Time-and-Materials and Labor-Hour Contracts The New Policies

Overview:

Time-and-materials and labor-hour (T&M/LH) contracts are the least preferred contract types, but they may play an important role in helping the Government meet its needs in certain situations -- namely, 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. To ensure the appropriate and effective use of T&M/LH contracting, this overview emphasizes the following key points:

- Before using a T&M/LH contract, the contracting officer (CO) must establish that no other contract type is suitable. A CO may not use a T&M/LH contract simply by establishing that the service is offered on a T&M/LH basis. The CO must affirmatively establish that it is not suitable to acquire the service using any other contract type before considering a T&M/LH contracting arrangement.
- COs need to clearly and carefully document their findings in a written determination and findings (D&F). This documentation will help not only to establish that T&M/LH contracts are being used properly but also to provide appropriate insight into the circumstances where these vehicles are needed.
- COs must recognize that once needs become known, they must maximize the use of other contracting forms, which, in the context of a commercial item acquisition, means firm-fixed-price or fixed-price with economic price adjustment contracts. Reliance on these more favored contract types will ensure the contractor bears the risk for non-performance when requirements are known.
- COs should familiarize themselves with and use the alternate clause (FAR 52.212-4, Alternate I) for terms and conditions designed for T&M/LH contracts. The alternate clause was developed to address payment, inspection and acceptance, and access to records in a T&M/LH environment.

I. Restrictions on Use of T&M/LH Contracts

Basic Restrictions A.

All T&M/LH Contracts. T&M/LH contracts should be used only if the CO executes a D&F that no other contract type is suitable (FAR 16.601(d)). A CO may not use a T&M/LH contract simply by establishing that the service is offered on a T&M/LH basis commercially and that the offered rate is fair and reasonable. The CO must first affirmatively establish that it is not suitable to acquire the service using any other contract type. For a commercial item, this requirement can be met by establishing that it is not suitable to acquire the service using either a firm-fixed-price contract or a fixed-price contract with economic price adjustment. The FAR explains that this demonstration may be made by establishing that 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 (FAR 16.601(c)).

Example - A critical piece of power generation hardware has failed. No one knows what happened. It is important to bring the power back as quickly as possible. It is not possible at the time of placing the contract to estimate accurately the extent of work necessary to repair the hardware. As a result, it is difficult to obtain the services on a fixed-price basis at a fair and reasonable price. Market research shows that this type of repair generally is done on a T&M/LH contract. In this case, the CO may decide to use a T&M/LH contract.

Example – A two-acre lawn on a Government facility must be fertilized and cut for six months. Market research shows that companies generally provide this work both on a fixed-price and T&M basis. Company prices on a fixed-price basis to fertilize and cut a two-acre lawn generally range from \$50 to \$100 per visit. As such, the CO can estimate accurately the extent and duration of the work and anticipate costs with a reasonable degree of confidence. Thus, a T&M/LH contract is not appropriate for this contract.

Commercial T&M/LH Contracts. The law that authorized use of T&M/LH contracts for commercial items requires that they be awarded using competitive procedures. Any of the procedures described in FAR 6.102 comply with that requirement (e.g., sealed bid, competitive proposals, or orders under multiple award schedules). Other procedures that are competitive procedures include set-aside procedures under FAR Subpart 19.5 and competition under FAR Part 13 (12.207(b)(1)).

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B. Determination and Findings (D&F)

(1) All T&M/LH Contracts

- (a) The CO must execute a D&F that no other contract type is suitable (FAR 16.601(d)).
- (b) The D&F must be signed before the base contract is awarded and before each option, if any, is exercised. If the T&M/LH contract or option periods will exceed three years, the D&F for the base contract must be approved by the Head of the Contracting Activity (HCA) (FAR 16.601(d)).

Example: A CO enters into a base contract for 2007, with a one-year option for 2008. The CO must prepare a D&F prior to entering into the contract, and also must prepare a D&F prior to exercising the option for 2008. However, HCA approval of the D&F is not required for this contract.

Example: A CO enters into a base contract for 2007, with three one-year options for 2008, 2009, and 2010. The CO must prepare a D&F prior to entering into the contract, and also must prepare a D&F prior to exercising each option for 2008, 2009, and 2010. In addition, the HCA must approve the D&F prior to entering into the base contract because the base plus option periods exceeds three years.

