

**DEPARTMENT OF DEFENSE****GENERAL SERVICES  
ADMINISTRATION****NATIONAL AERONAUTICS AND  
SPACE ADMINISTRATION****48 CFR Parts 16, 32, and 52**

[FAR Case 2004–015]

RIN 9000–AK32

**Federal Acquisition Regulation;  
Payments Under Time-and-Materials  
and Labor-Hour Contracts**

**AGENCIES:** Department of Defense (DoD), General Services Administration (GSA), and National Aeronautics and Space Administration (NASA).

**ACTION:** Proposed rule with request for comments.

**SUMMARY:** The Civilian Agency Acquisition Council and the Defense Acquisition Regulations Council (Councils) are proposing to amend the FAR regarding payments under Time-and-Materials (T&M) and Labor-Hour (LH) Contracts.

**DATES:** Interested parties should submit written comments to the FAR Secretariat on or before November 25, 2005, to be considered in the formulation of a final rule.

**ADDRESSES:** Submit comments identified by FAR case 2004–015 by any of the following methods:

- Federal eRulemaking Portal: <http://www.regulations.gov>. Follow the instructions for submitting comments.
- Agency Web Site: <http://www.acqnet.gov/far/ProposedRules/proposed.htm>. Click on the FAR case number to submit comments.

- E-mail: [farcase.2004-015@gsa.gov](mailto:farcase.2004-015@gsa.gov). Include FAR case 2004–015 in the subject line of the message.

- Fax: 202–501–4067.
- Mail: General Services Administration, Regulatory Secretariat (VIR), 1800 F Street, NW., Room 4035, ATTN: Laurieann Duarte, Washington, DC 20405.

*Instructions:* Please submit comments only and cite FAR case 2004–015 in all correspondence related to this case. All comments received will be posted without change to <http://www.acqnet.gov/far/ProposedRules/proposed.htm>, including any personal and/or business confidential information provided.

*Public Meeting:* A public meeting will be held on Tuesday, October 18, 2005, from 9:00 a.m. to 4:00 p.m. Eastern Time, in the GS Building Auditorium, 1800 F Street NW, Washington, DC

20405, to facilitate an open dialogue between the Government and parties interested in the implementation of section 8002(d), FAR Case 2003–027, Additional Contract Types. Because they are so closely related, the public meeting will also cover this FAR proposed rule 2004–015, Payment Under Time-and-Materials and Labor-Hour Contracts. Interested parties are encouraged to attend and engage in discussions regarding these proposed rules.

To facilitate discussions at the public meeting, interested parties are encouraged to provide written comments on issues they would like addressed at the public meeting no later than Tuesday, October 11, 2005. Interested parties may register and submit their input electronically at <http://www.acq.osd.mil/dpap/dars/index.htm>. Attendees are encouraged, but not required, to register for the public meeting, to ensure adequate accommodations.

Directions to the meeting can be found at the Web site. Participants are encouraged to check with the Web site prior to the public meeting to ensure the location has not been changed as a result of a large number of registrants. The public meeting is physically accessible to people with disabilities. Requests for sign language interpretation or other auxiliary aids should be directed to Mr. Jeremy Olson at 202–501–3221 at least 5 days prior to the meeting.

**FOR FURTHER INFORMATION CONTACT:** The FAR Secretariat at (202) 501–4755 for information pertaining to status or publication schedules. For clarification of content, contact Mr. Jeremy Olson, at (202) 208–3221. Please cite FAR case 2004–015.

**SUPPLEMENTARY INFORMATION:****A. Background**

The amendments made under this case are intended to be applicable only to non-commercial item contracts. Policies applicable to commercial item T&M or LH contracts are being addressed separately under FAR case 2003–027.

The proposed amendments to FAR 16.307, 16.601, 32.111, and the FAR clause at 52.232–7 are intended to amend the underlying policies and increase the clarity of the affected FAR language. The proposed rule addresses the areas related to payments made under T&M and LH contracts for non-commercial items, as described below.

