

**DEPARTMENT OF DEFENSE**

**GENERAL SERVICES ADMINISTRATION**

**NATIONAL AERONAUTICS AND SPACE ADMINISTRATION**

**48 CFR Chapter 1**

[Docket FAR—2006—0023, Sequence 8]

**Federal Acquisition Regulation; Federal Acquisition Circular 2005–15; Introduction**

**AGENCIES:** Department of Defense (DoD), General Services Administration (GSA),

and National Aeronautics and Space Administration (NASA).

**ACTION:** Summary presentation of final rules.

**SUMMARY:** This document summarizes the Federal Acquisition Regulation (FAR) rules agreed to by the Civilian Agency Acquisition Council and the Defense Acquisition Regulations Council in this Federal Acquisition Circular (FAC) 2005–15. A companion document, the Small Entity Compliance Guide (SECG), follows this FAC. The FAC, including the SECG, is available via the Internet at <http://www.regulations.gov>.

**DATES:** For effective dates and comment dates, see separate documents, which follow.

**FOR FURTHER INFORMATION CONTACT:** The analyst whose name appears in the table below in relation to each FAR case or subject area. Please cite FAC 2005–15 and specific FAR case number(s). For information pertaining to status or publication schedules, contact the FAR Secretariat at (202) 501–4755.

**LIST OF RULES IN FAC 2005–15**

Item	Subject	FAR case	Analyst
I .....	Payments Under Time-and-Materials and Labor-Hour Contracts .....	2004–015	Olson.
II .....	Additional Commercial Contract Types .....	2003–027	Olson.

**SUPPLEMENTARY INFORMATION:**

Summaries for each FAR rule follow. For the actual revisions and/or amendments to these FAR cases, refer to the specific item number and subject set forth in the documents following these item summaries.

FAC 2005–15 amends the FAR as specified below:

**Item I—Payments Under Time-and-Materials and Labor-Hour Contracts (FAR Case 2004–015)**

This final rule revises and clarifies policies related to award and administration of noncommercial item Time-and-Materials (T&M) and Labor-Hour (LH) contracts and the policies regarding payments made under those contracts. The objectives of the changes are to ensure fair and reasonable prices under T&M and LH contracts and to eliminate confusion related to payment amounts for subcontractor provided labor.

**Item II—Additional Commercial Contract Types (FAR Case 2003–027)**

This final rule implements section 1432 of the National Defense Authorization Act for Fiscal Year 2004 (Pub. L. 108–136). Title XIV of the Act, referred to as the Services Acquisition Reform Act of 2003 (SARA), amended section 8002(d) of the Federal Acquisition Streamlining Act of 1994 (FASA) (Pub. L. 103–355, 41 U.S.C. 264) to expressly authorize the use of Time-and-Materials (T&M) and Labor-Hour (LH) contracts for commercial services under specified conditions.

Dated: December 4, 2006.

**Linda K. Nelson,**  
*Deputy Director, Contract Policy Division.*

**Federal Acquisition Circular**

Federal Acquisition Circular (FAC) 2005-15 is issued under the authority of the Secretary of Defense, the Administrator of General Services, and the Administrator for the National Aeronautics and Space Administration.

Unless otherwise specified, all Federal Acquisition Regulation (FAR) and other directive material contained in FAC 2005-15 is effective February 12, 2007.

Dated: November 22, 2006.

**Shay D. Assad,**  
*Director, Defense Procurement and Acquisition Policy.*

Dated: November 22, 2006.

**Roger D. Waldron,**  
*Acting Senior Procurement Executive, General Services Administration.*

Dated: November 21, 2006.

**Tom Luedtke,**  
*Assistant Administrator for Procurement, National Aeronautics and Space Administration.*  
[FR Doc. 06–9611 Filed 12–11–06; 8:45 am]  
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**DEPARTMENT OF DEFENSE**

**GENERAL SERVICES ADMINISTRATION**

**NATIONAL AERONAUTICS AND SPACE ADMINISTRATION**

**48 CFR Parts 16, 32, and 52**

[FAC 2005–15; FAR Case 2004–015; Item I; Docket 2006–0020, Sequence 23]

RIN 9000–AK32

**Federal Acquisition Regulation; FAR Case 2004–015, 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:** Final rule.

**SUMMARY:** The Civilian Agency Acquisition Council and the Defense Acquisition Regulations Council (Councils) have agreed on a final rule amending the Federal Acquisition Regulation (FAR) to clarify payment procedures for Time-and-Materials (T&M) and Labor-Hour (LH) Contracts.  
**DATES:** *Effective Date:* February 12, 2007.

**FOR FURTHER INFORMATION CONTACT:** For clarification of content, contact Mr. Jeremy Olson at (202) 501–3221. Please cite FAC 2005–15, FAR case 2004–015. For information pertaining to status or publication schedules, contact the FAR Secretariat at (202) 501–4755.

**SUPPLEMENTARY INFORMATION:**

## A. Background

DoD, GSA, and NASA published a proposed rule in the **Federal Register** at 70 FR 56314 on September 26, 2005. The amendments made under this case are intended to be applicable primarily to non-commercial item contracts. Policies primarily 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, 16.602, 32.111, and 52.232-7 are intended to amend the underlying policies and increase the clarity of the affected FAR language. The FAR amendments address 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 amended 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 and related indirect costs. 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 revised 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 prior FAR description did 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 52.232-7. Also, that description did 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.

### 3. General structure of FAR 52.232-7 - Payments under Time-and-Materials and Labor-Hour Contracts.

The Councils amended the current paragraph (b) of the clause at FAR 52.232-7 to specify that the term "materials," as used in the clause,

includes direct materials, subcontracts for supplies and ancillary services, other direct costs, and applicable indirect costs (this is consistent with the proposed changes to FAR 16.601). Materials also include supplies and ancillary services transferred between divisions, subdivisions, subsidiaries, or affiliates of the contractor under a common control.

Although the proposed rule had proposed to revise "materials" to include all subcontracts for services, the final rule defines subcontracts for labor as part of the definition of labor, if the subcontracted labor meets the requirements of the prime contract for labor hours. The prior FAR language had caused significant confusion because it did not adequately describe what is included in "labor" or "materials."

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

The Councils moved and amended the prior Alternate I of the clause at FAR 52.232-7. When a contractor furnishes its own materials that meet the definition of a commercial item at 2.101, the price to be paid for such materials shall be the contractor's established catalog or the market price. 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 amended FAR 52.232-7(b)(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 clarified that subcontracts for incidental services are to be reimbursed at the actual subcontract price, plus allowable indirect costs, per the requirements of FAR 52.216-7, Allowable Cost and Payment. For interdivisional transfers, the Councils revised the language to limit reimbursement to the actual rates or commercial prices of the division performing the work and specified that only one division may obtain profit. No profit pyramiding within a company is to be permitted.

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

For services performed by employees of subcontractors, the proposed rule had included a process under which that labor would be reimbursed at actual cost (plus related indirect costs) unless it was included on a list in the prime contract. If it were included on the list, it was to be paid at the labor hour rate.

The final rule eliminates that proposed approach. The final rule provides that all labor hours that qualify under the labor hour requirements of the contract are to be paid at the labor hour rate specified in the contract. This applies regardless of whether an individual is an employee of the prime contractor, a subcontractor or an affiliate of the prime contractor.

### 8. Solicitation provisions.

The final rule incorporates three new solicitation provisions that direct how proposals address subcontract labor.