(2) Commercial T&M/LH Contracts

- (a) <u>Indefinite-delivery contracts</u>. If the contract authorizes the use of T&M/LH orders:
- (1) The contract must be structured to maximize the use of fixed-price orders and minimize the use of T&M/LH orders (12.207(c)(2)).
- (2) Each T&M/LH order must be authorized by a separate D&F (12.207(c)(3)).
- (3) If the contract only authorizes T&M/LH orders, the basic contract D&F must be approved one level above the CO (12.207(c)(3)).

Example: A CO enters into a one-year basic contract for a commercial item that provides for both fixed-price and T&M orders. Order Number 0001 is on a fixed-

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price basis. Order Number 0002 is entered into on a T&M basis. A D&F must be prepared prior to entering into Order Number 0002. However, a D&F is not required for Order Number 0001.

Example: A CO enters into a one-year basic contract for a commercial item that provides for only T&M orders. The CO must prepare a D&F prior to entering into the basic contract, and that D&F must be approved at one level above the CO. However, a D&F is not required for each order prepared under that contract.

- (b) For commercial T&M contracts, the D&F must also include the following (FAR 12.207(b)):
- (1) <u>Market research</u>. Describe the market research conducted.
- (2) <u>Duration or extent of work or costs cannot be</u> <u>estimated</u>. State why is it not possible to accurately estimate the extent of work, the duration of work, or the anticipated costs.
- (3) <u>Fixed pricing for portions of the work</u>. Describe how the requirement has been structured to maximize the use of firm-fixed-price or fixed-price with economic price adjustment contracts (e.g., by limiting the value or length of the T&M/LH contract or order; establishing fixed prices for portions of the requirement) on future acquisitions for the same or similar requirements. The use of fixed-price arrangements will ensure the contractor bears the risk for non-performance when the requirement is known.
- (4) <u>Future related effort to use fixed price</u>. Describe actions planned to maximize the use of firm-fixed-price or fixed-price with economic price adjustment contracts on future acquisitions for the same requirements.

Example: The Government needs to procure a substantial amount of material, which needs to be installed in different environments. The amount of material needed is reasonably well-established, but the extent and duration of the time required to install the material cannot be estimated with reasonably accuracy. The CO establishes a fixed-price line item for the purchase of the materials, and a T&M line item(s) for the installation.

Example: Repairs of a major piece of equipment are needed on an on-going basis. The repairs require an assessment of the damage to determine the extent of work

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required to perform the repair. However, after this assessment is performed, historical experience shows that it is possible to reasonably estimate the cost of the repair. To justify the use of T&M/LH for the assessment, the CO should document that the use any contract type other than a T&M/LH contract is not suitable. The CO may then enter into a T&M/LH line item for the assessment, and a fixed-price line item for performing the actual repair.

- C. <u>Ceiling Price</u>. Each T&M/LH contract must include a ceiling price that the contractor may not exceed (16.601(d)(2)).
- (1) For noncommercial contracts, the CO is required to justify the reasons for and amount of any changes in the ceiling price (16.601(d)(2)).
- (2) For commercial contracts, the CO is required to execute a determination that it is in the best interest of the procuring agency to change the ceiling price (12.207(b)(1)(ii)(C)).
- (3) The noncommercial justification and the commercial determination must be documented in the contract file (16.601(d)(2)).
- II. Payments On T&M/LH Contracts. The payment clause for commercial T&M/LH contracts is at Alternate I of FAR 52.212-4. The payment clause for noncommercial T&M/LH contracts is at FAR 52.232-7. In addition to the clause at FAR 52.232-7, a noncommercial T&M/LH contract must also include the Allowable Cost and Payment Clause at FAR 52.216-7. The Allowable Cost and Payment Clause only applies to the materials portion of the T&M/LH contract. As a result, FAR 52.216-7 should not be included if the contract is a labor-hour contract, i.e., there are no materials.

