine which alternative

offers the best value, lease including maintenance or purchase with contract or in-house maintenance.

*General Evaluation Requirements.*

**Step 1. Determine Solicitation Provisions.**

The solicitation should define what costs you will consider in the award decision and how you will consider those costs. For example:

- Will you adjust a flow of expenditures over time for an imputed (assumed) cost of money?
- Will you adjust expenditure estimates to consider the probability of incurrence?

**Step 2. Determine Offered Price(s).**

Determine the price(s) in each offer for each item or group of items being considered for contract award. Also assure that each offer includes any other information required for offer evaluation.

**Step 3. Evaluate Possible Award Combinations.**

Evaluate offers using the specific criteria established in the solicitation.

**Step 4. Make the Award.**

Award to the firm whose offer provides the best value to the Government under the terms of the solicitation.

*Evaluation Example.*

**Step 1. Determine Solicitation Provisions.**

Assume that you have a requirement for material handling equipment to replace existing equipment that is beyond repair. Even with the new equipment, the present operating facility will close in 24 months. At that time, purchased equipment will be sold at auction. Rental equipment will be returned to the vendor. Because of the limited period of use, you are soliciting offers for lease as well as for purchase. You expect the operation and maintenance cost to be the same with all items offered, as

a result you will only consider the costs related to acquisition and disposal.

The solicitation states that award will be made to the responsible offeror with a technically acceptable offer and the lowest discounted cost to the Government. It also includes the following provision:

The Government will acquire the equipment identified in Section B by either lease or purchase. The method of acquisition and the successful offeror will be determined based on the lowest discounted total cost to the Government for acquisition and disposal. Operation and maintenance costs will not be considered in offer evaluation.

**Step 2. Determine Offered Price(s).**

Offers were received from two firms. One offer was based on Government purchase of the item, the other on Government lease. The proposed lease is for a two-year period.

<b>Offer</b>	<b>Government Expenditure Beginning of Year 1</b>	<b>Government Expenditure End of Year 1</b>
1 (Purchase)	\$146,000	N/A
2 (Lease)	\$70,500	\$70,500*

\* The lease payment is due at the beginning of each year. For analysis purposes, the beginning of Year 2 is the same as the end of Year 1.

**Step 3. Evaluate Possible Award Combinations.**

To evaluate the cost to the Government, you must consider all of the relevant costs and receipts that would result from purchase or lease of the equipment.

- **For the purchase**, there would be an expenditure of \$146,000 at the beginning of Year 1 to purchase the equipment. There would also be a receipt at the end of Year 2 when the equipment is sold at auction. Your best estimate of the sale value is \$6,000.

**For the lease**, there would be an expenditure at the beginning of Year 1 for the first 12-month lease cost. There would be a second expenditure at the end of Year 1 for the second 12-month lease cost. There would be no receipt or expense at the end of Year 2.

Offeror	Government Expenditure Beginning of Year 1	Government Expenditure End of Year 1	Government Receipt End of Year 2
1 (Purchase)	\$146,000	N/A	\$12,000
2 (Lease)	\$70,500	\$70,500	N/A

As stated in the solicitation provision, expenditures and receipts must be "discounted." In terms of your analysis, discounting refers to adjustment for the net present value of a dollar expenditure or receipt at a later time.

- A dollar spent at the beginning of Year 1 would not be adjusted.
- If the interest rate is 10 percent:
  - The net present value of \$1.00 spent at the end of Year 1 would be \$.90909 (i.e., \$.90909 invested at 10 percent will be worth approximately \$1.00 at the end of one year).

The net present value of a dollar to be spent or received at the end of Year 2 is \$ .82645 (i.e., \$.82645 invested at 10 percent will be worth approximately \$1.00 at the end of two years).



Using the established values for net present value at the end of one year and at the end of two years, the net present value of the purchase and lease options would be:

Offeror	Government Expenditure Beginning of Year 1	Government Expenditure End of Year 1	Government Receipt End of Year 2	Evaluated Price
1 (Purchase)	\$146,000	N/A	\$9,917 (\$12,000 x .82645)	\$136,083
2 (Lease)	\$70,500	\$64,091 (\$70,500 x .90909)	N/A	\$134,591

**Step 4. Make Award Decision.**

Make award to the offeror with the lowest evaluated cost to the Government, Offeror 2.

**5.9 Small Disadvantaged Business Price Evaluation Adjustment**

*Small Disadvantaged Business Price Evaluation Adjustment.* ([FAR 19.201\(b\)](#) and [19.1101](#)).

The small disadvantaged business price evaluation adjustment (PEA) is a price-related factor that may be applied in contract award decisions where a small disadvantaged business (SDB) concern is competing with one or more concerns that are not SDB. Joint ventures that include an SDB may also qualify for a price adjustment if they meet requirements identified in the FAR.

The Department of Commerce will annually determine the applicable PEA factor(s). A factor may apply to all SDB concerns offering items in a Major Group in the Standard Industrial Classification (SIC) manual or it may only apply to SDB concerns from identified regions of the country.

- The determination affects solicitations issued on or after the effective date of the determination. Ongoing acquisitions are not affected.
- The effective date of the determination must be no less than 60 days after its publication date.

Determinations are summarized on the Internet at <http://www.arnet.gov/References/sdbadjustments.htm>.

*When to Consider as a Price-Related Factor* ([FAR 19.1102](#) and [USD-DP\(DAR\) Memo, January 25, 1999](#)-PDF format).

All competitive solicitations must provide for consideration of the applicable PEA set by the Department of Commerce (DoC) unless one of the following exemptions applies:

- The acquisition is:
  - Less than or equal to the simplified acquisition threshold;
  - Awarded pursuant to the 8(a) program;
  - Set aside for small business concerns; or
  - Set aside for HUBZone small business concerns.

Your agency has authority to deviate from the PEA requirement. For example, the Strom Thurman Defense Authorization Act for Fiscal Year 1999, prohibits the Department of Defense (DoD) from implementing the PEA requirement if the Secretary of Defense at the beginning of the fiscal year determines that the DoD achieved the 5 percent goal for SBD awards in the most recent fiscal year for which data are available.

*Solicitation Requirements.* ([FAR 19.307\(a\)\(1\)](#), [19.1104](#), [52.219-1](#), and [52.219-23](#)).

Assure that the FAR Small Business Program Representations provision is inserted in any solicitation that exceeds the micro-purchase threshold when the contract is to be performed inside the United States, its territories or possessions, Puerto Rico, the Trust Territory of the Pacific Islands, or the District of Columbia. Among other things, this provision permits each offeror to represent that it is an SDB.

Review  
<http://www.arnet.gov/References/sbdadjustments.htm> to

determine if a PEA applies to the SIC of one or more of the items included in a solicitation and the amount of the required adjustment. When a PEA applies to any solicitation item and the solicitation is not otherwise exempted from the requirement:

- Insert the FAR Notice of Price Evaluation Adjustment for Small Disadvantaged Business Concerns clause in the solicitation. If a PEA is authorized on a regional basis, insert the clause even if the place of performance is not in an authorized region.
  - Use Alternate I of the clause when the contracting officer determines that there are no SDB manufacturers that can meet the requirements of the solicitation. This alternate permits the contractor to provide end items manufactured by any small business instead of end items manufactured by an SDB as required by the basic FAR clause.
  - Use Alternate II of the clause when a price evaluation adjustment is authorized on a regional basis. This alternate only permits a PEA adjustment when it might affect award to an SDB in the designated region.

Assure that the appropriate PEA percentage is inserted into the FAR Notice of Price Evaluation Adjustment for Small Disadvantaged Business Concerns clause.

*General Evaluation Requirements.* ([FAR 19.1103](#) and [52.219-1\(b\)\(2\)](#)).

### **Step 1. Determine Solicitation Provisions.**

The solicitation must identify all factors that will be considered in offer evaluation. In particular:

- Assure that the solicitation includes the FAR Notice of Price Evaluation Adjustment for Small Disadvantaged Business Concerns clause and the Small Business Program Representations provision.
- Review offeror representations to identify any SDB offerors.
- Identify the PEA percentage cited in the FAR Notice of Price Evaluation Adjustment for Small Disadvantaged Business Concerns clause.

- Identify any SDB offerors that have waived PEA use in offer evaluation. Offerors may waive use for many different reasons (e.g., inability to comply with requirements to obtain manufactured items from an SDB).

## **Step 2. Determine Offered Prices**

Determine the price(s) in each offer for each item or group of items being considered for contract award.

## **Step 3. Evaluate Possible Award Combinations.**

Evaluate offers using the specific criteria set forth in the solicitation. Add other evaluation factors (e.g., transportation costs or factors to consider rent-free use of Government facilities) to the offers before applying the price evaluation adjustment. In applying the PEA:

- As you evaluate offers, add the PEA factor cited in the FAR Notice of Price Evaluation Adjustment for Small Disadvantaged Business Concerns clause to all offers, except:
  - Offers from:
    - SDB concerns that have not waived the PEA; or
    - If the PEA for small disadvantaged business concerns is authorized on a regional basis, offers from small disadvantaged business concerns, whose address is in such a region, that have not waived the PEA;
  - Otherwise successful offers of eligible products under the Trade Agreements Act when the acquisition equals or exceeds the applicable FAR application dollar threshold;
  - Otherwise successful offers where application of the factor would be inconsistent with a Memorandum of Understanding or other international agreement with a foreign government;
  - For DoD, NASA, and Coast Guard acquisitions, otherwise successful offers from historically black colleges and universities or minority institutions; or
  - For DoD acquisitions (when PEA consideration is required), otherwise successful offers of qualifying country end products.

- Apply the PEA factor on a line item basis or apply it to any group of affected items on which award may be made.
- Do not evaluate offers using the PEA when it would cause award, as a result of this adjustment, to be made at a price that exceeds fair market price by more than the factor as determined by the Department of Commerce.

**Step 4. Make Award Decision.**

Award to the firm whose offer provides the best value to the Government under the terms of the solicitation.

(FAR [25.402](#) and [52.219-23\(c\)](#), [DFARS 225.000-70](#) and [DFARS 252.225-7001](#))

*Evaluation Example* ([FAR 19.1103](#), [52.219-1\(b\)\(2\)](#), and [52.219-23\(c\)](#)).

**Step 1. Determine Solicitation Provisions.**

Assume that the solicitation states that award will be made to the responsible offeror with a technically acceptable offer and the lowest evaluated price.

- It also includes the FAR Notice of Price Evaluation Adjustment for Small Disadvantaged Business Concerns clause and the Small Business Program Representations provision.
- The PEA cited in the solicitation is 10 percent.

**Step 2. Determine Offered Price(s).**

Three domestic offers were received. Offeror 1 is a large business, but not an SDB concern. Both Offeror 2 and Offeror 3 are SDB concerns. However, Offeror 3 has waived PEA use in offer evaluation.

Offeror	Evaluation Status	Offer
1	Large Business	\$365,000

2	SDB -- No PEA Waiver	\$401,500
3	SDB -- Waived PEA	\$396,000

**Step 3. Evaluate Possible Award Combinations.**

Using the 10 percent PEA factor cited in the solicitation, the evaluated price for each offer is shown below:

Offeror	Offer	Price Evaluation Adjustment	Evaluated Price
1	\$364,000	\$365,000 x .10 = \$36,400	\$400,400
2	\$401,500	- 0 -	\$401,500
3	\$396,000	\$396,000 x .10 = \$39,600	\$435,600

**Step 4. Make the Award.**

Make award to the offeror with the lowest evaluated price, Offeror 1.

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**5.10 HUBZone Price Evaluation Preference**

*HUBZone Program* ([FAR 19.1301](#), [19.1305](#), [19.1306](#), and [FAR 19.1307](#)).

The Historically Underutilized Business Zone (HUBZone) Act of 1997 created the HUBZone Program (sometimes referred to as the HUBZone Empowerment Contracting Program). The purpose of the Program is to provide Federal contracting assistance for qualified small business concerns located in historically underutilized business zones, in an effort to

increase employment opportunities, investment, and economic development in those areas.

HUBZone Program assistance in a particular contracting situation could involve either a:

- Full and open competition HUBZone price evaluation preference (PEP) following the guidelines presented in this section;
- HUBZone set-aside; or
- HUBZone sole source award.

*Participating Agencies.* Until September 30, 2000, only following agencies will participate in the HUBZone Program:

- Department of Agriculture.
- Department of Defense.
- Department of Energy.
- Department of Health and Human Services.
- Department of Housing and Urban Development.
- Department of Transportation.
- Department of Veterans Affairs.
- Environmental Protection Agency.
- General Services Administration.
- National Aeronautics and Space Administration.

On or after September 30, 2000, all Federal agencies that employ one or more contracting officers will participate in the Program.

*When to Consider a HUBZone Preference* ([FAR 19.1304\(f\)](#) and [19.1307\(a\)](#)).

If you are in a participating agency, you must consider a PEP for HUBZone small business concerns in any acquisition conducted using full and open competition, unless:

- The acquisition is expected to be less than or equal to the simplified acquisition threshold;
- Price is not a selection factor (e.g., an architect-engineer acquisition);
- All fair and reasonable offers will be accepted (e.g., the award of multiple award schedule contracts); or
- The acquisition is for a commissary or exchange resale item.

*Solicitation Requirements* ([FAR 13.307\(a\)](#), [19.1308](#), [52.219-1](#), and [52.219-4](#)).

If you are in a participating agency:

- Assure that the FAR Small Business Program Representations provision with its Alternate II is inserted in any solicitation that exceeds the micro-purchase threshold when the contract is to be performed inside the United States, its territories or possessions, Puerto Rico, the Trust Territory of the Pacific Islands, or the District of Columbia. Among other things, this provision permits each offeror to represent that it is a HUBZone small business concern.
- When you anticipate full and open competition, assure that the FAR Notice of Price Evaluation Preference for HUBZone Small Business Concerns clause is inserted in any solicitation that exceeds the micro-purchase threshold. This clause:
  - Informs prospective offerors that a 10-percent PEP will be considered in contract award;
  - Establishes guidelines that an offeror must meet to qualify for the evaluation preference, including related contract performance requirements; and
  - Permits the offeror to waive PEP consideration.

*General Evaluation Requirements* ([FAR 19.1307](#) and [52.219-1\(b\)](#)).

### **Step 1. Determine Solicitation Provisions.**

The solicitation must identify all factors that will be considered in offer evaluation. In particular:

- Assure that the solicitation includes the FAR Notice of Price Evaluation Preference for HUBZone Small Business Concerns clause and the Small Business Program Representations provision with its Alternate II.
- Review offeror representations to identify any offeror representing that it is a HUBZone small business concern.
- Identify any HUBZone concern that has waived PEP consideration. Offerors may waive PEP consideration for many different reasons (e.g., inability to comply with requirements that at least 50 percent of all



manufacturing cost (excluding materials cost) will be performed by the contractor or another HUBZone small business concern).

### **Step 2. Determine Offered Prices**

Determine the price(s) in each offer for each item or group of items being considered for contract award.

### **Step 3. Evaluate Possible Award Combinations.**

Evaluate offers using the specific criteria set forth in the solicitation. As you evaluate offers consider the following PEP requirements:

- For each offer, calculate the base offer (BO). The BO is the total evaluated price considering **all** price-related evaluation factors (e.g., transportation cost, small disadvantaged business concern price evaluation adjustment (PEA), etc.) except the PEP.
- Calculate the final evaluated price.
  - For the following offers, the BO is the final evaluated price:
    - Offers from HUBZone small business concerns that have not waived the PEP;
    - Otherwise successful offers from small business concerns;
    - Otherwise successful offers of eligible products under the Trade Agreements Act when the acquisition equals or exceeds the applicable FAR dollar threshold; and
    - Otherwise successful offers where application of the factor would be inconsistent with a Memorandum of Understanding or other international agreement with a foreign government.
- For other offers:
  - If a PEA was added to the offered price in calculating the BO, calculate the final evaluated price as follows:

$$\text{Final Evaluated Price} = \text{BO} + [.10 \times (\text{BO} - \text{PEA})]$$

- o If a PEA was not added to the offered price in calculating the BO, calculate the final evaluated price as follows:

Final

$$\text{Evaluated Price} = \text{BO} + [.10 \times \text{BO}]$$

**Step 4. Make Award Decision.**

Award to the firm whose offer provides the best value to the Government under the terms of the solicitation.

*Evaluation Example* ([FAR 19.1103](#) and [52.219-1\(b\)](#)).

**Step 1. Determine Solicitation Provisions.**

Assume the solicitation states that award will be made to the responsible offeror with a technically acceptable offer and the lowest evaluated price. It also includes the FAR:

- Notice of Price Evaluation Preference for HUBZone Small Business Concerns clause;
- Notice of Price Evaluation Adjustment for Small Disadvantaged Business Concerns; and
- Small Business Program Representations provision with its Alternate II.

**Step 2. Determine Offered Price(s).**

Four domestic offers were received. Offeror 1 is an SBD concern located in a HUBZone. Offeror 2 is an SDB not located in a HUBZone. Offeror 3 is a small business not located in a HUBZone. Offeror 4 is a large business. The HUBZone concern did not waive the PEP.

Offeror	Evaluation Status	Offer
1	HUBZone SBD	\$220,000
2	SBD	\$231,000
3	Small Business	\$240,000

4	Large Business	\$223,200
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**Step 3. Evaluate Possible Award Combinations.**

A 10-percent PEA is only price-related factor that must be considered before PEP evaluation. The calculation of the final evaluated price is shown below:

Offeror	Offer	Base Offer (After PEA)	Final Evaluated Price
1	\$220,000	\$220,000	\$220,000
2	\$210,000	\$210,000	$\$210,000 + [.10 \times \$210,000] = \$231,000$
3	\$200,000	$\$200,000 + (.10 \times \$200,000) = \$220,000$	$\$220,000 + [.10 \times (\$220,000 - \$20,000)] = \$240,000$
4	\$186,000	$\$186,000 + (.10 \times \$186,000) = \$204,600$	$\$204,600 + [.10 \times \$186,000] = \$223,200$

**Step 4. Make the Award.**

Make award to the offeror with the lowest evaluated price, Offeror 1.

*Evaluation Example Note.* Suppose that the contracting officer rejected Offer 4 because Offeror 4 was nonreponsible. That would affect the remainder of the analysis because you must not add the PEP to an otherwise successful offer from a small business concern. The calculation of the final evaluated price is shown below:

Offeror	Offer	Base Offer (After PEA)	Final Evaluated Price
1	\$220,000	\$220,000	\$220,000

2	\$210,000	\$210,000	\$210,000
3	\$200,000	$  \begin{aligned}  &\$200,000 + (.10 \times \\  &\quad \$200,000) = \\  &\quad \$220,000  \end{aligned}  $	$  \begin{aligned}  &\$220,000 + [.10 \times \\  &\quad (\$220,000 - \$20,000)] = \\  &\quad \$240,000  \end{aligned}  $

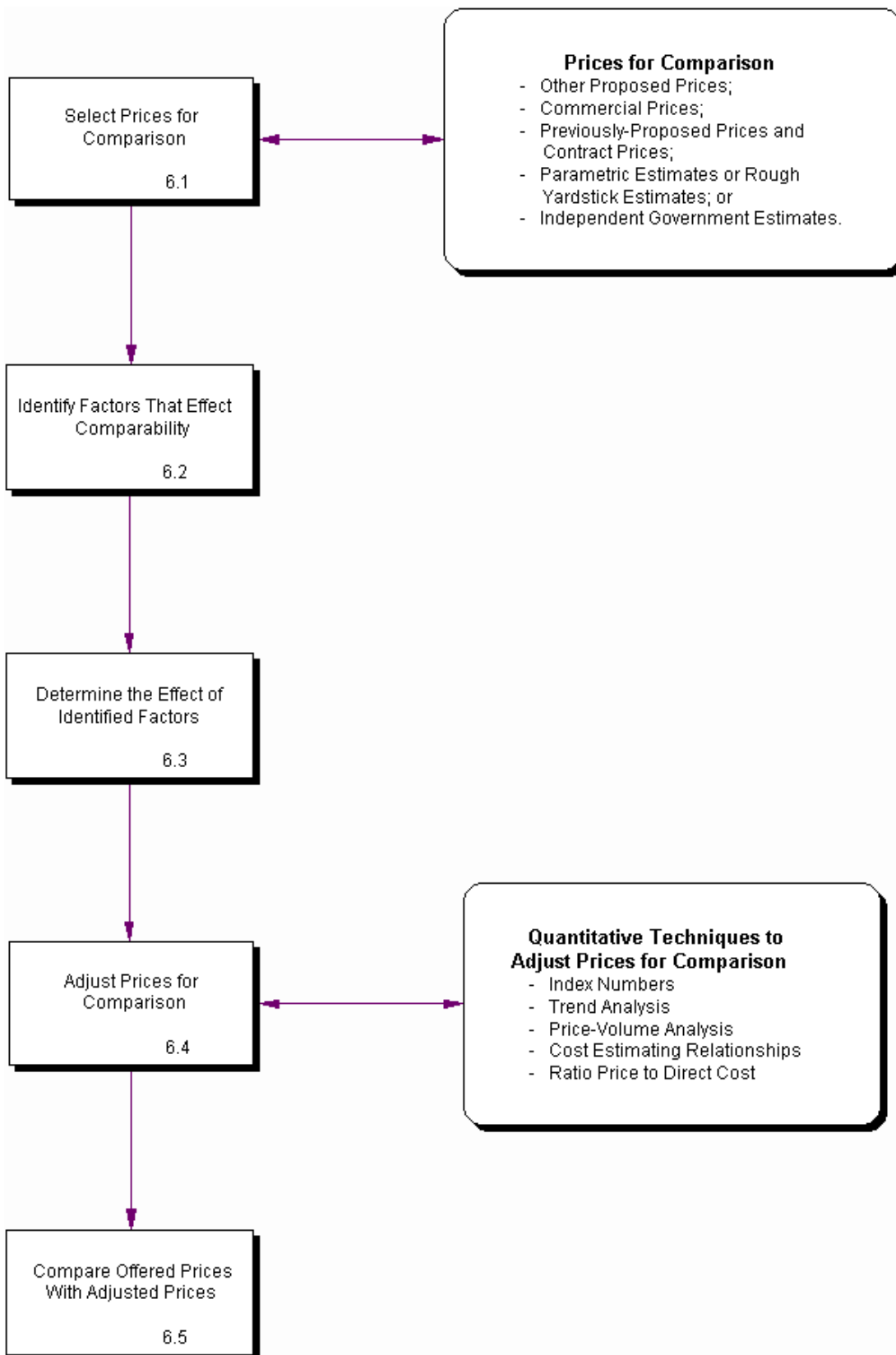
Now Offeror 2 has the lowest evaluated price after all other price-related factors are considered.

## Ch 6 - Comparing Prices

- 6.0 - [Chapter Introduction](#)
  - 6.1 - [Selecting Prices For Comparison](#)
    - 6.1.1 - [Other Proposed Prices](#)
    - 6.1.2 - [Commercial Prices](#)
    - 6.1.3 - [Previously-Proposed Prices And Contract Prices](#)
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  - 6.2 - [Identifying Factors That Affect Comparability](#)
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  - 6.4 - [Adjusting The Prices Selected For Comparison](#)
  - 6.5 - [Comparing Adjusted Prices](#)
- 

### **6.0 Chapter Introduction**

The figure below depicts the process involved in making price comparisons for price analysis.



*Comparisons in Price Analysis* ([FAR 15.404-1\(b\)\(1\)](#)). Price analysis:

- Is the process of examining and evaluating a proposed price to determine if it is fair and reasonable without evaluating its separate cost elements and proposed profit. Price analysis may, however, be supported by analysis of some cost elements and/or profit.
- Always involves some form of comparison with other prices.

