Subpart 16.2 - Fixed-Price Contracts

Parent topic: Part 16 - Types of Contracts

16.201 General.

(a) Fixed-price types of contracts provide for a firm price or, in appropriate cases, an adjustable price. Fixed-price contracts providing for an adjustable price *may* include a ceiling price, a target price (including target cost), or both. Unless otherwise specified in the contract, the ceiling price or target price is subject to adjustment only by operation of *contract clauses* providing for equitable adjustment or other revision of the contract price under stated circumstances. The *contracting officer shall* use firm-fixed-price or fixed-price with economic price adjustment contracts when acquiring *commercial products* and *commercial services*, except as provided in 12.207(b).

(b) Time-and-materials contracts and labor-hour contracts are not fixed-price contracts.

16.202 Firm-fixed-price contracts.

16.202-1 Description.

A firm-fixed-price contract provides for a price that is not subject to any adjustment on the basis of the contractor's cost experience in performing the contract. This contract type places upon the contractor maximum risk and full responsibility for all costs and resulting profit or loss. It provides maximum incentive for the contractor to control costs and perform effectively and imposes a minimum administrative burden upon the *contracting* parties. The *contracting officer may* use a firm-fixed-price contract in conjunction with an award-fee incentive (see 16.404) and performance or delivery incentives (see 16.402-2 and 16.402-3) when the award fee or incentive is based solely on factors other than cost. The contract type remains firm-fixed-price when used with these incentives.

16.202-2 Application.

A firm-fixed-price contract is suitable for acquiring *commercial products* or *commercial services* (see parts 2 and 12) or for acquiring other *supplies* or services on the basis of reasonably definite functional or detailed specifications (see part 11) when the *contracting officer* can establish fair and reasonable prices at the outset, such as when-

(a) There is adequate price competition;

(b) There are reasonable price comparisons with prior purchases of the same or similar *supplies* or services made on a competitive basis or supported by valid *certified cost or pricing data*;

(c) Available cost or *pricing* information permits realistic estimates of the probable costs of performance; or

(d) Performance uncertainties can be identified and reasonable estimates of their cost impact can be made, and the contractor is willing to accept a firm fixed price representing assumption of the risks

involved.

16.203 Fixed-price contracts with economic price adjustment.

16.203-1 Description.

(a) A fixed-price contract with economic price adjustment provides for upward and downward revision of the stated contract price upon the occurrence of specified contingencies. Economic price adjustments are of three general types:

(1) *Adjustments based on established prices.* These price adjustments are based on increases or decreases from an agreed-upon level in published or otherwise established prices of specific items or the contract end items.

(2) *Adjustments based on actual costs of labor or material*. These price adjustments are based on increases or decreases in specified costs of labor or material that the contractor actually experiences during contract performance.

(3) *Adjustments based on cost indexes of labor or material*. These price adjustments are based on increases or decreases in labor or material cost standards or indexes that are specifically identified in the contract.

(b) The *contracting officer may* use a fixed-price contract with economic price adjustment in conjunction with an award-fee incentive (see 16.404) and performance or delivery incentives (see 16.402-2 and 16.402-3) when the award fee or incentive is based solely on factors other than cost. The contract type remains fixed-price with economic price adjustment when used with these incentives.

16.203-2 Application.

A fixed-price contract with economic price adjustment *may* be used when (i) there is serious doubt concerning the stability of market or labor conditions that will exist during an extended period of contract performance, and (ii) contingencies that would otherwise be included in the contract price can be identified and covered separately in the contract. Price adjustments based on established prices *should* normally be restricted to industry-wide contingencies. Price adjustments based on labor and material costs *should* be limited to contingencies beyond the contractor’s control. For use of economic price adjustment in sealed bid contracts, see 14.408-4.

(a) In establishing the base level from which adjustment will be made, the *contracting officer shall* ensure that contingency allowances are not duplicated by inclusion in both the base price and the adjustment requested by the contractor under economic price adjustment clause.

(b) In contracts that do not require submission of *certified cost or pricing data*, the *contracting officer shall* obtain adequate data to establish the base level from which adjustment will be made and *may* require verification of data submitted.

16.203-3 Limitations.

A fixed-price contract with economic price adjustment *shall* not be used unless the *contracting officer* determines that it is necessary either to protect the contractor and the Government against significant fluctuations in labor or material costs or to provide for contract price adjustment in the event of changes in the contractor's established prices.

16.203-4 Contract clauses.

(a) Adjustment based on established prices-standard *supplies*.

(1) The *contracting officer shall*, when *contracting* by negotiation, insert the clause at 52.216-2, Economic Price Adjustment-Standard *Supplies*, or an agency-prescribed clause as authorized in paragraph (a)(2) of this subsection, in *solicitations* and contracts when all of the following conditions apply:

(i) A fixed-price contract is contemplated.

(ii) The requirement is for standard *supplies* that have an established catalog or market price.