The first provision applies to acquisitions of noncommercial items that are to be based on adequate price competition. This provision requires each offeror to indicate for each labor rate in the proposal whether it is a rate that applies to employees of one company or if it is a blended rate that applies to employees of more than one company. The offerors must show for each labor rate if it applies to employees of the prime contractor, employees a particular subcontractor or affiliate, or if it is a blended rate that applies to employees of more than one subcontractor or employees of the prime contractor or any subcontractor. Agency procedures may authorize contracting officers to select one of three options in the provision as mandatory, and/or to require each offer to identify individual subcontractors in the proposal.

The second provision applies to acquisitions of noncommercial items not based on adequate price competition. This provision requires the offeror to establish separate individual labor hour rates for prime contractor employees, employees of each subcontractor and employees from affiliates of the offeror.

The third provision applies to acquisitions of commercial items and it requires each offeror to identify for each proposed labor hour rate whether the rate applies to prime contractor employees, subcontractor employees or employees from affiliates of the offeror.

### 9. Application of the Prompt Payment Act.

The Councils amended FAR 52.232-7(i) to include application of the Prompt Payment Act for interim payments

under T&M and LH contracts for services. The Prompt Payment Act has been 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.

#### Discussion and Analysis

Payment for labor performed by subcontractors is treated differently depending on whether a contract action is awarded under adequate price competition or not. If a contract is not awarded on the basis of adequate price competition, the contract must separately identify labor rate categories for each subcontractor, in addition to the labor rates for the contractor. If the price of a contract is based on adequate price competition, the CO is not required to include separate rates for subcontractors, but may use blended rates that apply to any labor meeting the qualifications of the contract, regardless of whether provided by the contractor or a subcontractor.

The Councils adopted the philosophy on treatment of subcontractor labor that was developed under FAR Case 2003–027 and applied it to noncommercial T&M contracts awarded on the basis of adequate price competition. That is, FAR case 2003–027 requires no special treatment of labor provided by subcontractors. Any labor that meets the labor hour qualifications of the contract is to be paid at the labor hour rate specified in the contract, regardless if it provided by individual working for the prime contractor or a subcontractor. This approach was developed under FAR case 2003–027 for commercial items because it was felt that competitive pressure would produce fair and reasonable prices and eliminate potential abuses related to subcontractor labor. Competition for commercial items is the same as competition for noncommercial items and the approach should be the same for both FAR cases.

However, for noncommercial T&M contracts awarded without adequate price competition, competitive pressures are substantially diminished and the Government must take a much more cautious approach with respect to labor provided by subcontractors. Labor hour rates for these types of actions are largely based on cost information provided by the prime contractor. In order to avoid potential for issues arising after award of a noncompetitive T&M contract, each subcontractor must

have its labor hour rates specified in the prime contract. This will be required in FAR Part 16 and offerors will be required to include such rates in their offer by a solicitation provision.

The FAR amendment includes three new solicitation provisions to be used for noncommercial T&M/LH solicitations. These provisions serve several purposes. First, they communicate plainly that labor hour rates for subcontractors are a potential major issue that must be addressed by the CO and by the offerors. Second, they communicate that contracts awarded on the basis of adequate price competition may be approached in a much more flexible way than may be used for contracts not awarded competitively. Finally, they provide a structure to CO's that can be used to eliminate issues related to potential abuse of subcontract labor hour rates.

FAR 52.216–29, Time-and-Material/Labor-Hour Proposal Requirements—Noncommercial Item Acquisitions without Adequate Price Competition, instructs offerors that they may identify the labor rates they are proposing in either one of three different manners. First, offerors may propose blended rates under which labor hours will be paid at the same rate, regardless of whether the individual performing the labor works for the prime contractor or a subcontractor. Second, offerors may offer labor hour rates that include two sets of rates, one set for individuals employed by the offeror and a second set for individuals employed by subcontractors. Third, offerors may offer multiple sets of labor hour rates, one set for individuals employed by the offeror and additional sets for each subcontractor for individuals employed by different subcontractors. If CO's are authorized by agency procedures, the contracting officer may amend this provision to pre-select a single method from among those three methods that every offeror must use.

FAR 52.216–30, Time-and-Material/Labor-Hour Proposal Requirements—Noncommercial Item Acquisitions without Adequate Price Competition, instructs offerors that they must offer multiple sets of labor hour rates, one set for individuals employed by the offeror and a additional sets for each subcontractor for individuals employed by different subcontractors. The purpose of this solicitation provision is to enforce the policy in Part 16 which requires acquisitions awarded on the basis other than adequate price competition to include individual labor hour rates for each subcontractor.

FAR 52.216–31, Time-and-Material/Labor-Hour Proposal Requirements—

Commercial Item Acquisitions, instructs offerors that they must identify for each labor hour rate if the rate applies to only the offeror, a subcontractor, and affiliate of the offeror, or any combination.

#### Disposition of Public Comments

Comments were received from 17 respondents in response to the proposed rule. The Councils considered all of the comments and recommendations in developing the final rule. The Councils made the following changes to the proposed rule as a result of the public comments and deliberations:

(1) *Definition of "Hourly Rate."* Established a definition for "hourly rate" to permit reimbursement of subcontracts for services and services transferred between divisions, subsidiaries, or affiliates under a common control at the hourly rates in the schedule when the employee meets the labor qualification specified in the contract (see comment (4)(c)(3)).

(2) *Definition of "Materials."* Revised the definition for "materials" to (1) exclude subcontracts for services and services transferred between divisions, subsidiaries, or affiliates under a common control from the definition of "materials" because these services are included in the "hourly rate" when the services meet the labor qualifications specified in the contract (2) add incidental services to the examples of other direct costs (see comment (4)(c)(3)). Subcontracts for services and services transferred between divisions, subsidiaries, or affiliates under a common control that do not meet the labor qualifications specified in the contract are incidental services but see (3)(ii) below.

(3) *Reimbursement for Subcontract and Interdivisional Transfers of Services.* Eliminated the provisions in the proposed rule that only permitted reimbursement of subcontract costs at the hourly rates in the contract when the subcontractors were listed in the contract. (see comment (4)(c), (4)(e)). Added provisions that—

(i) Require reimbursement of subcontracts for services and services transferred between divisions, subsidiaries, or affiliates under a common control of at the hourly rates in the schedule that include profit when the employees performing the work meet the qualifications specified in the contract.

(ii) Address reimbursement for subcontracts for services and services transferred between divisions, subsidiaries, or affiliates under a common control when the employees performing the work do not meet the qualifications specified in the contract.

Payment for such services is at the sole discretion of the Government.

(iii) Require separate fixed hourly rates that include wages, overhead, general and administrative expenses, and profit for each category of labor. When the contract is awarded without adequate price competitions, the rule also requires a separate set of rates for labor performed by the contractor, each subcontractor, and each division, subsidiary, or affiliate of the contractor under a common control that will perform on the contract.

(4) *Solicitation Provisions*. Added three solicitation provisions to ensure contractors understand the methodology for reimbursing subcontract costs (see comment (4)(c),(11)(c)).

(5) *Timecards*. Revised the rule to recognize that companies use both paper-based and electronic timecards (see comment (4)(c), (9)).

(6) *Commercial Item Materials*. Revised the prescription for reimbursing commercial items to clarify the commercial catalog or market prices are subject to negotiation (see comment (4)(c)(4)(b)).

