November 18, 2004

VIA FAXSIMILE AND FIRST CLASS MAIL

General Services Administration
Regulatory Secretariat (VR)
Attn: Ms. Laurie Duarte
1800 F Street, N.W.
Room 4035
Washington, D.C. 20405

Re: FAR Case 2003-027, Advance Notice of Proposed Rulemaking, Additional Commercial Contract Types

Dear Ms. Duarte:

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

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


As amended, section 8002(d) imposes certain requirements to use T&M or LH contracts to procure commercial services under the commercial item procedures of Part 12 of the Federal Acquisition Regulation ("FAR"). FAR Part 12; 48 C.F.R. Part 12. Specifically, (1) the contract or order must be issued on a competitive basis; (2) the service must be a commercial service as defined in certain categories prescribed in section 8002(d), including any categories of services determined to be commercial by the Administrator of the Office of Federal Procurement Policy ("OFPP"); (3) the contracting officer must prepare a determination and findings ("D&F") that no other contract type is suitable; and (4) the contracting officer must include a ceiling price that the contractor would exceed at its own risk and that can only be increased when the contracting officer determines that it is in the best interests of the agency.

The Councils have provided in the ANPR a preliminary draft of revisions to the FAR’s current commercial items policies and associated contract clauses, which were originally intended only to support acquisitions through firm fixed-price or fixed-price with economic price adjustment contracts. The ANPR requests public comments on how best to implement these revisions to ensure that they address the risks associated with T&M and LH contracting.

As we did in our comments on July 25, 2001, on the Proposed Rule for Contract Types for Commercial Items (FAR Case 2000-013), the Section supports the implementation of T&M and LH contracts for commercial services and generally applauds the Councils’ efforts in this regard in this ANPR. We have, however, several comments and suggestions, as well as responses to some of the specific questions posed in the ANPR, each of which is addressed below.

While our comments are primarily concerned with implementing new rules and contract clauses for T&M and LH commercial services in a way that is consistent with commercial buying practices, we do not presume to identify all the
standard commercial services buying practices across all industries. Nor do we offer an opinion regarding which industries or which types of services OFPP should conclude are commercial. Instead, for purposes of these comments, we have in mind those services that have traditionally fallen within the definition of a commercial item in FAR 2.201. Recognizing that the definition of a commercial service will be evolving (pursuant to OFPP’s identification of other categories of commercial services), our commentary is aimed at giving the contracting officer sufficient discretion to implement contract terms and conditions that are appropriate for the particular commercial services that are being purchased. Rather than implementing a one-size-fits-all approach to commercial buying practices, we believe that our approach best suits the policy of enabling the Government to purchase commercial services under more commercial-like terms and conditions.

Discussion

1. Application of the Final Rule to Existing Contracts and Orders

As an initial matter, we note that the Councils’ preliminary draft does not address how or whether the new regulations and contract clauses for procuring T&M and LH commercial services would apply to contracts and task orders that are in effect before implementation of the final rules. We believe application of any final rules and regulations to outstanding contracts and orders would be administratively burdensome to both contractors and the Government, and would add unnecessary confusion and uncertainty to the ongoing projects. Accordingly, we recommend that the final rules explicitly state that they apply to contracts and orders that are executed on or after the effective date of those rules.

Where a task order contract is involved, however, we recommend that the Councils consider allowing contractors to request contracting officers to modify existing contracts to allow for T&M and LH task orders, so that implementation is not delayed. Thus, a task order awarded after the effective date of the rule could be on a T&M or LH basis even though the underlying contract was awarded prior to the effective date, if the underlying contract was so modified. Such modifications should be by mutual agreement without consideration. If a limitation on such authority is deemed necessary, such an avenue could be limited, for example, to contracts awarded subsequent to passage of SARA.

