

# Chapter 3 – Contracting and Contract Administration

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## **References**

- (a) Federal Acquisition Regulation (FAR)
- (b) NAVSEA Contracts Handbook (NCH)
- (c) NAVSEAINST 4200.17E, Contracting Officer's Representative
- (d) Defense Federal Acquisition Regulation Supplement (DFARS)
- (e) Navy Marine Corp Acquisition Regulation Supplement (NMCARS)
- (f) 31 U.S. Code 1535, Agency Agreements
- (g) SECNAVINST 4380.8C, Implementation of the DoN Small and Disadvantaged Business Utilization (SADBU) Program
- (h) NAVSEAINST 5400.60A, On-Site Program Manager Representatives (PMR)
- (i) DoD Directive 5000.01, The Defense Acquisition System
- (j) Federal Acquisition Streamlining Act (FASA) of 1994
- (k) Budget and Accounting Act of 1921
- (l) NAVSEAINST 5400.1F, NAVSEA Headquarters Organizational Manual

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## Chapter 3 – Contracting and Contract Administration

### 3.1 Introduction

This chapter provides background on the Federal acquisition process and an overview of contract procurement, administration, and contract-related functions performed as a part of the SUPSHIP mission. ***Although it addresses the responsibilities, procedures, and functions largely performed within the Contracts Department, it is not intended as guidance for Contracts personnel***, but rather as a basic contracting guide for non-contracts personnel. Major topics addressed in this chapter include:

- SUPSHIP Responsibilities
- Contracting Officer Authority and Responsibilities
- Overview of the Federal Acquisition Process
- Contract and Budget Authority
- Contracts and Agreements
- Overview of Contract Procurement Methods
- Contract Administration
- Processing Contractual Actions
- Subcontracts
- Contract Claims
- Contract Terminations
- Insurance

### 3.2 SUPSHIP Responsibilities

#### 3.2.1 Contract Administration Services (CAS)

Managing and administering contracts lie at the heart of the SUPSHIP Mission (SOM section 1.1.2). Virtually all work performed by a SUPSHIP, regardless of department, is either directly or indirectly involved with these contracting functions. Within the scope of the SUPSHIP mission, work is often classified as being CAS (Contract Administration Services) or non-CAS in nature. Contract Administration Services are defined in reference (a), Federal Acquisition Regulation (FAR), [Part 42.302](#), which includes a list of eighty-one specific functions. For SUPSHIPS, the more significant CAS responsibilities include:

- negotiating Forward Pricing Rate Agreements (FPRA)
- determining the contractor's compliance with Cost Accounting Standards
- reviewing and approving the contractor's requests for payment
- ensuring timely notification by the contractor of any anticipated cost overruns or underruns
- performing property administration
- performing production support, surveillance, and status reporting, including timely reporting of potential and actual slippage in contract delivery schedules
- monitoring contractor industrial labor relations matters under the contract
- ensuring contractor compliance with contractual quality assurance requirements
- ensuring contractor compliance with contractual safety requirements
- performing surveillance, evaluation, and analysis of contractor engineering efforts, including:
  - compliance with contractual terms for schedule, cost, and technical performance
  - contractor engineering efforts and management systems that relate to design, development, production, engineering changes, subcontractors, tests, management of engineering resources, reliability and maintainability, data control systems, configuration management, and independent research and development
  - engineering analyses of contractor cost proposals
  - engineering change proposals
  - contractor requests for waivers and deviations
  - contractor's Value Engineering program
- reviewing, approving/disapproving, and monitoring the contractor's purchasing system
- consenting to subcontracts
- accomplishing administrative contract closeout procedures

- supporting the program, product, and project offices regarding program reviews, program status, program performance, and actual or anticipated program problems
- monitoring the contractor's environmental practices
- issuing change orders and negotiating and executing supplemental agreements
- preparing evaluations of contractor performance

### **3.2.1.1 Other DoD CAS Responsibilities**

In order to provide consistent and uniform contract administration functions for each contractor, DoD has established the [Federal Directory of Contract Administration Services \(CAS\) Components](#) for those engaged in the performance of contract administration services, and identifies the geographic area or specific contractor plant for which they are assigned CAS responsibilities. This directory is mandatory for use by all DoD components and is available for use by non-DoD organizations requiring the performance of CAS.

Although the majority of CAS Components in the directory are Defense Contract Management Agency (DCMA) activities, SUPSHIPS are assigned CAS responsibilities for all major shipbuilders. Unless otherwise restricted to ship construction or ship repair contracts in the CAS Directory, SUPSHIPS may also be responsible for performing CAS functions for other DoD contracts awarded to the contractors under their cognizance, whether those contracts are procured by the Navy or some other DoD component.

In some cases, a DCMA component rather than SUPSHIP is assigned CAS responsibilities for a shipbuilder. This can occur with smaller shipyards located outside the geographic area of a SUPSHIP. When Navy shipbuilding contracts are awarded to one of these shipyards, DCMA may, at NAVSEA's request, reassign some or all CAS responsibilities to a SUPSHIP for oversight of that contract.

### **3.2.2 Non-CAS Responsibilities**

Non-CAS contracting functions include contract planning and procurement, contract termination, and other contracting functions not identified in [FAR 42.302](#). Although SUPSHIPS do not typically perform Procuring Contracting Officer (PCO) functions for new construction contracts, they may be tasked with assisting NAVSEA in the planning and procurement of these contracts. Additionally, SUPSHIP Contracting Officers, within the limits of their contracting warrant, are authorized to procure contracts for NAVSEA, Fleet, and other customers, as well as to procure service contracts in support of the command mission.

## **3.3 Contracting Officer Authority and Responsibilities**

The Federal Government conducts activities through employees with varying degrees of authority and responsibility. For contract administration purposes, this work is accomplished

through Contracting Officers assisted by Project Managers, Engineers, QA Specialists, Environmental Safety & Health specialists, and other SUPSHIP personnel.

Problems frequently arise when employees, other than a contracting officer, attempt to bind the Government in regards to a contract. The most common problems involve situations where the Government refuses payment of claims because the contractor dealt with an unauthorized agent or where the Government seeks to revoke or countermand action taken by its employees or agents.

### 3.3.1.1 Authorized Officials

The term “contracting officer” refers to people who have met the prerequisites and formal training requirements mandated by the Defense Acquisition Workforce Improvement Act (DAWIA) and who have been granted the authority to contractually bind the Government. Other titles and positions for contracting officers include:

- “Head of Contracting Activity (HCA)” is the official who has overall responsibility for managing the contracting activities. For NAVSEA and its field activities, the Commander, Naval Sea Systems Command is the HCA.
- “Chief of the Contracting Office (CCO)” is the supervisory official who is directly responsible for supervising, managing, and directing a contracting office.
- “Contracting Officer” is defined as a person with the authority to enter into, administer, and/or terminate contracts and make related determinations and findings. The term includes certain authorized representatives of the Contracting Officer acting within the limits of their authority as delegated by the Contracting Officer.
- “Procuring Contracting Officer (PCO)” refers to a contracting officer who normally establishes a contract for supplies or services. Note that FAR makes only a single reference to “procuring contracting officer” instead choosing to simply use the term “contracting officer” to identify the individual performing contract procurement functions.
- “Administrative Contracting Officer (ACO)” refers to a contracting officer who administers a contract.
- “Termination Contracting Officer” refers to a contracting officer who is responsible for negotiating any settlement for a terminated contract.

For Contracting Officers below the level of the Head of Contracting Activity (HCA), [FAR 1.603](#) establishes the basic requirements for the selection, appointment, and termination of Contracting Officer authority. NAVSEA 02 employs a Certificate of Appointment for designating individuals as Contracting Officers. These certificates state any limitation on the scope of authority to be exercised, other than those limitations contained in applicable laws or regulations. Additionally, agencies sometimes impose limitations on the authority of their

Contracting Officers by prescribing procedures that must be followed in order for the Contracting Officer's action to be binding on the Government.

- a. Commander, Naval Sea Systems Command is the HCA for the Naval Sea Systems Command and its subordinate commands and activities.
- b. In accordance with reference (b), the NAVSEA Contracts Handbook (NCH) 1.601, certain HCA authorities have been delegated to selected offices, primarily NAVSEA 02, NAVSEA 02B, and the Chiefs of the Contracting Office (CCO) of the Field Procurement Offices (FPO). For the NAVSEA Warfare Centers, SUPSHIPs, and Regional Maintenance Centers (RMCs), contracting authority is delegated in writing through NAVSEA 02.

### **3.3.1.2 Procuring Contracting Officer / Administrative Contracting Officer Relationship**

NAVSEA's Contracting Officers are responsible for the solicitation, negotiation, award, and administration of all necessary contracting actions and determinations for effective contracting and ensuring compliance with terms of the contract, safeguarding the interest of the United States in its contractual relationships. In performance of this task, procuring contracting officers delegate in writing contract administration or specialized support services to cognizant Contract Administration Office (CAO) for administration. The delegation has specific elements contained in ([FAR 42.202](#)), but inherent to these elements is the necessity to establish and maintain robust, open and frequent dialogue between PCO and ACO. Because both PCO and ACO retain warrant authority over contract, both must be aware of others' actions that materially affect the performance of the contract. It is critical that ACO and PCO remain engaged in each other's actions and anticipate upstream or downstream effects on contracts.

### **3.3.1.3 Contracting Officer's Representatives (CORs)**

A Contracting Officer's Representative (COR) is a technically qualified, properly- trained individual nominated by the requiring activity and appointed in writing by the Procuring Contracting Officer (PCO) to serve as liaison between the Government and a contractor for the technical aspects of a specific contract or order. Personnel assigned as CORs may include auditors, lawyers, engineers, shipbuilding specialist/production controllers, QA specialists, and other technical personnel. CORs monitor the contractor's performance, serve as the focal point for the resolution of technical issues, and provide technical and administrative support to the Contracting Officer. Individuals authorized to be a COR have a much narrower scope of authority than the person specifically designated as a Contracting Officer. Procurement regulations limit the authority of CORs. CORs have no authority to make any commitments or changes that affect price, quality, delivery, or other items and conditions of the contract (see [DFARS 201.602-2\(2\)](#)). NCH 1.602-2 and [NAVSEAINST 4200.17E\\*\\*](#) (Contracting Officer's Representative), reference (c),) provides specific guidance regarding COR duties, responsibilities, limitations, and relationship to the Contracting Officer.

\*\* Denotes secure hyperlink requiring NMCI/CAC access

### 3.3.1.4 Typical Contracting Officer's Representative (COR) Duties at SUPSHIP

CORs are responsible for the technical aspects of the contract. At SUPSHIPS, this may include preparing and reviewing contract work statements, delivery requirements and specifications, clarifying technical requirements, preparing independent estimates, providing technical liaison with the contractor, and monitoring contractor performance. In performing these functions, a COR must:

- a. ensure that the contract does not become a personal service contract
- b. ensure that constructive changes do not occur
- c. control, formalize, and issue technical direction that does not individually or collectively constitute an action that should be handled under the "Changes" clause or otherwise not within the scope of the contract
- d. ensure necessary file documentation
- e. monitor contractor performance regarding cost, quality, and delivery
- f. communicate with the Contracting Officer
- g. ensure that the work being required is within the scope of the Statement of Work for the terms and conditions of the contract
- h. certify contractor invoices
- i. provide reports associated with the task order
- j. maintain the Significant Events log
- k. provide a past performance information survey at completion of contract evaluation
- l. when tasked, submit CPARS information

### 3.3.1.5 Actual Authority Required

One of the concerns regarding CORs is that contractors may not understand the process necessary to create an "authorized representative". It is the ACO's responsibility to clearly articulate the authority of individuals participating in the contract administration process. NAVSEA requires that proper training be completed prior to formally designating employees as CORs. There are other Government representatives who interface directly with contractors in the normal course of their duties but who are not designated as having any formal status (e.g., where technical evaluation, testing, quality control, inspections, etc., are performed by individuals other than those specifically designated as CORs).

Government personnel must avoid all acts that could lead the contractor to conclude that a "constructive change" has been given, even though the individual has no contractual authority to do so. The ACO must clearly state to the contractor's representatives that, with the exception of assigned Contracting Officers, no Government personnel, and specifically the COR and ship's force, are authorized in any manner to supervise the contractor's personnel in the performance of the terms and conditions of the contract. This action is essential because in certain cases of contractor claims, the courts and boards tend to look more at the actual functions that such personnel perform than at their formal status. When they are given contract-related functions as part of their official duties, they may well be treated by the courts as authorized representatives with "implied authority" even though they are not authorized to act in a formal capacity to obligate the Government in accordance with their action.

Recognizing the importance of effective Government control over the conduct of its agent, the boards and courts have frequently stated the rule that the Government is not bound by the unauthorized acts of its agents, even though they are acting with "apparent authority."

It is important to recognize that the actual authority rule does not apply to contractors (i.e., contractors are governed by the usual rules of apparent authority). This means that a contractor shall normally be bound by acts of its employees with apparent authority, even though these employees may lack actual authority.

#### **3.3.1.6 Implied Authority**

While "apparent authority" shall not be sufficient to hold the Government bound by the acts of its agents, the boards and courts have frequently granted contractors relief on the basis of "implied authority" when such authority is considered to be an integral part of the duties assigned to a Government employee. Most of the litigated cases involving implied authority arise where Government technical personnel, lacking authority to order changes, issue interpretations or give instructions which induce the contractor to perform work beyond actual contract requirements. In such cases, the boards and courts frequently hold the Government to a "constructive change" when it is found that the Government has acted to change the contract without actually going through the "Changes" clause formalities.

#### **3.3.1.7 Contracting Officer/COR Relationship**

Successful contract performance depends heavily on the Contracting Officer and COR relationship. This relationship should be a harmonious and close partnership, where the expertise of each is best utilized, consistent with their inherent responsibilities. The authority, responsibility, and duties of the COR shall be clearly defined by the Contracting Officer, understood by the COR, and discussed in detail with the contractor. The duties of the assigned COR are to be included in the contract where feasible, but at a minimum should be detailed in writing by the Contracting Officer, with the original provided to the COR and a copy to the contractor and contract files. Since the COR functions not just as an official representative of the Government, but also as the "eyes and ears" of the Contracting Officer, the COR must essentially interface directly with the Contracting Officer.

## **3.4 Overview of the Federal Acquisition Process**

### **3.4.1 Procurement from Private or Government Sources**

The authority of an agency to use contractual agreements to carry out authorized programs is generally assumed in the absence of express statutory prohibitions or limitations. In some instances, it may be more efficient and economical for an agency to use its own employees, while in others it may requisition its needs from another agency better suited to provide the needed services or products.

Executive agencies have traditionally enjoyed broad discretion to achieve their objectives using Government employees or by contract with the private sector. Because of concerns that Government competition with private enterprise is inappropriate, the executive branch has an express policy that the Government should rely on the private sector to the greatest extent possible.

### **3.4.2 Contracting Techniques**

Executive agencies generally have wide latitude in selecting the methods for awarding contracts, as well as the terms and conditions to be included. The contracting parties must be aware of the large number of statutes and regulations giving specific guidance on the techniques to be followed in entering into most Government contracts. Contracting Officers are expected to adhere to such statutes and regulations and, in most instances, the validity of contracts can be affected if they are not followed.

### **3.4.3 General Procurement Statutes**

### **3.4.4 Procurement Regulations**

Congress has enacted two principal statutes establishing procedures for awarding Government contracts; the Armed Services Procurement Act of 1947 and the Federal Property and Administrative Services Act of 1949. These two acts have governed the federal procurement process. They were revised by the Competition in Contracting Act of 1984, the Small Business and Federal Procurement Competition Enhancement Act of 1984, and the Defense Procurement Reform Act of 1984, among other Acts. The Armed Services Procurement Act applied to purchases of the Army, Navy, Marine Corps, Air Force, Coast Guard, and the National Aeronautics and Space Administration. The Federal Property and Administrative Services Act applied to purchases of the General Services Administration and other executive agencies except those covered by the Armed Services Procurement Act.

Regulations issued by the various executive agencies contain detailed guidance as to both procedures for award, and terms and conditions of contracts. The Federal Acquisition Regulations (FAR) replaced the Federal Procurement Regulation, the Defense Acquisition Regulation, and the National Aeronautics and Space Administration Procurement Regulation. The chief goal of the FAR is to bring greater simplification and uniformity to the complex body of federal procurement regulations.

While the policy concerning Government contracts is formulated and implemented largely within the executive agencies that enter into these contracts, such policy is also directly affected by pronouncements issued by the President, the Office of Management and Budget (OMB - <http://www.whitehouse.gov/omb/>), and within OMB, the Office of Federal Procurement Policy (OFPP - <http://www.whitehouse.gov/omb/procurement/index.html>). The President issues executive orders that authorize and require executive agencies to use contract clauses that implement various social and economic programs. OMB periodically issues circulars that embody executive policy and have a status in the hierarchy of executive regulations above the procurement regulations promulgated by the agencies. The OFPP was created to provide overall direction to federal procurement policy with the responsibility for formulating and implementing a uniform federal procurement system that consists of a single FAR and agency regulations limited to those necessary to implement or supplement the FAR.

The procurement regulations and directives of major interest to contractual and technical personnel of the field office are briefly described below. Specific regulations, directives, and other procurement publications are also referenced throughout the text.

#### **3.4.4.1 Federal Acquisition Regulation (FAR)**

[FAR](#) is the primary regulation for use by all Federal Executive agencies in their acquisition of supplies and services. FAR precludes agency acquisition regulations that unnecessarily repeat, paraphrase, or otherwise restate the FAR and limits agency acquisition regulations to those necessary to implement FAR policies and procedures within an agency. FAR provides for coordination, simplicity, and uniformity in the Federal acquisition process.

#### **3.4.4.2 Department of Defense Federal Acquisition Regulation Supplement (DFARS)**

Reference (d), [Defense Federal Acquisition Regulation Supplement \(DFARS\)](#), is issued by the Secretary of Defense and establishes uniform policies and procedures that implement and supplement the FAR for Department of Defense (DoD). The DFARS contains guidance and direction pertaining to the provisions, clauses, cost principles, and cost accounting standards authorized for DoD contracts and other procedures and actions that must be followed in awarding and administering DoD contracts. The DFARS contains material that implements the FAR, as well as supplementary material that is unique to DoD. This supplement is not a stand-alone document and must be read in conjunction with the FAR. In addition to the DFARS hyperlink provided above, change notices can be accessed at the Defense Acquisition Regulations System (DARS) Directorate's [DFARS Changes](#) page.

##### **3.4.4.2.1 DFARS Procedures, Guidance, and Information (PGI)**

The DFARS Procedures, Guidance, and Information ([DFARS PGI](#)) is a companion resource to DFARS containing mandatory and non-mandatory internal DoD procedures. It is a web-based tool created to simplify and rapidly access guidance and information relevant to FAR and DFARS topics. DFARS remains the source for regulations, which include the implementation of statutes and DoD-wide contracting policies, authorities, and delegations. The PGI contains both mandatory and non-mandatory internal DoD procedures, guidance,

and supplemental information. Mandatory procedures must be followed by all contracting personnel, while non-mandatory procedures are subject to the discretion of the Contracting Officer based on the acquisition situation. PGI is managed and approved by the Defense Acquisition Review (DAR) Council and, unlike FAR and DFAR, is not subject to public comments or OMB review and is not published in the Federal Register or Code of Federal Regulations. Like the DFARS, PGI updates are available at the [DFARS Changes](#) page.

#### **3.4.4.3 Navy Marine Corp Acquisition Regulation Supplement**

Reference (e), the [Navy Marine Corp Acquisition Regulation Supplement \(NMCARS\)](#), implements and supplements the FAR and the DFARS and establishes uniform policies and procedures for the acquisition of supplies and services for the Department of the Navy. The NMCARS is not a stand-alone document and must be read in conjunction with the FAR and DFARS.

#### **3.4.4.4 NAVSEA Contracts Handbook**

The NAVSEA Contracts Handbook (NCH) provides general guidance to NAVSEA contracting officers in the execution of their delegated authority. It is not a stand-alone document; it is authorized by [DFARS 201.304](#) and must be read together with FAR, DFAR and NMCARS regulations. The NCH applies to NAVSEA Headquarters, Program Executive Officers, SUPSHIPS, and other NAVSEA field organizations. Because Commander, Naval Sea Systems Command (COMNAVSEASYS COM) serves as the Head of Contracting Activity (HCA) for the Regional Maintenance Centers (RMCs), the NCH also applies to these Fleet commands. In the event of a conflict, the FAR, DFARS, or NMCARS take precedence over the NCH. Additionally, the NCH takes precedence over the guidance provided in this manual as well as local instructions prepared by the SUPSHIPS and other field activities. NAVSEA 021 maintains the NCH and issues changes as required. Requests for deviations from the NCH must be submitted to NAVSEA 02B via NAVSEA 021.

#### **3.4.4.5 Other Navy Publications**

Although the NMCARS is the basic procurement publication issued at the Navy departmental level, procedures are further refined in directives, instructions, notices, and other publications issued by direction of the Secretary of the Navy. Distribution of these publications may differ from the distribution of the NMCARS because of security considerations and other reasons. Accordingly, they are generally not made available to organizations outside the Government.

#### **3.4.4.6 Command Publications**

Subject to the provisions of FAR Part [1.3](#) and [1.4](#), procuring activities may issue procurement and related directives, instructions, and other publications to implement and supplement DFARS, NMCARS, and other departmental publications. Each Command issues directives, instructions, notices, and other publications that are necessary for the efficient performance of procurement operations.

#### **3.4.4.7 Field Instructions and Notices**

Each SUPSHIP is authorized to issue instructions and notices pertaining to contracting procedures that govern the internal operations of the office. Instructions may be issued to establish or explain organization, policy, and procedures affecting more than one department of the SUPSHIP office and may remain in effect up to seven years. Notices may be issued to provide information of temporary interest and application to more than one department of the office. Each notice shall state its period of effectiveness up to a period of one year.

#### **3.4.4.8 Waiver of Regulations and Directives**

FAR [1.4](#) provides policy for submitting requests for deviation from the FAR. SUPSHIP personnel are encouraged to identify any regulation, directive, policy, or procedure that can be modified, waived, or eliminated in improving or streamlining business operations.

#### **3.4.4.9 Impact of Statutes and Regulations**

Regulations are issued by many offices in the agencies of the executive branch. There is frequently a substantial question as to their legal effect. When a board or court rules that a regulation is legally binding on either a contractor or the Government, that regulation is characterized as having the "force and effect of law". In such cases, the regulation is treated in the same manner as a statute. Generally, regulations shall have the force and effect of law if they are promulgated pursuant to specific statutory authority or formulated to implement a fundamental procurement policy and are appropriately published. SUPSHIPS should obtain the assistance of legal counsel in all such matters.

### **3.5 Contract and Budget Authority**

In order for any contract with the Government to be enforceable, it must comply with certain legal requirements that apply to all Federal Government contracts.

#### **3.5.1.1 Statutory Authorization**

Before a contract can be entered into, there must be statutory authorization for the work being performed. Most agencies have a continuing grant of general authority to work in designated areas as a part of their basic mission. The Constitution also provides that "No money shall be drawn from the Treasury, but in consequence of appropriations made by law." Using this constitutional authority, Congress has prohibited the executive branch from entering into contracts prior to the appropriation of funds or in greater amounts than contained in appropriations.

#### **3.5.1.2 Budget Authority**

Budget authority may be provided either in the form of an appropriation act or by a grant of contract authority. Contract authority is permitted by the last phrase of reference (f), [31 U.S. Code 1535](#) (Agency Agreements), and shall usually be found in specific language in statutes authorizing programs and permitting the contracts prior to the passage of an appropriation

act. Leases made for periods longer than that covered by appropriated funds, and contracts made for amounts greater than appropriations, are not binding on the Government.

In some cases, the executive agencies enter into agreements with contractors in advance of or in excess of appropriations, making the Government's obligation contingent on the passage of an appropriation. Since such agreements are not binding obligations of the Government until the passage of the appropriation, they do not violate the statutes.

### **3.5.1.3 Authorization of Appropriations**

Prior to the passage of an appropriation act, funds for agency programs are approved by "authorization acts" which authorize funding with dollar limitations. For DoD, the House Armed Services Committee (HASC) and the Senate Armed Services Committee (SASC) conduct their initial review of the scope of DoD programs and decide on the amount of funds that should be provided. These committees retain their prerogatives of control over DoD programs and limit the appropriations committees to providing funds up to, but not exceeding, the amounts authorized. Since the authorization process is a working rule of Congress, it would seem that an appropriation, even without the required authorization, would provide the necessary authority to enter into contracts. The courts have held, however, that an appropriation is not valid if there has been no authorization legislation because Congress may not legislate through appropriations laws. Authorization may also be in the form of provisions in the general legislation of the agency authorizing expenditures up to specified limits for designated programs.

The legislative committees also retain control of this area in cases where "contract authority" is contained in the statute authorizing the undertaking of a program. In such cases, there is no process for review of the matter by the appropriations committees, yet the agency is authorized to enter into contracts. Of course, subsequent appropriations are necessary before the contractor can be paid, but it is assumed that such appropriations shall be forthcoming without contest.

## **3.6 Contracts and Agreements**

A contract is an agreement between two or more parties that is enforceable by law. It may be agreed to either orally or in writing either as bilateral (two promises) or unilateral (promise for an act or forbearance of an act). [FAR 2.101](#) defines a contract to include all types of commitments that obligate the Government to an expenditure of appropriated funds and that, except as otherwise authorized, are in writing. In addition to bilateral instruments, contracts include awards and notices of awards; job orders or task letters issued under basic ordering agreements (BOAs); letter contracts; orders, such as purchase orders under which the contract becomes effective by written acceptance or performance; and bilateral modifications.

Elements of a Contract: There are five essential elements required to have a binding contract:

1. Offer
2. Acceptance
3. Consideration
4. Legal and possible objective
5. Competent parties

The Offer: An offer is nothing more than a promise to perform an act, or the forbearance of an act, for some consideration by the party accepting the offer. In order for the offer to be valid, the expression must be intended as an offer, it must be complete in all its essential terms, it must be communicated (in the manner intended) by the offeree, and it must be clear and without ambiguities. If after the contract is formed, it is found to be imprecise or ambiguous in some minor detail so that reasonable persons could differ as to its meaning, the "Rule of Ambiguities" comes into play and the contract shall be reformed at the expense of the party who drafted the contract.

The Acceptance: Acceptance is an expression of consent to the proposed contract. In order for the acceptance to be effective, i.e., to create a valid contract, it must be:

- clear and unequivocal
- timely (i.e., it must occur before the offer is revoked)
- a mirror image of the Offer (i.e., must use the same terms as the Offer)

Consideration: Consideration is the price bargained for and paid, for a promise. It may consist of an act, a forbearance of an act, or a return promise. To be valid, consideration must be legally sufficient; that is, the consideration must have value in the eyes of the law. In government contracting, the courts do consider the sufficiency and adequacy of the consideration.

The Legal and Possible Objective: The purpose of a contract (what it is the offeror is trying to accomplish) must be a legal and possible objective. If the objective is illegal, the contract is unenforceable. Likewise, impossibility can excuse performance under the contract.

