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December 5, 2005

VIA ELECTRONIC MAIL AND FACSIMILE

General Services Administration
Regulatory Secretariat (VIR)
1800 F Street, NW
Room 4035
Washington, DC 20405
Attn: Ms. Laurieann Duarte

**Re: Federal Acquisition Regulation; Payments Under Time-and-Materials
and Labor-Hour Contracts, Proposed Rule, 70 Fed. Reg. 56314 (Sept. 26,
2005). FAR Case 2004-015**

Dear Ms. Duarte:

On behalf of the Section of Public Contract Law of the American Bar Association ("the Section"), I am submitting comments on the above-referenced Proposed Rule. The Section consists of attorneys and associated professionals in private practice, industry, and government service. The Section's governing Council and substantive committees have members representing these three segments to ensure that all points of view are considered. By presenting their consensus view, the Section seeks to improve the process of public contracting for needed supplies, services, and public works.

The Section is authorized to submit comments on acquisition regulations under special authority granted by the ABA's Board of Governors. The views expressed herein have not been approved by the House of Delegates or the Board of Governors of the American Bar Association and, therefore, should not be construed as representing the policy of the American Bar Association.¹

¹ This letter is available in pdf format at <http://www.abanet.org/contract/Federal/regsgcomm/home.html> under the topic "Cost Allowability and Cost Accounting."

By Federal Register notice published on Monday, September 26, 2005 (70 Fed. Reg. 56314) the Civilian Agency Acquisition Council and the Defense Acquisition Regulations Council (“Councils”) requested comments on a Proposed Rule to revise the language at FAR 16.601(a) and FAR clause at 52.232–7 to provide a description of “materials” as used in “time-and-materials contract.” The term “materials” would include direct materials, subcontracts for supplies and services, other direct costs, and applicable indirect costs. The Councils are also proposing to revise “paragraph (b)(8) of the FAR clause at 52.232–7 to specifically state that the Government does not pay profit or fee to the prime contractor on materials (except for commercial items discussed in [Background] Item 4 ... or as otherwise provided for in FAR 31.205–26).” 70 Fed. Reg. 56315. The recovery of profit or fee is to be accomplished as part of the labor hour portion of the time-and-materials/labor hour (“T&M/LH”) contract.

Lastly, for services performed by employees of subcontractors, the Councils are proposing to amend the policies to provide the contracting parties two possible approaches that would be used depending on the contracting officer’s determination of circumstances applicable to an individual procurement. The first approach includes coverage in the clause at FAR 52.232-7 applicable to subcontractors providing services compliant with the labor hour requirements of a T&M or LH contract. Under this approach, payment of subcontract costs would be at the contract fixed labor rate under the contract requirements applicable to the labor hour portion of the contract only if a subcontractor is listed in the payment clause. The contracting officer can select the second available approach by inserting “none” in the clause, which would provide that any other labor provided by a subcontractor would be paid at actual cost (plus applicable indirect costs). The following discussion provides the Section’s comments on selected aspects of the Proposed Rule.

1. Definition of materials expanded to include subcontracted services.

The current description does not address subcontract costs; even though such costs are often a significant part of the work performed and are provided for under the payments clause at FAR 52.232-7. Also, the description does not address other direct costs and applicable indirect costs other than material handling (*e.g.*, general and administrative expenses) that may be appropriate for the acquisition. Thus, the Councils are proposing to revise “materials at cost” to include “direct materials, subcontracts for supplies and services, other direct costs, and applicable indirect costs.” The current language has caused significant confusion because it does not adequately describe what is included in “materials.” The new description will add more certainty to the proposal process and will eliminate significant issues arising in the audit process.

2. Disallowance of profit on “material” (which now includes subcontracted services) and CO authority to approve subcontracted effort.

The Councils are proposing to revise paragraph (b)(8) of the clause at FAR 52.232-7 to specifically state that the Government does not pay profit or fee to the prime contractor on materials (except for commercial items discussed in Background Item 4 of the notice or as otherwise provided for in FAR 31.205-26). The Councils believe this is consistent with the historical intent of the clause and the concept of a T&M contract. The recovery of profit or fee is accomplished as part of the labor hour portion of the T&M/LH contract.

A positive step in the Proposed Rule is formally allowing the opportunity for the Contracting Officer (“CO”) to identify subcontractors that may bill at the fixed labor hour rates in the contract depending on the circumstances applicable to an individual procurement. This clearly will allow the prime to obtain a profit on creating a team with superior qualifications and diversity.

Further guidance should be added to the proposed rule suggesting expanded circumstances where the CO should allow subcontractors to be billed at the fixed labor rates. Such circumstances should include those when the prime contractor’s proposal includes subcontracted services in order to meet the requirements of the RFP, teaming relationships with subcontractors offer the Government the best overall solution, or when the procurement lends itself to subcontracting opportunities for small and disadvantaged businesses. In addition, changes adding subcontractors during the course of performance should be allowed as long as the quality of services would not be reduced and the proposed labor hour rates are within the existing contract rate structure or the rate can be determined to be fair and reasonable based on price analysis.

One objective of federal government policy has been to encourage small and small-disadvantaged contracting. Small and small-disadvantaged businesses rely heavily upon subcontracting to prime contractors particularly under T&M contracts. If prime contractors may not bill at a rate that allows them to make an adequate profit, they are motivated towards performing all the work themselves. This could hurt small businesses and may not result in the best technical solution for the Government. Likewise, when responding to RFPs for IDIQ type T&M procurements, prime contractors must often establish a large team of both large and small business subcontractors to meet the varied requirements of the RFP. If businesses are not allowed to make a profit on the subcontracts, then competition will be reduced and the Government may neither get competition nor the best technical solution.

When the CO allows subcontractors to bill at the fixed hourly rate, the prime continues to assume the risk of subcontractor labor rate changes based on the fixed price nature of the labor hour rate. The Government is assured a fair and reasonable price based on the competitive nature of the procurement or through price analysis of the labor hour rate. Subcontracted services treated as materials without fee, if performed on a cost reimbursement basis, would likely shift the risk of labor escalation to the Government.

The Section appreciates the opportunity to provide these comments and is available to provide additional information or assistance as you may require.

Sincerely,

A handwritten signature in black ink, appearing to read "Robert L. Schaefer", with a stylized flourish at the end.

Robert L. Schaefer
Chair

cc: Michael A. Hordell
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Michael W. Mutek
Carol N. Park-Conroy
Patricia H. Wittie
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