(iii) The *contracting officer* has made the determination specified in 16.203-3.

(2) If all the conditions in paragraph (a)(1) of this subsection apply and the *contracting officer* determines that the use of the clause at 52.216-2 is inappropriate, the *contracting officer may* use an agency-prescribed clause instead of the clause at 52.216-2.

(3) If the negotiated unit price reflects a net price after applying a trade discount from a catalog or list price, the *contracting officer shall* document in the contract file both the catalog or list price and the discount. (This does not apply to prompt payment or cash discounts.)

(4) The *contracting officer may* modify the clause by increasing the 10 percent limit on aggregate increases specified in 52.216-2(c)(1), upon approval by the chief of the *contracting office*.

(b) Adjustment based on established prices-semistandard *supplies*.

(1) The *contracting officer shall*, when *contracting* by negotiation, insert the clause at 52.216-3, Economic Price Adjustment-Semistandard *Supplies*, or an agency-prescribed clause as authorized in paragraph (b)(2) of this section, in *solicitations* and contracts when all of the following conditions apply:

(i) A fixed-price contract is contemplated.

(ii) The requirement is for semistandard *supplies* for which the prices can be reasonably related to the prices of nearly equivalent standard *supplies* that have an established catalog or market price.

(iii) The *contracting officer* has made the determination specified in 16.203-3.

(2) If all conditions in paragraph (b)(1) of this subsection apply and the *contracting officer* determines that the use of the clause at 52.216-3 is inappropriate, the *contracting officer may* use an

agency-prescribed clause instead of the clause at 52.216-3.

(3) If the negotiated unit price reflects a net price after applying a trade discount from a catalog or list price, the *contracting officer shall* document in the contract file both the catalog or list price and the discount. (This does not apply to prompt payment or cash discounts.)

(4) Before entering into the contract, the *contracting officer* and contractor *must* agree *in writing* on the identity of the standard *supplies* and the corresponding *line items* to which the clause applies.

(5) If the *supplies* are standard, except for preservation, packaging, and packing requirements, the clause prescribed in 16.203-4(a) *shall* be used rather than this clause.

(6) The *contracting officer may* modify the clause by increasing the 10 percent limit on aggregate increases specified in 52.216-3(c)(1), upon approval by the chief of the *contracting office*.

(c) Adjustments based on actual cost of labor or material.

(1) The *contracting officer shall*, when *contracting* by negotiation, insert a clause that is substantially the same as the clause at 52.216-4, Economic Price Adjustment -Labor and Material, or an agency-prescribed clause as authorized in subparagraph (c)(2) of this section, in *solicitations* and contracts when all of the following conditions apply:

(i) A fixed-price contract is contemplated.

(ii) There is no major element of design engineering or development work involved.

(iii) One or more identifiable labor or material cost factors are subject to change.

(iv) The *contracting officer* has made the determination specified in 16.203-3.

(2) If all conditions in paragraph (c)(1) of this section apply and the *contracting officer* determines that the use of the clause at 52.216-4 is inappropriate, the *contracting officer may* use an agency-prescribed clause instead of the clause at 52.216-4.

(3) The *contracting officer shall* describe in detail in the contract Schedule-

(i) The types of labor and materials subject to adjustment under the clause;

(ii) The labor rates, including fringe benefits (if any) and unit prices of materials that *may* be increased or decreased; and

(iii) The quantities of the specified labor and materials allocable to each unit to be delivered under the contract.

(4) In negotiating adjustments under the clause, the *contracting officer shall*-

(i) Consider work in process and materials on hand at the time of changes in labor rates, including fringe benefits (if any) or material prices;

(ii) Not include in adjustments any *indirect cost* (except fringe benefits as defined in 31.205-6(m)) or profit; and

(iii) Consider only those fringe benefits specified in the contract Schedule.

(5) The *contracting officer may* modify the clause by increasing the 10 percent limit on aggregate increases specified in 52.216-4(c)(4), upon approval by the chief of the *contracting office*.

(d) *Adjustments based on cost indexes of labor or material*. The *contracting officer should* consider using an economic price adjustment clause based on cost indexes of labor or material under the circumstances and subject to approval as described in paragraphs (d)(1) and (d)(2) of this section.

(1) A clause providing adjustment based on cost indexes of labor or materials *may* be appropriate when-

(i) The contract involves an extended period of performance with significant costs to be incurred beyond 1 year after performance begins;

(ii) The contract amount subject to adjustment is substantial; and

(iii) The economic variables for labor and materials are too unstable to permit a reasonable division of risk between the Government and the contractor, without this type of clause.

(2) Any clause using this method *shall* be prepared and approved under agency procedures. Because of the variations in circumstances and clause wording that *may* arise, no standard clause is prescribed.

