# Contract Pricing Reference Guides Volume 1

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## I.0 Chapter Introduction

*Contract Pricing Environment.* An important part of your job as a contract specialist is to conduct the price analyses necessary to ensure that the Government purchases supplies and services from responsible sources at fair and reasonable prices. To begin your study of contract pricing, we will examine the pricing environment, including:

- Definitions of price;
- Seller pricing objectives and approaches;
- The Government pricing objective;
- Government approaches to contract pricing; and
- Potential participants in the acquisition process

*Definitions of Price* . From both work and personal business dealings, most people think of price as the amount of money that a buyer pays a seller for the delivery of a product or the performance of a service. The FAR definition of price ( FAR 15.401 ) emphasizes its components: Cost plus any fee or profit applicable to the contract type.

Both definitions of price are important. Primarily, price is defined as the amount the buyer pays for a product or service. However, it is important to remember that, if prices do not cover supplier costs and provide a profit, losses will occur. When a contract is priced below cost, performance risk increases. The contractor must finance contract performance with funds from other sources (e.g., profits from other contracts, financial reserves, or overpriced contract modifications). If contractor efforts to control costs result in unsatisfactory performance, contractor default is a real possibility.

I.1 - Identifying The Seller's Pricing Objectives And Approaches This section covers the following topics:

- I.1.1 - Identify Seller's Pricing Objectives
- I.1.2 - Identify Seller's Approaches To Pricing
- I.1.3 - Review Seller's Cost-Based Pricing Strategies
- I.1.4 - Review Seller's Market-Based Strategies

*Pricing Perspectives* . Buyers and sellers look at the same price from different perspectives. Each party to a sales transaction has unique pricing objectives. As a contract specialist, you should be aware that:

- Sellers in different markets often have different approaches to contract pricing.
- Different sellers in the same market may have different pricing objectives and approaches.
- A single firm may have different objectives and approaches in different contracting situations.

## I.1.1 - Identify Seller's Pricing Objectives

*Pricing Objectives.* To sellers, contract pricing has two primary, related objectives:

- To cover costs; and
- To contribute to attaining corporate operational objectives.

*Cover Costs.* Many firms would have us believe that they lose money on every unit they sell, but make up for it in volume. Unfortunately, business does not work that way. A seller may accept a loss on a particular contract or group of contracts, but a firm that consistently fails to cover its costs cannot survive.

*Operational Objectives.* All firms have several operational objectives that serve as benchmarks for business decisions. In the best firms, they are usually clearly defined and tailored to the market decisions. In other firms, they may be less clear.

Common objectives include:

- Short-term and/or long-term profitability;
- Market share;
- Long-term survival;
- Product quality;
- Technological leadership; and
- High productivity.

To attain its operational objectives, a firm must cover its costs and earn an overall profit. Some products may sell for less than cost, but if they do, other products must make sufficient profit to compensate for those losses. Profits are essential for:

- Investment;
- Product Development;
- Productivity Improvement;
- Retirement of Debt Principal; and
- Rewarding Investors.

## I.1.2 Identify Seller's Approaches To Pricing

*Seller's Pricing Approaches.* In product pricing, sellers commonly use one of two basic approaches -- cost-based pricing or market-based pricing. The following are common strategies associated with each approach:

*Cost-based pricing:*

- Mark-up pricing
- Margin on direct cost
- Rate-of-return pricing

*Market-based pricing:*

- Profit-maximization pricing
- Market-share pricing
- Market skimming
- Current-revenue pricing
- Promotional pricing
- Demand-differential pricing
- Market-competition pricing

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### I.1.3 Review Seller's Cost-Based Pricing Strategies

This subsection covers the following topics:

- I.1.3.1 - Mark-Up Pricing
- I.1.3.2 - Margin On Direct Cost
- I.1.3.3 - Rate-of-return Pricing

*General Approach.* The cost-based pricing approach to pricing involves an analysis of a firm's cost to produce a product, and the addition of a reasonable profit to determine the selling price.

Seller cost will depend on many factors including production methods and product sales volume.

The seller's definition of a reasonable profit will also depend on many factors, including:

- Competition;
- Objectives of the firm;
- Necessary investment; and
- Risk involved.

*Cost-based Pricing Strategies.* How is profit calculated and applied? There are three basic strategies:

- Mark-up pricing;
- Margin pricing; and
- Rate-of-return Pricing.

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### I.1.3.1 Mark-up Pricing

*Definition.* Mark-up pricing is the establishment of prices based on estimated direct cost or total cost plus a percentage mark-up. If the base is direct cost, the mark-up covers profit plus indirect costs (i.e., overhead and general and administrative costs). If the base is total cost, the mark-up only covers profit.

*Procedure.* To understand mark-up pricing, you must understand the steps followed by a firm when using the technique:

- Estimate the sales volume.
- Estimate product unit cost at the estimated sales volume.
- Determine the mark-up rate to be used.
- Calculate unit selling price by applying the mark-up rate to the product cost.

*Example.* Price the following product using straight mark-up pricing:

**Given** :

Estimated Sales Volume = 1,000 units
Estimated Unit Cost = $80
Mark-up Rate = 20%

**Calculate Unit Selling Price** :

Unit Selling Price = Cost + (Mark-Up Rate x Cost)
= $80 + (0.20 x $80)
= $80 + $16
= $96

*Strategy Implications for Buyers* Profit is set using a mark-up rate that is simply a percentage of direct or total cost. That rate depends on:

- Market Factors. The product line, tradition, competition, and other market factors will affect the mark-up rate. Investment required to produce the product is not normally one of the factors considered in setting a mark-up rate. Similar products are typically priced using similar mark-up rates. However, a new state-of-the-art product will typically be priced using a higher mark-up rate than a similar older product that has been on the market for a long time.
- Cost Base Used in Applying the Rate.
    - Mark-Up on Direct Cost. A firm that bases its mark-up on direct cost will have a higher mark-up than the firm that bases the mark-up on full cost. Why? Because a mark-up based on direct cost must cover overhead costs, as well as profit. A mark-up rate of 100 percent or more may be quite reasonable.
    - Mark-Up on Total Cost. A firm that bases its mark-up on full costs should have a lower mark-up rate than the firm that bases the mark-up on direct cost only. A mark-up rate of 100 percent on full cost would normally be considered excessive.

The use of mark-up pricing varies by:

- Industry. Mark-up pricing is particularly common in industries where customers are expected to negotiate sales price (e.g., automobiles). The profit represented in the mark-up is set high enough to provide the seller with room to compromise. Hence, a good buyer should be aware of relevant industry mark-up practices. Knowledge of prevailing mark-ups can be a tremendous advantage in negotiating reasonable prices.
- Product. Mark-up pricing is particularly common for unique items or services provided for a single customer or a small group of customers. The mark-up will commonly vary based on the type of work and risk involved.

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### I.1.3.2 Margin Pricing

*Definition.* Margin pricing is similar to mark-up pricing in that price is based on the relationship between cost and profit. Margin pricing based on direct costs must cover both indirect cost and profit. Margin pricing based on total cost must only provide for profit.

Instead of adding a mark-up based on a percentage of cost, margin pricing uses cost to calculate a price that will provide a profit margin that is an established percentage of price. Many commercial firms use this technique because it matches their accounting reports where costs and profits are reported as a percentage of sales.

*Procedure.* Use the following steps to calculate price based on the margin on direct cost pricing technique:

- Estimate the sales volume.
- Estimate cost at the estimated sales volume.
- Determine the margin rate to be used.
- Calculate the selling price by applying the margin rate to the product cost.

*Example.* Price the following product using margin pricing:

**Given** :

Estimated Sales Volume = 1,000 units
Estimated Unit Cost = $81
Margin Rate = 40%

**Calculate Unit Selling Price** :

Unit Selling Price = Cost/(1 - Margin Rate)
= $80/(1 - .40)
= $80/.60
= $133

*Strategy Implications for Buyers.* Like mark-up rates, margin rates depend on the product line, tradition, and competition. Similar products are priced using similar mark-up rates. A firm's management is often rated by the margin rate that they can obtain.

You should be aware of relevant industry mark-up practices. Knowledge of prevailing margins can be a tremendous advantage in negotiating reasonable prices, especially when buying in commercial markets.

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### I.1.3.3 Rate-Of-Return Pricing

*Definition.* Rate-of-return pricing is similar to mark-up pricing in that profit dollars are added to estimated costs. However, profit dollars are not calculated based on the cost of labor and material required to provide the product. Instead, profit is calculated based on the financial investment required to provide the product, the return needed to attract that investment, and estimated sales volume.

*Procedure.* Follow these steps to determine profit using rate-of-return pricing:

- Determine desired rate of return on investment.
- Estimate investment required.
- Estimate level of sales.
- Estimate unit cost at the projected sales level.
- Calculate desired unit profit.
- Calculate unit selling price (estimated cost + desired profit).

Price the following product using rate-of-return pricing:

**Given** :

Desired Rate of Return = 15%
Estimated Investment Required = $600,000
Estimated Sales = 5,000 units
Estimated Unit Total Cost = $80

**Calculate Unit Selling Price** :

Calculate Desired Unit Profit = (15% * $600,000)/5,000 Units = $90,000/5,000
= $18 per unit
Calculate Unit Selling Price = $80 + $18
(Unit Cost + Unit Profit) = $98

*Strategy Implications for Buyers.* Firms that use this method of pricing are probably more sensitive to changes in overall sales volume than firms using the other cost-based pricing methods. They are concerned about the rate of return, not just a mark-up or margin rate. A lower item price coupled with a higher sales volume can actually increase the rate of return. On the other hand, a higher item price coupled with a lower sales volume can decrease the rate of return.

You should be aware of the investment required to make different products. Any action that enables the seller to reduce its investment or spread that investment over more products should reduce the profit that must be earned on any one product to maintain a required rate of return on investment.

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### I.1.4 - Review Seller's Market-based Pricing Strategies

In a competitive market, the seller must consider the four "P"s of marketing: price, product, place, and promotion. Firms must develop pricing strategies to accomplish overall marketing objectives based on their assessment of market conditions (e.g., forecasts of supply and demand) and the economic condition of the business entity. This section covers the following market-based pricing strategies which can be used in various market conditions:

- I.1.4.1 - Profit-Maximization Pricing
- I.1.4.2 - Market-Share Pricing
- I.1.4.3 - Market Skimming
- I.1.4.4 - Current-Revenue Pricing
- I.1.4.5 - Promotional Pricing
- I.1.4.6 - Demand-Differential Pricing
- I.1.4.7 - Market-Competition Pricing

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### I.1.4.1 Profit-Maximization Pricing

*Definition.* In profit-maximization pricing, the seller assumes that demand falls as prices increase and grows as prices decrease. A firm using this strategy carefully analyzes the market to find the combination of price per unit and quantity of sales that maximizes profit.

*Strategy*. When employing this strategy, the seller considers the following questions:

- Is demand sensitive to price changes?
  - As price increases, does demand decrease?
  - As price decreases, does demand increase?
- What is the point of profit maximization?
  - This is determined through analysis of the relationship between price and demand.

This pricing strategy is:

- **Most effective** in situations where:
  - Price is an important marketing factor affecting demand.
  - Competitors react relatively slowly to price changes.
  - Actual relationships between price and customer demand can be effectively estimated.
- **Least effective** when competitors react rapidly to price changes.

*Strategy Implications for the Buyer* Be aware of the relationship between price and quantity in the marketplace. Working with users to take advantage of price breaks can save the Government substantial sums of money.

In Government contracting, the purchase quantity estimates are generally fixed, based on the needs of the Government. No matter how low the offeror's price, the quantity acquired by the Government does not change. Thus there is no advantage to the offeror to offer a price lower than that necessary to win the contract.

Prices for multiple-award Federal Supply Schedules are a possible exception. Another possible exception are prices for inventory items, when the amounts ordered by inventory managers vary from one period to the next based in part on price/quantity tradeoffs.

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### I.1.4.2 Market-Share Pricing

*Definition.* Market-share pricing is based on the assumption that long-run profitability is associated with market share. When using this strategy, the goal is to dominate the market through market penetration. Firms set prices relatively low to win customers and discourage competition. Early losses may occur, but as volume increases, cost per unit decreases and long-term profits are achieved.

*Strategy*. When employing this strategy, the seller normally attempts to:

- Build efficient operations;
- Set price at or below competitors' prices to win market share; and
- Lower prices as costs fall.

*Strategy Implications for the Buyer.* As a buyer, you should encourage mass production efficiencies that may reduce contractor costs and provide a reasonable profit. The Model T Ford is one example of a situation where a firm's use of this strategy generally benefited customers. Ford drove down prices to reach more customers. Other competitors were forced to reduce prices or offer product improvements to stay in the market.

You should discourage a contractor **"buy-in,"** (i.e., bid below cost to win a contract and exclude others from the market) when there is evidence that the contractor may jeopardize contract performance because the contract price will not cover costs. You should be particularly concerned when sellers:

- Have limited financial resources, or
- Are apparently gambling on capturing a larger share of the market (and of unit sales) than they are likely to achieve."

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### I.1.4.3 Market Skimming

*Definition.* In market skimming **,** prices are set to achieve a high profit on each unit by selling to buyers who are willing to pay a higher price for a product of perceived higher value. After the demand of these buyers is satisfied, or competitors produce similar products at lower prices, prices may be reduced to increase volume and maintain overall profitability.

*Strategy.* When employing this strategy, the seller considers the following points:

- Establish a high price to achieve a high profit margin at relatively low volume.
- Decrease price over time to attract buyers not willing to pay the price premium.

