



Time-and-Materials & Labor-Hour Contracting

How New Regulations
Will Impact Your Business

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Discussion Agenda

- Problems Under the Old Rules
- Services Acquisition Reform Act
- Overview of the New Regulations
- New Commercial Contract Types
- Payments Under T&M / LH contracts
 - Other Key Issues / Features

The Old Rules

Barriers to Procurements of Commercial Services

- Required “established catalog or market prices” per the definition of commercial item services [FAR 2.101]
- Firm-fixed-price procurements only– Commercial T&M / LH contracting not authorized [FAR 12.207]

The Old Rules

Confusion Over “Subcontract” Labor Rates for T&M / LH Contracts

- Nature of “subcontract” labor
- Common industry position - use the prime-contract rates
- Common DCAA position - Treat subcontract labor as “material”
 - » at cost
 - » no markup

Services Acquisition Reform Act of 2003

- Addressed barriers to T&M / LH procurements of commercial services
- Directed amendment of FAR to authorize commercial T&M / LH contracts
- Established certain restrictions for use:
 - » contracting officer must execute a “determination and findings” that no other contract type is suitable
 - » contract must include a ceiling price
 - contractor exceeds at its own risk
 - any change requires a documented determination that it is in the best interest of the procuring agency
 - » a list of the eligible services to be added to the FAR

Overview of the New Regulations

- Many changes from the previously-proposed rules
- FAR Case 2003-027
 - » implements SARA
 - » allows commercial T&M / LH Contracts for all types of services
 - » adds restrictions beyond those in SARA
- FAR Case 2004-015
 - » primarily addresses non-commercial T&M / LH contracts
 - » addresses labor rates / payments
- DFARS Case 2006-D030
 - » Interim Rule
 - » addresses labor rates under competitive, non-commercial T&M / LH contracts

Overview of the New Regulations

Basic Requirements for All Types of T&M / LH Contracts

- CO's D&F that no other contract type is suitable
 - » before execution of base period
 - » before execution of option periods
 - » if base plus options exceed 3 years, D&F must be approved by the head of the contracting activity

- Ceiling price in contract
 - » contractor exceeds at own risk
 - » increase in ceiling requires a separate determination that it is in the best interest of the procuring agency

Overview of the New Regulations

Additional Requirements for Commercial T&M / LH Contracts

- Commercial service contracts must be competitively awarded under:
 - » “competitive procedures” (e.g., FAR 6.102)
 - » FAR 6.3 procedures for other than full and open competition—provided 2 or more satisfactory offers are received; or
 - » fair opportunity procedures (FAR 16.505)

Overview of the New Regulations

Additional Requirements for Indefinite-delivery, Commercial item T&M / LH contracts

- Where possible, indefinite-delivery contracts with T&M or LH provisions must also allow for FFP orders
- If contract allows for FFP or T&M / LH orders, CO must prepare a new D&F for each T&M / LH order
- If contract allows only for T&M / LH orders, then:
 - » the initial D&F must explain why an alternative, FFP structure cannot be used for any orders
 - » this D&F must be approved one level above the CO

Overview of the New Regulations

Payments Under T&M / LH Contracts

For each labor category in the contract, offerors must specify fixed hourly rates that include wages, overhead, G&A expenses, and profit.

Overview of the New Regulations

Payments Under T&M / LH Contracts

- 3 separate approaches for pricing labor rates, depending upon the type of contract/award:
 - » commercial contracts
 - » non-commercial contracts with adequate price competition
 - » non-commercial contracts without adequate price competition

Payments Under T&M / LH Contracts

Commercial Contracts

Labor

- Offeror specifies whether the hourly rates for each labor category apply to labor performed by the prime, subs, and/or affiliates under common-control

Materials

- Reimbursed at actual cost
- Includes, e.g., direct materials and subcontracts for incidental services
- Exception for contractor's commercial items: pay the contractor's established catalog or market price
- "Less any rebates, refunds, or discounts" that are "identifiable to the contract"
- Gov't must receive credit for "cash and trade discounts, rebates, scrap commissions, and other amounts that are identifiable to the contract"

Payments Under T&M / LH Contracts

Commercial Contracts

Unless specifically identified in the contract, the gov't will not separately pay:

- “other direct costs” (e.g., incidental services for which there is not a labor category specified in the contract, travel, computer usage charges, etc.)
- indirect costs (e.g., mat'l handling, subcontract administration, etc.)
 - » may negotiate a pro-rata fixed price