Competent Parties: Both parties to a contract must have legal capacity to enter into the contract. In the Government, this must be a duly authorized and properly certified Contracting Officer who has the legal authority to obligate the Government, using authorized funds to comply with the agreed upon terms and conditions of the contract. Private companies are required to designate in writing the names of the individuals who are authorized to represent the contractor in contract matters and to obligate the company in writing to a promise to meet the agreed upon terms and conditions of the contract.

### 3.6.1 Types of Contracts

The Government enters into many types of contracts. [FAR Part 16](#) authorizes the use of various basic types of contracts (e.g., fixed-price, cost-reimbursement, etc.) and lists the factors to consider when determining the contract type best suited to a specific procurement. The contract types most commonly used by NAVSEA and SUPSHIPS for new construction, repair, and modernization, and supporting acquisitions include:

- Firm-Fixed Price (FFP)
- Fixed-Price Incentive (FPI)
- Cost-Plus-Incentive Fee (CPIF)
- Cost-Plus-Award-Fee (CPAF)
- Cost-Plus-Fixed-Fee (CPFF)
- Indefinite Delivery/Indefinite Quantity (IDIQ)

Federal Acquisition Regulations also authorizes the use of any combination of the approved contract types, such as a fixed-price-award-fee contract. For any contract other than FFP, the contracting officer must make a determination of the method of contracting.

### 3.6.2 Contract Selection

For the government, the contract type can substantially influence the cost of acquisition and the quality and delivery of the product or service being procured. For the contractor, the government's selection of an inappropriate contract type can result in financial setbacks or excessive profit.

#### 3.6.2.1 Fixed-Price Contracts (FP)

Fixed-Price (FP) contracts, discussed in [FAR 16.2](#), usually stipulate a firm price with the contractor bearing the entire risk of both cost and performance. Under some circumstances, a fixed-price may leave portions of the price open and provide for a later adjustment. The degree of risk assumed by the contractor shifts from the contractor to the Government when any variation of the FP type contract is used other than the FFP. In the FP contract with economic price adjustment, the contractor bears all cost risks except that portion which is covered by the adjustment provisions. A Fixed-Price-Incentive contract 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, with the contractor bearing any costs in excess of ceiling price.

### 3.6.2.2 Cost-Reimbursement Contracts

Cost-reimbursement contracts, discussed in [FAR16.3](#), are used when the estimate of costs is as reasonable as the circumstances permit, but because of the magnitude of uncertainties involved in the procurement, the risk is too great to expect a contractor to accept a FP arrangement. In the Cost-Plus-Fixed-Fee contract, the Government agrees to pay all allowable costs that are incurred under the contract, plus a fixed-dollar amount of fee. A Cost-Plus-Incentive-Fee type contract provides for an initially negotiated fee to be adjusted later by a formula based on the relationship of total allowable costs to total target costs. Under the Cost-Plus-Award-Fee, the allowable costs are paid, plus a fee. The fee typically consists of two parts, a fixed amount that does not vary with performance and an award amount. The award amount is based upon a subjective evaluation of contractor performance by the Government, judged in light of criteria set forth in the contract. The criteria and rating plan should be tailored to the specific procurement in order to provide the most positive way to motivate a contractor toward improved performance. In a cost-reimbursement contract, actual cost, plus fee, equals price.

### 3.6.2.3 Comparison of Fixed-Price and Cost-Reimbursement Contracts

The following table illustrates the basic differences between fixed-price and cost-reimbursement contracts.

Fixed-Price	Cost-Reimbursement
<ul style="list-style-type: none"> <li>• Low risk to the Government.</li> <li>• Well-defined requirement.</li> <li>• Guaranteed delivery by the contractor.</li> <li>• Payment after delivery or performance (progress payments may be made).</li> <li>• Profit based on efficient performance and cost control.</li> <li>• An IFB or RFP solicitation may be used.</li> </ul>	<ul style="list-style-type: none"> <li>• Higher risk to the Government.</li> <li>• Requirements may not be well-defined.</li> <li>• May be either completion type (definite target specifying an end product) or term type (contractor performs specified level of effort for stated period of time).</li> <li>• Payment as costs are incurred.</li> <li>• Fee that may be used to compensate the contractor beyond cost.</li> <li>• An RFP solicitation must be used.</li> </ul>

Table 3-1: Comparison of Fixed-Price and Cost-Reimbursement Contracts

#### **3.6.2.4 Indefinite Delivery/Indefinite Quantity Contracts (IDIQ)**

These contracts are used when there is a recurring demand for an item and the timing and extent of demand cannot be determined at the time of award. The contract establishes all terms and conditions except those to be included in orders issued there under.

#### **3.6.2.5 Letter Contracts**

Letter contracts are used to authorize urgent work when work must be started immediately and negotiating a definitive contract is not possible in sufficient time to meet the requirement. Use of letter contracts must be approved by NAVSEA at an appropriate level.

#### **3.6.2.6 Other Contracting Methods**

- a. Multiple Award Contract (MAC) refers to a task-order or delivery-order contract established by one agency for use by Government agencies to obtain supplies and services.
- b. Multi-Ship/Multi-Option (MS/MO) contracts enhance the Procuring Contracting Officer's (PCO) flexibility by allowing the PCO to package several ship repair availabilities spanning several years into a single procurement package. These procurements are usually made under cost-type contracts, with each availability planned and executed as a contract option.

### **3.6.3 Agreements**

#### **3.6.3.1 Basic Agreements**

Basic agreements are umbrella-type arrangements that promote time savings for recurring requirements. While they are not contracts, they establish ground rules for the required and applicable clauses that shall be incorporated in future contracts. [FAR 16.7](#) provides additional information on agreements.

#### **3.6.3.2 Basic Ordering Agreements (BOA)**

A Basic Ordering Agreement (BOA) is not a contract, but a written instrument of understanding negotiated between a contracting activity and a contractor that contains: terms and clauses applying to future contracts, a specific description of supplies or services to be provided, and methods for pricing, issuing, and delivering future orders under the BOA. BOAs may be used for a variety of procurements, including research and development, studies, services, shipbuilding post shakedown availabilities, and hardware procurement. [FAR 16.703](#) provides additional information on BOAs.

### **3.6.3.3 Master Agreement for Repair and Alteration of Vessels**

#### **3.6.3.3.1 General**

The complexity of Navy ship repair work, including the compact arrangement of ship machinery and systems, the sophistication of installed systems, and the Navy's absolute requirement for reliable operation, creates a unique repair environment that demands special experience and capability from the ship repair industry. In order to ensure this work is awarded only to firms capable of satisfying these demands, [DFARS 217.71](#) (Special Contracting Methods – Master Agreement for Repair and Alteration of Vessels) provides the authority for the Navy and other agencies to utilize special contracting methods for the repair and alteration of vessels. For acquisition of Firm-Fixed-Price contracts, the Master Agreement for Repair and Alteration of Vessels, or Master Ship Repair Agreement (MSRA), is the vehicle used to contract for the repair and alterations of ships of Frigate Guided Missile (FFG-7) Class-size or larger and the Agreement for Boat Repair (ABR) is the vehicle used to contract for boat or craft overhaul and repair work, or selective component, or selective ship repair work.

The MSRA and ABR are not contracts and contain no specifications or statement of work. The agreements are primarily a compilation of required clauses which are peculiar to ship repair and overhaul work and contain certain general terms and conditions under which the Navy or any other DoD agency can issue firm-fixed-price job orders for efforts involving repairs or alterations. The clauses which are to be included in each agreement are listed in [DFARS 217.7104](#).

A contract comes into existence when a proper job order is issued against either type of agreement. Only firm-fixed-price job orders may be awarded under MSRAs or ABRs, and these job orders may only be issued to contractors who have previously executed an agreement based on an on-site review of their facilities, organization and manning, production capabilities, and financial standing. Refer to the [JFMM Volume VII, Chapter 3](#) for more information on the MSRA/ABR Program.

#### **3.6.3.3.2 Complex and Refueling Overhauls of Nuclear-Powered Aircraft Carriers and Submarines**

Complex and refueling overhauls of nuclear-powered aircraft carriers and submarines assigned to the private sector are not procured through the Master Ship Repair Agreement, but by NAVSEA in a manner similar to that for new construction or conversion of vessels. These contracts may be either cost-reimbursement or fixed-price, and the assigned SUPSHIP performs the functions of Contract Administration Office (CAO).

## **3.7 Overview of Contract Procurement Methods**

### **3.7.1 Policy for Full and Open Competition**

[10 USC 2304](#) and [41 USC 253](#) require, with certain limited exceptions (see [FAR 6.2](#) and [6.3](#)), that Contracting Officers shall promote and provide for full and open competition in soliciting offers and awarding Government contracts.

### **3.7.2 Contracting Methods**

Contracting methods generally fall into one of three procedures:

1. Simplified Acquisition Procedures ([FAR 13.3](#))
2. Sealed bidding ([FAR Part 14](#))
3. Contracting by negotiation ([FAR Part 15](#))

#### **3.7.2.1 Simplified Acquisition Procedures**

Simplified acquisition procedures may be used for acquisitions that do not exceed the simplified acquisition threshold (see “simplified acquisition threshold” under [FAR 2.101](#) for current threshold and exceptions). These procedures are used to:

- reduce administrative costs
- improve opportunities for small, small-disadvantaged, women-owned, veteran-owned, HUBZone, and service-disabled veteran-owned small business concerns
- promote efficiency and economy in contracting
- avoid unnecessary burdens for agencies and contractors

Because of the relatively low threshold, use of simplified acquisition procedures in the SUPSHIP community is generally limited to satisfy organic requirements in support of the command mission.

#### **3.7.2.2 Sealed Bidding**

The purpose of sealed bidding is to realize the price and other benefits derived from full and open competition. [FAR 6.401](#)

states that Contracting Officers shall solicit sealed bids if:

- time permits the solicitation, submission, and evaluation of sealed bids
- award will be made on the basis of price and other price-related factors

- it is not necessary to conduct discussion with the responding offerors about their bids
- there is a reasonable expectation of receiving more than one sealed bid (competition)

All four of these conditions must be met in order to use sealed bidding; otherwise, Contracting by Negotiation must be used. Achieving these goals depends entirely upon the existence of real competition among bidders and upon the integrity of the system throughout its operation. Each bidder must be put on an equal basis and given the same opportunity to develop and submit the best bid initially. Sealed bidding procedures are described in detail in [FAR Part 14](#).

Because of the limited flexibility afforded by sealed bidding, its use requires the approval of the cognizant NAVSEA 02 Division Director or Deputy, except for acquisition of commercial items (see NCH 14.103-2).

### **3.7.2.3 Contracting by Negotiation**

Congress has recognized sealed bidding cannot satisfy all procurement requirements and has authorized procurement by means of negotiation in accordance with [FAR Part 15](#). A contract awarded by means other than sealed bidding is a negotiated contract. Negotiation has an inherent flexibility that is almost completely absent from sealed bidding. Negotiated contracts can be made with or without competition, and contractors that submit an offer may or may not be aware of the presence or absence of competition when establishing their prices. The flexibility of the negotiation provides the means of achieving a fair and reasonable pricing basis without reliance upon competitive pressure alone. Negotiated contracts are solicited through Requests for Proposals (RFPs).

#### **3.7.2.3.1 Best Value Contracting**

Best Value Contracting (BVC) is a competitive contracting process requiring projects to be awarded to the contractor offering the best combination of price and other factors instead of just the lowest bid. It is an approach for awarding contracts that, when properly designed and administered, rewards high-performance contractors who have trained, skilled workers and other essential qualifications for performing high quality projects in a safe, timely, and cost-efficient manner.

BVC is used in relation to Request for Proposal procedures, but it may also be referred to by other terms in the commercial business environment, such as "competitive sealed proposal contracting," or "negotiated contracting." Because the award decision is not based on price or price-related factors alone, BVC is never accomplished under Sealed Bidding (IFB) procedures.

Under the BVC process, submission of proposals is typically open to qualified contractors who submit detailed information on their past performance and qualifications in response to the Request for Proposal.

### 3.7.2.4 Comparison of Sealed Bidding and Contracting by Negotiation

The following table illustrates the differences between Sealed Bidding and Contracting by Negotiation.

<b>Sealed Bidding</b>	<b>Contracting by Negotiation</b>
Requirements must be well-defined.	Requirements may be less than well-defined.
Must have adequate competition.	May be competitive or sole source.
Uses an Invitation for Bid (IFB) solicitation.	Uses a Request for Proposal (RFP) solicitation.
Award based on price and price-related factors	Award based on evaluation criteria.
No discussions allowed.	Discussions/negotiations expected.

Table 3-2: Comparison of Requirements for Sealed Bidding and Negotiation

### 3.7.2.5 Business Clearances

The purpose of a business clearance is to demonstrate that the proposed acquisition conforms to good business practice, law, or regulation, and to justify, by written evidence, that the cost and price established are fair and reasonable. In addition, a business clearance serves as the historical record of the business cost and pricing aspects of an acquisition and contains all required approvals by higher authority. See section [3.8.9.3](#) of this chapter for information regarding business clearances.

## 3.7.3 Writing Contracts

### 3.7.3.1 Uniform Contract Format (UCF)

FAR requires the use of a Uniform Contract Format for most contracts procured by sealed bidding ([FAR 14.201](#)) or negotiation ([FAR 15.204](#)). This Uniform Contract Format is organized into the following parts and sections:

Part I – Schedule

- Section A: Solicitation/contract form
- B: Supplies or services and prices/costs
- C: Description/specifications/work statement
- D: Packaging and marking

- E: Inspection and acceptance
- F: Deliveries and performance
- G: Contract and administration data
- H: Special contract requirements

Part II - Contract Clauses

Section I: Contract clauses

Part III - List of Documents, Exhibits, and Other Attachments

Section J: List of attachments

Part IV - Representations and Instructions.

Section K: Representations, certifications, and other statements of offerors

L: Instructions, conditions, and notices to offerors or respondents

M: Evaluation factors for award

### **3.7.3.2 Standard Procurement System (SPS)**

Standard Procurement System (SPS) is an automated contracting system that was created by DoD in order to standardize procurement processes and provide an effective means to maintain a “paperless” procurement environment. SPS assists the procurement professional by providing both a contract writing tool as well as an automated system for contract administration, from initial award through contract closeout, including migrated awards. Migrated awards refer to contract documents that were not created in SPS, but are loaded manually into the system. Normally awards that are migrated are those that were either awarded prior to deployment of SPS, or were issued by non-SPS users and subsequently transferred to a SUPSHIP for contract administration. All NAVSEA personnel involved in the procurement process, including Contracts, Projects, and Comptroller Office personnel, are required to use SPS.

SPS is used for all awards issued by NAVSEA, including:

- Contracts
- Modifications
- Purchase Orders
- Indefinite-Delivery Contracts (Single and Multiple Awards)

- Delivery Orders under Single and Multiple Award Indefinite-Delivery Contracts
- GSA (Federal Supply System (FSS)) Orders
- Agreements
- Contract Awards placed against Basic Agreements
- Orders against Basic Ordering Agreements

Award actions are transmitted on a daily basis to the DFAS Electronic Document Access (EDA) site. This site serves as DoD's central repository for all award documents. The DFAS EDA site may be accessed at [DFAS EDA](#). Award actions not created in SPS will be manually uploaded to the EDA site.

### **3.7.4 Socioeconomic Programs**

Subchapter D of FAR (Parts 19-26), Socioeconomic Programs, describes specific contracting requirements in support of small business programs, application of labor laws, environmental and occupational safety considerations, protection of privacy and freedom of information, foreign acquisitions, and other socioeconomic programs. For the purposes of this manual, small business programs are addressed below; environmental and safety matters are addressed in Chapter 12, "Environmental, Safety, and Health."

#### **3.7.4.1 Small Business Programs**

In Federal acquisitions, it is the policy of the Government to provide maximum practicable opportunities to small business, veteran-owned small business, service-disabled veteran-owned-small business, historically underutilized business zone small business, small disadvantaged business, and women-owned small business. Within the Department of the Navy, these businesses are considered to fall within the Small Business Program. Such concerns must have the maximum practicable opportunity to participate as subcontractors in the contracts awarded by any executive agency, consistent with efficient contract performance. The Small Business Administration (SBA) counsels and assists small business concerns and assists contracting personnel to ensure that a fair proportion of contracts for supplies and services is placed with small business. For NAVSEA procurements, the Office of the Secretary of the Navy (OSN) assigns an annual goal for small business programs that is based on a share or percentage of total obligated dollars. The Commander, NAVSEA is responsible for achievement of program goals and implementation pursuant to reference (g), [SECNAVINST 4380.8C](#), [FAR Part 19](#), [DFARS Part 219](#), [NMCARS Part 5219](#), and NCH Part 19.

The Procurement Performance Management Assessment Plan (PPMAP) conducted by NAVSEA includes assessment of the SBP for both prime and subcontracting administration pursuant to guidelines developed by OSN.

##### **3.7.4.1.1 Deputy for Small Business**

[SECNAVINST 4380.8C](#) assigns responsibility for SBP implementation to commanding officers of contracting activities and contract administration activities. Commanding officers are required to appoint a full- or part-time Deputy for Small Business, who reports directly to the commanding officer on overall SBP implementation at the activity. The appointment directive should reference the pertinent responsibilities in [FAR 19.201](#), [DFARS 219.201](#), and [NMCARS 5219.201](#). Individuals appointed shall possess business acumen, knowledge of contracting policies and procedures, and the training and background essential to accomplish the objectives of the Small Business Program. A copy of the written appointment, or termination of appointment, should be forwarded to the NAVSEA Small Business Program Office (NAVSEA 00K).

#### **3.7.4.1.2 Subcontracting Program Administrator**

[FAR 19.705-1](#) through [19.707](#) contains responsibilities of the Contracting Officer, the Small Business Specialist, the ACO, and the Small Business Administration representative for implementation of Public Law 95-507. These responsibilities include documenting and monitoring contractor performance on subcontracting plans included in a contract. These responsibilities are also addressed in [DFARS 219.706\(a\)\(ii\)](#).

When invoked in the contract, Clause 52.219.9, Small Business Subcontracting Plan, imposes requirements on contractors regarding their subcontracting plans and requires periodic reports. Contractors are able to satisfy this requirement through the use of the Electronic Subcontracting Reporting System (eSRS), an electronic, web-based system that replaces the SF-294 and SF-295 paper forms. For additional information, visit the official eSRS website at <http://www.esrs.gov>.

#### **3.7.4.2 Assignment of Contract Administration**

A SUPSHIP performing contract administration under a plant cognizance assignment may require performance of quality assurance, source inspection, etc., at a subcontractor's plant that is under the cognizance of another Federal CAS component. In such a case, the SUPSHIP is to request the responsible CAS component to perform the CAS as prescribed by [FAR 42.202](#).

#### **3.7.4.3 Contract Manager Representatives**

The SUPSHIP points of contact for contracting matters are the Shipbuilding Contracts Division (NAVSEA 022) for new construction contracts, the Fleet Support Contracts Division (NAVSEA 024) for maintenance and modernization contracts, and the Surface Systems Contracts Division (NAVSEA 025) and Undersea Systems Contract Division (NAVSEA 026) for shipboard weapons systems.

#### **3.7.4.4 Correspondence and Visits**

Refer to [FAR 42.4](#) for contract administration correspondence, pertinent correspondence conducted between the Contract Administration Office (CAO) and the contractor, and visits to contractor's facilities.

### **3.7.4.5 Contracting Officer Certificate of Appointment**

NAVSEA 02 appoints all SUPSHIP contracting officers, including Corporate ACO warrants and leasing warrants.

### **3.7.4.6 Project Manager Representatives (PMRs)**

Reference (h), [NAVSEAINST 5400.60A](#), identifies the responsibilities, tasks, and reporting relationships of Project Manager Representatives (PMRs) located on-site at SUPSHIP offices. A PMR is authorized to act on behalf of the acquisition program manager where direction or guidance is required to the ACO or to the contractor through the ACO. The PMR will be assigned duty to a particular SUPSHIP, but will function as a resource of the Acquisition Program Manager. See Chapter 5, "Project Management," for more information regarding the responsibilities and reporting relationships of the PMR.

## **3.7.5 Involvement**

Involvement, previously called engagement, is defined as aggressive contract administration based on an in-depth knowledge of the contractor's operations, especially any weaknesses in areas such as policies, procedures, and performance.

Reference (i), [DoD Directive 5000.01](#), incorporates new laws and policies, including reference (j), the [Federal Acquisition Streamlining Act \(FASA\) of 1994](#), and the institutionalization of Integrated Product Teams (IPTs). A major theme of the policy improvements is teamwork, with the goal of creating an acquisition system that capitalizes on the strengths of each and every participant. Involvement relates directly to these initiatives.

### **3.7.5.1 Implementation of Involvement (New Construction)**

SUPSHIP will promulgate instructions that clearly delineate the responsibilities of SUPSHIP organizational components for implementing involvement. Instructions should describe functions performed by SUPSHIP personnel, by other Government agencies, and scheduling and coordinating responsibilities of SUPSHIP personnel for those agency functions. The local instructions also should list contractual requirements for data and reports the contractor furnishes the Government for involvement. Furthermore, the local instructions must provide for implementation of the total SUPSHIP responsibility for contract administration.

In general, the Supervisor or a designated individual is the coordinator for contract involvement. Implementation of involvement crosses all SUPSHIP departmental lines. It is important to note that just because SUPSHIP designates a coordinator for involvement, it does not in any way relieve personnel of the various SUPSHIP organizations from taking timely, vigorous action on matters within their cognizance.

The primary functions of the coordinator are:

- providing visibility for involvement within the SUPSHIP and serving as a focal point for overall analysis of contractor performance

- providing additional focus on Government actions required to resolve problems
- becoming aware of slippages, overruns, and other deficiencies as early as possible and enabling SUPSHIP to take action or to alert NAVSEA in sufficient time to take corrective measures not within SUPSHIP authority

Effective involvement requires a meshing of the SUPSHIP organization with the contractor organization at all echelons to ensure the SUPSHIP is completely informed of events and plans pertaining to contract performance. Personnel must recognize and anticipate problems in contract performance.

#### **3.7.5.1.1 Prerequisites and Primary Sources of Information for Involvement**

Prerequisites for implementing involvement include SUPSHIP analyses and input prior to contract award, establishment of Government and contractor understandings of mutual responsibility before or immediately after award, and proper use during contract performance of information sources inside and outside the SUPSHIP office.

Pre-involvement begins before contract award, when, and if NAVSEA, requests SUPSHIP to review the proposed specifications. Subsequently, SUPSHIP may be required to perform an evaluation of the prospective contractor's proposal and a pre-award survey. At that time, SUPSHIP can provide significant input to the Program Manager and the PCO. This input, when acted upon, increases the probability that SUPSHIP will successfully practice involvement after contract award. For example, during the evaluation, SUPSHIP should look for errors or ambiguities in areas such as contract provisions, specifications, contractor estimating, use of contract type and structuring, and contractor data, and report them. The pre-award survey report should note all deficiencies in facilities and management systems, especially those which SUPSHIP could not have the contractor correct on previous contracts. Special notice should be taken of the delivery schedule if it appears unrealistic when compared to the known and expected facility and manpower capacity of the yard and workload.

The starting point for actual involvement after contract award is an understanding of both contractor and Government responsibilities for carrying out the contract terms and conditions. This is usually achieved at a post-award conference. SUPSHIP personnel must recognize that, for the contractor to fulfill his/her requirements, SUPSHIP must promptly and effectively perform its required functions and provide the contractor property, data, approvals, and information which the contract specifies as Government-furnished. Furthermore, no Government personnel (except those holding contractual authority and acting within the scope of such authority) may properly take an action that modifies or changes a contract requirement. Also, the contract must be reviewed and an understanding reached with the contractor on what data he/she is required to provide to assist involvement, and what the Government will provide to permit the contractor to perform contract requirements at the least cost and within the specified schedule.

The primary source of information to assist involvement is the contractor. Such information is provided by contractual requirement and by extra-contractual arrangements between SUPSHIP and the contractor. If the contractor and Government make any extra-contractual arrangements, they should be documented by a Memorandum of Understanding (MOU) or Memorandum of Agreement (MOA) developed in conjunction with legal counsel.

Information required by the contract may include data such as a list of drawings and cost, progress, and manning reports. Each contract contains a DD Form 1423 which lists data the contractor is required to provide. Some required information results from extra-contractual arrangements that the SUPSHIP has made with the contractor for access to the contractor's internal reports prepared for management information. This information may include reports of production and scheduling, meetings, subcontractor delays and noncompliance with contractual requirements, manpower loading, internal audits, financial statements, and cash flow forecasts.

A post-award orientation aids both the Government and contractor personnel to (1) achieve a clear and mutual understanding of all contracting requirements, and (2) identify and resolve potential problems. However, it is not a substitute for the contractor fully understanding the work requirements at the time offers are submitted, nor is it to be used to alter the final agreement arrived at in any negotiations leading to contract award.

Many sources of information outside the SUPSHIP office provide data necessary for carrying out involvement. One important source is the cognizant DCAA. In addition to primary responsibility for performing auditing functions, the DCAA has been assigned a secondary responsibility to assist SUPSHIP in contract administration. Therefore, the SUPSHIP, in discharging its responsibility for total contract administration, must coordinate its efforts with those of DCAA so that DCAA performs the required functions in a proper and timely manner. SUPSHIPS should provide the DCAA with annual workload forecasts so the agency can schedule audits and reviews. When available DCAA manpower is inadequate to provide timely assistance on a SUPSHIP contract because of other DoD contractual responsibilities, SUPSHIP should advise NAVSEA 02.

The responsibilities of DCAA include:

- auditing review of the prospective contractor's proposal for pricing the contract
- assisting SUPSHIP in performing a pre-award survey
- auditing review of the contractor's proposal for pricing changes to the contract
- reviewing labor and overhead rates
- assisting SUPSHIP in reviewing the contractor's procurement system
- reviewing the contractor's estimating system, with SUPSHIP assistance

- performing post-audits on the accuracy, completeness, and currency of contractor-certified cost or pricing data submitted for negotiation in compliance with Public Law 87-653
- reviewing the contractor's invoices on costs incurred and provisional approval of payment for cost-reimbursement contracts
- reviewing the contractor's management, financial, accounting, and scheduling systems
- reviewing the contractor's material cost to establish material progress
- reviewing the contractor's certification on total cost and material costs on progress payment invoices
- reviewing costs incurred by the contractor to establish allowability
- reviewing the contractor's overtime
- reviewing the contractor's cost accounting standards
- reviewing the contractor's certified-cost statement for escalation

Other important sources of information outside the SUPSHIP office include:

- NAVSHIPSO: This office prepares schedules, based on statistics compiled from previous ship acquisition programs, for material ordering and erection of the ship; however, neither the contractor nor the Government is usually contractually bound by them.
- DCMA: DCMA offices having cognizance of subcontractors can provide useful information, particularly information on critical items requiring source inspection by the DCMA. The DCMA offices can provide forecasts of delivery dates for material and take appropriate expediting actions, especially for late items essential for meeting contract specific dates. The DCMA offices can also alert the SUPSHIP to subcontractor quality problems.
- Program Managers: Program Managers can provide information on the funding of contracts and Headquarters Modification Requisitions (HMRs) which are under consideration and could have significant cost and schedule impact.

The SUPSHIP organizational components can also generate and provide much useful information.