Personal computers are good examples of this strategy:

- Prices remained relatively high for years;
- Firms catered to buyers willing to "pay for the best"; and
- As quality competition increased, prices began to decrease.

*Strategy Implications for the Buyer.* As a buyer, you should resist user attempts to "pay for the best" when the "best" is more than the Government needs or the perception of quality is based more on superior marketing than on a superior product.

Remember the "best product" is not always the best value. To be the best value, the perceived benefits of a higher-priced product must merit the higher price. For example, a stainless steel screw may be the best product, but the quality does not justify the higher price when the screw will be used in constructing a wooden cabinet.

You should encourage attempts at source development to increase competition and control prices.

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### I.1.4.4 Current-Revenue Pricing

*Definition.* In current-revenue pricing, the emphasis is on maximization of current revenue rather than profit or long-term revenue. Firms using this strategy are typically concerned about long-term market uncertainty or the firm's financial instability. To them, a sure dollar today is much more important than the possibility of more dollars tomorrow.

*Strategy.* When employing this strategy, the seller must determine the price/quantity combination that maximizes revenue.

*Strategy Implications for the Buyer.* You need to be aware that this strategy predominates when risk is high. Action to reduce risk will likely be rewarded with lower prices and a more stable business environment.

Consider long-term demand for the product. Firms pricing product crazes, like the "hula hoop," are likely to consider current-revenue pricing.

- Demand is high one day, but may disappear the next.
- Near-term cash recovery is more important than long-term profitability.

Assure that all contractors are responsible. Firms with limited financial resources may employ this strategy.

- If near-term cash needs are not met, there will be no long term for the firm.
- Unfortunately, concentration on the near-term may also jeopardize the long-term future of the firm.

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### I.1.4.5 Promotional Pricing

*Definition.* In promotional pricing,products are priced to enhance the sales of the overall product line rather than to assure the profitability of each product.

*Strategy.* When employing this strategy, the seller considers the following points:

- Determine whether selling a product at a loss (a loss leader) will increase the sale of related products and increase profit.
- Determine whether selling a product at a high (prestige) price will improve the product-line quality image and increase profit.

*Strategy Implications for the Buyer.* This strategy can be used for pricing a wide range of consumer and industrial products, from groceries to electronics and services. Government personnel evaluating offers for a delivery-order or task-order contract with multiple line items should be particularly alert to offers prepared using this strategy.

Promotional contracting can take many forms:

- Bait and switch pricing can be particularly attractive to a firm preparing an offer for a delivery-order contract with multiple line items. An offeror using this strategy lures the buyer using a low-priced item (e.g., a low labor rate for a particular labor category) and then switches the buyer to a "better" item (e.g., a higher-priced category of labor) during the sale.
- Loss-leader can be attractive in situations where many items are commonly bought from the same source. An offeror using this strategy reduces the price of one, or a group of items, to near cost, or even below. Customers are attracted to buy the low-priced items and buy other related items at the same time (e.g., set the price of a system low and the price of supplies for the system high).
- Prestige pricing uses a high-quality, high-priced item to enhance the image of an entire product line and attract more buyers. For example, many consultants feel that buyers are reluctant to buy from firms that do not charge enough. In other words, it can be almost impossible to evaluate qualifications so high price equals high quality.

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### I.1.4.6 Demand-Differential Pricing

*Definition.* In demand-differential pricing, products or services sold in different market segments are priced in a way that is not consistent with the marginal costs related to segment differences.

*Strategy.* When employing this strategy, the seller considers the following points:

- Identify the segmentation factors that may affect pricing:
    - Customer;
    - Product Form;
    - Place; and
    - Time.
- Determine the demand intensity in each segment.
- Identify actual and potential competitors.
- Assure that demand-differential will not breed customer resentment.

*Strategy Implications for the Buyer*. You need to be aware of the effect of the various segmentation factors on different products.

- Customers may pay different prices based on buying power or negotiation skills-for example, automobile purchases. In addition, different classes of customers (e.g., wholesalers, retailers, and governments) may pay different prices.
- Product-form (e.g., electronic component assembly) may warrant a price higher than the price of the components plus assembly.
- Location of the sales transaction may affect price. The price of an item sold in New York may be substantially greater than the price of the item in Ohio plus the shipping charge to New York.
- Time may affect pricing, particularly in industries that have substantial fixed investment and identifiable peaks in demand. Utilities, for example, offer lower prices for service during "off- peak" hours.

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### I.1.4.7 Market-Competition Pricing

*Definition.* In market-competition pricing, emphasis is on competitive action/reaction to pricing actions that competitors have taken or are expected to take. Firms following this pricing strategy in relatively homogeneous markets establish prices based on what the competition charges or what they think the competition is going to charge.

*Strategy*. You may find that different companies may set prices at a level that keeps pace with competitor's prices. When employing this strategy, the seller considers the following points:

- Determine competitor prices and/or anticipated prices.
- Set price to keep pace with competitor prices.

Major strategy applications include sealed-bid and going-rate pricing.

- Sealed-bid pricing forces the seller to:
    - Estimate what competitors will bid
    - Determine what the seller can profitably bid
    - Submit the bid knowing that it will be accepted or rejected without further discussion
- Going-rate pricing requires the seller to:
    - Determine what competitors are charging
    - Establish product price within an established range of the competition.

*Strategy Implications for the Buyer*. Government policy on competition and market pricing is designed to encourage sellers to establish prices using market-competition pricing. You need to remember that this is only one method of market pricing. Many firms are reluctant to compete in a market where success is achieved by low price alone.

## I.2 Identifying Government's Pricing Objectives

This section covers the following topics:

- I.2.1 - Pay A Fair And Reasonable Price
- I.2.2 - Price Each Contract Separately
- I.2.3 - Exclude Contingencies

*Government Pricing Objectives.* When buying for the Government, your primary pricing objective for all contact actions is to acquire supplies and services from responsible sources at **fair and reasonable** prices.

When awarding contracts through the negotiated procedures of FAR Part 15, you must also ( see FAR 15.402(a), (b), and (c) ):

- Price each contract separately and independently and not **:** (1) use proposed price reductions under other contracts as an evaluation factor or (2) consider losses or profits realized or anticipated under other contracts.
- Not include in a contract price any amount for a specified contingency to the extent that the contract provides for price adjustment based upon the occurrence of that contingency.

### I.2.1 - Pay A Fair And Reasonable Price

*Understand Fair and Reasonable.* The first element of the Government pricing objective requires that contract prices be **fair and reasonable.**

Under the FAR, the contracting officer's primary objective in pricing a contract is to balance the contract type, cost, and profit or fee negotiated to achieve a total result -- a price that is fair and reasonable to both the Government and the contractor. **[The contracting officer must consider the terms and conditions (delivery, financing, etc.) of each specific contract in order to determine if the price for that contract is fair and reasonable.]**

The FAR does NOT define the term "fair and reasonable price," but it implies two tests:

- What is fair?
- What is reasonable?

*What Is Fair?* Buyers and sellers may have different perceptions on what price is fair.

**1. Fair to the Buyer.** To be fair to the buyer, a price must be in line with (or below) either of the following:

- The fair market value of the contract deliverable (if that can be ascertained through price analysis). Expect to pay the fair market value, given the prices of market transactions between informed buyers and sellers under similar competitive market conditions for deliverables with similar product, quality, and quantity requirements.
- The (1) total allowable cost of providing the contract deliverable that would have been incurred by a *well managed, responsible firm using reasonably efficient and economical methods* of performance plus (2) a reasonable profit.

As a buyer, you should consider a price that is TOO HIGH to be unfair. What happens if you agree to a price that is too high?

- You will have failed to fulfill your most basic responsibility as a Government contracting officer or contract specialist.
- You will waste scarce Government funds.
- Since you are publicly accountable as a Federal employee for your decisions, you may have to answer to management, the Inspector General, the General Accounting Office, a Congressional committee, or the public at large.

**2. Fair to the Seller.** To be fair to the seller a price must be realistic in terms of the seller's ability to satisfy the terms and conditions of the contract.

- **Risk of Prices Unfair to the Seller.** Why should you care if a low offer is unrealistic? Because an unrealistic price puts both parties at risk. The risk to the Government is that the firm -- to cut its losses -- might:
    - Cut corners on product quality;
    - Deliver late;
    - Default, forcing a time-consuming reprocurement; or
    - Refuse to deal with the Government in the future or be forced out of business entirely.

*Situations for Special Consideration.* Fairness to the seller can be a concern in both competitive and noncompetitive situations.

- **Below-Cost Prices.** Below-cost prices are NOT necessarily unfair to the seller. A bidder, for various reasons, in its business judgment may decide to submit a below-cost bid; such a bid is not invalid. Whether the awardee can perform the contract at the price offered is a matter of responsibility.
- On the other hand, be on guard against the practice of buying-in -- submitting offers below anticipated costs, expecting to:
    - Increase the contract amount after award (e.g., through unnecessary or excessively priced change orders); or
    - Receive follow-on contracts at artificially high prices to recover losses incurred on the buy-in contract.
    - FAR 3.501 presents a number of techniques to prevent a contractor from recovering buy-in losses. It also refers you to FAR 15.405 for guidance on treatment of unreasonable price quotations. That portion of the FAR (among other things) advises contracting officers to consider risks to the Government represented by the proposed contract type and price.
- **Mistakes.** The offered price may be unexpectedly low because the seller has made gross mistakes in estimating costs or is otherwise nonresponsible.
- The award of a contract to a supplier based on lowest evaluated price alone can be false economy if there is subsequent default, late deliveries, or other unsatisfactory performance resulting in additional contractual or administrative costs. While it is important that Government purchases be made at the lowest price, this does not require an award to a supplier solely because that supplier submits the lowest offer. A prospective contractor must affirmatively demonstrate its responsibility, including, when necessary, the responsibility of its proposed subcontractors.
- If a vendor offers a price that is far below other offered prices or your estimate of the probable price, treat the offer as a potential mistake. In such cases, both FAR Part 14 and Part 15 authorize fact-finding to determine whether the offeror understands the work and can perform at the offered price.
- **Single-Source Procurements.** Do NOT force a below-cost price on the offeror even if you believe that the offeror has the financial ability to absorb the probable loss. Instead, negotiate a contract of a type and a price that is likely to cover all allowable costs of performance, assuming reasonable

economy and efficiency, and provide a reasonable profit (consistent with FAR profit policies). Even your opening position in non-competitive negotiations should NOT be a "below cost" number. Rather, your opening position should be based on a more optimistic reading of the potential production improvements, risks, and costs of providing the contract deliverable than that of the target position on price.

*What Is Reasonable?* A **reasonable price** is a price that a prudent and competent buyer would be willing to pay, given available data on:

- Market Conditions. Economic forces such as supply, demand, general economic conditions, and competition change constantly. Hence, a price that is reasonable today may not be reasonable tomorrow.
    - **Supply and Demand.** The forces of supply and demand can have a significant effect on product prices:
    - If demand is constant, decreasing supply usually results in higher prices, while increasing supply usually results in lower prices.
    - If supply is constant, decreasing demand usually results in lower prices, while increasing demand usually results in higher prices.
    - **General Economic Conditions.** General economic conditions affect the prices of all products, but the effect will NOT be the same for every product. Inflation and deflation affect the value of the dollar. Boom, recession, and depression affect available production capacity.
    - **Competition.** When competition does not exist, the forces of supply and demand may not work effectively. The buyer or seller may have an advantage in the pricing decision process.
- Markets can be defined by considering: the number of buyers, the number of sellers, product homogeneity, and ease of market entry and exit.
- The buyer's relative pricing power compared with that of sellers changes in different market situations. The table below examines the relative pricing in each situation:

| Level | Buyers | Sellers | Market Entry/Exit | Relative Pricing Power |
|---|---|---|---|---|
| Perfect Competition | Many independent | Many independent | Relatively easy | Pricing balance between buyers and sellers |
| Effective Competition | Limited independent | Limited independent | Relatively easy | Relative pricing balance between buyers and sellers |
| Oligopoly | Many independent | Few independent | Restrictions | Relatively greater pricing advantage to sellers |
| Oligopsony | Few independent | Many independent | Relatively easy | Relatively greater pricing power to buyers |
| Monopoly | Many independent | One | Restrictions | Considerable pricing power to sellers |
| Monopsony | One | Many independent | Relatively easy | Considerable pricing power to buyers |
| Bilateral Monopoly | One | One | Restrictions | Pricing power established by negotiation (as in sole source Government negotiation) |

**Alternatives for Meeting the Requirement.** In making any acquisition, you should consider the alternatives. In a competitive acquisition, you should first consider how an offered price compares with competitive offers. However, your analysis should NOT end there. You should also consider other alternatives for acquiring the product or service. For example, sealed bidding procedures permit the agency head to cancel a solicitation when otherwise acceptable bids are at unreasonable prices (FAR 14.404-1(c)(6)) and negotiation procedures permit

the source selection authority to reject all proposals if doing so is in the best interest of the Government ( FAR 15.305(b) ).

**Price-Related Evaluation Factors.** A prudent buyer will consider differences in the cost of acquiring and owning a deliverable that are not covered by the contract price. To consider these price-related factors in a competitive acquisition, the solicitation must provide for such consideration. For example:

- **Direct Costs Not Included in The Contract Price.** The solicitation allowed offers to submit offers either for f.o.b. destination or f.o.b. origin. FAR requires that offer evaluation criteria provide for consideration of the shipping costs from f.o.b. origin points to destination.
- **Costs of Ownership Not Included in The Contract Price.** Your market research indicates that several products could satisfy your requirement. However, the products differ substantially in maintenance and repair costs. Offer evaluation criteria should provide for consideration of the related costs to the Government.
- **Costs of Contract Award and Administration.** In a competitive contracting situation, you may solicit line item prices and an aggregate price for all solicitation line items. The contracting officer could split the line items among five offerors, or award all line items to the single firm that offered the lowest aggregate price. To determine which method of award would provide the best value to the Government, offer evaluation criteria must provide for consideration of cost to the Government for awarding and administering multiple contracts (e.g., see FAR 14.201-6(q) ).

