Congressional Research Service
Informing the legislative debate since 1914

Contract Types: Legal Overview

Kate M. Manuel
Legislative Attorney

December 29, 2014

Congressional Research Service
7-5700
www.crs.gov
R41168

CRS REPORT
Prepared for Members and
Committees of Congress

Summary

Federal procurement contracts are commonly divided into two main types—fixed-price and cost-reimbursement—that primarily differ as to whether the government or the contractor assumes the risk of increases in the costs of performance (e.g., wages, materials). With a *fixed-price contract*, the contractor assumes this risk by agreeing to provide supplies or services to the government for a specified price established at the time of contracting. If the costs of performance exceed this price, the contractor generally cannot, absent some provision for price adjustment in the contract, recover more money from the government. Rather, it must perform the contract at a loss, or default on the contract. In contrast, with a *cost-reimbursement contract*, the government assumes the risk of increases in the costs of performance by agreeing to repay the contractor for all "allowable," "reasonable," and "allocable" costs of performing specified work, up to a total cost provided for in the contract. Additionally, under certain types of cost-reimbursement contracts, the contractor may be entitled to profit in the form of fixed fees, or incentive or award fees.

Other types of contracts are also recognized. For example, the various types of *incentive contracts*—fixed-price incentive contracts, cost-plus-incentive-fee contracts, cost-plus-award-fee contracts—are often characterized as occupying a middle ground between fixed-price and cost-reimbursement contracts because the parties share the risk by basing the contractor's profits, in part, on the cost or quality of its performance. In addition, there are (1) *time-and-materials* and *labor-hour contracts*, wherein the government pays the contractor hourly rates for labor and/or the costs of materials; (2) *indefinite-delivery contracts*, wherein the contractor agrees to deliver supplies or services at future dates unspecified at the time of contracting; (3) *letter contracts*, which are used prior to the execution of a formal (i.e., definitized) contract; and (4) *basic agreements* and *basic ordering agreements*, which are generally not themselves contracts, but contain terms applicable to future contracts or orders between the parties.

In a few cases, federal law expressly restricts the use of particular types of contracts. Namely:

- the use of *cost-plus-a-percentage-of-cost contracts*—which provide for the government to reimburse contractors' costs and pay them a percentage of these costs as an allowance for profit—is prohibited;
- the use of any type of cost-reimbursement contract to acquire "commercial items" is prohibited; and
- contracts resulting from "sealed bidding" must be firm-fixed-price or fixed price with an economic adjustment.

Aside from these restrictions, however, the determination as to which type of contract to use is generally within the contracting officer's discretion.

The types of contracts used by federal agencies have long been of interest to Congress and the executive branch, as they have sought to ensure that the most appropriate type of contract is used to acquire particular supplies or services. Early on, the use of cost-plus-a-percentage-of-cost contracts prompted concern among Members of the Continental Congress that some contractors ran up their costs in order to recover larger fees. Such contracts were later prohibited and, more recently, concerns have centered upon the use of other types of cost reimbursement contracts. President Obama articulated a "preference" for fixed-price type contracts in his March 4, 2009, memorandum on government contracting, which his Administration has sought to implement in various ways.

Contents

Tables

Contacts

This report provides an overview of the various contract types (e.g., fixed-price, cost-reimbursement) used in federal procurement and the legal requirements pertaining to each. The types of contracts used by federal agencies have long been of interest to Congress and the executive branch, as they have sought to ensure that the most appropriate type of contract is used to acquire particular supplies or services. Early on, the use of *cost-plus-a-percentage-of-cost contracts*—which provide for the government to reimburse contractors' costs and pay them a percentage of these costs as an allowance for profit—prompted concern among Members of the Continental Congress that some contractors ran up their costs in order to recover larger fees.[1] Such contracts were later prohibited[2] and, more recently, concerns have centered upon the use of other types of cost reimbursement contracts.[3] President Obama articulated a "preference" for fixed-price type contracts in his March 4, 2009, memorandum on government contracting,[4] which his Administration has sought to implement in various ways.[5]

The report begins by summarizing the legal prohibitions upon, or requirements for, the use of particular types of contracts. It then explains the differences between the various types of contracts, as well as the primary constraints that are placed upon the use of each type by the Federal Acquisition Regulation (FAR) and other provisions of law. The report focuses on the contract types included in Part 16 of the FAR. Some of these types are legally binding contracts; others are agreements that, while not necessarily legally binding, establish the terms and conditions of future binding contracts. The report does not discuss what some may describe as other "types" of procurement contracts (e.g., performance-based, share-in-savings, interagency, multiyear).[6] It also does not directly address orders or options because they are not types of contracts.[7]

---

[1] *See, e.g.*, James F. Nagle, *History of Government Contracting* 25-26 (2d ed. 1999).

[2] *See* P.L. 81-152, §304(b), 63 Stat. 395 (June 30, 1949) (codified, as amended, at 41 U.S.C. §3905) (procurements of civilian agencies); P.L. 84-508, §2306(a), 70A Stat. 130 (May 9, 1956) (codified, as amended, at 10 U.S.C. §2306(a)) (procurements of defense agencies); 48 C.F.R. §16.102(c).

[3] *See* Dep't of Defense, Office of the Inspector General, Audit Report, Acquisition Processes and Contract Management, DoD Needs to Improve Processes for Issuing and Managing Cost-Reimbursement Contracts, Nov. 7, 2014, *available at* http://www.dodig.mil/pubs/report_summary.cfm?id=6039 (finding that contracting personnel did not "consistently implement" the Federal Acquisition Regulation's (FAR's) requirements as to the use of cost-reimbursement contracts for 411 of the 604 contracts reviewed); Gov't Accountability Office, HealthCare.gov: Ineffective Planning and Oversight Practices Underscore the Need for Improved Contract Management, July 2014, at 14, *available at* http://www.gao.gov/assets/670/665179.pdf (noting that the contracts used for developing HealthCare.gov were cost-plus-fixed-fee contracts, which are "considered high risk for the government because of the potential for cost escalation and because the government pays a contractor's allowable cost of performance regardless of whether the work is completed").

[4] The White House, Office of the Press Secretary, Government Contracting, Mar. 4, 2009, at ¶ 3, *available at* http://www.whitehouse.gov/the_press_office/Memorandum-for-the-Heads-of-Executive-Departments-and-Agencies-Subject-Government

[5] For example, the Department of Defense (DOD)—the largest federal procuring agency—amended its regulations in 2011 to require contracting officers to "give particular attention" to the use of fixed-price incentive (firm target) contracts, especially for acquisitions moving from development to production. *See* Dep't of Defense, Defense Federal Acquisition Regulation Supplement; Increase the Use of Fixed-Price Incentive (Firm Target) Contracts, 76 Fed. Reg. 57677 (Sept. 16, 2011) (codified at 48 C.F.R. §216.403-1). However, more recently, DOD has indicated a focus upon the employment of other "appropriate contract types," with particular emphasis on the use of incentive-type contracts. *See* DOD, Office of the Under Secretary of Defense, Acquisition, Technology and Logistics, White Paper, Better Buying Power 3.0, Sept. 19, 2014, at 5, *available at* http://www.acq.osd.mil/docs/Better_Buying_Power_30-091914.pdf.

[6] The report also does not discuss task order/delivery order (TO/DO) contracts or multiple-award task-order contracts (MATOCs) as distinct types of federal procurement contracts. As the FAR explains, requirements contracts and ID/IQ contracts can be described as TO/DO contracts. 48 C.F.R §16.501-2(a). Similarly, any type of indefinite-delivery (continued...)

Selecting the Contract Type

In a few cases, federal law expressly restricts the use of particular types of contracts. Namely:

- The use of *cost-plus-a-percentage-of-cost contracts*—which provide for the government to reimburse contractors' costs and pay them a percentage of these costs as an allowance for profit—is prohibited,[8] and agency prime contracts must generally prohibit cost-plus-a-percentage-of-cost subcontracts.[9]
- The use of any type of cost-reimbursement contract to acquire "commercial items" is prohibited.[10] Contracts for commercial items must instead be firm-fixed-price or fixed-price with economic price adjustment contracts,[11] or of other types (e.g., time-and-materials, indefinite-delivery/indefinite-quantity (ID/IQ)) that price supplies or services on a firm-fixed-price or fixed-price-with-an-economic-price-adjustment basis.[12]
- Contracts resulting from "sealed bidding" must be firm-fixed-price or fixed price with an economic adjustment.[13]

(...continued)

contract could be a MATOC. 48 C.F.R. §16.500(a).

[7] An *order* is a request for delivery of goods or provision of services issued to a vendor currently holding a contract, or under an existing agreement. An *option* is a "unilateral right in a contract by which, for a specified time, the Government may elect to purchase additional supplies or services called for by the contract, or may elect to extend the term of the contract." 48 C.F.R. §2.101.