2. Draft Revisions of Contract Clauses

As part of the implementation of T&M and LH contracts for commercial services, the Councils have drafted preliminary revisions to the standard FAR Part 12 clauses that are used in commercial item acquisitions. The current FAR Part 12
clauses are intended to be used only for fixed price contracts. See FAR 12.207; 48 C.F.R. § 12.207. The draft revisions, which are based largely on the standard clauses for non-commercial services that are acquired on a T&M or LH basis, would be in the form of an alternative clause that modifies FAR 52.212-4 by replacing the provisions for fixed-price work with the alternative provisions for T&M or LH work.

Although we generally agree with that approach, we nevertheless have a few comments and suggestions to make the new rules and contract provisions more consistent with commercial buying practices. FASA mandates that government agencies rely to the maximum extent practicable on commercial products and services to fill the Government’s needs. FASA §§ 8002, 8104. FASA also requires that an agency impose only those terms and conditions in commercial item contracts that are required by law or that are customary in the commercial market place. Id.; see also FAR 12.302; 48 C.F.R. § 12.302.

a. Implementation of T&M and LH Contract Clauses

The Councils’ draft contemplates that the changes to FAR 52.212-4 to implement T&M and LH contracts would be in an alternative clause that the contracting officer would include in the contract if T&M or LH work were being performed. The implication in using an alternative clause is that it would replace certain provisions in FAR 52.212-4 that apply to fixed-price contracts. This suggests that a contract would not include both the provisions necessary for fixed-price services and T&M and LH services. If this is indeed the case, the contracting officer would be unable to issue fixed-price task orders under the same contract that contemplates T&M or LH task orders, and vice versa. We believe it would be in the best interests of contractors and the Government if the parties had the flexibility to perform fixed-price or T&M and LH orders as appropriate under the same contract. Accordingly, we suggest that implementing guidance make clear that standard and alternate clauses can be used in the same contract. Alternatively, rather than prescribing an alternative clause, the FAR Councils could prescribe a separate clause for use with T&M and LH contracts and orders so that the clause can be used with the standard provisions for fixed price work in contracts where work may be performed pursuant to fixed price and T&M or LH orders.
b. Ceiling Price

The payment provision in the ANPR’s draft alternative clause to FAR 52.212-4 requires the contracting officer to establish a ceiling price, within which the contractor must use “best efforts” to complete the work. It is not clear, however, how the ceiling price is to be established or what it should be based upon. This may cause a practical problem if the ceiling price is intended to be based on the estimated total cost of the T&M or LH work rather than simply being based on the availability of appropriated funds.

One of the primary reasons for T&M and LH work is that an accurate estimate of the total cost cannot be reasonably pre-determined with any degree of confidence. See FAR 16.601(b); 48 C.F.R. § 16.601(b). Indeed, if an accurate calculation of the total cost were possible, it would eliminate one of only two justifications available under the draft rules for issuing a T&M or LH contract instead of a fixed price contract. Under the ANPR’s draft rules, which closely mirror the current rules for non-commercial T&M and LH services, the contracting officer must first execute a D&F stating that either (1) it is impossible to accurately estimate the extent or duration of the work, or to anticipate costs with any degree of certainty; or (2) fixed pricing would unduly inflate the Government’s costs or impose unreasonable risk on the contractor. If contracting officers were required to establish the ceiling price according to the anticipated costs, the first justification may be effectively nullified: How could a contracting officer on one hand state in the D&F that the total cost cannot be estimated with confidence, while on the other hand base a ceiling price on the estimated cost? The section, therefore, suggests revising the draft payment clause so that the ceiling price is simply based on the availability of appropriated funds rather than the cost of performance. This solution has the benefits of being straightforward and preserving the availability of the first justification for issuing a T&M or LH contract; i.e., that an accurate estimate of the cost of the work is impossible to ascertain with a reasonable degree of confidence.

c. Inspection/Acceptance

The draft inspection and acceptance provision in the ANPR makes a significant change from the standard inspection and acceptance provision used for non-commercial T&M and LH services. See FAR 52.246-6(f); 48 C.F.R. § 52.246-6(f). Specifically, the new provision requires contractors to repair or replace rejected supplies or reperform rejected services at no cost to the Government. This change may make the new inspection/acceptance provision less consistent with standard commercial practices and imposes more contract risk on the contractor than under the non-commercial clause, which does not require repair or
reperformance at no cost to the Government. *Id.* Rather, FAR 52.246-6 specifically provides for the payment of costs (but not profit) incurred to perform corrective work.