Appropriate components independently prepare and receive reports from the contractor, perform reviews and analyses within the cognizant areas, and process requests from the contractor for information, assistance, contract changes, waivers, and deviations. The

SUPSHIP organizational components also prepare reports of meetings and conversations between SUPSHIP and contractor personnel.

#### **3.7.5.1.2 Dealings and Meetings with the Contractor**

SUPSHIPS should attempt to develop mutual trust, cooperation, and confidence with contractors to promote an atmosphere conducive to good business relations. Both close personal relationships and antagonistic relationships should be avoided to the maximum extent.

To establish such an atmosphere, the Supervisor may hold regularly scheduled meetings with a counterpart in the shipyard. During such meetings, the status of contract performance problems and requirements for SUPSHIP or NAVSEA action should be reviewed and time schedules established for resolving problems. Any conflicts between SUPSHIP and contractor personnel should be reviewed and resolved before they become major problems in contract administration.

All SUPSHIP personnel must be constantly on guard to ensure that a constructive change is not created in implementing the involvement concept. When it appears that there is no contractual basis for a corrective action or other action desired of the contractor, the ACO must be consulted before the contractor is requested or directed to take such action. All direction to the contractor must be processed through the ACO.

#### **3.7.5.1.3 SUPSHIP Actions**

Identifying, analyzing, and documenting significant events is important to proper involvement, effective contract monitoring, and effective claims programs. Details on these important functions are in [NMCARS 5233.90](#).

In administration of new construction, conversion and complex overhaul contracts, Government-proposed contract modifications have the potential for contract delay costs and significant disruption or loss of efficiency costs. In support of negotiations for such modifications, the Supervisor should require of the contractor: (1) time impact analysis illustrating the influence of the Government-proposed modification on the contract schedule, including, but not limited to, a fragmentary network (with relationships, durations, resources, budgets, etc.) demonstrating how the contractor proposes to incorporate the change into the production schedule, and (2) documents, reports, and analyses in support of the requested disruption or loss of efficiency estimate/costs. Any methodology which assumes causation should not be relied upon.

Unsatisfactory contractor work should be reviewed to ascertain the effect of corrections on schedule and cost of performance. For cost-type contracts, the expense of correcting unsatisfactory work is generally an allowable cost borne by the Government. Therefore, for such contracts, involvement dictates ensuring that the contractor's quality assurance system identifies unsatisfactory work as soon as possible to minimize the cost of corrections.

Since the Navy is essentially a self-insurer, it pays for property loss or damage to both Government-furnished and contractor-furnished property, less any deductible if applicable. SUPSHIP must ensure against a pattern of insurance claims indicating that management is not concerned with loss or damage to property for which the Government is liable. When such a pattern appears to be developing, the contractor should be notified that corrective actions are required. Command Legal Counsel or NAVSEA OOL should be consulted on the wording of such a notice.

The SUPSHIP should hold regular meetings with the cognizant DCAA office to coordinate its reviews. Meeting agendas should include review schedules as well as findings for reviews in process or previously conducted. In addition, the agenda should include discussion of the corrective actions the contractor is taking.

Surveillance of the contractor's Earned Value Management System (EVMS) is another critical function performed by the SUPSHIP. Refer to SOM Chapter 7, "Earned Value Management," for a more detailed discussion of this topic.

An important aspect of involvement is to ensure that the Government's responsibilities are carried out in a timely manner. Accordingly, requirements for Government-Furnished Material (GFM) listed in Schedule A and Government-Furnished Information (GFI) listed in Schedule C of the contract should be progressed to ensure on-schedule delivery. If it appears that delivery of GFM or GFI may be late, discussions should be held with the Program Manager on the appropriate corrective action. Similar action may be required when it appears that GFI may be late. In addition, SUPSHIP action may be required to ensure a timely response when the contractor requests data or when Government approval is required. The SUPSHIP must react quickly to Government Property Problem Reports (GPPRs) when the contractor finds a deficiency with Government-Furnished Property (GFP). In such instances, SUPSHIP should provide regular reports to the coordinator regarding involvement on GFM and GFI responses or approvals which are or may be late, require repair or replacement, and the expediting actions being taken.

On contracts which contain the Problem Identification Reports clause, SUPSHIP must ensure that the contractor complies with its requirements, especially submission of reports, when indicating SUPSHIP reasonably can anticipate the occurrence of any contract problem. When SUPSHIP anticipates a problem which would require a report under this clause, but the contractor has failed to submit a report, it will hold discussions with the contractor. If the contractor refuses to submit a report, SUPSHIP should prepare and submit the report.

On contracts which contain the Technical Data Withholding of Payment clause, the contracting officer may withhold, under certain circumstances, a portion of the total contract price until the contractor delivers acceptable data. SUPSHIP should exercise the rights of the Government when data is untimely or unsatisfactory. This withholding will serve as an incentive to the contractor to comply with the contractual requirements.

Because subcontracting, including material orders, may constitute 50 percent or more of total contract costs, SUPSHIP surveillance of subcontract operations is another important aspect

of involvement. A SUPSHIP instruction should set forth the elements and organizational responsibilities for the surveillance plan for subcontracting operations. The plan should include reporting requirements for findings and specify that the coordinator for involvement should receive copies of such reports. The coordinator should ensure that timely corrective action is taken by the contractor regarding deficiencies found by SUPSHIP personnel during the surveillance of subcontract operations. See [section 3.12](#) for more information on subcontracts.

### **3.7.5.2 Implementation of Involvement (Repair/PSA)**

Refer to [JFMM Vol VII Section 2.8.6](#) for guidance regarding implementation of involvement for ship repair and modernization contracts, including Post Shakedown Availabilities.

## **3.7.6 Files of Contract Actions**

### **3.7.6.1 Introduction**

[FAR 4.8](#) (Government Contract Files) requires the head of each office performing contracting, contract administration, or paying functions to establish files containing the records of all contractual actions. The documentation in the files must be sufficient to constitute a complete history of the transaction.

### **3.7.6.2 General**

A contract file should generally consist of:

- procuring contracting office contract file, which will document the basis for the acquisition and the award, the assignment of contract administration (including payment responsibilities), and any subsequent actions taken by the Contracting Officer ([FAR 4.803\(a\)](#))
- contract administration office contract file, which will document actions reflecting the basis for, and the performance of, contract administration responsibilities ([FAR 4.803\(b\)](#))
- paying office contract file, which will document actions prerequisite to, substantiating, and reflecting contract payments ([FAR 4.803\(c\)](#))

Contents of contract files that are proprietary or contain source selection information will be protected from disclosure to unauthorized personnel.

### **3.7.6.2.1 Contents of Contract Administration Office (CAO) Contract Files**

[FAR 4.803\(b\)](#) provides an extensive list of documents required to be maintained in the CAO Contract Files. The majority of these documents are prepared and maintained entirely within the Contracts Department, and is not intended to duplicate this listing here. It is important,

however, that SUPSHIP personnel working outside the Contracts Department know the types of documents that must be provided for the CAO Contract file. These include:

- copy of all modifications and supporting documents
- security requirements, including the Contract Security Classification Specification, DD Form 254
- cost and pricing data, Certificates of Current Cost or Pricing Data, cost or price analysis, and other documentation supporting contractual actions executed by the contract administration office
- post-award conference records
- orders issued under the contract
- notice to proceed and stop orders
- progressing, expediting, and production surveillance records. These are to be maintained separately to facilitate early disposal (six months after final payment), and include records such as:
  - Production plans and delivery schedules;
  - Progress or status reports;
  - Advice of delays or delinquencies and of corrective and production follow-up actions; and
  - Documents reflecting deliveries or production completion.
- QA and control (inspection) records used in planning, conducting, and recording product verifications, testing, reviewing quality programs and plans, evaluating procedures and processes or technical performance, and effecting corrective actions, where required, are to be maintained separately for earlier disposal and include:
  - QA records, such as reference to contractor's Quality Program document and disapproval, if any; subcontract inspection control records (request for source inspection and waiver of usual inspection procedures); inspection requests, agreements, and assignments; requests for waivers and deviations and copy of approvals or disapprovals, if any (including Material Review Board decisions); and, required inspection and test reports.
  - Quality control (inspection) records, such as quality program review reports (procedures and processes evaluation, periodic quality assurance survey); Government inspection and test reports; authority to ship and acceptance documents (e.g., Transportation Control and Movement Document, DD Form

1384; Material Inspection and Receiving Report, DD Form 250; Order for Supplies or Services/Request for Quotations, DD Form 1155); routing requests and orders, and shipment bills of lading (DD Form 250 may be excluded when maintained in paying office file and paying office is located at the contract administration office); reports of unsatisfactory material and corrective actions, and reports of damaged or improper shipments; and other papers necessary to document the quality control or inspection function.

- Property administration records used in the administration of Government property provisions of the contract (these are to be maintained separately for disposition) include:
  - Contract number, type of contract, and contractor name and address;
  - End item(s) and points of inspection and acceptance;
  - Listing and type of subcontracts which involve Government property or reference to location of such information;
  - Record of secondary administration assignments;
  - Reports relating to Government property

#### **3.7.6.2.2 Contents of Paying Office Contract Files**

This file should contain:

- copy of the contract and any modifications
- bills, invoices, vouchers, and supporting documents including:
  - shipment, acceptance, or receiving reports, such as DD Forms 250 and 1155 (Note: file DD Forms 250 and 1155 as a separate file series when such a filing will facilitate compilation of contract status and statistical reports)
  - authorizations for advance and progress payments
- record of payments or receipts
- other pertinent documents

#### **3.7.6.3 Changes Files**

SUPSHIP Contracts Departments maintain a separate file for each change for which the department is responsible. This file should be maintained to permit a ready reconstruction of all phases of the contractual action. Any of the documentation listed in the above sections will be included, where applicable. As a minimum, the file will include the following:

- the change, including any modifications, and the contractor's written scope of the change
- Government's preliminary estimate
- contractor's proposal
- auditor's advisory report
- memorandum of business clearance on the change
- resultant supplemental agreement
- all other pertinent correspondence and documentation

#### **3.7.6.4 Access to Files**

According to the provisions of reference (k), the [Budget and Accounting Act of 1921](#), authorized representatives of the GAO will be given access to examine such records as necessary to permit the representatives to carry out their required duties and responsibilities. In addition, Navy auditors are authorized access to any management information within the DoN consistent with the purpose of the audit and security clearance of the individual auditor. Reference (l), [NAVSEAINST 5400.1F\\*\\*](#), the NAVSEA Headquarters Organizational Manual, states that NAVSEA 021 is responsible for providing NAVSEA 02 liaison in connection with reviews, surveys, audits, and investigations of the GAO and the Naval Audit Service.

## **3.8 Processing Contract Change Proposals**

### **3.8.1 Introduction**

This section covers the policies, activities, and procedures in processing contract change proposals. The process begins when a change to the contract is initiated by the requiring activity that may affect the specifications, terms and conditions, and/or cost of the contract. It includes submission of the contractor's proposal, proposal analysis, and preparation of the pre-negotiation position through adjudication of the contract modification.

Not every action covered will apply to every proposal; however, the guidance provided can be used to readily determine the applicability of various actions.

### **3.8.2 Contract Modifications**

#### **3.8.2.1 Introduction**

This section covers the more pertinent regulatory requirements regarding contract modifications contained in the FAR, DFARS, and NMCARS. The NAVSEA Contracts Handbook (NCH) contains extensive coverage of the various types of contract modifications.

\*\* Denotes secure hyperlink requiring NMCI/CAC access

The requirements apply to both new construction and repair and overhaul contracts, where appropriate, unless otherwise indicated.

### **3.8.2.2 Definitions**

"Administrative change" means a unilateral (see [FAR 43.103\(b\)](#)) contract change, in writing, that does not affect the substantive rights of the parties (e.g., a change in the paying office or the appropriation data).

"Change order" refers to a written order signed by the Contracting Officer as authorized by the Changes clause. It is unilateral direction to the contractor to carry out the requirements of the change without requiring the contractor's consent ([FAR 43.201](#)).

"Contract modification" means any written change in the terms of a contract.

"Effective date" has one of the following meanings, based on the circumstances in which it is used:

- For a solicitation amendment, change order, or administrative change, the effective date will be the issue date of the amendment, change order, or administrative change.
- For a supplemental agreement, the effective date will be the date agreed upon by the contracting parties.
- For a modification issued as a confirming notice of termination for the convenience of the Government, the effective date of the confirming notice will be the same as the effective date of the initial notice.
- For a modification converting a termination for default to a termination for the convenience of the Government, the effective date will be the same as the effective date of the termination for default.
- For a modification confirming the Termination Contracting Officer's previous letter determination of the amount due in settlement of a contract termination for convenience, the effective date will be the same as the effective date of the previous letter determination.

"Supplemental agreement" means a bilateral contract modification that is accomplished by the mutual action of the parties.

### **3.8.2.3 Policy**

Only Contracting Officers acting within the scope of their authority are empowered to execute contract modifications on behalf of the Government. Other Government personnel will not:

- execute contract modifications

- act in such a manner as to cause the contractor to believe that they have authority to bind the Government
- direct or encourage the contractor to perform work that should be the subject of a contract modification

Contract modifications, including changes that could be issued unilaterally, will be priced before their execution if this can be done without adversely affecting the interest of the Government. If a significant cost increase could result from a contract modification and time does not permit negotiation of a price, at least a maximum price will be negotiated unless impractical.

DoN policy is to avoid use of contract modifications for additional quantities as a means of purchasing new requirements of supplies, when such a procedure would result in prolonging the life of a contract beyond the time when final settlement would normally be made.

#### **3.8.2.4 Types of Contract Modifications**

There are two types of contract modifications; bilateral and unilateral. A bilateral modification (supplemental agreement) is a contract modification that is signed by the contractor and the contracting officer. Bilateral modifications are used to:

- make negotiated equitable adjustments resulting from the issuance of a change order
- definitize letter contracts
- reflect other agreements of the parties modifying the terms of contracts

A unilateral modification is a contract modification that is signed only by the Contracting Officer. Unilateral modifications are used to:

- make administrative changes
- issue change orders
- make changes authorized by clauses other than a changes clause (e.g., Property clause, Options clause, Suspension of Work clause, etc.)
- issue termination notices

#### **3.8.2.5 Order of Preference for Contract Change Modifications**

The order of preference for contract modifications is as follows:

- A fully-priced supplemental agreement (bilateral)

- A maximum/minimum priced supplemental agreement (bilateral)
- An unpriced supplemental agreement (UPSA) (unilateral)
- A "13H" unresolved responsibility work item (bilateral)
- Change Order

### **3.8.3 Contract Change Pricing**

This section briefly discusses the pricing of contract changes.

#### **3.8.3.1 Objective of Contract Change Process and Pricing**

The objective of the contract change process is to acquire the desired specification change or any new terms and conditions in a timely manner at a "fair and reasonable" price. Within this framework, the objective of contract pricing is to establish and administer an arrangement that poses a fair and reasonable price for the change. A fair and reasonable price is fair to both contract parties considering the quality and timeliness of contract performance.

#### **3.8.3.2 Pricing Responsibility**

The Contracting Officer is responsible for exercising proper judgment and is solely responsible for the final pricing decision; however, NAVSEA prefers the use of the team concept in conducting negotiations. The requiring activity normally is required to perform an analysis of the contractor's proposal in the areas of material, subcontracts, labor hours, and other direct costs. This report is known as the Technical Advisory Report (TAR) and is submitted to the Contracting Officer.

The recommendations and counsel of contributing specialists, including auditors, are advisory only; however, the Contracting Officer should include comments in the price negotiation memorandum when significant auditor or other specialists' recommendations are not adopted.

#### **3.8.3.3 Forward Pricing Rate Agreements (FPRA)**

An FPRA is a written agreement negotiated between a contractor and the Government to establish direct and/or indirect rates available during a specified period for pricing contracts or modifications. Such rates represent reasonable projections of specific contractor's rates. These projections may include rates for labor, indirect costs, material obsolescence and usage, spare parts provisioning, and material handling. Negotiation of FPRAs may be requested by the PCO, the contractor, or initiated by the ACO. In determining the need for an FPRA, the ACO should evaluate whether the benefits from the agreement are worth the effort of establishing and monitoring it. Normally, FPRAs should only be negotiated with contractors having a significant volume of Government contract proposals. The cognizant SUPSHIP will determine whether to establish an FPRA.

Indirect costs, commonly defined as overhead, are defined and described in [FAR 31.203](#), along with the criteria for treatment and application of these indirect costs in contracts.

#### **3.8.3.4 Pricing of Deleted Work**

If a contract change will involve deleted work, the price should be based on the reasonable value of the work at the time of performance. The value of deleted work should not be based on itemized estimates provided by the contractor at the time of contract award. The value of deleted work should include all costs reasonably associated with the deleted work, including profit.

#### **3.8.3.5 Adjudications on the Basis of Estimates**

NAVSEA policy requires changes to be adjudicated on the basis of estimates; therefore, adjudications will not be deliberately delayed to allow the determination of actual incurred costs from which to adjudicate.

### **3.8.4 Proposal Analysis**

#### **3.8.4.1 General**

The objective of proposal analysis is to ensure that the final agreed-to cost/price is fair and reasonable ([FAR 15.404-1](#)). The complexity and circumstances of each acquisition should determine the level of detail analysis required.

A proposal must be analyzed regardless of when the proposal is received. The proposals are evaluated using cost analysis and/or price analysis, depending upon the contract-type and the extent of evaluation needed. Price analysis shall be used when cost or pricing data are not required. Cost analysis shall be used to evaluate the reasonableness of individual cost elements when cost or pricing data are required and may be used to evaluate information other than cost and price data. Price analysis should be used to verify that the overall price offered is fair and reasonable. The Contracting Officer should request the advice and assistance of other experts to ensure that an appropriate analysis is performed.

The Contracting Officer, exercising sole responsibility for the final pricing decision, will coordinate a team of experts and request and evaluate the advice of specialists in such fields as logistics, finance, law, contract audit, quality control, engineering, technical, and pricing. The Contracting Officer should have the appropriate specialists attend the negotiations. The Contracting Officer may assign responsibility to a negotiator or price analyst for determining the extent of specialist advice needed, evaluating that advice, coordinating a team of experts, consolidating pricing data and developing a pre-negotiation objective, and conducting negotiations.

##### **3.8.4.1.1 Definitions**

“Cost analysis” means the review and evaluation of the separate cost elements and proposed profit of an offeror’s or contractor’s cost or pricing data which is part of the

proposal. Cost or pricing data is not required when adequate price competition is determined to exist in a particular procurement, nor should a detailed profit analysis be conducted (utilizing DD Form 1547); however, a cost or pricing realism analysis may be required. The goal is to evaluate the degree to which the proposed costs represent what the cost of the contract should be, assuming reasonable economy and efficiency.

“Cost or pricing data” refers to all facts that prudent buyers and sellers would reasonably expect to significantly affect price negotiations. This concerns data as of the date of price agreement or, if applicable, another date agreed upon between the parties that is as close as possible to the date of agreement on price. Cost or pricing data is information requiring certification in accordance with [FAR 15.403](#).

“Price analysis” is the process of examining and evaluating a proposed price without evaluating its separate cost elements and proposed profit.

#### **3.8.4.2 Subcontract Pricing Considerations**

The Contracting Officer is responsible for the determination of price reasonableness for the prime contract. To make this determination, an analysis is required of all relevant facts and data, including required subcontractor cost or pricing data, results of the prime or higher tier subcontractor's analyses of subcontractor proposals, the field pricing support (if any), and historical pricing data. Even if a contractor or higher tier subcontractor has an approved purchasing system or performs an analysis of subcontractor cost or pricing data, the Contracting Officer or field pricing support team still has the responsibility of analyzing the prime contractor's submission, including the subcontractor cost or pricing data. The prime contractor or higher tier subcontractor is responsible, however, for conducting appropriate price and cost analysis before awarding a subcontract.

#### **3.8.4.3 Use of Independent Estimates**

Independent government estimates may be used in pricing sole source contracts and contract modifications less than the cost or pricing data threshold. An independent estimate forms the basis for pricing. Such estimates are to be made without reference to the supporting or back-up cost or pricing data of the contractor, nor will such data be requested when price analysis is to be employed. When cost or pricing data is submitted or identified, a cost analysis must be performed on the data.

#### **3.8.4.4 Price Analysis**

Price analysis shall be used when cost or pricing data are not required ([FAR 15.404-1](#)). Price is cost-plus any fee or profit applicable to the contract type. The Contracting Officer is responsible for selecting and using whatever price analysis techniques will ensure a fair and reasonable price.

Price analysis will generally be used in lieu of cost analysis, regardless of the dollar amount for contracts, where the conditions of [FAR 15.403](#) are met (e.g., prices are based on adequate price competition).

### **3.8.4.5 Cost Analysis**

This section contains an extended discussion of cost analysis. Topics include definitions, kinds of cost and pricing data, technical analysis, field pricing support, subcontract pricing, and purchased materials.

#### **3.8.4.5.1 Cost or Pricing Data**

Cost or pricing data submitted by an offeror or contractor enables the Government to perform cost or price analysis, and ultimately enables the Government and the contractor to negotiate fair and reasonable prices. Cost or pricing data should be submitted by specific identification in writing.

The Contracting Officer shall specify the format of the cost or pricing data submission unless submissions are required on one of the termination forms specified in [FAR 49.6](#). Data supporting forward pricing rate agreements or final indirect cost proposals will be submitted in a format acceptable to the Contracting Officer. Table 15-2 in [FAR 15.408](#) shows acceptable formats in which cost and pricing information may be requested.

#### **3.8.4.5.2 Defective Cost or Pricing Data**

If the Contracting Officer learns, before an agreement on price, that any cost or pricing data submitted are inaccurate, incomplete, or outdated, the Contracting Officer will immediately bring the matter to the attention of the contractor, whether the defective data increases or decreases the contract price. The Contracting Officer will negotiate the price either by using any new data submitted or by making satisfactory allowance for the incorrect data. The price negotiation memorandum will reflect the revised facts.

If cost or pricing data are found after award to be inaccurate, incomplete, or outdated at the date of final agreement on price given on the contractor's or subcontractor's Certificate of Current Cost or Pricing Data, the Government is entitled to a price adjustment, including profit or fee, of any significant amount by which the price increased because of the defective data. This entitlement is set forth in the appropriate clauses prescribed in [FAR 15.408](#). These clauses give the Government the right to a price adjustment for defects in cost or pricing data submitted by the contractor, a prospective subcontractor, or a present subcontractor.

#### **3.8.4.5.3 Cost Analysis Techniques and Procedures**

To perform cost analysis, the Contracting Officer will use, as appropriate, the following techniques and procedures for verifying cost or pricing data and evaluating cost elements:

- necessity for and reasonableness of proposed costs, including allowances for contingencies
- projection of the offeror's cost trends on the basis of current and historical cost or pricing data

- technical appraisal of the estimated labor, material, tooling, facilities requirements, and the reasonableness of scrap and spoilage factors
- application of audited or negotiated indirect cost rates, labor rates, and cost of money or other factors

#### **3.8.4.5.4 Technical Analysis**

The purpose of a technical analysis is to establish the acceptability and reasonableness of the labor hours and material items contained in the contractor's pricing proposal or back-up records and data. The criteria to use are the applicable specification requirements, any work scope understanding reached, and the manner in which the work is to be accomplished by the contractor with the contractor's facilities and manpower. Technical analysis is not to be made on the basis of an independent estimate on the optimum method for accomplishing the change by the contractor or another shipyard. The evaluation is to be based on an analysis of the specifications, the proposal and back-up data prepared by the contractor, and in accordance with any work scope understanding.

Technical analysis is the examination and evaluation by personnel with special knowledge, skills, or experience in ship work, engineering, science, or management. They examine proposed quantities and kinds of materials, labor, processes, special tooling, facilities, and associated factors set forth in a proposal to determine and report on the need for and reasonableness of the proposed resources, assuming reasonable economy and efficiency.

The Contracting Officer should generally request a technical analysis of proposals if cost or pricing data is required or whenever the Contracting Officer deems necessary, asking that, as a minimum, appropriate qualified personnel review and assess:

- quantities and kinds of material proposed
- need for the number and kinds of labor hours and the labor mix
- special tooling and facilities proposed
- reasonableness of proposed scrap and spoilage factors
- other data that may be pertinent to the cost or price analysis

#### **3.8.4.5.5 Allowability of Costs**

The allowability of costs is determined by [FAR 31](#) and supplements.

### **3.8.5 Technical Advisory Reports (TARs)**

A Technical Advisory Report (TAR) will be prepared by the technical analyst on claims/proposals that meet threshold criteria established by the SUPSHIP. At any value below that threshold, and at the discretion of the negotiator, a "desk" TAR may be performed

by the negotiator. Usually the evaluation involves review of direct labor hours and costs associated with material, delay in delivery, and/or disruption costs; it will also include review of the contractor's estimating standards. The TAR should reflect the technical evaluation and its results. The TAR serves several essential purposes, including essential file documentation, advice to the negotiator and ACO, and advice to the auditor if an audit is to be conducted. The objective of the TAR is to establish the acceptability and reasonableness of the contractor's proposal and/or backup data and records.

### **3.8.5.1 Requirements**

The TAR will contain a statement of the extent to which the analyst recognized that any cost or pricing data submitted or made available by the contractor was inaccurate, non-current, or incomplete. When the statement advises that there was defective data, the analyst will clearly delineate how the evaluation was conducted and the effect of deficient data on manhours or material dollars in the proposal and the analysis. Also, the TAR will clearly delineate the data not relied on during the evaluation. The TAR will reflect the technical analyst's professional judgment of the reasonableness of the manhours and material estimates in the contractor's proposal, the data accompanying the proposal, and the back-up data used by the contractor in preparing the proposal when a technical cost analysis is performed. The TAR will specifically address material which has been made excess or obsolete by a change and whether the Government has been given a credit or was charged for the material. The Government property administrator must be advised when title to Contractor Acquired Property (CAP) is to pass to the Government at the end of the contract.

If the technical analyst concludes the contractor's proposed labor hours and material are reasonable, the TAR must state the basis for the conclusion, e.g., historical data or actual return cost data. If, in the professional opinion of the technical analyst, the contractor's labor or material estimate is too high or too low in any area, the report must indicate the exact area of the proposal or back-up data in which the differences appear. The report also must indicate the rationale of the technical analyst and the contractor. Pinpointing the differences is essential for the TAR to be useful to the auditor or the negotiator. General statements of differences are of little or no use during negotiation.

The TAR will reference the local instructions and procedures followed in the evaluation instead of spelling out the steps in detail. When local instructions and procedures are not followed, the TAR will detail the steps taken in the evaluation and the rationale for not following the local instructions and procedures. The technical analyst will sign the TAR, which will be approved in accordance with local procedures. When independent estimates are made, the independent estimate will serve the purpose of a TAR. Technical analysts should, in particular, keep in mind that they should provide the negotiator with data which can be used in negotiations. For example, it does little good to state "the contractor's manhour estimate is too high and I know it is too high based on my personal experience." It would be far better for the technical analyst to demonstrate understanding of the scope of work (broken down into tasks), the trades/crafts involved, and reasonable manhours for each trade/craft.