(7) *Assignment and Release of Claims*. Re-titled the paragraph previously titled "Assignment" to "Assignment and Release of Claims" to clarify both topics are covered in the paragraph (see comment (4)(c), (7)).

(8) *Refunds*. Deleted the current provision on refunds from the clause because the provisions duplicate coverage in the Allowable Cost and Payment clause (see comment (4)(c), (4)(d)).

#### Discussion of Public Comments

(1) **Restrict Use of T&M Contracts**. A *respondent commented*: Revise FAR 16.601(c) to also restrict the use of T&M contracts when the costs other than direct labor are incidental to the work. If a contract requires substantial direct materials, interdivisional transfers, subcontracts, and other direct costs, or the costs are so high that they warrant the submission, auditing, and settlement of final indirect rates, the contract type should not be a T&M contract.

*Response*: When substantial direct materials, interdivisional transfers, subcontracts, and other direct costs are anticipated, a T&M contract type may not be appropriate. However, selecting the appropriate contract type is generally a matter for negotiation and requires the exercise of sound judgment. The objective is to negotiate a contract type and price (or estimated cost and fee) that will result in reasonable contractor risk and provide the contractor the greatest incentive for efficient and economical performance.

There are many factors the contracting officer must consider in selecting the appropriate contract type. T&M contracts are the least preferable contract type that can only be used when it is not possible at the time of placing the contract to estimate accurately the extent or duration of the work or to anticipate costs with any reasonable degree of confidence.

(2) **Allowable Cost and Payment Clause**. A *respondent commented*: Clarify which provisions of the Allowable Cost and Payment clause apply to the material portion of T&M contracts. Recommend either repeating the applicable portions of the clause in the T&M clause or identifying the Allowable Cost and Payment clause as a required clause in FAR Subpart 16.6.

*Response*: As prescribed in FAR 16.307(a), the Allowable Cost and Payment clause is a required clause for all cost-reimbursement contracts. All provisions of the clause are applicable to the material portions of T&M contracts. The rule clearly specifies that the Allowable Cost and Payment clause is included in T&M contracts and that it is only applicable to the portion of the contract that provides for reimbursement of materials at actual costs. The change is being made to ensure that the appropriate rights and responsibilities are provided in T&M contracts. The Councils see no reason to repeat the clause in the T&M clause. Multiple clauses will be included in T&M contracts.

(3) **Definition of Materials**. A *respondent commented*: The proposed definition of material that includes direct materials, subcontracts for supplies and services, other direct costs, and applicable indirect costs adds certainty to the process and will eliminate significant issues that arise during the audit process. A *respondent commented*: The proposed definition of materials is contrary to the common business meaning of the word. Instead of defining materials to include subcontracted services, the rule should exclude the word materials from the contract type. The Government routinely reimburses travel, equipment, communication, and other direct costs under T&M contracts. Recommend instead establishing a time-and-other-direct-cost contract type. A *respondent commented*: Do not include subcontracts in the definition of materials. Instead, separately address subcontracts and interdivisional transfers to clarify the payment policies for these elements of cost and to avoid inevitable disputes over whether the subcontract for supplies and services was "material consumed directly in

connection with furnishing the service" that is reimbursed at the fixed contract rates or another type of subcontract for supplies and services that would be reimbursed at actual costs. A *respondent commented*: Including services transferred between divisions, subsidiaries, or affiliates of the contractor under a common control and subcontracts for services in the definition of materials is contrary to the traditional, and common sense, definition of the term "materials." Prime, subcontract, and interdivisional labor should be included in the "time" element. A respondent commented: Including subcontract services and incidental expense in "materials" is contrary to common usage and to the language of FAR 31.205-26 and 45.301. Instead, recommend separately addressing the elements of costs as follows:

- Direct labor (time) means prime and subcontractor labor devoted to the performance of the tasks in the statement of work (SOW).

- Materials mean products, including raw materials, parts, subassemblies, components, and manufacturing supplies, whether manufactured or purchased by the contractor, and including such collateral items as inbound transportation and in transit insurance.

- Incidental services means services performed or purchased solely for the support of contract direct labor, such as travel, printing, or computer usage.

- Indirect costs.

*Response*: While the definition for materials in the rule is different from the referenced definitions at FAR 31.205-26 and 45.301, reimbursing subcontracts for services and other costs as materials is not contrary to common usage for T&M contracts. Currently, FAR 16.601(a) only identifies "direct labor" and "materials" as elements of T&M contracts. However, the associated payment clause at FAR 52.232-7, Payments Under T&M/LH Contracts addresses payment of "materials and subcontracts." In addition, the Government routinely pays contractors for other direct costs (ODC) and G&A incurred in performance of a T&M contract even though ODC and G&A are not mentioned in FAR 16.601 or 52.232-7. In addition, contractors commonly record subcontracts for services, like subcontracts for supplies, as elements of "materials" for accounting purposes. There are no known problems with the longstanding practice of reimbursing these other costs as materials. Therefore, the Councils see no reason to revise "time-and-materials" contracts to "time-and-other-direct-

cost” or “time-and-material-and-subcontract-and-interdivisional transfers” or “time-and-material-and-incidentalservices-and-indirect costs” contracts as recommended by the various commenters. The Councils did, however, establish a definition for “hourly rate” to clarify that subcontract and interdivisional labor will be reimbursed at the “hourly rate” whenever the employee satisfies the labor qualifications specified in the contract. The Councils also revised the definitions of “materials” to— (1) exclude subcontracts for services and interdivisional transfers of services that meet the labor qualifications specified in the contract from the definition of material because these elements of cost are now included in the definition of “hourly rate” for the purposes of reimbursing the subcontracts; and (2) add incidental services to the examples of other direct costs.

#### (4) Methodology for Reimbursing Materials.

(a) *A respondent commented:* Strongly support the proposed methodology for reimbursing commercial materials and the deletion of the “most favored customer” provisions.

(b) *A respondent commented:* Revise the prescription for reimbursing commercial materials from “shall be the contractor’s established catalog or market price” to “shall not exceed the contractor’s established catalog or market price” because the proposed language could be interpreted to mean contracting officers cannot negotiate better pricing.

*Response:* While the proposed language did not preclude negotiating better prices, the recommended change more clearly establishes that the prices are subject to negotiation. Therefore, the Councils revised the rule as recommended.

(c) *A respondent commented:* Pay the catalog or market price for materials of the prime’s own production that are commercial items (excluding the products of its affiliates) and reimburse the cost of other materials at actual costs, including properly allocable indirect costs, but no profit or fee.

*Response:* When a contractor furnishes its own material that meets the definition of a commercial item at FAR 2.101, the contractor will be paid the established catalog or market price for the item. Product of its affiliates will be reimbursed on the basis of costs incurred except when the supplies are sold or transferred between divisions, subdivisions, subsidiaries, or affiliates of the contractor under a common control and it is the established practice

of the transferring organization to price interdivisional transfers at other than cost and the other conditions of 31.205–26 are met. Profit or fee will not be paid on materials that are reimbursed at cost.

(d) *A respondent commented:* Delete the current provision on refunds from FAR 52.232–7, Payments Under Time-and-Materials and Labor-Hour Contracts, because the provision duplicates the provision in FAR 52.216–7, Allowable Cost and Payment.

*Response:* The Councils revised the rule to eliminate redundant coverage.

