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

Parent topic: Part 16 - Types of Contracts

16.600 Scope.

Time-and-*materials* contracts and labor-hour contracts are not fixed-price 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(f)(1)).

(ii) For *acquisitions* of other than *commercial products* or *commercial services* 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 service*" 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 or order *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 or order includes a ceiling price that the contractor exceeds at its own risk. Also see 12.207 (b) for further limitations on use of time-and-*materials* or labor-hour contracts for *acquisition* of *commercial products* and *commercial services*.

(e) Post award requirements. Prior to an increase in the ceiling price of a time-and-*materials* or labor-hour contract or order, the *contracting officer shall*-

(1) Conduct an analysis of *pricing* and other relevant factors to determine if the action is in the best interest of the Government;

(2) Document the decision in the contract or order file; and

(3) When making a change that modifies the general scope of-

(i) A contract, follow the procedures at 6.303;

(ii) An order issued under the Federal Supply Schedules, follow the procedures at 8.405-6; or

(iii) An order issued under multiple award task and *delivery order* contracts, follow the procedures at 16.505(b)(2).

(f) *Solicitation provisions*.

(1) The *contracting officer shall* insert the provision at 52.216-29, Time-and-*Materials*/Labor-Hour Proposal Requirements—Other Than Commercial *Acquisition* With Adequate Price Competition, in *solicitations* contemplating use of a time-and-*materials* or labor-hour type of contract for the *acquisition* of other than *commercial products* or *commercial services*, 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—Other Than Commercial *Acquisition* Without Adequate Price Competition, in *solicitations* for the *acquisition* of other than *commercial products* or *commercial services* 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 *Acquisition*, 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 *certified cost or pricing data* and *data other than certified 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 *certified cost or pricing data*, the words "and certified *cost or pricing data* in accordance with FAR 15.408, Table 15-1 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.