



DEC 13 2005

MEMORANDUM FOR DAVID CAPITANO
DIRECTOR
DEFENSE ACQUISITION REGULATIONS COUNCIL

FROM: *jd* RALPH V. DESTEFANO, DIRECTOR
REGULATORY AND FEDERAL ASSISTANCE
PUBLICATIONS DIVISION

SUBJECT: FAR Case 2004-015, Payments Under Time-and-Materials and Labor-Hour contracts

Attached are comments received on the subject FAR case published at 70 FR 56314; September 26, 2005. The comment closing date is December 9, 2005.

<u>Response Number</u>	<u>Date Received</u>	<u>Comment Date</u>	<u>Commenter</u>
2004-015-1	11/23/05	11/23/05	ESRI
2004-015-2	11/25/05	11/25/05	Robert J. Melby
2004-015-3	11/25/05	11/25/05	Arctic Slope Regional Corp.
2004-015-4	11/23/05	11/23/05	Jardon and Howard Technologies, Inc.
2004-015-5	11/30/05	11/30/05	Leslie Colleen
2004-015-6	11/23/05	11/23/05	NAVICP
2004-015-7	11/22/05	11/22/05	Argy, Wiltse & Robinson
2004-015-8	11/21/05	11/21/05	Coalition for Government Procurement

<u>Response Number</u>	<u>Date Received</u>	<u>Comment Date</u>	<u>Commenter</u>
2004-015-9	11/21/05	11/21/05	Business Management Research Associates, Inc.
2004-015-10	12/04/05	12/04/05	Vernon Edwards
2004-015-11	12/06/05	12/06/05	ABA
2004-015-12	12/09/05	12/05/09	CSA
2004-015-13	12/09/05	12/09/05	Centre Consulting, Inc and Centre Law Group
2004-015-14	12/09/05	12/05/09	CODSIA
2004-015-15	12/09/05	12/09/05	POGO
2004-015-16	12/09/05	12/08/05	DCAA
2004-015-17	12/08/05	12/08/05	ITAA
Attachments			



2004-015-1

November 23, 2005

Attention: Laurieann Duarte
General Services Administration
Regulatory Secretariat (VIR)
1800 F Street, NW
Room 4035
Washington, DC 20405

**Subject: Request for comments to FAR Case 2004-015
Payments Under Time-And Materials and Labor-Hour Contracts**

Gentlemen:

Environmental Systems Research Institute, Inc. (ESRI) appreciates the opportunity to provide comments for your consideration regarding the above-referenced proposed rule and the related FAR Case 2003-027. ESRI is a California corporation with its headquarters in Redlands, California and regional offices located throughout the United States. Our organization is the industry and worldwide market share leader in the field of Geographic Information Systems (GIS). Our software and services support diverse applications in commercial organizations, state, local, and federal governments as well as international entities.

Background

While software represents the largest component of our business, ESRI routinely sells professional services associated with the implementation of our software and GIS technology to support our clients. Time-and-materials (T&M) contract vehicles are utilized by ESRI throughout federal, state and local government; private industry; and international organizations. In addition, we supplement our Professional Services staff with subcontractor professionals as follows:

- To provide services in specialized areas of expertise currently not staffed
- To supplement the ESRI professional services staff when schedule or client demands cannot be met internally
- To provide resources at a lower cost than can be offered by ESRI (typically identified in the proposal process)

Comments

As the leading provider of GIS software and technology, ESRI has had significant experience working with most agencies within the Federal Government. We have worked to make our users successful and in step with fast-paced GIS technology. The development of competent subcontractors in a variety of technical fields has been a key component to our success. It expands GIS technology to a wider spectrum of customers.

2004-015-1

As our subcontractors represent ESRI, we take considerable measures to ensure that their performance exemplifies ESRI's standards and reputation.

In a time-and-materials contract scenario, the Government is often purchasing a level of skill or professional expertise. The evaluation process would include review of staff descriptions, including level of education and experience. It is incumbent upon the contractor to provide the level of expertise offered and contracted. If there are staff members who are critical to a specific project, they are named as "key personnel".

Recommendation for Consideration

It is our recommendation that the Government consider a process for controlling the use of subcontractors that properly places the responsibility on the contractor for performing and providing qualified staff. Toward this objective, ESRI suggests that the Government:

- Allow the contractor to provide competent staff within the framework of costs proposed—using subcontractors to supplement when a business need exists
- Require a notification process to the Government rather than request approval. This will give the opportunity for the Government to express any concerns.
- Designate key personnel when the criticality of the work dictates a need.
- Utilize the audit process currently defined in FAR 52.232-7 (e) Audit as the monitoring device for excessive profit or fee.

It is our view that incorporation of additional rates and approvals adds an unnecessary layer of administration to the government contracting process that is not commensurate with the level of risk or cost benefit. The Government has the ability to monitor each contractor's practices through various audit vehicles—and can request detailed information on any single invoice. In addition, the Government can reject the work provided by a subcontractor within the Inspection and Acceptance clauses. The assignment of staff, allocation of resources, and performance is the contractor's responsibility. Additional controls restricting a contractor's use of proven subcontractors greatly reduces the contractor's ability to efficiently support government programs.

Thank you for the opportunity to comment.

Sincerely,



Jason Brouillette
ESRI Corporate - Federal

2004-015-2



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cc

bcc

Subject FAR Case 2004-015

Attached are my comments with respect to the proposed rule.

Thank you.



rjm Comments on Proposed Rule Change FAR Case 2004-15.doc

2004-015-2

Comments Regarding Proposed Change
FAR Case No. 2004-15

Dear Sirs:

The following comments are offered with respect to the proposed rule change regarding subcontractor costs on Time and Material/Labor Hour contracts.

The proposal indicates that subcontractor labor hours paid at the labor hour contract rate must be accounted for and substantiated under the same standards as labor hours provided by the prime contractor. A casual reading might relate this requirement to the prime contractor's indirect rate structure/calculation methodology (e.g., mandating subcontractor costs to be included in the prime contractor's overhead base). However, the statement refers only to labor hours (which might not be the prime contractor's overhead base) and speaks about accounting and substantiation which generally refer to justification, support, and/or accounting records. To avoid any misunderstanding or misapplication of the new rule, it would be desirable to clarify exactly what is meant by the prescribed requirement.

For example, if the requirement relates only to recordkeeping, a contractor might estimate a blended contract labor hour rate consisting of its own direct labor rates/costs, applicable overhead, and G&A, plus subcontractor invoice rates/costs plus profit. As such, subcontractor labor costs might not include any allocation of the prime contractor's overhead costs. Documentary evidence of subcontractor labor hours/costs could then be accumulated in the same manner as prime contractor labor and maintained for government audit/inspection, but the subcontractor's labor cost would not become part of the prime contractor's overhead base.

Since the final rule likely will not prescribe a single cost accounting treatment for all contractors, it would be helpful to address the acceptability or preference of various alternatives with respect to allocating prime contractor overhead to subcontractor labor. Possibilities might include no allocation, special allocation, or full allocation. Likewise, comments to address the potential inconsistency of bidding/billing some subcontractor labor at contract rates and others at cost would also be of benefit with respect to Cost Accounting Standards compliance.

Aside from providing more explicit guidance with respect to the accounting treatment of subcontractor labor on future T&M contracts, promulgation language (background and/or clarifications regarding existing regulations) regarding the proposed rule could be of significant value with respect to the administration of thousands of existing T&M contracts. For example, in describing the alternatives that were considered before adopting the proposed rule, one of the options was to entirely preclude subcontractor hours from being costed/billed at contract rates. This would seem to indicate that the pricing/billing of subcontractor hours at contract rates is not entirely precluded under existing rules.

2004-015-2

Thank you for the opportunity to comment.

Sincerely,

Robert J. Melby
1819 Canoe Ridge NW
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November 25 2005

2004-015-3

arctic slope regional corp.

November 25, 2005

Sent via e-mail to: farcase.2004-015@gsa.gov

Ms. Laurieann Duarte
General Services Administration
Regulatory Secretariat (VIR)
1800 F Street, N.W.
Washington, D.C. 20405

Subject: FAR Case 2004-015, Payments Under Time-and-Materials and Labor-Hour Contracts

Dear Ms. Duarte:

Arctic Slope Regional Corporation (ASRC), an Alaska Native Corporation (ANC), appreciates the opportunity to submit comments upon the proposed rule published in Federal Register Volume 70, Number 185, on September 26, 2005. As an ANC, ASRC has several subsidiary companies that do business with the Federal Government under the Small Business Administration's 8(a) contracting program. It is on behalf of our 8(a) subsidiaries, and other qualified small businesses doing business with the Federal Government, that our comments are submitted to you.

The proposed rule intends primarily to change the current Federal Acquisition Regulation clause 52.232-7, entitled Payments Under Time-and-Materials and Labor-Hour Contracts, for the stated purpose of clarifying the payment policies with respect to the acquisition of "other direct costs," including materials, supplies, equipment, and especially, subcontract costs. Specifically, the proposed rule will do the following:

1. Amend FAR 16.307(a)(1) to require the inclusion of FAR clause 52.216-7, "Allowable Cost and Payment" in all T&M contracts, applicable only to the contract portion covering the acquisition of materials at actual cost.
2. Add a definition of "materials" under T&M contracts to FAR 16.601(a), for the purpose of clarifying what types of items may be reimbursed under T&M contracts at direct cost plus applicable indirect costs, including subcontracts.
3. Include within the FAR clause 52.232-7 itself the new definitions of "materials," to include subcontracts, interdivisional transfers, as well as other direct costs for supplies and services.

4. Integrate the language of Alternate I to FAR clause 52.232-7 into the body of the clause, to authorize contractors to bill for the provision of its own commercial products at established catalog or market prices, without the requirement of an additional contracting officer decision to include that by specific authorization of an alternate FAR clause.
5. Specify within FAR clause 52.232-7 that the Government will not pay profit or fee on any materials billed under T&M contracts.
6. Establish a category of subcontracts and interdivisional transfers for "incidental" services which may be billed at actual cost plus allowable indirect costs, per the requirements of FAR clause 52.216-7.
7. Establish a second category of subcontracts and interdivisional transfers, pertaining to the performance of those services that are to be billed by the contractor under its fixed contract labor rates. For this second category of subcontracts and interdivisional transfers, the Government will be required to select whether to require such subcontractors to be identified within FAR clause 52.232-7 at the time of contract award, and to then bill the Government for subcontract services using the contract's fixed labor hour rates, or whether to permit such subcontracts to be billed at their actual cost plus the applicable indirect costs (like the "incidental" services, above).
8. Amend the FAR clause 52.232-7 to permit the application of Prompt Payment Act interest to the interim payments made under T&M contracts, consistent with similar guidance for fixed price and cost reimbursement contracts.

ASRC has carefully evaluated these proposed changes, and we endorse most of them as positive measures that will assist both the Government and the community of contractors in achieving a smooth administrative process with respect to payments under T&M and Labor Hour contracts. However, we are deeply concerned with the practical effect of one of the proposed changes to FAR Clause 52.232-7 – specifically, the new requirement for the Contracting Officer to select whether to require subcontracts to be billed using the prime contract's fixed labor rates, or whether to permit the billing of subcontracts at actual cost plus applicable indirect costs. We are especially concerned with the requirement that subcontracts that will be required to bill at the prime contract's fixed labor rates must be named in the awarded contract.

At the present time, the Federal Government purchases a vast amount of services from contractors through the use of T&M and Labor Hour contracts. These take the form of Government-Wide Acquisition Contracts (GWAC's), and Indefinite Delivery Indefinite Quantity (IDIQ) contracts that span large programs, or generic types of services, as well as smaller T&M and LH contracts for the accomplishment of specific projects by single agencies. These contracts are often worth hundreds of millions of dollars or more, and they usually include large teams of subcontractors, each one involved to contribute specific expertise or experience to the overall program, or to fulfill a small business subcontracting goal requirement which must be met by the large business prime contractor.

As a practical matter, prime contractors who bid on large T&M contracts, backed by a team of subcontractors, may indeed make efforts to achieve a realistic set of “blended” or “composited” fixed labor rates to encompass all work to be done under the contract. This process is accomplished by using the estimated distribution of labor hours among the labor categories of the RFP, soliciting fixed labor rates from each subcontractor on the team, and integrating the rates into a “composite” by weighting the hours distribution of each labor category.

However, the reality of this system is that the work performed under the resulting contract – which we agree cannot be defined with any specificity at the time the fixed labor rates are developed – by definition cannot match the distribution of subcontracted hours used to develop the “blended” or “composite” rates proposed and awarded. Therefore, the only practical way for a prime contractor to manage a team of subcontracts under “composited” rates is to restrict the performance of subcontract work to only those subcontracts whose fixed labor rates are less expensive than the prime contract’s corresponding fixed labor rates (including an amount for the prime contractor’s applicable indirect cost and profit).

The necessity of managing the performance of a team of subcontractors under “composited” rates through this leveling process operates to restrict the actual usage of small business subcontractors, since it is usually their fixed labor rates that exceed the “composited” fixed rates of the prime contract. Small businesses cannot normally achieve the competitive indirect burden rates that large businesses obtain by distribution of indirect costs over a large cost base (including the cost of a large team of subcontractors).

This proposed rule therefore will be a financial disincentive for large business prime contractors to use small business subcontractors to any extent beyond the mandatory minimum commitment in the prime contractor’s required small business subcontracting plan. Once those minimum goals are met, the prime contractor will have no incentive to lose any additional money by utilizing any small business subcontractor whose rates are not significantly less expensive than its own. Few, if any, small business subcontractors can achieve the competitive T&M rates that can be bid by a large business – which, after all, has a large business base upon which to spread its indirect costs.

Additionally, the need to identify each subcontractor in the awarded contract, in order to permit it to bill under the fixed labor rates, also serves as a barrier to the addition of any new subcontractors during the course of contract performance, as this would require the proposal of new “blended” rates, the audit and approval of revised pricing, and the processing of a formal contract modification to add the new subcontractor to the approved list. This is a significantly more cumbersome process than the subcontract consent procedure currently required by FAR clause 52.244-2, Subcontracts, since the “composited” labor rates of the prime contract would have to be revised for the impact of each added subcontractor’s rates, against the estimated labor hours per labor category of subcontracted work.

While this alternative selection approach proposed by the new rule appears to be a reasonable way to ensure fair payment of costs to the contractor and its subcontractors, while also ensuring the Government’s payments are in accordance with its bargain, the practical reality is significantly different. The choice of the Government to use the “composited” rate system of

2004-015-3

subcontractor payments will become a clear disincentive for large prime contractors to use small businesses to any extent beyond what they are required to do by the mandates of their small business subcontracting plans – and perhaps not even to that extent, if the financial penalty is sufficiently severe in terms of small business labor costs above the composite rates.

Based on the foregoing, ASRC respectfully requests that the Government should not proceed with this particular proposed change to FAR Clause 52.232-7. ASRC supports the other proposed regulatory changes included in FAR Case 2004-015.

On behalf of ASRC, thank you for the opportunity to submit comments on the proposed regulatory changes included in FAR Case 2004-015, Payments Under Time-and-Materials and Labor-Hour Contracts. If you have any questions or require additional information regarding ASRC's comments, please do not hesitate to contact me.

Very truly yours,

ARCTIC SLOPE REGIONAL CORP.
An Alaska Corporation

Alma M. Upicksoun
Vice President & General Counsel

cc

Jacob Adams, President & CEO
Mark Kroloff, Executive Vice President & COO
ASRC In-House Legal Counsel

2004-015-4



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Subject FAR Case 2004-015

23 November 2005
General Services Administration
Regulatory Secretariat (VIR)
1800 F Street, N.W. Room 4035
ATTN: Laurieann Duarte
Washington, DC 20405

Subject: FAR Case 2004-015, Payment Under Time and Materials and Labor Hour Contracts, 70 Fed. Reg. 56314 (September 26, 2005); FAR Case 2003-027, Additional Contract Types, 70 Fed. Reg. 56318 (September 26, 2005)

Dear Ms. Duarte:

We submit that the prohibition against any profit or fee on materials proposed in paragraph (b) (9) is extremely detrimental especially to small businesses.

This change would inordinately impact small business both when they are prime contractors and as subcontractors to larger businesses. Many small businesses (especially 8(a), SDVOSB, and other categories which benefit from outreach programs) as prime contractors derive a large portion of their annual revenues from contracts for acquisition of large amounts of materials which have minor labor hour or T&M aspects to support integration, deployment or maintenance of the materials. Not allowing these small businesses to collect fees on the materials when the labor portion is small would erode any potential earnings for these small businesses.

In addition, many large businesses support small businesses through subcontracts for services that the large business could, in fact, perform itself. Often this is done in response to small business subcontracting requirements imposed under federal government contracts. If these businesses are no longer able to earn fee on these subcontracts they will be far less likely to subcontract the work. The proposed change is paradoxical to the government's goal to increase the use of small businesses as subcontractors. We believe it is critical that the Councils examine the potential consequences of this conflict between the applicable FAR regulations prior to finalizing the changes.

An objective of this change is "to ensure fair and reasonable prices under T&M contracts." Fair and reasonable must be applied both to the cost paid by the government and what is paid to the contractor. Depriving businesses of earnings (profit or fee) on the materials they sell is not a "fair" policy. Market forces will act in competitive procurements to keep the government's price fair and reasonable, the profit prohibition is not necessary for that purpose. JHT strongly recommends that the government allow the market forces inherent in the competitive procurement process to ensure fair and reasonable pricing for the government and to the contractor community.

2004-015-4

JHT appreciates the opportunity to provide comments on this change.
Sincerely,

Mary R. Carroll
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2004-015-5



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Subject I concur.