### **3.8.5.2 Local Instructions and Procedures**

SUPSHIPS will establish local instructions and procedures to cover the steps to take in conducting technical evaluations of various types of proposals and the preparation of TARs to submit under various circumstances. Such instructions and procedures will have the following advantages:

- practices among the technical analysts will be uniform
- essential steps and information will be included and unnecessary steps and information excluded
- formats for preparation of the TAR can be standardized and simplified to the maximum extent possible

Local instructions and procedures will stress that for non-complex, small, gross value proposals and changes, a more simplified procedure, such as a “Desk TAR”, may be employed. Desk TARS are somewhat abbreviated evaluations that are usually performed by the negotiator and require less involvement from personnel outside the Contracts Department.

Procedures will provide for notification of the Government Property Administrator when material has been made excess or obsolete by a change and the Government is charged for the material. This notification is necessary because title to such material will remain with the Government at the end of the contract, regardless of contract type.

## **3.8.6 Audit Evaluations and Field Pricing Support**

### **3.8.6.1 Audit Evaluation**

SUPSHIPS are not precluded from requesting audits regarding contractual modifications for less than the certified cost or pricing data threshold, where deemed necessary by the Contracting Officer. The audit evaluation to be performed by the auditor will be in accordance with the directives under which the auditor operates, the procedural arrangements made between the ACO and the head of the audit office, the contents of the TAR, and the special considerations identified in the request for audit evaluation and submission of the Audit Advisory Report (AAR).

### **3.8.6.2 Audit Advisory Reports (AARs)**

On completion of the audit evaluation, the auditor will prepare the AAR in accordance with the directives under which the auditor operates and the procedural arrangements made with the ACO, and submit the report to the negotiator.

The AAR should incorporate the findings of the TAR, when provided, and should address any additional items requested by the ACO or ACO representative. The ACO or ACO

representative may request that a discussion of the audit findings be held prior to the release of the formal audit report.

### **3.8.6.3 Field Pricing Assistance**

Field pricing assistance ([FAR 15.404-2](#)) is a review and evaluation of the contractor's or subcontractor's proposal by any or all field pricing support personnel. This may include DCAA audit support or any other type of pricing support. The Contracting Officer should request field pricing assistance when the information available at the buying activity is inadequate to determine a fair and reasonable price. The Contracting Officer must tailor the type of information and level of detail requested in accordance with the specialized resources available at the buying activity and the magnitude and complexity of the required analysis.

Field pricing assistance is generally available to provide technical, audit, and special reports associated with the cost elements of a proposal, including subcontracts; information on related pricing practices and history; information to help contracting officers determine commerciality and price reasonableness; and identifying general market conditions affecting determinations of commerciality and price reasonableness.

In accordance with [PGI 215.4.4-2](#), the Contracting Officer should consider requesting field pricing assistance for:

- fixed-price proposals exceeding the cost or pricing data threshold
- cost-type proposals exceeding the cost or pricing data threshold from offerors with significant estimating system deficiencies (see [DFARS 215.407-5-70\(a\)\(4\)](#) and [\(c\)\(2\)\(i\)](#))
- cost-type proposals exceeding \$10 million from offerors without significant estimating system deficiencies

#### **3.8.6.3.1 Cost Realism Analysis**

Cost Realism Analysis ([FAR 2.101](#)) is the process for independently reviewing and evaluating specific elements of each offeror's proposed cost estimate to determine whether the estimated proposed cost elements:

- are realistic for the work to be performed
- reflect a clear understanding of contract requirements
- are consistent with the unique methods of performances and materials described in the offeror's technical proposal

Even when adequate price competition exists, cost realism analysis may be appropriate, especially for cost-reimbursement contracts, to ensure a reasonable expectation that proposed costs are consistent with the technical proposal. Cost realism analysis should also

be used when the solicitation contains new requirements that may not be fully understood by competing contractors, when there are quality concerns, or when past experience has indicated that contractors have proposed costs which have resulted in quality or service shortfalls.

For more detailed information regarding Cost Realism Analysis, refer to the [DoD Contract Pricing Reference Guides, Volume 4, Chapter 8](#).

### **3.8.7 Reaching Work Scope Understanding**

This section provides an overview of work scope understandings and discusses work scope conferences and data.

#### **3.8.7.1 General**

It is unusual for a SUPSHIP to have to reach a work scope understanding with the contractor, as the term is used in this chapter, for a contract itself. Such understandings are usually reached in pre-bid/negotiation conferences or other discussions; therefore, work scope understandings are addressed in the context of contract changes.

Before a contractor can prepare an estimate of the cost of a change, it first must determine the work scope of the change. There should be an understanding between the contractor and the negotiating team on the work scope before the change is adjudicated. If there is no common basis of understanding the requirements of the change, there cannot be a common basis for adjudication. Reaching an early understanding of work scope prevents later conflicts and permits the negotiating team to limit the evaluation of the contractor's proposal to the estimated cost of performance. For unpriced modifications, a work scope understanding should be reached with the contractor before issuing the unpriced modifications. Such work scope understandings do not modify the content of the modification.

Work scope understandings will be reached before completion of the technical analysis. These understandings may be accomplished by any reasonable means including work scope conferences. The difficulty in reaching work scope understandings and the need and timing for holding work scope conferences is directly related to the clarity and accuracy of the applicable specifications. When the specifications are clear and accurate, a work scope conference may not be needed, especially if the contractor's proposal raises no serious technical questions. On the other hand, a work scope conference will generally be needed if the specifications are not clear and accurate, or if the contractor's proposal raises serious technical questions. For the former, the conference should be held before proposal submission. For the latter, the conference should be held after receipt of the proposal. When there are serious disagreements about the work scope, a work scope conference should be held, preferably before receiving the proposal. The ACO will establish local procedures for reaching work scope understandings with the contractor, including the use of work scope conferences.

When a work scope understanding is reached before proposal submission, the proposal for pricing the change is to be submitted in accordance with the understanding. The contractor's proposal will be submitted based on the work scope understanding reached. Thus, the technical analyst reviewing the work scope description prepared by the contractor or attending the work scope conference should conduct, if possible, the technical evaluation of the proposal when it is received.

### **3.8.7.2 Work Scope Conference**

The extent of participation by the Government and contractor representatives at work scope conferences will be determined based on type and complexity of work, issues for resolution, and gross dollar value. Participants should be limited to necessary personnel. A work scope will typically include a Project Office representative, the SUPSHIP negotiator, a technical analyst, and contractor representatives. Legal counsel, ACO, auditor, engineers, and other specialists should be included when deemed necessary.

#### **3.8.7.2.1 Work Scope Data**

As minimum, work scope data should include:

- description of the work required by the contract before the change
- work which is deleted by the change
- work deleted by the change which already has been completed

The description is to include a list of components, equipment, and other identifiable property. Also, the status of manufacture, procurement, or installation of such property is to be indicated. Personnel will furnish separate descriptions for design work and production work. Raw materials, purchase parts, components, and other identifiable hardware that the change makes expendable, and which the contractor will or will not retain, are to be listed for later disposition.

### **3.8.8 Profit/Fee**

This section outlines policy and procedures for profit/fee determination.

#### **3.8.8.1 General**

Profit or fee pre-negotiation objectives represent that element of the potential total remuneration that contractors may receive for contract performance over and above allowable costs. This potential remuneration element and the Government's estimate of allowable costs to be incurred in contract performance equal the Government's total pre-negotiation objective. Even as actual costs may vary from estimated costs, the contractor's actual realized profit or fee may vary from negotiated profit or fee.

It is in the Government's interest to offer contractors opportunities for financial rewards sufficient to stimulate efficient contract performance, attract the best capabilities of qualified large and small business concerns to Government contracts, and maintain a viable industrial base.

### **3.8.8.2 Policy**

[FAR 15.404-4](#) requires DoD to use a structured approach for determining the profit or fee objective in those contractual actions that require cost analysis and authorize prescribing exemptions for situations in which mandatory use of a structured approach would be clearly inappropriate (e.g., cost-plus-award-fee contracts). The Weighted Guidelines Method described in [DFAR 215.404.71](#) is DoD's structured approach for performing a profit analysis.

### **3.8.8.3 Procedures**

Before contract price negotiation, the negotiator will develop a profit objective. When the contractor's proposal contains cost or pricing data by identification or submission, cost analysis must be used to analyze the proposal, and the profit objective must be established in accordance with [DFARS 215.404](#).

Before the negotiation of the price adjustment for a contract modification, the negotiator will develop a profit objective. When price analysis (independent estimate) is employed, the profit objective is to be established in accordance with [DFARS 215.404-4](#).

In assigning the risk factors covered in [DFARS 215.404](#), the negotiator is to consider the contractor's proposal.

## **3.8.9 Negotiator's Evaluation and Pre-Negotiation Position**

### **3.8.9.1 General**

Upon receipt of the contractor's proposal, the TAR, the AAR, and any other field pricing assistance, if obtained, the negotiator then has the basic documents needed for the evaluation and preparation of the pre-negotiation position.

As a minimum, the negotiator, in making an evaluation, will consider the following matters if applicable:

- Have all of the prior actions required by the above procedures been accomplished?
- Are the findings and recommendations contained in the TAR and AAR clear on which costs are questionable or unreasonable? Has the rationale been provided?
- Should the contractor be required to provide additional information to support questionable items before establishing the pre-negotiation position?

- Does the proposed price contain costs which are not considered allowable in the pricing of the change?
- If there is excess or obsolete material resulting from the change, has that material been properly identified and appraised? Has sufficient credit been given to the Government for material to be retained by the contractor? Has the Government property administrator been appropriately notified?
- Is the overtime and shift work included in the proposal acceptable?
- Has the proposal been prepared and evaluation made in accordance with the requirements of any economic adjustment clause included in the contract?
- Is the profit/fee fair and reasonable?

The negotiator will consider the extent of defective cost or pricing data identified by the TAR and AAR. After all questionable matters are resolved, the negotiator will establish a pre-negotiation position in writing and obtain approval, as required.

### **3.8.9.2 Proposal Updates**

Most contractor proposals are only valid for a specific period of time. It is normally expected that negotiations would be completed prior to expiration of this time period; however, if not, it may be necessary to request an extension or an updated proposal from the contractor. If an updated proposal is submitted, it may also be necessary to obtain updated TARs and/or AARs.

### **3.8.9.3 Business Clearances**

#### **3.8.9.3.1 General**

The purpose of a business clearance is to demonstrate that the proposed acquisition or contract change conforms to good business practice, law, or regulation, and to justify, by written evidence, that the cost and price established are fair and reasonable. In addition, a business clearance serves as the historical record of the business cost and pricing aspects of the acquisition or contract change and contains all required approvals by higher authority.

In accordance with NCH 15.406, a business clearance must be prepared for all contract actions and in all circumstances set forth in NMCAR 5201.690 and other individual actions specified by NAVSEA 02/02B. The Contracting Officer signing the contract action is responsible for ensuring the required business clearance approval has been obtained prior to award. SUPSHIPs are authorized to approve business clearances up to a threshold established by NAVSEA 02. Per NCH 15.406, each business clearance, together with supporting source documents, must clearly establish that:

- the negotiation objective or Government position is fair and reasonable in terms of both price and contract terms as well as conditions

- the contemplated business arrangement and the contract to be awarded are sound and in compliance with laws, regulations, and policies

The format and content of clearances may be tailored for local use when the approval authority is below the threshold set by NAVSEA 02. Those clearances above the threshold must follow format and content set by NAVSEA 02.

[NMCARS 5201.690](#) requires that for all procurement actions subject to business clearance requirements, the Head of Contracting Activity (HCA) must establish business clearance approval levels that are at least one level above the individual responsible for conducting the negotiations or, if negotiations are not required, for handling the proposed actions.

### **3.8.10 Special Areas**

This section outlines some special areas regarding the administrative process for issuing and negotiating changes.

#### **3.8.10.1 Packaged Negotiations**

The negotiation of a number of changes as a package under a single contract and the use of single supplemental agreement for the package is a technique to be used under either of the following circumstances:

- when a group of fixed-price changes are related in such a way that establishing a separate work scope for each one would be impractical
- when the ACO decides that combining and adjudicating a group of changes after independent estimating has been performed would be advantageous

The type and level of business clearance approval will be determined by the gross value of the total package being adjudicated instead of the value of the individual changes in the package. If the gross value of a package of changes evaluated on the basis of independent estimates equals a price increase or decrease in excess of the cost or pricing data threshold, [FAR 15.403](#) requires that certified cost or pricing data be obtained from the contractors.

When, for administrative convenience, the ACO includes more than one separately negotiated and priced change in a single supplemental agreement with the equitable adjustment shown for each change, such a procedure is not package adjudication. Further, if none of the changes have an adjudicated price in excess of the cost or pricing data threshold, the mandatory requirements of Public Law 87-653 regarding cost or pricing data do not apply.

#### **3.8.10.2 Periods of Performance (POP)**

SUPSHIPs should monitor scheduling, reporting, and recording of realistic periods of performance required to complete a contract change. SUPSHIPs should ensure the completion of actions as scheduled. If meeting a POP is not feasible for any reason, the

negotiator should establish a new, realistic date through coordination with the Project Office and negotiation with the contractor.

### **3.8.10.3 Coordination and Relationship with DCAA**

The ACO will establish a close working arrangement with the cognizant DCAA office. Periodic meetings should be held to discuss the audit assistance and general accounting to be rendered. A general understanding should be reached covering pricing actions expected to require specific advisory reports and advisory reports for general use.

The content of advisory reports to be submitted by the auditors is very important and should be considered carefully. A properly prepared report will be an invaluable tool to the negotiator during discussions with the contractor. SUPSHIP should contact NAVSEA 02 if they encounter unresolved difficulties regarding any aspect of DCAA assistance.

### **3.8.10.4 Notification of Contract Changes**

When a contractor considers that the Government has affected or may affect a change in the contract that has not been identified as such in writing and signed by the Contracting Officer, it is necessary that the contractor notify the Government in writing as soon as possible. This will permit the Government to evaluate the alleged change and perform the following:

- confirm that it is a change, direct the mode of further performance, and plan for its funding
- countermand the alleged change
- notify the contractor that no change is considered to have occurred
- request more information

The clause at [FAR 52.243-7](#), Notification of Changes, which is prescribed in [FAR 43.107](#), basically:

- incorporates the policy expressed above
- requires the contractor to notify the Government promptly of any Government conduct that the contractor considers a change to the contract
- specifies the responsibilities of the contractor and the Government with respect to such notifications

### **3.8.10.5 Funding**

The Contracting Officer will not execute a contract modification that causes or will cause an increase in funds without having first obtained a certification of funds availability. The exception is for modifications to contracts that:

- are conditioned on availability of funds (see [FAR 32.703-2](#))
- contain a limitation of cost or funds clause (see [FAR 32.704](#))

The certification will be based on the negotiated price, except that modifications executed before agreement on price may be based on the best available estimate of cost.

### **3.8.10.6 Notification of Substantial Impact on Employment**

The Office of the Assistant Secretary of Defense (Public Affairs) is required to be notified of any contract award or modification of a defense contract that exceeds \$5.5 million ([DFARS 205.303](#)). Additionally, [DFARS Clause 252.249-7002](#) imposes notification requirements on the contractor for any subcontract termination or reduction that exceeds \$550,000.

### **3.8.10.7 Identification of Foreign Material Sales (FMS) Contract Modifications**

Each Foreign Material Sales (FMS) modification must be identified by clearly stamping or otherwise indicating “FMS Requirement” on the face of the modification. It also must specify within the modification each FMS case identifier code by line or sub-line item number (e.g., FMS Case Identifier GY-D-DCA).

### **3.8.10.8 Change Orders**

The following sections discuss change orders.

#### **3.8.10.8.1 General**

In general, Government contracts contain a “Changes” clause that permits the Contracting Officer to make unilateral changes, in designated areas, within the general scope of the contract. These are accomplished by issuing written change orders on an SF 30, Amendment of Solicitation/Modification of Contract (SF 30), unless otherwise provided. The contractor must continue performance of the contract as changed, except that in cost-reimbursement or incrementally funded contracts the contractor is not obligated to continue performance or to incur costs beyond the limits established in the “Limitation of Cost or Limitation of Funds” clause.

#### **3.8.10.8.2 Authority to Issue Change Orders**

Change orders are issued by the ACO unless the PCO retains the contract for administration. This authority has been delegated by COMNAVSEA to Supervisors of Shipbuilding, Conversion and Repair, USN, for job orders issued under Master Ship Repair Agreements (MSRAs) or Agreements for Boat Repairs (ABRs).

#### **3.8.10.8.3 Change Order Accounting Procedures**

Contractors’ accounting systems are seldom designed to facilitate the segregation of the costs of performing changed work. Therefore, before prospective contractors submit offers,

the Contracting Officer should advise the contractors of the possible need to revise their accounting procedures to comply with the cost segregation requirements of the Change Order Accounting clause at [FAR 52.243-6](#). The following categories of direct costs can normally be made segregable and accountable under the terms of the “Change Order Accounting” clause:

- nonrecurring costs (e.g., engineering costs and costs of obsolete or re-performed work)
- costs of added distinct work caused by the change order (e.g., new subcontract work, new prototypes, or new retrofit or backfit kits)
- costs of recurring work (e.g., labor and material costs)

#### **3.8.10.8.4 Administration**

The following sections discuss administrative concerns.

##### **3.8.10.8.4.1 Change Order Documentation**

If an equitable adjustment in contract price cannot be agreed in advance of a prospective change, then two documents are required: the change order and a supplemental agreement reflecting the resulting equitable adjustment in contract terms. If an equitable adjustment in the contract price or delivery terms or both can be agreed upon in advance, only a supplemental agreement need be issued. However, administrative changes and changes issued according to a clause giving the Government a unilateral right to make a change (e.g., an “Option” clause) initially require only one document.

In situations where an unpriced or undefinitized change is issued, the change must generally be sufficiently definitive so that the contractor is obligated to total performance within a stated period of time for a maximum not-to-exceed price that the Government can be charged under the change order. Exceeding this price is not an item subject to negotiation with the Government. This maximum not-to-exceed price must bear a reasonable relationship to the work to be performed. All such unpriced or undefinitized changes are to contain definitization schedules which provide for definitization by the earlier of two periods of time. The first is the end of a 180-day period beginning on the date of issuance of the change. (This period may be extended, as required, but may not exceed the 180-day period beginning on the date the contractor submits a qualifying proposal.) The second is the date on which the amount of funds expended under the change order is equal to more than 50 percent of the maximum not-to-exceed price.

##### **3.8.10.8.4.2 Definitization**

Contracting officers are to negotiate equitable adjustments resulting from change orders in the shortest practicable time.

The ACO must review change orders issued by the Contracting Officer to ensure compatibility with the status of performance. If the contractor has progressed beyond the effective point specified in the change orders, the ACO must determine the earliest practicable point at which the change order could be made effective and so advise the Contracting Officer. The Contracting Officer must issue another change order to correct, revise, or reference the first change order, and then definitize by supplemental agreement, citing both change orders.

ACOs are to establish suspense systems adequate to ensure accurate identification and prompt definitization of unpriced change orders.

The Contracting Officer will ensure that a cost analysis is made if required under [FAR 15.404-1](#), and will consider the contractor's costs that can be segregable for the change, if available. If additional funds are required as a result of the change, the Contracting Officer will secure the funds before making any adjustment to the contract.

When the Contracting Officer requires a field pricing review of requests for equitable adjustments, the Contracting Officer is to provide a list of any significant contract events which may aid in the analysis of the request. This list should include:

- date and dollar amount of contract award and/or modification
- date of submission of initial contract proposal and dollar amount
- dates of alleged delays or disruptions
- performance dates as scheduled at date of award and/or modification
- actual performance dates
- date that entitlement to an equitable adjustment was determined or Contracting Officer's decision was rendered, if applicable
- date of certification of the request for adjustment, if certification is required
- dates of any pertinent Government actions or other key events during contract performance that may have an impact on the contractor's request for equitable adjustment

#### **3.8.10.8.4.3 Complete and Final Equitable Adjustment**

To avoid subsequent controversies that may result from a supplemental agreement containing an equitable adjustment as the result of a change order, the Contracting Officer should:

- ensure that all elements of the equitable adjustment have been presented and resolved

- Include in the supplemental agreement, a release similar to the following

**“CONTRACTOR’S STATEMENT OF RELEASE”**

“In consideration of the modification(s) agreed to herein as complete equitable adjustments for the contractor’s \_\_\_\_\_ (describe) \_\_\_\_\_ proposal(s) for adjustment; the contractor hereby releases the Government from any and all liability under this contract for further equitable adjustments attributable to such facts or circumstances giving rise to the proposal(s) for adjustment (except for \_\_\_\_\_).”

#### **3.8.10.8.4.4 Consideration as Command Key Indicator**

Heads of Contracting Activities (HCAs) are to consider the backlog and age of undefinitized change orders as a command key indicator, placing routine management emphasis on undefinitized change orders.

### **3.9 Policy for Overtime and Multi-Shift Work**

FAR [Part 22](#), DFARS, [Part 222](#), and the NCH Part 22, prescribe contracting policy and procedures for implementing pertinent labor laws and associated contract clauses. Contractors shall perform all contracts so far as practicable without using overtime, particularly as a regular employment practice, except when lower overall costs to the Government will result or when it is necessary to meet urgent program needs. Any approved overtime, extra-pay shifts, and multi-shifts should be scheduled to achieve these objectives.

Approval of the overtime may be granted after determining in writing that overtime is necessary to:

- meet essential delivery or performance schedules
- make up for delays beyond the control and without the fault or negligence of the contractor
- eliminate foreseeable extended production bottlenecks that cannot be eliminated in any other way

Refer to [FAR 22.103-4](#), [DFARS 222.103-4](#), and NCH 22-103.4 for additional information regarding approvals.

#### **3.9.1 Overtime and Multi-Shift Premiums for Fixed-Price Contract Considerations**

DoD overtime and multi-shift premium regulations have been established to limit the amount of premium overtime and shift compensation that the Government may allow or consider in pricing. Overtime or shift premiums may not be authorized at Government expense when the contractor is already obligated to meet the required delivery dates without the right to

additional compensation. Thus, a contractor performing under a fixed-price contract generally is not entitled, under the overtime regulations, to obtain any compensation for overtime or shift pay in addition to the original contract price. In accordance with NCH 22.103-4, for vessel new construction, only NAVSEA 02/02B has authority to approve overtime work to obtain delivery of the vessel prior to the delivery date.

### **3.9.2 Overtime and Multi-Shift Premiums for Cost-Reimbursable and Letter Contract**

Cost-reimbursable and letter contracts require Government approval of contractor overtime and multi-shift premium payments. This contractual control is necessary since the premium payments, like other costs, are subject to audit and reimbursement. The contract provisions may require that all overtime and multi-shift premiums be approved by the contracting officer or the duly authorized representative. The terms of individual contracts must be examined to ascertain exact requirements and the applicability of the requirements to overtime and multi-shift premium work by subcontractors.

In accordance with NCH 22.103-4, NAVSEA 022 will normally determine and approve overtime and multi-shift premiums for new construction contracts, but may grant this authority to the ACO. These determinations and approvals are made prior to the time that the premium costs are incurred, but may be made retroactively if justified by circumstances. NAVSEA 022 may also authorize the ACO to make determinations and approve overtime. When forwarding any contractor request for overtime or multi-shift premium approvals to NAVSEA, SUPSHIP should ensure that all information necessary to make a determination is included, should comment on the accuracy of the facts in the contractor's request, and should advise whether or not the request should be approved. The DCAA office should be requested to provide advice to SUPSHIP with respect to the contractor's request.

For changes under cost-reimbursement contracts requiring overtime, the amount of overtime is limited to the ceiling established by NAVSEA for the contract. Any increase in ceiling required because of the change must be authorized by NAVSEA.

## **3.10 Warranties**

### **3.10.1 General**

The use of a warranty in an acquisition is no longer mandatory and shall be approved in accordance with agency procedures as stated in FAR [Part 46.703](#) and DFARS [Part 246.704](#). The Procuring Contracting Officer will determine if the use of a warranty clause(s) should be used in a contract. The principal purposes for having a warranty in a Government contract are to:

- delineate the rights and obligations of the contractor and the Government for defective items and services
- foster quality performance

When a warranty is included in the contract, it should specify:

- a contractual right for the correction of defects notwithstanding any other requirement of the contract pertaining to acceptance of the supplies or services by the Government; and
- a stated period of time or use, or the occurrence of a specified event, after acceptance by the Government to assert a contractual right for the correction of defects.

The benefits to be derived from a warranty must be commensurate with the cost of the warranty to the Government.

### **3.10.2 Criteria for the Use of Warranties**

In determining whether a warranty is appropriate for a specific acquisition, the following general factors shall be considered:

- Nature and use of the supplies or services
- Potential cost that the contractor will charge based on risk
- Government's cost for administration and enforcement. (Cost is driven by the existence of an adequate administrative system for reporting defects or whether one must be established.)
- Trade practice
- Reduced requirements
- Type of contract

### **3.10.3 Limitations on Use of Warranties**

The following must be considered as stated in [FAR 46.706](#):

- a. Warranties will not be included in cost-reimbursement contracts unless authorized in accordance with agency regulations or as required by FAR [52.246-3](#) and [52.246-8](#).
- b. Warranty clauses shall not limit the Government's rights under an inspection clause in relation to latent defects, fraud, or gross mistakes that amount to fraud.
- c. Except for warranty clauses in construction contracts, warranty clauses shall provide that the warranty applies notwithstanding inspection and acceptance or other clauses or terms of the contract.

### **3.10.4 Warranty Terms and Conditions**

When a warranty is to be included in an acquisition, the contracting officer shall ensure that the clause(s) clearly state the:

- a. Exact nature of the item and its components and characteristics that the contractor warrants;
- b. Extent of the contractor's warranty including all of the contractor's obligations to the Government for breach of warranty;
- c. Specific remedies available to the Government; and
- d. Scope and duration of the warranty.

FAR [46.706](#) through [46.709](#) provide specific guidelines that the contracting officer shall consider to facilitate pricing and enforcement when preparing warranty terms and conditions.

### **3.10.5 Contract Clauses for Warranties**

The clauses and alternates prescribed in FAR [46.710](#), FAR [52.246](#), DFARS [246.710](#) and NAVSEA developed clauses for specific acquisitions may be used in solicitations and contracts in which inclusion of a warranty is appropriate. However, because of the many situations that may influence the warranty terms and conditions appropriate to a particular acquisition, the procuring contracting officer may vary the terms and conditions of the clauses and alternates to the extent necessary.

### **3.10.6 General Definitions in Warranties**

"At no additional cost to the United States" means at no increase in price for firm-fixed-price contracts, in target or ceiling price for fixed-price-incentive contracts, or in estimated cost or fee for cost-reimbursement contracts. If a fixed-price-incentive contract contains a warranty, the estimated cost of the warranty to the contractor should be considered in establishing the incentive target price and the ceiling price of the contract. All costs incurred or estimated to be incurred by the contractor in complying with the warranty will be considered when establishing the total final price. Contractor compliance with the warranty after the establishment of the total final price will be at no additional cost to the Government.

"Design and manufacturing requirements" means structural and engineering plans and manufacturing specifications, including precise measurements, tolerances, materials, and finished product tests for the weapon system.