[8] P.L. 81-152, §304(b), 63 Stat. 395 (June 30, 1949) (codified, as amended, at 41 U.S.C. §3905) (procurements of civilian agencies); P.L. 84-508, §2306(a), 70A Stat. 130 (May 9, 1956) (codified, as amended, at 10 U.S.C. §2306(a)) (procurements of defense agencies); 48 C.F.R. §16.102(c). Despite this prohibition, agencies sometimes inadvertently enter cost-plus-a-percentage-of-cost contracts, which are generally seen to be void because they are unlawful. *See, e.g.*, Urban Data Sys., Inc. v. United States, 699 F.2d 1147 (Fed. Cir. 1983), *aff'g* Urban Data Sys., Inc., GSBCA 5545, 81-2 BCA ¶ 15,254 (1981) (finding that two contracts whose price adjustment clauses provided for item or unit prices to be audited after performance, with the contract prices adjusted by 5 to 10% based upon the audit findings, constituted cost-plus-a-percentage-of-cost systems of contracting and were thus void).

[9] 48 C.F.R. §16.102(c). Agencies may opt not to include the clause prohibiting cost-plus-a-percentage-of-cost subcontracts in their prime contracts only when the prime contract is a firm-fixed-price contract. *Id*.

[10] 48 C.F.R. §16.301-3(b). For purposes of federal procurement law, the term *commercial item* includes "[a]ny item, other than real property, that is of a type customarily used by the general public or by non-governmental entities for purposes other than governmental purposes, and (i) [h]as been sold, leased, or licensed to the general public; or (ii) [h]as been offered for sale, lease, or license to the general public ...." 48 C.F.R. §2.101.

[11] 48 C.F.R. §16.201(a).

[12] The Services Acquisition Reform Act (SARA) of 2003 explicitly authorized agencies to use time-and-materials and labor-hour contracts to acquire commercial items. *See* P.L. 108-136, §1432, 117 Stat. 1672 (Nov. 24, 2003). Before SARA was enacted, the FAR prohibited the use of contracts that were not fixed-price to acquire commercial items. *See* 48 C.F.R. §12.207 (2002) ("Agencies shall use firm-fixed-price contracts or fixed-price contracts with economic price adjustment for the acquisition of commercial items…. Use of any other contract type to acquire commercial items is prohibited.").

[13] 48 C.F.R. §16.102(a). *Sealed bidding* is one of two main source-selection methods used by the federal government. In sealed bidding, the procuring activity awards the contract to the lowest-priced, qualified, responsible bidder without conducting negotiations with the bidders. This is in contrast to the other main source-selection method, *negotiated procurement*, wherein the procuring activity bargains with offerors after receiving proposals, and awards the contract to the offeror whose proposal rates most highly on evaluation criteria that include, but are not limited to, cost or price. In the case of negotiated procurements, any type or combination of types of contracts allowed under Subpart 16 of the FAR may be used. 48 C.F.R. §16.102(b).

Aside from these restrictions, however, selection of the contract type for a particular procurement is generally within the contracting officer's discretion.[14] The contracting officer typically decides on the contract type prior to issuing a solicitation. This decision is made after considering a range of factors including the degree of price competition in the procurement, the type and complexity of the requirements, the urgency of the requirements, the period of performance or length of the production run, and the acquisition history.[15] These factors can cut in various ways in any given procurement. For example, while the requirements might be simple enough for a fixed-price contract, the procuring activity's need for them might be urgent, a circumstance which could be seen to justify use of cost-reimbursement contracts.[16] However, particularly in negotiated procurements, selection of the contract type can also be "a matter for negotiation" between the "procuring activity"[17] and the contactor. Most reports by the Government Accountability Office or agency inspectors general discussing agencies' use of particular types of contracts allege not that the type used was *unlawful* but that it was *imprudent* because it left the government vulnerable to paying too much, especially if agency oversight of contractor performance was inadequate.[18]

Provided they do not unilaterally modify particular contracts, procuring activities may generally change the type of contract used in the course of an acquisition program, a series of contracts for recurring requirements, or a single long-term contract, so as to shift more risk to the contractor as the uncertainties associated with the procurement are reduced.[19]

Types of Contracts

Federal procurement contracts are commonly divided into two main types—fixed-price and cost-reimbursement—that primarily differ as to whether the government or the contractor bears the risk of increases in the costs of performance (e.g., wages, materials). With a *fixed-price contract*,

---

[14] *See, e.g.*, Am. Tel. & Tel. Co. v. United States, 307 F.3d 1374, 1379 (Fed. Cir. 2002) ("[T]he regulations entrust the contracting officer with especially great discretion, extending even to his application of procurement regulations."); Master Sec., Inc., Comp. Gen. Dec. B-232263 (Nov. 7, 1988) (denying a protest that alleged the contracting officer's proposed use of a firm-fixed-price contract for three years of work was improper because it would impose an inordinate risk of high labor costs on the contractor).

[15] 48 C.F.R. §16.104(a)-(*l*).

[16] *See* HealthCare.gov: Ineffective Planning and Oversight Practices, *supra* note 3, at 11 ("[Agency] contracting officials explained that meeting project deadlines was a driving factor in a number of acquisition planning activities, such as the selection of a cost-reimbursement contract ...").

[17] 48 C.F.R. §16.103(a). A *procuring activity* is any component of an executive agency with significant acquisition functions that is designated as such by the head of the agency. 48 C.F.R. §2.101.

[18] *See, e.g.*, Treasury Inspector General for Tax Administration, Current Practices Might Be Preventing Use of the Most Advantageous Contractual Methods to Acquire Goods and Services, Feb. 10, 2009, at 2-3, *available at* http://www.treas.gov/tigta/auditreports/2009reports/200910037fr.html (reporting that 33 of 40 contracts reviewed were cost-reimbursement, time-and-materials, or labor-hour, but finding that the contracts were not improper based on the associated statements of works); Gov't Accountability Office, Troubled Asset Relief Program: Additional Actions Needed to Better Ensure Integrity, Accountability, & Transparency, GAO-90-161, Dec. 2008, at 36-37, *available at* http://www.gao.gov/new.items/d09161.pdf (noting extensive use of time-and-materials contracts and suggesting that there needs to be close government supervision to ensure that costs are contained).

[19] *See, e.g.*, 48 C.F.R. §16.103(c); Gov't Accountability Office, Troubled Asset Relief Program: Status of Efforts to Address Transparency and Accountability Issues, GAO-09-417T, Feb. 24, 2009, at 3 & 10, *available at* http://www.gao.gov/new.items/d09296.pdf (recommending that agencies shift toward fixed-price contracts as program requirements are better defined).

the contractor agrees to supply certain supplies or services to the government at the price specified in the contract. This means that, absent some provision for price adjustment in the contract, the contractor assumes the risk that the costs of performance will exceed the contract price.[20] In contrast, with a *cost-reimbursement contract*, the government agrees to pay certain costs that the contractor incurs in providing the supplies or services. While payment may only be made for "allowable," "reasonable," and "allocable" costs, up to a total cost specified in the contract,[21] the government assumes the risk that the costs of performance will increase over the term of the contract. While shifting as much risk as possible from the government to the contractor might seem like a good idea,[22] the FAR instructs contracting officers to use contract types that result in "reasonable contractor risk,"[23] in part because contractors who are forced to assume excessive risk may cease to be available as contracting partners for the government.[24]

Contracts can also be divided into other types, including (1) incentive contracts, (2) letter contracts, (3) ID/IQ contracts, and (4) time-and-materials (T&M) contracts, as discussed below.

Particular contracts may display features of various types (e.g., pricing on both fixed-price and cost-reimbursement bases for different line items) and could potentially be of multiple types (e.g., an ID/IQ T&M letter contract).[25]

Determining the type of a particular contract is a question of law,[26] and contract language stating that a contract is of a certain type is not necessarily dispositive.[27]

Fixed-Price Contracts

The various types of fixed-price contracts, described in **Table 1**, provide for the contractor to receive a specified (i.e., fixed) price for supplying certain supplies or services to the government. With some types of fixed-price contracts, the price is fixed without the possibility of change, absent modifications by the government or defective performance by the contractor, at the time of

[20] *See, e.g.*, Cleveland Telecomm. Corp. v. United States, 39 Fed. Cl. 649 (1997) (contractor not entitled to reimbursement for unforeseen premium wage payments); D.W. Clark, Inc., ASBCA 45562, 94-3 BCA ¶ 27,132 (1994) (contractor solely responsible for increases in material costs absent an economic price adjustment clause in the contract).