(e) Methodology for Reimbursing Subcontracts. *A respondent commented:* Concept of reimbursing subcontract labor at the hourly rates in the contract or the actual cost to the prime contractor is sound but do not permit blended prime and subcontractor labor rates. Establish separate hourly rates in the contract for subcontract labor not reimbursed based on actual costs. The subcontract rates should include prime contractor indirect costs allocable to subcontract costs and profit. *A respondent commented:* Reimburse all subcontract labor at the contract rates when the subcontracts satisfies all contract labor qualifications is appropriate, fair, and in the Government’s best interest. Requiring subcontracts to be listed in the contract in order to be reimbursed at the contract labor rates will make it extremely difficult for the Government to acquire “on-call” or “on-demand” services that sometimes require a prime contractor to take responsibility for hundred or even thousands of subcontractors often interspersed across a wide geographic area. Requiring contract modifications for every change in subcontractor poses an excessive administrative burden on both parties. Reimburse subcontract labor at the schedule labor rates without listing the subcontractors in the contract when the contractor’s proposal indicates that some of the work may be performed by subcontractors that meet the contract’s qualification requirements and that the price for that “type of work” will be the prime contract’s labor rate which may be blended or other rate. T&M/LH contracts specify the required labor qualifications. Whether the person filling the position is an employee of the prime or a subcontractor, the qualifications must be met. The Government has already determined through adequate price competition or otherwise the pricing is fair and reasonable for the “type of work.” The subcontract consent provisions are unduly burdensome. Absent the contracting officer’s approval and the resulting contract modification to add new subcontractors, contractors will not

be paid profit on the subcontract costs even though the contractor remains responsible for the subcontractor’s performance. Lack of profit will discourage the use of subcontractors. *A respondent commented:* Allowing contracting officers to identify the subcontracts to be reimbursed at the contract rates is a positive step since the rule clearly allows prime to be paid profit on subcontracts. Recommend also allowing reimbursement for subcontracts at the contract rates when the prime proposal includes subcontracted services, the contractor is in a teaming relationship with the subcontractor, or when the acquisition has opportunities for small and small disadvantaged businesses. Small and small disadvantaged businesses rely heavily on subcontracting with prime contractors on T&M contracts. If primes are not paid profit on the subcontracts, the primes will be motivated to perform all the work themselves which could hurt small businesses and may not result in the best technical solution for the Government. Contractors establish large teams of large and small businesses to meet the requirements of indefinite-delivery contracts. If they are not allowed to recover profit on subcontracts, competition will be reduced and the Government may not get competition or the best technical solution. When the subcontracts are reimbursed at the contract rates, the prime assumes the risk of subcontractor labor rate changes. The Government is assured fair and reasonable prices based on competition or price analysis. Reimbursing subcontracts at actual costs shifts the risk of subcontract labor escalation to the Government. *A respondent commented:* Reimburse subcontract labor under the labor portion of the contract and do not treat subcontracts as an element of “material.” If the work qualifies for the hourly rate in the schedule, the Government should not care if the work was performed by a subcontractor or another division of the contract. It is not always feasible to establish hourly rates for specific subcontractors at the time of contract award. In some cases, the fixed hourly rates are a blend of anticipated prime and subcontractor hourly rates. This approach yields more competitive hourly rates for the Government and promotes using all categories of small businesses to achieve price advantage. Requiring separate fixed hourly rates for individual subcontractors would further complicate an already complex invoicing and payment process. Further, the bargain agreed upon at the time of contract award must be maintained

throughout contract performance unless revised by mutual agreement. Some contractors have priced blended prime and subcontract rates but were subsequently reimbursed on their actual costs for subcontracts which is inequitable because it unilaterally changed the terms of the contract. *A respondent commented:* Requiring additional rates and approvals add an unnecessary layer of administration that is not commensurate with the level of risk or cost benefit. Additional controls that restrict a contractor's use of proven subcontractors greatly reduce a contractor's ability to efficiently support the Government. Recommend revising the rule to properly place the responsibility for performing and providing qualified staff on the prime. The rule should allow prime contractors to provide competent staff, including subcontractors when a business need exists, and only designate key personnel when the criticality of the work dictates a need to do so. Change the rule to only require a notification instead of the proposed requirement for consent to subcontract. Use the proposed audit provisions as the monitoring device for excessive profit or fee. The Government can reject the work provided by a subcontractor using the inspection and acceptance clauses. *A respondent commented:* It is not always feasible to establish hourly rates for specific subcontractors at the time of contract award. T&M contracts are only used when it is not possible at the time of award to estimate accurately the extent or duration of the work. It may be difficult to identify at the time of award all the subcontractors that ultimately will be needed to perform the work. For "on-call" or "on-demand" services, contractors are not able to predict which subcontractors will be called on to fulfill each requirement. The restriction on subcontract profit will reduce the use of qualified subcontractors, especially small and small disadvantaged business. In addition, contractors will not be paid the appropriate compensation for administrative cost and financial risk that accompany the use of subcontracts unless the subcontractors are identified in advance. Any final rule should allow contractors to be paid profit on all subcontract labor that is not incidental to performance. The Government should focus on the value of the hours worked instead of the name of the subcontractor performing the work to allow the prime contractor to identify and retain the best people available for contract performance. A more flexible approach should be used that does not require formal contract modification. The

flexibility in performance and selection of subcontractors is particularly critical to the prime contractor. *A respondent commented:* Prime contractors will only use subcontractors that are less expensive than the prime if blended prime and subcontract labor rates are used. This will limit the use of small business subcontractors since few small businesses achieve T&M rates that are competitive with large businesses because their overhead bases are smaller. Also, requiring each subcontract to be identified in the contract in order to be reimbursed at the contract rates will serve as a barrier to adding new subcontractors during contract performance. The requirement to list each subcontractor in the contract is significantly more cumbersome than the consent to subcontract requirements that are currently required for T&M contracts. Contractors will have to develop new blended rates that will be subject to audit and approval and formally modify the contract to add new subcontractors. Prime contractors will only use small businesses to the extent they are required to do so by their small business subcontracting plans and maybe not even then if the small businesses rates are sufficiently higher than the blended rates. *A respondent commented:* Not paying profit or fee on subcontracts is extremely detrimental to small businesses. Many small business prime contractors get much of their annual revenues from contracts with large amounts of materials and minor labor hour or T&M costs to support integration, deployment, or maintenance of the materials. Not paying profit on these materials would erode potential earnings for these small businesses. In addition, large businesses often subcontract out work that could be performed by the large business to meet small business subcontracting goals on Government contracts. If large businesses are no longer paid profit on subcontracts, large businesses will be far less likely to subcontract out work. An objective of the rule is to ensure fair and reasonable prices. Fair and reasonable must be applied to both the Government and the contractor. Not paying profit on materials is not a "fair" policy. Market forces will act competitively to keep the Government's price fair and reasonable. *A respondent commented:* The Government pays profit on materials and subcontracts on cost-plus-fixed-fee contracts. The existing prohibition on paying profit on materials and subcontracts on T&M contracts stems from the fact that such costs were incidental to the contract. Contrary to statements in the proposed rule, the