A. Subcontracts

- (1) <u>All T&M/LH Contracts</u>. The following apply to both commercial and noncommercial item contracts:
- (a) All labor hours performed under a prime contract that meet the requirements of a labor category or categories of that prime contract are to be paid at a fixed rate set in the prime contract, regardless of whether the labor hours are performed by the prime contractor or by a subcontractor (16.601(a)). The contract may identify separate rates for the contractor and subcontractor. See the following paragraph (b)(2).

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Example: A contract includes a fixed hourly rate for installation services by an electrical engineer. The prime contractor enters into a subcontract with Company A to perform some of these installation services using an electrical engineer that meets the qualifications of an electrical engineer specified in the prime contract. These subcontract labor hours must be reimbursed at the fixed hourly rate specified in the contract.

(b) Labor hours performed by a subcontractor are not "materials" and they cannot be reimbursed at actual cost. Most subcontractor labor hours are defined as "hourly rate" rather than "materials." The exception is subcontracts for supplies and incidental services for which there is not a labor category specified in the contract. Such supplies and incidental services are included in the definition of "materials" and reimbursed at actual cost (16.601(a)).

Example: A prime contractor enters into a subcontract for transportation services. The contract does not contain a fixed hourly rate for transportation services. This subcontract must be reimbursed at actual costs.

- (2) <u>Commercial T&M/LH Contracts Hourly Rates</u>. The contract may include (12.207):
 - (a) A single rate for each labor category;
- (b) Separate rates for the contractor, each subcontractor; and each affiliate; or
 - (c) Any combination of (a) and (b) above.

Example: Contract XYZ includes the following rates:

Engineer – Company A \$15 Engineer – Company B \$20

In this case, the prime contractor will be paid \$15 for each hour worked by a qualified engineer of Company A, and \$20 for each hour worked by a qualified engineer of Company B.

Example: Contract PQR includes a single blended rate as follows:

Engineer – All \$17

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In this case, the prime contractor will be paid \$17 for each hour worked by a qualified engineer, regardless of whether that engineer works for the prime contractor or a subcontractor.

- (3) Noncommercial T&M/LH Contracts Hourly Rates
- (a) <u>Contract Not Awarded on Competitive Basis</u>. The contract must have separate rates for the contractor, each subcontractor, and each affiliate.

Example: In structuring a contract for a sole source acquisition, the CO is deciding whether to include a single rate in Contract KLM for all engineers at \$17 per hour, regardless of whether that engineer works for the prime contractor or a subcontractor. Such an arrangement is not appropriate. The contract must include a separate rate for work performed by the prime contractor's engineers, and a separate rate for work performed by each subcontractor.

- (b) Contract Awarded on Competitive Basis
- (1) <u>FAR Rule</u>. Unless otherwise specified by agency procedures, the contract may include:
 - (a) A single rate for each labor category,
- (b) Separate rates for the contractor, each subcontractor, and each affiliate, or
 - (c) Any combination of (a) and (b) above.
- (2) The CO can mandate use of one or more of these methods only if authorized by agency procedures.
- (3) <u>DFARS Rule</u>. For all competitively awarded noncommercial T&M/LH contracts and orders awarded by, or on the behalf of DoD, DoD procedures require contractors to bid separate labor hour rates for the contractor, each subcontractor, and each affiliate (DFARS 216.601).
- B. <u>Materials</u>. "Materials," as defined at FAR 52.212-4 (commercial items) and FAR 52.232-7 (noncommercial items), include direct material

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(including supplies transferred between divisions, subsidiaries, or affiliates under common control), subcontracts for supplies and incidental services for which there is not a labor category specified in the contract, other direct costs (e.g., incidental services for which there is not a labor category specified in the contract, travel, computer usage, etc.), and applicable indirect costs.

(1) All T&M/LH Contracts

- If the contractor furnishes its own materials that meet the definition of a commercial item, the price to be paid for such materials shall not exceed the contractor's established catalog or market price.
- (b) All other materials are reimbursed based on the contractor's actual cost. Fee or profit cannot be paid on materials.
- Noncommercial T&M/LH contracts. Payment of materials is subject to the provisions of FAR Subpart 31.2 in effect on the date of the contract.

C. Other Direct Costs (ODC)

All T&M/LH Contracts. ODC is reimbursed based on the (1) contractor's actual costs.