**1. FAR 16.307—Contract clauses.**

The Councils are proposing to amend FAR 16.307(a)(1) to specify that the

Allowable Cost and Payment clause is included in T&M contracts. The clause is only applicable to the portion of the contract that provides for reimbursement of materials at actual cost. This change is being made to ensure that appropriate rights and responsibilities are provided in T&M contracts with respect to reimbursement for material cost.

**2. FAR 16.601—Time-and-materials contracts.**

The Councils are proposing to revise the language at FAR 16.601(a) to provide a description of “materials” as used in “time-and-materials contract.” FAR 16.601(a) currently describes a T&M contract as a contract that provides for acquiring supplies or services on the basis of—

- Direct labor hours at specified fixed hourly rates that include wages, overhead, general and administrative expenses, and profit; and
- Materials at cost, including, if appropriate, material handling costs as part of material costs.

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”.

**3. General structure of the FAR clause at 52.232–7—Payments under Time-and-Materials and Labor-Hour Contracts.**

The Councils are proposing to amend the current paragraph (b) of the FAR clause at 52.232–7 to specify that the term “materials,” as used in the clause, includes direct materials, subcontracts for supplies and services, other direct costs, and applicable indirect costs (this is consistent with the proposed changes to FAR 16.601). Materials also include supplies and services transferred between divisions, subdivisions, subsidiaries, or affiliates of the contractor under a common control. The current language has caused significant confusion because it does not adequately describe what is included in “materials.”

#### 4. Contractor furnished material—Alternate I.

The Councils are proposing to move and amend the current Alternate I to paragraph (b)(3) of the clause. When a contractor furnishes its own materials that meet the definition of a commercial item at FAR 2.101, the price to be paid for such materials shall be the contractor's established catalog or the market price. The ability of the contractor to bill at such prices should not be dependent on a contracting officer decision as to whether an alternate clause should be included in the contract.

#### 5. Profit or fee on materials.

The Councils are 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 Item 4 above 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.

#### 6. Billing subcontracts and interdivisional transfers for incidental supplies or services.

For subcontracts, the Councils are proposing to clarify that subcontracts for incidental services are to be reimbursed at the actual subcontract price, plus allowable indirect costs, per the requirements of the FAR clause at 52.216-7, Allowable Cost and Payment. For interdivisional transfers, the Councils are proposing to revise the language to limit reimbursement to the actual rates or commercial prices of the division performing the work.

#### 7. Billing subcontracts and interdivisional transfers for services that comply with the labor hour requirements.

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 FAR clause at 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 Councils believe this two option approach is appropriate for the following reasons:

- The Government should have the authority to limit subcontractors that are authorized to perform labor hours to be paid at the LH rate under a T&M or LH contract.

- o The authority should be independent of the approval/notification process in the "Subcontracts" clause.

- o The limitation should appear as part of the T&M Payment clause and it should include (or refer to) the list of subcontractors approved to provide labor hours paid at the LH rate under the contract.

- o If the prime contractor wishes to add a new subcontractor, the contracting officer would have to agree (and make any necessary adjustment to the LH rates as a result).

- o Subcontracted labor hours paid at the LH rate should not be subject to further material handling fees or any other type of reimbursement of the sort authorized for material.

- o Subcontracted labor hours paid at the LH rate must be accounted for and substantiated under the same standards as labor hours provided by the prime contractor.

- Subcontractors providing services that are ancillary to and not part of the LH portion of the contract should be paid actual costs, using the same procedures as are used for material (e.g., crane operators subcontracted as part of installation services, and drivers subcontracted to provide transportation to LH workers).

#### 8. Application of Prompt Payment Act.

The Councils are proposing to add the language at paragraph (i) of the FAR clause at 52.232-7 to include application of the Prompt Payment Act for interim payments under T&M and LH contracts for services. The Prompt Payment Act has applied to fixed-price contracts for services for many years. Congress also recently amended the Prompt Payment Act to include cost reimbursement contracts for services. The Councils believe that since the Prompt Payment Act is applicable to both fixed-price and cost reimbursement contracts for services, it should also be

applicable to T&M and LH contracts for services.