Government's use of T&M contracts has changed over time and other factors have significantly changed. Large businesses are now required to subcontract out to small and small disadvantaged subcontractors to meet their subcontracting goals. This requirement did not exist when the prohibition on paying profit on materials and subcontracts was adopted. Small businesses— (1) use consultants and subcontractors to supplement their capabilities and effectively compete for potential contracts; (2) need the flexibility to change subcontractors during contract performance; and (3) need to make profit on subcontracted services or they will not bid on contracts if they do not have the employees with the required expertise. The need for subcontracts and consultants is driven by the requirement of the contract. The contracts are not personal services contracts. The Government and prime contractors contract for services at specified prices and they negotiate the price for the work in terms of the effort required by the contract. When small businesses do not have the in-house staff to perform the work, they use salary surveys and their indirect cost structure to estimate the cost of employees they will ultimately subcontract with to perform the work which may or may not be disclosed to the Government. On large procurement, this may be the only way to be responsive. The small businesses takes the risk that they will be able to find subcontract labor at their estimated rate and there are times when the small businesses' actual cost for the labor exceeds their estimated price and the small business does not recover its cost of subcontracting. For many small businesses, subcontract labor may be used to perform the majority of the work. If the small business will not be paid profit on these subcontracts, the small business would not be adequately compensated and would have no incentive to bid on the effort. As a result, competition would decrease and some services would not be available in the small business community. In addition, placing too many limitations on subcontracting for large businesses will ultimately reduce the subcontracting opportunities for small businesses. It is in the best interest of the Government to encourage subcontracting. The Government should have the right to know when subcontractors are being replaced for quality assurance purposes and should be able to review and approve subcontractor's qualifications. Finally, listing only the known subcontracts in

the contract will not help small businesses and will discourage prime contractors from finding and using small businesses. Contract modifications to add subcontractors after contract award could take significant time and could significantly disrupt or delay the federal procurement process. When there is adequate competition or GSA schedule prices, the Government should have the right to approve new subcontractors for quality but not the right to automatically negotiate a new hourly rate which implies the right of contractors to increase the hourly rates after contract award. The administrative costs for T&M contracts will increase significantly and competition among small businesses will significantly decrease. The Government should focus on disclosure and verification of qualifications and not prohibitions or restrictions on subcontracting and renegotiating prices when adequate competition exists. Instead of limiting reimbursement to subcontractors listed in the contract, recommend also permitting subcontractors and consultants to be reimbursed at the contract rates if the labor categories are listed that that will be subcontracted out and simply adding the subcontractors name to the list when the subcontract is awarded. *A respondent commented:* The inability to make profit, coupled with the inherent prime contractor oversight requirements will have a negative affect on subcontracting. Prime contractors will be motivated to use their own employees in order to earn profit. The negative affect will fall disproportionately on small businesses which is contrary to current procurement policy. *A respondent commented:* Reimburse subcontract at the prime's actual cost because contractors are being reimbursed for subcontract at the prime's rates but are using lower costs, and less qualified, subcontracts to perform the work. *A respondent commented:* Restrict reimbursement of subcontract costs to actual costs because the prime contractor could subsequently negotiate lower rates with subcontractors that were authorized to be paid at the schedule rates and the Government would pay excessive prices for subcontracted effort that may be of a level less than that envisioned by the Government. Reimbursing at the schedule rates encourages contractors to maximize profit by subcontracting out more of the effort at lower subcontract rates. The Government will expend additional resources to monitor the quality and efficiency of the subcontract

labor since the subcontract effort will not be readily apparent when billed at the schedule rates.

*Response:* Limiting reimbursing of subcontract labor to actual costs is not consistent with the treatment on all other flexibly priced Government contracts where prime contractors are paid profit on subcontract costs. In addition, requiring subcontractors to be listed in the contract in order to be reimbursed at the hourly rates could have a negative impact on small businesses and was administratively burdensome to contractors. Upon further consideration, the Councils believe it is appropriate to reimburse subcontracts on competitively awarded T&M contracts at the schedule labor rates without listing the subcontracts. The Councils revised the rule accordingly. However, the Councils do not believe it is appropriate to eliminate the traditional consent and advance notification requirements for non-commercial T&M. These same consent and advance notification requirements are not new for T&M contracts. The Councils are unaware of any systemic issues relating to their applicability on T&M contracts. Therefore, the final rule does not change the standard consent and advance notification requirements for non-commercial T&M contracts. In addition, the Councils revised the rule to require separate labor rates for each subcontract and interdivisional transfer of services when adequate price competition is not obtained. There may be circumstances when it is appropriate to use blended prime and subcontract labor rates when the prices are based on adequate competition. Therefore, the rule permits use of blended prime and subcontract labor rates when the prime contract is awarded with adequate competition. However, nothing in the rule prevents the Government from establishing separate labor rates for each subcontract when the prime contract is awarded based on competition. Also, the rule provides for payment of profit on subcontract labor paid at the hourly rates in the contract.

**(f) Interdivisional Transfers.**

*Coalition Comment:* Imposing FAR Part 31 on interdivisional transfers should be avoided.

*Response:* The rule provides that interdivisional transfers of labor that meet the qualifications specified in the contract will be reimbursed at the "hourly rates" in the contract. For these interdivisional transfers, FAR Part 31 is not imposed. For all other interdivisional transfers, contractors will be reimbursed on the basis of cost incurred in FAR Subpart 31.2.

(g) *A respondent commented:* Pay allowable indirect costs allocable to subcontracts, either by inclusion in stipulated hourly rates for specific contractors or by addition to subcontract direct costs, (b) materials, and (c) incidental services.

*Response:* The rule permits payment of indirect costs either by inclusion in the hourly rates in the contract when the subcontract labor meets the labor qualifications specified in the contract or at actual costs as recommended by the commenter.

(h) *A respondent commented:* Reimburse the prime contractor for the cost of incidental services, including properly allocable indirect costs, but no profit or fee.

*Response:* Refer to Comment 3 above. The Councils did not adopt the recommendation to establish a new "incidental services" category. The rule does, however, result in reimbursement of these elements of costs, including properly allocable indirect costs, with no profit or fee.

**(5) Total Cost and Ceiling Price.** *A respondent commented:* Consolidate the "Total Cost" and "Ceiling Price" paragraphs.

*Response:* The "Total Cost" paragraph addresses contractor responsibilities. The "Ceiling Price" paragraph addresses the Government's responsibility to pay or not pay. Therefore, the Councils believe it is appropriate to separately address total cost and the ceiling price.

**(6) Assignment and Release of Claim.** *A respondent commented:* Change the title of paragraph (f) of the FAR clause at 52.232-7, Payments Under Time-and-Materials and Labor-Hour Contracts from "Assignment" to "Release of Claims," which is what the paragraph is really about.

*Response:* The Councils revised the title of the paragraph to "Assignments and Release of Claims" because both topics are discussed in the provision.

**(7) Withhold.** *A respondent commented:* Revise the rule to clarify the payment withhold is limited to five percent or \$50,000 and that the withhold is applied at the contract level instead of the task order level.

*Response:* The Payments under Time-and-Materials and Labor-Hour Contracts clause (52.232-7) was modified as suggested by the contractor in FAR Case 2004-003 which was published in the **Federal Register** at 71 FR 43576 on July 27, 2005.

**(8) Timecards.** *A respondent commented:* Delete the requirement to validate the individual daily job timecards to provide contractors the flexibility to use electronic time keeping systems.

*Response:* The Councils revised the final rule to require access to the timekeeping records instead of job timecards to recognize electronic timekeeping systems.