Hence, you compare prices to determine whether the price from the apparent successful offer is fair and reasonable. The base for your comparison should be a price that you feel is a reasonable estimate of the price that you should pay -- the "should-pay" price.

*Should-Pay Price.* The should-pay price is the price that, in your best judgment, the Government should reasonably expect to pay for the deliverable based on available information concerning competitive offers, historical prices, commercial prices, pricing yardsticks, and Independent Government Estimates.

Bear in mind that your should-pay price is an estimate. Being an estimate, it is by definition inexact. If you have done a good job of price analysis, your should-pay price will probably be close to the mark. Still, don't be dogmatic about your estimate - to the point of rejecting offers that are close to, but not exactly at, your should-pay price estimate.

If the apparent successful offer is significantly higher or lower than your estimate:

- Determine why there is a significant variance between the should-pay price and that offer and then

Make the critical price-related decisions in awarding contracts through sealed bidding or negotiations.

*Comparability.* Comparability is the quality or state of being comparable. Products do not have to be alike to be compared. Any two things can be compared, but the comparison may show that they have no characteristics in common. However, if you are attempting to evaluate price

reasonableness, the comparison will not be of any value if the items are unlike in every way.

For price analysis, the items being compared must have enough similar characteristics or qualities to make the comparison useful. The more similar the items are, the easier the comparison. If your examination discloses significant differences, you may need to quantify the effect of those differences (e.g., acquisition of different products, at different times, or in different places) and make adjustments before you can reach valid conclusions about price reasonableness. The greater the dissimilarities and the more subjective your adjustment, the greater the possibility for doubts about your conclusions and the less likely that your analysis will be persuasive.

*Multiple Comparisons.* Use the information gathered during your market research to make multiple comparisons in determining price reasonableness and increase confidence in your pricing decision.

**For example, adequate price competition is normally considered one of the best bases for price analysis.**

However, you can have apparent competition and still have prices that are unreasonably high. How would you know? You must consider other bases for price analysis (e.g., historical prices, catalog prices, or market prices).

The number of comparisons that you consider should depend on the availability of information and the pricing risk involved in the acquisition.

- If the information is readily available in a form that can be used for price analysis, why not consider it? A quick comparison will increase your confidence of price reasonableness.

If the price is large or you still have concerns about price reasonableness after your initial comparison, the risk involved makes it particularly important to consider other comparisons.

*Comparison Steps.* Each different comparison will involve different information and some bases will require substantial adjustment prior to making your analysis. However, the comparison process is described in five steps outlined below.



Step	Action	Questions to Consider
1	Select prices for comparison: <ul style="list-style-type: none"> <li>• Other proposed prices;</li> <li>• Commercial prices;</li> <li>• Previously-proposed prices and contract prices;</li> <li>• Parametric estimates or rough yardstick estimates; or</li> <li>• Independent Government Estimates</li> </ul>	Would this comparison be valid?  Are more comparable prices available?
2	Identify factors that affect comparability.	Have I considered all potentially significant factors, including differences in: <ul style="list-style-type: none"> <li>• Market conditions;</li> <li>• Quantity or size;</li> <li>• Geographic location;</li> <li>• Purchasing power of the dollar;</li> <li>• Extent of competition;</li> <li>• Technology; or</li> <li>• Terms and conditions (e.g., differences in features or capabilities, delivery lead-times, one-time costs, etc.).</li> </ul>
3	Determine the potential impact of these factors on prices selected for	How substantial is the impact? In view of these factors and their impact, will the contemplated comparison have any credibility?

	comparison.	
4	Adjust prices selected for comparison.	<p>Have I accounted for all factors that can be dollarized?</p> <p>What techniques should be applied in making the adjustment?</p> <p>How much reliance can I place on the resulting estimate?</p>
5	Compare adjusted prices to the offer in line for award.	<p>How much weight should I place on each comparison?</p> <p>If adjusted prices differ substantially from the apparent successful offer, what price should the Government reasonably expect to pay?</p>

## 6.1 Selecting Prices For Comparison

This section identifies and defines five potential bases for price analysis. After defining each base, special considerations for using each base are outlined.

- 6.1.1 - [Other Proposed Prices](#)
- 6.1.2 - [Commercial Prices](#)
- 6.1.3 - [Previously-Proposed Prices And Contract Prices](#)
- 6.1.4 - [Parametric And Rough Yardsticks Estimates](#)
- 6.1.5 - [Independent Government Estimates](#)

*Potential Bases* ([FAR 15.404-1\(b\)](#)). You may select any of the following bases for price analysis:

- Other proposed prices received in response to the solicitation;
- Commercial prices including competitive published price lists, published commodity market prices, similar indexes, and discount or rebate arrangements;
- Previously-proposed prices and contract prices for the same or similar end items, if you can establish both the validity of the comparison and the reasonableness of the proposed price;
- Parametric estimates or estimates developed using rough yardsticks; or

- Independent Government Estimates.

One of the bases for price analysis identified in the FAR is "prices for the same or similar items obtained through market research." Because market research can span commercial prices, previously-proposed prices, contract prices, parametric or rough yardstick estimates, and Independent Government Estimates, this base for price analysis will not be considered separately.

Types of comparisons used in price analysis typically vary with the estimated dollar value of the contract.

**Micro-purchases.** ([FAR 13.2](#)) You may solicit only one quote, if you consider the quoted price is reasonable. Your decision on price reasonableness should be based on information such as:

- Previous prices paid for the same or similar items purchased competitively; or
- Knowledge of the supply or service gained from published prices in catalogs, newspapers, and other sources of market information.

If you suspect that the quoted price is not reasonable or you do not have comparable pricing information readily available, take more aggressive action to collect the information necessary to determine price reasonableness. Normally, you should solicit additional quotes by phone or fax.

**Other Simplified Acquisitions** ([FAR 13.1](#)). Whenever possible, base price analysis on competitive quotes.

- Promote competition to the maximum extent practicable.
- Synopsise any contract action that exceeds \$25,000 in the Commerce Business Daily unless an exemption applies.
- If the contract action does not exceed \$25,000 and you do not use FACNET or another method providing access to the notice of proposed contract action through the single Government-wide point of entry, you can normally obtain the maximum practicable competition without soliciting sources from outside the local trading area. You should obtain competition from at least three sources, if three sources are reasonably

available. Consider the following factors when determining the number of sources to solicit:

- The nature of the article or service to be purchased and whether it is highly competitive and readily available in several makes or brands, or is relatively noncompetitive;
  - The availability of an electronic commerce method that employs widespread public notice of the requirement;
  - The urgency of the proposed purchase;
  - The dollar value of the proposed purchase; and
  - Past experience concerning specific dealers' prices.
- If you only receive one quote, consider the following bases for price analysis:
    - Prices identified during market research;
    - Prices found reasonable for previous purchases;
    - Current price list, catalog, or advertised prices;
    - Prices for similar items in a related industry;
    - Price estimates developed during value analysis;
    - Personal knowledge of item prices;
    - The Independent Government Estimate; or
    - Any other reasonable base for price analysis.

#### **Contracts over the Simplified Acquisition Threshold.**

Consider every type of comparison which you believe provides a valid should-pay price.

- For example, if you have data on previous contract prices and have reason to believe that these data reflect good prior decisions on price reasonableness, then compare the apparent successful offer to those prices. If you have reason to believe that previous contract prices were not reasonable, then give little or no weight to those prices as you perform your price analysis. If you have no price history, you must rely on other comparison bases for your price analysis.

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#### **6.1.1 Other Proposed Prices**

*Proposed Prices* ([FAR 15.404-1\(b\)\(2\)](#)). Comparison of a proposed price with other proposed prices received in response to the same solicitation is generally considered one of the best bases for price analysis, because all

offers were submitted to meet the same requirement during the same time period.

*Using Proposed Prices* ([FAR 15.403-1\(c\)\(1\)](#)). Any proposed price used as a base for prices analysis must meet the following general requirements:

- The price must be submitted by a firm competing independently for contract award.
- The price must be part of an offer that meets Government requirements.
- Award must be made to the offeror whose proposal represents the best value to the Government.

If you have more than one competitive offer, you could use more than one offer in your analysis.

**Do not** use the price from any offer that you would not consider for contract award as a basis for price analysis.

- Never use an offer from a firm that you have determined is nonresponsible.
- In sealed bidding, never use a nonresponsive bid.

In negotiations, never use a price from a proposal that is technically unacceptable.

*Special Concerns* (CGEN B-176217, December 14, 1972 and CGEN B-189884, March 29, 1979).

You should normally place less reliance on comparisons with other proposed prices when:

- The solicitation was made under conditions that unreasonably denied one or more known and qualified offerors an opportunity to compete.
- The apparent successful offeror has such a decided advantage that it is practically immune from competition.
- Another price comparison, cost analysis, or a cost realism analysis indicates that the apparent successful offer may be unreasonable (too high or too low).
- Government requirements permit offerors to propose widely different technical approaches to contract performance. For example, a ceramic mug and a paper cup may both meet a requirement to hold 8 ounces of

- coffee, but that does not mean that \$1.00 price for a paper cup is reasonable because it is less than a \$5 price for a ceramic mug. Even if no other offeror is proposing to provide a paper cup, the key element of your price analysis should be to compare the paper cup offer with prices paid for similar paper cups.
- Price is not a substantial factor in the evaluation of offers for contract award. However, the Comptroller General (CGEN) has found adequate price competition in cases where price was assigned a weight of only 20 percent in the award decision.
  - All offerors are expected receive contract awards. In such cases, there may not be sufficient competitive pressure to foster fair and reasonable pricing.
- 

### 6.1.2 Commercial Prices

*Definition* ([FAR 15.404-1\(b\)\(2\)](#)). Commercial prices are prices being paid by the general public for a product. The circumstances of your purchase may be different from the commercial sales, but data on commercial sales can provide valuable information for use in contract pricing.

"Horror stories" about overpricing of Government contracts seem to occur every few years. Most could have been avoided if contracting officers had considered the price that the general public would be willing to pay for the product. Contractors might have logical reasons for charging \$435 to provide a common hammer as part of a major systems contract. But, as the Government's agent, could you explain to the general public why you paid \$435 for a hammer that anyone could buy in any hardware store for less than \$35?

*Using Commercial Prices* ([FAR 15.404-1\(b\)\(2\)](#)). You can classify the sources of commercial pricing information into three categories:

- **Published price list** -- prices taken from a catalog, price list, schedule, or other verifiable and established record that is regularly maintained by a manufacturer or vendor and is published or otherwise available for customer inspection. For pricing purposes (but not cost or pricing data exception purposes), you can consider published pricing

information from the firm submitting the offer and/or published pricing information from other firms offering similar products.

- **Published market prices** -- prices established in the course of ordinary and usual trade between buyers and sellers free to bargain that can be substantiated from sources independent of the offeror. Normally, market pricing information is taken from independent market reports, but a market price could be established by surveying the firms in a particular industry or market.
- **Similar indexes** -- commercial item prices established using a means other than those described above. For example, an offeror might provide information on the prices charged commercial customers over a period of time. Such a record would not qualify as published price list or market price, but it would provide a good record of the firm's commercial pricing practices.

*Discounts.* Commercial sales typically include discounts for different types of customers. Discount amounts typically depend on the product and the marketing strategy of the firm. Common factors affecting discounts include, services provided by the seller (e.g., wholesale and retail sales) and the importance of the sale (e.g., dollars involved or the relationship to other sales).

*Rebates.* Rebates are often offered to various customers based on the customer's total purchases over a specific period of time. For example, automobile manufacturers typically offer dealers rebates, based on total sales. That is one reason why dealers can advertise sales "at invoice." Dealer profit is based on the rebate amount.

*Contracting Situation Differences.* Remember that your contracting situation may be different than the situation in the commercial market. For example, the offeror may provide services to commercial customers that are not required by the Government. If the Government is receiving less, you should expect to pay less.

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### 6.1.3 Previously-Proposed Prices And Contract Prices

*Historical Prices* ([FAR 15.404-1\(b\)\(2\)](#)). Previously-proposed prices and contract prices are historical prices - prices related to past purchasing activity. The purchase associated with a particular price may have been made by your office or another office with similar requirements.

*Using Historical Prices.* Whenever you consider using historical prices to analyze price reasonableness, ask the following questions:

- ***Has the product been purchased before?***

The purchase may have been made by your office or by another purchasing office.

- ***What was the historical price?***

You can obtain price information from purchase files, computer data files, or manual inventory item records.

- ***Was the historical price fair and reasonable?***

For a historical price to be useful in determining the reasonableness of an offered price, you must know that the historical price was fair and reasonable. Be careful! It is not uncommon to review an item purchase history and find that no base other than the last price paid has been used for years to determine price reasonableness. In one study, the entire pricing histories for several items were reviewed and analysts found that for every acquisition except the first, the determination of price reasonableness was based on the last price paid. Analysts also found that the first acquisition was a multiple-item acquisition and while there was an analysis of the reasonableness of the overall acquisition price, no one ever examined the reasonableness of individual item prices. In other words, for years contracting officers found prices reasonable based on an arbitrary decision made during the first acquisition.

- ***Is the comparison valid?***

For the comparison to be valid, you must be able to identify and consider any item or market differences that might significantly affect contract price.

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#### 6.1.4 Parametric And Rough Yardsticks Estimates

*Cost Estimating Relationships* ([FAR 15.404-1\(b\)\(2\)](#)). Cost estimating relationships (CERs) are used to develop parametric estimates or rough yardstick estimates. A CER is a formula for estimating prices based on the relationship of past prices with one or more product physical or performance characteristics (e.g., dollars per pound or dollars per horsepower). Whenever you can relate item price with the value of one or more physical or performance characteristics, you can use the relationship to estimate the price of a similar product. For example, builders commonly estimate the price of a planned building by multiplying the number of square feet in the building by an estimated cost per square foot.

*Using Cost Estimating Relationships.*

Whenever you consider using a CER to determine price reasonableness, ask the following questions:

- ***Has the CER been widely accepted in the market place?***

Determine whether both buyers and sellers agree on the validity of a particular relationship/yardstick and the reasonableness of values used in estimating. Sellers may use a relationship/yardstick that produces an estimate higher than that normally accepted by buyers.

- ***Does the CER produce reasonable results?***

The user of the relationship/yardstick has the burden of demonstrating that the relationship/yardstick produces reasonable estimates. The user should be able to demonstrate the data and calculations used to develop the relationship/yardstick.

- ***How accurate is the CER?***

Validate the using known product data and prices. Examine the accuracy of the results. Remember that even a properly developed pricing relationship/yardstick will not always predict price exactly. Some relationship/yardsticks are very accurate others will only give you a rough approximation of the proper price. As relationship/yardstick accuracy decreases, the weight that

you place on the relationship/yardstick in your pricing decision should also decrease.

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### 6.1.5 Independent Government Estimates

*Independent Government Estimates.* As the name implies, an Independent Government Estimate is an estimate made by the Government. This section will define and consider three types of Independent Government Estimate.

- The most common is the Independent Government Estimate that accompanies the **purchase request**.
- A **value analysis estimate** results from a specialized analysis of the function of a product and its related price. It may literally involve taking the item apart to determine how it is made and why it costs what it does.
- A **visual analysis estimate** results from a visual inspection of an item, or drawing of an item, to estimate its probable value.

*General Guidelines on Using Independent Government Estimates.* [Earlier in this text](#), you learned five questions to ask when analyzing the reliability and validity of Government purchase request estimates. Ask the same questions of any Independent Government Estimate before using it as a basis for comparison with offered prices.

- **How was the estimate made?**
- **What assumptions were made?**
- **What information and tools were used?**
- **Where was the information obtained?**
- **How did previous estimates compare with prices paid?**

*Special Considerations for Using Value Analysis.* You may apply the techniques of value analysis to any product, regardless of its complexity. However, generally consider only those products offering potential cost reductions that merit the time and cost of the analysis required.

Value analysis provides information on product value in comparison with possible substitutes. It is particularly useful when:

- The Independent Government Estimate is the only price analysis base available; or
- The product does not seem to be worth the price quoted.

To be effective, value analysis must be performed by individuals familiar with the product and its use by the Government. Actual analysis should follow a 5-step process:

1. Determine acquisition costs based on current proposal or other estimates.
2. Assure Government requirement documents reflect the minimum needs of the Government.
3. Identify alternative products or methods of meeting the minimum needs of the Government. This is typically the key step in the analysis. The following are examples of questions you should consider:
  - *Can any part of the product be eliminated?*
  - *Can a standard part replace a special part?*
  - *Can a lower cost material or method be used?*
  - *Can paperwork requirements be reduced?*
  - *Can the product be packaged more economically?*
4. Estimate the costs associated with alternative products or methods that would meet the minimum needs of the Government.
5. Document the reasonableness of the current prices or recommend appropriate changes. Assure that the process and results of the value analysis are clearly documented and include a copy of the documentation in the contract file. When you are satisfied that the value received supports the offered price, use that information to support your determination of price reasonableness. When you are not satisfied, use the information to document efforts to bring price in line with perceived value.

**For example:** Suppose you are purchasing a pair of shoes. Shoes are used to walk in, to protect the feet, to keep the feet warm, and to enhance appearance. If shoes are to be attractive, they must be made of certain types and quality of material. If appearance is not important to the Government, a less attractive, less expensive, but possibly more durable material can be used. By changing the quality of material required, price will change.

*Special Considerations for Using Visual Analysis.* In visual analysis, the analyst examines obvious external features of the product to determine value and related price. This technique is nothing more than technical experts comparing the product with other products by sight.

Consider using visual analysis as a pricing tool:

- In place of value analysis for products that do not offer potential cost reductions that merit the time and cost of analysis required for detailed value analysis.
- To review large numbers of products to identify any that appear to offer potential cost reductions that merit the time and cost associated with detailed value analysis.

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## **6.2 Identifying Factors That Affect Comparability**

*Introduction.* When comparing prices, you must attempt to account for any factors that affect comparability. The following factors deserve special consideration because they affect many price analysis comparisons:

- Market conditions;
- Quantity or size;
- Geographic location;
- Purchasing power of the dollar;
- Extent of competition;
- Technology; and
- Government unique requirements.

*Market Conditions.* Market conditions change. The passage of time usually is accompanied by changes in supply, demand, technology, product designs, pricing strategies, laws and regulations that affect supplier costs, and other such factors. An effort to equate two prices, separated by five years, through a simple inflation adjustment may not be successful. Too many characteristics of the market are likely to have changed. Do not stretch data beyond their limits.

Generally select the most recent prices available. The greater the time difference, the greater the likelihood and impact of differences in market conditions. If you are

comparing a current offer with a prior price, the ideal comparison would be with a contract price agreed to yesterday. That comparison would limit the effects of time on market conditions.

However, do not select a price for comparison merely because it is the most recent. **Look instead for prices that were established under similar market conditions.** For instance, if you are buying potatoes in October, offers from the previous October may be more comparable to current offers than prices paid last February, given the cyclical pattern of supply and demand in the market for potatoes.

Consider the most current available data on trends and patterns in market conditions. Remember that lags often occur between data collection and contract award. Changes in market conditions over that period can reduce the usefulness of the data assembled.

*Quantity or Size.* Variations in quantity can have a significant impact on unit price. A change in quantity can have an upward effect, a downward effect, or no effect at all.

In **supply and equipment** acquisitions, we usually assume that larger supply acquisitions command lower unit prices. Where economies of scale are involved, that should be the case. However, economies of scale do not always apply.

- Increases in order size beyond a certain point may tax a supplier's capacity and result in higher prices.
- Market forces may impose opportunity costs on a supplier which result in higher unit costs for greater volumes. For example, if the price of oil is expected to increase 20 percent over a 12-month period, a supplier may choose to withhold a portion for a sale at a later date when the price is higher. In such a market, the effect of purchase quantity on price may not be as expected; at some point, increases in volume will result in higher unit prices as the supply of the lower priced oil is exhausted.
- Finally, if a price comparison is based on standard commercial items that are produced at a regular rate, variations in quantity may have no effect at all.

A meaningful comparison of prices requires that the effect of volume on price be accounted for. The best way to

do this is to select prices for comparison based on equal volumes. If that is not possible, examine the specific suppliers and the nature of the market at the time of the purchase.

In **service acquisitions**, the problems are different. Variations in size can sometimes be neutralized by reducing the comparison to price per square foot or price per productive labor hour. Because these approaches are not always effective, try to factor out size or quantity variations as much as possible. If you don't succeed, the price comparison will have little value.

*Geographic Location.* Geography can have a range of effects on comparability. Prices for many nationally advertised products will not vary much from place to place. Nevertheless, because geographic location can affect comparability, you should first try to compare offered prices with prices obtained from the same area. In major metropolitan centers, you should generally be able to identify comparable bases for price analysis in the region. In more remote, less urban areas, you must often get pricing information from beyond the immediate area.

When you must compare prices across geographic boundaries, take the following actions to enhance comparability.

- Check for differences in the level competition that may affect price comparisons.
- Identify labor rate differences that must be neutralized for valid price comparisons.
- Check freight requirements and accompanying costs. These can vary considerably, especially for chemicals and other hazardous materials.

Identify geographic anomalies or trends. For example, an item may be more expensive on the West Coast than in the East.

*Purchasing Power of the Dollar.* Inflation undermines comparability by eroding the real value of money. Because prices over time are expressed in the same currency (dollars and cents), the denominations must have comparable purchasing power if comparison is to be meaningful. You can normally use price index numbers to adjust for the changing value of the dollar over time.

*Extent of Competition.* When comparing one price with another, assess the competitive environment shaping the prices. For example, you can compare last year's competitive price with a current offer for the same item. However, if last year's procurement was made without competition, you may not have a good price with which to compare the current offer. A poorly written specification and an urgent need may have combined to make competition impossible last year, but now the specifications have been rewritten and the delivery is not urgent. Given these circumstances, a current offer could be the same as (or less than) last year's best price and still not be reasonable.

*Technology.* Prices from dying industries can rise because the technologies don't keep pace with rising costs. Conversely, technological advances in growth industries can drive prices down. The computer industry is an example. Technological advances have been made so fast that a comparison of prices separated by only a few weeks must account for these advances if the comparison is to have any value.

Engineering or design changes must also be taken into account. This means you must identify the new or modified features and estimate their effect on price.

*Government-Unique Requirements.* Often, the Government's requirements vary to some degree from the commercial requirements for similar products. The question is the impact these variations have on price. For example, the Government may require that the carpet in a Navy ship be fireproof to a far greater extent than any commercial carpet. That may justify a substantial difference in price over otherwise comparable commercial carpets.

Similarly, you must often incorporate clauses in contracts that are not required in commercial market transactions. For example, contracts between buyers and sellers in the private sector do not include provisions relating to the Davis-Bacon Act, the Service Contract Act, clean air and water, and many other special conditions. Consequently, comparison of an offer with commercial prices may be difficult. Unique terms and conditions affect prices, but it is often extremely difficult to assign a dollar value to their effects.

Just as Government requirements may be different from commercial requirements, Government requirements at a specific time and place may be different than requirements at another time and place. These differences will also affect price comparisons.

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### **6.3 Determining The Effect Of Identified Factors**

*Introduction.* Once you have identified the factors that may affect comparability, you must determine the effect on each specific comparison with the offered price. As you determine the effect of various factors on price comparisons, you must ask yourself the following questions:

- **What factors affect this specific comparison?**
- **How do these factors affect the comparison?**
- **Does this comparison, even with its limitations, contribute to the price analysis?**

*Other Proposed Prices* ([FAR 15.206](#)). In sealed bidding, all bids are priced against the contract requirements. Comparison with competitive prices is a straight forward comparison that normally requires no adjustments unless the evaluation process involves the use of price-related factors.