#### B. Regulatory Planning and Review

This is not a significant regulatory action and, therefore, was not subject to review under Section 6(b) of Executive Order 12866, Regulatory Planning and Review, dated September 30, 1993. This rule is not a major rule under 5 U.S.C. 804.

#### C. Regulatory Flexibility Act

The changes may have a significant economic impact on a substantial number of small entities within the meaning of the Regulatory Flexibility Act, 5 U.S.C. 601, *et seq.*, because Time and Material or Labor Hour contracts are commonly awarded to small businesses.

An Initial Regulatory Flexibility Analysis (IRFA) has been prepared. The analysis is summarized as follows:

Initial Regulatory Flexibility Analysis

1. *Description of the reasons why action by the agency is being considered.* This proposed rule would revise the Federal Acquisition Regulation to amend underlying policies and increase the clarity of payments made under T&M and LH contracts for non-commercial items.

2. *Succinct statement of the objectives of, and legal basis for, the proposed rule.* The objectives of the amendment are to ensure fair and reasonable prices under T&M contracts and to eliminate the ambiguity in T&M contracts that has been responsible for confusion over payment amounts for subcontractor provided labor.

3. *Description of, and, where feasible, estimate of the number of small entities to which the proposed rule will apply.* The changes may have a significant economic impact on a substantial number of small entities within the meaning of the Regulatory Flexibility Act, 5 U.S.C. 601, *et seq.*, because T&M contracting is a common method of acquiring services from small entities. However, it is not feasible to estimate the number of small entities impacted.

4. *Description of projected reporting, record keeping, and other compliance requirements of the proposed rule, including an estimate of the classes of small entities which will be subject to the requirement and the type of professional skills necessary for preparation of the report or record.* The current FAR policies require contractors to maintain records to support invoices presented to the Government for payment. Such records include original timecards, the contractor's timekeeping procedures, distribution of labor, invoices for material, and so forth. These are standard records maintained by any company, large or small, and the fact that the contract would require that these records be made available to the Government should not place any additional record keeping burden on the entity.

5. *Identification, to the extent practicable, of all relevant Federal rules which may duplicate, overlap, or conflict with the proposed rule.* There are no Federal rules

that duplicate, overlap or conflict with the proposed rule.

6. Description of any significant alternatives to the proposed rule which accomplish the stated objectives of applicable statutes and which minimize any significant economic impact of the proposed rule on small entities. Significant alternatives to the proposed rule include:

- Not permitting any subcontractor to be paid at the labor hour rate and reimbursing all subcontractors at actual cost.
- Incorporating a list of each Other Direct Cost (ODC) into each T&M contract that would be authorized for reimbursement under that contract and prohibiting reimbursement of any other ODC.
- Not requiring a list of each Other Direct Cost (ODC) authorized for reimbursement and permitting any ODC to be reimbursed.

The FAR Secretariat has submitted a copy of the IRFA to the Chief Counsel for Advocacy of the Small Business Administration. A copy of the IRFA may be obtained from the FAR Secretariat. The Councils will consider comments from small entities concerning the affected FAR parts in accordance with 5 U.S.C. 610. Comments must be submitted separately and should cite 5 U.S.C 601, et seq. (FAR case 2004-015), in correspondence.

**D. Paperwork Reduction Act**

The Paperwork Reduction Act does not apply because the proposed changes to the FAR do not impose information collection requirements that require the approval of the Office of Management and Budget under 44 U.S.C. 3501, et seq.

**List of Subjects in 48 CFR Parts 16, 32, and 52**

Government procurement.

Dated: September 19, 2005.

**Gerald Zaffos,**

*Acting Director, Contract Policy Division.*

Therefore, DoD, GSA, and NASA propose amending 48 CFR parts 16, 32, and 52 as set forth below:

1. The authority citation for 48 CFR parts 16, 32, and 52 is revised to read as follows:

**Authority:** 40 U.S.C. 121(c); 10 U.S.C. chapter 137; and 42 U.S.C. 2473(c).

**PART 16—TYPES OF CONTRACTS**

2. Amend section 16.307 by revising paragraph (a)(1) to read as follows:

**16.307 Contract clauses.**

(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) is contemplated. If the contract is with

an educational institution, modify the clause by deleting from paragraph (a) the words "Subpart 31.2" and substituting for them "Subpart 31.3." If the contract is with a State or local government, modify the clause by deleting from paragraph (a) the words "Subpart 31.2" and substituting for them "Subpart 31.6." If the contract is with a nonprofit organization, other than an educational institution, a State or local government, or a nonprofit organization exempted under OMB Circular No. A-122, modify the clause by deleting from paragraph (a) the 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.