"Essential performance requirements" mean the operating capabilities and maintenance and reliability characteristics of a weapon system determined by the SECDEF (or delegated authority) to be necessary for the system to fulfill the military requirements for which it is designed.

"Initial production quantity" is the number of units of a weapon system contracted for in the first program year of full-scale production. Mature full-scale production is the follow-on production of a weapon system after manufacture of the lesser of the initial production quantity or one-tenth of the eventual total production quantity.

"The prime contractor" is a party who enters into an agreement directly with the United States to furnish a weapons system or a major subsystem.

"Weapon system" means a system or major subsystem used directly by the armed forces to carry out combat missions including, but not limited to: naval vessels; strategic and tactical missiles including launching systems; guided munitions; military surveillance, command, control, and communication systems; mines; torpedoes; fire control systems; propulsion systems; electronic warfare systems; and safety and survival systems.

"Acceptance," including the execution of an official document (e.g., DD Form 250, Material Inspection and Receiving Report), must be made by an authorized representative of the Government.

"Defect" refers to any condition or characteristic in any supply or service furnished by the contractor under the contract that is not in compliance with the requirements of the contract.

Contracts which the SUPSHIP administers may be in effect which include less stringent warranty or guaranty clauses. Particular attention, however, should be given to FAR [46.7](#) and NAVSEA developed clauses which are tailored to a particular acquisition.

### **3.10.7 Applicability to Foreign Military Sales (FMS)**

Special care must be exercised to ensure that the FMS purchaser will bear all of the acquisition and administration costs of any warranties obtained. The warranty requirements of FAR [46.7](#) are not mandatory for FMS production contracts. NAVSEA typically obtains for FMS purchasers the same warranties against defects in workmanship and material and conformance to design and manufacturing requirements as obtained by the United States Government for similar purposes. NAVSEA will not normally obtain essential performance warranties for FMS purchasers. The FMS purchaser will be advised of the warranties normally obtained by the United States Government. If the FMS purchaser requests a warranty in the LOA, the United States Government will obtain the same warranties on conformance to design and manufacturing requirements and against defects in material and workmanship that are obtained for U.S. supplies. If the FMS purchaser expressly requests a performance warranty, the United States Government will exert its best efforts to obtain the same warranty obtained on U.S. equipment or, if specifically requested by the FMS purchaser, a unique warranty. The costs for warranties for FMS purchasers may be different than the costs for such warranties for the United States due to factors such as overseas transportation and any tailoring to reflect the unique aspects of the FMS purchaser. An approved "direct sale" to a foreign government by the contractor is NOT administered by the Supervisor of Shipbuilding.

### **3.10.8 Cost-Benefit Analysis**

NAVSEA policy requires obtaining warranties only when the warranties are cost-effective. If a contracting officer considers a warranty not cost-effective, a waiver request will be initiated. To determine whether a warranty would be cost-effective, an analysis must be performed in which the benefits from the warranty are compared with the warranty's acquisition and administration costs. The analysis should examine a weapon system's life cycle costs, both with and without a warranty. When possible, a comparison of the cost of obtaining and the cost of enforcing similar warranties on similar systems should be made. The analysis should be documented in the contract file.

## **3.11 Guarantee and Acceptance**

### **3.11.1 General**

Subject to the limitation of liability set forth in the contract, the contractor is responsible for any defects or other failures of the ship to meet contract requirements discovered during the guarantee period.

### **3.11.2 Guarantee Period**

The guarantee period is to be specified in the contract. This period, however, is subject to extension for any length of time that NAVSEA determines the ship is not available for unrestricted service because of defects for which the contractor is responsible. The term "not available for unrestricted service" is contractual, and should be distinguished from the terms "acceptance for restricted service" and "acceptance for unrestricted service" which are used in connection with AT. Basically, the term "not available for unrestricted service" means that the ship is incapable of fulfilling its mission because of deficiencies that substantially reduce material readiness, that may cause the ship to be unseaworthy, or that may cause serious or fatal injuries to personnel or serious damage to the ship or installed equipment. Specifically, a ship is "not available for unrestricted service" when the ship is out of operation for repairs or corrections during the guarantee period. A ship also may be considered "unavailable for unrestricted service" although the ship may be able to operate in a disabled condition (e.g., it is unable to develop full power or fire missiles effectively).

NAVSEA determines whether the ship is not available for unrestricted service as a result of defects for which the contractor is responsible or for other causes. If NAVSEA considers the contractor to be responsible, the contractor is notified through the SUPSHIP that the running of the guarantee period is suspended. At the end of the period of suspension, NAVSEA again notifies the contractor of the date to which the guarantee period has been extended. Defects known at the time of delivery of the ship are not guarantee defects and are not subject to the contract's liability ceiling.

### **3.11.3 Surface Ship and Submarine Deployment during the Guarantee Period**

After delivery or redelivery, control and operation of a ship or submarine are the sole responsibilities of the Navy. During the guarantee period, tests and trials are normally conducted to ready the ship or submarine for fulfillment of its Navy mission and for acceptance as part of the operating forces.

Final Contract Trials (FCT) are conducted by the Navy before expiration of the contract guarantee period. These trials are witnessed by INSURV and are the same in scope as AT, except that these trials are run entirely by Navy personnel. When practical, the contractor will be invited to send representatives to the trials. Representatives of SUPSHIP may also attend to outline the status of contractor-responsible work items and to aid NAVSEA and the trial board as requested.

The contract guarantee period may expire in accordance with the contract terms regardless of whether final contract trials, shakedown, and the other operations described above are actually held by the Navy within the guarantee period. In this sense, the contractor has no contractual concern with the operations conducted by the Navy during the guarantee period. To the Navy, however, that final contract trials be scheduled for completion before the expiration of the guarantee period is more economical, since, if the trials are not held, material inspections must be made to tabulate all contractor-responsible deficiencies.

### **3.11.4 Contractor Responsibility under the Guarantee Provisions**

The guarantee provisions of the contract cover defects and deficiencies that develop and are discovered during the guarantee period, even though notice is not actually given to the contractor until after the guarantee period has expired. As discussed in SOM 10.6.8, NAVSEA procedures are designed to provide prompt notices to the contractor. In practice, several weeks may elapse after the end of the guarantee period before the contractor is finally notified of all defects because of the time required by the trial board to prepare and submit its Final Contract Trials Report, and because the trials may not be completed until immediately before the end of the guarantee period. Since the contractor's representatives may be onboard during the trials, however, the contractor may have preliminary information regarding all defects for which the contractor is considered responsible. Contract provisions may require or permit a contractor Guarantee Engineer aboard the ship during the guarantee period. This contract provision will tend to help resolve problems and to determine responsibility for correction of deficiencies. The SUPSHIP will provide necessary written guidance to the ship on dealing with this engineer and the engineer's work involved in correction of deficiencies.

The contract customarily sets forth a limitation on the contractor's liability for defects arising during the guarantee period. The amount of the limitation is established at award of the contract. In general, in a multi-ship procurement, the limit applies to all ships under the contract as a group; in other words, the limit is on a total contract basis and is not prorated for each ship. In addition, the limit applies only to defects arising during the guarantee

period. Any contractor-responsible defects that are known before delivery (noted as work items before delivery) are outside the limitation of liability, even if the defects are not corrected or decrease cost changes for the defects are not issued before delivery.

The Navy may elect to have the contractor correct or replace the defects for which the contractor is responsible under the guarantee provisions or to perform the work itself. This discretionary authority is necessary because the availability of the ship after acceptance depends on deployment and operational considerations. When practical, however, in accordance with the terms of the contract, the contractor will be given an opportunity to examine defective items before the Government replaces or corrects the items. The Navy activity performing or supervising performance of the work will obtain prior clearance from SUPSHIP so that the contractor may send representatives to the worksite.

### **3.11.5 Guarantee under Fixed Price Contracts**

The contractor is responsible for correcting contractor defects under fixed price contracts. If the Navy decides not to have the contractor perform the work, an equitable reduction in contract price is made by an appropriate contract modification. Under contracts for which the SUPSHIP has the authority, SUPSHIP issues and adjudicates field changes covering the non-correction of contractor-responsible defects arising before and during the guarantee period. See section 3.11.5 below regarding guarantees in cost-reimbursement contracts.

For contractor-responsible items which were not corrected by the contractor, contract modifications should be issued promptly and clearly specify defects or deficiencies. SUPSHIP will use cost data for the adjudication of the contract price reduction. During the guarantee period, SUPSHIP should obtain from the Navy fitting out activity (or NAVSEA) a copy of the report of the ship's departure from the fitting out activity (conventional-powered ships only). This report contains a record (including cost data) of all work performed or material supplied by the fitting out activity to complete or correct contractor-responsible work items. After post shakedown availability of the ship, SUPSHIP maintains close liaison with the CO, NAVSEA, and the contractor on the accomplishment of contractor-responsible work. Until final settlement of the contract, SUPSHIP should also maintain a complete list of unaccomplished contractor-responsible work items, showing the current status of each item.

### **3.11.6 Guarantee under Cost-Reimbursement Contracts**

As with fixed-price contracts, ships under cost-reimbursement type contracts are accepted preliminarily on delivery. These contracts provide for a period of guarantee as specified in the contract which is subject to extension for any time that the ship is not available for unrestricted service because of contractor-responsible defects. During the guarantee period, the Government may require the contractor to correct or replace any defects or nonconformance that existed at delivery. The costs of such work are reimbursable without fee to the contractor under the applicable contract cost principles; the contract limit of costs provision also applies. The Government, however, may require the contractor to correct or replace at the contractor's expense, defects or failures that arise because of fraud, lack of

good faith, or willful misconduct on the part of the contractor's directors, officers, or other managerial personnel, as defined in the clause.

### **3.11.7 Guarantee for Ships to be Transferred to Foreign Governments**

The usual guarantee provisions described above are included in contracts for ships that are expected to be transferred by the Navy to foreign Governments. Because of the difficulties inherent in administering these provisions after the ship has been transferred, NAVSEA typically considers deleting the guarantee requirements on the departure of the ship from the United States before the expiration of the normal contract guarantee period. If NAVSEA decides that the guarantee requirements should be eliminated, an equitable downward adjustment in the contract price will be negotiated with the contractor to cover the deletion of the remaining guarantee requirements and the contract modified accordingly.

### **3.11.8 Guarantee Provisions in Boat (Supply Type) Contracts**

The Guarantee clause of boat contracts that contain the standard supply form of General Provisions (SF 32) provides for a warranty period of two years after delivery and acceptance or for a period of six months of operation after installation in the operational configuration and site.

Under the clause, the contractor guarantees that at delivery the boats are free from any defects in material or workmanship and conform to the requirements of the contract. The clause also provides that the contractor will be given notice of any defects and permits the Government to require correction or replacement of the deficiencies, or a price reduction, by further notice to the contractor within a reasonable time after Government notice of the defect. When the contractor replaces or corrects a defect or a nonconformance, the guarantee continues with respect to the new work for a period equal to full contract guarantee period, unless a different period of guarantee is specified in the schedule.

### **3.11.9 Notification by SUPSHIP of Guarantee Provisions**

To ensure the full protection of the Government's interests under the guarantee provisions of contracts, SUPSHIP will furnish to the PCO or the Officer in Charge of the ship at the time of its delivery (with a copy to the appropriate Fleet Commander and TYCOM) written notification containing the information listed below (in the case of boats and service craft, SUPSHIP gives the notification to the receiving command or stocking activity):

- a. the date of the end of the guarantee period
- b. quoted excerpts of all applicable contract clauses pertaining to the contractor's responsibility under the guarantee provisions
- c. a notice that any malfunction, failure, or casualty occurring in the ship or boat during the guarantee period, including any equipment deficiencies, should be reported promptly to NAVSEA and a copy of the report should be furnished to SUPSHIP (in the case of

commissioned ships, reports should be forwarded to NAVSEA via SUPSHIP; however, an advance copy should be sent to NAVSEA)

- d. a notice that a list of unsatisfactory items including defects described in the preceding section should be forwarded in sufficient time to reach SUPSHIP and NAVSEA no less than 15 days before the expiration of the guarantee period (if any additional items are documented after the submission of this list and before the expiration of the guarantee period, a supplementary list will be immediately forwarded to the same activities); and
- e. a notice that during the final contract trial, the trial board should be provided with a complete list of known deficiencies to be included in its report

Before expiration of the guarantee period, SUPSHIP will communicate with the vessel, Fleet Commander, and NAVSEA requesting that SUPSHIP be advised of any guarantee defects for which the contractor is considered responsible.

### **3.11.10 Notices to the Contractor**

- a. If returning the ship to the contractor is considered practical and feasible, the notice to the contractor will advise the contractor of:
  - (1) The nature of the defects and deficiencies deemed to be the contractor's responsibility;
  - (2) The reason why the contractor is responsible, including references to the applicable job order, specification work item, and work item requirements; and
  - (3) The place and date the ship will be available for the contractor to inspect the defects and deficiencies involved and the arrangements made for the contractor's inspection.
- b. If returning the ship to the contractor is considered impractical or undesirable, the notice to the contractor will advise the contractor of:
  - (1) Nature of the defects and deficiencies deemed to be the contractor's responsibility;
  - (2) Reason why the contractor is responsible, including references to the applicable job order, specification work item, and work item requirements;
  - (3) Explanation why returning the ship to the contractor for repairs is impractical or undesirable; and
  - (4) Place and date the ship will be available for the contractor's inspection of the defects and deficiencies involved and the arrangements made for the contractor's inspection.

## 3.12 Subcontracts

### 3.12.1 Introduction

This section discusses policies and procedures for consent to subcontract and for review, evaluation, and approval of contractor's purchasing systems. Subcontracting policies and procedures addressed herein are based upon [FAR Part 44](#), [DFARS Part 244](#), and NCH Part 44.

Contractors generally attempt to award at least the major subcontracts shortly after receiving award of the prime contract. For this reason, SUPSHIPs should expect and be prepared to provide prompt service in order to avoid delaying the contractor.

Subcontract consent is not the sole responsibility of the Contracts Department. Other SUPSHIP departments, as appropriate, should be involved to ensure that all pertinent aspects for which they are responsible are adequately covered in subcontracts. All SUPSHIP departments involved in subcontract consent will develop and use checklists to assist in their reviews.

### 3.12.2 Definitions

"Approved purchasing system" refers to a contractor's purchasing system that has been reviewed and approved in accordance with [FAR 44.3](#).

"Consent to subcontract" refers to the Contracting Officer's written consent for the prime contractor to enter into a particular subcontract.

"Contractor" refers to the total contractor organization or a separate entity of the organization, such as an affiliate, division, or plant that performs its own purchasing.

"Contractor Purchasing System Review (CPSR)" refers to the complete evaluation of a contractor's purchasing of material and services, subcontracting, and subcontract management from development of the requirement through completion of subcontract performance.

"Subcontract," as used in this section, refers to any contract as defined in [FAR 2.101](#) and entered into by a subcontractor to furnish supplies or services for performance of a prime contract or a subcontract. A subcontract includes, but is not limited to, purchase orders and changes and modifications to purchase orders.

"Subcontract" as used in this section could also indicate (as defined in [FAR 12.001](#)), but not be limited to, a transfer of commercial items between divisions, subsidiaries, or affiliates of a contractor or subcontractor.

"Subcontractor" refers to any supplier, distributor, vendor, or firm that furnishes supplies or services to or for a prime contractor or another subcontractor.

### 3.12.3 Consent Requirements

If the contractor has an approved purchasing system, consent is required for subcontracts specifically identified by the Contracting Officer in the subcontracts clause of the contract. The Contracting Officer may require consent to subcontract if the Contracting Officer has determined that an individual consent action is required to protect the Government adequately because of the subcontract type, complexity, or value, or because the subcontract needs special surveillance. These can be subcontracts for critical systems, subsystems, components, or services. Subcontracts may be identified by subcontract number or by class of items (e.g., subcontracts for engines on a prime contract for airframes).

If the contractor does not have an approved purchasing system, consent to subcontract is required for cost-reimbursement, time-and-materials, labor-hour, or letter contracts, and also for unpriced actions (including unpriced modifications and unpriced delivery orders) under fixed-price contracts that exceed the simplified acquisition threshold for: (1) cost-reimbursement, time-and materials, or labor-hour subcontracts; and (2) for Department of Defense, fixed-price subcontracts that exceed the greater of the simplified acquisition threshold or 5 percent of the total estimated cost of the contract (see [FAR 52.244-2](#)).

The Contracting Officer's written authorization for the contractor to purchase from Government sources (see [FAR Part 51](#)) constitutes consent.

Refer to the specific contract clauses actually included in each contract to ascertain specific subcontract consent requirements.

#### 3.12.3.1 Advance Notification Requirements

Under cost-reimbursement contracts, even if the contractor has an approved purchasing system and consent to subcontract is not required under [FAR 44.201-1](#), the contractor is required by statute ([10 U.S.C. 2306](#)) to notify the agency before the award of:

- any cost-plus-fixed-fee subcontract
- any fixed-price subcontract that exceeds the greater of the simplified acquisition threshold or 5 percent of the total estimated cost of the contract applicable to the Department of Defense

#### 3.12.3.2 Contract Clauses

[FAR 52-244-5](#) requires that: (1) the Contractor shall select subcontractors (including suppliers) on a competitive basis to the maximum practical extent consistent with the objectives and requirements of the contract; and (2) if the Contractor is an approved mentor under the Department of Defense Mentor-Protégé Program, the Contractor may award subcontracts under this contract on a non-competitive basis to its protégés.

The Contracting Officer shall insert the clause at [FAR 52.244-6](#), Subcontracts for Commercial Items, in solicitations and contracts for other than commercial items. [FAR 52.244-6](#) requires to the maximum extent practicable, the Contractor and its subcontractors at all tiers to incorporate commercial items or non-developmental items as components of items to be supplied under the contract. Notwithstanding any other clause in the prime contract, only those clauses identified in the clause at [FAR 52.244-6](#) are required to be in subcontracts. Agencies may supplement the clause at [FAR 52.244-6](#) only as necessary to reflect agency unique statutes applicable to the acquisition of commercial items.

### **3.12.4 Subcontract Evaluation Responsibilities and Procedures**

Subcontract evaluation responsibilities, considerations and consent limitations are identified in FAR [44.202](#) and [44.203](#), DFARS [244.202-2](#), and NCH 44.2. Much of what is included below is discussed in these particular authorities.

#### **3.12.4.1 Responsibilities**

The cognizant Administrative Contracting Officer (ACO) is responsible for consent to subcontracts, except when the Contracting Officer retains the contract for administration or withholds the consent responsibility from delegation to the ACO. In such cases, the contract administration office should assist the contracting office in its evaluation as requested.

The Contracting Officer responsible for consent shall review the contractor's notification and supporting data to ensure that the proposed subcontract is appropriate for the risks involved and consistent with current policy and sound business judgment.

Designation of specific subcontractors during contract negotiations does not in itself satisfy the requirements for advance notification or consent pursuant to the clause at [52.244-2](#). However, if, in the opinion of the Contracting Officer, the advance notification or consent requirements were satisfied for certain subcontracts evaluated during negotiations, the Contracting Officer shall identify those subcontracts in paragraph (k) of the clause at [52.244-2](#).

See section [3.12.4.4](#) regarding ratification of subcontracts after they have been awarded.

#### **3.12.4.2 Considerations**

The Contracting Officer responsible for consent will review the request and supporting data and consider the following:

- consistency with contractor's approved make-or-buy program (see [FAR 15.407-2](#))
- subcontract is not for special test equipment of facilities available from Government sources (see [FAR 45.3](#))
- technical justification for selection of the particular supplies, equipment, or services

- compliance with SADB program (see [FAR Part 19](#))
- adequacy of price competition or justification for non-competitive procurement
- contractor assessment of subcontractor alternate proposals
- contractor basis for selecting and determining the responsibility of subcontractor
- contractor substantiation for selecting subcontractor on basis other than price
- adequacy of contractor-performed adequate cost or price
- appropriateness of subcontract-type given risks involved and current policy
- contractor consideration for any proposed subcontract involving the use of Government-furnished facilities
- adequacy of contractor's translation of prime contract technical requirements to subcontract requirements
- contractor compliance with applicable cost accounting standards for subcontract award
- ensuring subcontractor is not on the list of parties excluded from Federal procurement and non-procurement programs (see [FAR 9.4](#))

A thorough review of these considerations is particularly important when:

- the prime contractor's purchasing system or performance is inadequate
- close working relationships or ownership affiliations between the prime and subcontractor may preclude free competition or result in higher prices
- subcontracts are proposed for award on a noncompetitive basis, at prices that appear unreasonable, or at prices higher than those offered to the Government in comparable circumstances
- subcontracts are proposed on a cost-reimbursement, time-and-materials, or labor-hour basis

#### **3.12.4.3 Technical and Administrative Review**

Although General Specifications for Ships (GENSPECS) of the United States Navy has been cancelled, Section 042(h) may still be incorporated in the ship specifications of new construction contracts. This section requires the contractor to provide SUPSHIP with copies of purchase orders. Under the "Inspection" clauses of the contract, SUPSHIP can review

such procurements for technical adequacy and the need of assigning field administration responsibilities to Government representatives cognizant of subcontractor plants.

Like GENSPECS, inspection and quality assurance specifications MIL-I45208 and MIL-Q-9858 have been cancelled, but may still appear in new construction contracts. The appropriate ISO specification is generally replacing these canceled specifications. These specifications set forth contractor procedures and obligations pertinent to contract administration, including the review of subcontracts.

SUPSHIP may perform complete technical reviews of selected important subcontracts; other subcontracts may be appropriately examined on a spot-check basis. Technical review involves, but is not limited to, examination of a proposed subcontract to:

- determine the subcontract's conformance to applicable drawings, specifications, QA requirements, and good ship work practices
- ensure that orders for material requiring qualification approval are placed with suppliers on the qualified products list
- ensure that requirements regarding on-board repair parts, vendor plans, and technical manuals are included, when required
- determine that required options for stock components and stock repair parts are included
- determine that the proper issue of specifications is used

Each subcontract should contain all clauses required by the prime contract.

Contractors and SUPSHIPS should review the general provisions of subcontract and purchase order forms at regular intervals to ensure the incorporation of requirements imposed by the provisions of the applicable prime contract.

#### **3.12.4.4 Additional SUPSHIP Consent Procedures**

SUPSHIPS will prepare a local instruction that delineates the field activity organizational responsibilities for conducting required subcontract consent reviews.

ACOs will give the contractor's request for consent equal review whether the ACO has consent authority or must endorse the request to the PCO. The ACO endorsements to the PCO will contain all necessary information and recommendations for PCO action.

The Subcontract clauses permit the ACO to ratify a subcontract that has been placed by the contractor even though prior consent was required. In accordance with NCH 44.202-1, ACOs shall not ratify subcontracts as a routine procedure in lieu of granting consent prior to their placement. Ratification should be the exception to the rule and should be granted only on a case-by-case basis. If, based on the review, it appears that the ultimate cost to the

Government may have been increased by the placement of the subcontract without consent, the ACO will consult with counsel about placing the contractor on notice that the Government will not be liable for such an increase. If it appears that a change in the contractor's procedures is required to preclude further placement of subcontracts prior to consent, the ACO will direct the contractor to take corrective action.

#### **3.12.4.5 Consent Limitations**

The Contracting Officer's consent to a subcontract or approval of the contractor's purchasing system does not constitute a determination of the acceptability of the subcontract terms or price, or of the allowability of costs, unless the consent or approval specifies otherwise. Contracting Officers will not consent to:

- cost-reimbursement subcontracts if the fee exceeds the fee limitations of [FAR 16.301-3](#)
- subcontracts providing for payment on a cost-plus-percentage-of-cost basis
- subcontracts obligating the Contracting Officer to deal directly with the subcontractor
- subcontracts that make the results of arbitration, judicial determination, or voluntary settlement between the prime contractor and subcontractor binding on the Government
- repetitive or unduly protracted use of cost-reimbursement, time-and-materials, or labor-hour subcontracts (Contracting Officers should follow the principles of [FAR 16.103\(c\)](#))

Contracting Officers should not refuse consent to a subcontract merely because of a clause giving the subcontractor the right of indirect appeal to the Armed Services Board of Contract Appeals (ASBCA) if the subcontractor is affected by a dispute between the Government and the prime contractor. Indirect appeal means assertion by the subcontractor of the prime contractor's right to appeal or the prosecution of an appeal by the prime contractor on the subcontractor's behalf. The clause may also provide that the prime contractor and subcontractor will be equally bound by the Contracting Officer's or board's decision. The clause may not attempt to obligate the Contracting Officer or the appeals board to decide questions that do not arise between the Government and the prime contractor or that are not applicable under [FAR 52.233-1](#), "Disputes."

### **3.12.5 Contractor Purchasing System Reviews**

#### **3.12.5.1 Objective**

The objective of a Contractor Purchasing System Review (CPSR) is to evaluate the efficiency and effectiveness with which the contractor spends Government funds and complies with Government policy when subcontracting. The review provides the ACO a

basis for granting, withholding, or withdrawing approval of the contractor's purchasing system.

The ACO is responsible for reviewing the contractor's purchasing system. Members of other organizations, such as audit or program management activities should not conduct separate reviews of a contractor's purchasing system, but may participate in a review conducted by the ACO. These organizations may, if they suspect a problem, recommend that the ACO initiate a special review.

### **3.12.5.2 Requirements**

The ACO shall determine the need for a CPSR based on, but not limited to, the past performance of the contractor, and the volume, complexity, and dollar value of subcontracts. If a contractor's sales to the Government (excluding competitively awarded firm-fixed-price and competitively awarded fixed-price with economic price adjustment contracts and sales of commercial items pursuant to [FAR Part 12](#)) are expected to exceed \$25 million [[FAR 44.302](#)] during the next 12 months, a review to determine if a CPSR is needed should be performed. Sales include those represented by prime contracts, subcontracts under Government prime contracts, and modifications. Generally, a CPSR is not performed for a specific contract. The head of the agency responsible for contract administration may raise or lower the \$25 million [[FAR 44.302](#)] review level if it is considered to be in the Government's best interest.

A CPSR will be conducted by the cognizant contract administration agency at least every three years for contractors that continue to meet the requirements of the above section. This review may be accomplished at one time or on a continuing basis. A more frequent review cycle may be established if warranted and special reviews may be conducted when information reveals a deficiency or major change in the contractor's purchasing system, policy, procedures, or key personnel.

The ACO is responsible for establishing procedures and conducting contractor's purchasing system reviews at the SUPSHIPS.

### **3.12.5.3 Extent of Review**

A CPSR requires an evaluation of the contractor's purchasing system. Unless segregation of subcontracts is impracticable, this evaluation shall not include subcontracts awarded by the contractor exclusively in support of Government contracts that are competitively awarded firm-fixed-price, competitively awarded fixed-price with economic price adjustment, or awarded for commercial items pursuant to [FAR Part 12](#). The considerations listed in [FAR 44.202-2](#) for consent evaluation of particular subcontracts also shall be used to evaluate the contractor's purchasing system, including the contractor's policies, procedures, and performance under that system. Special attention shall be given to those areas identified in [FAR 44.303](#).

