

DFARS Procedures, Guidance, and Information

PGI 216—Types of Contracts

(Added July 11, 2006)

PGI 216.2—FIXED-PRICE CONTRACTS

PGI 216.203 Fixed-price contracts with economic price adjustment.

PGI 216.203-4 Contract clauses.

For adjustments based on cost indexes of labor or material, use the following guidelines:

(1) Do not make the clause unnecessarily complex.

(2) Normally, the clause should not provide either a ceiling or a floor for adjustment unless adjustment is based on indices below the four digit level of the Bureau of Labor Statistics—

(i) Producer Price Index;

(ii) Employment Cost Index for wages and salaries, benefits, and compensation costs for aerospace industries; or

(iii) Wage and Income Series by Standard Industrial Classification (Labor).

(3) Normally, the clause should cover all potential economic fluctuations within the original contract period of performance.

(4) The clause must accurately identify the index(es) upon which adjustments will be based.

(i) It must provide for a means to adjust for appropriate economic fluctuation in the event publication of the movement of the designated index is discontinued. This might include the substitution of another index if the time remaining would justify doing so and an appropriate index is reasonably available, or some other method for repricing the remaining portion of work to be performed.

(ii) Normally, there should be no need to make an adjustment if computation of the identified index is altered. However, it may be appropriate to provide for adjustment of the economic fluctuation computations in the event there is such a substantial alteration in the method of computing the index that the original intent of the parties is negated.

(iii) When an index to be used is subject to revision (e.g., the Bureau of Labor Statistics Producer Price Indexes), the economic price adjustment clause must specify that any economic price adjustment will be based on a revised index and must identify which revision to the index will be used.

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(5) Construct the index to encompass a large sample of relevant items while still bearing a logical relationship to the type of contract costs being measured. The basis of the index should not be so large and diverse that it is significantly affected by fluctuations not relevant to contract performance, but it must be broad enough to minimize the effect of any single company, including the anticipated contractor(s).

(6) Construction of an index is largely dependent upon three general series published by the U.S. Department of Labor, Bureau of Labor Statistics (BLS). These are the—

- (i) Industrial Commodities portion of the Producer Price Index;
- (ii) Employment Cost Index for wages and salaries, benefits, and compensation costs for aerospace industries; and
- (iii) Wage and Income Series by Standard Industrial Classification (Labor).

Since there is no BLS published series currently available that relates directly to total prices of delivered DoD aircraft, ships, missiles, electronics, etc., it will be necessary to construct composite indices from major portions of the three series identified.

(7) Normally, do not use more than two indices, i.e., one for labor (direct and indirect) and one for material (direct and indirect).

(8) The clause must establish and properly identify a base period comparable to the contract periods for which adjustments are to be made as a reference point for application of an index.

(9) The clause should not provide for an adjustment beyond the original contract performance period, including options. The start date for the adjustment may be the beginning of the contract or a later time, as appropriate, based on the projected rate of expenditures.

(10) The expenditure profile for both labor and material should be based on a predetermined rate of expenditure (expressed as the percentage of material or labor usage as it relates to the total contract price) in lieu of actual cost incurred.

(i) If the clause is to be used in a competitive acquisition, determine the labor and material allocations, with regard to both mix of labor and material and rate of expenditure by percentage, in a manner which will, as nearly as possible, approximate the average expenditure profile of all companies to be solicited so that all companies may compete on an equal basis.

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(ii) If the clause is to be used in a noncompetitive acquisition, the labor and material allocations may be subject to negotiation and agreement.

(iii) For multiyear contracts, establish predetermined expenditure profile tables for each of the annual increments in the multiyear buy. Each of the second and subsequent year tables must be cumulative to reflect the total expenditures for all increments funded through the latest multiyear funding.

(11) The clause should state the percentage of the contract price subject to price adjustment.

(i) Normally, do not apply adjustments to the profit portion of the contract.

(ii) Examine the labor and material portions of the contract to exclude any areas that do not require adjustment. For example, it may be possible to exclude—

(A) Subcontracting for short periods of time during the early life of the contract which could be covered by firm-fixed-priced subcontracting;

(B) Certain areas of overhead, e.g., depreciation charges, prepaid insurance costs, rental costs, leases, certain taxes, and utility charges;

(C) Labor costs for which a definitive union agreement exists; and

(D) Those costs not likely to be affected by fluctuation in the economy.

(iii) Allocate that part of the contract price subject to adjustment to specific periods of time (e.g., quarterly, semiannually, etc.) based on the most probable expenditure or commitment basis (expenditure profile).

(12) The clause should provide for definite times or events that trigger price adjustments. Adjustments should be frequent enough to afford the contractor appropriate economic protection without creating a burdensome administrative effort. The adjustment period should normally range from quarterly to annually.

(13) When the contract contains cost incentives, any sums paid to the contractor on account of economic price adjustment provisions must be subtracted from the total of the contractor's allowable costs for the purpose of establishing the total costs to which the cost incentive provisions apply. If the incentive arrangement is cited in percentage ranges, rather than dollar ranges, above and below target costs, structure the economic price adjustment clause to maintain the original contract incentive range in dollars.

(14) The economic price adjustment clause should provide that once the labor and material allocations and the portion of the contract price subject to price adjustment have

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been established, they remain fixed through the life of the contract and shall not be modified except in the event of significant changes in the scope of the contract. The clause should state that pricing actions pursuant to the Changes clause or other provisions of the contract will be priced as though there were no provisions for economic price adjustment. However, subsequent modifications may include a change to the delivery schedule or significantly change the amount of, or mix of, labor or material for the contract. In such cases, it may be appropriate to prospectively apply economic price adjustment coverage. This may be accomplished by—

(i) Using an economic price adjustment (EPA) clause that applies only to the effort covered by the modification;

(ii) Revising the baseline data or period in the EPA clause for the basic contract to include the new work; or

(iii) Using an entirely new EPA clause for the entire contract, including the new work.

(15) Consistent with the factors in paragraph (1) through (14) of this subsection, it may also be appropriate to provide in the prime contract for similar economic price adjustment arrangements between the prime contractor and affected subcontractors to allocate risks properly and ensure that those subcontractors are provided similar economic protection.

(16) When economic price adjustment clauses are included in contracts that do not require submission of cost or pricing data as provided for in FAR 15.403-1, the contracting officer must obtain adequate information to establish the baseline from which adjustments will be made. The contracting officer may require verification of the data submitted to the extent necessary to permit reliance upon the data as a reasonable baseline.