\* \* \* \* \*

- 3. Amend section 16.601 by—
  - a. Redesignating paragraphs (a), (b), and (c) as (b), (c), and (d), respectively;
  - b. Adding a new paragraph (a); and
  - c. Revising newly redesignated paragraph (b)(2).

The added and revised text reads as follows:

**16.601 Time-and-materials contracts.**

(a) *Definitions for the purposes of Time-and-Materials Contracts.*

*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) Any other direct costs (e.g., travel, computer usage charges, etc.); and
- (4) Applicable indirect costs.

(b) \* \* \*

(2) Actual cost for materials (except as provided for in 31.205-26(e) and (f)).

\* \* \* \* \*

4. Revise section 16.602 to read as follows:

**16.602 Labor-hour contracts.**

*Description.* A labor-hour contract is a variation of the time-and-materials contract, differing only in that materials are not supplied by the contractor. See 16.601(c) and 16.601(d) for application and limitations, respectively, for time and materials contracts that also apply to labor hour contracts.

**PART 32—CONTRACT FINANCING**

- 5. Amend section 32.111 in paragraph (a)(7) by—
  - a. Removing paragraph (i);
  - b. Redesignating paragraphs (ii) and (iii) as (i) and (ii), respectively; and
  - c. Revising newly designated paragraph (i).

The revised text reads as follows:

**32.111 Contract clauses for non-commercial purchases.**

(a) \* \* \*

(i) If a labor-hour contract is contemplated, the contracting officer shall use the clause with its Alternate I.

\* \* \* \* \*

**PART 52—SOLICITATION PROVISIONS AND CONTRACT CLAUSES**

- 6. Amend section 52.232-7 by—
  - a. Revising the date of the clause;
  - b. Revising the introductory paragraph of the clause;
  - c. Revising paragraphs (a), (b), (d), and (e) of the clause;
  - d. Revising the heading of paragraph (h);
  - e. Adding paragraph (i); and
  - f. Removing Alternate I, and redesignating Alternate II as Alternate I and revising it to read as follows:

**52.232-7 Payments under Time-and-Materials and Labor-Hour Contracts.**

As prescribed in 32.111(a)(7), insert the following clause:

PAYMENTS UNDER TIME-AND-MATERIALS AND LABOR-HOUR CONTRACTS (DATE)

The Government will pay the Contractor as follows upon the submission of vouchers approved by the Contracting Officer or the Contracting Officer's authorized representative:

(a) *Hourly rate.* (1) The amounts shall be computed by multiplying the appropriate hourly rates prescribed in the Schedule by the number of direct labor hours performed. The rates shall include wages, indirect costs, general and administrative expense, and profit. Fractional parts of an hour shall be payable on a prorated basis.

(2) Vouchers may be submitted once each month (or at more frequent intervals, if approved by the Contracting Officer), to the Contracting Officer or authorized representative. The Contractor shall substantiate vouchers (including any subcontractor hours reimbursed at the hourly rate in the schedule) by evidence of actual payment and by individual daily job timecards, records that verify the employees meet the qualifications for the labor categories specified in the contract or other substantiation approved by the Contracting Officer.

(3) Promptly after receipt of each substantiated voucher, the Government shall, except as otherwise provided in this contract,

and subject to the terms of paragraph (e) of this clause, pay the voucher as approved by the Contracting Officer. Unless otherwise prescribed in the Schedule, the Contracting Officer may unilaterally issue a contract modification requiring the Contractor to withhold amounts from its billings until a reserve is set aside in an amount that the Contracting Officer considers necessary to protect the Government's interests. The Contracting Officer may require a withhold of 5 percent of the amounts due under paragraph (a), but the total amount withheld for the contract shall not exceed \$50,000. The amounts withheld shall be retained until the Contractor executes and delivers the release required by paragraph (f) of this clause.