#### **3.12.5.4 Surveillance**

In accordance with [FAR 44.304](#) and NCH 44.304, the ACO is responsible for establishing a surveillance plan and maintaining a sufficient level of surveillance to ensure that the contractor is effectively managing its purchasing program. Surveillance may be accomplished with the assistance of subcontracting, audit, pricing, technical, or other specialists as necessary. For more specific information regarding an adequate surveillance plan and the initiation of special reviews, if necessary, refer to [FAR 44.304](#) and [DFARS 244.303](#).

#### **3.12.5.5 Granting, Withholding, or Withdrawing Approval**

The following sections discuss the granting, withholding, and withdrawal of approval of a contractor's purchasing system.

##### **3.12.5.5.1 Responsibilities**

The cognizant ACO is responsible for granting, withholding, or withdrawing approval of a contractor's purchasing system. The ACO will:

- approve a purchasing system only after a CPSR discloses that the contractor's purchasing policies and practices are efficient and provide adequate protection of the Government's interests
- promptly notify the contractor in writing of the granting, withholding, or withdrawing of approval

##### **3.12.5.5.2 Notification**

The notification that grants system approval shall include:

- identification of the plant or plants where the review was conducted
- the effective date of approval and period for which approval is valid
- a statement that system approval:
  - applies to all Federal Government contracts at that plant to the extent that cross-serving arrangements exist;
  - waives the contractual requirement for advance notification in fixed-price contracts, but not for cost-reimbursement contracts;
  - waives the contractual requirement for consent to subcontract in fixed-price contracts and for specified subcontracts in cost-reimbursement contracts but not for those subcontracts, if any, selected for special surveillance and identified in the contract schedule; and

- may be withdrawn at any time at the ACO's discretion.
- In exceptional circumstances, a consent requirement for certain subcontracts or classes of subcontracts, even though the contractor's purchasing system has been approved. The system approval notification will identify the class or classes of subcontracts requiring consent. Reasons for selecting the subcontracts include the fact that a CPSR or continuing surveillance has revealed sufficient weaknesses in a particular area of subcontracting to warrant special attention by the ACO.

At the completion of the in-plant portion of the review, the ACO shall hold an exit conference with the contractor. At the conference, the ACO should:

- Present the review team's recommendations, signed by the ACO;
- Request the contractor submit its plan for correcting deficiencies or making improvements within 15 days; and
- Not comment on the pending or planned decision to grant or withhold approval of the contractor's purchasing system.

The complete report is submitted to the ACO, or any department or agency established review board, within 10 days after receipt of the contractor's response.

The ACO should completely review the report and consider the contractor's response before making a decision on granting, withholding, or withdrawing purchasing system approval. The ACO shall notify the contractor of the decision within 10 days after receipt of the report with a copy of the decision to the contracting office, when requested.

When a contractor advises that it has corrected deficiencies that led the ACO to withhold or withdraw the purchasing system approval, the ACO:

- shall request the PSA to verify that the contractor has:
  - corrected the deficiencies
  - implemented any other ACO recommendations
- should ask for a review of purchasing policies and procedures issued since the last review

### **3.12.5.5.3 Withholding or Withdrawing Approval**

The ACO shall withhold or withdraw approval of a contractor's purchasing system when there are major weaknesses or when the contractor is unable to provide sufficient information upon which to make an affirmative determination. The ACO may withdraw approval at any time on the basis of a determination that there has been deterioration of the contractor's purchasing system or to protect the Government's interest. Approval shall be

withheld or withdrawn when there is a recurring non-compliance with requirements, including but not limited to:

- Cost or pricing data (see [FAR 15.403](#));
- Implementation of cost accounting standards ([FAR Part 30](#));
- Advance notification as required by the clauses prescribed in [FAR 44.204](#); or
- Small business subcontracting (see [FAR 19.7](#)).

#### **3.12.5.6 Disclosure of Approval Status**

Upon request, the ACO may inform a contractor that the purchasing system of a proposed subcontractor has been approved, but will caution that the Government will not keep the contractor advised of any changes in the approval status. If the proposed subcontractor's purchasing system has not been examined or approved, the contractor will be so advised.

#### **3.12.5.7 Reports**

The ACO shall distribute copies of CPSR reports; notifications granting, continuing, withholding, or withdrawing system approval; and Government recommendations for improvement of an approved system, including the contractor's response, to the following:

- cognizant contract audit office
- activities prescribed by the cognizant agency
- contractor (furnishing copies of the contractor's response is optional)

### **3.13 Contract Claims**

#### **3.13.1 Introduction**

It is the policy of the Government to try to resolve all contractual issues in controversy by mutual agreement at the Contracting Officer's level. The Contract Disputes Act (CDA) of 1978 (see [FAR 33.202](#)), as amended, establishes procedures and requirements for asserting and resolving claims subject to it. The "Disputes" clause included in Government contracts, [FAR 52.233-1](#), implements the CDA and obligates a contractor to continue to perform, pending resolution of disputes arising under a remedy granting clause in the contract. [FAR 33.2](#), [DFARS 233.2](#), [NMCARS 5233.2](#), and NCH 33.2 also cover disputes, claims, and appeals.

Analyzing and resolving claims can be the most time-consuming, costly, and difficult of all contract administration tasks. However, this process is greatly simplified if SUPSHIPS have an effective claims program which ensures that the analysis and resolution of claims is conducted in an unbiased and impartial manner. The purpose of this section is to define

what constitutes a claim under the CDA, point out areas where disputes generally arise, and to describe how SUPSHIPS can attempt to resolve and perhaps even avoid issues arising under or related to a contract in a timely, cost-effective manner.

### 3.13.2 Definition of a Claim

[FAR 52.233-1](#) defines a claim as "a written demand or written assertion by one of the contracting parties seeking, as a matter of right, the payment of money in a sum certain, the adjustment or interpretation of contract terms, or other relief arising under or related to this contract". The FAR further provides that the submission of a voucher, invoice, or other routine request for payment that is not in dispute when submitted is not a claim. However, a contractor's submission may become a claim if the contractor complies with the submission and certification requirements in accordance with the "Disputes" clause, and if the parties dispute the submission either as to liability or amount, or if the Contracting Officer fails to act on the request in a reasonable time. Conversely, not every non-routine submission constitutes a "claim" under the FAR. The Federal Circuit Court has held that the FAR definition of a claim does not require a pre-existing dispute as to either amount or liability when a contractor submits a non-routine written demand seeking payment of money in a sum certain.

In order for a contractor's submission to become a "claim" under the CDA, as it is implemented by the "Disputes" clause, there are four prerequisites which must be met. The submission must be:

- a written demand or assertion by one of the contracting parties
- seeking the payment of money in a sum certain as a matter or right
- submitted to the Contracting Officer for decision
- certified if the amount requested is \$100,000 or more

The certification for a CDA claim provides that the claim is made in good faith; supporting data is accurate and complete to the best of the contractor's knowledge and belief; the amount requested accurately reflects the contract adjustment for which the contractor believes the Government is liable; and the person submitting the claim is duly authorized to bind the contractor.

These requirements become important because the CDA requires on a contractor's claim, that the Government is to pay interest for the amount found due and unpaid from either the date that the contracting office received the claim or the date payment would otherwise have been due, if that date is later, until the date of payment. Receipt of a proper CDA claim by the Contracting Officer also triggers the amount of time the Government has to respond to the allegations made in the claim. For claims of \$100,000 or less, the Contracting Officer must render a decision within 60 days of receipt of the contractor's written request. For contractor-certified claims over \$100,000, the Contracting Officer must, within 60 days of the

receipt of the claim, issue a decision or notify the contractor of the date by which the decision will be made.

Often a contractor will file a “claim” which is lacking in one or more of the CDA requirements, or a contractor will specifically state that it is not filing a “claim” but a Request for Equitable Adjustment (REA). Per NCH 33.203, an REA is similar to a claim except that it is a contractor-request not submitted under the Contracts Disputes Act. Examples include non-routine written requests seeking recovery when unforeseen or unintended circumstances (such as government contract modification, differing site conditions, defective or late delivered government property or issuance of a late stop work order) increase the cost of contract performance. In prior years, there was a distinction made between the two submissions. However, decisions by the U.S. Court of Appeals for the Federal Circuit indicate that an REA which is not a routine request for payment is a claim within the meaning of the CDA, whether or not the Government’s liability for the amount was already disputed prior to the submission to the Contracting Officer. When there is a question as to whether the contractor submittal is an REA or a claim, request clarification and obtain concurrence from legal counsel.

### **3.13.3 Claims Program**

#### **3.13.3.1 Purpose**

The goals of a claims program are to: 1) determine the basis for claims; 2) generate, analyze, and store data related to the claims; 3) analyze the merits of claims through the preparation of Technical Advisory Reports (TARs); and 4) resolve claims. A claims program should not be confused with claims avoidance. Claims avoidance, although extremely important, is just one aspect of a claims program. NAVSEA 022 should be contacted for claims program assistance related to new construction contracts.

#### **3.13.3.2 Common Basis for Claims**

The basis for claims can be broadly categorized into breaches of contract, insufficient compensation for formal change, late or defective Government-Furnished Property or Information (GFP or GFI), and constructive changes.

##### **3.13.3.2.1 Breach of Contract**

A breach of contract is defined as an unexcused non-performance of a contract occurring when one party to a contract:

- fails to perform wholly or in part
- gives notice beforehand that he will not perform the contract when the time for performance arrives (anticipatory breach)
- makes performance impossible for himself or for other party

A breach of contract gives the injured party the right to collect damages. Additionally, the party harmed by the breach may sometimes be excused from performing that party's part of the contract.

Damages are an award to compensate an injured party for the harm suffered as a result of the breach of contract. Damages for breach of contract are awarded to place the injured party in a position as good as it would have been in had the contract not been broken; damages are not awarded to punish the party who has breached the contract. Therefore, if the innocent party is not ultimately harmed by the breach, the innocent party can collect only "nominal damages" (e.g., the costs of the legal action). In general, the courts attempt to fulfill the injured party's reasonable expectancy of profit or benefit from the contract.

#### **3.13.3.2.2 Insufficient Compensation for Formal Change**

Claims for insufficient formal change compensation may arise when contractors believe adjudicated formal changes have been insufficiently compensated or when agreement with the Government on the equitable adjustments for unadjudicated formal changes has not been reached. In the first case, contractors normally assert Government responsibility for additional impact costs, such as disruption beyond that recognized in contract modifications covering formal changes. Contractors usually allege unforeseen costs and circumstances associated with implementing a particular change or cumulative effects of formal and informal changes and attack any caveats or attempt to overcome any claim release language included in the modifications. In the second case, contractors simply assert the Government's offer for equitable adjustment is inadequate.

#### **3.13.3.2.3 Late or Defective GFP or GFI**

When a contract obligates the Government to provide Government-furnished property and information to a contractor, the Government must provide it by the date specified, or if no date is specified, whenever the contractor reasonably requires it. Failure to do so may entitle the contractor to an equitable adjustment. Further, the GFP or GFI must be suitable for its intended use or purpose when the contractor receives it (unless the contract provides otherwise) or the contractor may similarly be entitled to an equitable adjustment.

Late or defective furnished government property and information ranks second only to constructive change orders as the most frequent basis for claims.

#### **3.13.3.2.4 Constructive Change Orders**

The most common basis for claims is a constructive change order. A constructive change order is generally recognized as an unwritten change to the contract as a result of Government actions or inactions, which the contractor did not perform voluntarily, and has the effect of requiring the contractor to perform work different from, or in addition to, that prescribed by the terms of the contract.

The constructive change order doctrine is a judicially developed doctrine, the purpose of which is to achieve equity. A constructive change is generally held to have occurred when

some course of conduct by the Government is treated as the equivalent of a formal change order issued pursuant to the “Changes” clause of the contract; and so the designation “constructive change order”.

For a constructive change to have occurred there must be a change element and an order element. The change element involves a determination that actual performance by the contractor went beyond the minimum scope of work required by the terms of the contract. The order element involves a determination that the Government ordered the contractor to make the change; i.e., the Government, by words or deeds, required the contractor to perform the work which was not required by the contract.

An understanding of the constructive change order doctrine requires understanding of the authority rules because the Government’s order must have come from someone with authority to bind the Government. The Government is bound by acts of its employees only if the employees have the actual authority to perform the acts; whereas a contractor is bound by acts of employees with apparent authority. While this rule is applied in clear-cut situations, the rule’s harshness towards contractors has been mitigated by such principles and processes as implied authority, imputed knowledge, ratification, finality, and estoppels. Such principles and processes are frequently applied to situations to prevent injustices. Nonetheless, a contractor has the obligation to determine the authority of the Government personnel with whom the contractor is dealing, unless to do so is clearly impractical.

The five major areas in which constructive changes occur are addressed below.

#### **3.13.3.2.4.1 Contract Misinterpretation**

The most common and earliest type of constructive change order occurs where the contractor and the Government disagree on the work necessary to meet contract requirements. Normally in such a situation, either the contractor proposed to perform the contract in a certain manner and the Contracting Officer insists a more expensive method, or the parties disagree on whether completed work complies with contract requirements. Contractors generally perform in accordance with the Government’s interpretation to avoid the risk of default, but frequently submit a claim later.

The basic rule of constructive change in this area has been summarized by the Armed Services Board of Contract Appeals (ASBCA) as follows:

Whereas a result of the Government’s misinterpretation of contract provisions a contractor is required to perform more or different work, or to higher standards, not called for under its terms, the contractor is entitled to an equitable adjustment pursuant to the Changes Article, including extensions of time.

#### **3.13.3.2.4.2 Defective Specifications**

A second major category of constructive change order occurs when the Government provides defective specifications and the contractor incurs additional expense attempting to perform. The Government’s breach of the implied warranty of specifications information is

claimed to have occurred when the contractor is required to perform work beyond that originally contemplated by the Government's design specifications.

#### **3.13.3.2.4.3 Failure to Disclose Vital Information (Superior Knowledge)**

Nondisclosure is a change to the contract where the contractor undertakes to perform the contract without knowledge of vital information that affects performance. In order to be liable, the Government must be aware the contractor had no such knowledge, the specifications misled the contractor and did not put the contractor on notice to make inquiry, and the Government failed to provide the information.

#### **3.13.3.2.4.4 Constructive Acceleration**

Excusable delays give the contractor entitlement to schedule extensions. Constructive acceleration occurs when the Government refuses to recognize a new contract schedule extension based upon excusable delay and demands that the contractor complete performance in advance of the original schedule or complete performance within the original schedule. Acceleration can occur even in the case of non-excusable delay if the Government directs the contractor to accelerate. Of course, the Government does have the right to terminate for default in the event of non-excusable delay. The contractor's acceleration efforts need not be successful. A reasonable attempt to meet the completion date is sufficient for recovery should acceleration be found. In some instances, a contractor may accelerate on the contractor's own initiative to assure completion within the contract schedule or even ahead of schedule. The costs of such acceleration are, of course, not recoverable from the Government.

#### **3.13.3.2.4.5 Failure to Cooperate/Hindrance of Performance**

A category of constructive changes is the failure of the Government to cooperate with the contractor or to administer the contract in such a manner that hinders, delays, or increases the cost of performance. These obligations can be expressed or implied.

The Government may actively interfere with the contractor, making performance more costly or difficult. If the Government's interference is justified, there is no Government liability; however, if the Government's action is wrongful, the Government will be held to have breached its implied duty not to hinder or interfere with the contractor's performance. When some Government action is essential for the contractor to perform, the Government will be held liable if the Government wrongfully fails or refuses to take the action. In such cases, the Government is said to have breached its implied duty to cooperate. These implied duties are a part of every Government contract. Most of the more recent cases decided under this theory grant relief under the doctrines of constructive change or constructive suspension of work.

### **3.13.4 Generating, Analyzing, and Storage of Data**

Generating, analyzing, and storing of data can determine the success of resolving a claim by negotiation or litigation, especially the latter. Further, these actions are necessary to ensure

effective involvement by SUPSHIPs to monitor contractors' performance adequately, regardless of whether claims are submitted.

### **3.13.4.1 Generating Data**

#### **3.13.4.1.1 Significant Events**

One of the best approaches to ensure the generation of necessary data to analyze and resolve claims is requiring all relevant data on significant events be promptly generated. A significant event is anything that occurs pertaining to a contract, other than formal contract modifications, having a material impact on cost, quality, or delivery. Significant events can be caused by either the Government or contractors and include the following:

- ship delivery schedule changes or problems
- drawings, designs, and specifications which are ambiguous, defective, or impossible to perform
- differences in interpretation of contract provisions
- delay and disruption of contractor effort
- changes in method of sequence of work
- late or defective Government-furnished material, property, or information
- rejections, rework, waivers, and deviations
- planned versus actual performance milestones
- delays in Government actions, such as processing engineering change proposals, consent to subcontracts, and review of technical data
- contractor error and noncompliance with contract terms
- any other Government or contractor actions or inactions which have the effect of requiring the contractor to perform work different from the work prescribed by the original terms of the contract

NCH 33.9 provides as follows:

“(a) In addition to the significant events set forth in [NMCARS 5233.9000](#) which may contribute to a potential claim, the circumstances listed may apply:

(1) if the contractor believes the Government has superior knowledge of an aspect of the job and withheld that knowledge from the contractor;

(2) if the contractor believes that Government action or conduct under one contract adversely affects contractor performance on another contract (cross-contract impact);

(3) if the contractor believes that the Government has improperly performed contract administration duties, which interfere with the contractor's conduct of his own business;

(b) A contractor's failure to adhere to a schedule or to control costs may lead him to seek recovery of consequent losses via a claim."

Data that should be generated for each significant event should include as a minimum:

- nature and pertinent circumstances of the event
- date of the event and the identification of Government and contractor personnel involved, including the name and function of the respective individuals
- identification of any relevant documents involved
- substance of any oral communications related to the event
- statement concerning the possible consequences or effects of the event described upon the contract cost, schedule, or technical performance, including manner or sequence of performance

Normally, a separate file should be established for each significant event. An individual should be assigned this task to ensure that all relevant future data is generated and properly filed. A cross-reference on the location of documents that are impracticable to include in the file should be included.

#### **3.13.4.1.2 Routine Documents, Analyses, and Reports**

Routine documents, analyses, and reports are those documents: 1) prepared for the Government according to contract requirements; 2) prepared by the contractor for internal use; or 3) prepared by the Government for internal purposes. These documents typically include valuable information concerning cost and schedule (including reasons for variances) and general information concerning the contractor's facilities, manpower, and financial condition. These documents should be carefully analyzed and correlated with significant events.

#### **3.13.4.1.3 Special Documents, Analyses, and Reports**

Occasionally, the documents for significant events and the routine documents, analyses, and reports generated by the contractor will be insufficient. This need for additional information would be expected to happen most frequently on larger and more complex contracts where cumulative delay and disruption may be involved. Then, data regarding the operations of the

contractor, the instant contract, and any other contract or program with which the contract has had an impact may need to be systematically collected, organized, analyzed, and retained. These documents typically cover contractor programs or contracts, contractor resources, contract administration, and schedule and cost performance.

#### **3.13.4.2 Analyzing Data**

The data described in section [3.13.4.1](#) must not only be generated, it must be promptly analyzed by the claims team to determine causes, the responsible party, and the impacts on cost, quality, and delivery resulting from significant events. Many claims are submitted either toward the end of contract performance or after all work has been completed. In recent years, however, contractors have submitted claims during the middle of contract performance or complex contracts requiring massive work efforts. In these cases, usually numerous changes causing delay and/or disruption have taken place. The Government is at a decided disadvantage if the data described above has not been generated and analyzed during contract performance. Analysis can generally be performed easier and more accurately if performed within the same general timeframe of the significant event.

Proper resolution of contractor claims is dependent upon the adequacy of both the available contractor and Government information concerning the relevant facts. The claim will reflect the contractor's version of events, actions, circumstances, and conditions that may have taken place and the contractor's version may or may not be accurate. It is extremely difficult for the Government to accurately analyze and reconstruct the facts after receipt of the contractor's claim.

Adequate documentation and analysis during contract performance is necessary for the Government to verify, quantify, or refute matters which a contractor presents in support of, or as the basis of, the contractor's claim.

#### **3.13.4.3 Storing Data**

Data concerning significant events will be kept in a separate folder(s) for each contract and identified as the "Significant Events" file. Those records which are already maintained separately as part of the contract file, as required by regulations, need not be included in the "Significant Events" file. When pertinent documents needed to complete the record are located elsewhere, copies of such documents or a cross-reference will be included in the "Significant Events" file. All non-factual information (e.g., opinions and conclusions expressed) contained in the "Significant Events" file will be marked "FOR OFFICIAL USE ONLY". Legal documents should be placed in a separate file marked "Attorney-Client Privilege".

If a claim is submitted or anticipated, more extensive filing of data is required. A relatively small claim may require storage of much data for claims analysis and processing purposes, and litigation is always a possibility. If the amount of data is relatively small, a manual storage and retrieval system will suffice. On the other hand, if the amount of data is relatively large, data processing support may be necessary.

Collecting and managing a large volume of data can become impractical or impossible without the support of automated data processing and database management systems. In analyzing and processing a major claim, a database management system may also be needed for the following:

- reconstructing, merging, and reorganizing resource-related data, such as manpower applications and transactions
- repetitive and iterative computations, such as claim element pricing
- specialized analytic techniques and one-time computations involving many steps of voluminous data, such as statistical analysis

The system used should depend on cost, time, needs, and resources.

### **3.13.5 Analyzing Claims and Preparing TARs**

The approach used in analyzing a claim and presenting the results is much more important than was recognized in the past. The approach can result in a waste of time and money on the part of the Government and over-compensating the contractor. Inadequate consideration to areas presented in the claim and the format of TARs can result in considerable rework, particularly if negotiation is unsuccessful and the merits of the claim have to be litigated. It can also result in the case being lost.

#### **3.13.5.1 Analyzing Claims**

The analysis of claims involves the “Direct Approach”, the “Total Cost and Environment Approach”, or a combination of the two approaches. The latter should generally be used especially if the actions covered in this chapter have been taken regarding significant events. The unwarranted selection of the total cost and environment approach will result in wasted time and money, while the selection of the direct approach could result in over-compensating the contractor.

#### **3.13.5.2 Direct Approach**

Analysis of a claim by the “Direct Approach” involves primarily the facts about causes and impacts contained in the immediate claim environment. Additional relevant facts will expand the area covered during claims analysis. This approach leads to a position based on logic and conclusions derived from a restricted field of facts. Nevertheless, the time and cost advantages of the “Direct Approach” indicate that the “Direct Approach” should be used for small and simple claims analysis involving a single or rather straightforward cause and effect rationale.

#### **3.13.5.3 Total Cost and Environment Approach**

A “Total Cost and Environment Approach” extends the analysis of a claim to include the total environment of the claim and all cost and schedule growth related to the relevant contract. It

is distinguished from a claim analysis approach which pursues some paths of inquiry beyond the strict confines of the immediate claim environment. The “Total Cost and Environment Approach” is an expanded direct approach in that it is directed outside the immediate claim environment. This approach is preferred for larger and more complicated claims, such as those involving massive amounts of delay and disruption, unless the expanded claims preparation effort is unwarranted.

The “Total Cost and Environment Approach” consists of the following steps:

- “Profiling” the contractor’s operations and contracts or programs of interest. Profiling is the systematic collection, organization, analysis, and presentation of data regarding the contractor’s operations, the contract under which the claim is submitted, and any other contract or program having a cross-impact over the period of interest of the claim. For example, profiling of manpower (under contractor resources item below) should reveal information concerning the amount of manpower applied over specific periods of time, manpower characteristics (e.g., type, skill, turnover, absenteeism, etc.), and the way manpower was applied (e.g., overtime, manning, levels, supervisory ratios, etc. As appropriate, profiling should cover the following areas:
  - Contractor contracts or programs
  - Contractor resources
  - Contract administration
  - Schedule and cost performance
- Analyzing the profile reports generated in “profiling” to identify all causes of cost and schedule growth.
- Evaluating the causes of cost and schedule growth.
- Constructing an explanation of total cost and schedule growth.
- Including in the claim those aspects of cost and schedule growth that are the contractor’s responsibility.

#### **3.13.5.4 Combination Approach**

As indicated above, the combination approach should be used if the actions covered in this chapter have been taken regarding significant events. This is because the generation, analysis, and documenting of significant events will result in the necessary documentation to relatively quickly and accurately analyze and resolve contractor claims. In other words, a contractor’s claim will necessarily involve these same significant events.

### 3.13.5.5 Preparing TARs

Since the claim may be settled by negotiation, litigation, or both, the TAR should be developed in such a manner that it adequately covers all alternatives. A properly structured TAR format will ensure all alternatives and materials are addressed. Technical personnel and legal counsel personnel should work closely together on a TAR. If possible, legal counsel should be apprised of the progress being made on the TAR. Material that should be included in the TAR includes:

- Claim allegations - a brief description of the contractor's claim allegations written in layman's language so that personnel outside the contracts and engineering fields may readily understand it.
- Relevant facts
  - Applicable data - a listing of all data reviewed by the technical analyst while analyzing the claim
  - Sequence of events – a chronological listing of events pertaining to the claim
  - Identification of potential witnesses - identification of personnel who should be considered as witnesses in the event of litigation and an explanation of why these individuals were chosen
  - Contract modifications – a listing and summary of all relevant contract modifications
- Impact analysis - a presentation of cause and effect and quantification, assuming the contractor's position regarding entitlement is correct (this is necessary in the event of litigation and entitlement is decided in favor of the contractor)
  - Cause and effect
  - Quantification
- Entitlement – a presentation of cause and effect and quantification, making no assumptions regarding contractor entitlement
  - Cause and effect
  - Quantification
- Exhibits – all documents on which the facts, analysis, and conclusion of the TAR are based

### **3.13.6 Resolving Claims**

A contractor's claim can be resolved in the following ways:

- Negotiation and settlement
- Alternative Dispute Resolution (ADR)
- Litigation, if negotiation and settlement fail
- Use of the mistake after award procedure, the Contract Disputes Act, and Public Law 85-804

#### **3.13.6.1 Negotiation**

Negotiation is preferred for settling a contractor's claim; however, this cannot always be achieved. For example, the contractor may have no entitlement or may have entitlement, but not be willing to settle for an amount that appears reasonable to the Government.

