Regulatory/Contractual Update

December 19, 2006 Volume 11, Issue 12

- On December 12, 2006, Federal Acquisition Circular (FAC) 2005-15 was issued and included the following—all are effective February 12, 2007:
  - Payments Under Time-and-Materials and Labor-Hour Contracts (FAR Case 2004-015). "This final rule revises and clarifies policies (primarily) related to award and administration of noncommercial item Time-and-Materials (T&M) and Labor-Hour (LH) contracts and the policies regarding payments made under those contracts. The objectives of the changes are to ensure fair and reasonable prices under T&M and LH contracts and to eliminate confusion related to payment amounts for subcontractor provided labor." The rule "specifically states that the Government does not pay profit or fee to the prime contractor on materials (except for commercial items …or as otherwise provided for in FAR 31.205-26)." An extensive discussion of the public comments that were provided in response to the previously notice proposed rule is published.
  - Additional Commercial Contract Types (FAR Case 2003-027). "This final rule implements section 1432 of the National Defense Authorization Act for Fiscal Year 2004 (Services Acquisition Reform Act of 2003—SARA), … to expressly authorize the use of T&M and LH contracts for commercial services under specified conditions." Again, an extensive discussion of the public comments that were provided in response to the previously notice proposed rule is also published.

- On December 12, 2006, the Federal Register noticed a DoD "interim rule (effective on February 12, 2007) amending the DFARS to provide policy for reimbursing labor costs on competitively awarded DoD noncommercial time-and-materials and labor-hour contracts." This rule states that it is a supplement to the FAR coverage on the topic (see above) that was concurrently published as part of FAC 2005-15. Specifically, DoD has designated as "mandatory," for it, the FAR approach (among the so-called three approaches provided in FAR) that requires "separate fixed hourly rates that include profit for each category of labor performed by the contractor and each subcontractor, and for each category of labor transferred between divisions, subsidiaries, or affiliates of the contractor under a common control." Comments are due on/before February 12, 2007.

  COMMENT: The above is also interesting given that revised FAR 16.601(e)(1) provides that the "the contracting officer may amend the provision to make mandatory one of the three approaches in FAR 52.216.29(c)…, and/or to require the identification of all subcontractors, divisions, subsidiaries, or affiliates included in a blended labor rate." Here, DoD is making that determination with no noted deviation from the FAR!

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- On December 14, 2006, the Federal Register noticed a proposed FAR rule "intended to increase the use of performance-based payments (PBPs) as the method of contract financing on Federal Government contracts, and improve the efficiency of performance-based payments when used on these contracts. These proposed changes originated from recommendations submitted by the DoD Performance-based Payments Working Group in their March 8, 2005, report." Proposed changes include
  - To clarify that "events not requiring meaningful effort or action must not be included as events or criteria for PBPs."
  - To specifically state that "all cumulative events be identified."
  - "FAR 32.1004(b)(2)(ii) requires that the contracting officer must document the rationale for establishing a performance-based payment rate that is below the applicable progress payment rate."
  - To "clarify that the contracting officer shall not limit the amount of a PBP payment to a percentage of actual incurred cost for the scheduled event or performance criteria."
  - And, "to clarify that solicitations related to competitive source selections should state that the evaluation of the proposed prices will include an adjustment to reflect the estimated cost to the Government of providing each offeror's proposed PBP terms."

  Comments are due on/before February 12, 2007.

- On December 12, 2006, Assistant Secretary of the Air Force Sue Payton issued a reminder on the use of "Undefinitized Contract Actions."

  COMMENT: Are you accepting letter contracts or letter subcontracts for production items when the price in open? What is the incentive for the Buyer to definitize that letter arrangement in a timely manner and what happens to (final) mark-up as time progresses?

- On December 1, 2006, the Federal Register noticed a final DFARS rule "to update text addressing contract pricing matters and cost accounting standards administration. The rule implements statutory provisions regarding exceptions to cost or pricing data requirements and waiver of cost accounting standards, and relocates internal DoD procedures relating to pricing considerations and cost accounting standards to the DFARS companion resource, PGI." The initially proposed relocation of weighted guidelines profit analysis procedures to the PGI was not implemented!

  COMMENT: Kudos to the one responding industry association for advocating retention in the DFARS of mark-up/profit rules that significantly impact industry and the Government!