Under the ANPR's draft clauses, contractors will likely view the possibility of having to reperform services or repair supplies at no cost as requiring them to bear a level of risk that is similar to that of fixed-price work. This is especially so where, as here, the draft clauses combine (1) a ceiling price that contractors exceed at their own risk (rather than an estimate, which as explained below is more common in some commercial industries), and (2) a requirement that the contractor use "best efforts" to perform within the ceiling price (which may be a different standard of performance than contractors routinely provide under commercial warranties). Under the draft clauses, contractors may interpret a commercial T&M or LH contract to require accomplishment of a certain result, *i.e.*, "performance of the work specified in the Schedule," within a specified dollar amount, *i.e.*, the ceiling price. Having to reperform any work that does not accomplish the required result (*i.e.*, deficient) without additional compensation may well be viewed by commercial contractors as an unacceptable allocation of the parties' respective contract risks for T&M or LH work. Several adverse consequences could result:

- contractors will propose higher profit margins to cover the additional risk;
- contractors, during negotiations, may insist that the Government set artificially high ceiling amounts; and/or
- contractors, during contract performance, will have little incentive to complete the work under the ceiling amount because they will choose instead to perform quality assurance and testing beyond standard commercial practice in order to mitigate the risk of suffering losses resulting from having to reperform rejected work for free.

None of these scenarios is favorable to the Government's interests. To avoid these possibilities -- and to ensure that T&M and LH work is an effective alternative to fixed-price work for commercial services -- we suggest allowing the contracting officer, where appropriate, to provide that the contractor will be compensated for reperformance or repair of deficient services or supplies, respectively, up to the ceiling amount, but not including profit. This would be consistent with the non-commercial T&M and LH clauses and would give the Government the ability to more accurately reflect standard commercial practices.
Additionally, the term “best efforts” is normally associated with a standard of effort to meet required performance rather than a standard for cost containment. In this regard, if a standard of effort to achieve cost containment is deemed necessary, “reasonable efforts” or “all reasonable efforts” would be a better choice.

3. **Dollar Threshold for Filing a D&F**

Consistent with the requirements of SARA, the ANPR requires that the contracting officer execute a D&F stating that no other contract type is suitable before making a purchase on a T&M or LH basis. Neither SARA nor the ANPR establishes a dollar threshold for this requirement. Accordingly, a D&F would be required for every T&M or LH transaction no matter how small. This may unduly hamper the Government’s ability to procure commercial services efficiently. Contracting officers may find it necessary or more efficient to quickly issue small task orders for T&M or LH work. For example, it may be necessary due to time constraints for a contractor to begin work immediately rather than waiting until a more definitive, fixed-price statement of work can be developed. In that case, a relatively small T&M or LH order for that interim period would be the most efficient way to proceed. Requiring a D&F for such small orders would eliminate this kind of flexibility. Accordingly, the Section recommends that there be abbreviated requirements for filing a D&F for contracts or orders below a certain dollar threshold. For example, the requirement to conduct market research could be eliminated for orders below the $100,000 limit set for the simplified acquisition threshold. See FAR 2.101; 48 C.F.R. § 2.101. Establishing a truncated D&F process for orders below a dollar threshold would be consistent with the Councils’ discretion to implement SARA. See *Chevron, U.S.A. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837, 844 (1984) (holding that an executive agency’s construction of statutory scheme is entitled to considerable deference).