Comparing proposals may not be as simple as comparing bids, when:

- The offer in line for award departs from the stated solicitation requirements. If the departure does not meet stated contract requirements, but is acceptable to the Government, provide other offerors the opportunity to submit a revised proposal based on the revised requirements. However, you must not reveal any information about the proposed solution or any other offeror information entitled to protection.
- Offers differ in their basic approaches to meeting performance or functional requirements. Remember, the price of a ceramic mug is little help in determining if the price of a paper cup is reasonable, even though both can satisfy a requirement for a container that will hold eight ounces of coffee.



*Commercial Prices.* Any of the general factors identified earlier in this chapter could affect the comparability of commercial prices (i.e., market conditions may have changed since the effective date of published prices; the purchasing power of the dollar may have changed; the published prices may have been based on different terms and conditions than solicited by the Government).

During your analysis, you should give special consideration to asking how the following have affected price analysis comparisons:

- Is there a difference between the services provided commercial and Government customers? Are published prices retail, wholesale, or distributor prices?
- Is there a difference between the catalog (or suggested price) and the price paid by commercial customers with requirements similar to the Government's requirements?
- Are there different prices for different customer classes (e.g., are there different prices for different classes of customers-public vs. brokers vs. retailers?)
- What special rebates or discounts are offered commercial customers?

What is the value of extras provided commercial customers for promotional purposes (e.g., free packaging, free transportation, free insurance, etc.) without extra charge?

*Previously Proposed Prices and Contract Prices.* Consider all general factors identified earlier in the chapter. At minimum, ask the following:

- ***How have the specific changes in the contracting situation affected contract price?***

You need to understand the acquisition situation as it existed in the previous situation and how the current acquisition situation differs. Important data elements include:

- Sources
- Quantities
- Production/Delivery Rates
- Start-up Costs

- o Terms of Purchase
- ***How have changes in the general economic situation affected contract price?***

Economic changes are reflected in the general level of inflation or deflation related to the product that you are acquiring. Have prices gone up or down. If they have, how much have they changed?

*Parametric and Rough Yardstick Estimates.* Consider all general factors identified earlier in the chapter. In particular consider the questions above that apply to historical prices. After all pricing yardsticks are based on historical pricing information.

In addition, you must ask if the historical relationship remains valid. As a minimum, consider the following questions:

- ***How have changes in market conditions affected the estimating relationship?***
- ***How have changes in technology affected the estimating relationship?***
- ***How have changes in production efficiency affected the estimating relationship?***
- ***How have changes in the purchasing power of the dollar affected the estimating relationship?***

*Independent Government Estimates.* Consider all general factors identified earlier in the chapter for possible effects on comparability.

Independent Government Estimates, especially those developed previously for such purposes as preparing budgets, may no longer be valid. Budget optimism or pessimism can have a significant effect on budget estimates. In addition, many estimates are developed years before the actual contract action is initiated.

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#### **6.4 Adjusting The Prices Selected For Comparison**

*Introduction.* If you have a price analysis comparison base that does not require adjustment, use it! If you must make an adjustment, try to make the adjustment as objectively as

possible. You may need to use statistical techniques or algebraic formulas to establish a common basis for comparison.

You must complete two basic tasks in order to establish comparability:

- Identify and document price-related differences, taking into account the factors affecting comparability.
- Factor out price-related differences.

Restoring comparability by establishing a common basis for comparison requires that you assign a dollar value to each identified difference. However, you cannot always do this. The cost of terms and conditions peculiar to Government contracts is hard to estimate, so exercise discretion in such cases.

*Other Proposed Prices.* Apply any price-related factors established in the solicitation, to adjust the offered prices for comparison with one another.

*Other Information.* The challenge is to use the available information and to estimate the price that the Government should pay.

Use available information to estimate the effect of each factor on contract price. In this effort use appropriate quantitative analysis techniques.

If you cannot objectively adjust the prices for the factor involved, you may need to make a subjective adjustment. For example, estimating the effect on price of unique Government terms and conditions.

Every acquisition situation will be different. Whatever method you use, always document the information that you used and how you used it in making the adjustment.

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## **6.5 Comparing Adjusted Prices**

*Introduction.* Use adjusted prices to estimate range of reasonable prices. Use the price that appears most reasonable as your should-pay price.

If the should-pay price departs significantly from the apparent successful offer, analyze the differences. You will then be ready to make the price-related decisions required to determine the successful offeror and make contract award.

*Other Proposed Prices.* Comparing competitive offers is normally the easiest form of price analysis. It also tends to be the most valid, because you are comparing offers prepared for the same requirement under the same market conditions. However, the weight placed on this type of comparison depends on the circumstances of the acquisition. Place less weight on competitive prices (relative to other price comparisons) when:

- Adequate price competition does not exist (regardless of the number of offers) - in which case the weight should be zero.
- Relatively few of the responsible firms in the industry submitted responsive offers (especially if the conditions of the solicitation unreasonably denied such firms a chance to compete).
- The apparent offeror appears to enjoy an unfair competitive advantage.
- Having used a performance or functional specification, the apparent successful offeror's proposed approach is less comparable to other proposed approaches than (a) to work performed under prior contracts or (b) commercial contracts.
- The deliverable in line for award is less comparable to other offered deliverables than to (a) those acquired under prior contracts or to (b) commercial contracts.
- The apparent successful offer is significantly out of line with other offers.
- The apparent successful offer is significantly out of line (either lower or higher) with estimates of the should-pay price from other types of comparisons (to the extent that other comparisons are reliable and valid indicators of the should-pay price).
- The cost of the acquisition is substantial. The larger the dollar value of the contract, the more importance you should place on sizable differences in dollars between different types of comparisons (even if the differences are modest when expressed as percentages).

*Commercial Prices.* Ask the following questions to determine the weight that should be placed on comparisons with commercial prices.

- ***Can the offeror explain any differences between the offered price and its own commercial prices?***

The offeror must be able to explain any differences between the offered price and commercial prices. You may base prices for a family of products on a single base product. For example, a radio transceiver may require different connectors and adapters to work with different systems. The part number may even be different for each system, but the basic component is the same. If the offeror can support the price of the various related products by using the price of the basic component, plus the cost of the additional devices, you can use that data to price the entire family of products.

- ***Is your purchase situation different from the typical commercial market situation?***

Even when you grant an exception from the submission of cost or pricing data based on commercial pricing, you do not have to accept the commercial price as the contract price. If you feel that the circumstances of your purchase are different, you should attempt to negotiate a different price.

- ***Do other price analysis bases confirm that the offered price is reasonable?***

If other bases indicate that the offered price is fair and reasonable, use that information in preparing your price negotiation objectives.

*Previously Proposed Prices and Contract Prices.* Ask the following questions to determine the weight that should be placed on comparisons with historical prices.

- ***How does the offered price compare with the historical price, considering changes in the contracting situation?***

You may be able to use quantitative techniques to adjust prices for changes in the contracting situation. If you cannot, you must subjectively analyze the changes.

- ***Do other types of price comparisons confirm that the offered price is reasonable?***

Because of the changes in the acquisition situation, historical prices typically do not provide a precise base for determining price reasonableness. If possible, use other bases of price analysis to confirm that the offered price is fair and reasonable.

*Parametric and Rough Yardstick Estimates.* Ask the following questions to determine the weight that should be placed on comparisons with parametric or rough yardstick estimates.

- ***How does the offered price compare with the price developed using the pricing relationship?***

Use the appropriate price analysis technique(s) to estimate the should-pay price. Compare the offered price with the estimated price, and carefully document the techniques and the judgment you use in your analysis.

- ***Do other types of price comparisons confirm that the offered price is reasonable?***

Because of item differences, pricing relationships typically cannot precisely confirm or refute price reasonableness. If possible, use other price comparisons to confirm that the offered price is fair and reasonable.

*Independent Government Estimates.* Remember that your reliance on Independent Government Estimates should always be tempered by your answers to the following questions:

- ***How Was the Estimate Made?***
- ***What Assumptions Were Made?***
- ***What Information and Tools Were Used?***
- ***Where Was the Information Obtained?***
- ***How Did Previous Estimates Compare with Prices Paid?***

Place no weight on an Independent Government Estimate that originated with an offeror or is a sheer guess. If the Independent Government Estimate turns out to be a past

contract price, analyze that price as you would any historical price.

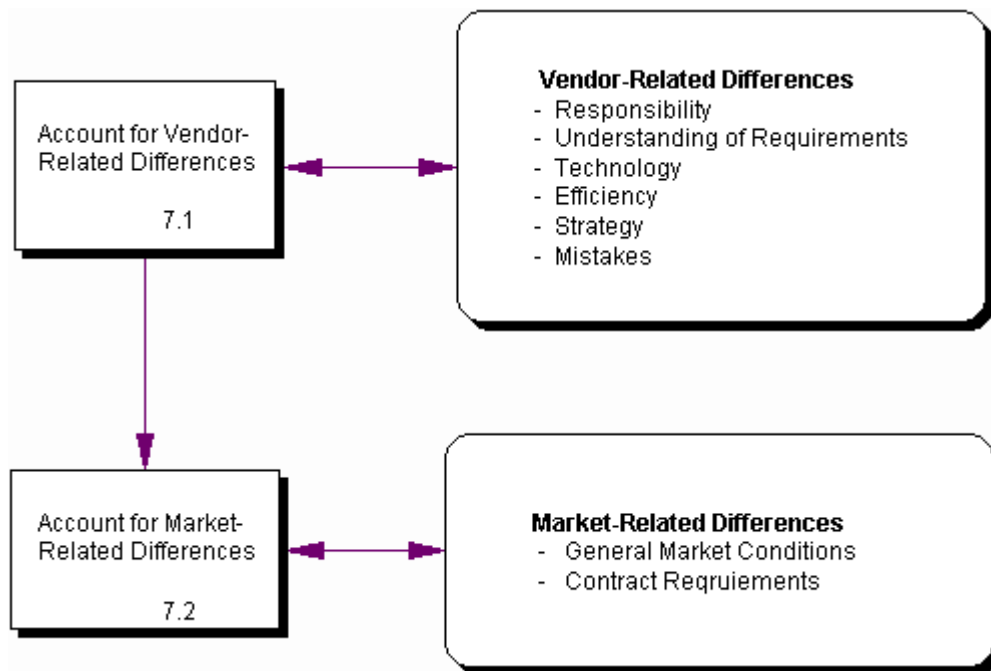
On the other hand, you might place great confidence in Independent Government Estimates built through detailed analysis - depending on how well that analysis was done.

## Ch 7 - Account for Differences

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- 

### 7.0 Chapter Introduction

*Identification and Accounting Process.* The figure below depicts the process involved in identifying and accounting for differences between the offered price and the should-pay price.



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*When to Account for Differences.* Your price analysis should compare the offered price with available estimates



of a reasonable price -- should-pay price estimates. The offered price may not be the same as any single should-pay price estimate. However, the offered price should fall within the range of should-pay estimates.

If the apparent successful offer is substantially above or below your best should-pay price estimate(s), you should attempt to account for differences. Remember that performance risk associated with a firm fixed-price that is too low may be as unacceptable as a price that is too high. In cost-reimbursement contracting, an unreasonably low cost estimate may result in a substantially higher final price, because the Government must reimburse all allowable costs.

*Accounting for Differences.* Accounting for differences between offered prices and should-pay estimate(s) should be part of your continuing market research during the contracting process.

You should attempt to collect additional information about the apparent successful offeror or the market in general that will account for apparent differences between an offered price and should-pay price estimate(s). Then consider your findings as you make the price-related decisions identified in the next two chapters.

Based on your findings, you might eventually determine that:

- The price of the apparent successful offer is reasonable despite the identified differences;
- The price of the apparent successful offer is unreasonable;
- The differences result from problems with the solicitation or other mistakes that require solicitation cancellation; or
- Some other course of action is appropriate.

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## **7.1 Identifying Vendor-Related Differences**

*Introduction.* In this section, you will learn the most common vendor-related reasons for differences between the low offer, other offers, and various estimates of reasonable prices.

- 7.1.1 - [Responsibility](#)
- 7.1.2 - [Understanding Of Requirements](#)
- 7.1.3 - [Technology](#)
- 7.1.4 - [Efficiency](#)
- 7.1.5 - [Strategy](#)
- 7.1.6 - [Mistakes](#)

*Vendor-Related Differences.* Vendor differences are circumstances that result primarily from the action or inaction of an individual firm. Buyers often look at a source list as a homogenous group of firms. However, individual firms have personalities, just like people do, with different needs and wants. These differences manifest themselves in the prices offered, as well as in the way each firm will perform any contract awarded.

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### **7.1.1 Responsibility**

*Price Analysis and Offeror Responsibility ([FAR 9.103\(c\)](#)).* There may be a direct connection between the apparent successful offer and the firm's ability to perform. The firm's price may be very attractive because the firm does not understand the contract requirements, or because it does not have the required investment in technology and equipment to perform the contract.

**Always remember that a contractor who cannot perform is never a good deal at any price.** In the words of the FAR:

The award of a contract to a supplier based on lowest evaluated price alone can be false economy if there is subsequent default, late deliveries, or other unsatisfactory performance resulting in additional contractual or administrative costs. While it is important that Government purchases be made at the lowest price, this does not require an award to a supplier solely because that supplier submits the lowest offer. A prospective contractor must affirmatively demonstrate its responsibility...

Hence, if the low offer is significantly lower than other offers or your estimate of the should-pay price, the burden is on the offeror to affirm its ability to perform

at that price. In sealed bidding, a "mistake in bid" procedure has been established in part to provide you with an opportunity to verify that a bidder can perform at a price that is greatly out of line with other bids. In negotiated procurements, you can directly ask the offeror to affirm its ability to perform at the proposed price during discussions.

*Effect on Contract Pricing.* You cannot make a determination of price reasonableness based on a price comparison with an offer that is technically unacceptable or an offer submitted by a firm that is not responsible.

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### **7.1.2 Understanding Of Requirements**

*Introduction.* The price offered by a firm represents the firm's **understanding of the contract requirements**. Even with a responsible firm and well-defined contract requirements, misunderstandings and varying interpretations are possible.

*Misunderstandings.* Misunderstandings are particularly likely when the solicitation contains unusual requirements that are different from what the offerors typically see in solicitations for similar requirements. The unusual requirement could be the inclusion of unique requirements or a change in requirements since the last similar contract. For example, there could be a change from a Federal Specification to a commercial purchase description for an item. Some firms may not recognize the change and continue to price based on the superseded Federal Specification. Others will recognize the change and price based on the actual solicitation requirements.

*Varying Interpretations.* Varying interpretations are particularly likely to occur in situations where performance requirements are used. For example, remember the "8-ounce coffee container" requirement. One offeror could interpret the requirement to mean "provide an 8-ounce ceramic mug." Another could interpret it to mean "provide an 8-ounce paper cup."

*Effect on Contract Pricing.* The effect of either misunderstandings or varying interpretations of specification requirements may be wide differences in

prices. Not only will prices be different from each other, they may also be different from other comparison bases used for price analysis.

- **Misunderstandings.** A firm that does not understand that the solicitation requirements have changed will offer a price based on its expectations about the contract requirements. In the example above, a firm that continued to price based on the Federal Specification will likely offer a higher price than a firm that did identify the change to a commercial specifications.
- **Varying Interpretations.** A firm that devises a more costly solution to meet the requirements of a performance specification will normally offer a higher price than a firm with a less expensive solution. In the example above, the paper cup will be substantially cheaper than the ceramic mug. However, the reasonableness of the price of the paper cup cannot be based on a competitive price comparison with the price of a ceramic mug. Comparisons with other bases for price analysis may also be complicated by similar differences in interpretation of the specification.

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### 7.1.3 Technology

*Introduction.* Pricing differences may involve technology in differences related to:

- Costs associated with special technology requirements; or
- Cost patterns associated with different technologies.

*Special Technology Requirements.* If an offeror must have a special product or production technology to meet Government requirements, there may be an effect on contract price. Some firms may have the required technology, while others may not.

- **Product Technology.** If the product technology is within a firm's existing capabilities, it will not need to conduct expensive research and development or purchase the technology from other firms.
- **Production Technology.** If a unique production technology, required for contract performance, is

currently available to a firm, it will not need to invest in new plant and equipment to perform the contract. If the technology is not available, investment, or possibly expensive subcontracting, will be required. There may also be schedule delays during the period that the firm is acquiring the new technology. Dealing with the effects of schedule delays may further increase the cost of the contract.

*Different Cost Patterns Associated with Different Technologies.* Differences in the cost patterns associated with different production technologies can also affect contract price. Firms can produce the same product with different types of equipment and different related costs. One firm may use a labor-intensive method of production, and, as a result, have a low fixed cost of production. Another firm might have an automated facility with high fixed costs of production and high set-up costs. For small quantities, the labor intensive firm will have the lower cost per unit. For large quantities, the automated firm will have the lower cost per unit because the fixed costs of production are spread over more units.

*Effect on Contract Pricing.* Technology can have a substantial effect on the prices offered by different firms:

- **Special Technology Requirements.** If costs are increased by the need to acquire a special product or production technology, prices are likely to increase because of the increased costs. If the required investment in technology has application to other products produced by the firm, the costs may be shared. If the technology requirements are unique, the costs will have to be charged to a single product.

If only one firm has access to the necessary technology, that firm may have a lock on the competition. If that happens, prices may be held at an artificially high level and expected price reductions from continuing production may not occur.

- **Different Technology Cost Patterns.** Differences in production technology may produce prices that are substantially different from what would be expected

from analysis of historical prices for substantially different quantities. For smaller quantities, the labor intensive firms may have a competitive advantage. For larger quantities, the automated firm may have a competitive advantage.

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#### **7.1.4 Efficiency**

*Introduction.* Firms with exactly the same equipment and technology can have substantially different cost structures, even when they are producing exactly the same products.

*Efficiency Differences.* The differences in cost structures result from operating at different levels of efficiency. Measures of efficiency examine the input, labor, materials, and equipment, required to obtain a given level of output. When compared with less efficient firms, more efficient firms can produce the same amount of product with less input, or more output with the same amount of input.

The difference lies mainly in the organization and operation of the firm's management. Concepts like total quality management have been developed to identify areas of operation that do not add value. The objective is to eliminate non-value-added effort and increase efficiency.

*Effect on Contract Pricing.* As stated above, efficiency is a comparison of input and output. When you examine a firm's efficiency in producing a product, the comparison is normally made in terms of dollars per unit of output. More efficient firms can produce a product at a lower cost than less efficient competitors. A firm that is substantially more efficient than its competitors can produce a unit of a product at a substantially lower cost. If the firm can produce at a substantially lower cost, it can sell for less and still make a greater profit than its competitors.

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#### **7.1.5 Strategy**

*Introduction.* Most firms have the same general pricing objectives, to:

- Cover costs; and
- Contribute to attaining corporate operational objectives.

However, different firms have different pricing strategies. And pricing strategies within a single firm can change with changes in the product and the market situation.

*Strategies.* Some offerors pursue **cost-based pricing strategies** and others pursue **market-based pricing strategies**. A single firm may follow different pricing strategies in different acquisition situations. Three cost-based and seven market-based pricing strategies are described in detail in the text Introduction.

*Effect on Contract Pricing.* Firms pursuing different pricing strategies may offer different prices, even when they have essentially the same production costs. As a result, you should consider differences between these strategies as you analyze price differences.

Be particularly careful if you believe that the apparent successful offeror's pricing strategy involves pricing the contract below cost. The Comptroller General has repeatedly dismissed protests against alleged below-cost, buy-in offers. In one case, the Comptroller General noted that a "bidder, for various reasons, in its business judgment may decide to submit a below-cost bid; such a bid is not invalid. ... Whether the awardee can perform the contract at the price offered is a matter of responsibility." (See Diemaster Tool, Inc., CGEN B-238877, April 5, 1990 and Tech. Appl., Inc., CGEN B-238259, May 4, 1990.)

Hence, when confronted with what appears to be a buy-in price, your challenge is to determine whether the price represents an unacceptable performance risk (i.e., to judge the degree of risk by calculating the extent to which the proposed price falls short of the amount the agency believes is required to perform as proposed).

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### 7.1.6 Mistakes

*Introduction.* Like individuals, businesses, even major corporations, are not perfect, and can make mistakes.

*Types of Mistakes.* You have already considered one form of mistake as part of your consideration of offeror understanding of the Government requirement. In pricing, you may also see mistakes that involve simple mathematical errors. The more complex the task, the more opportunity there is for error.

Mathematical mistakes may occur, even when prices are prepared by computer. Computers only do what they are programmed to do. If the programming is incorrect, the answer will also be incorrect.

*Effect on Contract Pricing.* Even a simple mathematical error can have a significant effect on contract pricing. Pricing is usually the last step in offer development. In the pressure to submit the offer, the mistake may be missed by the offeror's review process.

**For example:** A construction task requires remodeling of 20 identical buildings. The bidder estimates the price for one building and multiplies the price by 2 instead of 20. The bid price is one-tenth what the estimator meant it to be.

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## 7.2 Identifying Market-Related Differences

*Introduction.* In this section, you will learn about the most common market-related reasons for differences between the low offer, other offers, and various estimates of reasonable prices.

- 7.2.1 - [General Market Conditions](#)
- 7.2.2 - [Contract Requirements](#)

*Market-Related Differences.* Market-related differences are circumstances that are beyond the control of an individual firm and that affect all firms, but not always in the same way. Just like vendor differences, market differences can also affect price comparisons.

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### 7.2.1 General Market Conditions



*Introduction.* A general market condition is any factor that affects the general industry conditions under which products are bought and sold.

*Differences in General Market Conditions.* Consider changes in the contracting situation and in general economic conditions, whenever you are using historical prices as a comparison base for determining price reasonableness.

Three circumstances are worthy of special consideration:

- Changes in the level of competition;
- Limited competition and collusion; and
- Differing economic conditions.

*Changes in the Level of Competition.* Changes in the level of competition can affect offeror pricing strategies. If competition decreases from historical levels, firms typically will be less concerned about the threat of price competition. If the level of competition increases, firms will be more concerned.

*Limited Competition and Collusion.* In Government contracting, you normally assume that you have adequate price competition whenever there are two or more sources. However, you must be careful in assuming competition, particularly in situations where there are only two or three firms that can meet Government requirements.

Limited competition encourages collusion. Any agreement or mutual understanding among competing firms that restrains the natural market forces should be considered collusion. The understanding does not have to be the result of an active agreement. It can be a passive understanding that aggressive competition will lower profit margins for all competitors without increasing volume for any single competitor. As long as each firm gets its "fair share" of the business, all the firms can increase profit by not competing aggressively.

You may find it is often difficult to detect collusion and antitrust law violations. Practices or events that may evidence violation of antitrust laws include ([FAR 3.303\(c\)](#)):

- The existence of an "industry price list" or "price agreement" to which contractors refer when formulating offers.
- A sudden change from competitive bidding to identical bidding.
- Simultaneous price increases or follow-the-leader pricing.
- Rotation of offers or proposals, so that each competitor takes a turn in sequence as low offeror, or so that certain competitors submit low offers on some sizes of contracts and high on other sizes.
- Division of the market, so that certain competitors only offer low prices for contracts let by certain agencies, or for contracts in certain geographical areas, or on certain products, and offer high prices on all other contracts.
- Establishment by competitors of a collusive price estimating system.
- The filing of a joint bid by two or more competitors when at least one of the competitors has sufficient technical capability and productive capacity for contract performance.
- Any incidents suggesting direct collusion among competitors, such as the appearance of identical calculation or spelling errors in two or more competitive offers or the submission by one firm of offers for other firms.
- Assertions by the employees, former employees, or competitors of offerors, that an agreement to restrain trade exists.