2004-015-6



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Subject Comment on Proposed FAR Rule: Payments under
Time-and-Materials and Labor-Hour Contracts; FAR Case
2004-015

The NAVICP requests the Councils' consideration of the following comment on the proposed FAR Rule:

Our comment concerns the proposed revision to the FAR Clause 52.2372-7, *Payments Under Time-and-Materials and Labor-Hour Contracts*, specifically with respect to paragraph (b)(3). While we agree in principle with including the prior Alternate I language to the basic clause, we have concerns with the proposed wording used in the revised paragraph (b)(3).

The proposed wording in paragraph (b)(3) of the revised clause will read as follows:

'(b) *Materials*. For the purposes of this clause-

(3) If the Contractor furnishes its own materials that meet the definition of a commercial item at 2.101 of the FAR, the price to be paid for such materials shall be the Contractor's established catalog or the market price, adjusted to reflect the-

(i) Quantities being acquired; and

(ii) Actual cost of any modifications necessary because of contract requirements.'

This paragraph, as written, could be interpreted as meaning that the contracting officer is required/restricted to pay the catalog or market price for these materials, and is not free to negotiate better pricing. In our experience, we are often able to acquire these commercial items under time-and-material service contracts at prices that are less than commercial list/ market price.

To avoid potential conflicts in this area, we recommend that the paragraph be re-worded to replace the word 'be' with the words 'not exceed' as shown below:

(b) *Materials*. For the purposes of this clause-

(3) If the Contractor furnishes its own materials that meet the definition of a commercial item at 2.101 of the FAR, the price to be paid for such materials shall **[not exceed]** be the Contractor's established catalog or the market price, adjusted to reflect the-

(i) Quantities being acquired; and

(ii) Actual cost of any modifications necessary because of contract requirements.

This minor change makes it clear that the contracting officer may seek price reductions over catalog or market prices for contractor furnished commercial items.

Respectfully Submitted/

Linda Koone
NAVICP Code M0251.4
Phone: (717)605-7682

2004-015-7



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Subject FAR Case 2004-015

These comments are respectfully submitted by Argy Wiltse & Robinson, P.C.

<<FARCase2004015.doc>>

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Comments on the proposed changes to the Federal Acquisition Regulation concerning Time and Materials (T&M) and Labor-Hour (LH) contracts. FAR case 2004-015

Introduction

Argy, Wiltse & Robinson, P.C. (AWR) is presenting its comments on the proposed regulations from the small business's perspective. Unlike large government contractors, most small businesses are not going to respond to a forum of this type because they do not follow the government rule-making process. They do not have the time, nor the expertise, to participate. They do not have the funds to have lobbyists or attorneys make their case. This means that they will be reacting to the changes when they are being implemented. AWR believes that small businesses are not going to be adequately represented in this process.

The regulations do not need a band-aid approach to a regulation that addresses an area of contracting that has dramatically increased over the last decade. The proposed changes to the T&M and LH regulations would significantly hinder small-businesses from effectively competing for federal government work. While many understand what the problem is, most small businesses do not understand that the issues affect their normal mode of operation. In addressing the changes that should be made to the regulations, the FAR council needs to determine the current practices for such types of contracts and the ultimate intent of any proposed changes to the regulations.

If it is the intent of the changes to this regulation to eliminate many small businesses from competing for T&M or LH contracts, it will succeed. If the intent is to prevent any but approved subcontractors from being billed as labor, it needs further revision.

If the intent is to reduce the profits of small businesses it will succeed. If the intent is to prevent a misuse of T&M and LH contracts, it needs further revision.

If the intent is to clarify and make more inclusive what may be billed as 'materials', it has not addressed a key element. If the intent of the changes to the regulations is to provide a usable and flexible requirement to fit the Government's needs, it needs further revision.

Our specific comments and proposed revisions to the draft regulations clarify what, we believe, the regulations should reflect. We considered how the federal government is currently using such contracts and how small businesses normally bid such contracts. Ultimately, we concluded that the changes to the regulations should require disclosure of a subcontractor and verification of its qualifications. Further, redefining the contract type should be pursued to increase the Government's flexibility of what currently may be billed as 'materials'. The proposed change to the regulation redefining "materials" is contrary to the common business meaning of the word. The government would be better served by using commonly accepted terminology in the long run, even if it means changing the contract type nomenclature.

2004-015-7

Background and Observations

It is in the best interest of the government, and of the small businesses that have T&M and LH contracts, to encourage competition and to allow small businesses the flexibility to manage their operations. Our firm's professionals have been dealing with this issue from time to time for decades. Use of subcontractor to provide labor hours under T&M and LH contracts is not a new subject.

So with a plethora of experiences with these types of contracts and our knowledge of industry practices, we see a need for the regulations to be revised particularly given the following:

- Small businesses require the services of consultants and subcontractors to supplement their capabilities and effectively compete for a multitude of potential contracts.
- It is in the best interest of the federal Government to encourage competition.
- Small businesses need to have the flexibility to change subcontractors if they are having performance or business problems.
- The Government must be assured that it is getting the same qualifications as was originally proposed.
- Small businesses need to make a profit on subcontracted services that may be a major participant in one or more tasks; otherwise they will not bid such tasks.
- The Government should encourage competition on tasks under BOA and IDIQ contracts, but even if competition should not exist, the Government should want to ensure that it receives the services it contracted for.
- The Government should have the right to know when subcontractors are being replaced particularly for quality assurance purposes.
- The Government should be able to review and approve such a replacement's qualifications.
- That placing too many limitations on subcontracting by large businesses will ultimately reduce the subcontracting opportunities for small businesses.

The Environment

For decades, small businesses have been using consultants and subcontracts to supplement their workforce to compete on federal T&M and LH awards. Typically, these contracts require more staff or expertise than a small business has in-house. The federal procurement often does not require some hourly services full-time and the expense of hiring and retaining such personnel would be too costly for a small business. Other times the expertise of the small business is only in one area of the work they are being asked to bid. So the small business develops a team to bid on such work, combining their expertise and workforces to compete for and complete the potential task under the project.

There are times after the contract award that a small business may hire a subcontractor or consultant to do work under a federal T&M or LH award. They can be summarized as follows:

1. To replace another subcontractor.
2. To supplement its own workforce so that it may bid on the task.
3. To avoid the time and cost of hiring and benefits for a short-term need.

4. To provide the government with the expertise requested under a task but the small business does not currently have.

Such labor is invoiced at the government at the contracted rate. Sometimes using the subcontracted services results in an accounting loss. That is, the cost of the subcontract and allocable indirect costs is more than the amount of revenue generated from the contract.

We have never seen any small business use a subcontractor when it has the staff available to perform the work. Small businesses will use subcontracts when its own staff is not available and the time does not permit and business conditions do not warrant another employee to be hire and trained.

The need for the subcontracts and consultants is driven by the requirements of the contract and requested task orders. The contracts are not personal services contracts. The government or a prime contractor requests a service at a specified price. It negotiates the price of tasks in terms of effort required using the rates in the T&M or LH contract award. It is sometime during this process that a subcontractor may be used without the government's knowledge.

Sometimes the small business does not have the staff in-house to do the work when it has bid and may use salary surveys and its own indirect cost structure to estimate the cost of employees that it will subcontract. That intent may or may not be disclosed to the federal government. But on large procurements it may be the only way to be responsive. In essence, the small business takes the risk that it will be able to find the labor using a subcontract and at the same price. This is not always true and there are times the small business does not even recover its cost of subcontracting. Later, a federal auditor may find that subcontractors or consultants were used in fulfilling the government's requirement. This has been raised at many small businesses as a violation of the payments clause. In those cases where Government auditors claimed a breach of the payments clause by our clients, the proposal submitted to the Government disclosed the use of subcontractors.

The Problem

The real problem stems from the classification of labor versus subcontracted services. Several questions have been raised with regard to subcontracted services by the government, such as:

- Can the contractor use non-employees to do hourly work under T&M contracts?
- Is it permitted to charge non-employees through the hourly labor rate?
- Has the government expanded the use of this type of contracting and is requiring the contractors to bid contracts that require subcontracts in developing hourly rates?

T&M contracting has become a great source of business for companies. Such contracts are easier to administer for the government. But no one developing the original regulations ever envisioned the way they are presently used. Clearly the government's own contracting practices have long since altered the original purpose of the regulations in use.

An Approach

The federal government's concern should be that it obtains the services it contracted for at the agreed upon price and quality. Historically, T&M and LH contracts are subject to the Truth in Negotiation Act and, as such, intentionally misrepresenting the estimated cost has very serious consequences. Small businesses do understand this. The prices may also have been determined through competition or price analysis. Thus, the government should not ordinarily be concerned with renegotiating hourly rates because of new or changed subcontractors. The real focus should be on making sure that the government receives the quality of services for which it contracted.

One issue raised by some on the government procurement side is that the government may pay fee or profit twice when a subcontractor is used. But this is true of any non-labor item purchased and included in the hourly rate, such as costs in the indirect cost pool. The purpose of the prohibition in a T&M contract was because the amount was not known and was not material to the hourly labor charges. Under the current use of "T&M" contracts the "materials" are often significant, but still a small percentage of the total contract value. However, if the subcontract labor is reclassified to "materials", small businesses may be left with fees on less than 10% of the price. This may lead to significant increases in no-bidding task orders. In such cases both the government and the small business lose.

For many small businesses, a task calling for the subcontracted labor may require a majority of the task to be performed by the subcontractor. Thus, a small business would not be adequately compensated if they could not use the hourly rates and would have no incentive to contract for the task. The government's competition would decrease and some services would just not be available. The proposed rule would allow such contracting only if the subcontractor was known at the time of award and listed in the contract under clause 52.232-7. While we agree that the government should be informed, listing only the known subcontractors will not help many small businesses, and would discourage prime contractors from finding and using other small businesses.

The proposed changes to the regulation do not address modifications to the contract to allow the use of different subcontractors from the ones listed in the contract. While the ability to modify a contract is implicit, changing subcontractors should be explicit because of condition governing how the contract was awarded. Further, the process of obtaining a modification can take a significant time. If the proposed changes require a modification each time a prime or sub-contractor identifies a new subcontractor, the federal procurement process could be significantly disrupted or delayed. In addition, the proposed changes make no distinction based on how a contract was awarded. Where there was adequate competition or prices were based on a GSA schedule, the Government should have the right to approve the new subcontractor for quality, but not the right to automatically negotiate a new hourly rate. This implies the right of contractors to increase the hourly rates after contract award. For these examples, the administrative requirements governing T&M contracts would increase significantly. Alternately, competition among small businesses for T&M contracts may decrease significantly.

All businesses are in the business of making a profit. The government currently pays fees on materials and subcontracts under cost-plus-fixed-fee contracts. The original prohibition on paying profit on materials and supplies in the T&M contract stems from the fact that such costs were incidental to the contract. Contrary to what was stated in the discussion provided before the proposed changes to the regulation, the current use of T&M contracts by the government has changed over time and conditions have significantly changed.

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Since the original regulations were in place, a large contractor is required to find qualified small and small disadvantaged subcontractors to perform parts of its effort. Such requirements did not exist at the time the original T&M regulations were developed. The use of "materials" by the government has significantly been expanded and now includes virtually everything that may be included in a cost type contract. Many CPFF and FFP contracts have been replaced by T&M contracts. The purpose of which appears to be reducing the administrative burden and shared risk on the contractors and the Government. However, using the prior contract types allowed contractors to calculate profit on the total cost, including subcontracts and materials. Thus, we believe that the procurement office should be allowed to determine if a fee is appropriate under certain limited circumstances. Again, such rules should be specific.

Some procurement officials believe that using subcontractors to perform services under contractual hourly rates results in windfall profits. Such a view ignores the opposite also occurs. Many contractors also may lose money by using subcontractors. We have seen both cases in practice. As stated earlier there are numerous requirements to prevent such overpricing, including price competition. Also, substituting cheaper employees for more expensive subcontracted work is not addressed by the above concern. Thus, the regulations should not be changed with an undue concern about excessive profit. Any circumstance can be manipulated in a small number of cases and there are no reports of widespread abuses.

The use of T&M contracts has expanded widely over the years and now encompasses a far greater fundamental change in government contracting than the proposed changes in the regulation for the classification and payment of subcontract cost. Routinely, the government is reimbursing travel, equipment, communications and Other Direct Costs under T&M contracts. Instead of redefining materials to include subcontracted services, the government should exclude the word materials altogether in defining the contract type.

Some Suggestions

The proposed regulations should be revised but rather than restricting the way most small-businesses operate, it should be expended to cover how this form of contract is being used. First, we recommend that the government change the nomenclature of T&M contracts because it is not how they are currently used and it will bring attention to the changes. We suggest the new name for the contract type be referred to as Time and Other Direct Cost (T&O) contracts. The following revisions are being made to allow contractors to disclose that subcontractors or consultants are being proposed or may be used in the performance of the contract.

<u>AS PROPOSED</u>	<u>AWR SUGGESTS</u>
<p>16.601 Time-and-materials contracts</p> <p>(a) Definitions for the purposes of Time-and-Material Contracts. Direct materials means those materials that enter directly into the end product, or that are used and consumed directly in connection with the</p>	<p>16.601 Time-and-other direct cost contracts</p> <p>(a) Definitions for the purpose of Time-and-Other direct cost Contracts. Other direct costs means those materials that enter directly into the end product, or those materials, products or services that are consumed</p>

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<p>furnishing of the end product or service. Materials means –</p> <ul style="list-style-type: none"> (1) Direct materials, including supplies and services transferred between divisions, subsidiaries, or affiliates of the contractor under a common control; (2) Subcontracts for supplies and services; (3) Any other Direct costs (e.g. travel computer usage charges, etc); and (4) Applicable indirect costs. <p>(b) *** (2) Actual cost for materials</p>	<p>in completing the contract terms and are called out in the contract. Other costs means –</p> <ul style="list-style-type: none"> (1) Direct materials and supplies, including those transferred between divisions, subsidiaries, or affiliates of the contractor under a common control; (2) Subcontract or consultant services not included in the labor rates agreed upon (3) Travel costs (4) Computer and computer related costs (5) Others costs as required by contract terms <p>(b) *** (2) Actual cost for materials, including allocable indirect cost</p>
<p>52.232-7 ...</p> <p>(a) Hourly rate. (1) the amounts shall be computed... The rates shall include wages, indirect costs, general and administrative expense, and profit. ...</p> <p>(b) Materials. For the purpose of this clause-</p> <ul style="list-style-type: none"> (1) Direct materials means those materials that enter directly into the end product, or that are used and consumed directly in connection with the furnishing of the end product or service. (2) Materials means – <ul style="list-style-type: none"> (i) Direct materials, including supplies and services transferred between divisions, subsidiaries, or affiliates of the contractor under a common control; (ii) Subcontracts for supplies and services; (iii) Any other Direct costs (e.g. travel computer usage charges, etc); and (vi) Applicable indirect costs. ... <p>(4) Subcontracts. (1) Unless the subcontract is listed in paragraph (b)(4)(ii) of this clause subcontract costs will be reimbursed at actual costs as specified</p>	<p>52.232-7 ...</p> <p>(a) Hourly rate. (1) the amounts shall be computed... The rates shall include wages, indirect costs, subcontracted services cost, consultant cost, general and administrative expense, and profit. ...</p> <p>(b) Other costs. For the purpose of this clause includes-</p> <ul style="list-style-type: none"> (1) Other direct costs means those materials that enter directly into the end product, or those materials, products or services that are consumed in completing the contract terms and are called out in the contract. (2) Materials means – <ul style="list-style-type: none"> (i) Direct materials and supplies, including those transferred between divisions, subsidiaries, or affiliates of the contractor under a common control; and (ii) Applicable indirect costs. (iii) Subcontracts or consultants for services not included in the labor rates agreed upon (iv) Travel costs (v) Computer and computer related costs (vi) Others as required by contract; and (vii) Applicable indirect cost... <p>(4) Subcontracts and Consultants. (i) Unless the subcontract or consultant is for labor required under this contract and is listed in paragraph (b)(4)(ii) of</p>

<p>in paragraph (b)(5).</p> <p>(ii) Provided the subcontractor agreement requires the Contractor to substantiate the subcontract hours and employee qualification, the Contractor shall be reimbursed at the hourly rates prescribed in the schedule for the following subcontractors: <i>[Insert subcontractor name(s) or, if no subcontracts are to be reimbursed at the hourly rates prescribed in the schedule, insert "None"]</i></p>	<p>this clause, subcontract or consultant costs will be reimbursed at actual cost as specified in paragraph (b)(5). Where the contractor intends to use subcontractors or consultants, but one has not been identified, the labor categories should be listed where one may be used. Once the subcontractor has been identified, it must be added to the list in paragraph (b)(4)(ii)</p> <p>(ii) Provided the subcontractor or consultant agreement requires the Contractor to substantiate the subcontract hours and employee qualification, the Contractor shall be reimbursed at the hourly rates prescribed in the schedule for the following subcontractors, consultants and/or labor categories: <i>[Insert subcontractor or consultant name(s) or the labor categories that may be performed by subcontract or consultant labor, if no subcontracts or consultants are to be reimbursed at the hourly rates prescribed in the schedule, insert "None"]</i></p>
--	--

The above suggestions are directed at disclosing subcontracts and consultant costs that may be used to fulfill the requirements of a T&M of LH contract. Definitions of what is considered labor need to be expanded just to meet the subcontracting requirements being placed on large businesses. Identifying that the subcontracts and consultants may be used on a LH contract will give the flexibility to small businesses to fulfill the requirements of their contracts when employees cannot be hired or would be economically harmful to the small business.

Conclusion

The proposed regulation identifies the need for changes to the T&M and LH contracting practices. However, the proposed changes will be harmful to small businesses because they will not permit more flexible business decisions required by many small businesses. This could lead to a great reduction in small business participation in T&M and LH contracts.