**Noncompetitive Acquisitions.** In a noncompetitive acquisition, you should be alert to potential risks and costs NOT covered in the offered price. A price that seems reasonable on the surface may be unreasonable if proposed terms and conditions shift costs to the Government. For instance, an offered price may seem reasonable until you discover that the proposed terms and conditions have shifted responsibility for furnishing the necessary tooling from the firm (per the RFP) to the Government (per the proposal). Likewise, a contractor's proposed price, regardless of amount, might be unreasonable if conditioned on the use of a cost-reimbursement contract that transfers an inappropriate portion of the risk of cost growth to the Government.

**Non-Price Evaluation Factors.** In some acquisitions, the test of reasonableness requires a trade-off analysis between price, price-related factors, and non-price factors such as past performance and relative technical capabilities of the competing firms (see FAR 15.101-1 ). In particular, do NOT compete cost-reimbursement contracts primarily on the basis of lowest proposed costs. That would only encourage offerors to submit unrealistically low estimates and increase the likelihood of cost overruns (see FAR 15.404-1(d) ).

**Applying Judgment to the Determination.**
Your determination of whether an offer is **fair and reasonable** is a matter of judgment. There is no simple formula in which you can just plug in a few values and receive a firm answer of **fair and reasonable** . Determining what is **fair and reasonable** depends on market conditions, your alternatives for meeting the requirement, price-related factors, and the non-price evaluation factors that relate to each procurement. It also depends on what price you can negotiate with an offeror. FAR 15.405(a) states that:

*A fair and reasonable price does not require that agreement be reached on every element of cost, nor is it mandatory that the agreed price be within the contracting officer's initial negotiation position. Taking into consideration the advisory recommendations, reports of contributing specialists, and the current status of the contractor's purchasing system, the contracting officer is responsible for exercising the requisite judgment needed to reach a negotiated settlement with the offeror and is solely responsible for the final price agreement.*

There may be times when you find it impossible to reach agreement on a price that you consider fair and reasonable. If that happens, follow the FAR guidance at FAR 15.405(d) .

*If, however, the contractor insists on a price or demands a profit or fee that the contracting officer considers unreasonable, and the contracting officer has taken all authorized actions (including determining the feasibility of developing an alternative source) without success, the contracting officer shall refer the contract action to a level above the contracting officer. Disposition of the action should be documented.*

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### I.2.2 Price Each Contract Separately

The second element of the Government pricing objective requires that contracts be priced separately. FAR 15.402(b) .

*Perspective.* It is human nature to try to balance one contract against another in terms of financial results.

- A seller's position might be that the firm lost money on the last contract; therefore, an effort should be made to make up for that loss on the next contract.
- A buyer's position might be that the contractor made too much profit on the last contract; therefore, the next contract should be structured to restrict profit.

*Government Contracting.* While these attitudes may be understandable in a personal sense, they are not valid in Government contracting.

Government contracting is very complex because:

- Buyers and sellers do not have perfect knowledge of all transactions between a contractor and the Government.
- The market forces of competition, supply, and demand change.
- Business conditions change.

Thus, you must price each contract separately and independently to ensure that all proposed prices are fair and reasonable to all involved parties.

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### I.2.3 Exclude Contingencies

The third element of the Government pricing objective requires that contracts exclude contingencies that CANNOT be reasonably estimated at the time of award FAR 15.402(c) .

*Contingency Definition.* A **contingency** is a possible future event or condition arising from presently known or unknown causes, the outcome of which is not determinable at the present time.

*Types of Contingencies.* (see FAR 31.205-7 ) You should know that there are two types of contingencies that are important in Government contracting:

- Contingencies that may arise from presently known and existing conditions, the effects of which are foreseeable within reasonable limits of accuracy; and
- Contingencies that may arise from presently known or unknown conditions, the effects of which CANNOT be measured so precisely as to provide equitable results to the contractor and the Government

*Pricing Decision.* The following table shows you how to handle each type of contingency in terms of the contract price:

| Contingency | Examples | Contract Price |
|---|---|---|
| Foreseeable within reasonable limits of accuracy | • Cost of rejects<br>• Cost of defective work | Contingencies of this type should be included in contract cost estimates to make those estimates as accurate as possible. |
| CANNOT be measured so precisely as to provide equitable results to the contractor and to the Government | • Results of pending litigation<br>• Costs of volatile material price changes | Contingencies of this type should be excluded from the cost estimates under the several items of cost, but should be disclosed separately (including the basis on which the contingency is computed) to facilitate the negotiation of appropriate contract coverage. |

For example, if you have extensive production experience with a given product, the contractor and the Government can likely agree on the amount of scrap that can reasonably be expected during production. This type of contingency should be included in contract cost estimates.

On the other hand, in times of volatile material price changes, it would be unreasonable to both parties for an offeror to include a contingency to cover significant price increases when none may occur. In this situation, you should consider use of a contract type (e.g. fixed-price economic price adjustment) that provides for separate consideration of volatile price changes. Separate consideration will provide for better contract pricing and more effective competition.

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## I.3 Identifying Government Approaches To Contract Pricing

This section covers the following topics:

- I.3.1 - Identify Price Analysis Considerations
- I.3.2 - Identify Cost Analysis Considerations
- I.3.3 - Identify Cost Realism Analysis Considerations

Approaches to Determine Fair and Reasonable Prices ( FAR 15.402 )

As a contract specialist, your primary objective as a Government buyer is to acquire supplies and services from responsible sources as **fair and reasonable** prices. You can use three basic approaches to attain this objective:

- Price analysis;
- Cost analysis; and
- Cost realism analysis.

In this section, you will learn about each of these approaches, how it is defined, when it is used, and key elements to consider.

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### I.3.1 Identify Price Analysis Considerations

*Definition of Price Analysis.* Price analysis is the process of examining and evaluating a proposed price to determine if it is fair and reasonable, without evaluating its separate cost elements and proposed profit. Price analysis may be, when necessary, supplemented by evaluation of cost elements.

*When to Use Price Analysis.* When an offeror is not required to provide cost or pricing data, you must use price analysis to ensure that the overall price is fair and reasonable.

When an offeror is required to provide cost or pricing data, use cost analysis to evaluate the reasonableness of individual cost elements. Use price analysis to verify that the overall price offered is fair and reasonable.

*Bases for Price Analysis.* Price analysis **always** involves some form of comparison with other prices. As the contracting officer, you are responsible for selecting the bases for comparison that you will use in determining if a price is fair and reasonable, such as:

- Proposed prices received in response to the solicitation;
- Commercial prices including competitive published price lists, published commodity market prices, similar indexes, and discount or rebate arrangements;
- Previously-proposed prices and contract prices for the same or similar end items, if you can establish both the validity of the comparison and the reasonableness of the proposed price;
- Parametric estimates or estimates developed using rough yardsticks;
- Independent Government Estimates; or
- Prices obtained through market research for the same or similar items (Because market research can span commercial prices, previously-proposed prices, contract prices, parametric or rough yardstick estimates, and Independent Government Estimates, this base for price analysis will not be considered separately in the remainder of this text.)

The order in which the bases for price analysis are presented on this list represents the general order of desirability. However, the order is NOT set in concrete. For example:

- Comparisons with commercial catalog, market, or regulated prices can be just as desirable as comparisons with competitive offers. After all, the prices of commercial products are defined by commercial market competition.
- Independent Government estimates are normally considered to be the least desirable comparison base for price analysis. However, in cases (e.g., construction) where estimates are based on extensive detailed analysis of requirements and the market, the Government estimate can be one of the best bases for price analysis.

Moreover, you should use all bases for which you have recent, reliable, and valid data. For instance, you would be well advised to consider the last price paid in addition to current competitive prices -- especially if the prior contract was awarded at a reasonable price last month.

*Buyer Evaluation and Documentation.* Price analysis is a subjective evaluation. For any given procurement, different bases for price analysis may give you a different view of price reasonableness. Even given the same information, different buyers/contracting officers might make different decisions about price reasonableness.

It is the cognizant contracting officer who must be satisfied that the price is fair and reasonable.

You must document the file concerning the rationale used in making the pricing decision. Otherwise, the individuals who may review your file later may not know or understand the factors that affected your decision.

### I.3.2 Identify Cost Analysis Considerations

*Definition of Cost Analysis.* **Cost analysis** is the review and evaluation of the separate cost elements and proposed profit/fee of:

- An offeror's or contractor's cost or pricing data or information other than cost or pricing data and
- The judgmental factors applied in projecting from the data to the estimated costs.

The purpose of the evaluation is to form an opinion on the degree to which the proposed costs represent what the cost of the contract should be, assuming reasonable economy and efficiency.

*When to Use Cost Analysis.* Perform cost analysis in **either** of the following situations:

- When the Truth in Negotiations Act (TINA) applies and the offeror is required to submit cost or pricing data. In this situation, the offeror must provide complete, accurate, and current data to support all proposed costs and profit/fee.
- When you require an offeror to submit cost information other than cost or pricing data to support your decision on price reasonableness or cost realism. In this situation, require only the information necessary to determine price reasonableness or cost realism. This may be required, for example, when you are comparing a proposed price to a price previously paid on a similar item. You may need cost information from the contractor to determine the impact, on the price, of the differences between the two items.

*Definition of Contract Cost.* **Contract cost** is the sum of the allowable **direct and indirect costs** allocable to a particular contract, incurred or to be incurred, less any allocable credits, plus any allocable cost of money.

**Direct cost** is any cost that can be identified specifically with a final cost objective, such as a contract.

**Indirect cost** is any cost that CANNOT be directly identified with a single, final cost objective, but is identified with two or more final cost objectives or an intermediate cost objective.

For reasons of practicality, any direct cost of minor dollar amount may be treated as an indirect cost if the accounting treatment is consistently applied to all cost objectives and the treatment produces substantially the same results as treating the cost as a direct cost.

*Definition of Profit/Fee.* Profit/fee is the dollar amount **over and above allowable costs** paid to the contractor to motivate contractor performance. Together contract cost and contract profit/fee total contract price. Thus contract profit is an important element of contract price and must be considered in cost analysis. Each agency must establish a structured approach for analysis of proposed profit/fee.

*Identifying Contract Costs.* Not all contract costs are cash expenditures during the contract period. Major contract costs can fall in the following categories:

- Cash expenditures-the actual outlay of dollars in exchange for goods or services
- **Expense accrual** -expenses are recorded for accounting purposes when the obligation is incurred, regardless of when cash is paid out for the goods or services.
- **Draw down of inventory** -the use of goods purchased and held in stock for production and/or direct sale to customers. The term refers to both the number of units and the dollar amount of items drawn out of inventory.

For example, both direct and indirect costs can result from a draw down of inventory and many indirect costs are accrual expenses.

| Type of Contract Cost | Example |
|---|---|
| Cash expenditure | Payment by cash, check, or electronic funds transfer to a vendor for raw materials. |
| Expense accrual | Incurring of an obligation in the current year to pay an employee a retirement pension at some point in the future. |
| Draw down of inventory | Electronic components purchased in large volume against anticipated total demand and held in inventory until drawn out to fill a specific order. While the components were paid for in the past, the drawing out of a component to meet a contract need is a reduction of the assets of the firm and therefore a cost to the contract. |

*Cost Analysis Supplements Price Analysis.* Cost analysis is not a substitute for effective price analysis. Cost analysis should provide insight into what it will cost the firm to complete the contract using the methods proposed. However, cost analysis does not necessarily provide a picture of what the market is willing to pay for the product involved. For that you need price analysis.

**For example,** suppose that you wanted to procure a custom-made automobile. At your request, your neighborhood mechanic agrees to build you such a car. In building the car, the mechanic gets competitive quotes on all the necessary parts and tooling, pays laborers only the minimum wage, and asks only a very small profit.

How do you think the final price will compare to a car off an assembly line? Probably at least ten times more expensive. Parts alone may be five times more expensive. The entire cost of tooling will be charged to one car. Labor, although cheaper, will likely not be as efficient as assembly-line labor. Is the price reasonable? That decision can only be made through price analysis.

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### I.3.3 Identify Cost Realism Analysis Considerations

*Definition of Cost Realism Analysis.* Cost realism analysis is the process of 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 the requirements; and
- Are consistent with the unique methods of performance and materials described in the offeror's technical proposal.

*When to Use Cost Realism Analysis.* Perform a cost realism analysis of each cost-reimbursement contract offer to determine the probable cost of contract performance and use that estimate in your evaluation of the best value to the Government.

- The probable contract cost related to a cost-reimbursement contract offer may differ substantially from the proposed cost. Your most probable cost estimate should reflect your best estimate of the cost of any contract that is most likely to result from the offeror's proposal.
- Determine the probable cost for each offer by adjusting the proposed cost, and fee when appropriate, to reflect any additions or reductions in cost elements to realistic levels based on the results of the cost realism analysis.

You may also use cost realism analysis in evaluating competitive offers for fixed-price incentive contracts or, in exceptional cases, on other competitive fixed-price contracts.

- Give special consideration to using cost realism analysis to evaluate offers for fixed-price contracts when:
    - New requirements may not be fully understood by competing offerors;
    - There are quality concerns, or
    - Past experience indicates that contractors' proposed costs have resulted in quality or service shortfalls.
- When using cost realism analysis to evaluate offers for a fixed-price contract, you may use the results of your analysis in performance risk assessments and responsibility determinations. However, proposals must be evaluated using the criteria in the solicitation, and the offered prices must not be adjusted as a result of the analysis.