(9) **Prompt Payment.** *A respondent commented:* Revise the rule to permit Prompt Payment Act interest also on the material portion of T&M contracts. The Prompt Payment Act was revised to make prompt payment interest applicable to interim payments on cost reimbursement contracts for services. T&M contracts are not equivalent to cost reimbursement contracts and it is not logical to apply interest to labor without including the material resources required to provide the labor. However, the impact of excluding interest on the material portion is probably negligible since most of the payments on T&M contracts are for labor. Restricting prompt payment interest to labor will certainly make more work for Government disbursing official who will have to segregate labor from material to compute the interest penalties. Any amount the Government saves from only paying prompt payment interest on labor will likely be more than offset by the administrative costs of computing the interest on only the labor portion of the invoice.

*Response:* The Prompt Payment Act applies to fixed-price contracts and interim payments on cost-reimbursable contracts for services. The Councils lack the authority to extend the Act to interim payments for supplies.

(10) **Miscellaneous.**

(a) *A respondent commented:* Strongly request the Councils to hold additional public meetings to provide the public the opportunity to further explain the comments submitted.

*Response:* The Councils determined that the FAR changes are within the scope of changes contemplated by the proposed rule and that no further public meetings or proposed rule are appropriate. Further public meetings or public comments would not result in comments that are substantially different from those already submitted.

(b) *A respondent commented:* Recommend having the effective date for the rule be 60 days after publication in the **Federal Register** so agencies can develop implementing guidance and update the associated training.

*Response:* The effective date for FAR changes is generally 30 days after publication in the **Federal Register**. However, the Councils agree agencies may need additional time to implement guidance and update the associated training. Therefore, the rule will have an effective date 60 days after publication in the **Federal Register**.

(c) *A respondent commented:* Recommend the Councils take steps to ensure the solicitation process clearly addresses the method for reimbursing subcontract costs, *i.e.*, only at actual costs unless the subcontractor is listed in the contract.

*Response:* The rule no longer requires listing subcontracts in the contract in order for the costs to be reimbursed using the fixed hourly rates in the contract. The rule includes two solicitation provisions to ensure contractors understand the methodology for reimbursing subcontract costs.

(d) *A respondent commented:* Urge the Councils to also remove the “most favored customer” provisions from FAR 31.106–3.

*Response:* The provisions at FAR 31.106–3 are outside the scope of this rule. However, the Councils are considering the recommended change.

(e) *A respondent commented:* The Supplementary Information in the proposed rule said that subcontracted labor paid at the LH rate must be *accounted for* and *substantiated* under the same standards as labor hours provided by the prime contractor. This could be interpreted to mean prime contractors are required to include the subcontractor costs in the prime’s overhead base for direct labor. Clarify how prime contractors should allocate overhead to subcontract labor. Also, address the potential inconsistency of bidding/billing some subcontractor labor at contract rates and others at cost with respect to Cost Accounting Standards (CAS) compliance.

*Response:* The Supplementary Information in the proposed rule did include this statement. However, nothing in the proposed or final rule require prime contractors to include subcontractor costs in the overhead base for direct labor. Contractors should continue to allocate overhead to subcontract labor consistent with their disclosed or established procedures. CAS relate to allocation issues. The costs allocable to T&M contracts may differ significantly from the costs billed and paid for the T&M contract. The same is true for fixed-price contracts.

(f) *A respondent commented:* Replace the term “voucher” with “invoice”.

*Response:* The term “voucher” refers to interim payments on cost reimbursement contracts. The term “invoice” refers to delivery payments and payments on fixed-price contracts. Therefore, the Councils did not revise the terminology as recommended.

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.

## B. Regulatory Flexibility Act

The Regulatory Flexibility Act, 5 U.S.C. 601, *et seq.*, applies to this final rule. The Councils prepared a Final Regulatory Flexibility Analysis (FRFA) as follows:

### 1. Statement of need for, and objectives of, the rule.

This rule revises 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. 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.

### 2. Summary of significant issues raised by the public comments in response to the Initial Regulatory Flexibility Analysis (IRFA), a summary of the assessment of the agency of such issues, and a statement of any changes made in the proposed rule as a result of such comments.

Comments were received from 17 respondents in response to the proposed rule. The Councils considered all of the comments and recommendations in developing the final rule. The Councils made the following changes to the proposed rule as a result of the public comments and deliberations:

(a) *Definition of “Hourly Rate.”* Established a definition for “hourly rate” to permit reimbursement of subcontracts for services and services transferred between divisions, subsidiaries, or affiliates under a common control at the hourly rates in the schedule when the employee meets the labor qualification specified in the contract (see comment (4)(c)(3)).

(b) *Definition of “Materials.”* Revised the definition for “materials” to— (1) exclude subcontracts for services and services transferred between divisions, subsidiaries, or affiliates under a common control from the definition of “materials” because these services are included in the “hourly rate” when the services meet the labor qualifications specified in the contract; and (2) add incidental services to the examples of other direct costs (see comment (4)(c)(3)). Subcontracts for services and services transferred between divisions, subsidiaries, or affiliates under a common control that do not meet the labor qualifications specified in the contract are incidental services but see (3)(ii) below.

(c) *Reimbursement for Subcontract and Interdivisional Transfers of Services.* Eliminated the provisions in the proposed rule that only permitted reimbursement of subcontract costs at the hourly rates in the contract when the subcontractors were listed in the contract (see comment (4)(c)(4)(e)). Added provisions that—

(i) Require reimbursement of subcontracts for services and services transferred between divisions, subsidiaries, or affiliates under a common control of at the hourly rates in the schedule that include profit when the



employees performing the work meet the qualifications specified in the contract.

(ii) Address reimbursement for subcontracts for services and services transferred between divisions, subsidiaries, or affiliates under a common control when the employees performing the work do not meet the qualifications specified in the contract. Payment for such services is at the sole discretion of the Government.

(iii) Require separate fixed hourly rates that include wages, overhead, general and administrative expenses, and profit for each category of labor. When the contract is awarded without adequate price competitions, the rule also requires a separate set of rates for labor performed by the contractor, each subcontractor, and each division, subsidiary, or affiliate of the contractor under a common control that will perform on the contract.

(d) *Solicitation Provisions.* Added two solicitation provisions to ensure contractors understand the methodology for reimbursing subcontract costs (see comment (4)(c)(11)(c)).

(e) *Timecards.* Revised the rule to recognize that companies use both paper-based and electronic timecards (see comment (4)(c)(9)).

(f) *Commercial Item Materials.* Revised the prescription for reimbursing commercial items to clarify the commercial catalog or market prices are subject to negotiation (see comment (4)(c)(4)(b)).

(g) *Assignment and Release of Claims.* Retitled the paragraph previously titled "Assignment" to "Assignment and Release of Claims" to clarify both topics are covered in the paragraph (see comment (4)(c)(7)).

(h) *Refunds.* Deleted the current provision on refunds from the clause because the provisions duplicate coverage in the Allowable Cost and Payment clause (see comment (4)(c)(4)(d)).

**3. Description of, and an estimate of the number of, small entities to which the rule will apply or an explanation of why no such estimate is available.**

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 prior FAR policies required contractors to maintain records to support invoices presented to the Government for payment. Such records included 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. Description of any significant alternatives to the 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 final rule include:**

- Not permitting any subcontractor to be paid at the labor hour rate and reimbursing all subcontractors at actual cost.
- Requiring any subcontractor to be listed in the prime contract as the sole means of authorizing payments of labor for that subcontractor to be at the labor hour rate specified in the contract.
- 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.

Interested parties may obtain a copy of the FRFA from the FAR Secretariat. The FAR Secretariat has submitted a copy of the FRFA to the Chief Counsel for Advocacy of the Small Business Administration.