The practice of using T&M contracts by the federal government has undergone a dramatic change and increase. The regulations need to redefine the T&M contract to a T&O contract because this is the nature of many of these contracts currently awarded. While this is a greater change to the regulation, it is one that would be in the best interest to both parties in the long run. The regulations need to reflect the actual business practices and federal requirements currently placed on bidders, such as subcontracting goals, but still assure the government that it is receiving the products and services for which it contracted. The focus needs to be on disclosure and verification of qualifications, not prohibitions or restrictions on subcontracting, nor renegotiating prices when there was adequate price competition.

We recognize that we did not propose any suggested regulations for some of our recommendations. Those areas, such as when a price adjustment should be required or circumstances where a fee should be permitted, need further consideration on the part of both the federal government and industry.

If you have any questions please call Charles L. Bonuccelli, CPA at (703) 752-7381.

2004-015-8

November 21, 2005

General Services Administration
Regulatory Secretariat (VIR)
1800 F Street, N.W.
Room 4035
ATTN: Laurieann Duarte
Washington, DC 20405

Re: FAR Case 2004-015, Payment Under Time-and-Materials and Labor-Hour Contracts, 70 Fed. Reg. 56314 (September 26, 2005); FAR Case 2003-027, Additional Contract Types, 70 Fed. Reg. 56318 (September 26, 2005)

Dear Ms. Duarte:

The Coalition for Government Procurement (Coalition) is pleased to submit the attached comments on FAR Cases 2003-027 and 2004-015 concerning Time and Materials and Labor Hours (T&M-LH) Contracting. The Coalition is a non-profit association representing over 330 companies selling commercial services and products to the federal government. Our members are comprised of large and small firms that sell through FSS Multiple Award Schedule (MAS) contracts as well as other Indefinite Delivery Indefinite Quantity (IDIQ) and Government Wide Acquisition Contracts (GWAC's). Coalition members account for over 70% of schedule sales and a significant amount of GSA GWAC transactions. Since 1979, our mission has been to work with decision makers in GSA, the executive branch generally, and Congress to bring about common sense acquisition policies in the federal market place.

Coalition members experience a significant use of T&M-LH contracting in their commercial business activities. This contracting method permits effective cost control and provides operational flexibility, especially in a dynamic business environment. Companies are able to use market rates to attract key talent and still control project costs with dollar ceilings. In addition, T&M-LH contracting reduces redundancies and inefficiencies through flexibility in administration, and it allows rapid response to business needs by allowing changes in staffing levels without delay. If these benefits can be experienced in the private sector, the Coalition believes, especially in this time of budget constraint and the need for programmatic efficiency, these benefits should be brought to those who serve the public, as well. For this reason, we appreciate the opportunity to assist the government finding an appropriate methodology for the implementation of T&M-LH contracting.

Discussion

Section 1432 of the Services Acquisition Reform Act (SARA) of 2004 amended Section 8002 of the Federal Acquisition Streamlining Act (FASA) to authorize T&M-LH contracting for commercial services. Up until that time, there was confusion regarding the use of this contracting method. Under Section 8001 of FASA, services were considered commercial items based on established catalog prices for specific tasks under standard terms and

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conditions. In addition, the Act stated that firm fixed price and fixed price with economic price adjustment should be used to the maximum extent practicable for commercial item acquisition and that cost-type contracts were not to be used.¹ The absence of an explicit prohibition on the use of T&M contracting, however, left the issue of their use an open question. SARA addressed this confusion, explicitly authorizing T&M contracting under specific circumstances.²

Generally, Coalition members are concerned that the proposed rules would contradict the intent of SARA by creating, in practice and effect, a prohibition on the use of T&M-LH contracts. Specifically, the proposed rules, notably the rule for commercial services, appear to add administrative burden and procedural complication to the utilization of T&M-LH contracts so as to inhibit the use of these contracts as a practical contracting tool.

FAR Case 2003-027

Significant D&F Requirement

Currently, FAR 12.207, 16.601, and 16.602 collectively mirror the thrust of the grant of T&M-LH authority set forth in SARA. The proposed rule, however, adds to these regulatory requirements further mandatory elements of a D&F necessary to use this contracting type. These mandatory elements can effectively restrain what would be a legitimate use of T&M-LH contracting in the context of commercial item procurements. For instance, in the case of an IDIQ contract that contemplates award of only T&M-LH orders, the D&F must be approved one level above the contracting officer. This approval requirement, however, exceeds that of the non-commercial use of T&M ordering procedures under indefinite delivery contracts, a situation where, presumably, the government is exposed to greater risk than in the commercial context given the absence of a commercial market reference that might serve as a barometer for the services being procured. Assuming that there is a desire to use T&M-LH contracts to further the government's best interest, the absence of a rationale that would demonstrate how the government's risk increase in this commercial context compels the elimination of this extra approval requirement.

Restrictive Reimbursement for "Materials"

¹ Section 8002(d) of Title VIII of PL 103-355 specifically provides as follows:

(d) USE OF FIRM, FIXED PRICE CONTRACTS- The Federal Acquisition Regulation shall include, for acquisitions of commercial items--

- (1) a requirement that firm, fixed price contracts or fixed price with economic price adjustment contracts be used to the maximum extent practicable; and
- (2) a prohibition on use of cost type contracts.

² As set forth under Section 1432, for purchases made on a competitive basis; where the services fall within specific categories (including those specified by the Administrator of OFPP); where the CO executes a D&F that no other contract type is suitable; and where the CO includes a ceiling price that the contractor carries all risk for exceed and which may be changed only by written determination placed in the contract file that such change is in the agency's best interest.

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Direct materials are defined as including “supplies and services transferred between divisions, subsidiaries, or affiliates of the contractor under a common control.” Under the rule, labor which is used from a commercial division to support a Part 12 procurement would only be allowed to be billed at “cost” without profit and/or fee, unless a vendor’s practices, and the materials, meet the criteria of 52.212-4 (Alt. I), subsection (i)(1)(ii). This use of interdivisional labor would require that the “cost”³ of the individual be identified and exposed, potentially subjecting its “allowability” to a determination under Cost Principles.

Several Coalition members have commented that, as commercial companies, they simply do not have the systems necessary to meet an onerous, government-only requirement, nor is it cost effective for them to implement such systems for a small part of their overall business. Doing so would also be counter to every major piece of procurement reform legislation that, at their core, envision government buyers purchasing more like their commercial counterparts and the cessation of government-unique requirements for commercial items. We strongly recommend that commercial acquisitions be clearly separated from government-only requirements, especially those as onerous as cost accounting standards.

In a commercial context, members believe that vendors under these contracts should have the ability to use any of their own resources without penalty of profit erosion. Again, these contracts have commercial market reference points for testing price reasonableness competitively, and thus, to disallow profit (or fee) discourages the vendor from using its best employees to meet the government’s needs where appropriate.⁴ Moreover, allowing this fee is consistent with the notion expressed at the public meeting that the government should pay for actual contract performance. Compelling vendors to seek non-company employees may not always be the cost-effect, best value alternative available, but allow vendors to be paid for based on form over substance. Finally, although consideration should be given to the notion that utilization of these services through an in-house channel includes a process that does not exist when these services are provided elsewhere⁵, and thus, justifies the inclusion of that attendant fee.

³ The use of the word “cost” has a defined meaning as a term of art in a government contracting context, and it is typically associated with Cost Accounting Standards (CAS). From an accounting standpoint, vendors that commonly operate in a commercial environment are not structured along the lines of CAS principles. The notion of cost may have a different meaning in their commercial practice context, producing complications for the federal divisions of those companies that rely on commercial organizations to deliver many offerings. A potential solution for this conflict may be to redefine the notion of cost in the commercial context to omit expressly the application of CAS definitions and rules.

⁴ Interestingly, although subcontractors may be listed in the proposal/contract, and therefore, be billed at the contract labor rate, there appears to be no provision made for identifying other divisions of the vendor in the original proposal/contract, such that they could be billed at the contract labor hour rate(s). Perhaps the addition of such a provision might provide a step toward compromise on this point. That such a solution is only a step should be made clear. There are circumstances where suppliers simply cannot be added at the time an offer is submitted simply because commercial vendors may work with multiple suppliers in multiple contexts. Thus, provision needs to be made for the quick addition of those suppliers to the contract, as well. Moreover, the government may want to consider defining a commercial payment timeframe to assure that payment practices in the commercial market align with those of the government market.

⁵ Though certainly not of a consequence to invoke CAS-like accounting.

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Potentially Restrictive Use of Subcontractors

The proposed rule appears somewhat complex and confusing with regard to the use of and payment for a subcontractor's labor. For instance, the proposed language for FAR 52.212-4 Alternative 1 introduces into the commercial item contracting environment the contractor purchasing system review (CPSR) process that appears to be more suitable for non-commercial item acquisitions. In addition, the language of the alternative implies that only those subcontractors for whom the contracting officer has given consent are to be reimbursed at the hourly rates provided for in the prime contract.

As noted above, the thrust of acquisition reform has been to utilize commercial practices where appropriate. In this regard, members believe the restrictions imposed on vendor subcontractor determinations are inconsistent with the underlying intent of commercial acquisition. Commercial contractors may not perform sufficient government business to justify the establishment of a CPSR for one component of their government commercial business, so the government may lose out on the number of available competitors in this contracting context. Again, until the value-add of such a system in a commercial context is made apparent, the requirement should not be imposed.

Concerns Regarding Withholding

Some members expressed concern that commercial vendors may not be accustomed to the notion that the government might withhold funds from payment as it does in the non-commercial context. There is concern that with the use of T&M-LH contracting in the commercial context, contracting offices may elect to proceed with requiring withholdings even though the practice is not specifically allowed by the appropriate payment clause. To avoid any confusion here, explicit language should be set out that bars such withholdings.

Equity in Rebates

There is concern among our members that the proposed regulation requires vendors to provide the government credit for rebates on commercial T&M services. Such a requirement presents some complications. Vendors typically provide some services (e.g., maintenance on standard equipment) through the organizational resources of their commercial business. Federal divisions have little visibility into those business units, creating a dilemma as to how to account for a rebate. For this reason, members believe that the government should delete this requirement.

FAR Case 2004-015

Reimbursement for Materials

The updated definition of Direct materials in 16.601(a)(1) and 52.232-7(b)(2)(i) includes "supplies and services transferred between divisions, subsidiaries, or affiliates of the contractor under a common control." The concerns with this language of the proposed rule

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are substantially similar to those express above for FAR 2003-027 (see above). Though clearly the government has an interest in assuring that it is not subject to over-reaching in this context, the implication of "cost" principles represents a potential over reaction and should be avoided.

The Coalition recommends that the proposed rule for commercial Time and Material, Labor Hour contracts be withdrawn and substantially revised to better reflect the intent of Congress. This intent was to preserve Time and Material contracting for the procurement of commercial services when it is in the government's best interest to use this method. We believe that Time and Material, Labor Hour contracts continue to be a valuable government contracting tool that, properly utilized, can play a major role in meeting the contracting needs of a diverse government market.

We appreciate the opportunity to provide comments on these proposed rules, and we stand ready to assist you in your efforts to provide effective implementation guidance to agencies and vendors for T&M-LH contracting.

Sincerely,

Edward L. Allen
Executive Vice President
Coalition for Government Procurement

2004-015-9



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To farcase.2004-015@gsa.gov
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Subject Comments

Dear FAR staff,

The proposed rule would amend FAR section 16.307 to read:

"(a)(1) The contracting officer shall insert the clause at 52.216-7, Allowable Cost and Payment, in solicitations and contracts when a cost-reimbursement contract (other than a facilities contract) or a time-and-materials contract (other than a contract for a commercial item) words "Subpart 31.2" and substituting for them "Subpart 31.7." If the contract is a time-and-materials contract, the clause at 52.216-7 applies only to the portion of the contract that provides for reimbursement of materials (as defined in the clause at 52.232-7) at actual cost is contemplated. . . ."

The words "at actual cost" are ambiguous. Exactly what part of the clause at 52.216-7 applies when the contracting officer reviews the invoice for material costs? What exactly are the appropriate rights and responsibilities provided by the language of 52.216-7 that are not already provided by FAR clause 52.232-7? Rather than having the reader puzzle this out, would it not be better to simply extract whatever words in FAR 52.216-7 that have meaning for T&M contracts and add them to 52.232-7? As importantly, why bury this reference to T&M contracting in a FAR subpart devoted to cost reimbursement contracting? Why not add any reference to a clause required for T&M contracting in FAR subpart 16.6?

In particular, the language of FAR 52.216-7(d), (e), and (f) seems entirely out of place in a T&M setting. If the material costs of the contract are so high that they warrant the submission, auditing, and final settlement of a contractor's indirect cost rates per 52.216-7(d), the contract should not be T&M.

In fact, I would go further and recommend that you change the language of FAR 16.601(c) to stress that "A time-and-materials contract may be used only when (1) it is not possible at the time of placing the contract to estimate accurately the extent or duration of the work or to anticipate costs with any reasonable degree of confidence and (2) costs other than for direct labor hours are incidental to the work".

Here is a fundamental question — why would the Government employ time and material (T&M) arrangements for contracts where the direct material, ODC, and subcontract costs are of such dollar magnitude that they would warrant the language of FAR clause 52.1-216-7?

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If you look at the prescription at FAR 16.601(b) for the applicability of time and material contracts, it reads “A time-and-materials contract may be used only when it is not possible at the time of placing the contract to estimate accurately the extent or duration of the work or to anticipate costs with any reasonable degree of confidence.”

If you look at the prescription at FAR 16.301-2(a) for the applicability of cost type contracts, it reads: “Cost-reimbursement contracts are suitable for use only when uncertainties involved in contract performance do not permit costs to be estimated with sufficient accuracy to use any type of fixed-price contract.”

In short, time and material contracts are applicable under like conditions as cost type contracts. However, only time and material contracts have this limitation (at FAR 16.601(c)): “A time-and-materials contract may be used (1) only after the contracting officer executes a determination and findings that no other contract type is suitable ... “ So when the uncertainties of the acquisition are such that costs cannot be estimated with “with any reasonable degree of confidence”, the clear preference in the FAR is for the use of cost type contracts, NOT T&M contracts. In our instructional materials, we therefore advise students that T&M contracting makes sense ONLY WHEN THE DOLLAR VALUE OF THE CONTRACT IS TOO LOW TO JUSTIFY AN AUDIT AND SEPARATE NEGOTIATION AND SETTLEMENT OF THE INDIRECT COSTS ALLOCABLE TO THAT CONTRACT.

The reason for preferring cost type compensation arrangements to T&M arrangements is precisely because there is “no positive profit incentive to the contractor for cost control or labor efficiency.” That is, T&M contracts come perilously close to “cost plus percentage of cost arrangements”, inasmuch as the fee for the effort is not fixed but varies directly with hours worked — the more hours worked, the more profit made.

In the days of the Armed Services Pricing Manual (ASPM), T&M contracts were associated with repair and overhaul services. Today, T&M contracts are all too often the basis for task order contracting under FAR Part 16.5 — notwithstanding the fact that the FAR at 16.501-2 allows the use of cost reimbursable compensation arrangements for such contracts.

Historically most T&M contracts have had minimal direct material costs, minimal subcontract costs, and minimal ODCs; such costs have tended to be incidental to the effort. Any contract that requires substantial direct material costs, interdivisional transfers, subcontracts, and ODCs ought to be handled through a cost reimbursable arrangement.

Sincerely

Michael Miller
Vice President

Business Management Research Associates, Inc.

2004-015-9

2004-015-10



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cc
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Subject Comments on Proposed Rule for Payments Under
Time-And-Materials And Labor Hour Contracts

I submit the following comments about the subject proposed rule:

The proposed solution to the problem of payments to the prime contractor for work performed by subcontractors--to allow the contracting officer to chose either to: (a) pay the prime for subcontract direct labor at hourly rates stipulated for specific subcontractors, or (b) to reimburse the prime contractor for the incurred costs of payments to subcontractors for direct labor--is sound. However, the execution in terms of the text of the proposed clause is confusing. Specifically, referring to subcontracted services and incidental expense as "materials" is contrary to common usage and to the language of FAR 31.205-26 and 45.301, and is likely to cause confusion. Accordingly, I suggest the following changes to the proposed clause:

1. That the clause establish four categories of compensation, addressed in four separate paragraphs: (a) direct labor (or "time"); (b) materials; (c) incidental services, and (d) indirect costs. I suggest that the clause define "direct labor" or "time" as prime and subcontractor labor devoted to the performance of the tasks in the statement of work; that it define "materials" as "products, including raw materials, parts, subassemblies, components, and manufacturing supplies, whether manufactured or purchased by the contractor, and including such collateral items as inbound transportation and in-transit insurance"; and that it define "incidental services" as "services performed or purchased solely for the support of contract direct labor, such as travel, printing, or computer usage."
2. That the clause provide for payment to the prime for the direct labor of its own employees at stipulated hourly rates that include direct costs, indirect costs allocable to direct labor, and profit ("burdened rates").
3. That the clause provide for payment to the prime for the direct labor of its subcontractors, including its affiliates, either (a) at burdened hourly rates stipulated for specific contractors, or (b) by reimbursement of the cost of subcontractor direct labor, including properly allocable indirect costs, in accordance with the terms of the allowable cost and payment clause, FAR 52.216-7. The clause should state that burdened rates for subcontractor direct labor may include prime contractor indirect costs allocable to direct subcontract costs and profit.
4. That the clause provide for (a) payment to the prime of the catalog or market price of materials of the prime's own production that are commercial items (excluding the products of its affiliates), and (b) reimbursement to the prime for the cost of other materials, including properly allocable indirect costs, but no profit or fee, in accordance with the terms of the allowable cost and payment clause, FAR 52.216-7.

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5. That the clause provide for reimbursement to the prime of the cost of incidental services, including properly allocable indirect costs, but no profit or fee, in accordance with the terms of the allowable cost and payment clause, FAR 52.216-7.