[21] 48 C.F.R. §52.216-7 (allowable cost and payment); 48 C.F.R. §52.232-20(a) (limitation of cost).

[22] *See, e.g.*, Firm-Fixed-Price Contract Awards Require Discipline on DOD's Part, Comptroller Says, *Fed. Cont. Daily*, Mar. 20, 2009 (quoting some who would place all risk of cost overruns on the contractors).

[23] 48 C.F.R. §16.103(a).

[24] *See, e.g.*, John Cibinic, Jr. & Ralph C. Nash, Jr., *Formation of Government Contracts* 1080 (3d ed. 1998).

[25] *See, e.g.*, J.A. Jones Constr. Co., ASBCA 43344, 96-2 BCA ¶ 28,517 (1996) (contract displaying elements of firm-fixed price and cost-sharing contracts); Ben Bain, DHS Procurement Office Eyes Contract Hybrids, *Wash. Tech.*, Dec. 3, 2009, *available at* http://washingtontechnology.com/Articles/2009/12/07/WEEK-DHS-contracting-eagle.aspx. A "hybrid contract" is one that displays features of multiple types.

[26] *See, e.g.*, Coastal Gov't Servs., Inc., ASBCA 49625, 97-1 BCA ¶ 28,888 (1997) ("The determination of the contract type is a matter of law, … and we are not bound either by what the contract is called or by the label attached to it by the parties.").

[27] *See, e.g.*, LSI Serv. Corp. v. United States, 422 F.2d 1334 (Ct. Cl. 1970) (finding that a contract titled "Cost Reimbursement Contract" was a fixed-price contract because it contained a clause limiting the maximum total cost, including the contractor's fee, to a stated amount); Franklin Co., ASBCA 9750, 65-1 BCA ¶ 4,767 (1965), *aff'd* Franklin Co. v. United States, 381 F.2d 416 (Ct. Cl. 1967) (finding that the contracts in question were not requirements contracts, despite being designated as such, because they provided for the supply of the same kind of services in the same place, and there cannot be two simultaneous requirements contracts for the same services in the same place).

contracting (e.g., firm-fixed-price contracts). With others, the price is fixed at the time of contracting but could later change if specified circumstances change (e.g., fixed-price contracts with economic price adjustments,[28] fixed price contracts with prospective price redetermination, fixed-ceiling price contracts with retroactive price redetermination[29]). The extent of possible changes in price is sometimes restricted at the time of contracting (e.g., fixed-ceiling-price contracts with retroactive price redetermination). At other times, it may be left open (e.g., fixed-price contracts with economic price adjustments).

Fixed-price contracts are generally for the provision of specified quantities of supplies or services. However, some provide a specified fee in return for the contractor's expending a specified level of effort, regardless of whether particular objectives are realized (e.g., firm-fixed-price, level-of-effort term contracts).

Table 1. Types of Fixed-Price Contracts

Type	Description	Use	Conditions on Use
Firm-fixed-price contracts	Contractor agrees to provide supplies or services to the procuring activity for a specified price	Used when acquiring commercial items or other supplies and services when there are reasonably definite specifications, and fair and reasonable prices can be established at the outset	n/a
Fixed-price contracts with economic price adjustments[a]	Contractor agrees to provide supplies or services to the procuring activity for a specified price that could be adjusted if certain conditions change during performance of the contract	Used when the stability of market or labor conditions during an extended period of contract performance is uncertain, and contingencies that would otherwise be included in the contract price can be identified and separately addressed in the contract	Contracting officer must determine that a price adjustment clause is necessary to protect the contractor and government against significant fluctuations in costs, or to provide for price adjustment in the event of changes in the contractor's established prices
Fixed-price contract with prospective price redetermination	Contractor receives a firm fixed price for a specified initial period of performance, with the price for later periods revised in an equitable manner based on variables	Used to acquire quantity production or services when it is possible to negotiate a fair and reasonable firm fixed price for the initial period but not for later ones	Negotiations have established that conditions for use of firm-fixed price contract are not present, and a fixed-price incentive contract is not more appropriate; the contractor's

[28] Contracting officers have substantial discretion in determining whether to include an economic price adjustment clause in a fixed-price contract, and their determinations about whether to include such a clause generally will not be reversed by judicial or administrative tribunals. *See, e.g.*, B&P Refuse Disposal, Inc., Comp. Gen. Dec. B-253661 (Sept. 16, 1993); Master Security, Inc., Comp. Gen. Dec. B-232262 (Nov. 30, 1988); Sentinel Elecs., Inc., Comp. Gen. Dec. B-212770 (Dec. 20, 1983).

[29] Some commentators have suggested that fixed-price contracts with retroactive price redetermination are really cost-plus-a-percentage-of-cost contracts because profit is computed based on a percentage of the costs after performance. *See, e.g.*, 2-19 Gov't Cont.: L., Admin. & Proc. §19.40. The courts, however, have historically rejected this argument on the grounds that Congress explicitly prohibited cost-plus-a-percentage-of-cost contracts but has permitted fixed-price contracts with retroactive price redetermination. *See* Nat'l Elec. Labs., Inc. v. United States, 180 F. Supp. 337, 340 (Ct. Cl. 1960) ("There probably is some difference but not enough, we think, to justify us in treating the latter [retroactive] type of price provisions as illegal.").

Type	Description	Use	Conditions on Use
	agreed upon by the parties[b]		accounting system is adequate for redetermination; pricing periods can be made to conform to accounting system; and there is reasonable assurance redetermination will take place as scheduled
Fixed-ceiling-price contracts with retroactive price redetermination	Contractor receives no more than a fixed ceiling price that was agreed upon when the contract was formed; the determination of the actual price occurs after contract performance, based on previously agreed upon variables	Used for research and development contracts whose anticipated value is less than $150,000 when other fixed-price contracts cannot be used	Contractor's accounting system is adequate for price redetermination; there is reasonable assurance redetermination will take place as scheduled; and the head of the contracting activity (or other higher-level officials) approves use in writing
Firm-fixed-price, level-of-effort term contracts	Contractor receives a fixed amount for providing a certain level of effort over a certain period of time on work that "can be stated only in general terms"	Investigation or study in a research and development area whose anticipated value is generally less than $150,000;[c] usually yields a report describing the R&D results	Work required cannot otherwise be clearly defined; required level of effort is identified and agreed upon in advance; and there is reasonable assurance that the intended result cannot be achieved by less effort

Source: Congressional Research Service, based on Subpart 16.2 of the FAR.

a. Economic price adjustment clauses themselves can be of three types, depending upon whether the adjustment is made based upon (1) established prices, (2) the actual costs of labor or material, or (3) cost indexes of labor or material. 48 C.F.R. §16.203-1(a).

b. The initial performance period should be the longest possible period allowing for a "fair and reasonable firm fixed price," and the later performance periods should be a minimum of 12 months. 48 C.F.R. §16.205-2(a).

c. Use of firm-fixed price, level-of-effort term contracts valued in excess of $150,000 must be approved by the chief of the contracting activity. 48 C.F.R. §16.207-3(d).

Fixed-price contracts are generally favored by policy makers because the contractor, not the government, assumes the risk of increases in the costs of performance.[30] The government's liability is typically limited to the contract price, so long as the contract does not have a price adjustment clause and the government has not actually or constructively modified the contract.[31] If the costs of labor or materials increase during performance of the contract, the contractor must absorb these costs, even if doing so means choosing between performing the contract at a loss and breaching the contract. Additionally, the government can generally rely on the contractor to finance performance under a fixed-price contract.[32] This is because, unless the government agrees

[30] *See, e.g.*, Formation of Government Contracts, *supra* note 24, at 1061.

[31] *See, e.g.*, McDonnell Douglas Corp. v. United States, 37 Fed. Cl. 295 (1997) (when the government orders changes, the contractor is no longer required to deliver at the contract price, regardless of increases in performance costs, so long as the increases resulted from the government's changes); Martin-Copeland Co., ASBCA 26551, 83-2 BCA ¶ 16,752 (1983) (contractor not entitled to relief when the price of gold increased by 350% because it had assumed the risk that the price would not increase beyond the 10% provided for in the price adjustment clause).