*Differing Economic Conditions.* A firm can have a competitive advantage because of the economic conditions in the area in which it operates. Expect production costs to be different in different parts of the country. You may be able to use index numbers to consider the effect that different area costs will have on contract price.

*Effect on Contract Pricing ([FAR 3.303 \(f\)](#)).* General market conditions can have a substantial effect on prices:

- **Changes in the Level of Competition.** Changes in the level of competition will affect the accuracy of price estimates based on historical prices. As firms become less concerned about competition, prices may be expected to increase faster than national averages. As

firms become more concerned about competition, price increases may be slower than national averages.

- **Limited Competition and Collusion.** Collusion, active or passive, will increase prices. Carefully review any of the practices or events that may indicate evidence of violation of the antitrust law. Some events such as certain competitors being low only for contracts let by certain agencies, or for contracts in certain geographical areas, or on certain products, and high on all other jobs, may have economic explanations other than collusion. If your review confirms collusion, you should report your conclusions to the U.S. Department of Justice.
- **Differing Economic Conditions.** Differences in the area economic conditions can have a significant effect on production costs, including labor rates and material costs. Depressed economic conditions (e.g., high local unemployment rates) in an area can lower costs. Depressed sales can make suppliers more willing to cut prices to make a sale. Lower labor and material costs will permit a firm to produce a product more cheaply than its competitors operating in areas with better general economic conditions.

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### 7.2.2 Contract Requirements

*Introduction.* Contract requirements include more than just product requirements. They include any element of the solicitation or contract that defines what the contractor must do to complete the contract successfully. Changes in requirements and defective requirements can both affect price analysis comparisons.

*Defective Requirements.* The different elements of the solicitation/contract are termed defective when they do not adequately describe contract requirements. A contract should define, **who, what, when, where, and how** for any task that must be performed under the contract. If the contract is not clear, or the requirements are open to interpretation, widely different interpretations may result. If contract terms conflict, the contract may be impossible to perform.

*Changes in Contract Requirements.* Changes in contract terms can be particularly important when you use historical

prices as a comparison base to determine price reasonableness. Changes in type of contract, f.o.b. point, delivery requirements, quantities, and other terms can affect the contractor's cost and risk.

*Effect on Contract Pricing.* Contract requirements have a substantial effect on contract pricing:

- **Defective Requirements.** If requirements are unclear or conflict, firms may attempt to guess what the Government really wants. Some may underestimate, and others may overestimate actual requirements. The result may be a wide range of prices, depending on the interpretation of the individual offeror.

Some firms may even attempt to "game" the offer by assuming the lowest requirement possible in the belief that a contract change will be required to correct the conflict. Remember, judges normally interpret disputes over contract ambiguities and conflicts against the writer of the contract. In Government contracting, the Government writes the contract.

- **Requirements Changes.** Any element that will affect contractor cost or risk will also affect contract price. Changes from historical contract terms that increase cost or risk should increase price. Changes from historical terms that decrease cost or risk should decrease contract price.

## Ch 8 - Price-Related Decisions in Sealed Bidding

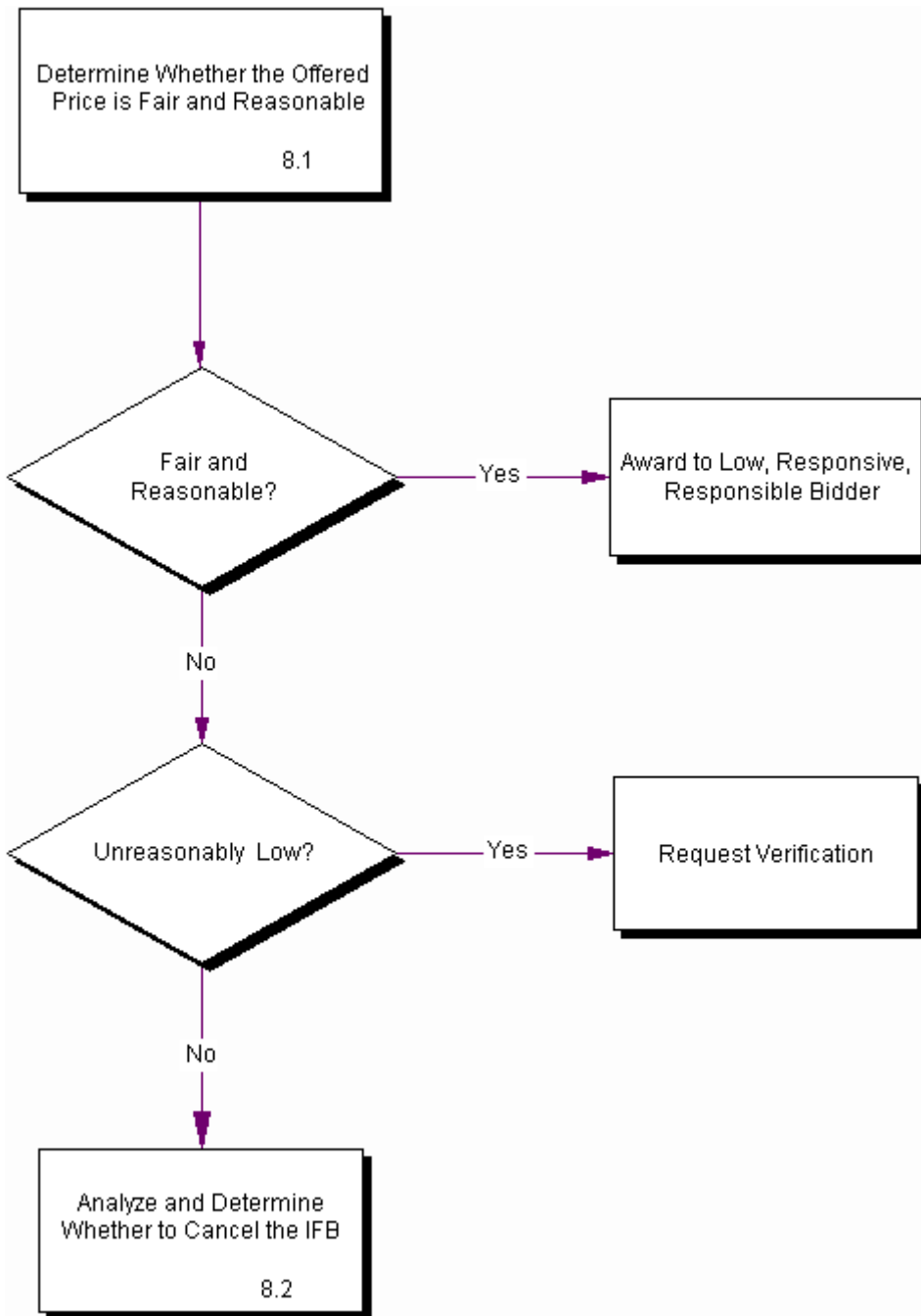
- 8.0 - [Chapter Introduction](#)
  - 8.1 - [Examine Individual Bids](#)
    - 8.1.1 - [Suspected Mistakes In Bids](#)
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  - 8.2 - [Determine Need To Cancel The IFB](#)
    - 8.2.1 - [Price-Related Reasons For Canceling The IFB](#)
    - 8.2.2 - [Negotiation After Cancellation](#)
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### **8.0 Chapter Introduction**

*Introduction* ([FAR 14.404-1](#) and [14.404-2](#)). To maintain the integrity of sealed bidding as a method of procurement, you must award to that responsible bidder which submitted the lowest responsive bid, as determined by applying the IFB's price-related factors. However, this general rule does not hold if you have reason to believe that the low bid is:

The result of a mistake by the bidder, Materially unbalanced, or Otherwise unreasonable as to price.

*Price-Related Decision Process.* The figure below depicts the process involved in making price-related decisions in sealed bidding.



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## 8.1 Examine Individual Bids

This section covers the following topics:

- 8.1.1 - [Suspected Mistakes In Bids](#)
- 8.1.2 - [Unbalanced Bids](#)

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### 8.1.1 Suspected Mistakes In Bids

*Unexpectedly Low Bids* ([FAR 14.404-2\(f\)](#)). What if the low bid is well below all other bids? What if the low bid is well below your estimate of the should-pay price? The FAR states that "any bid may be rejected if the contracting officer determines in writing that it is unreasonable as to price. Unreasonableness of price includes not only the total price of the bid, but the prices for individual line items as well." To determine whether an unexpectedly low bid is unreasonable, use the FAR "mistake in bid" procedure.

*Examining Bids for Mistakes* ([FAR 14.407](#)). After the bid opening, examine all bids for mistakes. Look for two kinds of mistakes:

- Apparent clerical errors; and
- Other indications of error -- such as a bid price that is far out of line with other bids or with the dollar amount determined by the contracting officer to be reasonable.

If you suspect that the bidder has erred, request verification of the bid from the bidder. This is your opportunity to talk with (and even meet) the bidder to find out why the bid price is so low. The bidder may, at this point, admit to having made a mistake in preparing the bid. Or the bidder may stand by the bid price. In either case, the burden of proof is on the bidder.

*Correcting Apparent Clerical Mistakes* ([FAR 14.407-2](#)). When you examine bids, you may spot a clerical error apparent on the face of the bid. Examples of apparent clerical errors:

- Obvious misplacement of a decimal point.
- Obviously incorrect discounts (e.g., 1% 10 days, 2% 20 days, 5% 30 days).
- Obvious reversal of the price f.o.b. origin, and the price f.o.b. destination.

The contracting officer may correct, before award, any clerical error which is apparent on the face of the bid. Follow this 3-step process:

1. Ask the bidder to verify the intended bid.
2. Attach the bidder's verification to the original bid and a copy of the verification to the duplicate bid.
3. Reflect the corrected price in the award document.

*Other Suspected or Alleged Mistakes* ([FAR 14.407-3\(g\)\(1\)](#)). If you suspect that the bidder made a less obvious mistake, such as grossly underestimating the cost of doing the work, immediately ask the bidder to verify the bid. Your action must be sufficient to reasonably assure that the bid is correct or to elicit an admission of a mistake by the bidder.

To put a bidder on notice of the suspected mistake, advise the bidder, as appropriate:

- That its bid is so much lower than the other bids or the Government's estimate as to indicate the possibility of error.
- Of important or unusual characteristics associated with the Government requirements,
- Changes in the requirements from those of previous acquisitions, or
- Any other information, proper for disclosure, that leads you to suspect a mistake.

After you have raised the possibility of a mistake to the bidder, the bidder may take one of three courses of action:

- Allege that a mistake was made and request permission to correct the mistake.
- Allege that a mistake was made and request permission to withdraw the bid.
- Verify the original bid.

*Clear and Convincing Evidence* ([FAR 14.407-3\(g\)\(2\)](#)). If a bidder alleges that a mistake was made, the bidder must submit a written request to withdraw or modify the bid supported by statements (sworn, if possible) and by clear and convincing evidence of the mistake.

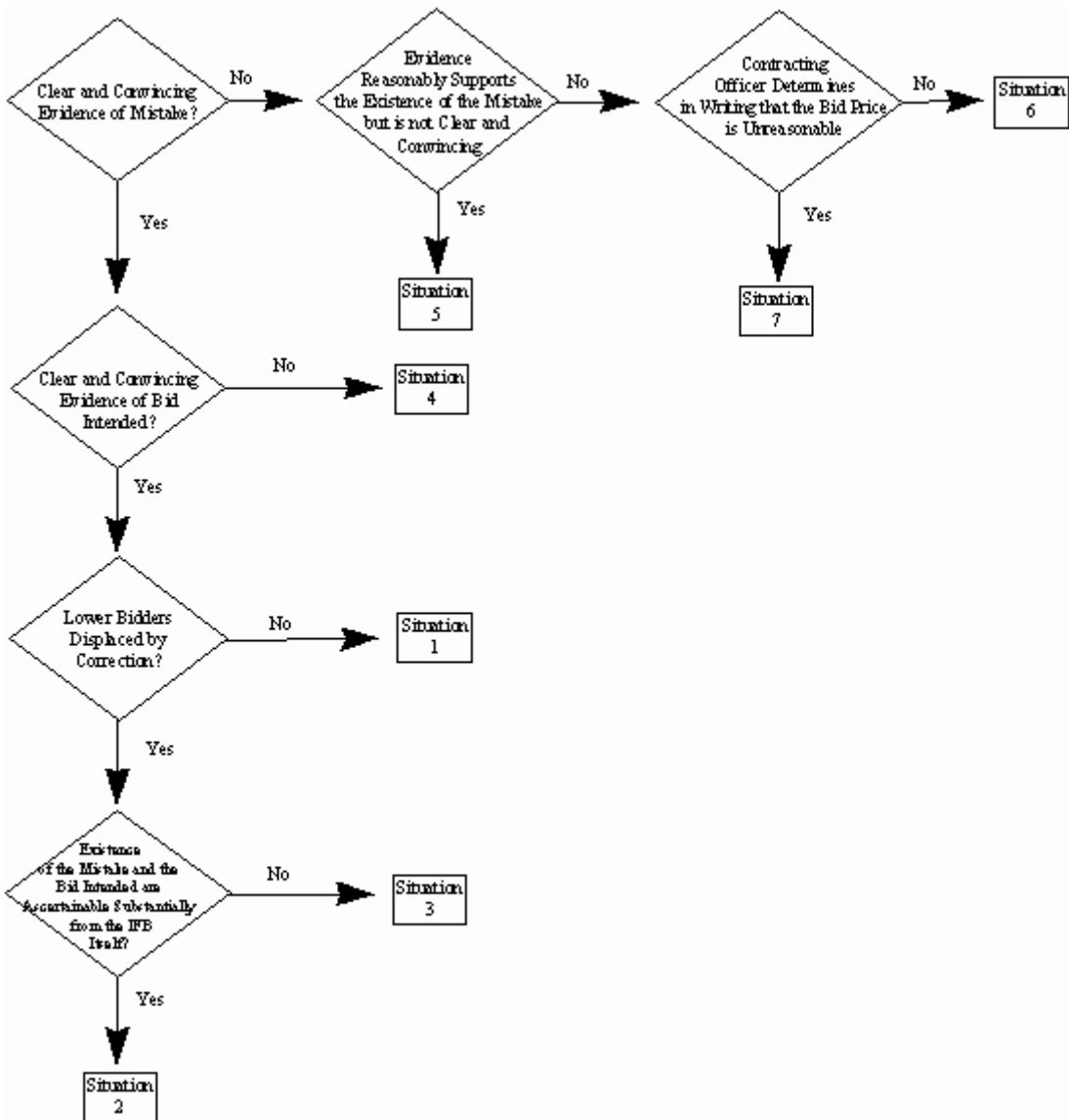
***What constitutes clear and convincing evidence?***



All pertinent evidence establishing the existence of the error, the manner in which it occurred, and the bid actually intended. Examples of such evidence include:

- The bidder's file copy of the bid.
- The original work sheets and other data used in preparing the bid.
- Subcontractors' quotations, if any.
- Published price lists.

*Bid Verification Flow Chart* ([FAR 14.407-3](#)). The flow chart below outlines the analysis of prices involved when a bidder requests permission to correct an alleged mistake in bid. The situations identified in this flow chart relate to the situations identified in the table that follows the flow chart.



*Bidder Requests Correction* ([FAR 14.407-3](#)). The following table documents authorized Government courses of action, given the circumstances of the alleged mistake. Each agency will publish any delegation of agency head authority. For example, in the Department of Defense, delegation of agency head authority is defined in DFARS.

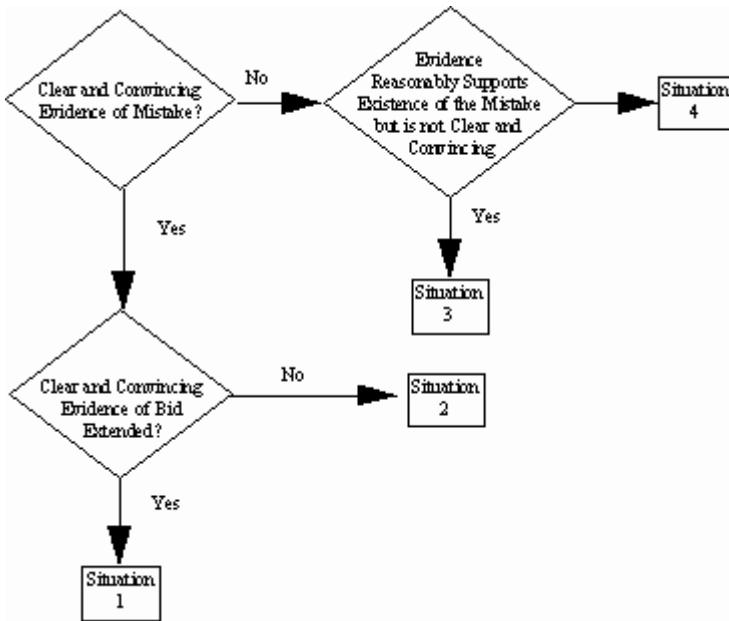
Bidder Requests Permission to Correct the Mistake		
Situation	If	Then
1 FAR	You have clear and convincing evidence of a	Agency head, or delegated official, may permit the bidder to

<p>14.407-3(a)</p>	<p>mistake</p> <p style="text-align: center;"><b>AND</b></p> <p>You have clear and convincing evidence of the bid intended</p> <p style="text-align: center;"><b>AND</b></p> <p>Lower bidders would NOT be displaced by the correction</p>	<p>CORRECT the mistake.</p>
<p>2</p> <p>FAR 14.407-3(a)</p>	<p>You have clear and convincing evidence of a mistake</p> <p style="text-align: center;"><b>AND</b></p> <p>You have clear and convincing evidence of the bid intended</p> <p style="text-align: center;"><b>AND</b></p> <p>Lower bidders WOULD BE DISPLACED by the correction</p> <p style="text-align: center;"><b>AND</b></p> <p>Existence of the mistake and the bid intended ARE ASCERTAINABLE substantially from the invitation and the bid itself</p>	<p>Agency head, or delegated official, may permit the bidder to CORRECT the mistake.</p>
<p>3</p> <p><u>FAR 14.407-3(a)</u></p>	<p>You have clear and convincing evidence of mistake</p> <p style="text-align: center;"><b>AND</b></p> <p>You have clear and convincing evidence of</p>	<p>The bidder SHALL NOT BE PERMITTED TO CORRECT the mistake.</p>

	<p>the bid intended</p> <p style="text-align: center;"><b>AND</b></p> <p>Lower bidders WOULD BE DISPLACED by the correction</p> <p style="text-align: center;"><b>BUT</b></p> <p>Existence of the mistake and the bid intended are NOT ASCERTAINABLE substantially from the invitation and the bid itself</p>	
<p>4</p> <p><a href="#"><u>FAR 14.407-3(c)</u></a></p>	<p>You have clear and convincing evidence of mistake</p> <p style="text-align: center;"><b>AND</b></p> <p>There is NO clear and convincing evidence of the bid intended</p>	<p>An official above the contracting officer may permit the bidder to WITHDRAW the bid.</p>
<p>5</p> <p><a href="#"><u>FAR 14.407-3(c)</u></a></p>	<p>The evidence reasonably supports the existence of the mistake but is NOT clear and convincing.</p>	<p>An official above the contracting officer may permit the bidder to WITHDRAW the bid.</p>
<p>6</p> <p><a href="#"><u>FAR 14.407-3(d)</u></a></p>	<p>The evidence does NOT reasonably support the existence of a mistake</p> <p style="text-align: center;"><b>AND</b></p> <p>The contracting officer has determined that the bid price is reasonable</p>	<p>Agency head, or delegated official, may determine that the bid can be NEITHER WITHDRAWN NOR CORRECTED.</p>
<p>7</p> <p><a href="#"><u>FAR 14.407-3(g)</u></a></p>	<p>The evidence does NOT reasonably support the existence of a mistake</p> <p style="text-align: center;"><b>AND</b></p> <p>The contracting officer has</p>	<p>Contracting officer must reject the bid as unreasonable</p>

	determined that the bid price is unreasonable	
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*Bid Verification Flow Chart* (FAR 14.407-3). The flow chart below outlines the analysis of prices involved when a bidder requests permission to withdraw an alleged mistake in bid. The situations identified in this flow chart relate to the situations identified in the table that follows the flow chart.



*Bidder Requests Withdrawal* (FAR 14.407-3). The table below documents authorized Government courses of action, given the listed circumstances of the alleged mistake. Each agency will publish any delegation of agency head authority. For example, in the Department of Defense, delegation of agency head authority is defined in DFARS.

<b>Bidder Requests Permission to Withdraw the Bid</b>		
<b>Situation</b>	<b>If</b>	<b>Then</b>
1 <a href="#">FAR</a>	You have clear and convincing evidence of	The agency head, or delegated official, may determine to CORRECT the

<p><a href="#"><u>14.407-3(b)</u></a></p>	<p>mistake</p> <p style="text-align: center;"><b>AND</b></p> <p>You have clear and convincing evidence of the bid intended</p> <p style="text-align: center;"><b>AND</b></p> <p>The bid, both as corrected and uncorrected, is the lowest received.</p>	<p>bid and NOT PERMIT WITHDRAWAL.</p>
<p>2</p> <p><a href="#"><u>FAR 14.407-3(c)</u></a></p>	<p>You have clear and convincing evidence of mistake</p> <p style="text-align: center;"><b>BUT</b></p> <p>Evidence of the bid intended is NOT clear and convincing</p>	<p>An official above the contracting officer may permit the bidder to WITHDRAW the bid.</p>
<p>3</p> <p><a href="#"><u>FAR 14.407-3(c)</u></a></p>	<p>The evidence reasonably supports the existence of the mistake but is NOT clear and convincing</p>	<p>An official above the contracting officer may permit the bidder to WITHDRAW the bid.</p>
<p>4</p> <p><a href="#"><u>FAR 14.407-3(d)</u></a></p>	<p>The evidence does NOT reasonably support the existence of the mistake</p> <p style="text-align: center;"><b>AND</b></p>	<p>Agency head, or delegated official, may determine that the bid can be NEITHER WITHDRAWN NOR CORRECTED.</p>

	The contracting officer has determined that the bid price is reasonable	
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*Bidder Verifies Bid as Submitted* (FAR 14.407-3(g)(5)). The table below documents authorized Government courses of action if the bidder verifies its original bid and denies that a mistake was made.

<b>Bidder Verifies Bid As Submitted</b>		
<b>Situation</b>	<b>If</b>	<b>Then</b>
1  <a href="#"><u>FAR 14.407-3(g)(5)</u></a>	<p>The dollar amount of the low bid is far out of line with:</p> <ul style="list-style-type: none"> <li>• The dollar amounts of other bids received, or</li> <li>• The Government price estimate, or</li> <li>• The dollar amount determined by the contracting officer to be reasonable.</li> </ul>	The contracting officer should consider rejecting the bid as unfair to the bidder and the other bonafide bidders.
2  <a href="#"><u>FAR 14.407-3(g)(5)</u></a>	<p>There are other clear indications of error, such as low bidder inability or unwillingness to:</p> <ul style="list-style-type: none"> <li>• Demonstrate a clear understanding of contract requirements.</li> <li>• Present original work sheets that support the reasonableness of</li> </ul>	Note: Fully document attempts made to obtain the information required to determine bid fairness and the action taken with respect to the suspect bid.

	<p>the bid price</p> <ul style="list-style-type: none"> <li>• Explain how the work can be completed at the bid price.</li> </ul>	
<p>3</p> <p><a href="#">FAR</a> <a href="#">14.407-3(g)(5)</a></p>	<p>Neither Situation 1 or 2 exist</p>	<p>The contracting officer should consider the bid as submitted.</p>

The following are summaries of two Comptroller General decisions related to contracting officer decisions to reject offers as unfair to the bidder or to other authorized bidders (Pamfilis Painting, Inc., CGEN B-237968, April 3, 1990, TLC Financial Grp., CGEN B-237384, January 26, 1990, and VA - Adv. Decision, CGEN B-225815.2, October 15, 1987).