6. That the clause provide for reimbursement to the prime for allowable indirect costs allocable to (a) subcontracts, either by inclusion in stipulated hourly rates for specific contractors or by addition to subcontract direct costs, (b) materials, and (c) incidental services, in accordance with the allowable cost and payment clause, FAR 52.216-7.

In addition, for clarity, I suggest the following editorial changes:

a. Replace "voucher" with "invoice."

b. Consolidate the "Total Cost" and "Ceiling Price" paragraphs.

c. Change the title of paragraph (f) from "Assignment" to "Release of Claims," which is what the paragraph is really about.

d. Delete paragraph (g) Refunds, since that topic will be covered by the allowable cost and payment clause, FAR 52.216-7.

Vernon J. Edwards

2004-015-11



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2005-2006

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December 5, 2005

VIA ELECTRONIC MAIL AND FACSIMILE

General Services Administration
Regulatory Secretariat (VIR)
1800 F Street, NW
Room 4035
Washington, DC 20405
Attn: Ms. Laurieann Duarte

**Re: Federal Acquisition Regulation; Payments Under Time-and-Materials
and Labor-Hour Contracts, Proposed Rule, 70 Fed. Reg. 56314 (Sept. 26,
2005). FAR Case 2004-015**

Dear Ms. Duarte:

On behalf of the Section of Public Contract Law of the American Bar Association ("the Section"), I am submitting comments on the above-referenced Proposed Rule. The Section consists of attorneys and associated professionals in private practice, industry, and government service. The Section's governing Council and substantive committees have members representing these three segments to ensure that all points of view are considered. By presenting their consensus view, the Section seeks to improve the process of public contracting for needed supplies, services, and public works.

The Section is authorized to submit comments on acquisition regulations under special authority granted by the ABA's Board of Governors. The views expressed herein have not been approved by the House of Delegates or the Board of Governors of the American Bar Association and, therefore, should not be construed as representing the policy of the American Bar Association.¹

¹ This letter is available in pdf format at <http://www.abanet.org/contract/Federal/regcomm/home.html> under the topic "Cost Allowability and Cost Accounting."

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By Federal Register notice published on Monday, September 26, 2005 (70 Fed. Reg. 56314) the Civilian Agency Acquisition Council and the Defense Acquisition Regulations Council ("Councils") requested comments on a Proposed Rule to revise the language at FAR 16.601(a) and FAR clause at 52.232-7 to provide a description of "materials" as used in "time-and-materials contract." The term "materials" would include direct materials, subcontracts for supplies and services, other direct costs, and applicable indirect costs. The Councils are also proposing to revise "paragraph (b)(8) of the FAR clause at 52.232-7 to specifically state that the Government does not pay profit or fee to the prime contractor on materials (except for commercial items discussed in [Background] Item 4 ... or as otherwise provided for in FAR 31.205-26)." 70 Fed. Reg. 56315. The recovery of profit or fee is to be accomplished as part of the labor hour portion of the time-and-materials/labor hour ("T&M/LH") contract.

Lastly, for services performed by employees of subcontractors, the Councils are proposing to amend the policies to provide the contracting parties two possible approaches that would be used depending on the contracting officer's determination of circumstances applicable to an individual procurement. The first approach includes coverage in the clause at FAR 52.232-7 applicable to subcontractors providing services compliant with the labor hour requirements of a T&M or LH contract. Under this approach, payment of subcontract costs would be at the contract fixed labor rate under the contract requirements applicable to the labor hour portion of the contract only if a subcontractor is listed in the payment clause. The contracting officer can select the second available approach by inserting "none" in the clause, which would provide that any other labor provided by a subcontractor would be paid at actual cost (plus applicable indirect costs). The following discussion provides the Section's comments on selected aspects of the Proposed Rule.

1. Definition of materials expanded to include subcontracted services.

The current description does not address subcontract costs; even though such costs are often a significant part of the work performed and are provided for under the payments clause at FAR 52.232-7. Also, the description does not address other direct costs and applicable indirect costs other than material handling (e.g., general and administrative expenses) that may be appropriate for the acquisition. Thus, the Councils are proposing to revise "materials at cost" to include "direct materials, subcontracts for supplies and services, other direct costs, and applicable indirect costs." The current language has caused significant confusion because it does not adequately describe what is included in "materials." The new description will add more certainty to the proposal process and will eliminate significant issues arising in the audit process.

Ms. Laurieann Duarte
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2. Disallowance of profit on "material" (which now includes subcontracted services) and CO authority to approve subcontracted effort.

The Councils are proposing to revise paragraph (b)(8) of the clause at FAR 52.232-7 to specifically state that the Government does not pay profit or fee to the prime contractor on materials (except for commercial items discussed in Background Item 4 of the notice or as otherwise provided for in FAR 31.205-26). The Councils believe this is consistent with the historical intent of the clause and the concept of a T&M contract. The recovery of profit or fee is accomplished as part of the labor hour portion of the T&M/LH contract.

A positive step in the Proposed Rule is formally allowing the opportunity for the Contracting Officer ("CO") to identify subcontractors that may bill at the fixed labor hour rates in the contract depending on the circumstances applicable to an individual procurement. This clearly will allow the prime to obtain a profit on creating a team with superior qualifications and diversity.

Further guidance should be added to the proposed rule suggesting expanded circumstances where the CO should allow subcontractors to be billed at the fixed labor rates. Such circumstances should include those when the prime contractor's proposal includes subcontracted services in order to meet the requirements of the RFP, teaming relationships with subcontractors offer the Government the best overall solution, or when the procurement lends itself to subcontracting opportunities for small and disadvantaged businesses. In addition, changes adding subcontractors during the course of performance should be allowed as long as the quality of services would not be reduced and the proposed labor hour rates are within the existing contract rate structure or the rate can be determined to be fair and reasonable based on price analysis.

One objective of federal government policy has been to encourage small and small-disadvantaged contracting. Small and small-disadvantaged businesses rely heavily upon subcontracting to prime contractors particularly under T&M contracts. If prime contractors may not bill at a rate that allows them to make an adequate profit, they are motivated towards performing all the work themselves. This could hurt small businesses and may not result in the best technical solution for the Government. Likewise, when responding to RFPs for IDIQ type T&M procurements, prime contractors must often establish a large team of both large and small business subcontractors to meet the varied requirements of the RFP. If businesses are not allowed to make a profit on the subcontracts, then competition will be reduced and the Government may neither get competition nor the best technical solution.

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When the CO allows subcontractors to bill at the fixed hourly rate, the prime continues to assume the risk of subcontractor labor rate changes based on the fixed price nature of the labor hour rate. The Government is assured a fair and reasonable price based on the competitive nature of the procurement or through price analysis of the labor hour rate. Subcontracted services treated as materials without fee, if performed on a cost reimbursement basis, would likely shift the risk of labor escalation to the Government.

The Section appreciates the opportunity to provide these comments and is available to provide additional information or assistance as you may require.

Sincerely,



Robert L. Schaefer
Chair

cc: Michael A. Hordell
Patricia A. Meagher
Michael W. Mutek
Carol N. Park-Conroy
Patricia H. Wittie
Hubert J. Bell, Jr.
Mary Ellen Coster Williams
Council Members
Co-Chairs and Vice-Chairs of the Accounting
Cost and Pricing Committee
David Kasanow

2003-015-12



December 9, 2005

Ms. Laurieann Duarte
General Services Administration
Regulatory Secretariat (VIR)
1800 F Street, N.W.
Washington, DC 20405

Subject: FAR Case 2004-015, Payments Under Time-and-Materials and Labor-Hour Contracts

Dear Ms. Duarte:

On behalf of the members of the Contract Services Association (CSA), I appreciate this opportunity to provide some brief comments on the proposed rule published in the *Federal Register* on September 26, 2005 (Volume 70, Number 185).

By way of background, CSA is the nation's oldest and largest association of service contractors representing over 200 companies that provide a wide array of services to Federal, state, and local governments. CSA members perform \$40 billion in Government contracts and employ nearly 500,000 workers, with nearly two-thirds of CSA companies using private sector union labor. CSA members represent the diversity of the Government services industry and include small businesses, 8(a)-certified companies, small disadvantaged businesses, women-owned, HubZone, Native American owned firms and global multi-billion dollar corporations. CSA promotes "Excellence in Contracting" by offering significant professional development opportunities for Government contractors and Government employees, including the only program manager certification program for service contractors.

This proposed rule would amend the Federal Acquisition Regulation (FAR) regarding contractor payments under non-commercial item Time-and-Materials (T&M) and Labor-Hour (LH) contracts. It is our understanding that the intent of the proposed rule is to amend the underlying payment policies and increase the clarity of the FAR, especially with respect to the payment of material costs and subcontracts. However, CSA does not believe the proposed rule achieves that outcome and, therefore, believes that certain changes need to be made to proposed rule. For that reason, CSA generally supports the comments submitted by the Council of Defense and Space Industry Associations (CODSIA), which makes substantive recommendations for revisions to the proposed rule.

This case focuses on payments under T&M/LH contracts for *noncommercial items*. On the same day, a proposed rule also was issued that focused on T&M/LH contracts for *commercial items* (FAR Case 2003-027). Although some payment issues are common to both proposed rules, our comments on this response are limited to T&M/LH contracts for *noncommercial items*. CSA, like CODSIA, will submit comments separately on FAR Case 2003-027.

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In particular, CSA wishes to highlight a couple of issues raised by CODSIA in its letter that are of critical concern to our membership on this proposed rule.

Definitions for Purposes of T&M Contracts

CSA strongly disagrees with including “subcontracts” in the definition of materials. As CODSIA noted in its comments,

the Councils should use this historic opportunity to create separate sections within the FAR 52.232-7 “Payments Under Time-and-Materials and Labor-Hour Contracts” clause for subcontracts and for interdivisional transfers. The present commingling the terms “materials” and “subcontracts” at paragraph (b) of the clause is not a workable approach today. By creating separate sections, the payment policies intended by the Council for subcontracts and interdivisional transfers can be properly segregated and clarified for all parties. It would also avoid the inevitable disputes over whether a subcontract for supplies or services was “materials consumed directly in connection with furnishing the service” (and thus reimbursed at the fixed hourly rates) or was another type of subcontract “for supplies and services” (and thus reimbursed only at actual costs plus applicable indirect costs). It would also avoid the potential misapplication of reimbursement policies such as imposing the “Allowable Cost and Payment” clause on interdivisional transfers of commercial items.

Subcontracts

CSA members are particularly concerned over the proposed bifurcated payment policy for subcontracts on T&M/LH contracts. For subcontractors expressly listed in proposed paragraph (b)(4)(ii) of the “Payments Under Time-and-Materials and Labor-Hour Contracts” clause, the prime contractor would be paid for subcontractor incurred hours at the fixed hourly rates contained in the prime contract. However, for subcontractors not expressly listed in the clause, the contractor would be reimbursed at actual costs (plus potentially available indirect costs). From a business perspective, it is not always feasible to establish hourly rates for specific subcontractors at the time of original contract formation. This form of contracting is used only generally when it is not possible at the time of award to estimate accurately the extent or duration of the work [FAR 16.601(b)]. And that means it may be difficult, at the time of the solicitation, to identify all the subcontractors that ultimately will be necessary to perform the work. For example, CSA members often provide “on-call” or “on-demand” services and are not able to predict at the time of award which subcontractors will be called upon to fulfill such requirements.

Therefore, CSA believes that the restrictions on subcontract fee will reduce the use of qualified subcontractors, especially small businesses and small, disadvantaged businesses, and other special categories of business. In addition, contractors would not be afforded appropriate compensation for administrative costs incurred and financial risks that accompany the use of any

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subcontractor unless those subcontractors are specifically named in advance. Any final rule should allow for a fee for all subcontract labor other than for services incidental to performance. Consistent with the above, CSA believes the Government is overlooking a significant policy issue. We recommend that the Government focus on the value of the hour worked rather than the name of the subcontractor performing the work. That type of focus permits the prime contractor to identify and retain the best people available for contract performance and the Government receives the benefit of the hour worked by the personnel best suited for performance.

While, we recognize the Government's desire to institute appropriate subcontractor disclosure requirement (under the "Payments Under Time-and-Materials and Labor-Hour Contracts" clause), we believe the proposal may work against all parties, especially when subcontractors not initially listed are needed to perform the work. Instead, a more flexible approach that does not require formal contract modifications to the "Payments Under Time-and-Materials and Labor-Hour Contracts" clause should be used. Indeed, flexibility in performance and selection of subcontractors is particularly critical to the prime contractor and valuable to the Government or the Government would (presumably) not have justified the use of a time-and-materials contract as opposed to a firm fixed price contract

Conclusion

Again, CSA appreciates this comment on the proposed rule, and we echo CODSIA's request that further public meetings be held to should to discuss this important proposed rule and the related commercial item proposed rule.

Sincerely,

A handwritten signature in black ink that reads 'Chris Jahn'. The signature is written in a cursive, flowing style.

Chris Jahn
President

2004-015-13



"Brian Caney"
<bcaney@centreconsult.com>

12/09/2005 04:28 PM

To farcase.2004-015@gsa.gov

cc

bcc

Subject Far case 2004-15

Centre Consulting, Inc. and Centre Law Group, LLC are offering the following comments on the above-referenced proposed change to the Federal Acquisition Regulations ("FAR"). The crux of the change will be to prohibit prime contractors performing time and material ("T&M") contracts from adding profit to services performed by their subcontractors. The change accomplishes this by amending FAR Subpart 16.3 and FAR Clause 52.232-7 "Payments under Time and Materials and Labor-Hour Contracts" to treat services offered by Subcontractors in the same manner as materials under T&M contracts. Under the present regulations, Prime contractors are prohibited from adding profit to materials furnished under T&M contracts and are limited to mark ups covering material handling costs. In addition, under FAR Clause 52.232-7, material handling costs are subject to audit since the clause covers only non-commercial purchases. For the reasons stated below, we believe that the proposed change will have a negative affect on small businesses and the results will be contrary to present federal acquisition policies which encourage utilization of small businesses. We also believe that the change is contrary to the policy inherent under the Federal Acquisition Streamlining Act ("FASA"), which is to encourage commercial practices in Federal acquisitions.

The proposed change will disproportionately affect small business. This is because the change fails to recognize a fundamental difference between the acquisition of materials, which does not entail substantial prime contractor effort, and the acquisition of services, which does require such an effort. For example, prime contractors can usually purchase materials through information readily available in the commercial sector, such as catalogs that list commercial prices and contain commercial descriptions of the standards and quality applicable to the materials. Thus, it is relatively easy for a prime contractor to obtain assurances that the selected materials will satisfy customer needs at reasonable prices that have been dictated through the commercial marketplace. In contrast, the selection and provision of services, particularly services of a technical nature, is much more subjective. Prime contractors have less access to readily available commercial information that objectively defines the quality and standards applicable to services, or information which enables a contractor to determine whether the prices are reasonable. For this reason, acquisition of services entails more risk, and prime contractors can expect to devote more effort towards assuring that they can acquire subcontractor services that will satisfy their government customers. The required effort is particularly exacerbated by the proposed change to FAR Clause 52.232-7, which will require that prime contractors substantiate vouchers with records that evidence that subcontractor employees providing the services meet labor category qualifications. Yet, despite the increased risk and effort, prime contractors will not be able to make a profit on the services furnished, through them, by the subcontractor employees. The inability to make a profit, coupled with the inherent prime contractor oversight requirements, will have a negative affect on any subcontracting since prime contractors will be motivated to utilize their own employee on a profitable basis, rather than subcontract for services.

The negative affect on subcontracting will fall disproportionately on small business. Thus, it is contrary to current procurement policy. Small businesses are often the recipients of T&M subcontracts, particularly for specialized technical services. Prime contractors who subcontract services performed on an hourly basis are still required to exercise a degree of supervision since they are ultimately responsible for assuring customer satisfaction. If prime contractors can not receive a reasonable profit on those

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services, they will instead perform the work with their own employees, rather than subcontract to small businesses. That outcome is inconsistent with present federal acquisition policies that encourage large business prime contractors to utilize small businesses and submit small business subcontracting plans towards that end.

The proposed change also is inconsistent with the purposes of FASA. FASA sought to interject standard commercial practices into federal acquisitions. It is standard commercial practice to allow a prime contractor a reasonable profit on subcontracted work. FASA also sought to limit the government's auditing rights by subjecting contractors to fewer audits. The proposed change, however, expands the government's rights to audit a contractor's performance. FAR Clause 52.232-7 presently provides for government auditing of material handling charges. Under the proposed change, those rights would be expanded to cover support documentation for subcontractor labor charges. The expansion of auditing rights is contrary to the motivation behind FASA. Furthermore, the increased expenses inherent in maintaining the required documentation necessary to respond to an audit represent a disincentive to subcontract the related services.

2004-015-14

Council of Defense and Space Industry Associations

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Arlington, Virginia 22209
703-243-2020

December 9, 2005
CODSIA Case No. 05-08

Ms. Laurieann Duarte
General Services Administration
Regulatory Secretariat (VIR)
1800 F Street, N.W.
Washington, DC 20405

Subject: FAR Case 2004-015, Payments Under Time-and-Materials and Labor-Hour Contracts

Dear Ms. Duarte:

The undersigned members of the Council of Defense and Space Industry Associations (CODSIA) appreciate the opportunity to offer comments on the proposed rule published in the *Federal Register* on September 26, 2005 (Volume 70, Number 185). Formed in 1964 by industry associations with common interests in the defense and space fields, CODSIA is currently composed of six associations representing 4,000 member firms across the nation. Participation in CODSIA projects is strictly voluntary. A decision by any member association to abstain from participating in a particular activity is not necessarily an indication of dissent.

The Civilian Agency Acquisition Council and the Defense Acquisition Regulations Council (Councils) proposed to amend the Federal Acquisition Regulation (FAR) regarding contractor payments under non-commercial item Time-and-Materials (T&M) and Labor-Hour (LH) contracts. The stated intent is to amend the underlying payment policies and increase the clarity of the FAR, especially with respect to the payment of material costs and subcontracts.