Payments Under T&M / LH Contracts

Non-Commercial Contracts with adequate price competition

Labor

- Three approaches available:
 1. separate rates for prime, subs, and common-control entities
 2. blended rates for each labor category
 3. any combination of separate and blended rates

- Agency / CO may choose to restrict offerors to one of these three approaches
 - » DoD Interim rule allows only option 1 above (DFARS Case 2006-D030)
 - » So far, no other agencies have issued similar rules
 - » Is there any reasonable rationale for treating competitively-awarded non-commercial contracts differently from commercial or for treating DOD contracts differently?
 - » If the CO does not provide direction, may the contractor choose any of the three methods?

- Agency / CO may choose to require identification of all subcontractors, divisions, subsidiaries, or affiliates included in a blended rate

Payments Under T&M / LH Contracts

Non-Commercial Contracts with adequate price competition

Materials

- Reimbursed at cost
- Unlike commercial services contracts, may include allocable indirect costs and other direct costs to the extent
 - comprised only of costs that are clearly excluded from the hourly rate
 - allocated in accordance with contractor's written or established accounting practices
- Indirect costs are not applied to subcontracts that are paid at the hourly rates

Payments Under T&M / LH Contracts

Non-Commercial Contracts without adequate price competition

Labor

- Must specify separate rates for prime, subs, and common-control entities for each labor category
- Special treatment of services provided by common-control entities
 - » Non-Commercial – fixed hourly rates cannot include profit for the transferring organization but may include profit for the prime
 - » Commercial – fixed hourly rates may be set at the established catalog or market price (if doing so is the established practice and the CO has not determined the price to be unreasonable)

Materials

- Reimbursed at cost – terms are the same as for non-commercial contracts procured with adequate competition

Payments Under T&M / LH Contracts

Foreseeable Problems with Implementation

- “Subcontractors” are generally providing supplemental personnel to prime contractors, making management of the size of the work force easier
- Government concerns about using a single set of rates for prime contractor employees and “purchased labor”
 - » usually lower fringe costs for purchased labor
 - » sometimes lower hourly rates
 - » overhead trade-offs – to burden or not to burden?

Payments Under T&M / LH Contracts

Foreseeable Problems with Implementation

- Contractors often bid multiple contracts simultaneously
 - » successful bidding increases demand for “subcontract” labor
 - » unsuccessful bidding reduces demand for “subcontract” labor
 - » contractors often cannot predict the mix of prime and purchased labor on any specific contract at the time of the proposal

Payments Under T&M / LH Contracts

Foreseeable Problems with Implementation

How to address the requirements for multiple labor rates on non-competitive awards (or any non-commercial award at DoD)?

- To have any hope of recovering all labor at fixed, contractual rates, Contractor must propose rates for subcontract and affiliate labor
- Each potential sub and affiliate apparently needs its own set of rates – no single rate for all subs
- It may be possible to bid separate, but identical, rates for all labor sources but identifying all possible sources will remain a problem

Payments Under T&M / LH Contracts

Foreseeable Problems with Implementation

Do these rules create opportunities and incentives for post-award gaming on costs?

- Incentives for contractors to use their own, more expensive employees on contracts that do not permit billing of purchased labor at prime contract rates
- Where there are differences in prime and subcontractor hourly rates, government personnel may push to minimize participation of the more-expensive personnel

Key Issues and Features

Cost Accounting Standards

- Currently, commercial item contracts are specifically exempt from CAS only if they have a firm-fixed price
- Unless and until the CAS Board authorizes a new exemption from CAS, T&M and LH contracts for commercial services will be CAS covered

Key Issues and Features

Commercial T&M / LH Contracts

- Established catalog or market price still required
 - » Increased risks?
 - requirements for D&Fs may increase scrutiny
 - GSA schedule purchases are increasingly under attack
 - commercial transfers from common-control entities may be especially vulnerable

Key Issues and Features

Commercial T&M / LH Contracts

- Replacement work:
 - » In most cases, reduce the hourly rate to eliminate profit on rework
 - 10% rule
 - » Rework without charge where due to:
 - “fraud, lack of good faith, or willful misconduct”; or
 - conduct of an employee after management has “reasonable grounds to believe an employee is habitually careless or unqualified”
 - » So much for “best efforts” contracts?

Key Issues and Features

Commercial T&M / LH Contracts

- Government access to employees:

At any time before final payment, the government will have access to “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.”