[32] *See, e.g.*, Formation of Government Contracts, *supra* note 24, at 1061.

to provide financing in the form of progress payments, it pays only for completed or delivered work.[33] With cost-reimbursement contracts, in contrast, the contractor needs to provide only a minimal amount of financing because its costs are reimbursed on a regular basis.[34] Further, fixed-price contracts are generally simpler for the government to administer because there is typically no need to audit the contactor's books or determine whether particular costs are allowable under the contract.[35] Rather, the government can pay the agreed-upon price upon acceptance of the supplies or services, or as otherwise scheduled under the contract.[36]

Fixed-price contracts are not without their drawbacks, however, as some commentators have noted.[37] Regardless of the type of fixed-price contract used, the government runs the risk of overpaying for supplies and services, especially if it overestimates its requirements.[38] It is not entitled to a price reduction if the contractor's actual costs are less than anticipated,[39] and certain payments that are incorrectly made may be recoverable under cost-reimbursement contracts but not under fixed-price contracts.[40] With firm-fixed-price contracts, in particular, the government could also (1) pay higher prices than would have been paid under cost-reimbursement contracts;[41] (2) have to convert the contract to another type to obtain completion of performance;[42] or (3) defend lawsuits filed by contractors attempting to recover increases in performance costs by alleging that the government constructively modified the contract.[43] Similarly, with fixed-price

[33] *Id*. Progress payments made on the basis of percentage of completion to construction contractors and architect-engineers are considered invoice payments. 48 C.F.R. §32.103. Progress payments made on the basis of performance milestones are considered financing payments. 48 C.F.R. §32.102(f). Any other progress payments based on costs are generally seen to be "unusual" and may be made only in exceptional cases. 48 C.F.R. §32.501.

[34] *See, e.g.*, Formation of Government Contracts, *supra* note 24, at 1061.

[35] *See, e.g.*, 2-19 Gov't Cont.: L., Admin. & Proc. §19.20 (2009).

[36] *Acceptance* occurs when an authorized representative of the government assumes ownership of identified supplies tendered, or approves specific services rendered, as partial or complete performance of the contract. *See* 48 C.F.R. §46.101.

[37] *See, e.g.*, Formation of Government Contracts, *supra* note 24, at 1080.

[38] North Chicago Disposal Co., ASBCA 25535, 82-1 BCA ¶ 15,488 (1981) (government could not recover the amounts it paid the contractor when it contracted for removal of "wet garbage" from galleys at the Great Lakes Naval Base and then did not use the service because the galley personnel were unaware of it and disposed of the garbage in-house); Rolligon Corp., ASBCA 8812, 65-2 BCA ¶ 15,488 (1965) (government liable for the full contract price when it leased two experimental vehicles from the contractor for a one-year testing-and-evaluation period and then discontinued testing after one month).

[39] Penker Constr. Co. v. United States, 96 Ct. Cl. 1 (1942) (government could not deduct payments from a fixed-price contract when the number of yards of materials excavated was less than the government had estimated it would be).

[40] Gould, Inc., ASBCA 46759, 97-2 BCA ¶ 29,254 (1997), *reaff'd on recons.* 98-1 BCA ¶ 29,469 (1998) (when the contractor over-funded pension accounts because of incorrect actuarial assumptions, the government was entitled to a credit on costs billed to cost-recovery contracts, but not on costs billed to firm-fixed-price contracts).

[41] *See, e.g.*, Commission on Army Acquisition and Program Management in Expeditionary Operations, *Urgent Reform Required: Army Expeditionary Contracting* 38 (2007) (reporting that contractors had to price firm-fixed-price contracts higher in order to cover possible risks of performing in war zones).

[42] *See, e.g.*, General Dynamics Corp. v. United States, 671 F.2d 474 (Ct. Cl. 1982) (government converting a firm-fixed-price contract into a cost-reimbursement contract in order to obtain completion of the work); Ball Bros. Research Group, NASABCA 1277-6, 80-2 BCA ¶ 14,562 (1980) (same).

[43] *See, e.g.*, McDonnell Douglas Corp. v. United States, 37 Fed. Cl. 295 (1997) (when the government orders changes, the contractor is no longer required to deliver at the contract price, regardless of increases in performance costs, so long as the increases resulted from the government's changes). In one case, Northrop Grumman reportedly sued to recover $14 million due to alleged modifications to the fixed-price portions of a $26 million contract to develop a prototype communications system. *See, e.g.*, Northrop Grumman May Sue for Overrun on $26 Million Prototype Contract, COFC Rules, 70 *Fed. Cont. Rep.* 417 (Oct. 26, 1998).

contracts with economic price adjustment clauses, the government could be vulnerable to "significant and unanticipated price increases," especially if the clauses do not adequately protect the government's interests.[44] However, refusal to use economic price adjustment clauses where significant economic fluctuations are possible could result in the government paying higher prices because fewer contractors will compete for such contracts.[45]

Cost-Reimbursement Contracts

The various cost-reimbursement contracts, described in **Table 2**, provide for the government to pay the contractor, at a minimum, allowable costs incurred in performing the contract, up to a total cost specified in the contract. As used here, "costs" do not necessarily include all expenses that the contractor incurred in performing the contract. Rather, *costs* are reasonable expenses that are allocable to the contract and reimbursable by the government under the terms of the contract (i.e., allowable).[46]

The types of cost-reimbursement contracts differ in whether the contractor recovers only costs (e.g., cost contracts, cost-sharing contracts) or whether there is some allowance for profit (e.g., cost-plus-fixed-fee contracts, cost-plus-a-percentage-of-cost contracts). Some contracts are with vendors that are nonprofits (e.g., cost contracts), or that at least are not expecting to profit from the contract (e.g., cost-sharing contracts). Others are with contractors who anticipate making a profit (cost-plus-fixed-fee contracts).

Cost-plus-a-percentage-of-cost contracts are prohibited,[47] and cost-reimbursement contracts may not be used to acquire commercial items.[48]

Table 2. Types of Cost-Reimbursement Contracts

Type	Description	Use
Cost contracts	Contractor reimbursed for allowable costs up to a specified total cost; no allowance for profit	Used for research and development projects, especially those involving nonprofits (e.g., colleges and universities)
Cost-sharing contracts	Contractor is reimbursed for some allowable costs; pays other costs itself	Used when the contractor expects "substantial compensating benefits" (e.g., commercializing the results of research and development)
Cost-plus-fixed-	Contractor is reimbursed for allowable costs	Used when requirements cannot be sufficiently

[44] Office of the Under Secretary of Defense, Acquisition, Technology & Logistics, Follow-on Actions in Response to OIG Report Notification: "Effect of Payments into Boeing Pension Funds on Economic Price Adjustment Clauses in DoD Contracts," Sept. 9, 2009, *available at* http://www.acq.osd.mil/dpap/policy/policyvault/USA005087-09-DPAP.pdf (reporting $1.9 billion in price increases on contracts for the C-17 Globemaster aircraft, F/A-18 E/F Super Hornet aircraft, and AH-64D Apache Longbow helicopter).

[45] *See, e.g.*, Formation of Government Contracts, *supra* note 24, at 1083.

[46] 48 C.F.R. §31.201-2 (allowable costs); 48 C.F.R. §31.201-3 (reasonable costs); 48 C.F.R. §31.201-4 (allocable costs). Whether particular costs are reimbursable can, thus, vary depending upon the terms of the contract. However, certain costs are *per se* unallowable under any contract. *See, e.g.*, 48 C.F.R. §31.205-13(b)-(c) (costs associated with gifts or recreation for employees (except for the costs of employees' participation in company sponsored sports teams or employee organizations designed to improve company loyalty, team work, or physical fitness) are unallowable).

[47] *See supra* notes 8-9 and accompanying text.

[48] 48 C.F.R. §16.301-3(b).

Type	Description	Use
fee contracts	up to the specified total cost and may receive a fee fixed at the inception of the contract[a]	defined for a fixed-price contract, or uncertainties involved in performance do not permit costs to be estimated with sufficient accuracy; use must be approved by an official at least one level above contracting officer
Cost-plus-a-percentage-of-cost contracts	Contractor is reimbursed for its costs and receives a certain percentage of these costs as an allowance for profit	Generally prohibited, even as a subcontract under most types of federal prime contracts

Source: Congressional Research Service, based on Subpart 16.3 of the FAR.

a. The fixed fee is independent of actual costs and is adjusted only if the procuring activity changes the work to be performed under the contract. 48 C.F.R. §16.306(a).