Specific amendments proposed by the Councils were as follows:

- Amend FAR 16.307(a)(1) to specify that the "Allowable Cost and Payment" clause at FAR 52.216-7 is to be included in T&M contracts. The clause, however, would be applicable only to the portion of the contract covering reimbursement of materials at actual cost.
- Revise FAR 16.601(a) to provide a definition of "materials" for the purpose of T&M contracts. The Councils believe that the current FAR does not adequately address subcontract costs, other direct costs, and applicable indirect costs other than material handling costs.
- Revise the "Payments Under Time-and-Materials and Labor-Hour Contracts" clause at FAR 52.232-7 to incorporate the above definitions at FAR 16.601(a), as well as address supplies and services transferred between divisions, subdivisions, subsidiaries, or affiliates of the contractor under a common control (i.e., interdivisional transfers) and commercial items sold at the contractor's established catalog or the market price.

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- Revise the “Payments Under Time-and-Materials and Labor-Hour Contracts” clause to provide two approaches for billing subcontracts and interdivisional transfers for services.
- Revise the “Payments Under Time-and-Materials and Labor-Hour Contracts” clause to state that the Government does not pay profit or fee to the prime contractor on materials (except on commercial items or as otherwise provided for in the cost principle on material costs at FAR 31.205-26).
- Revise the “Payments Under Time-and-Materials and Labor-Hour Contracts” clause to apply the Prompt Payment Act to interim payments under T&M and LH contracts for services.

FAR Case 2004-015 focuses on payments under T&M/LH contracts for *noncommercial items*. On September 26, 2005, the Councils published a companion proposed rule that, among other things, focused on T&M/LH contracts for *commercial items* (FAR Case 2003-027). Although some payment issues are common to both proposed rules, our comments on this response are limited to T&M/LH contracts for *noncommercial items*. CODSIA’s comments on FAR Case 2003-027 are submitted separately.

In addition to making these specific written comments, we strongly recommend and request that the Councils schedule additional public sessions to discuss all of the public comments that have been submitted on the rule and to provide the public with an opportunity to further explain the comments submitted.

With respect to FAR Case 2004-015, we agree with the need to make the current FAR 52.232-7 “Payments Under Time-and-Materials and Labor-Hour Contracts” clause more relevant to current business practices, particularly as the clause is applied to subcontracts, interdivisional transfers, and commercial items. In its present form, the clause is outdated and, increasingly, is a source of confusion and conflict among all parties. This is evident in the disturbing guidance issued last year by the Defense Contract Audit Agency (DCAA)¹ and more recently in a proposed amendment to S. 1042, the Senate version of the Fiscal Year 2006 National Defense Authorization Act.²

We are pleased that many of the problems with the current regulations are addressed in the proposed rule and offer the following comments for further consideration by the Councils.

1 DCAA Memorandum 04-PAC-022(R), “Audit Guidance on Review of Orders under GSA Schedule Contracts,” April 2004.

2 See Senate Amendment # 1492 to S. 1042, introduced by Senator Levin. As proposed, the amendment would require that direct labor hours provided by a subcontractor may be paid on the basis of specified hourly rates that included wages, overhead, general and administrative expenses, and profit, but only if such hourly rates are set forth in the contract for that specific subcontractor. However, the amendment was not offered for consideration before the bill passed the Senate.

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Definitions for Purposes of T&M Contracts

The Councils proposed to add identical definitions of “direct materials” and “materials” to FAR 16.601 that would be applicable to both commercial item and non-commercial item T&M contracts and to the “Payments Under Time-and-Materials and Labor-Hour Contracts” clause at 52.232-7 applicable only for non-commercial item T&M. By doing so, the same terms would apply inappropriately to both commercial item T&M contracts under FAR Part 12 and to non-commercial item T&M covered under FAR 32.111(a)(7).

The term “direct materials” would be defined identically in both places as “materials that enter directly into the end product or that are used or consumed directly in connection with the furnishing of the end product or service.” The term “materials” would be defined identically in both places as (1) direct materials, including interdivisional transfers of supplies and services, (2) subcontracts for supplies and services, (3) other direct costs, and (4) applicable indirect costs.

While we understand and appreciate the Councils’ efforts to clarify the treatment of subcontracts and interdivisional transfers under non-commercial item T&M contracts, we believe lumping both within the definition of “direct materials” is unnecessary and will, in fact, increase the confusion for all parties. For this reason, many member companies believe that all subcontracted labor should be reimbursed under the labor portion (i.e., fixed hourly rate) of the contract, and not treated as “material.” Thus, if the work qualifies for the hourly rate under the schedule, it should make no difference whether the work comes from a subcontractor or another division of the prime contractor.

Under the proposed rule, subcontracts and interdivisional transfers may fall under both the labor and material portions of the “Payments Under Time-and-Materials and Labor-Hour Contracts” clause. The only distinguishing feature proposed by the Councils is that, as “direct materials,” subcontracts and interdivisional transfers would be reimbursed under the labor portion (i.e., fixed hourly rate) of the contract. However, if any of these items were not considered to be for “direct materials,” such reimbursement would have to be considered as being made under the material portion (i.e., actual cost) of the contract. Further complicating the definitional problems that might be created by the proposed rule is that the Federal Acquisition Streamlining Act (FASA) specified that interdivisional transfers for commercial items are to be treated as subcontracts (see FAR 12.001). Since “direct materials” as defined by the Councils should never be reimbursed under the materials portion of a T&M contract, this is another reason why any type of labor, regardless of whether provided by a prime contractor or a subcontractor, should not be included in the definition of “materials.”

We believe the Councils should use this historic opportunity to create separate sections within the FAR 52.232-7 “Payments Under Time-and-Materials and Labor-Hour Contracts” clause for subcontracts and for interdivisional transfers. The co-mingling of these terms in paragraph (b) of the clause is not a workable approach today. By creating separate sections, the payment policies intended by the Councils for subcontracts and interdivisional transfers can be properly segregated and clarified for all parties. It would also avoid the inevitable disputes over whether a subcontract for supplies or services was “materials consumed directly in connection with furnishing the service” (and thus reimbursed at the fixed hourly rates) or was another type of subcontract “for supplies and services” (and thus reimbursed only at actual costs plus applicable indirect costs). It would also avoid the potential

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Page 4

misapplication of reimbursement policies such as imposing the "Allowable Cost and Payment" clause on interdivisional transfers of commercial items.

Furthermore, with respect to the contractor who furnishes its own material that meet the definition of a commercial item under FAR 2.101, we recommend modifying paragraph (b)(3)(ii) to delete "actual cost" and insert "price".

Subcontracts

The Councils propose a bifurcated payment policy for subcontracts on T&M/LH contracts. For subcontractors expressly listed in proposed paragraph (b)(4)(ii) of the "Payments Under Time-and-Materials and Labor-Hour Contracts" clause, the prime contractor would be paid for subcontractor incurred hours at the fixed hourly rates contained in the prime contract. These would be subcontractors providing services for meeting requirements specified in the statement of work. For subcontractors not expressly listed in the clause, the contractor would be reimbursed at actual costs (plus applicable indirect costs). As explained by the Councils, these would notionally be those subcontractors providing incidental supplies and services. "Incidental," however, is not otherwise defined in the proposed rule.³ We appreciate the efforts made by the Councils to propose a flexible solution to the subcontract payments issue.

From a business perspective, it is not always feasible to establish hourly rates for specific subcontractors at the time of original contract formation. In some cases based on the terms of the solicitation, the fixed hourly rates contained in the prime contract are a blend of anticipated prime contractor and subcontractor hourly rates. Not only does this approach often yield more competitive hourly rates for the Government, but it promotes using all categories of small businesses to achieve such price advantage. Furthermore, requiring separate fixed hourly rates for individual subcontractors would further complicate for all parties an already complex invoicing and payment process. We therefore recommend that the rule provide for reimbursement of both the direct labor and the labor provided by any subcontractor at the fixed hourly rate under the prime contract.

Furthermore, we believe that the bargain mutually agreed upon at the time of contract award must be maintained throughout contract performance until adjusted by mutual agreement. By its very nature, a fixed price contract shifts the risk of performance at that rate to the contractor. We are aware of examples where prime contractors who priced their fixed hourly rate based on blended rates for included subcontractors have been reimbursed for subcontractor effort at actual costs. This is clearly inequitable because it unilaterally changes the terms of the contract. In proceeding with this change in payment policy, we urge the Councils to take two additional steps:

1. The solicitation process must ensure that the new subcontract payment policy is clear to offerors. It would be unfair for the contracting officer to accept fixed hourly rates in a contract and then fail to expressly list the subcontractors (including

³ As one approach, the term "incidental services" could be defined to mean "those services that are of minor importance to the overall successful performance of the contract."

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interdivisional transfers) within the "Payments Under Time-and-Materials and Labor-Hour Contracts" clause.

2. Since the rule would adopt a new payment policy that could alter the terms of existing contracts, the new rule should be applicable only to new non-commercial item T&M/LH contracts awarded from solicitations issued after a specified date, preferably 60 days after the proposed rule is finalized. This will allow agencies the opportunity to develop implementing guidance and update the training of contracting officers on the new regulations.

In addition, the structure of any proposed rule needs to take into account the dynamic nature of T&M/LH contracting. After all, it is well recognized that such contracts are most appropriately used when it is not possible at the time of award to estimate accurately the extent or duration of the work (see FAR 16.601(b)). This may also be true for identifying subcontractors that would ultimately be used to perform the work. For example, several member companies note that they provide "on-call" or "on-demand" services and are not able to predict at the time of award which subcontractors will be called upon to fulfill such requirements.

To the extent that new subcontractors would be needed, the attendant administrative processes under the proposed rule might impede the contractor's ability to deliver such services in accordance with the terms of the contract. It is unfair to require the contractor to perform such services without knowing in advance whether the necessary subcontractors can be brought to the task and how the contractor will be reimbursed. The structure of the proposed rule would be difficult to establish and maintain throughout contract performance, and it would almost certainly impact the Government's efforts to review invoices submitted for payment. Any advantages of this proposed change to the Government might be negated by the administrative problems associated with establishing and maintaining the list of subcontractors whose costs would be treated as direct labor.

While we do not oppose appropriate subcontractor disclosure requirements, making it part of the "Payments Under Time-and-Materials and Labor-Hour Contracts" clause may work against all parties, especially when subcontractors not initially listed are needed to perform the work. We believe a more flexible approach that does not require formal contract modifications to the "Payments Under Time-and-Materials and Labor-Hour Contracts" clause should be used. At the public meeting on the proposed rules, Council members present expressed a willingness to consider alternative formulations that would permit notification to the contracting officer without the need for formal contract amendments.

Commercial Items

The proposed rule incorporates Alternate I to the "Payments Under Time-and-Materials and Labor-Hour Contracts" clause, which deals with commercial items when such circumstances arise, as a permanent section of the non-commercial items payment clause at paragraph (b)(3). In so doing, the contractor's ability to meet contract requirements with commercial items would not be dependent upon the inclusion of Alternate I at the time of award. Furthermore, the Councils propose to eliminate the "most favored customer" pricing requirement.

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CODSIA strongly supports these changes and believes it is long overdue in view of FASA and other commercial item acquisition reforms.⁴ Not only is the “most favored customer” requirement a barrier to market entry for member companies, it has long been inconsistent with the Government pricing policies contained in FAR Subpart 15.4. The “most favored customer” provision at FAR 16.601(c)(3)(iv)(B), as revised by this proposed rule, should be eliminated, as well.

Prompt Payment Act

The Councils propose to apply the Prompt Payment Act to interim payments made under T&M/LH contracts, but only for the labor portion. While we strongly concur with this limited change, we believe the Prompt Payment Act should apply to all labor and material payments made under T&M/LH contracts, as Congress directed in 1988 when the Prompt Payment Act was implemented at FAR Subpart 32.9.

The present guidance at paragraph (h) of the “Payments Under Time-and-Materials and Labor-Hour Contracts” clause was added under Federal Acquisition Circular 2001-02 on December 18, 2001. This addition was in response to a revision in the Office of Management and Budget (OMB) prompt payment regulations caused by a change to the Prompt Payment Act making interim payments under cost reimbursement contracts for services subject to interest penalties.⁵ We do not believe that a T&M/LH contract is equivalent to a cost reimbursement contract. In addition, it is not logical to apply interest penalties to labor without including the material resources necessary to provide such labor.

Inasmuch as payments under T&M/LH contracts would be mostly for labor, the impact of excluding material from interest penalties is probably negligible. On the other hand, it would almost certainly make more work for Government disbursing officials who would have to segregate labor and material on contractor invoices when computing interest penalties due the contractor. What the Government saves in interest penalties is likely to be more than offset with increased Government administrative costs. We recommend that paragraph (h) be removed altogether and the final rule should apply the Prompt Payment Act to all payments.

Additional Comments

Voucher Substantiation

Proposed FAR 52.232-7(a)(2) requires substantiating evidence to support vouchers submitted for hourly rates. We agree that the burden is on the contractor to substantiate billings. However, we recommend deleting the specific requirement for individual daily job timecards to provide prime

4 Over the years, the Councils have removed references to “most favored customer” pricing from the FAR. Assuming that the final version of FAR Case 2004-015 removes this phrase from non-commercial T&M contracts (FAR 16.601 and FAR 52.232-7), FAR 31.106-3 (facilities contracts) would be the only remaining section in the FAR where the phrase is used for pricing purposes. We urge the Councils to use this opportunity to also remove this phrase from FAR 31.106-3.

5 Section 1010 of the National Defense Authorization Act for Fiscal Year 2001 (Public Law 106-398).

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contractors the flexibility to have appropriate time card systems for their own labor and for validating subcontractor labor. With current electronic time reporting systems, requiring "time cards" may impede the use of more accurate and flexible time reporting systems.

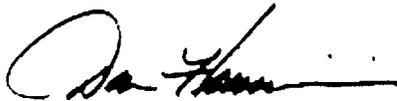
Payment Withholding

Proposed FAR 52.232-7(a)(3) authorizes the contracting officer to withhold funds determined to be necessary to protect the Government's interest, but not to exceed \$50,000. We recommend that this paragraph be clarified to permit withholding of "up to 5 percent, but not to exceed \$50,000." Furthermore, we recommend a clarification that this withholding amount is based on the totality of the contract and it is in the government and the contractor's mutual interest to not apply this withholding on a task-by-task basis. As you know, the Defense Department properly revised the DFARS to eliminate the automatic withholding and we interpret this FAR provision as providing that same discretionary authority government-wide. We would strongly oppose any effort to establish or continue an automatic withholding of funds.

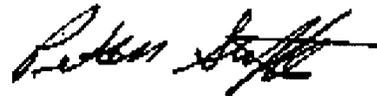
Conclusion

We appreciate the opportunity to comment on the proposed rule and renew our request for further public meetings to discuss this important proposed rule and the related commercial item proposed rule. If you have any questions, please contact Jim Serafin of GEIA, who serves as our project officer for this rule. He can be reached by email at jserafin@geia.org or at (703) 907-7585.

Sincerely,



Dan Heinemeier
President – GEIA
Electronic Industry Alliance



Peter Steffes
Vice President, Government Policy
National Defense Industrial Association



Alan Chvotkin
Senior Vice President & Counsel
Professional Services Council



Cynthia Brown
President
American Shipbuilders Association

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Chris Jahn

Chris Jahn
President
Contract Services Association

Robert T. Marlow

Robert T. Marlow
Vice President, Procurement &
Finance
Aerospace Industries Association

2004-015-15



"Scott Amey"
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12/09/2005 12:23 PM

Please respond to
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To farcase.2003-027@gsa.gov, farcase.2004-015@gsa.gov

cc

bcc

Subject FAR Cases 2003-027 & 2004-015

December 9, 2005

General Services Administration

Regulatory Secretariat (VIR)

1800 F Street, NW, Room 4035

ATTN: Ms. Laurieann Duarte

Washington, D.C. 20405

Via email: farcase.2003-027@gsa.gov

farcase.2004-015@gsa.gov

Subject: FAR Case 2003-027

FAR Case 2004-015

Dear Ms. Duarte:

The Project On Government Oversight ("POGO") provides the following public comment to FAR Case 2003-027 (Federal Acquisition Regulation; Additional Contract Types – 70 Fed. Reg. 56318, Sept. 26, 2005) and FAR Case 2004-015 (Federal Acquisition Regulation: Payments Under Time-and-Materials and Labor-Hour Contracts – 70 Fed. Reg. 56314, Sept. 26, 2005). POGO investigates, exposes, and seeks to remedy systemic abuses of power, mismanagement, and subservience by the federal government to powerful special interests. POGO is not opposed to time-and-material ("T&M") and labor-hour ("LH") contracts *per se*, but it opposes the

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proposed rules because FAR Case 2003-027 does not subject commercial contracts to full oversight and audit provisions which protect taxpayer interests. Additionally, FAR Case 2004-015 does not limit costs billed to the government on “non-commercial item contracts.”

Additional Contract Types (FAR Case 2003-027)

The proposed rule will implement section 1432 of the National Defense Authorization Act for Fiscal Year 2004 (Public Law 108-136) in the Federal Acquisition Regulation (“FAR”). Section 1432 amends section 8002(d) of the Federal Acquisition Streamlining Act (FASA) to expressly authorize the use of T&M/LH contracts for the procurement of commercial services that are commonly sold to the general public and are purchased on a competitive basis. Although the proposed rule includes a provision for determinations and findings containing sufficient facts and rationale to justify why fixed-firm pricing arrangements are not suitable, other taxpayer protections are missing.