Decision Summary 1. Pamfilis Painting, Inc.

The contracting officer suspected a mistake in Pamfilis's bid because it was 44% below the government estimate. Three bid verification meetings were held with Pamfilis. During these meetings, agency officials reviewed the contract requirements, specifications, government estimate, and bid submission with Pamfilis to en-sure that the firm's bid represented a clear understanding of the scope of work. It be-came apparent that Pamfilis did not understand the requirements of the IFB. As a result, Pamfilis had not priced several essential items of work required by the IFB, and the bid contained numerous errors based on Pamfilis's erroneous interpretation of the IFB. The contracting officer rejected Pamfilis's bid.

The CGEN concluded that "A contracting officer's decision to reject an apparently mistaken bid under ... [FAR] 14.407-3(g)(5) is subject to question only where it is shown to be unreasonable. See TLC Financial Group, B-237384, Jan. 26, 1990, 90-1 CPD P 116; Veterans Administration - Advance Decision, B-225815.2, Oct. 15, 1987, 87-2 CPD P 362. **Moreover, an obviously erroneous bid may not be accepted even if it is verified by the**



**bidder.**" (emphasis added).

Decision Summary 2. TLC Financial Group.

TLC bid \$500,000 for a line item. This bid was 68% below the Government estimate and 64% below the second low bid. Government officials met with TLC officials, to verify whether TLC's bid was based on a full understanding of the scope of work and to review work sheets used by TLC to calculate its bid price.

Despite several requests, TLC did not submit its bid work sheets. However, based on information contained in TLC's bid and discussions at the meeting, the contracting officer determined that TLC had misinterpreted the scope of work required by the IFB, resulting in an unrealistically low bid.

The contracting officer concluded that TLC's bid was clearly a mistake and determined that award to TLC would be unreasonable and unfair to the other bidders under FAR 14.407-3(g)(5). The Navy therefore rejected TLC's bid. The Comptroller General upheld Navy's decision.

*Determine the Reasonableness of a Low Bid.* As demonstrated in the above cases, bid verification gives you the opportunity to investigate the reasons for a bid that is "far out of line" with other bids or your should-pay estimate. Reject such a bid when the evidence supports a finding that the bidder is nonresponsible, misunderstands the requirement, or has underestimated the costs and risks of performance. Accept the bid when the evidence establishes that the bidder can ably perform at the price bid (e.g., because the bidder is the most efficient performer or has knowingly submitted a below-cost bid and has the financial reserves to cover probable losses). You may have to cancel the IFB if your investigation uncovers a Government mistake (e.g., a defective requirement).

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### **8.1.2 Unbalanced Bids**

*Identify Unbalanced Pricing* ([FAR 14.404-2\(g\)](#) and [15.404-1\(g\)](#)). Analyze all bids with separately priced line items or subline items to determine if prices are unbalanced.

Unbalanced pricing exists when, despite an acceptable total evaluated price, the price of one or more contract line items is significantly over or understated as indicated by application of cost or price analysis techniques.

*Consider Risk to the Government.* Whenever you identify unbalance pricing, you must consider the probability that award to the bidder with the unbalanced price will:

- Increase contract performance risk; or
- Result in payment of unreasonably high prices.

The risk is normally greatest when:

- Startup work, mobilization, first articles, or first article testing are separate line items;
- Base quantities and option quantities are separate line items; or
- The evaluated price is the aggregate of estimated quantities to be ordered under separate line items of an indefinite-quantity contract.

*Reject Bids with Unacceptable Risk.* You may reject a bid if the contracting officer determines that the lack of balance poses an unacceptable risk to the Government. Such bids are generally described as materially unbalanced. A bid is **materially unbalanced** IF it is **mathematically unbalanced** AND one of the following is true:

- There is reasonable doubt that the lowest evaluated bid will actually result in the lowest cost to the Government.
- The offer is so grossly unbalanced that its acceptance would be tantamount to allowing an advanced payment.

A bid is **mathematically unbalanced** IF it is based on prices that are significantly less than cost for some line items AND significantly more than cost for other line items.

*Identification of Materially Unbalanced Bids.* In sealed bidding, you must normally use price analysis to determine if bids are materially unbalanced.

**For example.** You could use the following price analysis comparisons to determine if bid prices for a contract

requiring both first article testing and production are materially unbalanced:

- Compare all bids to determine if the structure of any bid differs significantly from the structure of other bids concerning the pricing for first articles and production units. (Does one bid contain a first article price that is significantly greater than other bids, while production units are significantly cheaper?)
- Compare the production unit price with the price of similar production units.
- Compare the difference between the first article price and the production unit price, with the price differences experienced between first article and production units on contracts for similar items.
- Compare the difference between the first article price and the production unit price, with the Independent Government Estimate of the price of first article test effort, excluding the price of the units required for test.
- Compare the price for the first article and the price for production units with the Independent Government Estimates.

*Document Analysis of Unbalanced Bids.* Carefully document your analysis of bids that appear to be materially unbalanced. This documentation will form the basis for any determinations and Government actions.

- If analysis supports a determination that unbalanced pricing poses an unacceptable risk to the Government, the documentation will serve as a basis for rejecting the bid.
- If analysis shows that the risk is acceptable, the documentation will provide information on the facts as they were considered during analysis.

*Example of a Materially Unbalanced Bid* (Person Sys. Integ., Ltd., CGEN B-236790.2 May 20, 1990).

In the case of Person System Integration, Ltd., the CGEN found that the PSI bid was unbalanced because the bid was front-loaded. A fixed-price service contract was to be awarded for a firm requirement for a 60-day mobilization period, an initial 10-month option period, 3 subsequent option years, an additional 10-month option

period, and a final 60-day transition option period.

The CGEN found that PSI's price for the 60-day mobilization period was 63 percent of the price for a 1-year performance period and 22 percent of the potential 5-year contract. PSI stated that the amount included the cost of extensive advance purchases of replacement parts. However, the CGEN found the amount to be so far in excess of the actual value of the items or services to be provided that acceptance of the bid would provide a disincentive for the Government to administer (i.e., terminate) the contract after the enhanced payments were made.

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## 8.2 Determine Need To Cancel The IFB

- 8.2.1 - [Price-Related Reasons For Canceling The IFB](#)
- 8.2.2 - [Negotiation After Cancellation](#)

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### 8.2.1 Price-Related Reasons For Canceling The IFB

*Reasons for Canceling IFBs* ([FAR 14.404-1\(b\)](#) and [14.404-1\(c\)](#)). FAR provides eleven possible reasons for canceling an invitation for bid (IFB) after bid opening. The highlighted paragraphs below show that five of eleven are clearly pricing-related. Other reasons for cancellation (e.g., cancellation clearly in the public interest) could also be related to pricing concerns.

(b) When it is determined before award but after opening that the requirements of FAR 11.201 (relating to the availability and identification of specifications) have not been met, the invitation shall be canceled.

(c) Invitations may be canceled and all bids rejected before award but after opening when, consistent with subparagraph (a)(1) above, the agency head determines in writing that-

(1) Inadequate or ambiguous specifications were cited in the invitation;

- (2) Specifications have been revised;
- (3) The supplies or services being contracted for are no longer required;
- (4) The invitation did not provide for consideration of all factors of cost to the Government, such as cost of transporting Government-furnished property to bidders' plants;
- (5) Bids received indicate that the needs of the Government can be satisfied by a less expensive article differing from that for which the bids were invited;
- (6) All otherwise acceptable bids received are at unreasonable prices, or only one bid is received and the contracting officer cannot determine the reasonableness of the bid price;
- (7) The bids were not independently arrived at in open competition, were collusive, or were submitted in bad faith (see Subpart 3.3 for reports to be made to the Department of Justice);
- (8) No responsive bid had been received from a responsible bidder;
- (9) A cost comparison as prescribed in OMB Circular A-76 and Subpart 7.3 shows that performance by the Government is more economical; or
- (10) For other reasons, cancellation is clearly in the public's interest.

*Situations Requiring Cancellation ([FAR 14.404-1\(b\)&\(c\)](#)).*

The following table summarizes the five price-related reasons for canceling the solicitation after bid opening, how to avoid each situation and analyze it when it occurs.

Possible Cancellation Situation	Avoiding the Situation	Analyzing the Situation When It Occurs
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<p>IFB Did Not Consider All Factors of Cost</p>	<p>In earlier chapters, you learned about selecting and applying price-related factors in making the award decision. In preparing a solicitation, you should consider those principles. Doing so should help you avoid most situations in which you must cancel an IFB for failing to properly consider all factors of cost to the Government.</p> <p>During the solicitation period, you must be alert to price-related factors that are not considered in the solicitation. Carefully review comments and questions received from potential bidders to identify such factors.</p>	<p>In price analysis, you must apply the price-related factors included in the award criteria.</p> <p>During your analysis, you must be alert to identifying price-related factors that were not properly considered in developing the award criteria and to identifying important price-related factors that were not considered at all.</p>
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<p>Government Needs Can Be Satisfied with Less Expensive Product</p>	<p>Establish a best estimate of price or value as part of acquisition planning. In that process, you should carefully review the purchase request estimate, analyze market data and acquisition histories, and identify and collect other related pricing data. During that review, you must be alert to alternative products that will meet Government needs at a lower total cost.</p> <p>If you identify a lower priced product, coordinate with the requiring activity to assure that the product is acceptable. If it is, assure that the solicitation is modified to permit bidders to furnish the product identified.</p> <p>Develop solicitations that:</p> <ul style="list-style-type: none"> <li>• Maximizes competition;</li> <li>• Maximizes use of commercial products; and</li> <li>• Eliminates unnecessary costs.</li> </ul> <p>During the solicitation period, you must be alert to alternative products.</p>	<p>During your efforts to determine price reasonableness, you should consider pricing yardsticks and cost estimating relationships based on the prices of similar items. You may also request Government technical personnel to perform a visual or value analysis.</p> <p>Analysis could identify a product, other than the product for which bids were solicited, that will meet Government requirements at a lower price.</p> <p>Review the impact of the specification on bids, bearing in mind that revising the specification can be a reason for canceling the solicitation.</p>
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<p>Unacceptable Prices for Otherwise Acceptable Bids</p>	<p>Maximize price competition. Efforts such as source development, proper selection of business terms, and appropriate publicizing of the purchase should maximize price competition. Adequate price competition should encourage bidders to submit fair and reasonable prices.</p>	<p>Analyze significant differences between different estimates of price reasonableness and between the estimates and actual prices. Both vendor differences and market differences must be carefully explored before you determine that a price is so unacceptably high as to justify cancellation.</p>
<p>Bids Not Arrived at Independently</p>	<p>Encourage independent bid development.</p> <p>Take special care to avoid brand name purchase descriptions and contract requirements that require all bidders to use a key component or technology controlled by one of the competitors. Such requirements make independent bid development a practical impossibility.</p> <p>During the solicitation period, be alert to potential bidder comments concerning specifications that will restrict independent competition.</p>	<p>Earlier in the text, you learned about practices and events that indicate collusive practices and potential antitrust violations. You also learned about the importance of thorough review before making any allegation of collusive practices.</p>
<p>More Economical Government Performance  (<a href="#">FAR 7.304(b)</a>),</p>	<p>The Government is always a potential competitor to perform required services. If you have reason to believe that the bid price will be higher than the cost of Government</p>	<p>If a cost estimate has been prepared and the appropriate notices included in the IFB:</p> <p>Open the cost</p>



[7.306](#), and  
[52.207-1](#))

performance, request that Government personnel prepare a cost estimate and include the FAR Notice of Cost Comparison (Sealed-Bid), in the IFB. This action will put potential bidders on notice that the requirement may be performed in-house and encourage price competition.

comparison form containing the Government performance cost estimate at the time of bid opening.

After evaluation of bids and determination of low bidder responsibility, provide the low bid price to the organization that prepared the Independent Government Estimate for final cost comparison.

Provide cost comparison results to the agency authority responsible for deciding between Government and contract performance.

If the cost estimate has not been prepared under FAR requirements and the appropriate notices have not been included in the IFB, the solicitation cannot be formally compared with the cost of Government performance.

The contract price must still be determined

		<p>reasonable based on other bases of price analysis. If the price cannot be determined to be reasonable, consider canceling the solicitation based on unreasonable prices.</p> <p>If you believe that Government performance would be more economical, schedule the requirement for a formal cost comparison.</p>
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*Decision to Cancel the Invitation.* In some circumstances, when you are determining if the invitation should be canceled, you will need to consider the relative advantages and disadvantages to the Government. In other circumstances, the pricing concern is so great that you should cancel the solicitation whenever the situation is confirmed to exist.

<b>Possible Cancellation Situation</b>	<b>Recommend Invitation Cancellation If ...</b>
IFB Did Not Consider All Factors of Cost	<p>One of the following statements about the IFB is true:</p> <ul style="list-style-type: none"> <li>• It did not consider all price-related factors, or</li> <li>• It did not properly consider all price-related factors</li> </ul> <p style="text-align: center;"><b>AND</b></p> <p>The lack of proper consideration will affect selection of the successful bidder,</p> <p style="text-align: center;"><b>AND</b></p>

	The anticipated total cost to the Government for canceling the solicitation and soliciting new bids with revised award criteria is less than the cost for proceeding with award under the current award criteria.
Government Needs Can be Satisfied with Less Expensive Product	An alternative product will satisfy the needs of the Government at a lower price,  <b>AND</b>  The total cost to the Government for canceling the solicitation and resolicitation is less than the cost for proceeding with award under the current award criteria.
Unacceptable Prices for Otherwise Acceptable Bids	The Government's requirement can be deferred,  <b>OR</b>  There is reason to believe that canceling and resoliciting or negotiating would result in an acceptable price <sup>1</sup>
Bids Not Arrived at Independently	Available information demonstrates that bids were not arrived at independently.
More Economical Government Performance  ( <a href="#">FAR 7.304</a> , <a href="#">7.305</a> , and <a href="#">OMB Circ A-76</a> )	The cost estimate for Government performance was prepared prior to bid opening,  <b>AND</b>  The appropriate notices were included in the solicitation,  <b>AND</b>  Cost comparison demonstrates sufficient savings, to warrant in-house Government performance,  <b>AND</b>  The responsible agency official determines that performance by the Government is in the Government interest.

<sup>1</sup> Because you expect demand to decline relative to supply, or you expect to reenter the market at a more favorable point in the cycle, or you have plans for source development, or you plan to resolicit under business terms and conditions which are more in keeping with market norms, etc.

*Document Your Decision.* Whenever you consider an invitation cancellation, you should document your analysis and decision process. Documentation is essential to support the decision by the agency head, or delegated official, to cancel an invitation for bids.

Documentation is also necessary when a determination is made not to cancel the solicitation. Buyers will later be able to use the information provided in acquisition planning to prevent similar situations and possible solicitation cancellations.

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### **8.2.2 Negotiation After Cancellation**

*Introduction.* Negotiation after IFB cancellation is authorized in two of the situations where the invitation may be canceled for pricing-related reasons. To use negotiations to complete the sealed-bid acquisition, the agency head, or delegated official, must determine that the invitation is to be canceled and that the use of negotiations is appropriate to complete the acquisition.

*Possible Cancellation Situations* ([FAR 14.404-1\(e\)](#) and [DFARS 214.404-1](#)). The table below identifies five possible cancellation situations and describes whether acquisition through negotiation is authorized after IFB cancellation.

<b>Possible Cancellation Situation</b>	<b>Is completion of the Acquisition through Negotiation Authorized after IFB Cancellation?</b>
IFB Did Not Consider All Factors of Cost	No, acquisition completion through negotiation is not authorized. Proceed with a new acquisition.
Government Needs Can be Satisfied with Less Expensive	No, acquisition completion through negotiation is not authorized. Proceed with a new acquisition.

Product	
Unacceptable Prices for Otherwise Acceptable Bids	Yes, if authorized by the agency head, or delegated official, in the determination to cancel the IFB.
Bids Not Arrived at Independently	Yes, if authorized by the agency head, or delegated official, in the determination to cancel the IFB.
More Economical Government Performance	Not applicable.

*Make Award without Issuing a New Solicitation* ([FAR 14.404-1\(f\)](#)). When the agency head has determined that the IFB should be canceled and that the use of negotiations is in the Government's interest, the contracting officer may award the contract without issuing a new solicitation, provided:

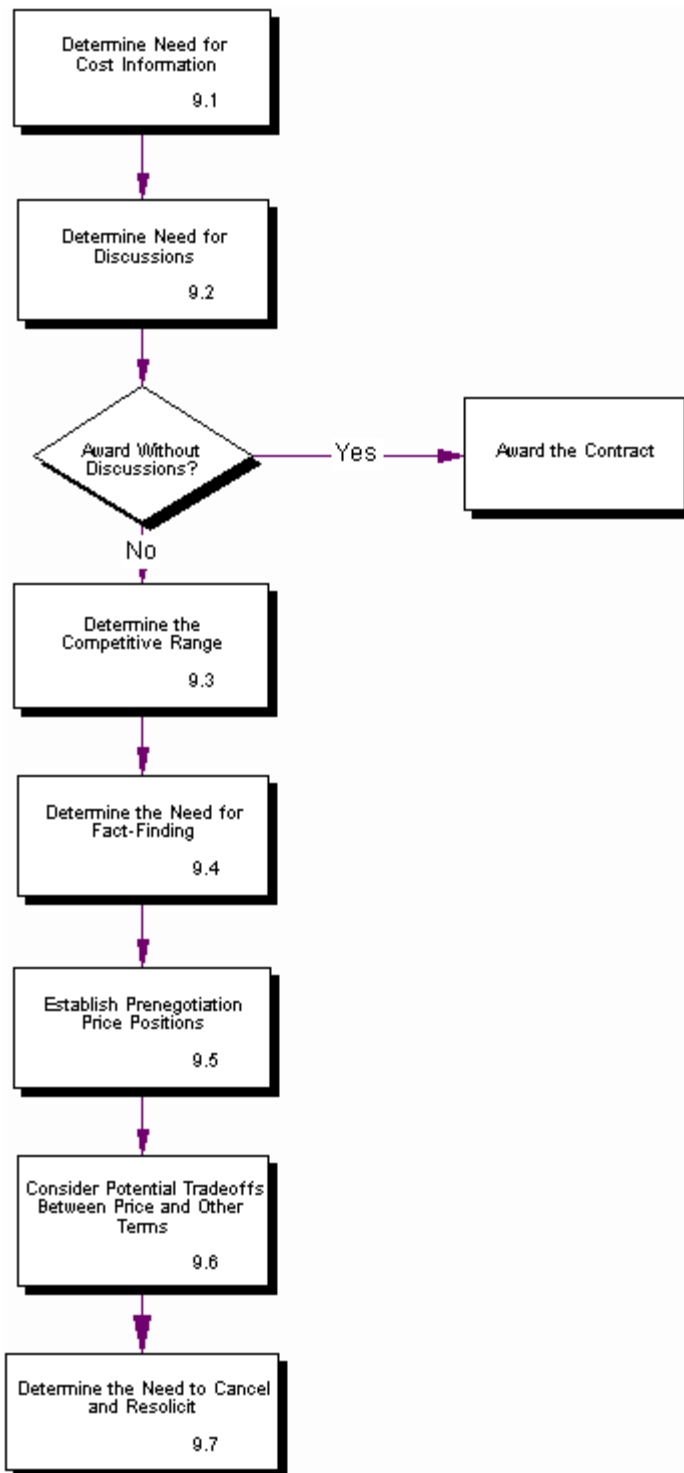
- Each responsible bidder in the sealed bid acquisition has been given notice that negotiations will be conducted and has been given an opportunity to participate in the negotiations; and
- The award is made to the responsible bidder offering the lowest negotiated price.

## Ch 9 - Price-Related Decisions in Negotiations

- 9.0 - [Introduction](#)
  - 9.1 - [Determine The Need For Cost Information](#)
  - 9.2 - [Determine The Need For Discussions](#)
  - 9.3 - [Determine The Competitive Range](#)
  - 9.4 - [Determine The Need For Prenegotiation Exchanges](#)
  - 9.5 - [Establish Pre-Negotiation Price Positions](#)
    - 9.5.1 - [Analyze Risk](#)
    - 9.5.2 - [Develop Negotiation Positions](#)
  - 9.6 - [Consider Potential Trade-Offs Between Price And Other Terms](#)
  - 9.7 - [Determine The Need To Cancel And Resolicit](#)
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### **9.0 Introduction**

*Price-Related Decision Process.* The figure below depicts the process involved in making price-related decisions in negotiation.



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## 9.1 Determine The Need For Cost Information

*Situations Where Additional Information Might Be Necessary*  
([FAR 15.402](#), [15.403-3](#), and [15.403-4](#)).

After you receive a proposal and perform your initial evaluation, you may determine that you need additional information on offeror costs before you can make a final decision on price reasonableness. You can require an offeror to provide information on proposed costs prior to contract award. However, bear in mind that the offeror will need additional time to produce the information and that you will need additional time to analyze the information-which will probably delay award. Hence, requesting cost information should be a last resort when one of the following situations exists:

- You cannot except the offeror from the requirement for cost or pricing data.

**Example 1: Offeror request for exception denied.** Suppose you are using negotiation procedures and received only one offer. That offer exceeded the cost or pricing data threshold. The offeror requested an exception from the requirements for cost or pricing data, but you determined that the offer did not qualify for the exception requested or any other exception. In such situations, you must require submission of cost or pricing data.

**Example 2: Single offer over the cost or pricing data threshold.** Suppose you expected adequate price competition, but received only one offer. That offer exceeded the cost or pricing data threshold. After further market research, you determined that you were wrong to expect price competition, because only one firm makes and sells an item that meets Government requirements. If you determine that no other exception applies, you must require submission of cost or pricing data. However, if any exception does apply, you must not require cost or pricing data.

- Price analysis alone is not sufficient to establish the reasonableness of proposed prices.

**Example 1: Competition cost realism.** Suppose you are using negotiation procedures for an acquisition with an estimated price in excess of the cost or pricing data threshold. You received two proposals but you are not convinced that the price of the apparent successful offer is fair and reasonable. Price comparisons between the competitive



offers are not very useful because the two offerors submitted such different technical proposals in response to the contract performance requirements. After comparing the price of the apparent successful offer with historical data and commercial prices, you are not convinced that it is reasonable. In such situations, you can require the offeror(s) to submit information other than cost or pricing data to support your pricing decision.

**Example 2: Single offer below the cost or pricing data threshold.** Suppose that you did not require the offeror to submit cost or pricing data because the estimated acquisition price did not exceed the cost or pricing data threshold. Now the offeror has submitted a proposal with a price that (while below the threshold) appears unreasonable, based on comparison with commercial prices and the item price history. In such situations, you could require the offeror to submit cost information other than cost or pricing data. Alternatively, you might require cost or pricing data if the proposal exceeds the simplified acquisition threshold and the requirement is authorized by the head of the contracting activity.

**Example 3: Single offer in simplified acquisition.** Suppose that you are using simplified acquisition procedures and the only offeror submitted a proposal with a price that appears unreasonable, based on comparison with commercial prices and the item price history. In such situations, you could require the offeror to submit cost information other than cost or pricing data. You could not require cost or pricing data because the anticipated acquisition price is less than the simplified acquisition threshold.