- The GAO recently sustained a protest in Kellogg Brown & Root Services, Inc., (21 CGEN ¶112,263, November 16, 2006) since the Contracting Officer had conducted a cost realism analysis that reclassified the treatment of certain costs for the awardee in a manner that deviated from the awardee's accounting practices (including CAS) as well as operating to the detriment of the protestor. Decision available at http://www.gao.gov/decisions/bidpro/298694.pdf

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- On December 6, 2006, Shay Assad, Director of DoD Defense Procurement and Acquisition Policy, issued an exhaustive memorandum on an attached Class Deviation and the planned change to DFARS 252.225-7014 entitled "Preferences for Domestic Specialty Metals." The memorandum covers flow down issues associated with the specialty metals restrictions on sourcing. Further, "in any contract awarded after November 15, 2006, DoD can no longer continue the practice of withholding payment while conditionally accepting noncompliant items in these categories."

  COMMENT: Must reading for those that follow the Berry Amendment! See prior Updates and…how does the Contingency Cost Principle apply in contract negotiation?

- On November 17, 2006, Assistant Secretary of the Navy (Research, Development and Acquisition) Delores Etter issued a memorandum "directing that standardized contract language relating to Software Process Improvement Initiative (SPII) be included in all solicitations that include software development, acquisition or life cycle support issued after 01 Jan 07. Specifically, the language requires Software Development Plans to be procured for all Naval computer software to ensure that the systems have well-documented, standardized software processes as well as CMMI (process improvement model) capability level 3." It is reported that "standardized contract language" is in preparation with implementing guidance.

  COMMENT: Expect to see anything in the Federal Register? Talk to your industry representative.

- On December 6, 2006, Shay Assad, Director of DoD Defense Procurement and Acquisition Policy, also issued an memorandum on designation of the Contracting Officer's Representative (COR) and the associated duties, etc. for same in connection with technical monitoring or administration of a contract. On December 1, 2006, the Federal Register noticed a final DFARS rule "to update text pertaining to the designation of a contracting officer's representative. The rule clarifies the authority of a contracting officer's representative and relocates text to the DFARS companion resource, PGI."

- It is reported that some Government contracting sites are experiencing 20% annual turnover! This should be of concern to all.

- The NDIA Contract Finance Committee members drafted some suggested CAS Disclosure Statement language to "address allocability and allowability of B&P cost due to the Bagley decisions." See prior Updates. Specifically, this suggestion provides, "The Company incurs proposal preparation expenses in connection with teaming agreements, joint venture agreements, and other similar arrangements that do not constitute a final cost objective (i.e. contract) in the Company's accounting system. B&P costs that relate to these arrangements where each party bears its own cost for any proposal efforts will be treated as allowable indirect B&P cost per FAR 31.205-18."

  COMMENT: Is an advance agreement desirable? Talk to counsel.

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- On December 19, 2006, the Federal Register noticed a final DFARS rule "to adjust acquisition-related thresholds for inflation. Section 807 of the National Defense Authorization Act for Fiscal Year 2005 requires periodic adjustment of statutory acquisition-related dollar thresholds, except those established by the Davis-Bacon Act, the Service Contract Act, or trade agreements. This rule also amends other acquisition-related thresholds that are based on policy rather than statute." Noteworthy changes include…
  - The threshold at DFARS 207.170-3 (Consolidation of Contract Requirements) is the only threshold in the final rule that was not addressed in the proposed rule, because the calculated threshold now rounds up to $5.5 million, from $5 million.
  - The threshold in the clause at DFARS 252.232-7009, Mandatory Payment by Governmentwide Commercial Purchase Card, was increased from $2,500 to $3,000 in the proposed rule. The final rule revises this threshold to the micro-purchase threshold, for consistency with the corresponding clause prescription at DFARS 232.1110.

- On December 19, 2006, the Federal Register noticed a final DFARS rule "to clarify requirements for preparation of material inspection and receiving reports under DoD contracts. In addition, the rule relocates text to the PGI."

- On December 19, 2006, the Federal Register noticed a final DFARS rule "to clarify the restriction on the acquisition of foreign carbon, alloy, or armor steel plate."

- Remarks as delivered by Under Secretary of Defense for Acquisition, Technology and Logistics Kenneth J. Krieg to the Contract and Fiscal Law Symposium, Charlottesville, VA, December 7, 2006, have been posted to the web. The remarks covered 7 goals for his senior leadership team…
  - Goal 1 - High Performing, Agile and Ethical Workforce
  - Goal 2 - Strategic and Tactical Acquisition Excellence.
  - Goal 3 - Focused Technology to Meet Warfighting Needs.
  - Goal 4 - Cost-effective Joint Logistics Support for the Warfighter
  - Goal 5 - Reliable and Cost-effective Industrial Capabilities Sufficient to Meet Strategic Objectives.
  - Goal 6 - Improved Governance and Decision Processes.
  - Goal 7 - Capable, Efficient and Cost-Effective Installations.