As commentators have noted, cost-reimbursement contracts can be "high risk" for the government because the contractor has little incentive to keep the performance costs down given that the government will ultimately pay these costs.[49] These risks are even greater when the contractor is assured of not only recovery of its costs, but also profit based on a percentage of the costs (i.e., cost-plus-a-percentage-of-cost contracts).[50] Cost-reimbursement contracts also impose certain administrative demands upon procuring activities that are generally not present with fixed-price contracts. Among other things, procuring activities must (1) ensure that the contractor's accounting system is adequate for determining the costs applicable to the contract, and (2) have adequate resources to award and manage a contract that is not firm-fixed price.[51] Further, cost-reimbursement contracts can give rise to disputes between the parties over whether particular costs are allowable under or allocable to the contract.[52]

However, the alleged risks of cost-reimbursement contracts can be lessened with effective government oversight of contractor performance,[53] and the contracts themselves contain certain protections for the government. Key among these protections are limitations on allowable costs and total costs.[54] The government is only required to reimburse the contractor for costs that are reasonable, allowable under, and allocable to the contract, and the maximum total cost that the government must potentially reimburse is fixed at the time of contracting. Under the terms of the contract, the contractor must notify the government when costs approach or exceed this total. The government then has the right—but not the obligation—to approve additional costs.[55] If the government approves additional costs, the contractor must continue working until the funds are spent or performance is completed. However, if the government does not approve the additional

---

[49] *See, e.g.*, Executive Office of the President, Office of Management and Budget, Improving Government Acquisition, July 29, 2009, at 2, *available at* http://www.whitehouse.gov/omb/assets/memoranda_fy2009/m-09-25.pdf.

[50] Muschany v. United States, 324 U.S. 49, 61-62 (1944) ("The evil of such contracts is that the profit of the other party to the contract increases in proportion to that other party's costs expended in the performance.").

[51] 48 C.F.R. §16.301-3(a)(3)-(4).

[52] *See, e.g.*, 2-19 Gov't Cont.: L., Admin. & Proc. §19.20.

[53] *See, e.g.*, Geoffrey Emeigh, DOD Acquisition Experts Chime in on SASC Weapon Systems Acquisition Reform Agenda, *Fed. Cont. Daily*, Mar. 4, 2009 (quoting Jacques Gansler, former Under Secretary of Defense for Acquisition, Technology & Logistics, as stating that the government has not been using cost-type contracts as effectively as it could).

[54] 48 C.F.R. §52.216-7 (allowable cost and payment); 48 C.F.R. §52.232-20 (limitation of cost).

[55] *See, e.g.*, Eyler Assocs., ASBCA 16804, 75-1 BCA ¶ 11,320 (1975) (contracting officer has substantial discretion in determining whether to fund an overrun); ARINC Research Corp., ASBCA 15861, 72-2 BCA ¶ 9,721 (1972) (same).

costs, the contractor is expected to cease performance. If it does not cease performance, it generally cannot recover any further costs from the government.[56]

Cost-plus-fixed-fee contracts are also subject to limitations on the amount of the fixed fee, which generally cannot exceed 10% of the estimated cost (6% for architectural and engineering work; 15% for experimental, research, or development work).[57]

Incentive Contracts

The various types of incentive contracts—fixed-price incentive contracts, cost-plus-incentive-fee contracts, and cost-plus-award-fee contracts—are often characterized as occupying a "middle ground" between fixed-price and cost-reimbursement contracts because the parties share the risk by basing the contractor's profits, in part, on the cost or quality of its performance.[58] The various types of incentive contracts are alike in that they provide for the contractor to get (1) a specified base amount and (2) the opportunity to earn additional fees (i.e., incentive or award fees) based upon its performance in meeting cost, schedule, or technical goals under the contract.[59] They differ in the basis upon which the additional fee is determined and, in the case of incentive-fee contracts, the circumstances in which they can be used.

With *cost-plus-award-fee contracts*, the award fee is entirely separate from the base fee,[60] and is determined based on the procuring activity's subjective evaluation of the contractor's performance.[61] Such determinations are generally final and generally considered to be exempt from the "disputes clause" of the contract, which otherwise permits the contractor to contest matters involving the contract's terms or performance with the government.[62] However, in *Burnside-Ott Aviation Training Center v. Dalton*, the U.S. Court of Appeals for the Federal Circuit held that such unilateral determinations by the government may be disputed and,

[56] However, in certain circumstances, the government's failure to fund a cost overrun could constitute an abuse of discretion. *See, e.g.*, Gen. Elec. Co. v. United States, 440 F.2d 420 (Ct. Cl. 1971) (government abused its discretion in failing to fund a cost overrun when the circumstances were such that the contractor could not have known of the overrun).

[57] 48 C.F.R. §15.404-4(c)(4)(i). The FAR authorizes payment of this fixed fee either (1) upon completion and delivery of a specified end product or (2) after the contractor has worked at a specified level of effort for an agreed upon period of time. 48 C.F.R. §16.306(d)(1)-(2). Payment upon completion is preferred and must be used "whenever the work … can be defined well enough to permit development of estimates within which the contractor can be expected to complete the work." 48 C.F.R. §16.306(d)(3). Payment based upon work at a specific level of effort for an agreed upon period of time may be used only when the contract requires the contractor "to provide a specific level of effort within a definite time period." 48 C.F.R. §16.306(d)(4).

[58] *See, e.g.*, Formation of Government Contracts, *supra* note 24, at 1061.

[59] 48 C.F.R. §16.403(a); 48 C.F.R. §16.405-1(a); 48 C.F.R. §16.405-2. Because exclusive focus upon meeting delivery or technical performance goals can result in excessive costs, any contract including delivery or technical performance goals must also include cost goals. *See, e.g.*, 48 C.F.R. §16.402-4(b).

[60] 48 C.F.R. §16.405-2.

[61] 48 C.F.R. §16.401(e)(2). The FAR requires that cost-plus-award-fee contracts include award-fee plans, specifying the procedures that the procuring activity will use when evaluating the contractor's performance to determine award fees. 48 C.F.R. §16.401(e)(3). Among other things, these plans provide for "evaluation period(s) to be conducted at stated intervals during the contract period … so that the contractor will periodically be informed of the quality of its performance and the areas in which improvement is expected." 48 C.F.R. §16.401(e)(3)(vi).

[62] 41 U.S.C. §§7101-7109 (codification of the Contract Disputes Act); 48 C.F.R. §52.233-1 (standard disputes clause).

potentially, reversed if "the discretion employed in making the decision is abused, for example, if the decision was arbitrary or capricious."[63]

With fixed-price incentive contracts and cost-plus-incentive-fee contracts, in contrast, the incentive fee is determined based upon formulaic adjustments of the base fee.[64] The formula for *fixed-price incentive contracts* focuses upon "the relationship of total final negotiated cost to total target cost"[65] and can include either (1) a target cost, a target profit, a price ceiling, and a profit adjustment formula, in the case of firm-target incentives;[66] or (2) an initial target cost, an initial target profit, an initial profit adjustment formula to be used in establishing the firm target profit, the production point at which the firm target cost and firm target profit will be negotiated, and a ceiling price that is the maximum that may be paid to the contractor (absent any adjustment), in the case of successive-target incentives.[67] The formula for *cost-plus-incentive-fee contracts* focuses upon "the relationship of total allowable costs to total target costs"[68] and includes a target cost, a target fee, a minimum fee, a maximum fee, and a fee adjustment formula as components.[69] The FAR arguably contemplates that cost-plus-incentive-fee contracts will be used more narrowly than fixed-price incentive contracts.[70]

Contractors who fail to meet incentive-related goals often also fail to meet other terms of the contract, which could carry different penalties. For example, failure to meet a technical performance goal could be seen as a failure to meet a specification requirement. However, the penalty for the former is a reduction in profits or fees, while the penalties for the latter could involve rejection of the work by the contracting officer, redoing the work so that it meets the specifications, or termination for default.[71] Most contracts reportedly do not make clear that the government is not entitled to a "double remedy" in these situations,[72] but courts and boards of contract appeals sometimes construe them to such an effect.[73]

[63] 107 F.3d 854, 860 (Fed. Cir. 1997), *aff'g* Burnside-Ott Aviation Training Center, ASBCA 43184, 96-1 BCA ¶ 28,102 (1996). *See also* Textron Defense Sys., A Div. of AVCO Corp., ASBCA 47352, 47950, 96-2 BCA ¶ 28,332 (1996).

[64] 48 C.F.R. §16.403(a); 48 C.F.R. §16.405-1(a).

[65] 48 C.F.R. §16.403(a).

[66] 48 C.F.R. §16.403-1(a).

[67] 48 C.F.R. §16.403-2(a)(1)(i)-(v).

[68] 48 C.F.R. §16.405-1(a).

[69] *Id.*

[70] The FAR states that cost-plus-incentive-fee contracts are "appropriate" for "services or development and test programs." 48 C.F.R. §16.405-1(b)(1). Additionally, cost-plus-incentive-fee contracts, like other cost-reimbursement contracts, cannot be used to acquire commercial items. 48 C.F.R. §301-3(b).

[71] *See generally* CRS general distribution memorandum, *Potential "Remedies" Available to the Government for a Contractor's Misconduct or Failure to Perform*, Feb. 11, 2010, by Kate M. Manuel (copies available upon request from the author).

[72] Formation of Government Contracts, *supra* note 24, at 1145.