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## I.4 Identifying Potential Acquisition Team Members

The Acquisition Team includes everyone involved in the acquisition -- beginning with the customer and ending with the contractor providing the product or service. This text refers to Government participants in the acquisition process as the Government Acquisition Team.

The Government is committed to providing training, professional development, and other resources necessary for maintaining and improving the knowledge, skills, and abilities of all Government Acquisition Team participants. This commitment applies both to the individual's particular area of expertise within the Government and the individual's role as a Team member.

*Potential Team Members* For most contracts, the Government Acquisition Team will be relatively small. The following will typically play a key role in contract pricing:

- Contracting officer or contract specialist;
- Requirements manager (i.e., program or project manager);
- End user; and
- Commodity specialist.

You might also obtain assistance from one or more of the following:

- Inventory manager;
- Auditor;
- Technical specialist;
- Transportation, property, or logistics managers;
- Legal counsel;
- Competition advocate;
- Administrative contracting officer or administration specialist; or
- Cost/price analyst.

This table summarizes the role that potential Government Acquisition Team members might play in making or supporting the contract pricing decision.

| Potential Members<br><br>Typical Role in Contract Pricing | |
|---|---|
| Contracting Officer | The contracting officer is the person with 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 operating within the limits of their authority as delegated by the contracting officer. |
| Contract Specialist | A contract specialist may be responsible for performing a wide variety of contracting activities under the authority of the contracting officer assigned to the contract. In this capacity, a contract specialist will likely provide key input to the pricing decision, but the ultimate decision on price reasonableness rests with the contracting officer. |
| Requirements Manager | Requirements managers initiate acquisitions by preparing purchase requests. Purchase requests specify the requirement and generally include an Independent Government Estimate. After you receive of the purchase request, requirements managers often can help:<br><br>• Review alternatives for improving the solicitation,<br>• Identify potential price-related factors for award,<br>• Account for significant discrepancies between different comparison bases used in price analysis, and<br>• Provide advice and information for price-related decisions. |
| End User | The end user may or may not be the requirements manager. If the requirements manager is not the end user, you may find it useful to consult the end user when building the solicitation and making price-related decisions. In addition, the end user may be more knowledgeable about the product and a better source for an Independent Government Estimate than the requirements manager. |
| Commodity Specialist | Some organizations have dedicated commodity specialists who, among other things, heavily research the markets for their respective commodities. |
| Inventory Manager | Inventory managers keep track of large stocks of products in Government warehouses and other such facilities. Among other things, inventory managers generate purchase requests for replacement supplies as users draw on the Government stocks. They tend to be especially concerned about the solicitation/contract, in terms of its potential impact on delivery, inventory levels, and inventory costs. |
| Auditor | Auditors are accountants with specialized training and experience in examining and analyzing cost or pricing data provided by offerors and contractor records (particularly accounting records). Their support can be invaluable in cost proposal analysis. In the Department of Defense, contract auditors are assigned to the Defense Contract Audit Agency ( DCAA ). In other agencies, auditors are typically assigned to the agency Inspector General. |
| Technical Specialist | These specialists generally write specifications or statements of work and technical evaluation factors and evaluate technical proposals. In many acquisitions, the requirements manager acts as the technical specialist. Larger acquisitions, however, may involve teams or panels of technical experts (who, depending on the specific deliverable, may be engineers, scientists, or other similar professionals).<br><br>From a pricing standpoint, technical specialists may have a good understanding of the |

| | |
|---|---|
| | costs necessary to build a deliverable and also of the types and sources of commercial products that may be available to satisfy a requirement. |
| Transportation, Property, or Logistics Managers | These specialists can help you select and apply price-related factors that involve transportation costs, Government-furnished property, and ownership costs. All may be involved if you plan to solicit based on a full life-cycle cost model. |
| Legal Counsel | Lawyers may play a role in clearing contracts and reviewing justifications for such price-related decisions as cancellation of an IFB after opening. Look to them for advice on the solicitation and on making the price-related decisions. |
| Competition Advocate | Competition advocates review acquisition plans and analyze specifications to identify and, where possible, remove "barriers" to full and open competition. They also review justifications for other than full and open competition. From a pricing standpoint, they can be valuable allies in maximizing price competition. |
| Administrative Contracting Officers and Administration Specialist | Some Federal agencies have dedicated contract administration offices. These offices are often involved in preaward reviews of contract pricing proposals because contract administrators have more complete information on the production and pricing practices of specific offerors. Administrative contacting officers may also be responsible for pricing certain kinds of contract modifications. |
| Cost/Price Analyst | Some contracting activities have dedicated cost/price analysts who can assist in performing the tasks described in this book. However, such analysts are typically only available for higher dollar, more complex procurements. |



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## 1.0 Chapter Introduction

*Presolicitation Market Research.* In Government acquisition, market research requires collecting and analyzing information about capabilities within the market to satisfy Government needs. Market research policies and procedures should be designed to arrive at the most suitable approach to acquiring, distributing, and supporting supplies and services. The personnel involved must ensure that legitimate needs are identified and trade-offs evaluated to acquire items which meet those needs.

To get the supplies and services that will best meet the needs of the Government, the Government members of the Acquisition Team must understand the true needs of the Government and know what is available in the marketplace. Market research should be an on-going process for every member of the Acquisition Team, but there are three points where effective market research is particularly important:

- The purchase request should reflect the results of market research conducted by the requester. The requester should consider input from other Government members of the Acquisition Team, especially from the user (if different than the requester) and Government technical personnel. Contracting personnel should support and encourage requester market research efforts whenever possible. For example, the catalogs and price lists available in the contracting office may be invaluable to the requester's market research effort. Contracting personnel should not take the responsibility for developing the requirements documents and should remind other members of the Team not to disclose source selection information outside channels authorized by the agency head (see FAR 3.104-4 ).
- Before soliciting offers for acquisitions with an estimated value in excess of the simplified acquisition threshold, you must conduct market research to assure that together the requirements documents and the contract business terms form the most suitable approach to acquiring, distributing, and supporting supplies and services. This research may be a one-time analysis or part of your on-going effort to know and understand the marketplace for the items that you routinely procure. As you perform your market research, you may question the requirements documents, but you must never change those documents without authorization from the requester.
- Before soliciting offers for acquisitions with an estimated value less than the simplified acquisition threshold, you should perform market research whenever adequate information is not available and the circumstances justify its cost.

*Information for Market Research.* When conducting market research, you should not request potential sources to submit more than the minimum information necessary. Most firms will gladly support Government market research as long as the result will benefit the firm. Most will provide complete information about how the products that they can provide will meet Government requirements. However, they are unlikely to provide information about problems with their products or about other products that could better meet the Government's needs at a lower total cost.

Generally, information on a particular product or industry is available from many sources other than potential offerors. These sources include:

- Knowledgeable individuals in Government and industry;
- The results of recent market research undertaken to meet similar or identical requirements;
- Government data bases that provide information relevant to agency acquisitions;
- Interactive, on-line communication among industry, acquisition personnel, and customers;
- Source lists of similar items obtained from other contracting activities or agencies, trade associations or other sources; or
- Catalogs and other generally available product literature published by manufacturers, distributors, and dealers or available on-line.

*Market Research Results* Use the results of market research to:

- Determine if there are sources capable of satisfying the agency's requirements;
- Determine if commercial items or, to the extent commercial items are not available, nondevelopmental items are available that:
    - Meet the agency's requirements;
    - Could be modified to meet the agency's requirements; or

    - Could meet the agency's requirements if those requirements were modified to a reasonable extent.
- Determine the extent to which commercial items or nondevelopmental items could be incorporated at the component level;
- Determine the practices of firms engaged in producing, distributing, and supporting commercial items, such as terms for warranties, buyer financing, maintenance, and packaging and marking; and
- Ensure maximum practicable use of recovered materials and promote energy conservation and efficiency.

*Market Research and Contract Pricing.* FAR Part 10 requires that you use the results of market research in developing Government requirements and determining how you will satisfy those requirements. This research is required because the decisions made in the presolicitation phase of the acquisition process will be key factors in defining what the Government receives and the price that the Government will pay. For example, contracting decisions that:

- Increase contractor performance costs will normally increase contract price.
- Lower contractor performance costs will normally reduce contract price.
- Limit competition will normally increase contract price.
- Facilitate competition will normally reduce contract price.
- Increase contractor risk will normally increase contract price.
- Limit contractor risk will normally decrease contract price.

The better you understand the marketplace the better you will be able to make decisions that will enable you to meet the needs of the Government at a reasonable price.

This same understanding of the marketplace will enable you to develop a better estimate of a reasonable price for a contract that meets the needs of the Government. Your preliminary price estimate and the factors that affect contract price will be key inputs to the acquisition planning process. For example, the method of contracting and required contract terms and conditions both depend on your estimate of contract price. In addition, your preliminary estimate of contract price will become a key input to your final determination of contract price reasonableness.

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## 1.1 Reviewing The Purchase Request And Related Market Research

When determining how much reliance you can place on the Independent Government Estimate in making contracting decisions, you must evaluate the depth and quality of the analysis involved in developing the estimate. As a minimum, you should consider the following five areas:

- 1.1.1 - How Was The Estimate Made?
- 1.1.2 - What Assumptions Were Made?
- 1.1.3 - What Information And Tools Were Used?
- 1.1.4 - Where Was The Information Obtained?
- 1.1.5 - How Did Previous Estimates Compare With Prices Paid?

*Purchase Request.* The purchase request is the document that formally transmits the requirement to the contracting office. It is the purchase request that typically first combines the Government requirements document with the Independent Government Estimate of contract price. Normally, the purchase request will also include an assurance that funds are available or will be available to fund the acquisition of the required supplies or services.

*Independent Government Estimate ( FAR 15.404-1(b)(2)(v) ).* As the name implies, the Independent Government Estimate must be developed independently by the Government. Independent development is vital because this estimate normally provides your first indication of a reasonable contract price and it is also one of the bases that you should consider in contract price analysis. The estimate development process may be automated or manual, but the best estimates reflect the requester's market research.

*Reviewing Requester Market Research.* FAR Part 10 requires market research before developing new requirements documents for an acquisition. Logically, this responsibility falls on the requester. The quality of the requester's Independent Government Estimate usually depends on the quality of the requester's market research. Because of the importance of the Independent Government Estimate to your selection of appropriate acquisition techniques and eventually your decision on price reasonableness, you should review the estimates carefully, before initiating further procurement action.

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### 1.1.1 How Was The Estimate Made?

*Estimate Preparation.* To judge the reliability of a Government estimate, you must know how the estimate was made. Purchase requests may be prepared by an automated system or manually by the requester or an estimating specialist.

- Automated Purchase Request Estimates
  - Estimates for purchase requests prepared by an automated system are developed following an algorithm that has been programmed into the system. The most common algorithm is to set the unit price estimate equal to the last unit price paid.
  - Estimates prepared by automated systems rarely take changes in the market situation into account. Even such basic factors as changes in price related to changes in quantity are not considered. For example, assume that the requirement is for 5,000 generators. If the last acquisition was for a single generator, the estimated unit price for each of the 5,000 generators would be the same as the price for a single generator.
  - When you make acquisitions based on automated purchase requests, you must learn what market factors (if any) are considered in preparing the request. Factors not considered in estimate development should be special areas of emphasis in your market research. Once you understand the algorithm for developing the automated estimate, you should remain alert to possible changes in that algorithm.
- Manual Purchase Request Estimates
  - Estimates for manual purchase requests are typically prepared by the individual preparing the purchase request. Different organizations, and different individuals within the same organization, may have different methods of developing the Government estimate.
  - Estimates should reflect any market changes identified during market research. Unfortunately, many do not. Instead manual estimates, like automated estimates, are often based on the last unit price paid with no consideration of changes in the market situation.
  - You must determine how each individual estimate was developed so that the other questions concerning reliability can be examined. This also provides a general insight into the amount of time devoted by the requester to market research.

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### 1.1.2 What Assumptions Were Made?

Every estimate involves assumptions. Knowing and understanding those assumptions can give you an insight into the estimator's understanding of reliable estimate development.

*Analysis of Assumptions* In many cases, user/technical/program personnel are not familiar with relevant cost factors and market forces that affect contract pricing. As a result, assumptions and estimates may not be accurate.

If the rationale used to develop the estimate is not clear or does not seem reasonable, ask questions! **IN PRICING, THERE ARE NO DUMB QUESTIONS!** If you do not know, ask! By asking questions about the Independent Government Estimate and accompanying documentation, you can identify assumptions that are not consistent with market realities and work with the requester to improve the estimate before the contracting process begins.

**Estimate Example 1:** The requester used the last price paid for an item to estimate the price for the same item 10 years later.

- **Assumptions** The requester has assumed that the last price paid was reasonable, and that the market situation has not changed in 10 years.
- **Analysis** Over a few days or weeks, it may be reasonable to assume that the price has not changed if quantity, delivery, and other factors have not changed. But in this case the last purchase was made 10 years ago. Normally, it is not reasonable to assume that the price has not changed in 10 years. Once you identify the assumptions used in estimate development, you can evaluate them and adjust for any that do not appear consistent with market realities.

**Estimate Example 2** : The requester estimated the price of 100 warehouse trucks with 3 cubic foot capacity based on the price paid for 2 cubic foot units acquired during the last month.