(2) Commercial T&M/LH Contracts

Only the types of ODC specifically listed in the contract (a) are reimbursed to the contractor. For example, if travel is to be authorized, the CO would list "Travel" in paragraph FAR 52.212-4, Alternate I, (i) (1)(ii)(D)(1), Other Direct Costs. Any limitations on travel should also be listed there. If no reimbursement for ODC will be provided, the CO should insert "None" in the contract clause.

Example: The contract includes the following list of ODC's:

Travel Computer Usage

The contractor submits a payment invoice that includes \$4,000 for printing costs. Payment for this \$4,000 of printing costs is not permitted, since printing costs were not listed as a specific ODC in the contract.

For indefinite-delivery contracts, the CO awarding the contract may list the elements of other direct costs in the basic contract, or may provide for each order to separately list the elements of ODC.

D. **Indirect Costs**

Noncommercial T&M/LH Contracts. Indirect costs are reimbursed at the contractor's actual costs.

(2) Commercial T&M/LH Contracts

- Indirect costs are not paid based on the contractor's actual costs. Instead, a fixed amount for indirect costs is negotiated in the contract (FAR 52.212-4, Alternate I (i)(1)(ii)(D)(2)) and paid on a pro-rata basis over the period of contract performance. The CO must insert the fixed amount and the payment schedule in the contract clause. If no reimbursement of indirect costs will be provided, the CO should insert "\$-0-" in the contract clause.
- The fixed amount is the total amount of indirect costs (b) that is paid on the contract.
- The fixed amount will be determined for each contract (c) through the competitive negotiation process. Offerors will propose an amount in their offer, the negotiation process will proceed, and the contract will include the amount that results from negotiation.
- (d) For indefinite-delivery contracts, the CO awarding the contract may specify "None" for the fixed amount of indirect costs or provide for each order to separately fix the amount and payment schedule.

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Example: The contract provides for reimbursement of \$60,000 of indirect costs. The contract period is 12 months. The expenditure of materials is expected to be spread evenly over the contract period. Thus, the contract states that the contractor is reimbursed \$5,000 per month (\$60,000 divided by 12) for indirect costs under this contract. In Month 12, the contractor submits a bill for an additional \$8,000 of indirect costs, claiming that the actual indirect costs applicable to this contract were higher than anticipated. Payment for this additional \$8,000 is not permitted, since the indirect costs are limited to the \$60,000 specified in the contract.

- E. <u>Prompt Payment</u>. Prompt Payment Act penalties for late payments apply to—
 - (1) All Commercial T&M/LH contracts; and
 - (2) Noncommercial T&M/LH contracts for services.

III. Inspection and Correction of Defects

- A. <u>All T&M/LH Contracts</u>. If the contractor provides services or materials that do not meet the requirements of the contract, the Government may require the contractor to replace or correct the services or material anytime up to six months (or other time listed in the contract) from the date the CO or authorized representative approved the related voucher. Except as provided for in the inspection and acceptance clause of the contract, the contractor must be paid for reperformance if the Government requires such correction or replacement. The following limits apply to payment for reperformance--
- B. <u>Noncommercial T&M/LH Contracts</u>. The hourly rate for any labor performed by the contractor to correct the defects shall be reduced to reflect the portion of the rate attributable to profit.
- C. <u>Commercial T&M/LH Contracts</u>. The hourly rates for any labor performed by the contractor to correct the defects shall be reduced to reflect the portion of the rate identified in the clause (FAR 52.212-4, Alternate I(a)(4)). The CO should negotiate the percent that will be used to reduce the hourly rates when the contract or order is executed. If the contracting parties are unable to negotiate a percentage at the time of contract award, the labor rates will be reduced by 10 percent.

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IV. Government Access to Records

- A. <u>Noncommercial T&M Contracts</u>. The Government has the standard access to records clause at FAR 52.215-2.
- B. Commercial T&M/LH Contracts. The Government has access to records necessary to verify (FAR 52.212-4, Alternate I, paragraph (i)(4)):
- (1) That the employee met the specifications for the labor categories for which they have been billed;
 - (2) The employee worked the hours shown on the invoice; and
 - (3) Amounts paid, when actual costs are the basis for reimbursement.

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