[73] *See, e.g.*, North Am. Aviation, Inc., ASBCA 11603, 68-1 BCA ¶ 6,998 (1968); Gen. Precision, Inc., ASBCA 11071, 66-2 BCA ¶ 5,904 (1966).

Time-and-Materials and Labor-Hour Contracts

In a *time-and-materials contract*, the contractor is paid a fixed "hourly rate"[74] for direct labor expended during the contract's performance (e.g., wages, overhead, general and administrative expenses, profit[75]), as well as the actual cost of materials.[76] The materials covered by a time-and-materials contract can include direct materials, subcontracts for supplies or incidental services, other direct costs, and applicable indirect costs.[77] However, the FAR specifies that material handling costs, which include "all appropriate indirect costs allocated to direct materials," may be part of the materials cost only if they are not part of the labor-hourly rate.[78] It imposes this requirement to ensure that material handling costs are not "paid twice" in a way that could result in a prohibited cost-plus-percentage-of-cost system of contracting.[79]

A *labor-hour contract* is similar to a time-and-materials contract, except the contractor supplies only direct labor, not materials.[80]

Subpart 16 of the FAR addresses procuring activities' use of time-and-materials and labor-hour contracts in general. It authorizes agencies to use such contracts only when:

- the parties cannot accurately estimate the extent or duration of the work, or reasonably estimate costs, at the time of contracting;[81]
- the contracting officer prepares a determination and findings (D&F) that "no other contract is suitable";[82] and
- the contract includes a ceiling price that the contractor exceeds at its own risk.[83]

Subpart 12 of the FAR imposes additional requirements upon use of time-and-materials and labor-hours contracts to acquire commercial services.[84] Under Subpart 12, agencies generally may

[74] The FAR defines *hourly rate* as "the rate(s) prescribed in the contract for payment for labor that meets the labor category qualification of a labor category specified in the contract that [is] (1) [p]erformed by the contractor; (2) [p]erformed by the subcontractors; or (3) [t]ransferred between divisions, subsidiaries, or affiliates of the contractor under a common control." 48 C.F.R. §16.601(a). *See* 48 C.F.R. §16.601(c)(2) for more detailed requirements as to fixed hourly rates.

[75] 48 C.F.R. §16.601(b)(1).

[76] 48 C.F.R. §16.601(b)(2).

[77] 48 C.F.R. §16.601(a). *Direct materials* are "those materials that enter directly into the end product, or that are used or consumed directly in connection with the furnishing of the end product or service." *Id*.

[78] 48 C.F.R. §16.601(c)(3).

[79] *See, e.g.*, Gen. Eng'g & Mach. Works v. O'Keefe, 991 F.2d 775 (Fed. Cir. 1993) (affirming a board holding that recovery of a separate material handling charge and inclusion of material handling costs in the hourly rate of a time-and-materials contract violated the prohibition on cost-plus-a-percentage-of-cost contracts because it allowed a "double recovery").

[80] 48 C.F.R. §16.602.

[81] 48 C.F.R. §16.601(c).

[82] 48 C.F.R. §16.601(d)(1). Additionally, the head of the contracting activity must approve the D&F "prior to the execution of the base period when the base period plus any option periods exceeds three years." 48 C.F.R. §16.601(d)(1)(ii).

[83] 48 C.F.R. §16.601(d)(2). The contracting officer must document any subsequent changes in the ceiling price. *Id*.

[84] There has been some uncertainty as to whether purchases under the Federal Supply Schedules, which list commercial items, are subject to the requirements of Subpart 12 or just those of Subpart 16. The General Services Administration reportedly has taken the position that the Federal Supply Schedules are not subject to Subpart 12 because the Federal (continued...)

use time-and-materials and labor-hour contracts to acquire commercial services only under contracts or orders that were "competitively" awarded.[85] Additionally, under Subpart 12, D&Fs must not only conclude that "no other contract type … is suitable," but must also:

1. include a description of the market research that was conducted to reach this conclusion;
2. establish that it is not possible at the time of contracting or ordering to accurately estimate the extent or duration of the work or anticipate the costs;
3. establish that the requirement is structured to maximize use of firm-fixed-price or fixed-price with economic price adjustment contracts in future acquisitions for the same requirements (e.g., limiting the length of the contract); and
4. describe plans to maximize the use of firm-fixed-price or fixed-price with economic price adjustment contracts in future acquisitions.[86]

Indefinite-Delivery Contracts

The three types of indefinite-delivery contracts—definite-quantity, requirements, and indefinite-delivery/indefinite-quantity (ID/IQ) contracts—are alike in that they provide for the contractor to deliver supplies or services to the procuring activity at future dates unspecified at the time of contracting. They differ in the quantity of supplies or services that the procuring activity must order and, thus, in the circumstances in which they are generally used.

- *Definite-quantity contracts* provide for the procuring activity to order a fixed quantity of supplies or services from the contractor over the term of the contract.[87] Such contracts are used when the procuring activity knows that it will require a specific quantity of supplies or services that are regularly available or will be available after a short lead time.[88]
- *Requirements contracts*, in contrast, provide for the procuring activity to order all its "requirements" for supplies or services of the type provided for in the contract from the contractor during the term of the contract.[89] If the procuring activity has

(...continued)

Acquisition Streamlining Act (FASA) of 1994, not the Services Acquisition Reform Act (SARA) of 2003, authorized use of time-and-materials and labor-hour contracts under the Federal Supply Schedules, and SARA, not FASA, is the basis for the requirements in Subpart 12. *See* Gov't Accountability Office, Contract Management: Minimal Compliance with New Safeguards for Time-and-Materials Contracts for Commercial Services and Safeguards Have Not Been Applied to GSA Schedules Program, GAO-09-579, June 24, 2009, *available at* http://www.gao.gov/new.items/d09579.pdf. *See also* CRS Legal Sidebar WSLG1120, Court Decision Raises Questions about the Rules Governing Acquisitions of Commercial Items, by Kate M. Manuel.

[85] 48 C.F.R. §12.207(b)(1)(i)(A). For purposes of Subpart 12.2, this means (1) contracts awarded using competitive procedures or procedures for other than full and open competition, provided that the procuring activity received offers from two or more responsible offerors, or (2) orders issued under a multiple-award ID/IQ using the "fair opportunity" procedures described below. 48 C.F.R. §12.207(b)(1)(i)(A)-(C). *See infra* note 105 and accompanying text for more information on the "fair opportunity" procedures.

[86] 48 C.F.R. §12.207(b)(2)(i)-(iv). Subpart 12 similarly limits agencies' authority to use ID/IQ contracts to acquire commercial services. *See* 48 C.F.R. §12.207(c).

[87] 48 C.F.R. §16.502(a).

[88] 48 C.F.R. §16.502(b).

[89] 48 C.F.R. §16.503(a) ("A requirements contract provides for filling all actual purchase requirements of designated (continued...)

no requirements for these supplies or services, it generally "owes" the contractor no orders.[90] However, if the procuring activity has requirements and purchases them from another vendor[91] or, in some cases, develops additional in-house capabilities to perform the work,[92] it could potentially be found to have terminated the contract for convenience or even breached the contract.[93] Requirements contracts are used when the government anticipates recurring needs for supplies or services, but cannot predetermine the precise quantities needed during a definite period.[94]

- *ID/IQ contracts* are also used when the government anticipates recurring needs but cannot specify the quantity needed.[95] However, an ID/IQ contract does not entitle the contractor to fill all the procuring activity's needs for certain supplies or services. Rather, the contractor is assured of orders for only the "minimum

(...continued)

Government activities for supplies or services during a specified contract period.").

[90] *See, e.g.*, G.T. Folge & Co. v. United States, 135 F.2d 117 (4th Cir. 1943) (government not liable for failure to order if it has no requirements for the supplies or services). Any estimates of quantity contained in the solicitation or the contract are nonbinding. *See, e.g.*, Franklin Co. v. United States, 381 F.2d 416 (Ct. Cl. 1967) (government not obligated to furnish work orders up to the estimated amount); Kasehagen Sec. Servs., Inc., ASBCA 25629, 86-2 BCA ¶ 18,797 (1986) (contractor must fill orders above the estimate). However, the government could potentially be liable to the contractor if the estimate was negligently prepared. *See, e.g.*, Alert Care Ambulance Serv., VACAB 2844, 90-3 BCA ¶ 22,945 (1990) (government failed to exercise due care in preparing the estimates because it did not consider historical data regarding prior years' requirements); Pied Piper Ice Cream, Inc., ASBCA 20605, 76-2 BCA ¶ 12,148 (1976) (same). If feasible, the contract should specify a maximum quantity of supplies or services, orders in excess of which the contractor is generally not required to meet. 48 C.F.R. §16.503(a)(2).