- **Assumptions.** The requester has assumed that the recent price was reasonable, and that the unit price is not affected by changes in unit capacity.
- **Analysis.** The assumption that unit price will not be affected by the unit's capacity may or may not be reasonable. However, the great difference in capacity should lead you to subject this assumption to closer scrutiny during your market research.

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### 1.1.3 What Information And Analysis Were Used?

It is important to determine what the requester knows about the item or service being requested and what type of analysis was used in estimate development.

*Market Research Information.* The most successful estimators know their item. Before they make an estimate, they collect information on the product and the market for that product. Their market research may be a one-time effort or part of an on-going process that is an integral part of their normal job.

The most reliable estimates are prepared by estimators who have performed detailed market research and can answer "yes" to the following questions that apply to a particular purchase request:

- Did the estimator perform a detailed analysis of the Government requirements documents?
- Did the estimator identify performance, quality, and/or acceptance criteria differences exist between new "requirement" and the information analyzed?
- Is the estimator familiar with the market for the item, including:

- Last price paid?
- General market price changes?
- Current commercial market price?
- Quantity price breaks?
- Possible substitutes?

*Estimating Analysis.* Market information alone is usually not enough. The estimator must be able to apply appropriate analysis to estimate development. Reasoned analysis provides a much more supportable estimate than one that is simply based on estimator judgment and experience. The strongest estimates are usually the result of a reasoned analysis supported by the use of appropriate quantitative techniques.

**Reasoned Analysis.** A reasoned analysis is an analysis that sets forth the known information and clearly explains how it was used in estimate development. This analysis may or may not be supported by the use of quantitative techniques.

**Quantitative Techniques.** When appropriate, adjustments should be made using accepted quantitative techniques. For example, index numbers can be used to quantify price changes and adjust historical pricing data.

*Estimate Support Comparison.* Estimates supported by words such as "professional judgment," but no factual data and explanations about how that professional judgment was applied, are typically of little value. Estimates based on good information and the application of appropriate quantitative techniques or reasoned analysis will generally be more accurate and easier to support throughout the acquisition process. For example, in an analysis of changes in technology, which of the following techniques would be more useful in price estimation?

**Professional Judgment.** "Based on my 20 years of experience as a Project Engineer and my knowledge of the product, I estimate the price of this unit at $585,000."

**Reasoned Analysis.** "We are requesting new high sensitivity replacement units. A year ago, a product could not be produced with this level of sensitivity to high frequency sound. Today, units with similar sensitivity improvements are available at a 30 percent higher price than the less sensitive units they replaced. Therefore the estimated price for this unit, $585,000, is 30 percent higher than the $450,000 price last paid for the less sensitive unit that it will replace."

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### 1.1.4 Where Was The Information Obtained?

The breadth and depth of the requester's market information will have a substantial impact on the quality of the estimate. Learn what you can about the sources of information used by the requester in estimate development, because some sources of information are better than others. Knowing the sources of information will make it easier for you to evaluate the reliability of the estimate.

*Estimate Information Sources.* Many estimators rely exclusively on historical prices as their base for estimate development. Historical prices are an excellent source of information on the price at some point in the past but market conditions and Government requirements change over time. Past prices for a similar item may have been based on detailed Government specifications while the current requirement is based on products commonly traded in the commercial market place. In that situation, historical prices may not provide a viable price estimate.

Encourage requesters to provide source data with their estimates. Information, such as a vendor catalog or portion thereof, will provide an excellent starting point for your market research.

*Product Analysis.* If the requirement is unique and there is no price history available, the estimator must develop a price estimate by some other form of analysis. One option is for the requester to develop an estimate based on an evaluation of the material and labor required to produce the product, as well as the risks associated with design, development, production, delivery, and acceptance. When such estimates are required, the more current the data used to develop the cost estimate, the more reliance you can place on the estimate.

*Misleading Information.* Many data sources, such as stock lists, can present information that is difficult to use in price estimating. The price information is usually not current and there is typically little information about its source. Prices may be historical prices from an unknown point in the past or even averages of historical prices. It is typically difficult or impossible to adjust these prices for changes in the market situation. As a result, you must be particularly careful when using such data as a base for estimated development.

*Emphasize Estimator Independence.* While use of vendor catalogs and other methods of market research should be encouraged, estimators MUST BE DISCOURAGED FROM CONTACTING VENDORS FOR SPECIFIC QUOTATIONS. This is particularly true in sole source situations, where the Independent Government Estimate may be a primary basis for determining price reasonableness. If both the estimate and the proposal come from the offeror, there is no independent measure of price reasonableness. If the estimator must contact a vendor to better understand specifications, pricing, discounts, etc. then two very important steps must be taken:

- First discuss the need to contact the vendor with the responsible contracting officer
- Also, make it very clear, in writing, to the vendor that you are performing market research and need more information about the product or pricing, and that you ARE NOT REQUESTING A QUOATATION OF ANY KIND.

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### 1.1.5 How Did Previous Estimates Compare With Prices Paid?

An examination of the Independent Government Estimate should include an examination of the estimator's track record. Just as past vendor performance is an indicator of future contract performance, the quality of past estimator performance is an indicator of the quality of the current estimate.

*Comparison with Prices Paid.* In evaluating estimates, ask: "Have the estimator's past estimates been close to contract prices determined fair and reasonable through analysis using other price analysis techniques?"

If the answer is yes, greater reliance can be placed on current estimates developed using similar techniques.

If the answer is no, less reliance should be placed on these estimates.

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## 1.2 - Considering Contract Pricing In Your Market Research

The Independent Government Estimate is only one preliminary estimate of contract price. As a minimum, your research, should consider the following data sources:

- 1.2.1 - Historical Pricing Data For Market Research
- 1.2.2 - Published Data For Market Research

- 1.2.3 - Market Research Data From Buyers And Other Experts
- 1.2.4 - Market Research Data From Prospective Offerors
- 1.2.5 - Market Research Data From Other Sources

*Factors to Consider in Researching the Market.* Each time you conduct market research the process will be different because of differences in Government requirements, market conditions, and other factors. The following table identifies research factors and outlines the type of questions that you should be able to answer when you complete your market research. Not all of the questions identified in the table will be valid for every acquisition. For some acquisitions, you will have many specialized questions that are not covered in the following table. However, the research factors identified and the related questions provide a good framework for your market research.

| **Pricing Factors to Consider in Market Research** | |
|---|---|
| **Research Factor** | **You Should Be Able to Answer Questions Such As...** |
| Pricing History | • What information is available concerning past prices paid for the product and chang the product or market since then?<br>• Have there been historic differences between prices paid by the Government vis--vi other buyers? Why? |
| Current Competitive Conditions | • How many sellers are in the market?<br>• How many buyers? |
| Current Overall Level of Demand | • What is the relationship of the quantity we intend to buy vis--vis the quantities that buy?<br>• Will our volume justify a lower than market price due to the seller's increased econ of scale?<br>• Will our volume be so large as to drive the sellers to or beyond full capacity, resulti unanticipated inflation? |
| Trends in Supply and Demand | • Will demand be higher or lower at the time of award than now?<br>• Will supply capacity keep pace with demand? |
| Pattern of Demand | • Is there a cyclical pattern to supply and demand?<br>• Would awarding six months from now result in lower prices than an immediate awa<br>• Or would it be better to stock up now at today's prices? |
| Other Market Forces Expected to Affect Contract Price | • What forces might drive up prices in the near future? Strikes? Labor shortages? Subcontractor bottlenecks? Energy shortages? Other raw material shortages?<br>• What forces might lead us to expect lower prices in the future? |
| Pricing Strategies | • What are the pricing strategies of firms in the market?<br>• What are the implications for expected prices? |

| | |
|---|---|
| Sources of Supplies or Services | • Which firms in the market are the most likely to submit offers to a Government solicitation?<br>• Which are the least likely and why? |
| Product Characteristics | • What features distinguish one product from another?<br>• Which commercial products match most closely with the Government requirements document (as it currently reads in the purchase request).<br>• What is the apparent tradeoff between features and price? |
| Delivery/ Performance Terms | • What are the current distribution channels?<br>• What are current transportation costs (if available and applicable)?<br>• What are the commercial lead-times? |
| Ownership Costs | • What are the commercial warranty terms and conditions (if any)?<br>• What are the historical repair costs for each product?<br>• What are the historical maintenance costs for each product? |
| Contract Terms and Conditions | • What terms and conditions are used in commercial transactions?<br>• What terms and conditions have been used in other Government acquisitions?<br>• What type of contract is generally used in commercial transactions? Government acquisitions? |
| Problems | • What has been the historical default rate by firms performing similar contracts?<br>• What performance problems have typically been encountered?<br>• Have similar acquisitions been characterized by claims or cost overruns? |

### 1.2.1 Historical Pricing Data For Market Research

Prior to contracting, FAR 7.103(l) requires the contracting officer to review:

- The acquisition history of the supplies and services; and
- A description of the supplies, including, when necessary for adequate description, a picture, drawing, diagram, or other graphic representation.

One of the reasons for this requirement is to ensure that prior prices are considered in estimating the proper price of the current acquisition. However, you must also remember that information from Government historical price data bases provides a picture of what happened in the past. You must integrate this information with information from other market research to enhance the accuracy of your price estimate.

*Sources of Acquisition Histories.* Acquisition histories can be found in many sources. Typically, the best sources are contract files, computerized acquisition data files, and manual item records.

**Contract Files.** Usually, the best source of information on past pricing decisions is the original file of the contract action. Detailed information, and the rationale used to determine price reasonableness should be available in the file.

**Computerized Acquisition Data Files.** Computers provide immediate access to the data considered most important to purchase decision making. While computer data files may not be as complete as purchase files, they do provide key data in a form that can be used by the buyer in a timely fashion.

**Manual Item Records.** Manual item records typically provide data similar to that contained in computerized acquisition data files.

*Researching Historical Acquisition Pricing Information.* Historical prices are an excellent source of market information. Research of historical market information can tell you a lot about the acquisition situation for the product at some point or points in the past. For that information to be useful, you must be able to determine what the market situation was in the past and how it has changed since then. The following table presents research elements that you should consider in your examination of historical acquisition information and questions that you should consider in your research.

| **Historical Acquisition Data for Pricing** | |
|---|---|
| **Research Element** | **You Should Be Able to Answer Questions Such As...** |
| Trends in Supply and Demand | • When did past acquisitions take place?<br>• Is there any indication of prevailing market conditions at that time? |
| Pattern of Demand | • What quantities were solicited for each acquisition?<br>• What quantities were acquired? |
| Trends in Prices | • What was the contract price?<br>• How did the unsuccessful offers compare with the successful offer? |
| Start-up Costs and Pricing Strategy | • Did the contract price include one-time engineering, tooling, or other start-up costs?<br>• Should future contracts include similar or related costs?<br>• Were necessary start-up costs paid for in a manner separate from the price for the ite service? |
| Sources of Supplies or Services | • How many sources were solicited for the prior acquisition?<br>• What specific sources were solicited?<br>• How many sources offered bids or proposals?<br>• What specific sources offered bids or proposals? |
| Product Characteristics | • Are there any significant differences between the Government requirements docume for the prior contract and the current requirements? |
| Delivery/ Performance Terms | • What was the delivery or performance period in days, weeks, months, or years?<br>• In what month(s) were the supplies to be delivered or the service to be performed? |

| | |
|---|---|
| | • Did the vendor meet the delivery targets?<br>• What was the FOB point?<br>• Was premium transportation required for timely delivery? |
| Ownership Costs | • What costs of ownership were associated with the acquisition? |
| Acquisition Method | • What acquisition method was employed for past acquisitions? |
| Contract Terms and Conditions | • What were the general terms of past contracts?<br>• Are there any significant differences between terms of the last contract (e.g., packin requirements, type of contract, and the like) and those recommended for this acquisi |
| Problems | • What problems (if any) were encountered during contract performance? |

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### 1.2.2 Published Data For Market Research

This subsection presents examples of several types of published information that you can use in developing your preliminary estimates of contract price.

- 1.2.2.1 - Manufacturer And Dealer Catalogs
- 1.2.2.2 - Product Brochures And Promotional Material
- 1.2.2.3 - Trade Journals
- 1.2.2.4 - Government Or Independent Testing
- 1.2.2.5 - Source Identification Publications
- 1.2.2.6 - Federal Supply Schedules (FSS)
- 1.2.2.7 - Government Economic Data
- 1.2.2.8 - Non-Government Economic Data

*Typical Data Available by Source.* The table below summarizes the sources of pricing related data and typical data available for each source.

| **Typical Data Available by Source** | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| **Source** | **Product Specs.** | **Product Picture** | **Pricing Info.** | **Order Quantity Req. Info.** | **Delivery Data** | **Source Location** | **Warranty and Guarantee Info.** | **Independ. Eval.** | **General Econ. Data** |
| Catalogs | Yes | Often | Yes | Yes | Yes | Yes | Rarely | No | No |
| Product Brochures | Yes | Often | Often | Often | Often | Yes | Yes | No | No |
| Trade | | | | | | | | | |

| | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| Journals<br>Advertisement<br>Product Evals<br>Articles | Yes<br>Yes<br>Yes | Often<br>Often<br>Rarely | Rarely<br>Often<br>Rarely | Rarely<br>No<br>No | Rarely<br>No<br>No | Often<br>Often<br>No | Often<br>Often<br>No | No<br>Yes<br>Yes | No<br>No<br>No |
| Source ID Pubs<br>Yellow Pages<br>Thomas Register | No<br>Yes | Rarely<br>Yes | No<br>No | No<br>No | No<br>No | Yes<br>Yes | No<br>No | No<br>No | No<br>No |
| Govt or Independent Testing<br>Qualified Products Lists<br>Underwriters Laboratory | Yes<br>Yes | No<br>No | No<br>No | No<br>No | No<br>No | No<br>No | No<br>No | Yes<br>Yes | No<br>No |
| Federal Supply Schedules | Yes | Often | Yes | Yes | Yes | Yes | Often | Yes | Yes |
| Govt Economic Data | No | No | No | No | No | No | No | No | Yes |
| Non-Govt. Economic Data | No | No | Some Do | No | No | No | No | No | Yes |

### 1.2.2.1 Manufacturer And Dealer Catalogs

Catalogs are familiar sources of data that can be found in both department stores and mail order houses. The manufacturer and dealer catalogs used in Government purchasing resemble these catalogs in the type of information they provide. [ **These catalogs can often be found on the company's website.** ] Typical data you can find in manufacturer and dealer catalogs include:

- Product descriptions
- Pictures
- Prices and quantity discounts
- Minimum order requirements
- Delivery data

- Points of contact for quotes and orders

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### 1.2.2.2 Product Brochures And Promotional Material

Brochures and promotional material provide much greater detail about specific products than would normally be included in a catalog with several thousand other products. [ **This type of material may also be available on the company's website.]** While details on pricing and delivery are often included, this information may be excluded in order to provide greater latitude in negotiating the terms of sale.