4. **Competition Requirements**

Section 1432 of SARA requires that T&M and LH commercial services be purchased “on a competitive basis.” Echoing this requirement, the ANPR requires that the contract be awarded “using competitive procedures.” The Section requests clarification that this requirement would be satisfied when task orders are issued using the FAR’s “fair opportunity” requirements. FAR 16.505(b)(1); 48 C.F.R. § 16.505(b)(1). Otherwise, the new rules for commercial T&M and LH services might be construed to require the use of full and open competition, which ordinarily applies to contract awards, not task orders. See FAR Part 6; 48 C.F.R. Part 6.
5. **Answers to Questions Posed by the Councils in the ANPR**

The ANPR poses a number of questions to assist the Councils in preparing new rules and contract clauses for T&M and LH commercial services. The Section responds to some of those questions below. Some of the questions posed in the ANPR, however, are not well suited for the Section to answer because they request industry-specific viewpoints and input.

a. *What steps should a contracting officer be required to take to establish that a fixed-price contract is not suitable?*

Section 1432 of SARA requires the contracting officer to determine that a fixed price contract is not suitable before purchasing T&M or LH services. The Section commends the approach taken by the Councils in the ANPR of requiring a contracting officer to conduct market research according to the procedures established in FAR Part 10 (48 C.F.R. Part 10). Because the contracting officer will be procuring commercial services, the descriptions and types of services the Government wants will likely be sold in substantial quantities in the marketplace and, therefore, already be well understood by both the Government and the contractors. Thus, the market research procedures in FAR Part 10 will be an effective way to determine whether it is feasible to purchase such services on a fixed price basis or a T&M or LH basis.

b. *What responsibility should the contractor bear for correction of non-conforming services under T&M and LH commercial contracts (e.g., who should bear the cost of correction or re-performance)? Does the burden of responsibility depend on whether the Government has accepted the service?*

As explained above, in most cases it is more consistent with commercial buying practices under T&M or LH contracts to pay for reperformance of deficient services or repair of defective goods. See FAR 52.246-6; 48 C.F.R. § 52.246-6. Thus, the contracting officer should have the ability to enter into contracts that provide for payments (not including profit) for reperformed services.

As an alternative approach, rather than having to compensate contractors for reperformance of defective work, the parties’ respective allocation of contract risk can be adjusted to better approximate commercial practices. As mentioned above, standard practice in some industries is to establish cost estimates, not ceiling prices. These estimates are often not guarantees; neither party has the right to rely on the estimates, and the contractor does not have a duty to use “best efforts” to achieve a
defined goal within the stated dollar amount. Instead of the contractor using "best efforts" to perform the statement of work within the ceiling price, the contractor is obligated to perform the services according to the same performance standard provided in the contract warranty. So, for example, if the contract warranty provides that the services will be provided "in a professional manner consistent with industry standards" — a common warranty for commercial services in several industries — then the contractor would have to provide the services according to that standard until the ceiling price is reached. When the ceiling price is reached, the contractor could not continue working (unless the contracting officer raises the ceiling price) and would only be required to reperform the services that did not satisfy the contract warranty.

Implementation of the commercial T&M and LH contract clauses in this way would better allocate the parties' contract risk so that it would be fair to require the contractor to bear the cost of correcting deficient performance. The Government's interests are also protected by the competitive nature of the commercial services, that, by definition, are also widely offered in the commercial marketplace. The forces of competition give contractors an added performance incentive, thereby reducing the Government's risk in non-commercial contracts that unscrupulous contractors will "run up" the time or labor hours. This approach is

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1 This is similar to the situation when the Government provides an estimate of the amount of work it will order under a given Indefinite Delivery Indefinite Quantity contract. The Government's estimate is no guarantee of the amount of work that will be ordered. Instead, the Government is merely required to order the minimum amount stated in the contract, and unless the estimate was prepared in good faith, the contractor may not recover damages, no matter how great the difference between the minimum amount and the estimated total. See, e.g., J. Cooper & Assocs. v. United States, 58 Fed. Cl. 8 (2002), aff'd 2003 U.S. App. LEXIS 13088 (Fed. Cir. 2003).

