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Aversion To Fixed-Price Deals May Compel Gov't To Change

By **Daniel Wilson**

Law360 (February 23, 2024, 10:56 AM EST) -- An emerging trend among large defense contractors to avoid fixed-price contracts with the federal government may force agencies to ease up on inflexible terms that undermine contractors' efforts to mitigate the lingering effects of COVID-19 and current inflation.

Several companies, including Northrop Grumman, The Boeing Co., Lockheed Martin Corp. and L3Harris Technologies Inc., have said in statements and financial reports over the last year that they intend to pull back on bidding for fixed-price deals, which pay contractors a lump sum for their work and leave companies liable for potential cost overruns.

Northrop Grumman and Boeing both suffered losses above a billion dollars on various fixed-price deals, while the CEOs of Lockheed Martin and L3Harris have spoken out against the value of such contracts given the risks they may face.

The industry's aversion to taking on risks will inevitably put government agencies at a disadvantage during contract negotiations and compel contracting officers to use their authority to be flexible with fixed-price contracts, for example, by including economic adjustment clauses to account for increases in labor costs or the price of raw materials.

When agencies aren't willing to be flexible, some contractors won't bid on anything but the lowest-risk fixed-price contracts, which are generally short-term deals with very clearly defined requirements, said Steven Masiello, chair of Dentons' U.S. government contracts practice.

"The shorter the term of a deal, the lower the risk financially to the contractor if the project ends up growing compared to what was originally estimated in effort," he said.

Even companies still willing to bid on higher-risk fixed-price deals, that may have offered "aggressively priced" proposals in the pre-COVID, pre-inflation era, might now be more cautious and price their bids in a way that builds in a buffer for unexpected risks, according to Crowell & Moring LLP partner Skye Mathieson. Such bids could ultimately drive up costs for the government.

"That's really been on industry's radar, when you do firm fixed-price contracting and you don't know what four years from now is going to look like — you don't even know what four days from now is going to look like, when the next COVID or when the next inflation bombshell is going to hit," Mathieson said.

Given that one of the main benefits of fixed-price contracting for the government is the ability to control costs, an inflexible fixed-price solicitation could backfire, with bids costlier than the government's estimate or by limiting competition to a few willing vendors, Masiello said.

"If they're unable to receive sufficient bids to create competition amongst the contractor community for certain very risky fixed-price [requests for proposal], then I would think that a response there might be that the agency would rethink its requirements and perhaps consider sharing the financial risk," he said.

Wiley Rein LLP partner Craig Smith said that contractors should take a collaborative approach to address their concerns with agencies that aren't actively seeking to make their fixed-price deals more attractive.

"A mantra that I feel applies in so many circumstances, and it definitely does here, is communicating between contractor and customer agency to really have a good bidirectional dialogue on 'What are these risks, and are those risks ones that make fixed-price contracting not feasible or feasible?'" he said. "It may not solve everything, but I think it's something that should never be overlooked."

--Editing by Jay Jackson Jr.