The following are typical data you can find in product brochures and promotional material:

- Detailed specifications
- Pictures
- Available service guarantees and products
- Points of contact for quotes and orders
- Pricing information
- Delivery data

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### 1.2.2.3 Trade Journals

Trade journals provide a variety of information from different sources, including advertisements, product evaluations, and independent articles.

*Trade Journal Data Sources.*

**Advertisements** typically consist of product descriptions, often with pictures and comparisons with competitor's products. Sources to consult for additional information may also be identified.

**Product evaluations** provide independent information to members of the trade who may be considering the purchase of that product or a similar one. Evaluations usually deal with technical capabilities, but often include information on source locations, pricing, and warranties.

**Articles** about the trade may indirectly provide an independent analysis of product capabilities. Successes or failures in using particular products or services serve as evaluations of their quality.

The table below gives an overview of typical data you can find in trade Journals.

| Data Source | Typical Data |
|---|---|
| Advertisements for Products Used in the Trade | • General product descriptions<br>• Pictures<br>• Comparisons with competitive products<br>• List prices |
| Independent Product | • Strengths and weaknesses of products |

| | |
|---|---|
| Evaluations | • Warranty or guarantee provisions<br>• Comparisons with competitive products<br>• Pricing information |
| Articles | • Application of existing products to problem solving<br>• Strengths and weaknesses of products in problem solving |

### 1.2.2.4 - Government Or Independent Testing

Product testing by Government or independent laboratories can provide essential product data. The data can be used to determine if a product meets minimum requirements and to identify and compare similar products.

*Qualified Products Lists* ( FAR 9.201 and 9.202(c) ). Successful testing of a product, by the Government may result in inclusion of that product on a Qualified Products List (QPL).A QPL is a listing of products which have been examined, tested, and have satisfied all applicable Government product qualification requirements. When a QPL applies to a particular product, all potential offerors must either be on the list or demonstrate to the satisfaction of the contracting officer that their product meets or can meet QPL standards before the date set for contract award. You can also use QPLs to identify potential sources for similar products.

*Underwriters Laboratory.* The best known independent testing laboratory is **Underwriters Laboratory (UL)** . Testing and approval by UL is essential for a wide variety of electrical products.

The table below gives an overview of typical data you can obtain from product standards and testing laboratories.

| Data Source | Typical Data |
|---|---|
| Qualified Products Lists | Results of product tests to Government requirements |
| Underwriters Laboratory (UL) | Results of tests of electrical products to UL commercial standards |

### 1.2.2.5 Source Identification Publications

There are thousands of publications designed to assist you in locating possible sources of product information. The most widely accepted of these are the Yellow Pages and the Thomas Register of American Manufacturers .

*Yellow Pages.* Every city, large or small, has a telephone book with an associated Yellow Pages. Larger cities and metropolitan areas typically have one or more Commercial Yellow Pages and Business Yellow Pages. Many firms advertise in both types, but the business Yellow Pages specialize in the business and industrial products that are more relevant to Government acquisition. Both Commercial and Business Yellow Pages identify firms by the products or services that they provide. Listings may even include pictures of major products.

*The Thomas Register of American Manufacturers.* The Thomas Register of American Manufacturers, commonly referred to as the Thomas Register, devotes 23 volumes to assisting commercial buyers identify potential product sources. The volumes are divided into four sections:

- Products and Services -- companies listed by product or service.
- Company Profiles -- capabilities and contact information are presented for listed firms.
- Catalog Files -- detailed product information, specifications, drawings, photos, availability, and performance data.
- Inbound Traffic Guide -- intermodal guide to transportation sources.

The table below gives an overview of typical data you can find in the Yellow Pages and the Thomas Register.

| Data Source | Typical Data |
|---|---|
| Yellow Pages | • Sources of identified products and services by geographic location<br>• Specific products within a product service category |
| Thomas Register | • Sources of identified products and services<br>• Source capabilities and contact information<br>• Product specifications<br>• Selected product pictures<br>• Product availability<br>• Product performance<br>• Transportation sources |

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**1.2.2.6 Federal Supply Schedules ( FAR 8.401 and FAR 8.404(a) )**

The General Services Administration (GSA) is best known for its stock program which buys, stores, and distributes a wide variety of items for use by all Government agencies. However, GSA also directs and manages the Federal Supply Schedule program that provides Federal agencies with a simplified process for obtaining commonly used supplies and services at prices associated with volume buying. GSA establishes indefinite delivery contracts with commercial firms to provide supplies and services at stated prices for given periods of time. The Federal Supply Schedule (FSS) program then issues Federal Supply Schedules (FSSs) that contain the information for placing delivery orders with contractors. Contracting offices can then issue delivery orders directly to the FSS contractors for the required supply or service.

The FSS provides you with sources for a wide variety of supplies and services. It is important to understand the basics for using the FSSs. Oversight organizations have found in the past that contracting officers sometimes simply compare a proposed price for a sole source item to prices posted on the FSS for similar items to determine price reasonableness. This is not sufficient, especially for larger purchases, nor does it meet the requirements for obtaining competition. Lets look at the FSS process, including specific DoD requirements.

Use of the FSSs is considered a "competitive procedure" when the procedures established by the GSA Administrator are followed. Under the existing FAR, the FSSs prices have been determined to be fair and reasonable and a separate determination of fair and reasonableness is not required except for orders of services that require a statement of work (SOW). For orders of services that require a SOW, the ordering activity is

responsible for considering the level of effort and the mix of labor proposed to perform a specific task being ordered, and for determining that the total price is reasonable.

Effective March 13, 2014, a deviation to the FAR was issued requiring ordering contracting officers using Federal Supply Schedules on behalf of the Department of Defense to evaluate prices using the proposal analysis techniques at FAR 15.404-1 in lieu of FAR 8.404 (d), Pricing. The deviation states:

> Supplies offered on the schedule are listed at fixed prices. Services offered on the schedule are priced either at hourly rates, or at a fixed price for performance of a specific task (e.g., installation, maintenance, and repair). GSA has determined the prices of supplies and fixed-price services, and rates for services offered at hourly rates, to be fair and reasonable for the purpose of establishing the schedule contract (emphasis added). GSA's determination does not relieve the ordering activity contracting officer from the responsibility of making a determination of fair and reasonable pricing for individual orders, BPAs, and orders under BPAs, using the proposal analysis techniques at 15.404-1. The complexity and circumstances of each acquisition should determine the level of detail of the analysis required.

This deviation remains in effect until incorporated into the DFARS or rescinded. A copy of the Director, Defense Procurement policy memo may be found at http://www.acq.osd.mil/dpap/policy/policyvault/USA001004-14-DPAP.pdf.

GSA has established a maximum order threshold on a Special Item Number (SIN)-by-SIN basis for each schedule contract. For all FSSs orders that exceed the maximum order threshold, ordering activities must seek additional price reductions from the schedule prices. The FAR also permits ordering activities to seek additional price reductions for orders that do not exceed the maximum order thresholds. Additional FSS ordering procedures are discussed below.

(1) For orders of supplies, and services that do not require a SOW, ordering activities are required to survey at least three schedule contractors or review the catalogs or pricelists of at least three schedule contracts before placing an order that exceeds the micro-purchase threshold. If the order exceeds the maximum order threshold, ordering activities are also required to-

(a) Review the pricelists of additional schedule contractors;

(b) Seek price reductions from the schedule contractor(s) considered to offer best value; and

(c) Place an order with the schedule contractor that provides best value.

(2) For orders of services that require a SOW over the micro-purchase threshold, ordering activities-

(a) Must develop a SOW that includes the work to be performed, location of work, period of performance, deliverable schedule, applicable performance standards, and any special requirements.

(b) Must provide the RFQ (including the SOW and evaluation criteria) to at least three schedule contractors that offer services that will meet the agency's needs.

(c) Should request that contractors submit firm-fixed prices to perform the services identified in the statement of work.

(3) For orders of services that require a SOW over the maximum order threshold, the ordering activity is required to-

(a) Provide the RFQ (including the SOW and evaluation criteria) to additional schedule contractors that offer services that will meet the needs of the ordering activity. To determine the appropriate number of additional schedule contractors to provide the RFQ to, ordering activity are advised to consider the complexity, scope and estimated value of the requirement and the market search results.

(b) Seek price reductions.

(c) Further, ordering activities are required to provide the RFQ (including the SOW and evaluation criteria) to any schedule contractor who requests a copy of it and evaluate all responses received.

**Additional DoD FSS Ordering Procedures** (DFARS 208.405-70) **.** DoD policy requires each order exceeding $100,000 to be made on a competitive basis. An order is placed on a competitive basis only if the contracting officer provides fair notice of the intent to make the purchase, including a description of the supplies to be delivered or the services to be performed and the basis upon which the contracting officer will make the selection, to-

(1) As many schedule contractors as practicable to reasonably ensure that offers will be received from at least three schedule contractors that can fulfill the requirements, and the contracting officer receives offers from at least three contractors that can fulfill the requirements; or

(2) All contractors offering the required supplies or services under the schedule.

(3) All offers received must be fairly considered. These requirements apply to orders placed by DoD and non-DoD agencies placing orders on the behalf of DoD. In December 2006, the SARA panel cited the DoD competition policy as a "best practice" and recommended that the policy be adopted government-wide.

Other Related Matters. On December 6, 2006, DoD and GSA established a Memorandum of Agreement (MOA) to identify the roles and responsibilities of DoD and GSA for the FSSs. As a part of the MOA, an action plan was established, in part, to improve the pricing of DoD orders on the FSSs. Specifically, the plan includes actions to ensure-

(1) Price reasonableness determinations are completed on every contract or order placed by or on the behalf of DoD.

(2) Pricing on GSA contract vehicles and the services it provides represents the best value on a contract/order basis.

(3) Adequate price competition is obtained for contracts or orders either issued by or on the behalf of DoD in accordance with statutory and regulatory requirements.

(4) In addition, the plan requires GSA to perform comprehensive reviews of targeted GSA schedules to ensure competitive market pricing has been established and to conduct a follow-on review of compliance with DoD competition requirements including Section 803 of the 2002 National Defense Authorization Act.

GSA Advantage GSA Advantage is an electronic on-line shopping mall maintained by the General Services Administration to support Government operations. With GSA Advantage, you can instantly obtain a wide variety of product information that you can use in pricing the same or similar products. Research capabilities include:

Browsing or searching for items using key words, part numbers, National Stock Numbers, or vendor names;

Comparing features, prices, and delivery options; and

Configuring products and adding accessories.

The following gives an overview of typical data available in FSS including FSS available published from GSA Advantage:

Product descriptions

Pictures

Pricing and discount information

Delivery/performance terms

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### 1.2.2.7 - Government Economic Data

The Federal Government develops and publishes large amounts of economic data. Much of this information is used to make national economic decisions. It is valuable to buyers attempting to develop preliminary price estimates, because knowledge of the economy and market forces is vital.

Data are published by several Government departments and bureaus. The best known sources include:

- Department of Agriculture
- Department of Commerce
- Bureau of Labor Statistics (BLS)
- Federal Reserve System
- Congress

*Index Numbers.* Specific price comparisons, known as price index numbers, are particularly useful in making price comparisons over time. You can use price index numbers to adjust the price for any purchase or sale of a particular product at any time, to estimate the contract price for your current requirement. You can even make comparisons using information from several acquisitions involving several different vendors.

You can use indexes routinely published by the Government or you can tailor indexes to fit your particular needs. The organizations that prepare Government indexes may even be willing to construct a special price index to meet your estimating needs, if the need for the index justifies their cost of developing it.

Probably the best known Government index is the **Consumer Price Index (CPI)**, an index published by the Bureau of Labor Statistics. You may be able to use the CPI to evaluate price changes related to labor and labor intensive products. However, the index most commonly used by Government buyers is the **Producer Price Indexes (PPI)**, another index published monthly by the Bureau of Labor Statistics. You can use the PPI to monitor and estimate price changes for products traded at the wholesale level.