**C. Paperwork Reduction Act**

The Paperwork Reduction Act (Pub. L. 104-13) does not apply because the 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: December 4, 2006.

Linda K. Nelson,

Deputy Director, Contract Policy Division.

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

■ 1. The authority citation for 48 CFR parts 16, 32, and 52 continues 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. Revise section 16.601 to read 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.

*Hourly rate* means the rate(s) prescribed in the contract for payment for labor that meets the labor category qualifications of a labor category specified in the contract that are—

- (1) Performed by the contractor;
- (2) Performed by the subcontractors;

or

- (3) Transferred between divisions, subsidiaries, or affiliates of the contractor under a common control.

*Materials means—*

- (1) Direct materials, including supplies transferred between divisions, subsidiaries, or affiliates of the contractor under a common control;

- (2) Subcontracts for supplies and incidental services for which there is not a labor category specified in the contract;

- (3) Other direct costs (*e.g.*, incidental services for which there is not a labor category specified in the contract, travel, computer usage charges, etc.); and
- (4) Applicable indirect costs.

(b) *Description.* A time-and-materials contract provides for acquiring supplies or services on the basis of—

- (1) Direct labor hours at specified fixed hourly rates that include wages, overhead, general and administrative expenses, and profit; and

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

(c) *Application.* A time-and-materials contract may be used only when it is not possible at the time of placing the contract to estimate accurately the

extent or duration of the work or to anticipate costs with any reasonable degree of confidence.

(1) *Government surveillance.* A time-and-materials contract provides no positive profit incentive to the contractor for cost control or labor efficiency. Therefore, appropriate Government surveillance of contractor performance is required to give reasonable assurance that efficient methods and effective cost controls are being used.

(2) *Fixed hourly rates.* (i) The contract shall specify separate fixed hourly rates that include wages, overhead, general and administrative expenses, and profit for each category of labor (see 16.601(e)(1)).

(ii) For acquisitions of noncommercial items awarded without adequate price competition (see 15.403-1(c)(1)), the contract shall specify separate fixed hourly rates that include wages, overhead, general and administrative expenses, and profit for each category of labor to be performed by—

- (A) The contractor;
- (B) Each subcontractor; and
- (C) Each division, subsidiary, or affiliate of the contractor under a common control.

(iii) For contract actions that are not awarded using competitive procedures, unless exempt under paragraph (c)(2)(iv) of this section, the fixed hourly rates for services transferred between divisions, subsidiaries, or affiliates of the contractor under a common control—

- (A) Shall not include profit for the transferring organization; but
- (B) May include profit for the prime contractor.

(iv) For contract actions that are not awarded using competitive procedures, the fixed hourly rates for services that meet the definition of commercial item at 2.101 that are transferred between divisions, subsidiaries, or affiliates of the contractor under a common control may be the established catalog or market rate when—

(A) It is the established practice of the transferring organization to price interorganizational transfers at other than cost for commercial work of the contractor or any division, subsidiary or affiliate of the contractor under a common control; and

(B) The contracting officer has not determined the price to be unreasonable.

(3) *Material handling costs.* When included as part of material costs, material handling costs shall include only costs clearly excluded from the labor-hour rate. Material handling costs may include all appropriate indirect

costs allocated to direct materials in accordance with the contractor's usual accounting procedures consistent with Part 31.

(d) *Limitations.* A time-and-materials contract may be used— (1) only after the contracting officer executes a determination and findings that no other contract type is suitable, and (2) only if the contract includes a ceiling price that the contractor exceeds at its own risk. The contracting officer shall document the contract file to justify the reasons for and amount of any subsequent change in the ceiling price. Also see 12.207(b) for further limitations on use of Time-and-Materials or Labor Hour contracts for acquisition of commercial items.

(e) *Solicitation provisions.* (1) The contracting officer shall insert the provision at 52.216-29, Time-and-Materials/Labor-Hour Proposal Requirements—Non-Commercial Item Acquisitions With Adequate Price Competition, in solicitations contemplating use of a Time-and-Materials or Labor-Hour type of contract for noncommercial items, if the price is expected to be based on adequate price competition. If authorized by agency procedures, the contracting officer may amend the provision to make mandatory one of the three approaches in paragraph (c) of the provision, and/or to require the identification of all subcontractors, divisions, subsidiaries, or affiliates included in a blended labor rate.

(2) The contracting officer shall insert the provision at 52.216-30, Time-and-Materials/Labor-Hour Proposal Requirements—Non-Commercial Item Acquisitions without Adequate Price Competition, in solicitations for noncommercial items contemplating use of a Time-and-Materials or Labor-Hour type of contract if the price is not expected to be based on adequate price competition.

(3) The contracting officer shall insert the provision at 52.216-31, Time-and-Materials/Labor-Hour Proposal Requirements—Commercial Item Acquisitions, in solicitations contemplating use of a Commercial Time-and-Materials or Labor-Hour contract.

## PART 32—CONTRACT FINANCING

■ 4. Amend section 32.111 in paragraph (a)(7) by removing (a)(7)(i) and redesignating paragraphs (a)(7)(ii) and (iii) as (a)(7)(i) and (a)(7)(ii), respectively; and by revising the newly designated paragraph (a)(7)(i) to read as follows:

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

(a) \* \* \*

(7) \* \* \*

(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

■ 5. Add sections 52.216-29, 52.216-30, and 52.216-31 to read as follows:

### 52.216-29 Time-and-Materials/Labor-Hour Proposal Requirements—Non-Commercial Item Acquisition With Adequate Price Competition.

As prescribed in 16.601(e)(1), insert the following provision:

#### TIME-AND-MATERIALS/LABOR-HOUR PROPOSAL REQUIREMENTS—NON-COMMERCIAL ITEM ACQUISITION WITH ADEQUATE PRICE COMPETITION (FEB 2007)

(a) The Government contemplates award of a Time-and-Materials or Labor-Hour type of contract resulting from this solicitation.

(b) The offeror must specify fixed hourly rates in its offer that include wages, overhead, general and administrative expenses, and profit. The offeror must specify whether the fixed hourly rate for each labor category applies to labor performed by—

- (1) The offeror;
- (2) Subcontractors; and/or
- (3) Divisions, subsidiaries, or affiliates of the offeror under a common control;

(c) The offeror must establish fixed hourly rates using—

(1) Separate rates for each category of labor to be performed by each subcontractor and for each category of labor to be performed by the offeror, and for each category of labor to be transferred between divisions, subsidiaries, or affiliates of the offeror under a common control;

(2) Blended rates for each category of labor to be performed by the offeror, including labor transferred between divisions, subsidiaries, or affiliates of the offeror under a common control, and all subcontractors; or

(3) Any combination of separate and blended rates for each category of labor to be performed by the offeror, affiliates of the offeror under a common control, and subcontractors.

(End of provision)

### 52.216-30 Time-and-Materials/Labor-Hour Proposal Requirements—Non-Commercial Item Acquisition without Adequate Price Competition.

As prescribed in 16.601(e)(2), insert the following provision:

**TIME-AND-MATERIALS/LABOR-HOUR PROPOSAL REQUIREMENTS—NON-COMMERCIAL ITEM ACQUISITION WITHOUT ADEQUATE PRICE COMPETITION (FEB 2007)**

(a) The Government contemplates award of a Time-and-Materials or Labor-Hour type of contract resulting from this solicitation.