[91] *See, e.g.*, Rumsfeld v. Applied Cos., Inc., 325 F.3d 1328, 1339 (Fed. Cir. 2003) ("[T]he government breaches a requirements contract when it has requirements for contract items or services, but diverts business from the contractor and does not use the contractor to satisfy those requirements."); Ready-Mix Concrete Co. Ltd. v. United States, 158 F. Supp. 571 (Ct. Cl. 1958) (contractor entitled to an equitable adjustment if the government purchases the needed supplies or services from any other source during the contract period).

[92] Contract language stating that the contractor is entitled to supply those items "required to be purchased by the government" will generally be construed to allow the procuring activity to develop additional in-house capacity during the term of the contract. *See, e.g.*, Export Packing & Crating Co., Inc., ASBCA 16133, 73-2 BCA ¶ 10,066 (1973); Applied Painting & Decorating Co., ASBCA 15919, 73-2 BCA ¶ 10,358 (1973). However, language stating that the contractor is entitled to supply items "in excess of the quantities which the activity may itself furnish with its own capabilities" generally will not be so construed because it is read as referring to the procuring activity's capabilities at the time of contracting. *See, e.g.*, Kozak Micro Sys., Inc., GSBCA 10519, 91-1 BCA ¶ 23,342 (1991) ("Where the contract demands that the contractor provide all the required supplies or services of a named Government activity 'in excess of the quantities which the activity may itself furnish with its own capabilities,' the document is understood to refer to the capabilities in existence at the time the contract is awarded. The government may not develop and use additional capabilities to eliminate a part of work that the contractor raised every expectation of receiving, and thereby prevent the contractor from recovering its costs."); Maya Transit Co., ASBCA 20186, 75-2 BCA ¶ 11,552 (1975) (government not permitted to reorder its budget priorities and redistribute its capabilities to assume more bus routes for its own drivers when the contract provided for the contractor to furnish bus services "in excess of the quantities which the activity may itself furnish within its own capabilities").

[93] Courts often treat governmental failures to comply with the terms of procurement contracts as constructive terminations of the contract. *See, e.g.*, Nesbitt v. United States, 543 F.2d 583 (Ct. Cl. 1965); Integrity Mgmt. Int'l, Inc., ASBCA 18289, 75-1 BCA ¶ 11,235 (1975). However, they will generally not convert failure to order under a requirements contract into a termination for convenience when the failure was in bad faith or based on circumstances known to the government at the time of contracting. *See, e.g.*, Torncello v. United States, 681 F.2d 756 (Fed. Cl. 1982) (termination based on the contractor's prices, which were known to the government at the time of contracting); Kalvar Corp. v. United States, 543 F.2d 1298 (Ct. Cl. 1976) (termination in bad faith).

[94] 48 C.F.R. §16.503(b)(1).

[95] 48 C.F.R. §16.504(b).

quantity" of supplies or services specified in the contract.[96] This quantity must be a "more than nominal amount,"[97] but the Government Accountability Office has, in at least one case, taken the view that $500 can be used as the guaranteed minimum, regardless of the maximum ordering limitations or total contract value, in the absence of reliable historical data suggesting otherwise.[98]

Under the various types of indefinite-delivery contracts, the procuring activity issues task or delivery orders to the contractor when it requires supplies or services, a process which is generally not subject to the Competition in Contracting Act's requirements that agencies generally obtain "full and open competition through the use of competitive procedures" when awarding contracts. However, Congress has imposed certain competition requirements upon agencies issuing orders under requirements and ID/IQ contracts, in particular. The Federal Acquisition Streamlining Act (FASA) of 1994 established a "preference" for multiple-award contracts by requiring agencies to use them, instead of single-award contracts, "to the maximum extent practicable."[99] A *multiple-award contract* is one held by several vendors, each of whom can receive orders under it, while a *single-award contract* is one held by one vendor, who is the only vendor who can receive orders under it.[100] This preference is generally seen to apply to ID/IQ contracts,[101] and could potentially also be said to apply to requirements contracts.[102]

FASA also requires agencies using multiple-award contracts to provide contractors "a fair opportunity to be considered" when issuing task or delivery orders in excess of $3,000 unless certain conditions apply.[103] The National Defense Authorization Act for FY2008 (NDAA '08) and

---

96 *See, e.g.*, 48 C.F.R. §16.504(a)(1); Peter J. Brandon, AGBCA 91-186-1, 92-1 BCA ¶ 24,648 (1991). Provided the minimum quantity is ordered, the government is not liable for ordering similar supplies and services from other contractors; failing to order any estimated quantities, even if those estimates were negligently prepared; or any costs that the contractor incurs due to lack of orders. *See, e.g.*, Bliss Co. v. United States, 74 Ct. Cl. 14 (1932) (government not liable for losses due to the contractor's plant being idled for lack of orders); Crown Laundry & Dry Cleaners, ASBCA 39982, 90-3 BCA ¶ 22,993 (1990) ("[W]e do not examine the reasonableness of the estimates in indefinite quantity contracts."); Alta Constr. Co., PSCBA 1395, 87-2 BCA ¶ 19,720 (1987) (government's awarding work orders to a competitor of the contractor does not give rise to a breach of contract claim). An ID/IQ contract may also contain a maximum quantity, orders in excess of which the contractor generally need not fill. 48 C.F.R. §16.504(a)(1).

97 Goldwasser v. United States, 325 F.2d 722 (Ct. Cl. 1963) (contract with a minimum quantity of $100 compared to estimated price of $40,000 "would have been a one-sided bargain, bordering upon lack of mutuality"); Tennessee Soap Co. v. United States, 126 F. Supp. 439 (Ct. Cl. 1954) (a $10 minimum order was nominal and thus insufficient).

98 Library of Congress, Comp. Gen. Dec. B-318046 (July 7, 2009).

99 P.L. 103-355, §1004, 108 Stat. 3249-54 (Oct. 13, 1994) (codified at 10 U.S.C. §2304a(d)(3)) (procurements of defense agencies); *id*. at §1054, 108 Stat. 3261-65 (codified at 41 U.S.C. §4103(d)(4)(A)) (procurements of civilian agencies).

100 A single-award ID/IQ contract differs from a requirements contract in that the procuring activity has not committed to purchasing all its requirements for particular supplies and services from that contractor and is free to contract with other vendors for the same supplies and services.

101 *See, e.g.*, 48 C.F.R. §16.500(a) ("This subpart prescribes policies and procedures for making awards of indefinite-delivery contracts and establishes a preference for making multiple awards of indefinite-quantity contracts.").

102 *See, e.g.*, Formation of Government Contracts, *supra* note 24, at 1191 (raising the question of whether single-award requirements contracts violate FASA). *See also* Nations, Inc., Comp. Gen. Dec. B-272455 (Nov. 5, 1996) (finding such a violation when the procuring activity proposed to issue a single requirements contract whose anticipated value was over $10 million).

103 10 U.S.C. §2304c(b)(1)-(4); 41 U.S.C. §4106(c). For an agency to issue an order without providing contractors "a fair opportunity to be considered," one of the following conditions must be exist: (1) the agency's need for the supplies or services is of "unusual urgency;" (2) only one contractor is capable of providing the supplies or services; (3) the order should be issued on a sole-source basis in the interests of economy and efficiency because it is "a logical follow-on" to an order issued on a competitive basis; or (4) the order must be placed with a particular contractor to satisfy a (continued...)

regulations promulgated under its authority further strengthened the competition requirements for orders under requirements and ID/IQ contracts by prohibiting agencies from using single-award contracts whose anticipated value exceeds $103 million, including options, unless the agency head makes certain determinations in writing.[104] The NDAA '08 also defined what constitutes a *fair opportunity to be considered* for orders in excess of $5.5 million under multiple-award contracts.[105]

Also, in the interests of promoting competition, agencies are likewise prohibited from awarding requirements contracts for "advisory and assistance services"[106] in excess of three years and $12.5 million, including options, unless certain conditions are met.[107]

Letter Contracts

There are times when an agency's need for a contractor's supplies or services is so pressing that the agency cannot wait for the execution of a formal (i.e., definitized) contract. However, contractors recognize that performing in the absence of a legal commitment binding the government to compensate them is risky and could result in their "being called a mere volunteer and ... recover[ing] nothing."[108] As a result, the government developed *letter contracts* (sometimes also referred to as *undefinitized contracts*).[109] These are temporary contracts intended to "authorize immediate commencement of … work" prior to the execution of the final contract.[110] Letter contracts typically state that a formal contract will be executed at a later date

(...continued)

minimum guarantee under an ID/IQ. *Id*.