The table below gives an overview of indexes and other data available from various Government departments and bureaus.

| Data Source | Typical Data |
|---|---|

| | |
|---|---|
| **Department of Agriculture** | **Agricultural Price Monthly** --Monthly agricultural price information by commodity<br><br>**Agricultural Statistics** -- Annual agricultural commodity information including price data |
| **Department of Commerce** | **Monthly Wholesale Trade: Sales and Inventories** -- Monthly data on wholesale trade and inventories<br><br>**Current Industrial Reports** -- A series of periodic reports on production and consumption in identified industries |
| **Bureau of Labor Statistics** | **Consumer Price Index** -- Monthly report on changes in the prices paid by urban consumers for a fixed market basket of consumer goods and services<br><br>**Producer Price Index** -- Monthly report on the selling prices received by domestic producers of goods and services<br><br>**Employment Cost Index** -- Monthly report on the change in the cost of labor, free from the influence of employment shifts among occupations and industries |
| **Federal Reserve System** | **Federal Reserve Bulletin** -- Monthly economic indexes and business data<br><br>**The Beige Book** -- Summary of comments on current economic conditions received from business and other contacts outside the Federal Reserve |

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### 1.2.2.8 Non-Government Economic Data

There are a number of non-Government sources of economic and market data, including:

- Purchasing organizations;
- Commodity or industry publications; and
- Economic analysis services.

*Purchasing Organizations.* The most noted purchasing organization that publishes market data is the Institute for Supply Management (ISM ). The ISM provides members with monthly information on market price trends and product availability. Data are based on the actual experience and projections of purchasing managers throughout the country.

*Commodity or Industry Publications.* Numerous commodity and industry publications provide specific market data. Periods of publication and the information presented vary.

*Economic Analysis Services.* Commercial economic analysis services have also been established to provide estimators with current analyses of general market conditions and price trends. Currently, the economic analysis service most widely accepted by Government purchasing organizations is Global Insights, Inc. A number of Government agencies contract with Global Insight which gives them access to Global Insight's economic analysis and forecasts. Global Insight, and similar companies provide a variety of services. As the timeliness and amount of information increases, the price also increases.

*Data from Non-Government Economic Sources.* The table below gives an overview of typical economic and market data that you can obtain from various non-Government sources.

| Data Source | Typical Data |
|---|---|
| **Purchasing Organizations** | **Manufacturing NAPM Report on Business** -- Monthly information on business activity, orders, backlog of orders, supplier deliveries, and prices |
| **Commodity or Industry Publications** | **American Metal Market** -- Daily information on the metals industry from scrap to precio metals including prices<br>**Black's Guide** -- Periodic information on commercial and industrial real estate leasing in k U.S. metropolitan areas<br>**Chemical Marketing Reporter** -- Weekly information on market indexes, current prices, a price changes<br>**Platt's Oilgram Price Report** -- Daily information on current oil prices<br>**Pulp and Paper Week** -- Weekly information on paper industry prices, economics, and technology<br>**Random Lengths** -- Weekly information on prices of wood products |
| **Economic Forecasting Services** | **Standard & Poor's DRI Cost Information Service** -- Information and forecasts for more 650 prices and wages in North America, Europe, and the Pacific Rim |

Buyers and other experts are important sources of market information. This is especially true when they have been involved in the acquisition of the same or similar items. They can refer you to official contract files that you may not otherwise find and they can provide tips and insights that may not appear in official files.

*Data from Government Personnel* Examples of Government personnel who can provide information useful in pricing include:

- Buyers;
- Contract administrators;
- Technical experts, and
- Auditors

The table below gives an overview of typical data you can obtain from Federal Government buyers and analysts.

| Data Source | Typical Data |
|---|---|
| Buyers | • Information on purchases of the same or similar products<br>• Identification of potential sources<br>• Information on the capabilities of sources already identified |
| Contract Administrators | • Information on purchases of the same or similar products<br>• Information on the capabilities of sources already identified<br>• Contractor performance assessment review data |
| Technical Experts | • Identification of potential sources<br>• Information on the capabilities and efficiency of sources already identified<br>• Identification of price drivers in the Government requirements |

| | |
|---|---|
| Auditors | • Information from prior audits, including rate and other cost trends<br>• Information from contractor compensation reviews |

*Data from Personnel Outside the Government.* Buyers and other experts from industry, state and local governments can also provide useful information, particularly for common supplies and services. The information that you can gather will depend on the personnel involved. For example, a buyer from outside the Federal Government can provide the same type of information that you would expect to receive from a Government buyer. However, the amount and types of data that you can gather depends largely on the willingness of the source to release what is often considered proprietary data.

*Collecting Inf* ormation. Information can be gathered in several ways. The two most common methods are interaction at professional meetings and specific questions or surveys.

- **Professional Meetings and Presentations.** Discussions at professional meetings and presentations are a good way to gather general information on purchasing particular categories of supplies and services. Professional organizations such as the National Contract Management Association and the National Association of Purchasing Managers actively encourage such professional development.
- **Telephone Surveys.** Telephone surveys can also provide useful information on potential sources in the area. Both government and non-government experts are usually anxious to respond to questions from fellow professionals. However, be aware that proprietary data restrictions may prevent many responses.

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### 1.2.4 Market Research Data From Prospective Offerors

*Encourage Early Exchanges* ( FAR 15.201(a) ) Potential offerors are a good source of information of market information for planning purposes. Early exchanges of information between potential offerors and members of the Government Acquisition Team can identify and resolve concerns regarding the acquisition strategy, the Government requirement, proposal instructions, offer evaluation criteria, reference documents, and other industry concerns.

*Techniques to Promote Early Exchanges* When draft Request for Proposals are released, they should be complete as possible, including factors for evaluation and price. Without this level of detail, offerors do not have sufficient insight into the Government's plans for the solicitation to be able to provide meaningful feedback. Techniques to promote early exchanges of information include:

- **Industry or Small Business Conferences.** Many industries sponsor periodic conferences to share information on technical achievements and business practices.
- **Public Hearings.** Government personnel can use public hearings to disseminate information about projected Government requirements. Prospective offerors and other interested parties can ask questions and provide input to the acquisition decision makers.
- **One-On-One Meetings.** Any meetings with prospective offerors that are substantially involved with potential contract terms and conditions should include the contracting officer.
- **Presolicitation Notices.** The notice may be used as a preliminary step in preparation for a negotiated acquisition. Issue the notice to potential sources and synopsize the notice in accordance with FAR 5.2.

- **Draft Requests for Proposals.** Distributing a draft of the proposed solicitation in as complete a form as possible will provide prospective offerors an opportunity to comment on specific requirements that may unreasonably restrict competition or favor one firm over other firms in the industry.
- **Requests for Information.** A request for information (RFI) may be used when the Government does not presently intend to award a contract, but wants to obtain price, delivery, or other information for planning purposes. Responses to an RFI are not offers and cannot be accepted by the Government to form a binding contract. Agency approval may be required before issuing an RFI.
- **Presolicitation or Preproposal Conferences.** When you use a preproposal or presolicitation conference, materials distributed at the conference should be made available to all potential offerors, upon request.
- **Site Visits.** Visits to contractor plants or proposed sites of Government contract performance can facilitate information exchange.

*Public Disclosure of Information.* When specific information about a proposed acquisition that would be necessary for proposal preparation is disclosed to one or more potential offerors, that information must be made available to the public as soon as practicable, but no later than the next general release of information, in order to avoid creating an unfair competitive advantage. Information provided to a potential offeror in response to that offeror's request must not be disclosed if doing so would reveal the potential offeror's confidential business strategy.

The table below gives an overview of typical data available from these various mechanisms for exchanging information with prospective offerors.

| Data Source | Typical Data |
|---|---|
| Industry Or Small Business Conferences | • General information about industry capabilities and business practices |
| Public Hearings | • Industry feedback on projected Government requirements |
| One-On-One Meetings | • Individual company feedback on ways and means to meet Government requirement |
| Presolicitation Notices | • Expressions of potential offeror interest in the contemplated acquisition<br>• Information on potential offeror's management, engineering, and production capabi<br>• Other preliminary information based on a general description of the supplies or serv involved |
| Draft Request For Proposal | • Comments on requirements that will unreasonably restrict competition and increase<br>• Comments on unreasonably complex or potentially biased evaluation criteria |
| Request For Information | • Comments on quantity breaks for discounts<br>• Comments on delivery terms<br>• Information on market conditions affecting the proposed solicitation<br>• Comments on the proposed requirement |
| Presolicitation | • Information on uncertainties that may drive up prices |

| | |
|---|---|
| Conferences | • Information on noncommercial requirements that may drive up prices<br>• Information on other aspects of the requirement that may limit competition or affec pricing |
| Site Visits | • Plant site visits may provide information on industry methods and capabilities<br>• Prospective offeror visits to Government contract performance sites may provide ur insights into factors that will affect contract price and performance |

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### 1.2.5 Market Research Data From Other Sources

Other important sources of market data include trade and professional associations, state and local watchdog agencies, and interactive on-line communication groups.

*Trade and Professional Associations.* Trade and professional associations can provide information about sources, source responsibility, commercial standards, and cost drivers.

*Chamber of Commerce and Better Business Bureau.* Professional organizations devoted to business development and the maintenance of responsible business practices, such as the Chamber of Commerce and Better Business Bureau, can provide substantial information on pricing, available competition, and the responsibility of identified sources.

*State and Local Watchdog Agencies.* State and local watchdog agencies can provide information on the capabilities and pricing of sources, particularly sources accused of price gouging or poor performance.

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## 1.3 - Using Market Research To Estimate Probable Price

This section covers the following topics:

- 1.3.1 Evaluating Your Market Research
- 1.3.2 Developing Your Price Estimate

*Use Market Research to Estimate Probable Price.* As you perform your market research, document the sources of information that you considered and what you found. Consider how you can increase competition that includes firms that commonly sell the same or similar items in the commercial market. At the same time, consider how current requirements, particularly Government-unique requirements will affect competition and contract price. Generally, both tasks will focus on the same requirements, because requirements that unnecessarily limit competition will also unnecessarily increase contract price.

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### 1.3.1 Evaluating Your Market Research

*Questions to Consider in Evaluating Your Research.* The better your research, the more reliance you should be able to place on the price estimate that you develop from that research. The list below contains questions that you can use to evaluate the quality of your market research. Note that there may be some acquisitions where a

particular question does not apply. For example, the first question deals with the use of historical price. If the Government has never acquired the product or a similar product, this question would not apply in your evaluation of estimate quality.

**Factors to Consider in Developing an Estimated Price**

**In preparing your price estimate, have you considered:**

- Historical prices paid for the product and changes in the product or market since then?
- The current level of competition between prospective offerors and how it will affect contract price?
- How increasing or decreasing the quantity being acquired would likely affect contract price?
- How changing the timing of the acquisition would likely affect contract price because of projected trends in supply or demand?
- How changing the timing of the acquisition would likely affect contract price because of projected cyclical changes in supply or demand?
- How other forces are expected to affect prices in the near future?
- How the pricing strategies of prospective offerors will affect contract price?
- Which firms in the market are expected to respond to the solicitation and how their prices compare with the firms that are not expected to respond?
- Whether the requirements document will unnecessarily increase prices proposed by offerors?
- Whether delivery/performance requirements will unnecessarily increase prices proposed by offerors?
- Whether different products from different vendors will have different costs of ownership?
- Whether contract terms and conditions will unnecessarily increase prices proposed by offerors?
- Ways to improve the risk related to problems associated with performance of similar contracts?

*Evaluating Your Research.* If you can answer "Yes" to all the questions in the list above, you have done an excellent job of market research for estimate development. When you must answer "No," your research is incomplete. For smaller dollar acquisitions, an incomplete evaluation may be acceptable as long at the evaluation covers the factors that you feel are most likely to affect contract price. However, as the estimated price increases, the need for in-depth research also increases.

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### 1.3.2 Developing Your Price Estimate

*Different Data, Different Estimates.* As you perform your market research, you will likely find different data that could lead you to different preliminary estimates of contract price. Using the price that you paid for the item 11 months ago, your estimate might be $19,700. If you use the last price paid for the item plus 4 percent inflation your estimate might be $20,488. The catalog price for a similar item from a commercial vendor might be $19,750. The catalog price for a comparable item from a second vendor might be $19,900.

*Consider Various Estimates.* Which estimate is correct? There is no one answer. They all appear to be valid estimates based on the information used to develop them. This demonstrates a common situation -- there is no single estimate that you can say is right to the exclusion of all other estimates. In fact, they define a range of reasonable prices from $19,700 to $20,488.

You could document the various estimates in a paragraph or in a table similar to the following:

| **Preliminary Estimate of Contract Price** |
|---|

| Price Estimate | Estimating Rationale |
|---|---|
| $19,700 | Estimate based on the price determined fair and reasonable 11 months ago under contract XX-9X-XXXX. |
| $20,488 | Estimate based on the price determined fair and reasonable 11 months ago under contract XX-9X-XXXX plus 4 percent inflation estimated using the Producers Price Index for similar items. |
| $19,750 | Estimate based on current FloMo Systems catalog price for the quantity required. |
| $19,900 | Estimate based on current Acme Products catalog price for the quantity required. |

*Point Estimate.* Given this same information, different estimators could have different opinions as to which of these estimates you should use as your preliminary price estimate. That is one reason why it is so important to present the range of possible estimates and the rationale for each. However, in this case an estimate of $19,750 appears most reasonable because it is based on a current catalog price. Remember, the lower $19,700 estimate is 11 months old.