(b) The offeror must specify separate fixed hourly rates in its offer that include wages, overhead, general and administrative expenses, and profit for each category of labor to be performed by—

- (1) The offeror;
- (2) Each subcontractor; and
- (3) Each division, subsidiary, or affiliate of the offeror under a common control.

(c) Unless exempt under paragraph (d) of this provision, the fixed hourly rates for services transferred between divisions, subsidiaries, or affiliates of the offeror under a common control—

- (1) Shall not include profit for the transferring organization; but
- (2) May include profit for the prime Contractor.

(d) The fixed hourly rates for services that meet the definition of commercial item at 2.101 that are transferred between divisions, subsidiaries, or affiliates of the offeror under a common control may be the established catalog or market rate when it is the established practice of the transferring organization to price interorganizational transfers at other than cost for commercial work of the offeror or any division, subsidiary or affiliate of the offeror under a common control.

(End of provision)

**52.216–31 Time-and-Materials/Labor-Hour Proposal Requirements—Commercial Item Acquisition.**

As prescribed in 16.601(e)(1), insert the following provision:

**TIME-AND-MATERIALS/LABOR-HOUR PROPOSAL REQUIREMENTS—COMMERCIAL ITEM ACQUISITION (FEB 2007)**

(a) The Government contemplates award of a Time-and-Materials or Labor-Hour type of contract resulting from this solicitation.

(b) The offeror must specify fixed hourly rates in its offer that include wages, overhead, general and administrative expenses, and profit. The offeror must specify whether the fixed hourly rate for each labor category applies to labor performed by—

- (1) The offeror;
  - (2) Subcontractors; and/or
  - (3) Divisions, subsidiaries, or affiliates of the offeror under a common control.
- (End of provision)

■ 6. Revise section 52.232–7 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 (FEB 2007)**

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

(a) *Hourly rate.* (1) *Hourly rate* means the rate(s) prescribed in the contract for payment for labor that meets the labor category qualifications of a labor category specified in the contract that are—

- (i) Performed by the Contractor;
- (ii) Performed by the subcontractors; or
- (iii) Transferred between divisions, subsidiaries, or affiliates of the Contractor under a common control.

(2) The amounts shall be computed by multiplying the appropriate hourly rates prescribed in the Schedule by the number of direct labor hours performed.

(3) The hourly rates shall be paid for all labor performed on the contract that meets the labor qualifications specified in the contract. Labor hours incurred to perform tasks for which labor qualifications were specified in the contract will not be paid to the extent the work is performed by employees that do not meet the qualifications specified in the contract, unless specifically authorized by the Contracting Officer.

(4) The hourly rates shall include wages, indirect costs, general and administrative expense, and profit. Fractional parts of an hour shall be payable on a prorated basis.

(5) 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—

- (i) Individual daily job timekeeping records;
- (ii) Records that verify the employees meet the qualifications for the labor categories specified in the contract; or
- (iii) Other substantiation approved by the Contracting Officer.

(6) 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 or authorized representative.

(7) 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) of this clause, 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.

(8) 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.* (1) For the purposes of this clause—

(i) *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.

(ii) *Materials* means—

(A) Direct materials, including supplies transferred between divisions, subsidiaries, or affiliates of the Contractor under a common control;

(B) Subcontracts for supplies and incidental services for which there is not a labor category specified in the contract;

(C) Other direct costs (*e.g.*, incidental services for which there is not a labor category specified in the contract, travel, computer usage charges, etc.); and

(D) Applicable indirect costs.

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

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

(3) Except as provided for in paragraph (b)(2) 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 invoice; or

(ii) Ordinarily 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.

(4) 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.

(5) 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 that are paid at the hourly rates.

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

(i) Obtain materials 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.

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

(c) 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) *Total cost.* It is estimated that the total cost to the Government for the performance of this contract shall not exceed the ceiling price set forth in the Schedule, and the Contractor agrees to use its best efforts to perform the work specified in the Schedule and all obligations under this contract within such ceiling price. If at any time the Contractor has reason to believe that the hourly rate payments and material costs that will accrue in performing this contract in the next succeeding 30 days, if added to all other payments and costs previously accrued, will exceed 85 percent of the ceiling price in the Schedule, the Contractor shall notify the Contracting Officer giving a revised estimate of the total price to the Government for performing this contract with supporting reasons and documentation. If at any time during performing this contract, the Contractor has reason to believe that the total price to the Government for performing this contract will be substantially greater or less than the then stated ceiling price, the Contractor shall so notify the Contracting Officer, giving a revised estimate of the total price for performing this contract, with supporting reasons and documentation. If at any time during performing this contract, the Government has reason to believe that the work to be required in performing this contract will be substantially greater or less than the stated ceiling price, the Contracting Officer will so advise the Contractor, giving the then revised estimate of the total amount of effort to be required under the contract.

(e) *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.

(f) *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 or authorized representative 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 paragraphs (f) and (g) of this clause), 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.

(g) *Assignment and Release of Claims.* The Contractor, and each assignee under an assignment entered into under this contract and in effect at the time of final payment under this contract, shall execute and deliver, at the time of and as a condition precedent to final payment under this contract, a release discharging the Government, its officers, agents, and employees of and from all liabilities, obligations, and claims arising out of or under this contract, subject only to the following exceptions:

(1) Specified claims in stated amounts, or in estimated amounts if the amounts are not susceptible of exact statement by the Contractor.

(2) Claims, together with reasonable incidental expenses, based upon the liabilities of the Contractor to third parties arising out of performing this contract, that are not known to the Contractor on the date of the execution of the release, and of which the Contractor gives notice in writing to the Contracting Officer not more than 6 years after the date of the release or the date of any notice to the Contractor that the Government is prepared to make final payment, whichever is earlier.

(3) Claims for reimbursement of costs (other than expenses of the Contractor by reason of its indemnification of the Government against patent liability), including reasonable incidental expenses, incurred by the Contractor under the terms of this contract relating to patents.

(h) *Interim payments on contracts for other than services.* (1) Interim payments made

prior to the final payment under the contract are contract financing payments. Contract financing payments are not subject to the interest penalty provisions of the Prompt Payment Act.

(2) The designated payment office will make interim payments for contract financing on the \_\_\_\_\_ [Contracting Officer insert day as prescribed by agency head; if not prescribed, insert “30th”] day after the designated billing office receives a proper payment request. In the event that the Government requires an audit or other review of a specific payment request to ensure compliance with the terms and conditions of the contract, the designated payment office is not compelled to make payment by the specified due date.

(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 (FEB 2007).* 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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## DEPARTMENT OF DEFENSE

### GENERAL SERVICES ADMINISTRATION

### NATIONAL AERONAUTICS AND SPACE ADMINISTRATION

#### 48 CFR Parts 2, 10, 12, 16, and 52

[FAC 2005–15; FAR Case 2003–027; Item II; Docket 2006–0020, Sequence 22]

RIN 9000–AK07

#### Federal Acquisition Regulation; FAR Case 2003–027, Additional Commercial Contract Types

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

**ACTION:** Final rule.

**SUMMARY:** The Civilian Agency Acquisition Council and the Defense Acquisition Regulations Council (Councils) have agreed on a final rule amending the Federal Acquisition Regulation (FAR) to implement section 1432 of the National Defense Authorization Act for Fiscal Year 2004. Title XIV of the Act, referred to as the Services Acquisition Report Act of 2003 (SARA), amended section 8002(d) of the Federal Acquisition Streamlining Act of