2 This solution also requires that the new contract clauses for T&M and LH commercial services permit the parties to replace the current warranty prescribed in FAR clause 52.212-4 with a warranty that is more suitable to commercial services. The current warranty in FAR clause 52.212-4 is better suited for the acquisition of goods rather than commercial services because it provides that the items delivered will be merchantable and fit for use for the particular purpose described in the contract. FAR 52.212-4(a); 48 C.F.R. § 52.212-4(a).

3 This is commonly implemented in commercial T&M or LH services contracts in one of two ways:
- The services are accepted upon performance (or delivery if the contract calls for deliverables), in which case the Government, rather than rejecting the services for being deficient, would have a warranty claim, thereby obligating the contractor to reperform the deficient services at no additional cost to the Government; or
- The contract provides an acceptance period for the services, but (1) the standard for determining whether the services are deficient is the same standard that is provided in the warranty, and (2) the warranty's validity period is reduced by whatever amount of time is allocated to the acceptance period.
also consistent with the statutory requirements set forth in SARA. SARA does not require the contractors to bear the risk of not being able to accomplish the work described in the contract under the ceiling price. Instead, it requires that a ceiling price be established so that a contractor that continues working past that point does so at its own risk. SARA § 1432 (amending FASA § 8002(d)(2)(B)(ii)).

c. What oversight is used to ensure work is being properly charged under T&M and LH contracts (e.g., what type of information is required to substantiate payment requests)?

The ANPR’s draft payment clause gives the Government audit rights that are broader in significant respects than the audit rights provided under the standard non-commercial clause for T&M and LH services. The standard T&M and LH payment clause requires that contractors provide “invoices or vouchers and substantiating material.” FAR 52.232-7; 48 C.F.R. § 52.232-7. The ANPR payment clause, however, goes further and is much more specific: it requires the contractor to provide access to the following for purposes of verifying labor hours: (1) the original timecards; (2) the contractor’s timekeeping procedures; (3) contractor reports that show the distribution of labor between jobs or contracts; and (4) “employees whose time has been included in any invoice for the purpose of verifying that these employees have worked the hours shown on the invoices.” Additional categories of information are specified for purposes of verifying material costs and subcontract costs.

The Section applauds the Councils’ approach of being more specific with respect to the types of information that may be audited rather than merely repeating the vague “substantiating material” description. We do, however, have concerns with the requirement that contractors give the Government access to the contractor’s employees to interview them regarding the hours they charged to the contract. This right, in our view, is substantially broader than the Government’s rights under the existing T&M payment clause and is inconsistent with commercial business practices. Moreover, it is not necessary. In the absence of some indicia of fraud or wrongdoing, the employees’ timecards will be sufficient evidence of the hours actually worked. Indeed, due to the time and expense conducting interviews would entail, in practice, the Government would likely interview employees only when there was a basis to investigate alleged wrongdoing. In those cases, the Government would not need a contract clause to interview employees because the same information can be obtained through
subpoenas that are issued pursuant to an investigative body’s specific powers; e.g., the Inspector General Act of 1978, as amended, 5 U.S.C. App.4

d. Is consent to subcontract required for subcontracts not identified in the original proposal?

The Section agrees with the ANPR’s requirement that contractors obtain the contracting officer’s consent to subcontract, and with the procedures in the ANPR to obtain such consent. When professional services are being purchased on a T&M or LH basis, the Government should know what entity is providing the services. We suggest, however, that the requirement to obtain consent to subcontract be clarified to make clear that it applies only to charges that are directly charged to the contract, as opposed to overhead expenses and general and administrative expenses. Many commercial companies have corporate-wide agreements with vendors to perform those functions.

e. How are material handling or subcontract administration rates charged under T&M commercial contracts? If material handling or subcontract administration rates are reimbursed based on actual rates, how can this be done without application of FAR Subpart 31.2?