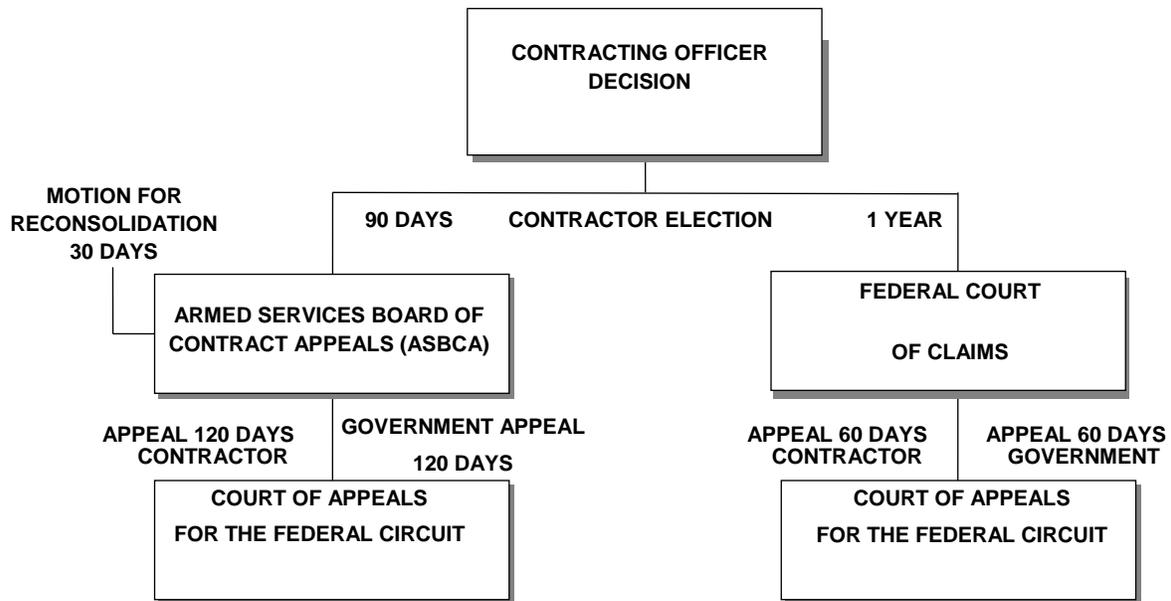
#### **3.13.6.2 Alternative Dispute Resolution (ADR)**

Alternative Dispute Resolution means any type of procedure or combination of procedures voluntarily used to resolve issues in controversy. These procedures may include, but are not limited to, conciliation, facilitation, mediation, fact-finding, mini-trials, arbitration, and use of ombudsmen.

Per [FAR 33.204](#), it is Government policy to try to resolve all contractual issues in controversy by mutual agreement at the Contracting Officer's level. Reasonable efforts should be made to resolve controversies prior to the submission of a claim. Agencies are encouraged to use ADR procedures to the maximum extent practicable.

#### **3.13.6.3 Litigation**

The litigation process for new construction contracts is outlined in Figure 3-1.



**Figure 3-1: Federal Courts Improvement Act Procedure**

The litigation process for repair and overhaul contracts is the same as the above, with the exception that some District Courts will accept appeals from Contracting Officer decisions since District Courts have jurisdiction over admiralty issues. Appeals from District Court decisions may be taken to the appropriate Appellant Court for that particular circuit.

Negotiation is generally preferred to litigation for the following reasons:

- business relations between the two parties may be negatively affected and consequently day-to-day business is difficult to conduct
- the contractor's management personnel devote much time to prosecuting the claim against the Government at the expense of managing the contract efforts
- litigation is time-consuming and expensive
- the "right" party does not always prevail
- an adverse legal precedent may be established

#### **3.13.6.4 Use of the "Mistake After Award" Procedures, the Contracts Dispute Act, and Public Law 85-804**

##### **3.13.6.4.1 Use of the "Mistake After Award" Procedures**

If the general area of the contractor's claim or dispute involves a mistake in the bid or proposal that is not discovered until after award, then the procedures authorized by [FAR 14.407-4](#) may be to the party's advantage in lieu of dispute procedures. These procedures authorize an agency to make a determination:

- to rescind a contract
- to reform a contract to:
  - delete the items involved in the mistake
  - increase the price if the contract price, as corrected, does not exceed that of the next lowest acceptable bid or proposal under the original invitation for bids

These determinations may only be made on the basis of clear and convincing evidence of a mistake in the bid or proposal. In addition, the mistake must clearly have been mutual or, if unilaterally made by the contractor, so apparent as to have charged the Contracting Officer with notice of the mistake.

To support a mistake after award claim, the contractor will be required to submit a written statement and pertinent evidence, such as the following, to the Contracting Officer:

- the contractor's file copy of the bid
- the contractor's original worksheets and other data used in preparing the bid
- subcontractors' and suppliers' quotations, if any
- published price lists
- any other evidence that will serve to establish the mistake, the manner in which the mistake occurred, and the bid actually intended

A case file will then have to be prepared and processed in accordance with [FAR 14.407-4](#) (e) and (f) and any implementing regulations. Each determination must be coordinated with legal counsel.

#### **3.13.6.4.2 Use of the Contract Disputes Act (CDA)**

Certain kinds of relief previously available only under Public Law 85-804 (i.e., legal entitlement to rescission or reformation for mutual mistake) is now available under the Contract Disputes Act of 1978 and the "Disputes" clause.

A contractor's allegation of being entitled to rescission or reformation of the contract to correct or mitigate the effect of a mistake is required by [FAR 33.205](#)(b) in order to be treated as a claim under the Contract Disputes Act. A contract may be reformed or rescinded by the

Contracting Officer if the contractor would be entitled to such remedy or relief under the law of Federal contracts. While it is not clear, this authority apparently applies to instances having a recognized judicial basis for the contractor's claim, such as mistakes.

A claim that is either denied or not approved in its entirety according to the procedure discussed above may be recognized as a request for relief under Public Law 85-804. The claim must first, however, be submitted to the Contracting Officer for consideration under the Contract Disputes Act because the claim is not recognized under Public Law 85-804, as implemented by [FAR Part 50](#), unless other legal authority in the agency concerned is determined to be lacking or inadequate.

#### **3.13.6.4.3 Use of Public Law 85-804**

Public Law (P.L.) 85-804 "empowers the President to authorize agencies exercising functions in connection with the national defense to enter into, amend, and modify contracts, without regard to other provisions of law related to making, performing, amending, or modifying contracts, whenever the President considers that such actions would facilitate the national defense." This authority has been conferred on the heads of DoD and DoN, who may delegate it to other officials within the departments. Requests for relief under P.L. 85-804 are not claims within the CDA or the "Disputes" clause, and are to be processed under [FAR Part 50](#).

Examples of the types of contract adjustments that may be made under Public Law 85-804 include, but are not limited to, the following instances:

- modification to the contract without consideration from the contractor
- correcting mistakes
- formalizing informal commitments

P.L. 85-804 may not be relied upon when other adequate legal authority exists with a department. Any requests from contractors for relief under Public Law 85-804 will be forwarded to NAVSEA 022 for action.

### **3.13.7 Specific NAVSEA Requirements**

#### **3.13.7.1 Applicability**

The contents of this section are applicable to claims which are asserted by a contractor under the Contract Disputes Act of 1978.

#### **3.13.7.2 Definitions and Approval Levels**

A claim is defined in [FAR 52.233-1](#) as a written demand or written assertion by one of the contracting parties seeking, as a matter of right, the payment of money in a sum certain, the adjustment or interpretation of contract terms, or other relief arising under or relating to the

contract. The contractor seeking the payment of money exceeding \$100,000 ([FAR 52.233-1](#)) is not considered a claim under the Contract Disputes Act of 1978 until certified as required by the Act and [FAR 33.207](#). The contractor also must request a Contracting Officer's decision under the Contract Disputes Act of 1978. All claims, regardless of amounts, are to be reported to NAVSEA 02 by the SUPSHIP. In general, claims received in the field will be handled by the cognizant SUPSHIP. This includes reviewing the claims for sufficiency processing, unless the specific circumstances of a claim dictate that Headquarters will handle these matters. NAVSEA 02 will notify the cognizant SUPSHIP in such cases. If all data necessary to adequately support the requested compensation is included in the contractor's submission, a contract modification should be executed so that payment can be made. Any submission from a contractor requesting payment beyond the obligations covered in the contract, which does not request a Contracting Officer's decision under the Disputes Act and contains the claim certification (if applicable), is considered to be a claim.

### 3.13.7.3 Claims Prevention

NAVSEA's policy is to try to resolve all contractual issues by mutual agreement at the Contracting Officer's level without litigation. In appropriate circumstances, the Contracting Officer should consider the use of informal discussions between parties or individuals who have not participated substantially in the matter in dispute to aid in objectively resolving the differences.

Any issue which remains unresolved between the contractor and the Navy represents a potential claim. To minimize the potential for claims, Navy personnel are expected to be aware of problem areas and to keep adequate records of events, particularly significant events. Matters having potential problems raised with or by the contractor must be fully documented and brought to the attention of the cognizant Contracting Officer for prompt resolution.

Issues leading to claims are often based on assessments made, opinions expressed, or other actions or inactions by Navy personnel who caused the contractor to perform additional work. Lack of schedule adherence or cost control by the contractor may lead the contractor to seek recovery of consequent losses through a claim. Identification of significant actions regarding contractor management and performance must be documented, i.e., actions pertaining to manning, facilities, methods, and procedures. Proper analysis of data may lead to the identification and mitigation or avoidance of potential trouble areas.

In an effort to prevent claims, the following activities will perform the functions discussed below:

NAVSEA 02 will:

- Conduct periodic reviews of NAVSEA's and SUPSHIP's claims avoidance activities.

- Provide training and assistance to NAVSEA and SUPSHIPs in the claims avoidance, claims prevention, and claims settlement areas as requested by NAVSEA managers or the individual Contract Administration Office (CAO).
- Participate with NAVSEA Program Managers and Contracting Officers in identifying and eliminating potential claims items during the formulation of new contracts.
- Periodically review on-going procurements for potential claim-producing items and recommend corrective action, as appropriate.

Supervisors of Shipbuilding, Conversion, and Repair will:

- Ensure the participation of all Departments in the identification and elimination of potential claims items throughout the procurement process.
- Avoid to the maximum practicable extent, all Government actions or inactions that impede contractor performance, particularly those that impede efforts to improve productivity. Contractors should be encouraged to report any such Government conduct.
- Monitor contractor performance and ensure that sufficient data is developed during contractor performance to enable prompt and accurate analysis of any claim. Use this same documented data to identify actual and potential problems and to defend against claims, overruns, and other problems.
- Strive to improve the ability to analyze and develop positions on contractor proposals that include delay and disruption, particularly those involving an allegation concerning cumulative effects. This requirement is closely related to the requirements above regarding monitoring of contractor performance.
- Conduct claims avoidance presentations periodically to ensure that CAO personnel are instructed in claims avoidance procedures. Emphasis should be placed on increasing the effectiveness of the local claims avoidance program.
- Assessment of contractor responsibility, such as pre-award surveys and records of past performance under Government contracts, will be relied upon to ensure that award is made only to those companies which are capable of meeting the contract requirements.
- Maintain lines of communication with PCOs to ensure that the lessons learned while administering current contracts can be used to benefit the Navy when planning and drafting future contract actions.
- Promptly review all new contracts assigned for administration and identify all clauses, provisions, specifications, and any other contract requirements that are new to the CAO or have the potential for causing a claim if not properly administered. CAO

personnel will be properly briefed. These requirements also apply to job orders and modifications, where appropriate.

- Adhere to requirements for properly documenting significant contract events.

#### **3.13.7.4 Processing Claims and REAs**

Contracting Officers should be familiar with the Contract Disputes Act of 1978 which establishes procedures and requirements for asserting and resolving claims by or against contractors arising under or relating to a contract subject to the Act. The Act provides for payment of interest on contractor claims, for the certification of contractor claims in excess of \$100,000, and for a civil penalty for contractor claims that are fraudulent or based on misrepresentation of fact. For claims exceeding \$100,000 the Act requires the Contracting Officer's Final Decision (COFD) within 60 days or notification to the contractor of the time within which the COFD will be issued. A direct appeal to the Armed Services Board of Contract Appeals (ASBCA) is allowed if there is an undue delay in issuance of the COFD. Under such circumstances, the FAR considers such actions to be deemed denial of the contractor's claim. Refer to [FAR 33.211](#) (g).

NAVSEA 02 will have overall responsibility for NAVSEA claims settlement for shipbuilding contracts as specified below:

- Provide direction and assistance to field activities relative to claims and Request for Equitable Adjustments (REAs), as requested.
- Assign claims for processing.
- Process particular claims and REAs which are deemed to be of a precedent-setting nature, as determined by Headquarters.
- Provide technical support to field claims and REA teams, as requested.
- Compile and report status and statistics relative to claims and REAs which are either active, settled, or under appeal.
- Review and approve all field-originated Contracting Officer's Final Decisions (COFDs) under disputes which are valued by the contractor at \$5 million or over in accordance with NCH 33.211. Review and revision will be done in conjunction with NAVSEA 00L for evaluation of entitlement, accuracy, and completeness. Following Headquarters' review and approval, the COFD will be returned to the ACO for execution and delivery to the contractor.
- Budget for, control, and allocate the required resources for Headquarters claims management efforts, including computer services and litigation support contracts.
- Support field efforts to secure funding for claim settlement.

In accordance with NCH 4.692, SUPSHIPs are to report all claims, regardless of dollar amount, and REAs over \$250,000 to NAVSEA 02 no later than one week after receiving the claim or REA. The cognizant SUPSHIP will be responsible for establishing a claim analysis team and for assigning to the team a Contracting Officer or negotiator to act as the Claims Team Manager (CTM), an engineer to be the Claims Team Engineer (CTE), and additional personnel (Legal, DCAA Auditor, or Project Officer) as necessary for effective claim processing. The claim analysis team should be physically separate from the rest of the SUPSHIP operation and will not include personnel involved in the claim allegations.

REAs and claims often involve complex legal, factual, and financial issues. These issues normally require extensive fact finding and analyses. A system of checks and balances is needed to determine entitlement, if any, and any expenditure of Government funds. In REA and claim submissions, contractors often fail to differentiate between factual and judgmental assertions or fail to support all assertions with specific evidence; such submissions only serve to delay the process and frustrate the contractor and the Government. Rejection and return of the REA or claim is required should the documentation and support remain deficient. Before the claim can be evaluated and payment made for any Government-responsible costs, the contractor must provide data which illustrates that all claimed costs are accurate and the Government is responsible for the claimed costs.

Preliminary review of the claim will be made to determine acceptability and regulatory compliance. On REAs and claims with allegations proposing an impact of delay, disruption (local and cumulative), congestion, and acceleration and in cases involving specific constructive changes, the following or similar documentation (to the extent applicable and practicable) needs to be included in the claim or REA to enable Government evaluation and to avoid the rejection and return of the submission to the contractor as unsupported:

- The assertions must be supported by specific evidence (including applicable historical evidence such as bid and planned costs supported by shop-level production data from contractor's books and records). In general, the Government will not acknowledge damages based on a reason-value or total cost concept. The contractor must establish a causal link or connection between the alleged Government-responsible act and the increased costs. Opinions, conclusions, or judgmental assertions not supported by such evidence or by a sound and reasonable rationale are without probative value and are unacceptable.
- Claimant's documentation or charts of production manning for all trades and all projects throughout the period of performance, proposed and actual, should be available.
- A copy of the claimant's master schedule originally developed to support work items/packages and start and finish milestones must be included. Documentation supporting all updates and the interrelationship of schedule slippage with REA or claim items, sequence, data, etc. should also accompany a claim or REA.

- Claimant's shop manning requirements for all trades through period (proposed and actual) of performance must be provided.
- Contractors must provide basic bid data broken down into prime contractor hours by item with prime contractor responsibility, prime contractor material by item number, identification of material source and price bid, and the subcontracted portion of the basic bid, by item, with copies of subcontractor contracts definitizing the tasks to be performed by the subcontractors and the material to be supplied by the subcontractor as part of the basic bid. The total of all items must equal the bid price, or an explanation must be provided.
- Contractors must provide the planned or budgeted manhours after contract award for each item by trade and define whether the hours were performed by the prime contractor or subcontractor at a regular or premium time.
- Claimant's actual manhours expended for each work item by trade excluding modifications as performed by the prime contractor and subcontractors must also be included. Documentation needs to support the prime contractor's actual material costs for the basic job order and subcontractor costs and if the subcontractor has made a demand on the prime contractor. Hours should be broken down by straight time and premium time hours.
- A listing of all contract modifications by work item with the manhours proposed, budgeted, agreed to, and actually expended by modification must be provided.
- A breakdown of the claimant's entire overtime expended by work item or modification by trade, weekly through the contract performance period must be provided.
- Copies of all individual purchase orders, invoices, and receipts for payment of all subcontracts and material in support of REAs or claims must be provided.
- A written description by sequence, providing a logical, auditable trail, of the interrelationship between the as bid, as planned, and the actual as accrued schedule by work item distinguishing item labor hour details by trade and the event causing the delay or disruption must be provided.
- A copy of all SUPSHIP written work authorizations against any disputed effort included in the claim must be provided.

**Note that there is no privity of contract between the Government and subcontractors.**

Subcontractor claims exist between the prime contractor and the subcontractor. The Government is not in a position to consider subcontractor claims that are simply passed through the prime contractor to the Government by a letter of transmittal. The prime contractor must provide the certification required and submit the claim on behalf of the subcontractor in order for the Government to evaluate the claims.

All REAs or claims involving subcontractors must establish the prime contractor's damage, payment for damage, or commitment to pay damage. Prime contractor's claims that show no commitment to pay the subcontractor do not constitute damage. The prime contractor must evaluate the subcontractor's claim, obtain objective evidence, and demonstrate that cause and effect were beyond the control of the prime contractor's prudent management business practices. The prime contractor must definitize what positive management actions were taken to minimize the prime contractor's exposure. A "Reason-Value" concept must not be accepted by the Government for subcontractor submittals. Prime contractors are to be cautioned to analyze subcontractor allegations thoroughly under prime contractor certification.

When a contractor submits a claim exceeding \$100,000, the Contract Disputes Act requires the contractor to make certain representations above the claim in the form of a certification. The claim certification must be in accordance with [FAR 33.207](#).

Certification is necessary before a Contracting Officer can consider the claim, analyze it, and issue a final decision. The contractor should properly certify the claim prior to submission to the Contracting Officer. When a contractor must certify the claim, supporting data and the amount of the contractor's entitlement must also be certified. To submit a proper certification, the person who signs the certification must have authority to bind the contractor with respect to the claim.

According to the provisions of the Contract Disputes Act, the Contracting Officer must issue a decision on any submitted claim of \$100,000 or less within 60 days from the receipt of a written request for a decision from the contractor. For claims or more than \$100,000, the Contracting Officer must, within 60 days, either issue a decision or notify the contractor of the time when a decision will be issued. The time established will be "reasonable", based on such factors as the size and complexity of the claim and the adequacy of the information in support of the claim provided by the contractor.

The Claim Team Manager (CTM), assisted by the claim analysis team, will review the claim or REA, prepare a claim or REA settlement milestone schedule within seven days, and provide NAVSEA 02 with information regarding the claim or REA required claims reports. Each claim or REA status report will be updated quarterly and submitted to NAVSEA 02 no later than five days following the last business day of each fiscal quarter or 48 hours following any significant event which would make obsolete the previous claim report. A final update marked "Final Report" will be submitted upon resolution of a claim or REA or an appeal.

The claim analysis team will investigate the claim or REA to assess the relevant facts required to establish a Government position. Pertinent legal issues will be addressed by counsel so that the factual inquiry will be thorough and comprehensive, extending to all sources (contractor, Government, and other) from which relevant data may be available. The burden of proof rests with the contractor to establish which additional costs were caused by an action or a failure to act by the Government and the amount of Government-responsible costs. The Government can request, receive, and inspect any and all relevant

data and records of the contractor. The claim settlement team will request the contractor to make available such documentation as necessary.

The team engineer will prepare the final TAR and consider the comments of all members of the team. The team engineer will endeavor to resolve any questions of factual issues. The TAR is a factual recitation of the claim, the existing facts, and the engineering evaluation and analysis of the validity of the claim on technical grounds. The TAR should include a recommendation on quantum and entitlement, supported by analysis, and identify questions or issues which require additional facts of expert testimony and potential witnesses. The TAR and addenda will be made available for use in legal and audit evaluation of the claim.

In accordance with (draft) NCH 33.204, DCAA audits will be requested for any claim or REA over \$550,000 on which cost or pricing data is provided. The audit request letter should include a due date (approximately 45 days) for receipt of the formal audit report. The CTM will consult with the auditor to provide assistance in evaluating the contractor's proposal. A copy of the TAR should be provided to DCAA for incorporation into the DCAA audit report, if time permits.

The team's legal counsel will be responsible for the preparation of the legal memorandum analyzing the merits of the claim, including a litigation risk assessment and recommendation on the course of action based on the facts. This memorandum will be furnished to other team members for reference purposes to develop a pre-negotiation position.

The CTM is responsible for following up regarding the due dates of the audit report, TAR, and Legal Memo to ensure that all advisory data is received timely. The CTM will develop a business clearance showing the pre-negotiation position range based upon the final TAR, Audit Report, legal memorandum, and other facts developed by the claim settlement team which will form the basis for negotiations. The pre-negotiation position will be presented to appropriate levels for approval. Negotiations will be conducted as soon as practicable after approval of the pre-negotiation business clearance. Unless otherwise directed by NAVSEA 02, the negotiation will be conducted by the CTM or designee with other team members participating when requested by the CTM. No settlement commitment will be made until a post-negotiation business clearance position has been approved. The post-negotiation business clearance will be prepared by the CTM and presented for approval.

After final agreement on price, the contractor will be required to provide a certificate of current cost or pricing data as set forth in [FAR 15.406-2](#). After approval, the final settlement of the claim or REA will be made by supplemental agreement. If a Contracting Officer's final decision is issued, all files and back-up data will be preserved since this information is essential to the defense of the Government position in the event the contractor appeals the decision. The CTM is responsible for all administrative close-out actions. Within 90 days after settlement of a claim, the CTM will forward to NAVSEA 02 a memorandum report discussing lessons learned from claim analyses and suggested actions to avoid recurrence of similar claims.

When the cognizant Contracting Officer becomes aware of a potential claim by the Government against a contractor, a letter of intent will be prepared advising the contractor of the Government's impending claim. The letter will:

- Identify the contract to which the claim applies.
- State the legal or contractual basis of the intended action(s) by the Government.
- Provide the facts relating to the potential claim.
- Request the contractor to respond with any facts that would show why the impending Government claim should not be asserted.
- Establish the date on which the Government action will be initiated should the contractor not respond.

Prior to delivering the letter of intent to the contractor, the Contracting Officer will obtain the advice of counsel on its legal sufficiency. A receipt will be obtained from the contractor clearly showing the name of the person accepting the letter of intent and the date of acceptance. The Contracting Officer will advise NAVSEA 00L of the issuance of each letter of intent and provide a copy.

On receipt of the contractor's response, the Government's claim will be processed in the same manner as a contractor's claim. If the Government's claim results in a Contracting Officer's final decision, that decision will be processed similar to a contractor's claim against the Government. The applicable contract file will include a discrete file containing all material relating to each Government claim against a contractor. An office log will be maintained listing all claims against contractors.

#### **3.13.7.5 Interest on Claims by Contractors**

NAVSEA policy requires interest to accrue from the date of certification ([FAR 33.207](#)) when a dispute arises and not when the claim is filed with the CO.

#### **3.13.7.6 Legal Fees**

In general, the Government's policy is that claim preparation costs will not be compensated; [FAR 31.205-33](#) and [31.205-47](#) contain details.

#### **3.13.7.7 Contracting Officer's Final Decision**

Per NCH 33.211, all field activities are authorized to issue COFDs for claims and denial letters for REAs less than \$5 million without prior NAVSEA approval. If a COFD is issued, all files and back-up data will be preserved. They are essential to the defense of the Government position if the contractor appeals the decision.

NAVSEA 022 will provide technical support to claims and REA teams (if needed), review and approve field COFDs for disputes over \$5 million, and support field office efforts to secure funding for claim settlement. The CTM is responsible for all administrative closeout actions.

ACOs are cautioned to pay particular attention to the time limitations on the issuing of a Contracting Officer's decision as imposed by [FAR 33.211\(c\)](#). If an ACO doubts that the applicable time limitation will be met, NAVSEA 00L will be advised immediately.

### **3.13.8 Resolution of Disputes**

NAVSEA policy is that a dispute between a contractor and NAVSEA should be resolved by the cognizant Contract Administration Office (CAO). NAVSEA does not serve as a higher level of appeal for contractors in the event of disagreements between the contractor and the CAO.

#### **3.13.8.1 Appeals**

In accordance with NCH 33.212, when the Contracting Officer receives a contractor's appeal of a COFD, the Contracting Officer shall immediately forward the COFD and appeal to the cognizant office of counsel. Upon notification of an appeal, the Contracting Officer shall compile all documentation relating to the appeal as required by legal counsel, including the COFD, the contract file, relevant correspondence, and transcripts of statements or affidavits by witnesses.

#### **3.13.8.2 Negotiations with Appeal Pending**

While the Navy is not precluded from seeking further agreement with the contractor after an appeal is filed, all such attempts are to be in accordance with Regulatory Requirements.

#### **3.13.8.3 Third Party Lawsuits**

If a third party enters a suit against a contractor who holds a cost-reimbursement or other type of contract under which the judgment of litigation fees might be reimbursable, the ACO should immediately inform NAVSEA counsel and the PCO, forwarding copies of the summons and complaint.

### **3.13.9 Constructive Changes**

#### **3.13.9.1 General**

The incidence of constructive changes resulting from actions of SUPSHIP personnel can be used to measure the effectiveness and efficiency of SUPSHIP in performing contract administration. In addition, a constructive change may be a violation of the administrative control of funds, and the person responsible may be subject to the penalties specified for such a violation.

This section covers procedures necessary to preclude the occurrence of constructive changes, where such changes have been issued, and the procedures necessary to resolve the matters involved at the earliest practical date. [FAR 43.104](#) provides the policy of DoD with respect to constructive changes.

### **3.13.9.2 Contracts Containing FAR 52.243-7, “Notification of Changes” Clause**

The “Notification of Changes” clause, [FAR 52.243-7](#), is designed to obtain prompt reporting of Government conduct that the contractor considers a change to the contract. It should be noted that, pursuant to the clause, the Government can be bound by an order given by a Government representative whom the Contracting Officer has specifically empowered to issue instructions, directions, or orders with respect to a specific limited scope of contract performance.

Supervisors are advised to familiarize themselves with the particular clauses of each contract administered and to ensure that satisfactory local procedures are implemented for proper administration of the clauses within the requisite time constraints. While the Changes clause is designed to eliminate the occurrence of constructive change orders, it cannot operate effectively unless it is properly and conscientiously administered.

Supervisors are advised to familiarize themselves with other parts and clauses that may be included in contracts containing the [FAR 52.243-7](#).

For contracts not containing [FAR 52.243-7](#), supervisors will reach agreement with each contractor regarding the procedures to follow by both parties when a constructive change is identified. The following are to be covered in the administrative agreement:

- The need for the contractor to notify the ACO at the earliest possible time of the receipt and substance of an alleged constructive change;
- The fact that the contractor is not to comply with any written or oral communications considered to be a change in the contract requirements which are not otherwise designated in writing by the Contracting Officer as a change order;
- The format and supporting documentation to be submitted by the contractor identifying and reporting the occurrence of alleged constructive changes;
- The rapid response procedure that is to be established by the Supervisor to ensure timely response to the contractor; and
- The limits of the ACO's authority with respect to the issuance of a contract modification, when it is determined that a constructive change has in fact occurred, and for which a formal modification pursuant to the Changes clause is in order.

Any supplemental agreement entered into pursuant to the Changes clause will include the costs of delay or disruption attributable to the change and appropriate release language.