T&M/LH contracts have been used in both the private sector and government markets. The proposed rule, however, has less to do with commercial practices than it does with putting American taxpayer dollars at risk. For example, two industry witnesses testified before the Acquisition Advisory Panel (the “AAP” was authorized by Section 1423 of the Services Acquisition Reform Act of 2003) that they do not prefer to use T&M contracts and would not use them for information technology work. Both industry witnesses stated that fixed-price contracts are the more preferred contracting vehicle. In essence, Congress and federal agencies were duped into believing that TM & LH contracts were standard commercial practice.

POGO testified before the AAP stating that TM and LH contracts allow contractors to bill the government without producing a product or service and that the lack of oversight requires those contracts to be used in limited circumstances only. POGO is not the only entity concerned with the use of such contracts. The Defense and General Service Administration Inspectors General and the Government Accountability Office have all expressed concerns with the risks placed on the government and unjustified use of TM & LH contracts. The Senate must have looked into the crystal ball when it considered TM & LH contracts, because it had included, but later withdrew an amendment that placed strict safeguards and limitations on TM & LH contracts.

The main difference between the commercial market and the proposed rule is the rule’s **contractor-friendly threshold governed by FAR 52.212-4, stating that a contractor “agrees to use its best efforts** to perform the work specified in the Schedule and all obligations under this

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contract within such ceiling price.” (Emphasis added) These types of contracts pay for time or money spent, not for milestones reached or work completed. There is no consumer in the commercial market that would blindly allow a car repair shop to work on his or her car for up to \$1,000 without any guarantee that the car will be fixed.

FAR 52.232-7(e) prescribes that “[a]t any time before final payment under this [T&M/LH] contract the Contracting Officer may request audit of the invoices or vouchers and substantiating material.” That provision, however, contradicts other provisions for commercial items that are not subject to post-award audits.

For T&M/LH contracts to provide benefits to the government and protect taxpayer interests, they must be subject to full oversight, audits, and Cost Accounting Standards protections. POGO opines that post-award audits must be included in T&M/LH contracts. In most instances, audits could be conducted when the contractor notifies the government that the contract cost will exceed 85% of the ceiling. Additionally, POGO avers that the contract must include refund or price reduction clauses that will allow the government to recoup any overages identified in the audit.

The government already has the ability to use T&M and LH contracts, but POGO’s concern is with the use of such contracts under FAR Part 12, which does not provide adequate taxpayer protections.

Payments Under Time-and-Materials and Labor-Hour Contracts (FAR 2004-015)

Because of confusion concerning subcontract costs for good and services, acquisition professionals and contractors have raised the question of whether a prime contractor is entitled to be paid for a subcontractor’s work based on the prime’s hourly rate, which costs the government hundreds of millions of dollars each year, or be paid the rate the prime paid to the subcontractor. In other words, does the FAR allow the government to pay for subcontract hours at the negotiated prime contractor rates rather than at subcontract prices.

As I read it, the proposed rule will allow a prime to bill the government at its high rate(s) (rather than the subcontractor’s actual rate(s)) so long as the prime specifies that arrangement in the contract. In essence, the government will allow over billing so long as it is on notice.

2004-05-15

The *Washington Post* has reported that \$20-an-hour subcontract workers were billed by the prime contractors to the government at \$48 per hour. Contractor representatives claim that those increased hourly rates include "risk and overhead." That assertion is erroneous because the prime contractors can already add overhead, general and administrative expenses, and profit to their subcontract costs. The primes are misrepresenting their subcontract costs by submitting bills to the government claiming that the rates they are paying subcontractors are the same as their own prime contract rates. In fact, what the primes are doing is shopping their hourly rate(s) to the lowest cost, and possibly the least qualified, subcontractor they can find. Then, for each hour the subcontractor works, the prime contractor bills its own labor rate, not the subcontractor's actual billed costs to the prime. As a result, the prime recovers profit on the subcontract costs, which could result in a windfall profit.

POGO opposes the proposed regulation. The federal government should not enter into T&M/LH contracts that allow prime contractors to bill the agency for subcontracted or purchased labor or material at an amount in excess of the prime contractor's actual costs for acquiring the subcontracted or purchased labor or material. The industry's over billing of the government is nothing more than an attempt at increasing prime contractors' profit margins. The problem is that the government is not getting what it contracted for; instead, the government is paying high labor rates to have a middleman. The fact that some agencies are willing to accept higher hourly rates strongly suggests that something is wrong with the government's buying system.

Sincerely,

Scott H. Amey

General Counsel

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2004-015-16



DEFENSE CONTRACT AUDIT AGENCY
DEPARTMENT OF DEFENSE
8725 JOHN J. KINGMAN ROAD, SUITE 2135
FORT BELVOIR, VA 22060-6219

IN REPLY REFER TO

PPD 710.5.6

December 8, 2005

**MEMORANDUM FOR GENERAL SERVICES ADMINISTRATION, REGULATORY
SECRETARIAT (VIR)**

**SUBJECT: DCAA Comments on FAR Case No. 2004-015 Payments under Time-and-
Materials and Labor-Hour Contracts**

We have reviewed the proposed amendments to the FAR regarding payments under Time-and-Material (T&M) and Labor Hour (LH) contracts published in the Federal Register under FAR Case 2004-015. Based on our review of the proposed rule, we provide the following comments.

The proposed amendments to FAR 16.307, 16.601, 32.111, and 52.232-7, according to the Federal Register notice, are to "amend the underlying policies and increase the clarity of the affected FAR language." We do not agree that the proposed FAR revision, allowing prime contractors to be reimbursed for subcontracted effort at amounts other than the prime contractors' actual cost, is in the Government's best interest. We believe this proposed change places the Government at a far greater and unnecessary risk of paying costs that are higher than what the prime contractors actually pay for the subcontracted work, without receiving any additional benefits in return. As proposed under FAR 52.232-7, once the contract schedule rates are negotiated between the Government and the prime contractor, and named subcontractors are approved by the contracting officer, the prime contractor could then negotiate lower rates with those subcontractors. The Government would be billed at the negotiated contract schedule rates and the prime contractor would recognize as profit the difference between the billed amount and what was actually paid to the subcontractor. The result would be increased costs with no additional benefit to the Government – the prime contractor would recognize increased profits, and potentially, the Government could receive services at a lower level of expertise than what was envisioned under the initial contract.

We recognize that the proposed regulatory changes provide for contracting officer authority to approve and limit subcontractors that are authorized to be paid at the contract schedule labor hour rates; however, in addition to the Government paying more under the contract, there is added risk and monitoring effort required to ensure the Government is receiving subcontracted labor that meets the qualifications required in the contract, as well as ensuring it is comparable to the experience, reputation, or recognized superiority that the Government intended to procure from the prime contractor.

With the proposed change, unless separate labor rate schedules are proposed, negotiated, and used for billing each subcontractor labor hour delivered, the Government will always be at a greater risk of paying higher costs than what the prime contractor pays. We see no benefit to

2004-015-16

PPD 710.5.6

December 8, 2005

SUBJECT: DCAA Comments on FAR Case No. 2004-015 Payments under Time-and-Materials and Labor-Hour Contracts

adding this additional workload burden on the contracting community when payment of subcontracted effort at cost, and under the provisions of FAR Subpart 31.2, has provided sufficient incentives for many years for contractors to participate in Government contracts under T&M or LH pricing arrangements.

In summary, FAR 16.601(b)(1) states "*A time-and-materials contract provides no positive profit incentive to the contractor for cost control or labor efficiency. Therefore, appropriate Government surveillance of contractor performance is required to give reasonable assurance that efficient methods and effective cost controls are being used.*" We believe the proposed change to allow subcontracted effort to be reimbursed using contract negotiated rates, rather than at cost, will incentivize contractors to maximize profits by subcontracting out more of their effort at lower subcontractor rates/costs and result in the Government paying higher costs than it otherwise would if the subcontracted effort was reimbursed at cost. We further believe the Government will be required to (i) expend additional resources to implement additional controls to monitor the quality and efficiency of the subcontracted labor; and (ii) expend additional resources during the negotiation and administration of the prime contract to address known subcontracts in order for the prime contractor to be in the position to increase profits by allowing those identified subcontracts to be billed at the negotiated contract rates. We strongly believe that reimbursing prime contractors for subcontracted effort at cost will adequately protect the Government's interests and not result in increased cost and monitoring efforts on Government contracts.

We appreciate the opportunity to review and provide comments on the proposed FAR coverage. Please direct any questions on this matter to Mr. Wayne Goff, Chief, Policy Programs Division at (703) 767-3280.

/s/ Terry M. Schneider
/for/Earl J. Newman
Assistant Director
Policy and Plans



2003-027-9
2004-015-17

December 8, 2005

Via E-mail

General Services Administration
Regulatory Secretariat (VIR)
1800 F Street, N.W.
Room 4035
ATTN: Laurieann Duarte
Washington, DC 20405

Re: FAR Case 2004-015, Payment Under Time-and-Materials and Labor-Hour Contracts, 70 Fed. Reg. 56314 (September 26, 2005); FAR Case 2003-027, Additional Contract Types, 70 Fed. Reg. 56318 (September 26, 2005)

Dear Ms. Duarte:

The Information Technology Association of America ("ITAA") ^{1/} is pleased to submit these comments in response to the proposed rules dated September 26, 2005 to amend the Federal Acquisition Regulation (the "FAR") provisions applicable to time-and-materials ("T&M") and labor-hours ("LH") contracts. The proposed rules address both commercial item acquisitions (70 Fed. Reg. 56318) (hereinafter "the proposed Commercial Item Rule") and non-commercial item acquisitions (70 Fed. Reg. 56314) (hereinafter "the proposed Non-Commercial Item Rule"). Our comments focus mainly on the Commercial Item Rule, although the treatment of subcontracted labor is a critically important issue under both proposed rules and is addressed in Section I below.

The proposed Commercial Item Rule implements Section 1432 of the Services Acquisition Reform Act ("SARA") of 2004, which amended Section 8002 of the Federal Acquisition Streamlining Act ("FASA"), to authorize contracting for commercial services.

^{1/} ITAA provides global public policy, business networking, and national leadership to promote the continued rapid growth of the IT industry. ITAA consists of almost 400 corporate members throughout the U.S. and a global network of 67 countries' IT associations. The Association plays the leading role in issues of IT industry concern, including information security, taxes and finance policy, digital intellectual property protection, telecommunications competition, workforce and education, immigration, online privacy and consumer protection, government IT procurement, human resources and e-commerce policy. ITAA members range from the smallest IT start-ups to industry leaders in the Internet, software, IT services, ASP, digital content, systems integration, telecommunications, and enterprise solution fields. For more information visit www.ita.org.



Under FASA, services were considered commercial items based on having established catalog prices for specific tasks under standard terms and conditions. The statute created an issue, however, regarding whether Government agencies could use T&M contracts for commercial items. SARA addressed this issue by explicitly authorizing T&M contracting under specific circumstances.

ITAA is deeply concerned that the proposed Commercial Item Rule will undercut the intent of SARA by creating what effectively amounts to a prohibition on the use of T&M contracts. The proposed rule will add significant administrative burden, procedural complication, and certain significant financial disincentives concerning use of T&M contracts even where use of a T&M contract clearly furthers the Government's best interests, such as where the scope of work cannot be sufficiently defined up front to reasonably permit firm-fixed-price contracting. ITAA is similarly concerned regarding the proposed Non-Commercial Item Rule.

ITAA's comments are organized as follows:

- Section I.** Both the proposed Commercial Item Rule and Non-Commercial Item Rule are unduly restrictive regarding the treatment of subcontracted labor. The proposed rules will (i) impose substantial administrative burdens on both contractors and Government agencies; (ii) make it very difficult for the Government to acquire "on-call" and similar "on-demand" services; (iii) decrease prime contractors' incentive to add qualified subcontractors during performance, including qualified small and small, disadvantaged businesses that become known only during performance; (iv) destroy the motivation that many contractors currently have to offer their corporations' standard commercial solutions; (v) fail to appropriately compensate a prime contractor for costs incurred and financial risks associated with subcontracting; and (vi) otherwise inhibit the employment of the best qualified personnel on Government projects.
- Section II.** The proposed Commercial Item Rule's provisions regarding use of subcontracted labor, the determination and findings requirement, the right to compel contractor employee interviews, and time card requirements are unduly burdensome, inconsistent with customary commercial practice, and intrusive.
- Section III.** The proposed Commercial Item Rule's material handling provisions should be revised to afford contractors the flexibility to comply with commitments associated with their Cost Accounting Standards Disclosure Statements.



- Section IV.** ITAA agrees with the Office of Federal Procurement Policy's apparent conclusion that use of T&M and LH contracts should not be limited by a list of specific service categories.
- Section V.** The proposed Commercial Item Rule's warranty provisions are a significant improvement on the September 2004 advanced notice of proposed rulemaking.
- Attachment** ITAA's specific recommended changes to the proposed Commercial Item Rule are presented in the Attachment hereto.

Finally, ITAA would like to urge that further public meetings be held to discuss these proposed rules and their impact on the provision of commercial and non-commercial items to the Government. Of additional concern is the issuance of these rules prior to the completion of the report from the Acquisition Advisory Panel, which could cause a conflict between their recommendations and those included in these rules. We are also concerned over implementation of the proposed Commercial Item Rule before the Cost Accounting Board has issued appropriate waivers for commercial services performed under T&M or LH contracts. All of these parallel actions need to be examined and possibly addressed prior to the issuance of a final rule.

Our comments are discussed in detail below.

COMMENTS APPLICABLE TO BOTH THE PROPOSED COMMERCIAL ITEM RULE AND NON-COMMERCIAL ITEM RULE

I. The Proposed Rules' Treatment of Non-Prime Contractor Labor Is Unduly Restrictive.

Both the proposed Commercial Item Rule and the Non-Commercial Item Rule unduly restrict a prime contractor's ability to recover reasonable compensation for subcontracted labor and otherwise pose substantial administrative burdens that will likely cause significant procurement delays. Of greatest concern to ITAA, both proposed rules establish a default rule that treats subcontracted labor as "material" and treats as a "pass-through" cost (*i.e.*, no prime contractor mark-up to account for the prime contractor's services) the labor provided by every subcontractor not specifically identified in the prime contract. ITAA strongly believes that the FAR Councils' proposed approach on this issue in many instances would—

- pose substantial administrative burdens at the pre-award and post-award stages of an acquisition due to the need to negotiate and modify contracts to gain the Government's permission to charge prime contract rates for subcontract labor;
- make it extremely difficult for the Government to acquire "on-call" and similar "on-demand" services that sometimes require a single contractor to take responsibility for hundreds or even thousands of subcontractors —

- often interspersed across a wide geographic area – through the life of the contract;
- decrease the incentive for prime contractors to add qualified subcontractors during contract performance, including adding qualified small and small, disadvantaged businesses that become known only during contract performance, because of the uncertainty of the prime contractor's ability to charge prime contract rates for the subcontract labor;
 - destroy the motivation of many contractors' Federal Government divisions to offer the Government best value by taking advantage of their company's standard commercial services, because such offerings often entail an ever-changing pool of qualified subcontractors;
 - fail to appropriately compensate contractors for the financial risk and potential liability it assumes by managing a pool of qualified subcontractors for the Government;
 - often negate any reasonable business case for a contractor to perform a project on a T&M or LH basis, thereby leaving the Government with no choice but to use firm-fixed priced contracts that do not impose such restrictive requirements. This option will result in higher Government prices to account for risk contingencies required for performing work that may vary significantly in scope and volume; and
 - otherwise inhibit the employment of the best-qualified personnel on Government projects.

ITAA urges the FAR Councils to reconsider their proposed approach because the Government significantly benefits from the use of subcontract labor and the risks associated with subcontracting for T&M and LH contracts is low.

ITAA members – who are both major providers and purchasers of services performed on a T&M or LH basis – perform a wide-variety of IT-related professional services for the Government on T&M and LH bases. Contractors frequently require use of subcontractors for any number of reasons, including: (1) to secure specific skill sets; (2) to augment an existing workforce; (3) to use small and/or small, disadvantaged businesses to meet socioeconomic goals; (4) to incorporate small business innovation into solutions; and (5) to replace a subcontractor during contract performance for failure to achieve the prime contractor's performance standards.

Any additional risk posed to the Government from a contractor's use of subcontractors is low. In ITAA's view, Federal agencies are cognizant of industry's use of subcontractors on T&M and LH (as well as other) contracts and have, on the whole, been satisfied. Importantly, purchasing agencies hold prime contractors solely responsible for nonconforming performance—whether the performance is by the prime contractor or a subcontractor. Subcontract performance issues are dealt with as any other performance issue, and the Government has available several contract remedies



for unsatisfactory performance, including those remedies provided by the Disputes clause.

The proposed provisions restricting the use of subcontractors seem to be a solution in search of a problem. The current practice of billing subcontracted labor at the prime contract labor rates—provided that the subcontract labor satisfies all prime contract qualification requirements—is appropriate, fair, and in the Government’s best interests. However, if the FAR Councils do promulgate a rule on this issue, ITAA provides the following comments.

A. The Proposed Rules Should Define “Time” To Include All Labor Provided Under the Prime Contract—Qualified Subcontractor Labor Should Not Be Treated As “Material.”

The proposed rules’ definition of “Time” should encompass all labor provided under the prime contract, regardless of the labor’s source; that is, the term should include the prime contractor’s work force, inclusive of interdivisional transfers, as well as any subcontracted labor. Conversely, the definition of “Materials” essentially should cover costs other than those incurred as part of a contractor’s “Time.” Currently, however, the proposed rules define “Materials” to include “**services** transferred between divisions, subsidiaries, or affiliates of the contractor under common control” and “subcontracts for . . . **services.**” The proposed approach is contrary to the traditional (and common sense) meaning of the term “materials.” Moreover, this approach effectively establishes a default rule whereby contractors must treat subcontracted labor as a “pass through” cost. This treatment unreasonably precludes contractors from recovering adequate compensation for the time and resources it expends on administering subcontracts and for the financial exposure it assumes for a subcontractor’s performance.

