

FEDERAL ACQUISITION CIRCULAR

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In the original issuance of the FAC 2005-15 looseleaf version, the section heading 16.603, Letter contracts, was inadvertently removed. The corrected pages are reissued in this supplement, as well as the original version.

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

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FAC 2005-15 LOOSELEAF CORRECTION FILING INSTRUCTIONS

NOTE: The FAR is now segmented by subparts. The FAR page numbers reflect FAR Subparts. For example, "16.6-1" is page one of Subpart 16.6.

Remove Pages

16.6-1 thru 16.6-4

Insert Pages

16.6-1 thru 16.6-4

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Subpart 16.6—Time-and-Materials, Labor-Hour, and Letter Contracts

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. See 12.207(b) for the use of time-and-material contracts for certain commercial services.

(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 only if—

(1) The contracting officer prepares a determination and findings that no other contract type is suitable. The determination and finding shall be—

(i) Signed by the contracting officer prior to the execution of the base period or any option periods of the contracts; and

(ii) Approved by the head of the contracting activity prior to the execution of the base period when the base period plus any option periods exceeds three years; and

(2) 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.

16.602 Labor-hour contracts.

Description. A labor-hour contract is a variation of the time-and-materials contract, differing only in that materials are not supplied by the contractor. See 12.207(b), 16.601(c), and 16.601(d) for application and limitations, for time-and-materials contracts that also apply to labor-hour contracts. See 12.207(b) for the use of labor-hour contracts for certain commercial services.

16.603 Letter contracts.

16.603-1 Description.

A letter contract is a written preliminary contractual instrument that authorizes the contractor to begin immediately manufacturing supplies or performing services.

16.603-2 Application.

(a) A letter contract may be used when (1) the Government's interests demand that the contractor be given a binding commitment so that work can start immediately and (2) negotiating a definitive contract is not possible in sufficient time to meet the requirement. However, a letter contract should be as complete and definite as feasible under the circumstances.

(b) When a letter contract award is based on price competition, the contracting officer shall include an overall price ceiling in the letter contract.

(c) Each letter contract shall, as required by the clause at 52.216-25, Contract Definitization, contain a negotiated definitization schedule including (1) dates for submission of

the contractor's price proposal, required cost or pricing data, and, if required, make-or-buy and subcontracting plans, (2) a date for the start of negotiations, and (3) a target date for definitization, which shall be the earliest practicable date for definitization. The schedule will provide for definitization of the contract within 180 days after the date of the letter contract or before completion of 40 percent of the work to be performed, whichever occurs first. However, the contracting officer may, in extreme cases and according to agency procedures, authorize an additional period. If, after exhausting all reasonable efforts, the contracting officer and the contractor cannot negotiate a definitive contract because of failure to reach agreement as to price or fee, the clause at 52.216-25 requires the contractor to proceed with the work and provides that the contracting officer may, with the approval of the head of the contracting activity, determine a reasonable price or fee in accordance with Subpart 15.4 and Part 31, subject to appeal as provided in the Disputes clause.

(d) The maximum liability of the Government inserted in the clause at 52.216-24, Limitation of Government Liability, shall be the estimated amount necessary to cover the contractor's requirements for funds before definitization. However, it shall not exceed 50 percent of the estimated cost of the definitive contract unless approved in advance by the official that authorized the letter contract.

(e) The contracting officer shall assign a priority rating to the letter contract if it is appropriate under 11.604.

16.603-3 Limitations.

A letter contract may be used only after the head of the contracting activity or a designee determines in writing that no other contract is suitable. Letter contracts shall not—

(a) Commit the Government to a definitive contract in excess of the funds available at the time the letter contract is executed;

(b) Be entered into without competition when competition is required by Part 6; or

(c) Be amended to satisfy a new requirement unless that requirement is inseparable from the existing letter contract. Any such amendment is subject to the same requirements and limitations as a new letter contract.

16.603-4 Contract clauses.

(a) The contracting officer shall include in each letter contract the clauses required by this regulation for the type of definitive contract contemplated and any additional clauses known to be appropriate for it.

(b) In addition, the contracting officer shall insert the following clauses in solicitations and contracts when a letter contract is contemplated:

(1) The clause at 52.216-23, Execution and Commencement of Work, except that this clause may be omitted from letter contracts awarded on SF 26;

(2) The clause at 52.216-24, Limitation of Government Liability, with dollar amounts completed in a manner consistent with 16.603-2(d); and

(3) The clause at 52.216-25, Contract Definitization, with its paragraph (b) completed in a manner consistent with 16.603-2(c). If, at the time of entering into the letter contract, the contracting officer knows that the definitive contract will be based on adequate price competition or will otherwise meet the criteria of 15.403-1 for not requiring submission of cost or pricing data, the words “and cost or pricing data supporting its

proposal” may be deleted from paragraph (a) of the clause. If the letter contract is being awarded on the basis of price competition, the contracting officer shall use the clause with its Alternate I.

(c) The contracting officer shall also insert the clause at 52.216-26, Payments of Allowable Costs Before Definitization, in solicitations and contracts if a cost-reimbursement definitive contract is contemplated, unless the acquisition involves conversion, alteration, or repair of ships.

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