*Requiring Cost or Pricing Data* ([FAR 15.403](#), and FAR Table 15-2). You have already learned that you:

- MUST NOT REQUIRE cost or pricing data when an exception applies.
- MUST REQUIRE an offeror to submit cost or pricing data for non-competitive contract actions over the cost or pricing data threshold, when no exception applies.
- MAY REQUIRE an offeror to submit cost or pricing data for acquisitions below the cost or pricing data threshold but over the simplified acquisition threshold, when no exception applies and you have approval from the head of the contracting activity.

When you require cost or pricing data, the data should meet the general requirements of [FAR Table 15-2](#). Depending on the situation, the contracting officer may require data submission in:

- The format prescribed by Table 15-2;
- Another format prescribed by the contracting officer; or
- A format selected by the offeror.

*Requiring Information Other Than Cost or Pricing Data* ([FAR 15.403-3](#) and [15.403-5\(b\)](#)).

For noncompetitive acquisitions where the price is not set by law or regulation, minimum price information other than cost or pricing data must include appropriate information on the prices at which the same or similar items have been sold that is adequate to support price analysis. Requirements for cost information should be limited to specific areas of concern (e.g., the cost of high-cost material items). However, if necessary, the contracting officer may require cost information other than cost or pricing data to support the complete price offered.

Permit offerors to submit information other than cost or pricing data in a format selected by the offeror, unless the contracting officer decides that a specific format is essential.

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## 9.2 Determine The Need For Discussions

*When Not to Conduct Discussions with Offerors* ([FAR 15.209\(a\)\(1\)](#) and [52.215-1\(f\)\(4\)](#)). The standard FAR instructions to offerors for competitive acquisitions notify offerors that the Government intends to evaluate proposals and award a contract without discussions. As the contracting officer, you must determine the need for negotiations. **Do not conduct discussions with offerors unless they are necessary to identify the proposal that offers the best value to the Government based on the offer evaluation criteria.** For example, do not conduct discussions to squeeze lower prices from offerors when initial offers appear fair and reasonable.

If offerors know that award is likely to occur without negotiations, they will be encouraged to submit better offers initially. If they know that you will always negotiate, they may wait until your request for a final proposal revision (FPR) to submit a truly competitive price. Many offerors actually distrust the security of the competitive negotiation process and fear that their price will leak to competitors.

*When to Conduct Discussions with Offerors* ([FAR 15.215-1](#) and [52.215-1 Alt 1](#)). If the solicitation instructions to offerors notified offerors that the Government intends to evaluate proposals and award a contract after conducting discussions with offerors in the competitive range, you must conduct discussions.

If the solicitation instructions to offerors notified offerors that the Government intends to evaluate proposals and award a contract without discussions, you can conduct discussions if the contracting officer determines that discussions are necessary and documents the rationale for that decision in the contract file. Generally, the contracting officer should only consider such a determination when there is a question about which proposal truly offers the best value to the Government. For example, negotiations might be necessary to resolve concerns about the cost realism of a proposal that appears substantially under priced.

*Clarifications without Discussions* ([FAR 15.306\(a\)](#) and [14.407-2\(a\)](#)). Clarifications are limited exchanges, between the Government and offerors, that may occur when award without discussions is contemplated.

When award will be made without conducting discussions, you may give offerors an opportunity to clarify:

- Certain proposal aspects (e.g., the relevance of an offeror's past performance information and adverse past performance information to which the offeror has not previously had an opportunity to respond); or
- Apparent minor or clerical errors. Examples of minor or clerical errors include, but are not limited to:
  - Obvious misplacement of a decimal point;
  - Obviously incorrect discounts (e.g., 1 percent, 20 days, 5 percent, 30 days);

- o Obvious reversal of the price f.o.b. destination and price f.o.b. origin; or
- o Obvious mistake in designation of the unit.

Carefully document any proposal aspects or apparent errors requiring clarification and the actions taken to clarify the proposal. If any clarification would prejudice the interest of another offeror, you should conduct discussions with all offerors in the competitive range.

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### **9.3 Determine The Competitive Range**

*Competitive Range* ([FAR 15.306\(c\)](#)). Once you make the decision to negotiate, you must determine which firms will participate in discussions.

Identify firms to be included in the competitive range by evaluating each offer against the evaluation criteria enumerated in the solicitation.

- Establish a competitive range comprised of all the most highly rated proposals, unless the competitive range is further limited for purposes of efficiency.
- If the solicitation provides that the competitive range can be limited for purposes of efficiency, the contracting officer may determine that the number of most highly rated proposals that might otherwise be included in the competitive range exceeds the number at which an efficient competition can be conducted. Then the contracting officer may limit the number of proposals in the competitive range to the greatest number that will permit an efficient competition among the most highly rated proposals.

*Steps for Determining the Competitive Range* ([FAR 15.306\(c\)](#)). When you determine the competitive range, you should follow these steps:

1. **Evaluate All Proposals.** Evaluate all proposals considering all award criteria (price and technical) established in the solicitation.
2. **Identify Evaluation Score Groupings.** Identify the grouping, or arrangement, of evaluation scores for all proposals. This may be done by arranging the proposals

from highest to lowest score and then looking for breaks in the scores such that natural groupings of similar scores may be identified.

3. **Identify the Most Highly Rated Proposals.** Look for breaks in the evaluation ratings that separate the most highly rated proposals from the others. Identify the most highly rated proposals for possible inclusion in the competitive range. If all proposals are tightly grouped, you could include all proposals as highly rated. However, you must exclude proposals that are not highly rated.
4. **Determine Whether To Limit The Competitive Range.** When permitted by the solicitation, the contracting officer may determine to limit the number of most highly rated proposals that might otherwise be included in the competitive range to support more efficient competition. This determination should depend on the number of offerors initially included in the competitive range and the issues involved in the competitive discussions. For example, it may be possible to efficiently conduct discussions with 20 offerors if the issues are relatively simple. When complex issues are involved, efficient competition may require limiting the competitive range to five firms or less. The number of firms actually included should not be set arbitrarily (e.g., to five), but should be set after an evaluation of the proposal ratings and the complexity of the issues involved in the discussions.
5. **Notify Unsuccessful Offerors.** You must notify an unsuccessful offeror in writing as soon as practical after determining that the proposal is no longer eligible for award.

*Consider Price Reasonableness* ([FAR 15.305\(a\)](#) and [15.306\(c\)](#)). As you evaluate proposals to establish the competitive range, consider price reasonableness based on your should-pay price estimate(s). However, remember that price may only be one element in the proposal evaluation criteria.

*Consider Cost Realism* ([FAR 15.404-1\(d\)](#)). You must consider cost realism in evaluating proposal for any cost-reimbursement contract. For these contracts, your analysis should center on developing an estimate of most probable

cost. Remember that, for these contracts, final price will depend on final cost. An unrealistically low proposal could result in a unreasonably high final contract price.

You may consider cost realism in evaluating proposals for fixed-price contracts, particularly fixed-price incentive contracts. For these contracts, your analysis should center on evaluating the performance risk associated with an unrealistically low price. Proposed prices must not be adjusted, because the final contract price is either firm or limited on price, contract performance risk can increase substantially.

*Evaluation Practices to Avoid.* When determining the competitive range, you **should not**:

- Establish arbitrary limits on the competitive range based on comparisons with the proposal with the most favorable evaluation. For example, do not arbitrarily determine that all proposals with prices within 20 percent of the most favorably evaluated proposal will be included in the competitive range and all others excluded.
- Establish arbitrary limits on the competitive range based on the Independent Government Estimate or a preset evaluation score.
- Include any proposal in the competitive range if it is not among the most highly rated.

*Example of Proper Exclusion from Competitive Range* (Cadd Mgmt. Sys., Inc., CGEN B-239116, July 24, 1990).

In the matter of Cadd Management Systems, Inc., the CGEN found that Cadd had been properly excluded from the competitive range. Cadd protested the exclusion from the competitive range of its proposal under an RFP issued by the Department of Interior for engineering and drafting services at the Grand Coulee Dam. Cadd's proposal was excluded from the competitive range because Cadd's proposed price was so much higher than the prices of other proposals that received similar technical scores. The Department of Interior did not consider Cadd to have a reasonable chance of receiving an award. Cadd contended that in determining its price it relied on information not revealed to other offerors as to the true scope of the work, and thus Cadd was the only offeror whose price accurately reflected the

solicitation requirements. The CGEN found that the facts did not support the Cadd contention.

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#### **9.4 Determine The Need For Prenegotiation Exchanges**

*Prenegotiation Exchanges* ([FAR 15.306](#)). Prenegotiation exchanges include any dialogue between the Government and the contractor after proposal receipt and prior to contract negotiation. The Government objective is to identify and obtain available contractor information needed to complete proposal analysis. In addition, most types of prenegotiation exchanges also provide the contractor an opportunity to seek clarification of the Government's stated contract requirements.

- **Competitive Negotiations.** In competitive negotiations, there may be several different types of exchanges, each with its own unique rules:
  - Clarifications with the intent to award without discussions;
  - Communications with contractors before establishment of the competitive range; and
  - Exchanges after establishment of the competitive range but before negotiations.
- **Noncompetitive Negotiations.** In noncompetitive negotiations, exchanges after receipt of proposals and prior to negotiations are normally referred to as fact-finding.

*Information Already Available.* As you determine the need for a prenegotiation exchange, consider the information already available, including:

- The solicitation, unilateral contract modification, or any other document that instigated the contractor's proposal;
- The proposal and all information submitted by the contractor to support the proposal;
- Information from your market research concerning the product, the market, and any relevant acquisition history;
- Any relevant field pricing or audit analyses;
- In-house technical analyses; and
- Your initial analysis of the proposed price and, where appropriate, specific elements of cost.

*Clarifications* ([FAR 15.306\(a\)](#)). Clarifications are limited exchanges, between the Government and contractors, that may occur when the Government contemplates a competitive contract award without discussions. Remember that award may only be made without discussions when the solicitation states that the Government intends to evaluate proposals and make award without discussions.

Consider giving one or more contractors the opportunity to clarify certain aspects of proposals that may have an effect on the award decision. For example, a request for clarification might give the contractor an opportunity to:

- Clarify the relevance of a contractor's past performance information;
- Respond to adverse past performance information if the contractor has not previously had an opportunity to respond; or
- Resolve minor or clerical errors, such as:
  - Obvious misplacement of a decimal point in the proposed price;
  - Obviously incorrect prompt payment discount;
  - Obvious reversal of price f.o.b. destination and f.o.b. origin; or
  - Obvious error in designation of the product unit.

*Communications* ([FAR 15.306\(b\)](#)). Communications are exchanges, between the Government and contractors, after receipt of proposals, leading to establishment of the competitive range. Communications with a contractor are only authorized when the contractor is not clearly in or clearly out of the competitive range. Specifically, communications:

- Must be held with contractors whose past performance information is the determining factor preventing them from being placed within the competitive range. Such communications must address adverse past performance information to which the contractor has not had a prior opportunity to respond.
- May be held with other contractors whose exclusion from, or inclusion in, the competitive range is uncertain. They may be used to:
  - Enhance Government understanding of the proposal;
  - Allow reasonable interpretation of the proposal; or
  - Facilitate the Government's evaluation process.



- Must not be held with any contractor not in one of the situations described above.

The purpose of communications is to address issues that must be explored to determine whether a proposal should be placed in the competitive range.

- Use communications to address any adverse past performance information to which the contractor has not previously had an opportunity to comment.
- You may use communications to address:
  - Ambiguities in the proposal or other concerns (e.g., perceived deficiencies, weaknesses, errors, omissions, or mistakes); and
  - Information relating to relevant past performance.
- You must not use communications to permit the contractor to:
  - Cure proposal deficiencies or material omissions;
  - Materially alter the technical or cost elements of the proposal; and/or
  - Otherwise revise the proposal.

*Exchanges After Establishment of the Competitive Range But Before Negotiations.* You should normally not need to conduct any exchanges after establishment of the competitive range but before negotiations. Proposals included in the competitive range should be adequate for negotiation. However, there may be situations when you need additional information to prepare reasonable negotiation objectives.

The purpose of such exchanges is to obtain additional information for proposal analysis and to eliminate misunderstandings or erroneous assumptions that could impede objective development. Never use this type of exchange to give a contractor an opportunity to modify its proposal.

*Fact-Finding ([FAR 15.406-1](#)).* In a noncompetitive procurement, fact-finding may be necessary when information available is not adequate for proposal evaluation. It will most often be needed when:

- The proposal submitted by the contractor appears to be incomplete, inconsistent, ambiguous, or otherwise questionable; and

- Information available from market analysis and other sources does not provide enough additional information to complete the analysis.

The purpose of fact-finding is to obtain a clear understanding of the contractor's proposal, Government requirements, and any alternatives proposed by the contractor. Typically, fact-finding centers on:

- Analyzing the actual cost of performing similar tasks. This analysis should include such issues as whether:
  - Cost or pricing data are accurate, complete, and current;
  - Historical costs are reasonable; or
  - Historical information was properly considered in estimate development.
- Analyzing the assumptions and judgments related to contract cost or performance, such as:
  - The reasonableness of using initial production lot direct labor hours and improvement curve analysis to estimate follow-on contract labor hours;
  - Projected labor-rate increases; or
  - Anticipated design, production, or delivery schedule problems.

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## **9.5 Establish Pre-Negotiation Price Positions**

This section covers the following topics:

- 9.5.1 - [Analyze Risk](#)
- 9.5.2 - [Develop Negotiation Positions](#)

*Prenegotiation Objectives* ([FAR 15.406-1\(a\)](#)).

Prenegotiation objectives establish the Government's initial negotiation position and assist in determining whether a price is fair and reasonable. They should be based on the results of proposal analysis, taking into consideration all pertinent information including:

- Field pricing assistance;
- Audit reports;
- Technical analyses;
- Fact-finding results;
- Independent Government Estimates; and

- Price histories.

In addition to your price objective, your prenegotiation positions should also consider the range of reasonable prices around that objective. Many contracting officers fail in negotiations, because they believe that there is only one price that is reasonable for a particular contract requirement. Instead of negotiating, they attempt to force the offeror to accept that one reasonable price.

### **9.5.1 Analyze Risk**

*Risk in Pricing.* As you begin to develop your price negotiation positions, you must analyze the risk involved. The acquisition may be the 99th acquisition of a standard commercial item or it may be the first acquisition of complex state-of-the-art equipment manufactured to precise Government specifications.

Acquisition of the standard commercial item may involve little pricing risk. You have price histories, commercial item price comparisons, and competition. All will likely lead you to the same should-pay price or very similar should-pay prices.

The state-of-the-art item will likely have a much higher level of pricing risk. You may have only the Independent Government Estimate. Commercial items may permit only very general comparisons. These different price estimates may lead you to a wide range of prices that appear reasonable.

*Risk Assessment and Should-Pay Prices.* You must begin to estimate should-pay prices when you begin acquisition planning, and you should continue to refine your estimate as information is collected throughout the acquisition process. Use judgment in evaluating the reliability of each estimate when developing the total estimate of the price the Government should pay.

*Judgment in Risk Assessment.* It is likely that, given the same data, buyers and sellers will develop different judgments on which price is most reasonable. These judgments will be based on different perspectives and different assessments of the risk involved. Sellers are concerned about being able to complete contracts, cover costs, and make a profit. Buyers are concerned about

contract completion, budgets limitations, fairness to all offerors, and the public perception of their actions.

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### 9.5.2 Develop Negotiation Positions

*Price Positions in Noncompetitive Negotiations.* In noncompetitive negotiations, you should define the range of reasonable prices using three pricing positions. These positions should be based on your should-pay estimates developed during the acquisition process. As you prepare these positions, remember that:

- **The minimum price position** should be your starting place in negotiations and your first offer. Never offer a price that cannot be supported by reasoned analysis.
- **The objective (or target) price position** should be the price that you think is most reasonable, based on your analysis of the reliability of different price estimates. It should be the price that you think the Government should pay.
- **The maximum price position** should be the highest price that you can reasonably accept, given the information you have at the beginning of negotiations. The maximum price may change during negotiations if additional information is presented by the offeror that changes the situation.

Both parties to a negotiation expect movement by the other party. If you offer one price throughout the negotiation, you may appear inflexible and that appearance could jeopardize agreement. Different positions also provide you with an opportunity to collect information needed to understand the offeror's perspective on a reasonable price, and to sell the reasonableness of your negotiation positions.

*Price Positions in Competitive Discussions* ([FAR 15.306\(d\)](#)). Before entering into competitive discussions, develop separate minimum, objective, and maximum positions for each proposal. Use these positions in identifying the strengths, weaknesses, deficiencies, and uncertainties in the offeror's proposal.

As you prepare these positions, remember that they will be used to advise the offeror of deficiencies in its proposal so that the offeror is given an opportunity to improve its proposal.

- Include your reasons (if any) for believing that the offeror's pricing is deficient based on comparisons with historical prices, commercial prices, parametric estimates, rough yardstick estimates, or the Independent Government Estimate.
- Be prepared to point out any indicators that the proposed price is too high or too low.

Remember that you will not be able to engage in offers and counteroffers during discussions. The offeror must determine how to modify its proposal in order to increase the value offered.

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## **9.6 Consider Potential Trade-Offs Between Price And Other Terms**

*Introduction* (FAR [15.206](#)). The price positions described in the last section should be based on the requirements stated in the original solicitation, unless Government requirements changed after proposals were received. If requirements have changed, all offerors must be notified of the change.

*Requirement Changes* ([FAR 15.206](#)). **In noncompetitive negotiations**, all elements of the contract are subject to negotiated change during the negotiation process. In preparing for such negotiations, you should identify any changes in terms and conditions that you are willing to trade for certain related changes in price. The potential requirements changes could be either additions or deletions. The potential price changes should correspond with the value to the Government of the change in technical requirements. A technical requirements increase should result in a higher price objective, while technical requirements decrease should result in a lower price objective. A change in requirements that is neither an increase or decrease in overall technical requirements should result in no change to the price objective.

**In competitive discussions**, you must not change minimum contract requirements unless all offerors remaining in the competitive range have an opportunity to revise their proposal based on the change. If the proposed change is so substantial that additional sources would likely have submitted offers had the amendment been known, the contracting officer must cancel the solicitation.

You must obtain approval from appropriate Government technical personnel before suggesting or agreeing to any change in technical requirements. As you and the appropriate Government technical personnel agree on requirements changes that you would be willing to consider, develop an estimate of the related objective price change.

*Format for Analyzing Potential Tradeoffs.* The following chart provides a format for analyzing potential tradeoffs during negotiations. A data page containing the type of information described below will greatly speed negotiations and enable you to concentrate on the important issues involved.

<b>Type Of Change In Requirements</b>	<b>Related Objective Increase</b>	<b>Related Objective Decrease</b>
Technical Requirements:		
Inspection and Acceptance Terms:		
Delivery or Performance Terms:		
Contract Type:		
Socioeconomic Terms:		
Payment Terms:		

Government Furnished Property:		
Warranties:		
Patents and Rights in Data:		
Other Terms and Conditions:		

### **9.7 Determine The Need To Cancel And Resolicit**

*Authority to Reject All Proposals* ([FAR 15.303\(a\)](#) and [15.305\(b\)](#)). The source selection authority may reject all proposals received in response to a solicitation, if doing so is in the best interests of the Government. The source selection authority is the contracting officer unless the agency head appoints another individual for a particular acquisition or group of acquisitions.

*Examples of Reasons to Reject All Proposals* (G.K.S., Inc., CGEN B-235208, August 9, 1989).

Consider canceling and resoliciting anytime that you expect such action will increase competition or reduce cost to the Government.

Common price-related reasons for canceling a solicitation include the following:

- All otherwise acceptable proposals have unreasonable prices.
- Proposals were not independently priced.
- A cost comparison shows that in-house performance by the Government is more economical.

Pricing concerns may also lead the contracting officer to cancel a solicitation based on the potential for increased competition or cost savings. Such action in the best interest of the Government is supported by the

Comptroller General (CGEN) decision in the protest by G.K.S., Inc. In that case:

- The Air Force canceled a solicitation and resolicited when it learned of the possibility of increased competition and cost savings because of a newly approved source.
- G.K.S., argued that the Air Force should not have canceled the solicitation because the new solicitation was not substantially different from the original. G.K.S. argued that an agency cannot cancel an RFP solely for the purpose of allowing another party to have an opportunity to participate in a resolicitation with identical requirements. Further, G.K.S. alleged that there was a fair and reasonable price available under the original RFP since its proposed price was less than prices paid by the Government in the previous 3 years and was 30 percent less than the Government's estimated unit price. G.K.S. also claimed that there was com

petition under the original RFP because three sources of supply were identified in the RFP and two of the identified sources submitted offers.

- The CGEN found that, a procuring agency may cancel a negotiated procurement based on the potential for increased competition or cost savings.
  - Once the Air Force learned of the possibility of increased competition and cost savings because of a newly approved source, it could properly cancel the RFP and resolicit.
  - While the Air Force may not have been required to cancel, the CGEN found that the Air Force did act reasonably under the circumstances in canceling the RFP



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- 

## **I.0 Chapter Introduction**

*Contract Pricing Environment.* An important part of your job as a contract specialist is to conduct the price analyses necessary to ensure that the Government purchases supplies and services from responsible sources at fair and reasonable prices. To begin your study of contract pricing, we will examine the pricing environment, including:

- Definitions of price;
- Seller pricing objectives and approaches;
- The Government pricing objective;
- Government approaches to contract pricing; and
- Potential participants in the acquisition process

*Definitions of Price.* From both work and personal business dealings, most people think of price as the amount of money that a buyer pays a seller for the delivery of a product or the performance of a service. The FAR definition of price ([FAR 15.401](#)) emphasizes its components: Cost plus any fee or profit applicable to the contract type.

Both definitions of price are important. Primarily, price is defined as the amount the buyer pays for a product

or service. However, it is important to remember that, if prices do not cover supplier costs and provide a profit, losses will occur. When a contract is priced below cost, performance risk increases. The contractor must finance contract performance with funds from other sources (e.g., profits from other contracts, financial reserves, or overpriced contract modifications). If contractor efforts to control costs result in unsatisfactory performance, contractor default is a real possibility.

**I.1 - Identifying The Seller's Pricing Objectives And Approaches** This section covers the following topics:

- I.1.1 - [Identify Seller's Pricing Objectives](#)
- I.1.2 - [Identify Seller's Approaches To Pricing](#)
- I.1.3 - [Review Seller's Cost-Based Pricing Strategies](#)
- I.1.4 - [Review Seller's Market-Based Strategies](#)

*Pricing Perspectives.* Buyers and sellers look at the same price from different perspectives. Each party to a sales transaction has unique pricing objectives. As a contract specialist, you should be aware that:

- Sellers in different markets often have different approaches to contract pricing.
- Different sellers in the same market may have different pricing objectives and approaches.
- A single firm may have different objectives and approaches in different contracting situations.

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### **I.1.1 - Identify Seller's Pricing Objectives**

*Pricing Objectives.* To sellers, contract pricing has two primary, related objectives:

- To cover costs; and
- To contribute to attaining corporate operational objectives.

*Cover Costs.* Many firms would have us believe that they lose money on every unit they sell, but make up for it in volume. Unfortunately, business does not work that way. A seller may accept a loss on a particular contract or group of contracts, but a firm that consistently fails to cover its costs cannot survive.

*Operational Objectives.* All firms have several operational objectives that serve as benchmarks for business decisions. In the best firms, they are usually clearly defined and tailored to the market decisions. In other firms, they may be less clear.

Common objectives include:

- Short-term and/or long-term profitability;
- Market share;
- Long-term survival;
- Product quality;
- Technological leadership; and
- High productivity.

To attain its operational objectives, a firm must cover its costs and earn an overall profit. Some products may sell for less than cost, but if they do, other products must make sufficient profit to compensate for those losses. Profits are essential for:

- Investment;
- Product Development;
- Productivity Improvement;
- Retirement of Debt Principal; and
- Rewarding Investors.