(4) 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 overtime work is approved in advance by the Contracting Officer, 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.

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

(1) 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.

(2) Materials means—

(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

(iv) Applicable indirect costs.

(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.

(4) *Subcontracts.* (i) Unless the subcontractor is listed in paragraph (b)(4)(ii) of this clause, subcontract costs will be reimbursed at actual costs as specified in paragraph (b)(5).

(ii) 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, insert "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."]*

(5) Except as provided for in paragraphs (b)(3) and (4) of this clause, the Government will reimburse the Contractor for allowable cost of materials provided the Contractor—

(i) Has made payments for materials in accordance with the terms and conditions of the agreement; or

(ii) 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.

(6) Payment for materials is subject to the Allowable Cost and Payment clause of this contract. The Contracting Officer will determine allowable costs of materials in accordance with Subpart 31.2 of the Federal Acquisition Regulation (FAR) in effect on the date of this contract.

(7) The Contractor may include allocable indirect costs and other direct costs to the extent they are—

(i) Comprised only of costs that are clearly excluded from the hourly rate;

(ii) Allocated in accordance with the Contractor's written or established accounting practices; and

(iii) Indirect costs are not applied to subcontracts listed in paragraph (b)(4) for reimbursement at the labor hour rate.

(8) To the extent able, the Contractor shall—

(i) Obtain direct materials and subcontracts at the most advantageous prices available with due regard to securing prompt delivery of satisfactory materials; and

(ii) Take all cash and trade discounts, rebates, allowances, credits, salvage, commissions, and other benefits. When unable to take advantage of the benefits, the Contractor shall promptly notify the Contracting Officer and give the reasons. The Contractor shall 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. The Contractor shall not deduct from gross costs the benefits lost without fault or neglect on the part of the Contractor, or lost through fault of the Government.

(9) Except as provided for in 31.205–26(e) and (f) of the FAR, the Government will not pay profit or fee to the prime contractor on materials.

(10) If the Contractor enters into any subcontract that requires consent under the clause at 52.244–2, Subcontracts, without obtaining such consent, the Government is not required to reimburse the Contractor for any costs incurred under the subcontract prior to the date the Contractor obtains the required consent. Any reimbursement of subcontract costs incurred prior to the date the consent was obtained shall be at the sole discretion of the Government.

\* \* \* \* \*

(d) *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.

(e) *Audit.* At any time before final payment under this contract, the Contracting Officer may request audit of the vouchers and supporting documentation. Each payment previously made shall be subject to reduction to the extent of amounts, on preceding vouchers, that are found by the Contracting Officer not to have been properly payable and shall also be subject to reduction for overpayments or to increase for underpayments. Upon receipt and approval of the voucher designated by the Contractor as the "completion voucher" and supporting documentation, and upon compliance by the Contractor with all terms of this contract (including, without limitation, terms relating to patents and the terms of (f) and (g) of this section), the Government shall promptly pay any balance due the Contractor. The completion voucher, and supporting documentation, shall be submitted by the Contractor as promptly as practicable following completion of the work under this contract, but in no event later than 1 year (or such longer period as the Contracting Officer may approve in writing) from the date of completion.

\* \* \* \* \*

(h) *Interim payments on contracts for other than services.* \* \* \*

\* \* \* \* \*

(i) *Interim payments on contracts for services.* For interim payments made prior to the final payment under this contract, the Government will make payment in accordance with the Prompt Payment Act (31 U.S.C. 3903) and prompt payment regulations at 5 CFR part 1315.

(End of clause)

*Alternate 1 (Date).* If a labor-hour contract is contemplated, the Contracting Officer shall add the following paragraph (i) to the basic clause:

(i) The terms of this clause that govern reimbursement for materials furnished are considered to have been deleted.

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**BILLING CODE 6820–EP–S**