16.204 Fixed-price incentive contracts.

A fixed-price incentive contract is a fixed-price contract that provides for adjusting profit and establishing the final contract price by a formula based on the relationship of final negotiated total cost to total target cost. Fixed-price incentive contracts are covered in subpart 16.4, Incentive Contracts. See 16.403 for more complete descriptions, application, and limitations for these contracts. Prescribed clauses are found at 16.406.

16.205 Fixed-price contracts with prospective price redetermination.

16.205-1 Description.

A fixed-price contract with prospective price redetermination provides for-

(a) A firm fixed price for an initial period of contract deliveries or performance; and

(b) Prospective redetermination, at a stated time or times during performance, of the price for subsequent periods of performance.

16.205-2 Application.

A fixed-price contract with prospective price redetermination *may* be used in *acquisitions* of quantity production or services for which it is possible to negotiate a fair and reasonable firm fixed price for

an initial period, but not for subsequent periods of contract performance.

(a) The initial period *should* be the longest period for which it is possible to negotiate a fair and reasonable firm fixed price. Each subsequent *pricing* period *should* be at least 12 months.

(b) The contract *may* provide for a ceiling price based on evaluation of the uncertainties involved in performance and their possible cost impact. This ceiling price *should* provide for assumption of a reasonable proportion of the risk by the contractor and, once established, *may* be adjusted only by operation of *contract clauses* providing for equitable adjustment or other revision of the contract price under stated circumstances.

16.205-3 Limitations.

This contract type *shall* not be used unless-

(a) Negotiations have established that-

(1) The conditions for use of a firm-fixed-price contract are not present (see 16.202-2); and

(2) A fixed-price incentive contract would not be more appropriate;

(b) The contractor's accounting system is adequate for price redetermination;

(c) The prospective *pricing* periods can be made to conform with operation of the contractor's accounting system; and

(d) There is reasonable assurance that price redetermination actions will take place promptly at the specified times.

16.205-4 Contract clause.

The *contracting officer shall*, when *contracting* by negotiation, insert the clause at 52.216-5, Price Redetermination-Prospective, in *solicitations* and contracts when a fixed-price contract is contemplated and the conditions specified in 16.205-2 and 16.205-3(a) through (d) apply.

16.206 Fixed-ceiling-price contracts with retroactive price redetermination.

16.206-1 Description.

A fixed-ceiling-price contract with retroactive price redetermination provides for-

(a) A fixed ceiling price; and

(b) Retroactive price redetermination within the ceiling after completion of the contract.

16.206-2 Application.

A fixed-ceiling-price contract with retroactive price redetermination is appropriate for research and development contracts estimated at the *simplified acquisition threshold* or less when it is established at the outset that a fair and reasonable firm fixed price cannot be negotiated and that the amount involved and short performance period make the use of any other fixed-price contract type impracticable.

(a) A ceiling price *shall* be negotiated for the contract at a level that reflects a reasonable sharing of risk by the contractor. The established ceiling price *may* be adjusted only if required by the operation of *contract clauses* providing for equitable adjustment or other revision of the contract price under stated circumstances.

(b) The contract *should* be awarded only after negotiation of a billing price that is as fair and reasonable as the circumstances permit.

(c) Since this contract type provides the contractor no cost control incentive except the ceiling price, the *contracting officer should* make clear to the contractor during discussion before award that the contractor's management effectiveness and ingenuity will be considered in retroactively redetermining the price.

16.206-3 Limitations.

This contract type *shall* not be used unless-

(a) The contract is for research and development and the estimated cost is the *simplified acquisition threshold* or less;

(b) The contractor's accounting system is adequate for price redetermination;

(c) There is reasonable assurance that the price redetermination will take place promptly at the specified time; and

(d) The *head of the contracting activity* (or a higher-level official, if required by agency procedures) approves its use *in writing*.

16.206-4 Contract clause.

The *contracting officer shall*, when *contracting* by negotiation, insert the clause at 52.216-6, Price Redetermination-Retroactive, in *solicitations* and contracts when a fixed-price contract is contemplated and the conditions in 16.206-2 and 16.206-3(a) through (d) apply.

16.207 Firm-fixed-price, level-of-effort term contracts.

16.207-1 Description.

A firm-fixed-price, level-of-effort term contract requires-

(a) The contractor to provide a specified level of effort, over a stated period of time, on work that can be stated only in general terms; and

(b) The Government to pay the contractor a fixed dollar amount.

16.207-2 Application.

A firm-fixed-price, level-of-effort term contract is suitable for investigation or study in a specific research and development area. The product of the contract is usually a report showing the results achieved through application of the required level of effort. However, payment is based on the effort expended rather than on the results achieved.

16.207-3 Limitations.

This contract type *may* be used only when-

(a) The work required cannot otherwise be clearly defined;

(b) The required level of effort is identified and agreed upon in advance;

(c) There is reasonable assurance that the intended result cannot be achieved by expending less than the stipulated effort; and

(d) The contract price is the *simplified acquisition threshold* or less, unless approved by the chief of the *contracting office*.