  His complete remarks are posted at http://www.acq.osd.mil/usd/previous_krieg_speeches/12-13-06%20%20NR-Contract%20and%20Fiscal%20Law%20Symposium.doc

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Comments on items that may be of potential interest in contract negotiation and contract drafting/management—

- The recent 7th Circuit Court opinion in Autotech Technology Limited Partnership (Autotech) v. Automationdirect.com (ADC) et al (No. 05-4544, December 11, 2006) provides an important lesson in having counsel participate in the drafting of co-development/marketing agreements. In the Autotech case the parties entered into two "agreements" in 1999 calling for the joint development, manufacture and eventual sale of products involving commercial touch screen technology. The court noted that "non-lawyer employees at ADC and Autotech drafted both documents; there were no lawyers involved. This usually sets the stage for a lovely lawsuit."

  The parties each contributed funding to the endeavor and the parties were to "mutually agree upon the dispersion of funds." The term "partners" and "marriage" were "peppered through the contract." And, each party could not create any obligation on behalf of the other party. Neither party was prohibited from developing competing products. And the initial term of the agreements was five and a half years with an automatic renewal of 1 year terms in the absence of termination notice.

  Unbeknownst to Autotech, ADC began the development of a purported "similar" product with another company during the performance period of its agreements with Autotech but with sales contemplated after the expiration of those agreements with Autotech. ADC was found to have given "timely notice of nonrenewal (of those agreements) to Autotech."

  Subsequently, Autotech filed, among other things, in district court a request for preliminary injunction seeking to enjoin sale of the "similar" product "claiming breach of fiduciary duties, etc. and asserting that it was a "clone" of that which was the subject of the Autotech/ADR agreements and based upon the use of Autotech proprietary data. The request for injunctive relief was denied by the district court where it found, "there was no partnership or joint venture to support a fiduciary relationship because the parties had no right or ability to create liabilities with third persons" nor was such a relationship "created by special circumstances."

  The Court of Appeal determined, among other things, that a joint venture did not exist "to support a fiduciary relationship." And, while "special circumstances also can give rise to a fiduciary duty" based upon several factors including business experience of the parties, entrusting of business affairs in a "dominant" party, etc. the Court of Appeal found the evidence was "insufficient to establish special circumstances where fiduciary duties are owed" in affirming the lower court conclusions in connection with the denial of the preliminary injunction request.

  COMMENT: Are your development/teaming arrangements subject to the proper level of scrutiny and legal review?

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- Professor Peter Fitzgerald, Stetson University College of Law, has posted an interesting request for individuals to complete an International Contracting Practices Survey in order to

> "assess the familiarity, use, and value of the United Nation's Convention on the International Sale of Goods (CISG) … to practitioners, jurists, and legal academics. …This year marks the twentieth anniversary of the United States' accession to the CISG, and sixty-eight other countries have now ratified or acceded to this treaty – including many of our major trading partners. However, the CISG only appears in forty-six reported cases in the U.S…."

There are a couple of questions addressing ADR. The portal to the survey is at http://www.law.stetson.edu/CISG/

Future Speaking Topics Include—

- Los Angeles/South Bay NCMA Chapter, "Putting the International Business Deal Together—The Latest Benchmarking In International Contracting."
- Inland Empire ISM Affiliate, "Big Changes to UCC Rules on Contract Formation and Terms of the Deal are Around the Corner— Are You Ready?"
- Leadership Forum, NCMA Leadership Conference, Las Vegas, Nevada.
- New Orleans and Huntsville NCMA Chapters, National Educational Seminar, "Performance-Based Acquisition."
- Phoenix NCMA Chapter, "Putting the International Business Deal Together—The Latest Benchmarking In International Contracting."
- "Contract Negotiations," NCMA World Congress NES, Dallas, Texas. Information/registration available at www.ncmahq.org
- ISM International Conference, Las Vegas, "Update on Recent Developments in International Purchasing/Contracting" and "Factors in Drafting/Negotiating a Dispute Resolution Clause with Customers/Suppliers."

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