### 3.13.9.2.1 FAR 43.204 Equitable Adjustments: Waiver and Release of Claims

The Equitable Adjustments clause ([DFARS 52.243-7002](#)) provides, in part, that when a request for equitable adjustment is submitted under the Changes clause, it is to include all types of adjustments in the total amounts to which the Changes clause entitles the contractor, including, but not limited to, adjustments arising out of delays or disruptions caused by such changes. The clause also provides that, if required by the Contracting Officer, the supplemental agreement setting forth such equitable adjustment will include a release discharging the Government and its officers, agents, and employees from any further claims arising out of delays or disruptions caused by such changes. The foregoing release language will be included in each supplemental agreement establishing the equitable adjustment of the price and time of performance with respect to a change.

### 3.13.9.3 SUPSHIP Procedures and Reports

For processing constructive changes, local instructions and procedures will be prepared and issued to ensure that the regulatory requirements are met. Copies of the local instructions and procedures, and all revisions thereto, will be submitted to NAVSEA 04Z and NAVSEA 02.

The following are matters to consider in preparing the local instructions and procedures:

- Occurrence of a constructive change is to be treated as a serious action similar to a violation of the administrative control of funds.
- SUPSHIP personnel should be thoroughly briefed on the requirements of this chapter, with emphasis on the limitation of their authority to direct the contractor to perform work.
- A follow-up procedure is to be established to ensure timely replies for SUPSHIP correspondence to NAVSEA, contractors, and other organizations when such correspondence requires action by them, and when delays could result in a constructive change if correspondence is not promptly answered. The follow-up procedure should include provisions for obtaining the assistance of NAVSEA 04Z when NAVSEA replies have been unduly delayed.
- Reports are to be submitted by the head of a department to the Supervisor when personnel of the department are responsible for a constructive change. The penalties to be recommended in the report should be similar to those which would be imposed for a violation of the administrative control of funds. The report should contain a complete explanation of the circumstances that led to the constructive change, the status of the vessels for which the constructive change is applicable, and an estimate of cost for the change.
- It is required that the contracts officer and legal counsel, when assigned to the SUPSHIP office, concur with controversial correspondence to the contractor not signed by a Contracting Officer. SUPSHIP personnel are not required to report

failure of visiting personnel to send standard visit request letters prior to the visit, but will be responsible for the preparation of reports delineating the status of any unresolved problems, agreements made, and dates requested from the contractor.

- It is required that constructive changes be resolved as soon as is practical. In no case is a constructive change to be held for resolution as part of an overall claim under the contract or for resolution as part of final settlement, unless approved by NAVSEA.

Local procedures for the processing of nucleus crew deficiency reports to identify operational deficiencies will be developed and agreed to by all parties involved (i.e., the SUPSHIP, PCO, and contractor). The definition of operational deficiency will be developed by the SUPSHIP and the ship's crew. Where such procedures do not exist, all noted deficiencies will be prescreened by the SUPSHIP. Items noted during inspection which require alterations to ship design (potential constructive changes) will be prescreened by the SUPSHIP prior to transmittal to the contractor. Nucleus crews will be briefed on local procedures which govern the processing of deficiency reports. The procedures should provide for coordination with the inspections of the SUPSHIP's QA personnel and use the Quality Deficiency Record (QDR) reporting system described in Chapter 9, "Contract Administration Quality Assurance Program."

#### **3.13.9.4 SUPSHIP Authority to Formalize Identified Constructive Changes**

Except for contracts containing [FAR 52.243-7](#), the SUPSHIP may recognize an identified constructive change and prepare and approve a covering Field Modification Request (FMR) only when all of the following prerequisites have been met:

- The change is within the Engineering Change Proposal (ECP) approval authority and FMR issuance authority of SUPSHIP;
- The constructive change is the responsibility of a person in the SUPSHIP office;
- Reporting procedures have been complied with by the appropriate head of the department;
- Funds for reservation purposes are available in SUPSHIP in the amount of the estimated cost of the change; and
- The work is actually beyond the contract requirements and resulted in a benefit to the Government, and the contractor did not perform work voluntarily.

In general, it must be work that would have been authorized by a contract change if proper procedures had been followed. Only the person(s) designated in writing may approve the change and the issuance of an FMR.

If the contract contains the [FAR 52.243-7](#) Notification of Changes clause, the contractor is required to notify the Contracting Officer of the issuance of the constructive change and,

other than in a situation described in the clause, is not to proceed with the change unless and until the Contracting Officer has responded to such notice in accordance with the clause. The authority to approve and issue an FMR in such a situation is the same as for ECPs. In addition, any prerequisite listed above applies to determinations under this section.

### **3.13.9.5 Processing Identified Constructive Changes**

When a constructive change has been identified, it will be processed in the format and in accordance with the procedures required for ECPs, unless such procedures hinder the requisite expeditious processing of the constructive changes or conflict with the stated time requirements of specific contract clauses for response to such changes.

## **3.14 Release of Performance Reserves**

After delivery of a ship, the contractor may request release of performance reserves. The contractor's request should include the following information, as applicable:

- a. List of contractor-responsible incomplete work and estimated completion dates;
- b. List of deficiencies and estimated completion dates;
- c. List of guaranty items; and
- d. Endorsement by SUPSHIP to NAVSEA which will comment on the contractor's letter, supplementing the letter with status of incomplete work, deficiencies, guaranty items, and adjustments in price made or anticipated.

## **3.15 Contract Terminations**

Terminations may be either a Termination for Convenience or a Termination for Default, depending on the nature of the termination. A contract may be terminated for convenience for any reason that the Contracting Officer determines would be in the best interest of the Government. Terminations for Default are also performed when it is in the Government's best interest, but the reason for the termination is based on the contractor's actual or anticipated failure to perform contractual obligations.

### **3.15.1 Authority to Terminate**

Although [FAR Part 49](#) grants Contracting Officers the authority to suspend or terminate contracts when it is in the Government's interest, NCH 49.101 does not authorize SUPSHIP Contracting Officers to terminate completely or partially any new construction or ship repair contract. All determinations for default, cure notices, and show cause letters must be approved by NAVSEA 02/02B. ACO authority to terminate a ship repair contract requires NAVSEA 024 concurrence prior to a termination for convenience (whole or in part) action, and NAVSEA 02 approval for termination for default action.

The ACO may terminate for convenience, with approval of the CCO, locally issued job orders. NAVSEA 02 Division Director or FPO CCO approval is required prior to partial or complete termination for convenience on non-major program contracts.

### **3.15.2 Extent of Termination**

Terminations can be either partial or complete. A partial termination means the termination of a part, but not all, of the work that has not been completed and accepted under the contract. A complete termination means the termination of all of the work that has not been completed and accepted under the contract.

### **3.15.3 Effect of Termination**

Terminations are very serious matters. Depending on factors such as the dollar amount of the contract, the contractor's financial condition, and the availability of other work to the contractor, a termination can severely impact a contractor's financial condition or even drive the contractor into bankruptcy and out of business. The contractor is not the only one hurt, however, as the contractor must terminate any subcontractors under the contract. Furthermore, the contractor must lay off employees unless the contractor has other work to assign to employees working on the terminated contract. Such circumstances frequently result in political involvement.

### **3.15.4 Termination Contracting Officer**

After the Contracting Officer has issued a notice of termination, a Termination Contracting Officer shall be assigned to handle the termination actions. [FAR Part 49](#) details the duties and responsibilities of the Termination Contracting Officer.

## **3.16 Insurance**

### **3.16.1.1 Introduction**

Although this section describes the types of insurance routinely required for fixed-price and cost-reimbursable contracts, the only insurance coverage required of the contractor are those specified by each contract. In accordance with FAR 28.311-2, agencies are permitted to develop their own solicitation provisions and contract clauses to implement the basic policies contained in [FAR 28.3](#).

In general, there are two types of insurance coverage. The first covers loss, damage, or destruction to the vessel, its equipment, or materials; the second covers third party and collision, protection, and indemnity liabilities.

This section describes typical insurance coverage provided by fixed-price and cost-reimbursable contracts. In all cases, however, the type of insurance coverage required of the contractor is specified by the contract. It is essential to remember that insurance claims are different from contract claims. Specifically, insurance claims:

- Require direct physical damage to vessel from external cause.
- Exclude delay, disruption, faulty workmanship and materials, cost of sea trials, and consequential damages.
- Exclude fixed overhead.
- Exclude overtime, unless authorized.
- Exclude cost of money.
- Can pay negotiated profit influenced by degree of contractor fault and based upon profit of all yard work.
- Do not allow for reimbursement to be based on estimates, but on return costs for labor performed and bills paid for material.
- Can settle outside contract price (targets).
- Do not allow for deductibles to be a contract cost.

### **3.16.1.2 Shipbuilding Fixed-Price Contracts**

#### **3.16.1.2.1 Builder's Risk Policy**

Under vessel fixed-price contracts, the Government customarily assumes the same risk of loss or damage as would have been assumed by private insurance underwriters had the contractor obtained and maintained marine builders risk insurance. This risk is subject to a deductible as identified in the contract. The risk is assumed by the Government with respect to the vessel itself, Government-Furnished Material (GFM) and equipment, and all Contractor-Furnished Material (CFM) and equipment to which the Government has title under the provisions of the contract.

Government assumption of property damage risks under vessel fixed-price contracts replaces property insurance coverage that would normally be provided by the contractor. Because the Navy assumes specified risks (except to the extent of the deductible), the contractor will not carry insurance for loss of or damage to the vessel or contract property, Government-furnished or contractor-acquired, to which the Government has title, unless the Navy directs the contractor in writing to acquire available insurance.

Although the contractor is protected regarding the damages caused by defective workmanship or material, no such protection is afforded for the costs of correcting the defective workmanship itself. Specifically, the Government will not pay for any costs of the contractor for the inspection, repair, replacement, or renewal of any defects in the vessel or such materials and equipment due to defective workmanship or defective materials or equipment performed by or furnished by the contractor or its subcontractors, or

workmanship, materials, or equipment performed by or furnished by the contractor or its subcontractors which does not conform to the requirements of the contract.

#### **3.16.1.2.2 Collision Liability and Protection and Indemnity Liabilities Insurance**

The Government Syndicate Form Collision Liability and Protection and Indemnity Liabilities insurance addresses contractor liabilities resulting from collision of the ship with any other ship or craft. This insurance also provides liability protection against damage to structures (e.g., piers, wharves, and stages). Liabilities for personal injuries and death (excluding contractor's employees) caused by collision are covered at launching, after the ship is fully waterborne, and during trial and delivery trips.

In general, vessel contracts require the contractor to procure and maintain, within the contract price, Government Syndicate Form Collision Liability and Protection and Indemnity Liabilities insurance with respect to each ship. This insurance must be obtained in an amount equal to the lesser of 80 percent of the sum of the contract price of the ship and the value of applicable GFM as estimated by the Navy, or \$2 million. In excess of these limitations, the Government assumes the obligation of indemnifying the contractor for liabilities to third parties within the scope of the policy.

Under the clause entitled "Additional Insurance Provisions (FT) (Jan 90)," which is invoked in fixed-price shipbuilding contracts, the contractor is directed that Collision Liability and Protection and Indemnity Liabilities insurance is not required during underway trials.

#### **3.16.1.2.3 Boat Building Fixed-Price Contracts**

Fixed-price boat contracts normally include provisions that require the contractor to maintain insurance at the contractor's expense for damage to or loss of boats, including both Government-furnished and contractor-furnished material. These provisions are designed to ensure protection of the Government's interests. The amount of the insurance is required to be no less than the sum of the aggregate payments made by the Government against the contract price plus the value of GFM, as periodically determined by the Contracting Officer.

The contractor is required to procure the physical damage policies jointly in the name of the contractor and the name of the United States. Losses must be payable to the order of the Secretary of the Navy for the use of the United States to the extent of the Government's payments against the contract price plus the amount of loss of or damage to GFM, and for the contractor's use to the extent of the balance. In addition, the contract provides that the policy terms and the insurance companies selected are to be satisfactory to the Navy.

#### **3.16.1.3 Shipbuilding Cost-Reimbursable Contracts**

##### **3.16.1.3.1 Loss or Damage to Government Property**

Unlike fixed-price shipbuilding contracts when loss, damage, or destruction to Government property is covered under the "Insurance" clause and a deductible amount applies, the contractor's responsibility for loss, damage, or destruction to Government property under

cost-reimbursable contracts is primarily covered by the "Government Property" clause and there is no deductible. This clause provides that the contractor will not receive reimbursement for, and is not to include as an item of overhead, the cost of insurance or any reserve covering the risk of, loss of, or damage to Government property, unless the Government has required the contractor to carry such insurance under other provisions of the contract. Government property under cost-reimbursable contracts includes Government-furnished property and all property purchased by the contractor for which the contractor is entitled to be reimbursed as a direct item of cost under the contract.

Under cost-reimbursable contracts, the Government generally reimburses the contractor for loss of or damage to Government property as an item of allowable costs. The contractor is responsible for loss or damage in certain situations, however, such as loss or damage resulting from willful misconduct or lack of good faith of the contractor's directors or officers and other managerial personnel as defined in the clause. The contractor is also responsible in the event of willful misconduct or lack of good faith to establish and administer a program for repair, protection, preservation, control, use, and maintenance of the property. As is the case in where the Government has assumed the risk of loss, the Government does not reimburse the contractor if the damage is in fact covered by insurance or if the contractor is otherwise compensated for the damage.

#### **3.16.1.3.2 Collision Liability and Protection and Indemnity Liabilities Insurance and Third Party Liabilities**

In its "Insurance Property Loss or Damage Liability to Third Persons" clause, NAVSEA adds the requirement that the contractor procure Collision Liability and Protection and Indemnity Liabilities insurance. This insurance is required in the same amount as under fixed-price contracts (i.e., 80 percent of the sum of the contract price and the value of GFM, or \$2 million, whichever is less). This insurance applies at and after the time the ship becomes waterborne and is subject to the same restrictions and limitations.

The FAR clause provides for reimbursement to the contractor "for that portion of the reasonable cost of insurance allocable to this contract". To the extent allocable to and arising out of contract performance and subject to the availability of funds, the contractor is also reimbursed for liabilities to third parties (as represented by a final judgment or approved settlement) for personal injury, death, or loss of or damage to the property of others that is not in the contractor's possession. These third party liabilities will be reimbursed whether or not the liabilities result from negligence of the contractor. The liabilities will not be reimbursed by the Government if:

- contractor is otherwise responsible under particular contract clauses
- liabilities are the result of willful misconduct or lack of good faith on the part of contractor managerial personnel as defined in the clause
- contractor is compensated for them by insurance or otherwise
- contractor has failed to insure or maintain insurance as required by the contract

With regard to Collision Liability and Protection and Indemnity Liabilities risks, these provisions of the clause have the effect of obligating the Government to indemnify the contractor for liabilities in excess of the limitations of the insurance coverage, as in the case of fixed-price vessel contracts.

### **3.16.1.4 Administration of Insurance Requirements**

#### **3.16.1.4.1 Responsibilities of Deputy Assistant Secretary of the Navy (DASN) – Acquisition and Logistics Management (A&LM)**

DASN (A&LM) is available to contracting activities to provide guidance on insurance matters and is authorized by direction of the Secretary of the Navy, or the duly authorized representative of the head of a contracting activity, the Contracting Officer, or any other naval official designated in such a contract, to do the following:

- Require or approve insurance when a contract provides that a contractor will procure such insurance;
- Execute, sign, or endorse in the name of, and by direction of the Secretary of the Navy, any and all lost policy releases, proofs of loss, subrogation agreements, endorsements of policies for claims or return premiums, payment orders, and insurance drafts made payable to the Secretary of the Navy and not affecting the obligating of appropriations;
- For risk pooling arrangements, confirm to the cognizant activity the amount of premium due and, if the funds allocated to the contract are not sufficient, the amount due shall be paid as an item of cost under the contract out of other appropriated funds; and
- Advise and recommend to the Secretary of the Navy or other authorized interested officials of the Navy Department regarding insurance drafts that affect the obligating of appropriations and assignment, in order to assure payment of premiums found to be due after the completion of a contract.

NAVSEA determines, under the applicable Marine Builder's Risk policy of any shipbuilding contract, whether or not the Government has assumed the risk of loss and the extent of any Government responsibility with regard to contractor's claims. DASN (A&LM) should be consulted if any assistance is required in determining Government responsibility. All matters concerning self-insurance covering any kind of risk will be submitted to the ASN (RD&A) - ABM.

#### **3.16.1.4.2 Authority of SUPSHIPs**

Per NCH 28.301, offices with legal counsel are authorized to process and approve insurance claims without limitation, subject to business clearance thresholds.

#### **3.16.1.4.3 PCO/SUPSHIP ACO Responsibilities**

NCH 28.301 assigns responsibility to the PCO or SUPSHIP for:

- Establishing and maintaining contractor insurance records
- Ensuring the contractor maintains qualifying insurance under the annual PL. 85-804 SECNAV Determination or individual authorization (see [FAR 50.103](#))
- Establishing and maintaining adequate contract records of contractor claims when the Government assumes the risk or indemnifies the contractor under the contract, analyzing such claims to ascertain patterns of neglect or misconduct, and calling such matters to the attention of the contractor
- Taking action on insurance as directed by NAVSEA
- Ensuring that contract modifications for repairs to GFM are not issued when the need for corrective action results from damages of an insurance nature
- Ensuring that the contractor submits an insurance claim in writing for loss or damage

All SUPSHIPS will take the following actions for loss or damage that may be the subject of an insurance claim:

- Assure such loss or damage is reported by the contractor in writing to the ACO.
- The ACO is responsible for recording and accomplishing the following:
  - contractor's name and contract number
  - Navy classification symbol and hull number, if appropriate (not the contractor's hull number)
  - claim number or job order number
  - date of occurrence
  - full description of accident, damage, or the event causing damage
  - details of the estimated or actual costs of repair or replacement
  - comments about the contractor's responsibility for the loss, such as willful misconduct, damages to material when in the possession of a subcontractor, or statements supporting contentions that the damages were not accidental; and discussions of mitigating circumstances concerning the responsibility of either party
  - comments about Government liability for any future claims
  - ACO comments to the extent of the contractor's entitlement

#### **3.16.1.4.4 Notification of Legal Action Against the Contractor**

As required by the insurance clause(s) of job orders or contracts, a contractor will immediately, or as soon as practical, notify the ACO of any legal action filed against the contractor if the legal action arises out of the performance of the contract and if the cost may be reimbursable, the risk is uninsured, or the amount claimed is in excess of the amount of insurance coverage. The ACO will then direct the contractor to immediately furnish copies of all pertinent papers received in connection with the claim, if not provided with the contractor's notification. The ACO will also promptly notify the NAVSEA Contracting Officer and NAVSEA counsel of any such legal actions filed against the contractor and forward copies of all papers and statements of available facts concerning any action resulting from bodily injury, death, or property damage and involving a member of the public or any employee of the contractor or subcontractor.

#### **3.16.1.4.5 Procedures for Treating Claims by Third Parties Under Navy Contracts Providing for Assumption of Risk by the Government**

The following procedure will be followed in making all payments for the contract provisions prescribed in FAR and DFARS under which the Government assumes the risk of liability to third persons. This procedure applies only to the cases of liability to third persons not compensated by insurance or otherwise.

When a claim is made by a third person for loss of or damage to property, death, or bodily injury not compensated by insurance or otherwise arising out of performance of a contract, the investigating officer will submit to the contracting activity cognizant over the contract, all statements, pertinent facts, recommendations of the contractor, and recommendations of the investigating officer related to the claim. The amount, if any, to be paid in discharge will also be submitted. The contracting activity will promptly forward these statements with any of its recommendations to ASN (RD&A) – AM to determine whether the Government has assumed liability for such claim and, if so, the amount to be paid to the person in discharge of the claim.

If the ASN (RD&A) - AM determines that the Government has assumed the liability for the claim of a third person arising out of performance of a contract, such third person will be paid the amount fixed by the ASN (RD&A) - AM. If the ASN (RD&A) - ABM determines that the Government did not assume such liability, no payment by the Government will be made; if appealed by the contractor under the "Disputes" clause, a different decision will be considered.

#### **3.16.1.4.6 Liability of Subcontractors**

Subcontractor liability is discussed in the following sections.

##### **3.16.1.4.6.1 Deductibles Under Incentive Contracts**

Paragraph (c) of the Special Provisions Clause, entitled "Insurance Property Loss or Damage Liability to Third Persons," provides that payments for insurance claims are outside the scope of and will not affect the pricing structure of the contract.

The "Incentive Price Revision" clauses of the contracts explicitly exclude from incurred costs, for purposes of negotiating the total final cost or establishing the total final price, any amounts reimbursed to the contractor for paragraph (e) of the "insurance" clause.

In view of the preceding, the adjudicating SF 30 should reflect a firm-fixed price with no change in contract targets. The SF 30 ought to reflect the amount of cost included in the price. Such cost is the amount that the contractor should exclude from incurred costs for incentive price revision purposes. (Sample language should be as follows: "Furthermore, this modification results in no change to the Contract Targets, and the payment described herein will not be included in the total final cost negotiated or in the total final price established in accordance with Clause J4 entitled 'Incentive Price Revision (Firm Target)'".)

At times the Government makes repairs to damage covered under the "insurance" clause. If the contractor or a third party makes the repair, then the contractor is responsible for paying the cost of the repair up to the deductible. When the Government does the repair work, then the contractor should pay the Government for doing the work up to the amount of the deductible.

Although the previous section describes a specific regulatory requirement, SUPSHIPs are cautioned that shipbuilding contracts may be written so that the Government could have title and be liable for property at a subcontractor's facility.

#### **3.16.1.4.6.2 Nuclear and Ultra-Hazardous Risk Indemnity**

Under both cost-reimbursement and fixed-price contracts, the Government may agree to indemnify the contractor against claims arising from bodily injury sustained by employees or others or arising from loss of, damage to, or loss of use of the contractor's own, the Government's, or a third party's property. The agreement to indemnify is limited to claims arising from performance of the contract and from unusually hazardous risks as defined in the contract. The indemnity may also be written to cover nuclear risks not considered unusually hazardous through appropriate modification of the indemnity clause.

Although the statutory basis for extending such indemnity to contractors are different for research and development contracts, as opposed to contracts for other than research and development, the limits and conditions of the indemnity agreement are very similar. Contracts for vessel and boat construction will ordinarily be classified as other than research and development, and extension of such indemnity will be governed by [FAR 50.104-3](#).

The provisions of the indemnity agreement are similar for both cost-reimbursement and fixed-price contracts. Both provide exceptions to the operation of the indemnity agreement where the claim results from willful misconduct or lack of good faith on the part of the contractor's chief officials. Another exception covers liabilities for which the contractor is compensated, or is entitled to be compensated, by insurance or otherwise.

Because the Government may ultimately bear the loss under such indemnity agreements, it is extremely important that the contractor notify SUPSHIP immediately upon occurrence of any such incident within the scope of the indemnity agreement. SUPSHIP will promptly provide the notification as required by section [3.16.1.4.4](#) of this chapter.

## Appendix 3-A: Acronyms

AAR	Audit Advisory Report
ABR	Agreement for Boat Repair
ACO	Administrative Contracting Officer
ADR	Alternative Dispute Resolution
ASBCA	Armed Services Board of Contract Appeals
ASN(RD&A)ABM	Assistant Secretary of the Navy (Research, Development and Acquisition) Acquisition Business Management
AT	Acceptance Trials
BOA	Basic Ordering Agreement
BVC	Best Value Contracting
CAO	Contract Administration Office
CAP	Contractor Acquired Property
CAS	Contract Administration Services
CCO	Chief of the Contracting Officer
CDA	Contract Disputes Act
CFM	Contractor Furnished Material
CO	Commanding Officer
COFD	Contracting Officer's Final Decision
COMNAVSEASYSKOM	Commander, Naval Sea Systems Command
COR	Contracting Officer's Representative
CPAF	Cost Plus Award Fee
CPARS	Contractor Performance Assessment Reporting System
CPFF	Cost Plus Fixed Fee

CPIF	Cost Plus Incentive Fee
CPSR	Contractor Purchasing System Review
CTE	Claims Team Engineer
CTM	Claims Team Manager
DASN(A&LM)	Deputy Assistant Secretary of the Navy (Acquisition and Logistics Management)
DAWIA	Defense Acquisition Workforce Improvement Act
DCAA	Defense Contract Audit Agency
DCMA	Defense Contract Management Agency
DD Form	Department of Defense Form
DFARS	Defense Federal Acquisition Supplement
DFARS PGI	DFARS Procedures, Guidance and Information
DFAS EDA	Defense Finance and Accounting Service Electronic Document Access
DoD	Department of Defense
DoDD	Department of Defense Directive
DoN	Department of the Navy
ECP	Engineering Change Proposal
eSRS	Electronic Subcontractor Reporting System
EVMS	Earned Value Management System
FAR	Federal Acquisition Regulations
FASA	Federal Acquisition Streamlining Act
FCT	Final Contract Trials
FFP	Firm Fixed Price
FMR	Field Modification Request
FMS	Foreign Military Sales

FPI	Fixed Price Incentive
FPO	Field Procurement Offices
FPRA	Forward Pricing Rate Agreement
FSS	Federal Supply System
GAO	General Accountability Office
GENSPECS	General Specifications for Ships
GFI	Government Furnished Information
GFM	Government Furnished Material
GFP	Government Furnished Property
GPFR	Government Property Problem Report
HASC	House Armed Services Committee
HCA	Head of the Contracting Activity
HMR	Headquarters Modification Request
HUBZone	Historically Underutilized Business Zone
IDIQ	Indefinite Delivery/Indefinite Quantity
IFB	Invitation for Bid
INSURV	Board of Inspection and Survey
IPT	Integrated Product Team
JFFM	Joint Fleet Maintenance Manual
LOA	Letter of Agreement
MAC	Multiple Award Contract
MARAV	Master Agreement for Repair and Alteration of Vessels
MOA	Memorandum of Agreement
MOU	Memorandum of Understanding

MS/MO	Multi-Ship/Multi-Option
MSRA	Master Ship Repair Agreement
NAVSEA	Naval Sea Systems Command
NAVSEAINST	Naval Sea Systems Command Instruction
NAVSHIPSO	Naval Sea Systems Command (NAVSEA) Shipbuilding Support Office
NCH	Naval Sea System Command (NAVSEA) Contracts Handbook
NMCARS	Navy and Marine Corps Acquisition Regulation Supplement
OFPP	Office of Federal Procurement Policy
OMB	Office of Management and Budget
OSN	Office of the Secretary of the Navy
PCO	Procuring Contracting Officer
PL	Public Law
PMR	Program Manager Representative
POP	Period of Performance
PPMAP	Procurement Performance Management Assessment Plan
PSA	Post Shakedown Availability
QA	Quality Assurance
QDR	Quality Deficiency Record
REA	Request for Equitable Adjustment
RFP	Request for Proposal
RMC	Regional Maintenance Center
SADBU	Small and Disadvantaged Business Utilization Program
SASC	Senate Armed Services Committee
SBA	Small Business Administration

SBP	Small Business Program
SECDEF	Secretary of Defense
SECNAVINST	Secretary of Navy Instruction
SOM	SUPSHIP Operations Manual
SPS	Standard Procurement System
SSA	Source Selection Authority
SSEB	Source Selection Evaluation Board
SUPSHIP	Supervisor of Shipbuilding, Conversion and Repair, USN
TAR	Technical Advisory Report
TCO	Termination Contracting Officer
TYCOM	Type Commander
UCF	Uniform Contract Format
UPSA	Unpriced Supplemental Agreement
USC	United States Code