With respect to material handling and subcontract costs, the Section shares the Councils’ concern over avoiding the application of FAR Part 31 (48 C.F.R. Part 31), which establishes specific cost principles and procedures for determining the allowability of contractor costs. Wholesale application of FAR Part 31 to commercial services contractors would be inconsistent with the policy of procuring commercial items using practices customarily used in the commercial marketplace. See FAR 12.201; 48 C.F.R. § 12.201. Thus, we commend the Councils’ recommendation that material handling costs be limited to direct costs, thereby precluding allowability of indirect material costs and, therefore, application of FAR Part 31.

With respect to subcontract costs, however, we do not believe it is necessary or in the Government’s interest to limit subcontract costs to the contractor’s actual cost of subcontracting where, as here, the work is awarded competitively. In other words, we believe it would be in the Government’s interest in certain cases to allow contractors to mark-up their subcontractor’s T&M or LH

4 Moreover, in the absence of a subpoena, companies may be reluctant to expose an employee to potential personal liability and may have a duty to provide legal counsel to the employee upon request.
service rates, but *only if:* (1) the amount of the mark-up is fully disclosed to the Government, and (2) the total rate, including the mark-up, does not exceed the contractor’s own rate for the same services. This practice would not require application of FAR Part 31 because the contractor would not be applying any indirect costs. Nor would it implicate concerns regarding the prohibition on cost plus percentage of cost contracting because the contractor would be adding a fixed charge to the subcontractor’s rates that is not based on cost. Moreover, any issues concerning cost principles are ameliorated by the fact that the work will be awarded competitively. Consistent with this reasoning, the FAR explicitly recognizes that cost and pricing data is not required when awards are based on adequate price competition. See FAR 15.403-1(b)(1); 48 C.F.R. § 15.403-1(b)(1).

Allowing contractors to mark-up the subcontractor’s service rates would preserve the Government’s ability on large projects to have a prime contractor, such as an IT services integrator, coordinate the work of several parties and shoulder the administrative burden of doing so. If the prime contractor were unable to mark up the subcontractors’ rates, the prime contractor would have little incentive to undertake complex projects that involve managing the work of several parties. The result would be that the Government would be unable to avail itself of the expertise large commercial contractors have in managing large complex projects.

\[f. \quad \text{What is the impact if Cost Accounting Standards apply to these contracts?}\]

The Section recommends that the Cost Accounting Standards (“CAS”) be amended so that commercial services purchased under T&M or LH contracts are exempted from CAS coverage. CAS regulations prescribe certain types of contracts that are exempt from CAS coverage. 48 C.F.R. § 9903.201-1. Currently, fixed-price and fixed-price with economic adjustment contracts for commercial items are exempt, but T&M and LH commercial services are not. *Id; see also FAR 12.214; 48 C.F.R. § 12.214.* We believe that including within the exemption commercial services purchased under T&M and LH terms would be consistent with the original intent to exclude commercial items from coverage. We further believe that application of CAS to T&M or LH commercial contracts is not only unnecessary, but would have adverse consequences to the commercial services contractors and to the Government. Commercial contractors that sell exclusively in the commercial marketplace most likely do not have accounting systems configured to comply with CAS. Reconfiguring a company’s entire accounting architecture to comply with CAS would require substantial investment and would likely also require significant internal policy and organizational changes. If accepting T&M or LH orders for commercial services requires previously exempt
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contractors to comply with CAS, those contractors may decline to perform any commercial services on a T&M or LH basis. Accordingly, the Section recommends that the exemption for commercial items be extended to include commercial services that are purchased on a T&M or LH basis.

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

Sincerely,

[Signature]

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Chair, Section of Public Contract Law

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