B. The Proposed Rules Should Permit Prime Contractors To Bill for Qualified Subcontract Labor Accepted by the Government at the Prime Contract Labor Rate Without the Unwieldy Imposition of Subcontractor Listing and New Subcontractor Consent Requirements.

The default rule should provide that contractors may bill at the prime contract labor rates for qualified subcontracted labor (*i.e.*, labor provided by subcontractor personnel who satisfy the prime contract’s labor category qualification requirements). This rule should hold true regardless of whether or not the prime contract specifically identifies the subcontractor at the time of contracting.

There are generally two methods by which service offerings may be developed. Under the first method, the prime contractor provides a standard service that is available as a commercial offering. The contractor develops these offerings at the corporate level, and the corporation’s federal sales team supporting the federal business may or may not even know of the existence or identities of subcontractors, or



changes to them. Also, the contractor's federal sales team very likely does not know the costs for those subcontractors. "On-call" IT installation and repair service contracts in support of commercial IT products are often performed in this manner—quite often on a T&M or LH basis.

Under the second method, the contractor provides a service in response to a unique Government agency requirement. The contractor's federal team typically develops the proposal for this type of service. While the anticipated subcontractors may be identified in the initial contract, each time a prime contractor identifies an additional subcontractor that is best capable of performing the required work, but is not listed in the prime contract, the prime contractor and the Government will be forced to seek a contract modification. This poses an excessive administrative burden on both parties in terms of both delay and resources. If a prime contractor's proposal is based upon charging the Government the prime contract labor rate **for the type of work**, whether it is performed by the prime or subcontractor, the resulting contract should permit the prime contractor to charge the Government at that labor rate. This should be permitted regardless of whether or not the subcontractor performing the work has been identified in the prime contract – provided the subcontractor meets the applicable labor category requirements and the prime contractor remains responsible for its performance. ^{2/}

Some commentators appear to have confused this issue with what is characterized as a bait-and-switch, in which a contractor promises the Government performance by an entity that formed the basis of the Government's award decision and then substitutes the performance of another entity without the Government's consent. That is **not** the issue at hand. Rather, ITAA is addressing the situation where a prime contractor's proposal indicates (1) that some of the work performed on the project may be performed by subcontractors that meet the contract's qualification requirements, but are not specifically listed at the time of contracting, and (2) that the prime contract's price **for that type of work** will be at the prime contract's labor rate, which may be a blended or other rate. With respect to point (1), unlike contracts that may simply require deliverables without regard to who will actually perform, LH and T&M contracts contain specific labor categories with specific qualifications. Whether a person filling a position on such a contract is employed by the prime or a subcontractor, the qualifications must be met.

As to point (2), whether the prime contract rates for labor are fair and reasonable for subcontracted labor is not an issue. By rule, the Government already has determined (through adequate price competition or otherwise) that the prime contract pricing is fair and reasonable for the type of work performed. Therefore, the Government is assured that qualified individuals will perform the services at fair and reasonable rates.

^{2/} Additional labor categories required during the course of contract performance should be handled through the normal contract modification process.



Ultimately, the Government holds the prime contractor accountable for performing the work, including any performance deficiencies. The proposed rules, however, will often work to preclude prime contractors from receiving adequate compensation for the administrative cost and financial risk of administering the subcontracts. This result is unfair and contrary to customary commercial practice.

C. The Subcontract Consent Provisions Are Unduly Burdensome.

T&M and LH contracts are intended for use only when a fully defined statement of work cannot be developed to support another contract type. The proposed rules will slow the procurement process and in many cases make expediency unobtainable. For example, the proposed provisions prohibiting a contractor from billing at the prime contract labor rates for subcontracted labor not specifically identified in the prime contract will result in lengthy contract negotiations at the outset of contract formation. These negotiations between the contractor and Government over what subcontractors may or may not be billed at the prime contract rate will be an invitation to dispute. In addition, a significant amount of additional administrative work will be required to add a subcontractor during contract performance, which will drain an already understaffed Government acquisition workforce.

The proposed provisions permitting contractors with approved purchasing systems to forego Government consent provide no assistance to the thousands of commercial businesses that do not have such systems in place. Moreover, the consent provisions even for those contractors that have such Government-approved purchasing systems provide little relief because the proposed rule still requires the contracting officer's approval to add subcontracted labor at the prime contract labor rates. Absent the contracting officer's approval and resulting contract modification to add the subcontractor, the contractor will be stuck billing for the subcontractor's effort as a pass-through cost, even though the contractor remains responsible for the subcontractor's performance. The proposed requirements will discourage use of subcontractors.

For the proposed Commercial Item Rule, ITAA urges the FAR Councils to revise proposed FAR 12.216 and FAR 52.212-4(u) (Alternate 1), to simply read:

Unless the Contract specifically provides otherwise, the Contractor is permitted to use Subcontractor personnel and charge for the services performed by such personnel at the Contract labor rates provided that such subcontractor personnel satisfy the qualification and other requirements for the labor categories for which the Contractor seeks compensation.

ITAA's language is consistent with customary commercial practice (see FAR 12.301(a)(2), which requires that contracts include only those provisions determined to be consistent with customary commercial practice) and would remove the most significant impediments posed by the proposed rule.



ITAA also urges the FAR Councils to make a corresponding change to FAR 52.232-7(b)(4) of the proposed Non-Commercial Item Rule.

COMMENTS SPECIFIC TO THE PROPOSED COMMERCIAL ITEM RULE

II. The Proposed Commercial Item Rule Will Impose Significant Administrative Burdens.

The proposed rule's provisions regarding a contractor's use of subcontracted labor, the lack of a dollar threshold for the determinations and findings ("D&F") requirement, the Government's right to compel employee interviews, and the use of time cards amount to a framework that will prove unduly burdensome and will be inconsistent with customary commercial practice. ITAA's comments address the use of the subcontracted labor issue in Section I above; the remaining issues are addressed directly below.

Dollar Threshold for D&F Requirement. The proposed rule's requirement for a D&F stating that no other contract type is suitable before T&M or LH contracts shall be permitted, regardless of the contract's dollar value, is unduly burdensome. The proposed rule requires a D&F for every T&M or LH transaction ***no matter how small***. This approach will unduly restrict the Government's ability to efficiently procure commercial services. Contracting officers must often quickly issue small task orders for T&M or LH work. For example, time constraints and urgent circumstances may make it necessary for work to commence immediately instead of waiting until a suitable fixed-price statement of work can be developed. Requiring a D&F for such small orders severely limits this necessary flexibility. ITAA asks the FAR Councils to revise the proposed rule to exempt from the D&F requirements small purchases at or below the five-million-dollar threshold already existing under FAR 12.203 (applicable to commercial items), which permits agencies to use simplified acquisition procedures. ITAA's request is consistent with the FAR Councils' discretion to implement the statutory provisions addressing D&Fs. *See Chevron, U.S.A. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837, 844 (1984).

Further, ITAA recommends that the FAR Councils consider changing the wording of proposed 12.207(b)(2)(ii), which requires that each D&F include sufficient details to "[e]stablish that it is ***not possible*** at the time of placing the contract or order to accurately estimate the extent or duration of the work or to anticipate costs with any degree of certainty." (Emphasis added.) At times, it may be ***possible*** for the Government to definitize its requirements to such an extent that one could reasonably estimate the duration and cost of the work needed to fulfill those requirements, yet doing so would be ***impracticable*** given the time and effort that would be required, the urgency of the work, and the agency's competing priorities. At a minimum 12.207(b)(2)(ii) should be revised to read: "Establish that it is ***not practicable*** at the time of placing the contract or order"



ITAA also recommends that the FAR Councils delete the proposed requirement for a D&F for each individual task order. We are concerned that this proposed requirement will unnecessarily delay acquisitions. A single D&F based on the contract's statement of work and covering the entire contract should constitute sufficient justification for task orders issued consistent with that contract's statement of work.

Compulsory Interviews of Contractor Employees. The proposed provision seeking to grant the Government a right to interview contractor employees regarding their work is unreasonably intrusive and contrary to customary commercial practice. Notwithstanding a statement made to the contrary in the commentary accompanying the proposed rule, no similar right exists in the FAR for any other contract type, including for FAR Part 15 non-commercial item cost-reimbursement, T&M, or any other form of contracts. The commentary accompanying the proposed rule stating that FAR 52.215-2, *Audit and Records-Negotiation*, provides for a similar right is inaccurate. Not even the Offices of Inspectors General under the Inspectors General Act ("OIG Act") have the authority that the FAR Councils now seek through the proposed rule.

In addition, the right to compel interviews of contractor employees conflicts with the Federal Acquisition Streamlining Act ("FASA").^{3/} FASA mandates that Government agencies rely to the maximum extent practicable on commercial products and services to fill their needs. FASA further requires that an agency revise, to the maximum extent practicable, its procurement policies, practices, and procedures that are not required by law to reduce impediments to the acquisition of commercial items. FASA also requires that commercial item contracts contain only those terms and conditions that are required by law or that are customary in the commercial marketplace. FAR 12.301(a) implements these requirements by limiting, to the maximum extent practicable, the terms and conditions that can be inserted into a commercial items contract to those terms and conditions that are required by law or are determined to be consistent with customary commercial practice. The right to interview a service contractor's employees is not customary—and is, in fact, very unusual—in the commercial marketplace. And considering that no similar requirement exists in the FAR or even in the OIG Act, it cannot reasonably be claimed that the imposition of anything less than this intrusive requirement would be impracticable.

Government Inspections. The proposed rule requires contractors and subcontractors to provide accommodations in connection with Government testing and inspections, including testing and inspections conducted at a contractor's or subcontractor's facility. The proposed rule does not address, however, the responsibility for costs incurred by a contractor or subcontractor in connection with this requirement. Fairness dictates that the Government reimburse contractors (and their subcontractors) for the reasonable costs they incur as a result of the required accommodations.

^{3/} Federal Acquisition Streamlining Act, Pub. L. No. 103-355, §§ 8002, 8104, Oct. 13, 1994.



Time Card Provisions. The proposed rule requires timecard substantiation of labor hours. Most service providers no longer use timecards to record labor hours. Most contractors instead use automated record keeping tools. ITAA recommends that the proposed rule be revised so that such automated record keeping tools are recognized as an alternative to time cards.

III. The Rules Should Allow Prime Contractors to Recover for Material Handling in a Manner Consistent with Contractors' CAS Disclosure Statements.

As currently worded, the proposed rule requires contractors that are committed to certain cost accounting practices prescribed in their Cost Accounting Standards ("CAS") Disclosure Statements to significantly change their CAS disclosure statements or perhaps keep a separate set of accounting books in order to recover their costs incurred in connection with material handling. Although the proposed FAR provision permitting companies to recover material handling costs on a pro-rated fixed-price basis satisfies many contractors' need to recover their material handling costs, it does not satisfy the need of contractors that must comply with CAS-disclosed practices. In addition to permitting commercial companies to recover their material handling costs on a pro-rated fixed-priced basis, the proposed rule should allow companies the flexibility necessary to comply with CAS-disclosed accounting practices.

Some contractors perform both commercial and traditional FAR Part 15 Government work within the same business unit and subject to a single CAS-disclosed practice. To comply with CAS, these contractors often have to allocate material handling costs in accordance with their Government-approved material handling rates. These contractors apply such rates on FAR Part 15 cost-reimbursement and T&M contracts. ITAA sees no reason why a contractor cannot similarly charge its material-handling rate under FAR Part 12 commercial T&M contracts.

In this regard, the FAR Councils have based the proposed rule apparently on a concern that material handling rates would violate the prohibition against cost-plus-a-percentage-of-cost contracts. We disagree with the conclusion that forms the basis of the concern. As indicated above, Government-approved material handling rates already are used on FAR Part 15 contracts. More importantly, a material-handling rate is a well-recognized method—both in the Federal and commercial markets—for allocating estimated costs incurred in the material handling function. A material handling rate does not add fee or any other price component to cost. It is a reflection of the contractor's actual costs, which of course should be reimbursed. ITAA requests that the FAR Councils consider including in the proposed clause the language that allows prime contractors to recover their reasonable cost provided they are excluded in hourly rates.

IV. ITAA Supports the Office of Federal Procurement Policy's Conclusion that Use of T&M and Labor Hour Contracts Should *Not* be Limited by a List of Specific Categories of Services.



Section 1432 of the National Defense Authorization Act for Fiscal Year 2004 (P.L. 108-136) amended Section 8002(d) of the Federal Acquisition Streamlining Act to expressly authorize the Government's use of T&M and LH contracts for the procurement of commercial services. In this regard, the amendment authorizes the Administrator of Office of Federal Procurement Policy ("OFPP") to designate categories of services that agencies may procure on T&M and LH contract terms on the basis that (1) the commercial services in such category are of a type that are commonly sold to the general public through use of T&M or LH contracts, and (2) it would be in the best interests of the Federal Government to authorize use of T&M or LH contracts for purchase of the commercial services in such category. The commentary to the proposed Commercial Item Rule indicates that the OFPP has studied the issue and specifically found that commercial services are commonly sold on both T&M/LH and fixed-priced contract terms and has apparently concluded that it would serve no useful purpose to limit the use of T&M and LH contracts to a list of specific categories of services. For the reasons addressed below, ITAA agrees with this conclusion.

In the commercial marketplace, the determination on whether to use a T&M/LH contract or a fixed-price contract depends mainly on whether the contract requirements can be defined sufficiently up-front such that a reasonable basis exists for firm-fixed pricing. No general rule or practice exists that requires use of firm-fixed pricing based upon whether the purchased service falls within a limited list of specifically-defined categories of services. An informal survey of ITAA membership has confirmed that many types of services are purchased or provided by ITAA members in the commercial marketplace on **both** T&M and firm fixed-price terms depending on the circumstances of the particular project. If the work is not defined with a reasonable degree of certainty at the outset, or if the contractor may be required to ramp up or ramp down quickly as the volume of work changes, or if other characteristics of the project impose significant pricing risks, the project would likely be bid on a T&M or LH basis. When these circumstances exist, use of firm-fixed price contract terms would impose too much financial risk on both the service provider and customer.

Bottom line, although some types of services are procured in the commercial marketplace much more often on a T&M basis than other types of services—for example, on-call repair or installation services—there are no general rules or practices that restrict use of T&M and LH terms for any specific service category. There are often times, regardless of service type, that the work cannot be sufficiently defined at the outset to provide for meaningful firm-fixed prices.

Accordingly, a list constraining the procurement of commercial services on a T&M or LH basis to those services that are perceived to be procured commonly in the commercial market based on T&M or LH terms would provide little if any value considering that any such list would reasonably include an extremely wide array of services.

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V. The Proposed Warranty Provision Constitutes a Significant Improvement over the Advanced Notice of Proposed Rulemaking and Properly Reflects Commercial Practice.

The proposed warranty provision set out in proposed FAR clause 52.212-4, (6) Alternate 1, is a significant improvement over the corresponding provision set out in the September 2004 advanced notice of proposed rulemaking ("ANPR"). The ANPR's proposed warranty provision would have required service providers to reperform nonconforming services under a limited warranty provision at no additional cost to the Government—an approach that would be inconsistent with customary commercial practice for most, if not virtually all, service types and that would impose greater risk on the service provider than the FAR non-commercial item clause. The proposed Commercial Item Rule provides some balance on this issue by requiring the Government to pay the service provider, less profit, for nonconforming work required to be reperformed (capped at the contract ceiling price). This approach bears a better resemblance to commercial practice and is consistent with the provisions for noncommercial T&M contracts at FAR clause 52.246-6. ITAA assumes that the parties will be permitted to tailor this provision pursuant to FAR 12.302 in those cases where the customary commercial practice for the specific type of service provides for different warranty terms.

ITAA appreciates this opportunity to provide its comments on this very important issue. Our comments set out above are not intended to be critical of the proposed rule, but are intended to foster the development of final rules that properly reflect the nature of T&M and LH contracts and allow these contract types to be used efficiently when the Government decides to rely on them.

ITAA would be pleased to respond to any questions the FAR Councils may have on these comments.

Respectfully submitted,

Harris N. Miller
President
Information Technology Association of America



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2004-015-17

ATTACHMENT

ITAA'S RECOMMENDED REVISIONS TO PROPOSED COMMERCIAL ITEM RULE

PART 2—DEFINITIONS OF WORDS AND TERMS

2.101 [Amended]

* * * * *

PART 10—MARKET RESEARCH

* * * * *

PART 12—ACQUISITION OF COMMERCIAL ITEMS

5. Revise section 12.207 to read as follows:

12.207 Contract type.

(a) Except as provided in paragraph (b) of this section, agencies shall use firm-fixed-price contracts or fixed-price contracts with economic price adjustment for the acquisition of commercial items.