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### **I.1.2 Identify Seller's Approaches To Pricing**

*Seller's Pricing Approaches.* In product pricing, sellers commonly use one of two basic approaches -- cost-based pricing or market-based pricing. The following are common strategies associated with each approach:

*Cost-based pricing:*

- Mark-up pricing
- Margin on direct cost
- Rate-of-return pricing

*Market-based pricing:*

- Profit-maximization pricing
- Market-share pricing
- Market skimming

- Current-revenue pricing
  - Promotional pricing
  - Demand-differential pricing
  - Market-competition pricing
- 

### **I.1.3 Review Seller's Cost-Based Pricing Strategies**

This subsection covers the following topics:

- [I.1.3.1 - Mark-Up Pricing](#)
- [I.1.3.2 - Margin On Direct Cost](#)
- [I.1.3.3 - Rate-of-return Pricing](#)

*General Approach.* The cost-based pricing approach to pricing involves an analysis of a firm's cost to produce a product, and the addition of a reasonable profit to determine the selling price.

Seller cost will depend on many factors including production methods and product sales volume.

The seller's definition of a reasonable profit will also depend on many factors, including:

- Competition;
- Objectives of the firm;
- Necessary investment; and
- Risk involved.

*Cost-based Pricing Strategies.* How is profit calculated and applied? There are three basic strategies:

- Mark-up pricing;
  - Margin pricing; and
  - Rate-of-return Pricing.
- 

#### **I.1.3.1 Mark-up Pricing**

*Definition.* Mark-up pricing is the establishment of prices based on estimated direct cost or total cost plus a percentage mark-up. If the base is direct cost, the mark-up covers profit plus indirect costs (i.e., overhead and

general and administrative costs). If the base is total cost, the mark-up only covers profit.

*Procedure.* To understand mark-up pricing, you must understand the steps followed by a firm when using the technique:

- Estimate the sales volume.
- Estimate product unit cost at the estimated sales volume.
- Determine the mark-up rate to be used.
- Calculate unit selling price by applying the mark-up rate to the product cost.

*Example.* Price the following product using straight mark-up pricing:

**Given:**

Estimated Sales Volume = 1,000 units  
Estimated Unit Cost = \$80  
Mark-up Rate = 20%

**Calculate Unit Selling Price:**

Unit Selling Price = Cost + (Mark-Up Rate x Cost)  
= \$80 + (0.20 x \$80)  
= \$80 + \$16  
= \$96

*Strategy Implications for Buyers* Profit is set using a mark-up rate that is simply a percentage of direct or total cost. That rate depends on:

- Market Factors. The product line, tradition, competition, and other market factors will affect the mark-up rate. Investment required to produce the product is not normally one of the factors considered in setting a mark-up rate. Similar products are typically priced using similar mark-up rates. However, a new state-of-the-art product will typically be priced using a higher mark-up rate than a similar older product that has been on the market for a long time.

- Cost Base Used in Applying the Rate.
  - Mark-Up on Direct Cost. A firm that bases its mark-up on direct cost will have a higher mark-up than the firm that bases the mark-up on full cost. ◦ Why? Because a mark-up based on direct cost must cover overhead costs, as well as profit. A mark-up rate of 100 percent or more may be quite reasonable.
  - Mark-Up on Total Cost. A firm that bases its mark-up on full costs should have a lower mark-up rate than the firm that bases the mark-up on direct cost only. A mark-up rate of 100 percent on full cost would normally be considered excessive.

The use of mark-up pricing varies by:

- Industry. Mark-up pricing is particularly common in industries where customers are expected to negotiate sales price (e.g., automobiles). The profit represented in the mark-up is set high enough to provide the seller with room to compromise. Hence, a good buyer should be aware of relevant industry mark-up practices. Knowledge of prevailing mark-ups can be a tremendous advantage in negotiating reasonable prices.
- Product. Mark-up pricing is particularly common for unique items or services provided for a single customer or a small group of customers. The mark-up will commonly vary based on the type of work and risk involved.

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### **I.1.3.2 Margin Pricing**

*Definition.* Margin pricing is similar to mark-up pricing in that price is based on the relationship between cost and profit. Margin pricing based on direct costs must cover both indirect cost and profit. Margin pricing based on total cost must only provide for profit.

Instead of adding a mark-up based on a percentage of cost, margin pricing uses cost to calculate a price that will provide a profit margin that is an established percentage of price. Many commercial firms use this

technique because it matches their accounting reports where costs and profits are reported as a percentage of sales.

*Procedure.* Use the following steps to calculate price based on the margin on direct cost pricing technique:

- Estimate the sales volume.
- Estimate cost at the estimated sales volume.
- Determine the margin rate to be used.
- Calculate the selling price by applying the margin rate to the product cost.

*Example.* Price the following product using margin pricing:

**Given:**

Estimated Sales Volume = 1,000 units  
Estimated Unit Cost = \$81  
Margin Rate = 40%

**Calculate Unit Selling Price:**

$$\begin{aligned} \text{Unit Selling Price} &= \frac{\text{Cost}}{(1 - \text{Margin Rate})} \\ &= \frac{\$80}{(1 - .40)} \\ &= \frac{\$80}{.60} \\ &= \$133 \end{aligned}$$

*Strategy Implications for Buyers.* Like mark-up rates, margin rates depend on the product line, tradition, and competition. Similar products are priced using similar mark-up rates. A firm's management is often rated by the margin rate that they can obtain.

You should be aware of relevant industry mark-up practices. Knowledge of prevailing margins can be a tremendous advantage in negotiating reasonable prices, especially when buying in commercial markets.

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### **I.1.3.3 Rate-Of-Return Pricing**

*Definition.* Rate-of-return pricing is similar to mark-up pricing in that profit dollars are added to estimated costs. However, profit dollars are not calculated based on the cost of labor and material required to provide the product. Instead, profit is calculated based on the financial investment required to provide the product, the return needed to attract that investment, and estimated sales volume.

*Procedure.* Follow these steps to determine profit using rate-of-return pricing:

- Determine desired rate of return on investment.
- Estimate investment required.
- Estimate level of sales.
- Estimate unit cost at the projected sales level.
- Calculate desired unit profit.
- Calculate unit selling price (estimated cost + desired profit).

Price the following product using rate-of-return pricing:

**Given:**

Desired Rate of Return		= 15%
Estimated Investment Required	=	\$600,000
Estimated Sales		= 5,000
units		
Estimated Unit Total Cost	=	\$80

**Calculate Unit Selling Price:**

Calculate Desired Unit Profit		=
<u>15% of \$600,000</u>		
5,000 units		
<u>90,000</u>		
5,000 units	=	

= \$18 per unit		
Calculate Unit Selling Price	=	\$80 + \$18
(Unit Cost + Unit Profit)	=	\$98

*Strategy Implications for Buyers.* Firms that use this method of pricing are probably more sensitive to changes in overall sales volume than firms using the other cost-based



pricing methods. They are concerned about the rate of return, not just a mark-up or margin rate. A lower item price coupled with a higher sales volume can actually increase the rate of return. On the other hand, a higher item price coupled with a lower sales volume can decrease the rate of return.

You should be aware of the investment required to make different products. Any action that enables the seller to reduce its investment or spread that investment over more products should reduce the profit that must be earned on any one product to maintain a required rate of return on investment.

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#### **I.1.4 - Review Seller's Market-based Pricing Strategies**

In a competitive market, the seller must consider the four "P"s of marketing: price, product, place, and promotion. Firms must develop pricing strategies to accomplish overall marketing objectives based on their assessment of market conditions (e.g., forecasts of supply and demand) and the economic condition of the business entity. This section covers the following market-based pricing strategies which can be used in various market conditions:

- [I.1.4.1 - Profit-Maximization Pricing](#)
- [I.1.4.2 - Market-Share Pricing](#)
- [I.1.4.3 - Market Skimming](#)
- [I.1.4.4 - Current-Revenue Pricing](#)
- [I.1.4.5 - Promotional Pricing](#)
- [I.1.4.6 - Demand-Differential Pricing](#)
- [I.1.4.7 - Market-Competition Pricing](#)

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##### **I.1.4.1 Profit-Maximization Pricing**

*Definition.* In profit-maximization pricing, the seller assumes that demand falls as prices increase and grows as prices decrease. A firm using this strategy carefully analyzes the market to find the combination of price per unit and quantity of sales that maximizes profit.

*Strategy.* When employing this strategy, the seller considers the following questions:

- Is demand sensitive to price changes?
  - As price increases, does demand decrease?
  - As price decreases, does demand increase?
- What is the point of profit maximization?
  - This is determined through analysis of the relationship between price and demand.

This pricing strategy is:

- **Most effective** in situations where:
  - Price is an important marketing factor affecting demand.
  - Competitors react relatively slowly to price changes.
  - Actual relationships between price and customer demand can be effectively estimated.
- **Least effective** when competitors react rapidly to price changes.

*Strategy Implications for the Buyer* Be aware of the relationship between price and quantity in the marketplace. Working with users to take advantage of price breaks can save the Government substantial sums of money.

In Government contracting, the purchase quantity estimates are generally fixed, based on the needs of the Government. No matter how low the offeror's price, the quantity acquired by the Government does not change. Thus there is no advantage to the offeror to offer a price lower than that necessary to win the contract.

Prices for multiple-award Federal Supply Schedules are a possible exception. Another possible exception are prices for inventory items, when the amounts ordered by inventory managers vary from one period to the next based in part on price/quantity tradeoffs.

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#### **I.1.4.2 Market-Share Pricing**

*Definition.* Market-share pricing is based on the assumption that long-run profitability is associated with market share. When using this strategy, the goal is to

dominate the market through market penetration. Firms set prices relatively low to win customers and discourage competition. Early losses may occur, but as volume increases, cost per unit decreases and long-term profits are achieved.

*Strategy.* When employing this strategy, the seller normally attempts to:

- Build efficient operations;
- Set price at or below competitors' prices to win market share; and
- Lower prices as costs fall.

*Strategy Implications for the Buyer.* As a buyer, you should encourage mass production efficiencies that may reduce contractor costs and provide a reasonable profit. The Model T Ford is one example of a situation where a firm's use of this strategy generally benefited customers. Ford drove down prices to reach more customers. Other competitors were forced to reduce prices or offer product improvements to stay in the market.

You should discourage a contractor "**buy-in,**" (i.e., bid below cost to win a contract and exclude others from the market) when there is evidence that the contractor may jeopardize contract performance because the contract price will not cover costs. You should be particularly concerned when sellers:

- Have limited financial resources, or
- Are apparently gambling on capturing a larger share of the market (and of unit sales) than they are likely to achieve."

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#### **I.1.4.3 Market Skimming**

*Definition.* In market skimming, prices are set to achieve a high profit on each unit by selling to buyers who are willing to pay a higher price for a product of perceived higher value. After the demand of these buyers is satisfied, or competitors produce similar products at lower prices, prices may be reduced to increase volume and maintain overall profitability.

*Strategy.* When employing this strategy, the seller considers the following points:

- Establish a high price to achieve a high profit margin at relatively low volume.
- Decrease price over time to attract buyers not willing to pay the price premium.

IBM and Apple Macintosh personal computers are good examples of this strategy:

- Prices remained relatively high for years;
- Firms catered to buyers willing to "pay for the best"; and
- As quality competition increased, prices began to decrease.

*Strategy Implications for the Buyer.* As a buyer, you should resist user attempts to "pay for the best" when the "best" is more than the Government needs or the perception of quality is based more on superior marketing than on a superior product.

Remember the "best product" is not always the best value. To be the best value, the perceived benefits of a higher-priced product must merit the higher price. For example, a stainless steel screw may be the best product, but the quality does not justify the higher price when the screw will be used in constructing a wooden cabinet.

You should encourage attempts at source development to increase competition and control prices.

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#### **I.1.4.4 Current-Revenue Pricing**

*Definition.* In current-revenue pricing, the emphasis is on maximization of current revenue rather than profit or long-term revenue. Firms using this strategy are typically concerned about long-term market uncertainty or the firm's financial instability. To them, a sure dollar today is much more important than the possibility of more dollars tomorrow.

*Strategy.* When employing this strategy, the seller must determine the price/quantity combination that maximizes revenue.

*Strategy Implications for the Buyer.* You need to be aware that this strategy predominates when risk is high. Action to reduce risk will likely be rewarded with lower prices and a more stable business environment.

Consider long-term demand for the product. Firms pricing product crazes, like the "hula hoop," are likely to consider current-revenue pricing.

- Demand is high one day, but may disappear the next.
- Near-term cash recovery is more important than long-term profitability.

Assure that all contractors are responsible. Firms with limited financial resources may employ this strategy.

- If near-term cash needs are not met, there will be no long term for the firm.
- Unfortunately, concentration on the near-term may also jeopardize the long-term future of the firm.

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#### **I.1.4.5 Promotional Pricing**

*Definition.* In promotional pricing, products are priced to enhance the sales of the overall product line rather than to assure the profitability of each product.

*Strategy.* When employing this strategy, the seller considers the following points:

- Determine whether selling a product at a loss (a loss leader) will increase the sale of related products and increase profit.
- Determine whether selling a product at a high (prestige) price will improve the product-line quality image and increase profit.

*Strategy Implications for the Buyer.* This strategy can be used for pricing a wide range of consumer and industrial products, from groceries to electronics and services. Government personnel evaluating offers for a delivery-order

or task-order contract with multiple line items should be particularly alert to offers prepared using this strategy.

Promotional contracting can take many forms:

- Bait and switch pricing can be particularly attractive to a firm preparing an offer for a delivery-order contract with multiple line items. An offeror using this strategy lures the buyer using a low-priced item (e.g., a low labor rate for a particular labor category) and then switches the buyer to a "better" item (e.g., a higher-priced category of labor) during the sale.
- Loss-leader can be attractive in situations where many items are commonly bought from the same source. An offeror using this strategy reduces the price of one, or a group of items, to near cost, or even below. Customers are attracted to buy the low-priced items and buy other related items at the same time (e.g., set the price of a system low and the price of supplies for the system high).
- Prestige pricing uses a high-quality, high-priced item to enhance the image of an entire product line and attract more buyers. For example, many consultants feel that buyers are reluctant to buy from firms that do not charge enough. In other words, it can be almost impossible to evaluate qualifications so high price equals high quality.

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#### **I.1.4.6 Demand-Differential Pricing**

*Definition.* In demand-differential pricing, products or services sold in different market segments are priced in a way that is not consistent with the marginal costs related to segment differences.

*Strategy.* When employing this strategy, the seller considers the following points:

- Identify the segmentation factors that may affect pricing:
  - Customer;
  - Product Form;
  - Place; and
  - Time.

- Determine the demand intensity in each segment.
- Identify actual and potential competitors.
- Assure that demand-differential will not breed customer resentment.

*Strategy Implications for the Buyer.* You need to be aware of the effect of the various segmentation factors on different products.

- Customers may pay different prices based on buying power or negotiation skills—for example, automobile purchases. In addition, different classes of customers (e.g., wholesalers, retailers, and governments) may pay different prices.
- Product-form (e.g., electronic component assembly) may warrant a price higher than the price of the components plus assembly.
- Location of the sales transaction may affect price. The price of an item sold in New York may be substantially greater than the price of the item in Ohio plus the shipping charge to New York.
- Time may affect pricing, particularly in industries that have substantial fixed investment and identifiable peaks in demand. Utilities, for example, offer lower prices for service during "off- peak" hours.

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#### **I.1.4.7 Market-Competition Pricing**

*Definition.* In market-competition pricing, emphasis is on competitive action/ reaction to pricing actions that competitors have taken or are expected to take. Firms following this pricing strategy in relatively homogeneous markets establish prices based on what the competition charges or what they think the competition is going to charge.

*Strategy.* You may find that different companies may set prices at a level that keeps pace with competitor's prices. When employing this strategy, the seller considers the following points:

- Determine competitor prices and/or anticipated prices.
- Set price to keep pace with competitor prices.

Major strategy applications include sealed-bid and going-rate pricing.

- Sealed-bid pricing forces the seller to:
  - Estimate what competitors will bid
  - Determine what the seller can profitably bid
  - Submit the bid knowing that it will be accepted or rejected without further discussion
- Going-rate pricing requires the seller to:
  - Determine what competitors are charging
  - Establish product price within an established range of the competition.

*Strategy Implications for the Buyer.* Government policy on competition and market pricing is designed to encourage sellers to establish prices using market-competition pricing. You need to remember that this is only one method of market pricing. Many firms are reluctant to compete in a market where success is achieved by low price alone.

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## I.2 Identifying Government's Pricing Objectives

This section covers the following topics:

- [I.2.1 - Pay A Fair And Reasonable Price](#)
- [I.2.2 - Price Each Contract Separately](#)
- [I.2.3 - Exclude Contingencies](#)

*Government Pricing Objectives.* When buying for the Government, your primary pricing objective for all contract actions is to acquire supplies and services from responsible sources at **fair and reasonable** prices.

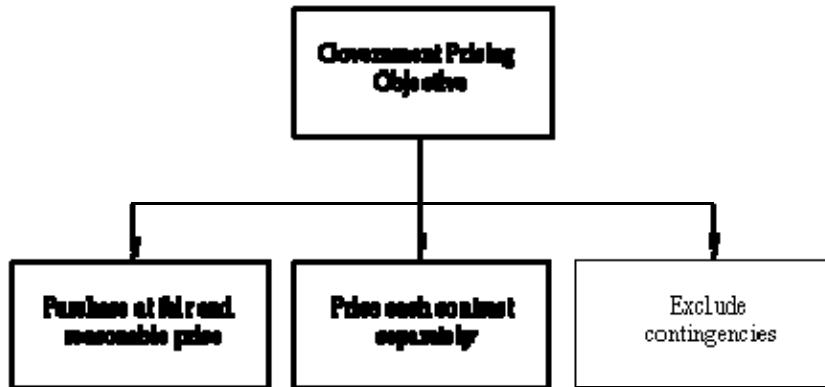
When awarding contracts through the negotiated procedures of FAR Part 15, you must also ([see FAR 15.402\(a\), \(b\), and \(c\)](#)):

- Price each contract separately and independently and not
  - (1) use proposed price reductions under other contracts as an evaluation factor, or (2) consider losses or profits realized or anticipated under other contracts.
- Not include in a contract price any amount for a specified contingency to the extent that the contract



provides for price adjustment based upon the occurrence of that contingency.

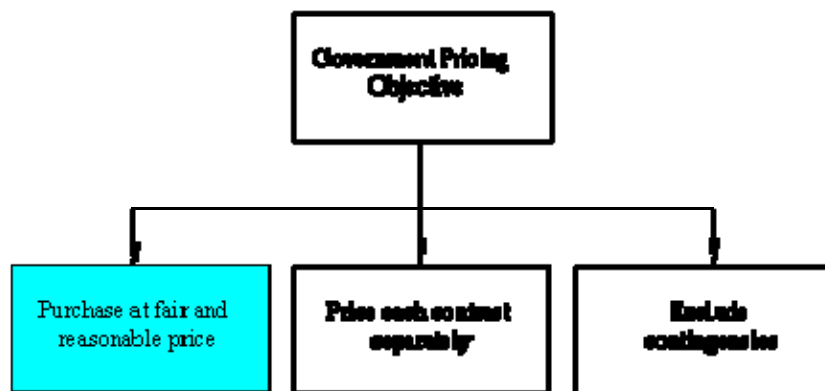
The figure below graphically depicts how these three elements form the foundation of the Government's pricing objectives.



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### I.2.1 - Pay A Fair And Reasonable Price

*Understand Fair and Reasonable.* The first element of the Government pricing objective requires that contract prices be **fair and reasonable**.



Under the FAR, the contracting officer's primary objective in pricing a contract is to balance the contract type, cost, and profit or fee negotiated to achieve a total result -- a price that is fair and reasonable to both the Government and the contractor.

The FAR does NOT define the term "fair and reasonable price," but it implies two tests:

- What is fair?
- What is reasonable?

*What Is Fair?* Buyers and sellers may have different perceptions on what price is fair.

**1. Fair to the Buyer.** To be fair to the buyer, a price must be in line with (or below) either of the following:

- The fair market value of the contract deliverable (if that can be ascertained through price analysis). Expect to pay the fair market value, given the prices of market transactions between informed buyers and sellers under similar competitive market conditions for deliverables with similar product, quality, and quantity requirements.
- The (1) total allowable cost of providing the contract deliverable that would have been incurred by a *well managed, responsible firm using reasonably efficient and economical methods* of performance plus (2) a reasonable profit.

As a buyer, you should consider a price that is TOO HIGH to be unfair. What happens if you agree to a price that is too high?

- You will have failed to fulfill your most basic responsibility as a Government contracting officer or contract specialist.
- You will waste scarce Government funds.
- Since you are publicly accountable as a Federal employee for your decisions, you may have to answer to management, the Inspector General, the General Accounting Office, a Congressional committee, or the public at large.

**2. Fair to the Seller.** To be fair to the seller a price must be realistic in terms of the seller's ability to satisfy the terms and conditions of the contract.

- **Risk of Prices Unfair to the Seller.** Why should you care if a low offer is unrealistic? Because an unrealistic price puts both parties at risk. The risk

to the Government is that the firm -- to cut its losses -- might:

- o Cut corners on product quality;
- o Deliver late;
- o Default, forcing a time-consuming reprocurement;  
or
- o Refuse to deal with the Government in the future  
or be forced out of business entirely.

*Situations for Special Consideration.* Fairness to the seller can be a concern in both competitive and noncompetitive situations.

- **Below-Cost Prices.** Below-cost prices are NOT necessarily unfair to the seller. A bidder, for various reasons, in its business judgment may decide to submit a below-cost bid; such a bid is not invalid. Whether the awardee can perform the contract at the price offered is a matter of responsibility.
- On the other hand, be on guard against the practice of buying-in -- submitting offers below anticipated costs, expecting to:
  - o Increase the contract amount after award (e.g., through unnecessary or excessively priced change orders); or
  - o Receive follow-on contracts at artificially high prices to recover losses incurred on the buy-in contract.
  - o [FAR 3.501](#) presents a number of techniques to prevent a contractor from recovering buy-in losses. It also refers you to [FAR 15.405](#) for guidance on treatment of unreasonable price quotations. That portion of the FAR (among other things) advises contracting officers to consider risks to the Government represented by the proposed contract type and price.
- **Mistakes.** The offered price may be unexpectedly low because the seller has made gross mistakes in estimating costs or is otherwise nonresponsible.
- The award of a contract to a supplier based on lowest evaluated price alone can be false economy if there is subsequent default, late deliveries, or other unsatisfactory performance resulting in additional contractual or administrative costs. While it is important that Government purchases be made at the lowest price, this does not require an award to a supplier solely because that supplier submits the

lowest offer. A prospective contractor must affirmatively demonstrate its responsibility, including, when necessary, the responsibility of its proposed subcontractors.

- If a vendor offers a price that is far below other offered prices or your estimate of the probable price, treat the offer as a potential mistake. In such cases, both FAR [Part 14](#) and [Part 15](#) authorize fact-finding to determine whether the offeror understands the work and can perform at the offered price.
- **Single-Source Procurements.** Do NOT force a below-cost price on the offeror even if you believe that the offeror has the financial ability to absorb the probable loss. Instead, negotiate a contract of a type and a price that is likely to cover all allowable costs of performance, assuming reasonable economy and efficiency, and provide a reasonable profit (consistent with FAR profit policies). Even your opening position in non-competitive negotiations should NOT be a "below cost" number. Rather, your opening position should be based on a more optimistic reading of the potential production improvements, risks, and costs of providing the contract deliverable than that of the target position on price.