[104] P.L. 110-181, §843, 122 Stat. 236-39 (Oct. 14, 2008). Before using a single-award contract, the agency head must find that (1) the orders expected under the contract are "so integrally related" that only a single source can reasonably perform them; (2) the contract provides for only firm-fixed-price orders for supplies or services whose prices are established in the contract; (3) only one source is qualified and capable of performing the work at a reasonable price; or (4) because of exceptional circumstances, it is "necessary in the public interest" to award the contract to a single source. *Id*. Agency heads must notify also Congress within 30 days after making a determination to award a single-award contract in excess of $103 million. *Id*. P.L. 110-181 applies to the requirements and ID/IQ contracts of both defense and civilian agencies. An earlier law had imposed similar restrictions on DOD's requirements and ID/IQ contracts, but this provision was subsequently repealed because it was redundant. *See* National Defense Authorization Act for FY2009, P.L. 110-417, §863(f), 122 Stat. 4548 (Oct. 14, 2008) (repealing defense-specific requirements); National Defense Authorization Act for FY2002, P.L. 107-107, §803, 115 Stat. 1179 (Dec. 28, 2001) (establishing defense-specific requirements).

[105] P.L. 110-181, §843. Under the NDAA, for contractors to have a "fair opportunity to be considered," agencies must provide them with (1) a notice of the task or delivery order that includes a clear statement of the agency's requirements; (2) a reasonable period of time to provide a proposal in response to the notice; (3) disclosure of the significant factors and subfactors that the agency expects to consider in evaluating proposals and their relative importance; (4) a written statement documenting the basis for the award and the relative importance of quality and price or cost factors, if the award is to be made on a best-value basis; and (5) an opportunity for post-award debriefing. *Id*.

[106] As used here, the term *advisory and assistance services* includes "those services provided under contract by nongovernmental sources to support or improve: organizational policy development; decision-making; management and administration; program and/or project management and administration; or R&D activities." 48 C.F.R. §2.101.

[107] Before issuing a solicitation for such a contract, the contracting officer or other designated official must determine in writing that the services are "so unique or highly specialized that it is not practicable to make multiple awards." 48 C.F.R. §16.503(d)(1).

[108] 2-19 Gov't Cont.: L., Admin. & Proc. §19.160 [1]. *See also* Baltimore & Ohio R.R. v. United States, 261 U.S. 592 (1923).

[109] 2-19 Gov't Cont.: L., Admin. & Proc. §19.160 [1].

[110] *Id*.; 48 C.F.R. §16.603-1.

and incorporate certain terms and conditions by reference.[111] The use of letter contracts is subject to numerous conditions,[112] including a written determination from the head of the contracting activity (or designee) that no other contract is suitable.[113] Agencies are also prohibited from "[c]ommit[ing] the Government to a definitive contract in excess of the funds available at the time the letter contract is executed."[114] In the event that a definitive contract cannot be negotiated because of failure to reach agreement as to price or fee after reasonable efforts, the contractor must proceed with the work, and the contracting officer may determine a reasonable price or fee with the approval of the head of the procuring activity.[115]

Courts may or may not consider letter contracts to be legally binding, depending upon the language contained in the contracts. If, for example, the document contains a clear and unconditional acceptance of the offer, then the government may be found to have been bound as of the date it was issued.[116] However, if the government's acceptance is conditioned upon execution of a formal contract, the document may not be seen as legally binding.[117]

Letter contracts are of particular concern to Congress because of the potential for agencies to commit themselves to spending in excess of appropriations.[118] Because letter contracts only contain general terms, many terms and conditions, including price, often have not been negotiated and agreed upon.[119] As a result, the cost of the definite contract cannot easily be predicted. Additionally, the Comptroller General once expressed concern that letter contracts may violate the prohibition upon cost-plus-a-percentage-of-cost contracts when the definitive contract is not executed until the work is finished.[120] However, the latter view, in particular, has generally not been seen to foreclose the use of letter contracts.

[111] *See* Briggs & Turivas v. United States, 83 Ct. Cl. 664 (1936). The FAR requires contracting officers to include within the letter contract the standard contract clauses for the type of contract that is contemplated by the letter contract. 48 C.F.R. §16.603-4(a).

[112] *See* 48 C.F.R. §§16.603-2—16.603-3.

[113] 48 C.F.R. §16.603-3.

[114] 48 C.F.R. §16.603-3(a).

[115] 48 C.F.R. §16.603-2(c). The contractor is required to continue work under the standard contract clause found at 48 C.F.R. §52.216-25. However, because of the lack of detailed terms in the letter contract, litigation can result if the letter is not converted into a detailed contract. *See, e.g.*, Chrysler Corp., ASBCA 4749, 60-2 BCA ¶ 2,669 (1960).

[116] *See, e.g.*, Secretary of Navy, Comp. Gen. Dec. B-22324 (Dec. 15, 1941). So long as the letter is sufficiently clear that the contractor can proceed with the work and the government can make substantial payments on the account, courts will generally hold that a contract was created and therefore allow a contractor to sue, despite the absence of a formal contract. Bass & Assocs. v. United States, 205 F.2d 1386 (Ct. Cl. 1974). Pre-contract costs are generally recoverable only if they were incurred prior to definitization and directly pursuant to negotiations with the procuring activity; and they would have been allowable if they had been incurred after definitization. *See* Integrated Logistics Support Sys. v. United States, 47 Fed. Cl. 248, 256 (2000). The Government's maximum liability for pre-contract costs is "the estimated amount necessary to cover the contractor's requirements for funds before definitization" but cannot exceed 50% of the estimated costs of the definitized contract unless approved in advance by the authorizing official. 48 C.F.R. §16.603-2(d); s*ee also* General Servs. Admin., 33 Comp. Gen. 291 (1954).

[117] *See, e.g.*, Secretary of Commerce, Comp. Gen. Dec. B-21873 (Dec. 22, 1941).

[118] For example, Congress has passed significant restrictions on the use of letter contracts in defense procurements. *See* 10 U.S.C. §2326.

[119] 2-19 Gov't Cont.: L., Admin. & Proc. §19.160 [1].

[120] *See* General Servs. Admin., 33 Comp. Gen. 291 (1954).

Agreements

Although they are included in Part 16 of the FAR, the two types of agreements—basic agreements and basic ordering agreements—are not necessarily legally binding contracts.[121] Rather, they are written instruments of understanding, negotiated between procuring activities and contractors, that contain terms applicable to future contracts[122] or orders[123] between the parties.

Basic agreements and basic order agreements are used in different circumstances. *Basic agreements* are used when the procuring activity anticipates awarding a "substantial number" of contracts to a contractor with whom it has experienced "significant recurring negotiating problems;"[124] while *basic ordering agreements* are used when the procuring activity anticipates acquiring a substantial, but presently unknown, quantities of supplies or services.[125] However, the two types of agreements are alike in that they must be reviewed annually before the anniversary of their effective dates.[126] Additionally, their terms may be changed only by modifications of the agreement, not by any contracts incorporating the agreement or orders issued under it.[127]

Author Contact Information

Kate M. Manuel
Legislative Attorney
kmanuel@crs.loc.gov, 7-4477

[121] 48 C.F.R. §16.702(a) (basic agreement); 48 C.F.R. §16.703(a) (basic ordering agreement). However, an agreement could potentially be a contract when consideration and mutuality of assent are present. *See, e.g.*, Almar Indus. Inc. v. United States, 16 Cl. Ct. 243 (1989); 2-19 Gov't Cont.: L., Admin. & Proc. §19.170; *see also* CRS Legal Sidebar WSLG919, Certain Blanket Purchase Agreements Are Not Binding Contracts, Federal Circuit Finds, by Kate M. Manuel.

[122] *See* 48 C.F.R. §16.702(b)(1) (basic agreements). These terms must include (1) the clauses required for negotiated contracts by statute, executive order, and the FAR and (2) any other clauses prescribed by the FAR or agency regulations that the parties agree to include. *Id*.

[123] *See* 48 C.F.R. §16.703(c)(1) (basic ordering agreements). These terms must (1) describe the method for determining prices to be paid to the contractor for supplies or services; (2) include delivery terms or conditions, or specify how they will be determined; (3) list one or more procuring activities authorized to issue orders under the agreement; (4) specify the point at which an order becomes a binding contract (e.g., issuance, acceptance); (5) provide that failure to reach agreement on price for any order issued before price is established is a dispute under the "disputes clause;" and (6) include any special data required when "fast payment" procedures will apply to orders. *Id*.

[124] 48 C.F.R. §16.702(a).

[125] 48 C.F.R. §16.703(b).

[126] 48 C.F.R. §16.702(b)(3) (basic agreements); 48 C.F.R. §16.703(c)(2) (basic ordering agreements).

[127] *Id*.

Acknowledgments

CRS Legislative Attorney Carol J. Toland contributed to an earlier version of this report.