(b)(1) A time-and-materials contract or labor-hour contract (see Subpart 16.6) may be used for the acquisition of commercial services when—:

- (i) The service is acquired under a contract awarded using competitive procedures; and
- (ii) The contracting officer—:
 - (A) Executes a determination and findings (D&F) for each contract in excess of \$5 million, in accordance with paragraph (b)(2) of this section (but see paragraph (c) of this section for indefinite-delivery contracts), that no other contract type authorized by this subpart is suitable;
 - (B) Includes a ceiling price in the contract or order that the contractor exceeds at its own risk; and



- (C) Authorizes any subsequent change in the ceiling price only upon a determination, documented in the contract file, that it is in the best interest of the procuring agency to change the ceiling price.
- (2) Each D&F required by paragraph (b)(1)(ii)(A) of this section shall contain sufficient facts and rationale to justify that no other contract type authorized by this subpart is suitable. At a minimum, the D&F shall—:
- (i) Include a description of the market research conducted (see 10.002(e));
 - (ii) Establish that it is not ~~possible~~ practicable at the time of placing the contract or order to accurately estimate the extent or duration of the work or to anticipate costs with any reasonable degree of certainty; and
 - (iii) Establish that the requirement has been structured to maximize the use of fixed price contracts (e.g., by limiting the value or length of the Time and Material/Labor Hour contract or order) on future acquisitions for the same or similar requirements.
- (c)(1) Indefinite-delivery contracts (see Subpart 16.5) may be used when—:
- (i) The prices are established based on a firm-fixed-price or fixed-price with economic price adjustment; or
 - (ii) Rates are established for commercial services acquired on a time-and-materials or labor-hour basis.
- (2) When an indefinite-delivery contract is awarded with services priced on a time-and-materials or labor-hour basis, contracting officers shall, to the maximum extent practicable, also structure the contract to allow issuance of ~~orders on a firm-fixed-price or fixed-price with economic price adjustment basis~~. For such contracts, the contracting officer shall execute the D&F required by paragraph (b)(2) of this section, ~~for each order placed on a time-and-materials or labor-hour basis~~. Placement of orders shall be in accordance with Subpart 16.5.
- (3) If an ~~indefinite~~-delivery contract only allows for the issuance of orders on a time-and-materials or labor-hour basis, the D&F required by paragraph (b)(2) of this section shall be executed to support the basic contract and shall also explain why providing for an alternative firm-fixed-price or fixed-price with economic price adjustment pricing structure is not practicable. The D&F for this contract shall be approved one level above the contracting officer. Placement of orders shall be in accordance with Subpart 16.5.



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(d) The contract types authorized by this subpart may be used in conjunction with an award fee and performance or delivery incentives when the award fee or incentive is based solely on factors other than cost (see 16.202-1 and 16.203-1).

(e) Use of any contract type other than those authorized by this subpart to acquire commercial items is prohibited.

6. Add section 12.216 to read as follows:

12.216 Subcontracts.

(a) Unless the Contract specifically provides otherwise, the Contractor is permitted to use Subcontractor personnel and charge for the services performed by such personnel at the Contract labor rates provided that such subcontractor personnel satisfy the qualification and other requirements for the labor categories for which the Contractor seeks compensation. ~~When a time and materials or labor hour contract is awarded pursuant to 12.207(b), Alternate I to the clause at 52.212-4 is used. Alternate I includes a subcontract consent provision that requires the contractor to obtain the contracting officer's consent prior to awarding certain subcontracts.~~

~~(b) When the contractor has an approved purchasing system, the contracting officer shall identify, in an addendum to the clause, those subcontracts that will require consent.~~

~~(c) When the contractor does not have an approved purchasing system, the contracting officer shall identify, in an addendum to the clause—:~~

~~(1) Those subcontracts reviewed during proposal evaluation for which consent is not required after contract award;~~

~~(2) Those subcontracts for which consent is not required by the clause, but which the contracting officer has determined that an individual consent action is required to protect the Government; and~~

~~(3) Any other exceptions to the standard consent requirements.~~

~~(d) The contracting officer shall consider the risk, complexity and dollar value of anticipated subcontracts when determining the consent requirements.~~

7. Amend section 12.301 by revising paragraph (b)(3) to read as follows:

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

* * * * *

(b)* * *

(3) The clause at 52.212-4, Contract Terms and Conditions—Commercial Items. This clause includes terms and conditions which are, to the maximum extent practicable, consistent with customary commercial



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practices and is incorporated in the solicitation and contract by reference (see Block 27, SF 1449). Use this clause with its Alternate I when a time and materials or labor hour contract will be awarded. The contracting officer may tailor this clause in accordance with 12.302, except that paragraph (u) of Alternate I may be tailored only for indefinite delivery contracts and only to indicate that subcontract consent requirements apply to individual orders and not the basic contract.

* * * * *

8. Amend section 12.403 by revising paragraph (d)(1)(i) to read as follows:

12.403 Termination.

* * * * *

* * * * *

PART 16—TYPES OF CONTRACTS

* * * * *

PART 44—SUBCONTRACTING POLICIES AND PROCEDURES

* * * * *

PART 52—SOLICITATION PROVISIONS AND CONTRACT CLAUSES

13. Amend section 52.212-4 by—:

- a. Revising the date of the clause;
- b. Adding a new fourth sentence to the introductory text of paragraph (a) of the clause; and
- c. Adding Alternate I to read as follows:

52.212-4 Contract Terms and Conditions—Commercial Items.

* * * * *

CONTRACT TERMS AND CONDITIONS—COMMERCIAL ITEMS (DATE)

(a) *Inspection/Acceptance.* * * * If repair/replacement or reperformance will not correct the defects or is not possible, the Government may seek an equitable price reduction or adequate consideration for acceptance of nonconforming supplies or services.* * *

* * * * *



Alternate I (Date). When a time and materials or labor-hour contract is contemplated, substitute the following paragraphs (a), (e), (i) and (l) for those in the basic clause and add the following paragraph (u) to the basic clause.

(a) *Inspection/Acceptance.* (1) The Government has the right to inspect and test all materials furnished and services performed under this contract, to the extent practicable at all places and times, including the period of performance, and in any event before acceptance. The Government may also inspect the plant or plants of the Contractor or any subcontractor engaged in contract performance. The Government will perform inspections and tests in a manner that will not unduly delay the work and will be responsible for the costs reasonably incurred by the Contractor or its subcontractors in connection with the Government's inspection or testing activity.

- (2) If the Government performs inspection or tests on the premises of the Contractor or a subcontractor, the Contractor shall furnish and shall require subcontractors to furnish all reasonable facilities and assistance for the safe and convenient performance of these duties.
- (3) Unless otherwise specified in the contract, the Government will accept or reject services and materials at the place of delivery as promptly as practicable after delivery, and they will be presumed accepted 60 days after the date of delivery, unless accepted earlier.
- (4) At any time during contract performance, but not later than 6 months (or such other time as may be specified in the contract) after acceptance of the services or materials last delivered under this contract, the Government may require the Contractor to replace or correct services or materials that at time of delivery failed to meet contract requirements. Except as otherwise specified in paragraph (a)(6) of this clause, the cost of replacement or correction shall be determined under paragraph (i) of this clause, but the "hourly rate" for labor hours incurred in the replacement or correction shall be reduced to exclude that portion of the rate attributable to profit. Unless otherwise specified below, the portion of the "hourly rate" attributable to profit shall be 10 percent. The Contractor shall not tender for acceptance materials and services required to be replaced or corrected without disclosing the former requirement for replacement or correction, and, when required, shall disclose the corrective action taken.

* * * * *

(e) *Definitions.* (1) The clause at FAR 52.202-1, Definitions, is incorporated herein by reference. As used in this clause—

Approved purchasing system means a Contractor's purchasing system that has been reviewed and approved in accordance with Part 44 of the Federal Acquisition Regulation (FAR).



Consent to subcontract means the Contracting Officer's written consent for the Contractor to enter into a particular subcontract.

Direct materials means those materials that enter directly into the end product, or that are used or consumed directly in connection with the furnishing of the end product or service.

Materials means—:

- (1) Direct materials, including supplies ~~and services~~ transferred between divisions, subsidiaries, or affiliates of the contractor under a common control;
- (2) Subcontracts for supplies ~~and services~~;
- (3) Other direct costs (*e.g.*, travel, computer usage charges, etc.); or
- (4) Indirect costs specifically provided for in this clause.

Subcontract means any contract, as defined in FAR Subpart 2.1, entered into by a subcontractor to furnish supplies or services for performance of the prime contract or a subcontract. It includes, but is not limited to, purchase orders, and changes and modifications to purchase orders.

Time means the labor provided by the Contractor (including any subcontracted labor) to perform the services required by the contract.

* * * * *

(i) *Payments.* (1) *Services accepted.* Payment shall be made for services accepted by the Government that have been delivered to the delivery destination(s) set forth in this contract. The Government will pay the Contractor as follows upon the submission of commercial invoices approved by the Contracting Officer:

(i) *Hourly rate.* The amounts shall be computed by multiplying the appropriate hourly rates prescribed in the contract by the Time provided under the Contract (measured by the number of direct labor hours performed-). Fractional parts of an hour shall be payable on a prorated basis. Invoices may be submitted once each month (or at more frequent intervals, if approved by the Contracting Officer) to the Contracting Officer or the Contracting Officer's representative. When requested by the Contracting Officer or the Contracting Officer's representative, the Contractor shall substantiate invoices (including any subcontractor hours reimbursed at the hourly rate in the schedule) by evidence of actual payment, individual daily job timecards, records that verify the employees meet the qualifications for the labor categories specified in the contract, or other substantiation specified in the contract. Unless the Schedule prescribes otherwise, the hourly rates in the Schedule shall not be varied by virtue of the Contractor having performed work on an overtime basis. If no overtime rates are provided in the Schedule and the Contracting Officer approves overtime work in advance, overtime rates shall be negotiated. Failure to agree upon these overtime rates shall be treated as a dispute under the



Disputes clause of this contract. If the Schedule provides rates for overtime, the premium portion of those rates will be reimbursable only to the extent the overtime is approved by the Contracting Officer.

(ii) *Materials.* (A) If the Contractor furnishes its own materials that meet the definition of a commercial item at 2.101, the price to be paid for such materials shall be the Contractor's established catalog or the market price, adjusted to reflect the—:

- (1) Quantities being acquired; and
- (2) Actual cost of any modifications necessary because of contract requirements.

(B) *Subcontracts.* ~~(1) Unless the subcontractor is listed in paragraph (i)(1)(ii)(B)(2) of this clause, The Contractor shall be paid for the services performed by subcontractors as provided for in subcontract costs will be reimbursed at actual costs as specified in (u)(i)(1)(ii)(C) of this clause.~~

~~(2) Provided the subcontract agreement requires the contractor to substantiate the subcontract hours and employee qualification, the contractor shall be reimbursed at the hourly rates prescribed in the schedule for the following subcontractors: [Insert subcontractor name(s) or, if no subcontracts are to be reimbursed at the hourly rates prescribed in the schedule, "None." If this is an indefinite delivery contract, the Contracting Officer may insert "Each order must list separately the subcontractor(s) for that order or, if no subcontracts under that order are to be reimbursed at the hourly rates prescribed in the schedule, insert 'None.'"]~~

(C) Except as provided for in paragraphs (i)(1)(ii)(A) and (B) of this clause, the Government will reimburse the Contractor the actual cost of materials (less any rebates, refunds, or discounts received by or accrued to the contractor) provided the Contractor:

- (1) Has made payments for materials in accordance with the terms and conditions of the agreement or invoice; or
- (2) Makes these payments within 30 days of the submission of the Contractor's payment request to the Government and such payment is in accordance with the terms and conditions of the agreement or invoice.

(D) To the extent able, the Contractor shall—:

- (1) Obtain materials at the most advantageous prices available with due regard to securing prompt delivery of satisfactory materials; and
- (2) Give credit to the Government for cash and trade discounts, rebates, scrap, commissions, and other amounts that have accrued to the benefit of the Contractor, or would have accrued except for the fault or neglect of the Contractor.



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- (E) *Other Costs.* Unless listed below, other direct and indirect costs will not be reimbursed.
- (1) *Other Direct Costs.* The Government will reimburse the Contractor on the basis of actual cost for the following, provided such costs comply with the requirements in paragraph (i)(1)(ii)(C) of this clause: *[Insert each element of other direct costs (e.g., travel, computer usage charges, etc.) Insert "None" if no reimbursement for other direct costs will be provided.]*
- (2) *Indirect Costs (Material Handling, Subcontract Administration, etc.).* The Government will reimburse the Contractor for indirect costs (i) on a pro-rata basis over the period of contract performance at the following fixed price: *[Insert a fixed amount for the indirect costs and payment schedule. Insert "\$0" if no fixed price reimbursement for indirect costs will be provided.]; or (ii) in accordance with the Contractor's current cost accounting practice as disclosed to and approved by the cognizant Government auditing agency and which may be described as follows:[insert].*
- (2) *Total cost.* It is estimated that the total cost to the Government for the performance of this contract shall not exceed the ceiling price set forth in the Schedule and the Contractor agrees to use its best efforts to perform the work specified in the Schedule and all obligations under this contract within such ceiling price. If at any time the Contractor has reason to believe that the hourly rate payments and material costs that will accrue in performing this contract in the next succeeding 30 days, if added to all other payments and costs previously accrued, will exceed 85 percent of the ceiling price in the Schedule, the Contractor shall notify the Contracting Officer giving a revised estimate of the total price to the Government for performing this contract with supporting reasons and documentation. If at any time during the performance of this contract the Contractor has reason to believe that the total price to the Government for performing this contract will be substantially greater or less than the then stated ceiling price, the Contractor shall so notify the Contracting Officer, giving a revised estimate of the total price for performing this contract, with supporting reasons and documentation. If at any time during performing this contract, the Government has reason to believe that the work to be required in performing this contract will be substantially greater or less than the stated ceiling price, the Contracting Officer will so advise the Contractor, giving the then revised estimate of the total amount of effort to be required under the contract.
- (3) *Ceiling price.* The Government will not be obligated to pay the Contractor any amount in excess of the ceiling price in the Schedule, and the Contractor shall not be obligated to continue performance if to do so would exceed the ceiling price set forth in the Schedule, unless and until the Contracting Officer notifies the Contractor in writing that the ceiling price has been increased and specifies in the notice a revised ceiling that shall constitute the ceiling price for performance under this contract. When and to the extent that the ceiling price set forth in the Schedule has been increased, any hours expended and material costs incurred by the Contractor in excess of the ceiling price before the increase shall be allowable to the same extent as if the hours expended and material costs had been incurred after the increase in the ceiling price.



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(4) *Access to records.* At any time before final payment under this contract, the Contracting Officer (or authorized representative) will have access to the following (access shall be limited to the listing below unless otherwise agreed to by the Contractor and the Contracting Officer):

- (i) Records that verify the employees whose time has been included in any invoice meet the qualifications for the labor categories specified in the contract;
- (ii) For labor hours (including any subcontractor hours reimbursed at the hourly rate in the schedule), when ~~timecards are required as substantiation for payment is required~~—:
 - (A) ~~The original timecards~~ Contractor records that reasonably support the amount of Time charged to the contract;
 - (B) The Contractor’s timekeeping procedures; and
 - (C) Contractor records that show the distribution of labor between jobs or contracts.; and
 - (D) ~~Employees whose time has been included in any invoice for the purpose of verifying that these employees have worked the hours shown on the invoices.~~
- (iii) For material and subcontract costs that are reimbursed on the basis of actual cost—:
 - (A) Any invoices or subcontract agreements substantiating material costs; and
 - (B) Any documents supporting payment of those invoices.

(5) *Overpayments/Underpayments.* (

* * * * *

(l) *Termination for the Government’s convenience*

* * * * *

(u) *Subcontracts.* Unless the Contract specifically provides otherwise, the Contractor is permitted to use Subcontractor personnel and charge for the services performed by such personnel at the Contract labor rates provided that such subcontractor personnel satisfy the qualification and other requirements for the labor categories for which the Contractor seeks compensation. ~~(1) If the Contractor has an approved purchasing system, the Contractor shall obtain the Contracting Officer’s written consent only before placing subcontracts identified in an addendum to this clause.~~



~~(2) — If the Contractor does not have an approved purchasing system, consent to subcontract is required for any subcontract that —:~~

~~(i) — Is of the cost reimbursement, time and materials, or labor hour type; or~~

~~(ii) — Is fixed price and exceeds —:~~

~~(A) — For a contract awarded by the Department of Defense, the Coast Guard, or the National Aeronautics and Space Administration, the greater of the simplified acquisition threshold or 5 percent of the total estimated cost of the contract; or~~

~~(B) — For a contract awarded by a civilian agency other than the Coast Guard and the National Aeronautics and Space Administration, either the simplified acquisition threshold or 5 percent of the total estimated cost of the contract.~~

~~(iii) — Exceptions to this requirement may be as specified by the Contracting Officer in an addendum to this clause.~~

~~(3) — The Contractor shall notify the Contracting Officer reasonably in advance of placing any subcontract or modification thereof for which consent is required under paragraph (u)(1) or (u)(2) of this clause, including the following information:~~

~~(i) — A description of the supplies or services to be subcontracted.~~

~~(ii) — Identification of the type of subcontract to be used.~~

~~(iii) — Identification of the proposed subcontractor.~~

~~(iv) — Extent of competition or basis for determining price reasonableness.~~

~~(v) — The proposed subcontract amount.~~

~~(vi) — If a time and materials or labor hour subcontract, a list of the labor categories, corresponding labor rates and estimated hours.~~

~~(4) — The Contractor is not required to notify the Contracting Officer in advance of entering into any subcontract for which consent is not required under paragraph (u)(1) or (u)(2) of this clause.~~

~~(5) — Unless the consent or approval specifically provides otherwise, neither consent by the Contracting Officer to any subcontract nor approval of the Contractor's purchasing system shall constitute a determination —:~~

~~(i) — Of the acceptability of any subcontract terms or conditions; or~~

~~(ii) — Relieve the Contractor of any responsibility for performing this contract.~~



~~(6) — No subcontract or modification thereof placed under this contract shall provide for payment on a cost plus a percentage of cost basis, and any fee payable under cost-reimbursement type subcontracts shall not exceed the fee limitations in FAR 15.404-4(c)(4)(i).~~

~~(7) — The Contractor shall give the Contracting Officer immediate written notice of any action or suit filed and prompt notice of any claim made against the Contractor by any subcontractor or vendor that, in the opinion of the Contractor, may result in litigation related in any way to this contract, with respect to which the Contractor may be entitled to reimbursement from the Government.~~

~~(8) — If the contractor enters into any subcontract that requires consent without obtaining such consent, the Government will not be liable for any costs incurred under that subcontract prior to the date the contractor obtains the required consent. Any payment of subcontract costs incurred prior to the date of the consent will be reimbursed only if the Contracting Officer subsequently provides the consent required by paragraph (u) of this clause.~~

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