*What Is Reasonable?* A **reasonable price** is a price that a prudent and competent buyer would be willing to pay, given available data on:

- Market Conditions. Economic forces such as supply, demand, general economic conditions, and competition change constantly. Hence, a price that is reasonable today may not be reasonable tomorrow.
  - **Supply and Demand.** The forces of supply and demand can have a significant effect on product prices:
    - If demand is constant, decreasing supply usually results in higher prices, while increasing supply usually results in lower prices.
    - If supply is constant, decreasing demand usually results in lower prices, while increasing demand usually results in higher prices.
  - **General Economic Conditions.** General economic conditions affect the prices of all products, but the effect will NOT be the same for every product. Inflation and deflation affect the value

of the dollar. Boom, recession, and depression affect available production capacity.

- **Competition.** When competition does not exist, the forces of supply and demand may not work effectively. The buyer or seller may have an advantage in the pricing decision process.
- Markets can be defined by considering: the number of buyers, the number of sellers, product homogeneity, and ease of market entry and exit.
- The buyer's relative pricing power compared with that of sellers changes in different market situations. The table below examines the relative pricing in each situation:

Level	Buyers	Sellers	Market Entry/Exit	Relative Pricing Power
Perfect Competition	Many independent	Many independent	Relatively easy	Pricing balance between buyers and sellers
Effective Competition	Limited independent	Limited independent	Relatively easy	Relative pricing balance between buyers and sellers
Oligopoly	Many independent	Few independent	Restrictions	Relatively greater pricing advantage to sellers
Oligopsony	Few independent	Many independent	Relatively easy	Relatively greater pricing power to buyers
Monopoly	Many independent	One	Restrictions	Considerable pricing power to sellers
Monopsony	One	Many independent	Relatively easy	Considerable pricing power to buyers
Bilateral Monopoly	One	One	Restrictions	Pricing power established by negotiation (as in sole source Government)

negotiation)

**Alternatives for Meeting the Requirement.** In making any acquisition, you should consider the alternatives. In a competitive acquisition, you should first consider how an offered price compares with competitive offers. However, your analysis should NOT end there. You should also consider other alternatives for acquiring the product or service. For example, sealed bidding procedures permit the agency head to cancel a solicitation when otherwise acceptable bids are at unreasonable prices ([FAR 15.404-1\(c\)](#)) and negotiation procedures permit the source selection authority to reject all proposals if doing so is in the best interest of the Government ([FAR 15.305\(b\)](#)).

**Price-Related Evaluation Factors.** A prudent buyer will consider differences in the cost of acquiring and owning a deliverable that are not covered by the contract price. To consider these price-related factors in a competitive acquisition, the solicitation must provide for such consideration. For example:

- **Direct Costs Not Included in The Contract Price.** The solicitation allowed offers to submit offers either for f.o.b. destination or f.o.b. origin. FAR requires that offer evaluation criteria provide for consideration of the shipping costs from f.o.b. origin points to destination.
- **Costs of Ownership Not Included in The Contract Price.** Your market research indicates that several products could satisfy your requirement. However, the products differ substantially in maintenance and repair costs. Offer evaluation criteria should provide for consideration of the related costs to the Government.
- **Costs of Contract Award and Administration.** In a competitive contracting situation, you may solicit line item prices and an aggregate price for all solicitation line items. The contracting officer could split the line items among five offerors, or award all line items to the single firm that offered the lowest aggregate price. To determine which method of award would provide the best value to the Government, offer evaluation criteria must provide for consideration of cost to the Government for awarding and administering multiple contracts (e.g., see [FAR 14.201-6\(q\)](#)).

**Noncompetitive Acquisitions.** In a noncompetitive acquisition, you should be alert to potential risks and costs NOT covered in the offered price. A price that seems reasonable on the surface may be unreasonable if proposed terms and conditions shift costs to the Government. For instance, an offered price may seem reasonable until you discover that the proposed terms and conditions have shifted responsibility for furnishing the necessary tooling from the firm (per the RFP) to the Government (per the proposal). Likewise, a contractor's proposed price, regardless of amount, might be unreasonable if conditioned on the use of a cost-reimbursement contract that transfers an inappropriate portion of the risk of cost growth to the Government.

**Non-Price Evaluation Factors.** In some acquisitions, the test of reasonableness requires a trade-off analysis between price, price-related factors, and non-price factors such as past performance and relative technical capabilities of the competing firms (see [FAR 15.101-1](#)). In particular, do NOT compete cost-reimbursement contracts primarily on the basis of lowest proposed costs. That would only encourage offerors to submit unrealistically low estimates and increase the likelihood of cost overruns (see [FAR 15.404-1\(d\)](#)).

**Applying Judgment to the Determination.**

Your determination of whether an offer is **fair and reasonable** is a matter of judgment. There is no simple formula in which you can just plug in a few values and receive a firm answer of **fair and reasonable**. Determining what is **fair and reasonable** depends on market conditions, your alternatives for meeting the requirement, price-related factors, and the non-price evaluation factors that relate to each procurement. It also depends on what price you can negotiate with an offeror. [FAR 15.405\(a\)](#) states that:

*A fair and reasonable price does not require that agreement be reached on every element of cost, nor is it mandatory that the agreed price be within the contracting officer's initial negotiation position. Taking into consideration the advisory recommendations, reports of contributing specialists, and the current status of the contractor's purchasing system, the contracting officer is responsible for*

*exercising the requisite judgment needed to reach a negotiated settlement with the offeror and is solely responsible for the final price agreement.*

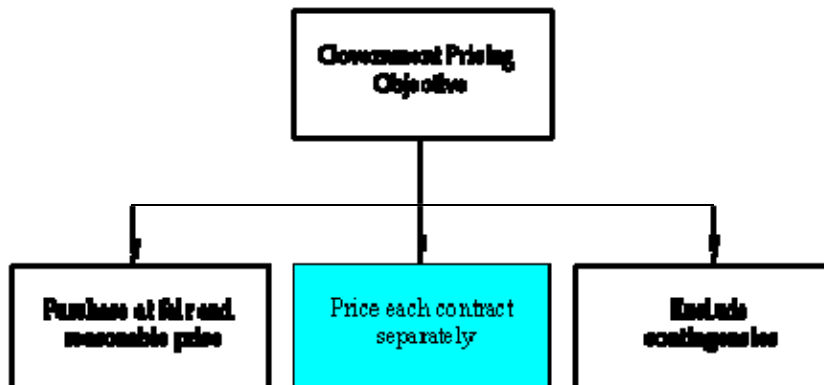
There may be times when you find it impossible to reach agreement on a price that you consider fair and reasonable. If that happens, follow the FAR guidance at [FAR 15.405\(d\)](#).

If, however, the contractor insists on a price or demands a profit or fee that the contracting officer considers unreasonable, and the contracting officer has taken all authorized actions (including determining the feasibility of developing an alternative source) without success, the contracting officer shall refer the contract action to a level above the contracting officer. Disposition of the action should be documented.

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### **I.2.2 Price Each Contract Separately**

The second element of the Government pricing objective requires that contracts be priced separately. [FAR 15.402\(b\)](#).



*Perspective.* It is human nature to try to balance one contract against another in terms of financial results.

- A seller's position might be that the firm lost money on the last contract; therefore, an effort should be made to make up for that loss on the next contract.
- A buyer's position might be that the contractor made too much profit on the last contract; therefore, the



next contract should be structured to restrict profit.

*Government Contracting.* While these attitudes may be understandable in a personal sense, they are not valid in Government contracting.

Government contracting is very complex because:

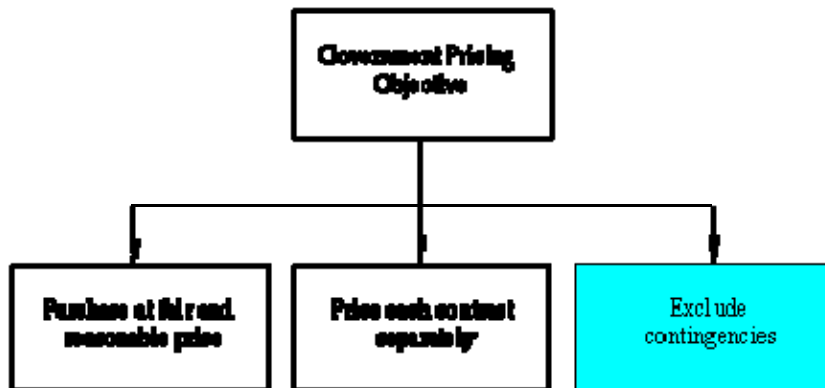
- Buyers and sellers do not have perfect knowledge of all transactions between a contractor and the Government.
- The market forces of competition, supply, and demand change.
- Business conditions change.

Thus, you must price each contract separately and independently to ensure that all proposed prices are fair and reasonable to all involved parties.

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### I.2.3 Exclude Contingencies

The third element of the Government pricing objective requires that contracts exclude contingencies that CANNOT be reasonably estimated at the time of award [FAR 15.402\(b\)](#).



*Contingency Definition.* A **contingency** is a possible future event or condition arising from presently known or unknown causes, the outcome of which is not determinable at the present time.

*Types of Contingencies.* (see [FAR 31.205-7](#)) You should know that there are two types of contingencies that are important in Government contracting:

- Contingencies that may arise from presently known and existing conditions, the effects of which are foreseeable within reasonable limits of accuracy; and
- Contingencies that may arise from presently known or unknown conditions, the effects of which CANNOT be measured so precisely as to provide equitable results to the contractor and the Government

*Pricing Decision.* The following table shows you how to handle each type of contingency in terms of the contract price:

<b>Contingency</b>	<b>Examples</b>	<b>Contract Price</b>
Foreseeable within reasonable limits of accuracy	<ul style="list-style-type: none"> <li>• Cost of rejects</li> <li>• Cost of defective work</li> </ul>	Contingencies of this type should be included in contract cost estimates to make those estimates as accurate as possible.
CANNOT be measured so precisely as to provide equitable results to the contractor and to the Government	<ul style="list-style-type: none"> <li>• Results of pending litigation</li> <li>• Costs of volatile material price changes</li> </ul>	Contingencies of this type should be excluded from the cost estimates under the several items of cost, but should be disclosed separately (including the basis on which the contingency is computed) to facilitate the negotiation of appropriate contract coverage.

For example, if you have extensive production experience with a given product, the contractor and the Government can likely agree on the amount of scrap that can reasonably be expected during production. This type of contingency should be included in contract cost estimates.

On the other hand, in times of volatile material price changes, it would be unreasonable to both parties for an offeror to include a contingency to cover significant price increases when none may occur. In this situation, you should consider use of a contract type (e.g. fixed-price

economic price adjustment) that provides for separate consideration of volatile price changes. Separate consideration will provide for better contract pricing and more effective competition.

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### **I.3 Identifying Government Approaches To Contract Pricing**

This section covers the following topics:

- [I.3.1 - Identify Price Analysis Considerations](#)
- [I.3.2 - Identify Cost Analysis Considerations](#)
- [I.3.3 - Identify Cost Realism Analysis Considerations](#)

Approaches to Determine Fair and Reasonable Prices ([FAR 15.402](#))

As a contract specialist, your primary objective as a Government buyer is to acquire supplies and services from responsible sources as **fair and reasonable** prices. You can use three basic approaches to attain this objective:

- Price analysis;
- Cost analysis; and
- Cost realism analysis.

In this section, you will learn about each of these approaches, how it is defined, when it is used, and key elements to consider.

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#### **I.3.1 Identify Price Analysis Considerations**

*Definition of Price Analysis.* Price analysis is the process of examining and evaluating a proposed price to determine if it is fair and reasonable, without evaluating its separate cost elements and proposed profit.

*When to Use Price Analysis.* When an offeror is not required to provide cost or pricing data, you must use price analysis to ensure that the overall price is fair and reasonable.

When an offeror is required to provide cost or pricing data, use cost analysis to evaluate the reasonableness of

individual cost elements. Use price analysis to verify that the overall price offered is fair and reasonable.

*Bases for Price Analysis.* Price analysis **always** involves some form of comparison with other prices. As the contracting officer, you are responsible for selecting the bases for comparison that you will use in determining if a price is fair and reasonable, such as:

- Proposed prices received in response to the solicitation;
- Commercial prices including competitive published price lists, published commodity market prices, similar indexes, and discount or rebate arrangements;
- Previously-proposed prices and contract prices for the same or similar end items, if you can establish both the validity of the comparison and the reasonableness of the proposed price;
- Parametric estimates or estimates developed using rough yardsticks;
- Independent Government Estimates; or
- Prices obtained through market research for the same or similar items (Because market research can span commercial prices, previously-proposed prices, contract prices, parametric or rough yardstick estimates, and Independent Government Estimates, this base for price analysis will not be considered separately in the remainder of this text.)

The order in which the bases for price analysis are presented on this list represents the general order of desirability. However, the order is NOT set in concrete. For example:

- Comparisons with commercial catalog, market, or regulated prices can be just as desirable as comparisons with competitive offers. After all, the prices of commercial products are defined by commercial market competition.
- Independent Government estimates are normally considered to be the least desirable comparison base for price analysis. However, in cases (e.g., construction) where estimates are based on extensive detailed analysis of requirements and the market, the Government estimate can be one of the best bases for price analysis.

Moreover, you should use all bases for which you have recent, reliable, and valid data. For instance, you would be well advised to consider the last price paid in addition to current competitive prices -- especially if the prior contract was awarded at a reasonable price last month.

*Buyer Evaluation and Documentation.* Price analysis is a subjective evaluation. For any given procurement, different bases for price analysis may give you a different view of price reasonableness. Even given the same information, different buyers/contracting officers might make different decisions about price reasonableness.

It is the cognizant contracting officer who must be satisfied that the price is fair and reasonable.

You must document the file concerning the rationale used in making the pricing decision. Otherwise, the individuals who may review your file later may not know or understand the factors that affected your decision.

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### **I.3.2 Identify Cost Analysis Considerations**

*Definition of Cost Analysis.* **Cost analysis** is the review and evaluation of the separate cost elements and proposed profit/fee of:

- An offeror's or contractor's cost or pricing data or information other than cost or pricing data and
- The judgmental factors applied in projecting from the data to the estimated costs.

The purpose of the evaluation is to form an opinion on the degree to which the proposed costs represent what the cost of the contract should be, assuming reasonable economy and efficiency.

*When to Use Cost Analysis.* Perform cost analysis in **either** of the following situations:

- When you require an offeror to submit cost or pricing data. In this situation, the offeror must provide complete, accurate, and current data to support all proposed costs and profit/fee.

- When you require an offeror to submit cost information other than cost or pricing data to support your decision on price reasonableness or cost realism. In this situation, require only the information necessary to determine price reasonableness or cost realism.

*Definition of Contract Cost.* **Contract cost** is the sum of the allowable **direct and indirect costs** allocable to a particular contract, incurred or to be incurred, less any allocable credits, plus any allocable cost of money.

**Direct cost** is any cost that can be identified specifically with a final cost objective, such as a contract.

**Indirect cost** is any cost that CANNOT be directly identified with a single, final cost objective, but is identified with two or more final cost objectives or an intermediate cost objective.

For reasons of practicality, any direct cost of minor dollar amount may be treated as an indirect cost if the accounting treatment is consistently applied to all cost objectives and the treatment produces substantially the same results as treating the cost as a direct cost.

*Definition of Profit/Fee.* Profit/fee is the dollar amount **over and above allowable costs** paid to the contractor to motivate contractor performance. Together contract cost and contract profit/fee total contract price. Thus contract profit is an important element of contract price and must be considered in cost analysis. Each agency must establish a structured approach for analysis of proposed profit/fee.

*Identifying Contract Costs.* Not all contract costs are cash expenditures during the contract period. Major contract costs can fall in the following categories:

- Cash expenditures-the actual outlay of dollars in exchange for goods or services
- **Expense accrual**-expenses are recorded for accounting purposes when the obligation is incurred, regardless of when cash is paid out for the goods or services.
- **Draw down of inventory**-the use of goods purchased and held in stock for production and/or direct sale to customers. The term refers to both the number of units and the dollar amount of items drawn out of inventory.

For example, both direct and indirect costs can result from a draw down of inventory and many indirect costs are accrual expenses.

Type of Contract Cost	Example
Cash expenditure	Payment by cash, check, or electronic funds transfer to a vendor for raw materials.
Expense accrual	Incurring of an obligation in the current year to pay an employee a retirement pension at some point in the future.
Draw down of inventory	Electronic components purchased in large volume against anticipated total demand and held in inventory until drawn out to fill a specific order. While the components were paid for in the past, the drawing out of a component to meet a contract need is a reduction of the assets of the firm and therefore a cost to the contract.

*Cost Analysis Supplements Price Analysis.* Cost analysis is not a substitute for effective price analysis. Cost analysis should provide insight into what it will cost the firm to complete the contract using the methods proposed. However, cost analysis does not necessarily provide a picture of what the market is willing to pay for the product involved. For that you need price analysis.

**For example,** suppose that you wanted to procure a custom-made automobile identical to a Pontiac Trans Am. At your request, your neighborhood mechanic agrees to build you such a car. In building the car, the mechanic gets competitive quotes on all the necessary parts and tooling, pays laborers only the minimum wage, and asks only a very small profit.

How do you think the final price will compare to a car off an assembly line? Probably at least ten times more expensive. Parts alone may be five times more expensive. The entire cost of tooling will be charged to one car. Labor, although cheaper, will likely not be as efficient as

assembly-line labor. Is the price reasonable? That decision can only be made through price analysis.

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### **I.3.3 Identify Cost Realism Analysis Considerations**

*Definition of Cost Realism Analysis.* Cost realism analysis is the process of independently reviewing and evaluating specific elements of each offeror's proposed cost estimate to determine whether the estimated proposed cost elements:

- Are realistic for the work to be performed;
- Reflect a clear understanding of the requirements; and
- Are consistent with the unique methods of performance and materials described in the offeror's technical proposal.

*When to Use Cost Realism Analysis.* Perform a cost realism analysis of each cost-reimbursement contract offer to determine the probable cost of contract performance and use that estimate in your evaluation of the best value to the Government.

- The probable contract cost related to a cost-reimbursement contract offer may differ substantially from the proposed cost. Your most probable cost estimate should reflect your best estimate of the cost of any contract that is most likely to result from the offeror's proposal.
- Determine the probable cost for each offer by adjusting the proposed cost, and fee when appropriate, to reflect any additions or reductions in cost elements to realistic levels based on the results of the cost realism analysis.

You may also use cost realism analysis in evaluating competitive offers for fixed-price incentive contracts or, in exceptional cases, on other competitive fixed-price contracts.

- Give special consideration to using cost realism analysis to evaluate offers for fixed-price contracts when:



- New requirements may not be fully understood by competing offerors;
- There are quality concerns, or
- Past experience indicates that contractors' proposed costs have resulted in quality or service shortfalls.
- When using cost realism analysis to evaluate offers for a fixed-price contract, you may use the results of your analysis in performance risk assessments and responsibility determinations. However, proposals must be evaluated using the criteria in the solicitation, and the offered prices must not be adjusted as a result of the analysis.

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#### **I.4 Identifying Potential Acquisition Team Members**

The Acquisition Team includes everyone involved in the acquisition -- beginning with the customer and ending with the contractor providing the product or service. This text refers to Government participants in the acquisition process as the Government Acquisition Team.

The Government is committed to providing training, professional development, and other resources necessary for maintaining and improving the knowledge, skills, and abilities of all Government Acquisition Team participants. This commitment applies both to the individual's particular area of expertise within the Government and the individual's role as a Team member.

*Potential Team Members* For most contracts, the Government Acquisition Team will be relatively small. The following will typically play a key role in contract pricing:

- Contracting officer or contract specialist;
- Requirements manager (i.e., program or project manager);
- End user; and
- Commodity specialist.

You might also obtain assistance from one or more of the following:

- Inventory manager;
- Auditor;

- Technical specialist;
- Transportation, property, or logistics managers;
- Legal counsel;
- Competition advocate;
- Administrative contracting officer or administration specialist; or
- Cost/price analyst.

This table summarizes the role that potential Government Acquisition Team members might play in making or supporting the contract pricing decision.

<p><b>Potential Members Typical Role in Contract Pricing</b></p>	
<p>Contracting Officer</p>	<p>The contracting officer is the person with authority to enter into, administer, and/or terminate contracts and make related determinations and findings. The term includes certain authorized representatives of the contracting officer operating within the limits of their authority as delegated by the contracting officer.</p>
<p>Contract Specialist</p>	<p>A contract specialist may be responsible for performing a wide variety of contracting activities under the authority of the contracting officer assigned to the contract. In this capacity, a contract specialist will likely provide key input to the pricing decision, but the ultimate decision on price reasonableness rests with the contracting officer.</p>
<p>Requirements Manager</p>	<p>Requirements managers initiate acquisitions by preparing purchase requests. Purchase requests specify the requirement and generally include an Independent Government Estimate. After you receive of the purchase request, requirements managers often can help:</p> <ul style="list-style-type: none"> <li>• Review alternatives for improving the solicitation,</li> <li>• Identify potential price-related factors for award,</li> </ul>

- Account for significant discrepancies between different comparison bases used in price analysis, and
- Provide advice and information for price-related decisions.

End User                   The end user may or may not be the requirements manager. If the requirements manager is not the end user, you may find it useful to consult the end user when building the solicitation and making price-related decisions. In addition, the end user may be more knowledgeable about the product and a better source for an Independent Government Estimate than the requirements manager.

Commodity Specialist     Some organizations have dedicated commodity specialists who, among other things, heavily research the markets for their respective commodities.

Inventory Manager       Inventory managers keep track of large stocks of products in Government warehouses and other such facilities. Among other things, inventory managers generate purchase requests for replacement supplies as users draw on the Government stocks. They tend to be especially concerned about the solicitation/contract, in terms of its potential impact on delivery, inventory levels, and inventory costs.

Auditor                   Auditors are accountants with specialized training and experience in examining and analyzing cost or pricing data provided by offerors and contractor records (particularly accounting records). Their support can be invaluable in cost proposal analysis. In the Department of Defense, contract auditors are assigned to the Defense Contract Audit Agency ([DCAA](#)). In other agencies, auditors are typically assigned to the agency Inspector General.

Technical Specialist     These specialists generally write specifications or statements of work and technical evaluation factors and evaluate technical proposals. In many acquisitions, the requirements manager acts as the technical specialist. Larger acquisitions,

however, may involve teams or panels of technical experts (who, depending on the specific deliverable, may be engineers, scientists, or other similar professionals).

From a pricing standpoint, technical specialists may have a good understanding of the costs necessary to build a deliverable and also of the types and sources of commercial products that may be available to satisfy a requirement.

Transportation, Property, or Logistics Managers	These specialists can help you select and apply price-related factors that involve transportation costs, Government-furnished property, and ownership costs. All may be involved if you plan to solicit based on a full life-cycle cost model.
Legal Counsel	Lawyers may play a role in clearing contracts and reviewing justifications for such price-related decisions as cancellation of an IFB after opening. Look to them for advice on the solicitation and on making the price-related decisions.
Competition Advocate	Competition advocates review acquisition plans and analyze specifications to identify and, where possible, remove "barriers" to full and open competition. They also review justifications for other than full and open competition. From a pricing standpoint, they can be valuable allies in maximizing price competition.
Administrative Contracting Officers and Administration Specialist	Some Federal agencies have dedicated contract administration offices. These offices are often involved in preaward reviews of contract pricing proposals because contract administrators have more complete information on the production and pricing practices of specific offerors. Administrative contracting officers may also be responsible for pricing certain kinds of contract modifications.
Cost/Price Analyst	Some contracting activities have dedicated cost/price analysts who can assist in performing the tasks described in this book. However, such analysts are typically only available for higher dollar, more complex

procurements.