*Contract Type and Risk.* Estimators must consider the impact of contract type and resulting performance risk to contractors when estimating future costs and price, whether estimates are based on historical or market data or whether estimates are based on the judgment of qualified estimators. For example, sound estimating practices would include probable impacts of performance risk in estimates prepared under a fixed price contract. Performance risk at the pre-proposal and proposal preparation stage of the acquisition cycle is analogous to estimating uncertainty. In this context, risk associated with future performance must be evaluated by estimators in terms of the potential for variability of performance under a resulting fixed price contract arrangement and include, as appropriate, estimated costs associated with mitigating risk and the impact of the probable occurrence of risk. Prudent estimators will perform a risk assessment in conjunction with development of estimates to evaluate those presently known and existing conditions and their foreseeable effects on future performance such that, and within reasonable limits of estimating accuracy, estimates of future costs reflect the best estimate of performance cost and resulting price to the government. ( FAR 16.103(a) , FAR 31.205-7 )

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## 2.0 - Chapter Introduction

*Acquisition strategy.* In this chapter, we will examine the effect of numerous acquisition decisions on competition and contract pricing. The sections of this chapter, provide answers to the following three questions:

- How can solicitation Schedules (e.g., Part I of the Unified Contract Format or UCF) be improved to yield more effective price competition?
- How can business terms and conditions (e.g., Parts II - IV of the UCF) be improved to yield more effective price competition?
- How can the methods of publicizing the buy be tailored to yield more effective price competition?

*Why promote competition?* The Government policy regarding competition is stated in FAR 6.101(b) :

Contracting officers shall provide for full and open competition through the use of competitive procedure(s) . . . that are best suited to the circumstances of the contract action and consistent with the need to fulfill the Government's requirements efficiently.

Competition is important to contract pricing in three ways:

- Competition is widely acknowledged as the best way to encourage firms to offer a quality product at a reasonable price.
- Competitive prices are one of the best bases to use in evaluating the reasonableness of an offered price.
- Adequate price competition is the most common basis for excepting offerors from the Truth in Negotiations (TINA) requirement to submit cost or pricing data.

*What does "Maximizing Price Competition" mean?* To maximize price competition, you must:

- Attract competitive offers from the best vendors (in terms of their track records for pricing, quality, timeliness, and integrity), and
- Obtain reasonably-priced offers, in part because the solicitation:
    - Reflects the Government's actual minimum need and
    - Prospective contract provisions balance the cost risk associated with satisfying that need.

*Key acquisition team members.* Efforts to maximize competition require a detailed analysis of Government requirements. To be effective this analysis must involve affected members of the Acquisition Team. Member participation will vary from acquisition to acquisition, but most often contracting personnel and one or more of the following team members will be involved:

- Users-key source of information on the real needs of the Government;
- Requirement Managers-key decision makers;
- Suppliers-information source in market research and analysis; and
- Contracting Personnel-responsible for the effectiveness of the acquisition decision.

*Potential impediments to competition.* In various acquisition situations, you may use many different formats to organize a solicitation or contract. Regardless of the format, there are potential impediments to competition.

| **Potential Impediments to Price Competition** | |
|---|---|
| **Solicitation Element** | **Potential Impediments** |
| Supplies or Services and Prices | • Failure to consolidate requirements |
| Requirements Documents | • Use of vague or ambiguous terms<br>• Excessive (i.e., gold plated) or impractical requirements<br>• Use of design specifications when performance specifications are feasible<br>• Brand-name specifications<br>• Brand-name-or-equal specifications that admit few, if any, equals<br>• Use of Government-unique specifications for commercial or commercial-type deliverables<br>• Biased specifications (i.e., specifications geared to the unique features of a single product or of premium priced products) |
| Packaging and Marking | • Noncommercial requirements<br>• Excessive requirements<br>• Biased requirements |
| Inspection and Acceptance | • Noncommercial requirements<br>• Excessive requirements<br>• Biased requirements |
| Deliveries or Performance | • Noncommercial terms<br>• Delivery requirements not in tune with market cycles (e.g., requirements for "out-of-season" deliveries.)<br>• Excessively tight deadlines |
| Contract Administration Data | • Noncommercial requirements<br>• Excessive requirements |
| Special Contract Requirements | • Noncommercial requirements<br>• Excessive requirements |
| Contract Clauses | • Noncommercial terms and conditions<br>• Excessive requirements (e.g., an excessively long warranty period, relative to commercial warranties)<br>• Use of the wrong type of contract, given risks inherent in the work<br>• Failure to use terms and conditions that could encourage competition |

| | |
|---|---|
| Instructions, Conditions, and Notices to Offerors | • Noncommercial requirements<br>• Excessive requirements |
| Evaluation for Award | • Price given too little weight relative to technical factors<br>• Biased evaluation factors (e.g., geared to unique features of a single product or of premium priced products) |

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## 2.1 - Improving The Schedule

*Section Introduction.* Solicitations and contracts must include the product or service requirements that the contractor is expected to meet. These requirements should be specified in a manner designed to promote full and open competition and should only include restrictive provisions or conditions that are necessary to satisfy the minimum needs of the Government (see FAR 11.002(a)(1) ).

This section covers the following strategies for improving purchase descriptions and related terms (i.e., Part I of the UCF-Schedule) to obtain more effective price competition:

- 2.1.1 - Consolidate Requirements
- 2.1.2 - Describe Government Needs To Promote Competition
- 2.1.3 - Review Requirements Documents
- 2.1.4 - Use And Maintain Requirements Documents
- 2.1.5 - Acquire Other Than New Material
- 2.1.6 - Consider Delivery Or Performance Schedules
- 2.1.7 - Use Liquidated Damages
- 2.1.8 - Use Variation In Quantity
- 2.1.9 - Pursue Restrictive Requirement Relief

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### 2.1.1 - Consolidate Requirements

*Introduction.* Federal agencies are required to procure supplies in quantities that will:

- Result in the total cost and unit cost most advantageous to the Government, where practicable ( FAR 7.202 ).
    - Total cost is the sum of allowable direct and indirect costs allocable to the contract, incurred or to be incurred, less any allocable credits, plus any allocable facilities capital cost of money ( FAR 31.201-1 ).
    - Unit cost is the cost to complete any unit identified in the contract.
- Not exceed the reasonable quantity expected to be required by the agency.

In contracting, the general assumption is that larger quantities will attract greater competition and result in lower prices due to manufacturing economies of scale and specialization. However, most inventory management systemsdo not consider the effect of larger quantities on price. Price is considered to be fixed regardless of the quantity purchased. Because inventory management systems typically do not consider the benefits of requirement consolidation, contracting personnel must often take primary responsibility for coordinating consolidation efforts.

*Consolidation decision.* As you review the Government requirements and prepare the schedules of supplies or services, consider the following:

| Consolidation Decision | | |
|---|---|---|
| **If you can answer "YES" to the following questions...** | **AND...** | **Then...** |
| Is the contracting office likely to receive more purchase requests for this item or service during the coming year?<br><br>Can we reasonably estimate total organization requirements for the coming year?<br><br>Can this requirement be combined with other known requirements to reduce the total cost to the Government? | Quantity and delivery requirements are firm and full funding is currently available. | Consolidate purchase requests into a single definite delivery contract. |
| | Quantity or timing of requirements is not firm or full funding is not currently available. | Consolidate purchase requests into a single indefinite delivery contract. |

*Consolidate purchase requests.* If you expect to receive purchase requests from a number of different activities for the same end item, encourage those activities to submit their purchase requests at roughly the same time. Then award a single contract for the aggregate quantity in the purchase requests.

Consider polling the requiring activities by phone if you suspect that a number of requiring activities will need the same end item. You might also consider "riding" the contract of another agency that needs the same end items (see FAR 17.502 ).

*Place economic order quantities.* The major drawback to consolidating requirements is that you may acquire a warehouse full of supplies that are not immediately needed. The Government incurs a daily cost for storing unused supplies-a cost that may over time outweigh any price breaks from having purchased in bulk. Therefore, when deciding the quantity to acquire at any one time, you should minimize the total cost of both:

- Buying the supplies; and
- Storing the supplies.

This means balancing per unit prices against per unit storage costs, taking into account how many units are likely to be drawn from inventory each month. The "Economic Order Quantity" is the quantity that represents the best balance of acquisition and storage costs-this is the quantity that ideally you should award at any one time.

If inventory managers are available, work with them to determine the economic order quantity. You can also solicit information from offerors relevant to determining the economic order quantity.

*Use indefinite delivery contracts.* Indefinite-deliverycontracts give the Government greater flexibility and buying power by combining requirements over an extended period of time with limited obligation regarding the exact time of delivery. They establish limits on the Government's obligation under the contract and provide flexibility in scheduling deliveries to minimize the costs to the Government for holding and managing inventory. See FAR 16.5 for specific details about the various types of indefinite-delivery contracts available.

*Comparison of contract types.* The following table compares the Government pricing leverage for the three indefinite-delivery contract types and a definite-quantity definite-delivery contract:

| Contract Type and Pricing Leverage | |
|---|---|
| **Contract Type** | **Pricing Leverage Ranking** |
| Definite-Quantity-Definite-Delivery | First, if the entire quantity is known and contracted for at one time.<br><br>Last, if individual small orders are required. |
| Definite-Quantity-Indefinite-Delivery | Second |
| Indefinite-Quantity-Indefinite-Delivery or Requirements | Third |

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### 2.1.2 Describe Government Needs To Promote Competition

*Need description objectives.* FAR 11.002(a) requires that agencies describe Government needs in a manner designed to:

- Promote full and open competition, with due regard to the nature of the supplies or services to be acquired; and
- Only include restrictive provisions or conditions to the extent necessary to satisfy the minimum needs of the agency or as authorized by law.

*Contracting officer responsibility.* Normally, you will not be ultimately responsible for describing Government needs. That will normally be the responsibility of technical experts and the requiring activity. However, as a member of the Acquisition Team, you are responsible for sharing your acquisition knowledge in an attempt to meet the needs of the Government. See FAR 11 for additional information on describing Agency needs/requirements.

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### 2.1.3 Consider Acquiring Other Than New Material

*Introduction.* Your market research may identify situations were it would be advantageous to the Government to acquire items that are not new (e.g., rebuilt items), former Government surplus property, or residual inventory. Such items may be available at a fraction of the price of new material. You must consider the best interests of the Government in deciding whether to solicit offers based on providing such items.

*Contracting Officer Authorization.* Do not permit a contractor to provide other than new material, former Government surplus property, or residual inventory unless the contractor has obtained the appropriate contracting officer authorizations required by FAR 52.211-5 , Material Requirements clause.

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### 2.1.4 Consider Delivery Or Performance Schedules

The time of delivery or performance is an essential contract element and must be clearly stated in solicitations and contracts. See **FAR 11.4** for additional considerations related to delivery or performance schedules **.** Assure that delivery or performance schedules are realistic and meet the requirements of the acquisition. Remember that unreasonably tight or difficult to attain schedules:

- Tend to restrict competition;

- Are inconsistent with small business policies; and
- May result in higher prices.

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### 2.1.5 Consider Liquidated Damages

In Government contracting, a liquidated damages clause is a stipulation by the Government and contractor to a sum of money to be recovered by the Government in the event the contractor fails to meet a specified contract delivery or performance requirement. Liquidated damages are normally assessed at a daily rate for each day of delay in meeting the delivery or performance requirement. A liquidated damages clause may be used in any type of contract, but such clauses are most commonly used in construction contracts. See FAR 11.5 for additional information on Liquidated Damages.

As you decide whether to include a liquidated damages clause in the contract, consider the probable effect on contract pricing, competition, and contract administration:

- Concern among prospective offerors about the cost risk associated with liquidated damages may increase contract prices and decrease competition. A tight delivery schedule will increase offeror concern. If the risk of timely performance is substantial, consider using positive performance incentives rather than liquidated damages.
- The cost/difficulty of contract administration will likely increase if the contractor perceives that timely performance is unlikely or impossible. Numerous claims may result as the contractor attempts to use Government action or inaction to justify its failure to meet the contract schedule.

*Estimating a Reasonable Rate* ( FAR 11.502(b) , FAR 11.503(b) , and FAR11.503(c) ). Whenever you use liquidated damages, you must calculate the rate on a case-by-case basis, based on an estimate of actual damage to the Government if the contractor does not perform on time. Assure that the rate is reasonable because a rate fixed without any reference to probable actual damages may be held to be a penalty, and therefore unenforceable.

If a liquidated damages clause is used in a construction contract, the contract should identify a daily rate for the assessment of liquidated damages. As a minimum, the rate should cover the estimated cost of inspection and superintendence for each day of delay in contract completion. Whenever the Government will suffer other specific losses due to the failure of the contractor to complete the work on time, the rate should also include an amount to cover those losses. Examples of specific losses include the:

- Cost of substitute facilities;
- Rental of buildings and/or equipment; or
- Continued payment of quarters allowances.

Usually, a single liquidated damages rate (e.g., $500 per day) is used from the date of contractually required delivery/performance until the contractor actually delivers or the contract is terminated. However, the probable damage to the Government may not follow a linear pattern.

- If appropriate to reflect probable damages to the Government, you may develop two or more incremental rates which provide for a declining rate assessment as the delinquency continues.
- You may also include an overall maximum dollar amount or period of time, or both, during which liquidated damages may be assessed, to ensure that the result is not an unreasonable assessment of liquidated damages.

## 2.2 - Improving Business Terms And Conditions

*Section Introduction.* This section covers the following strategies for selecting clauses and provisions for the solicitation to maximize price competition:

- 2.2.1 - Base The Contract Type On Risk Analysis
- 2.2.2 - Review Applicability Of Socioeconomic Requirements
- 2.2.3 - Match Payment And Finance Terms To Market Conditions
- 2.2.4 - Furnish Government Property
- 2.2.5 - Consider Warranty Requirements
- 2.2.6 - Optimize Price/Technical Tradeoffs

### 2.2.1 - Base The Contract Type On Risk Analysis

*Introduction.* The selection of contract type can have a significant effect on both competition and contract price. See FAR 16.1 for additional information on selecting contract types.

*Two Contract Categories.* Most contract types fit into one of two categories:

- Fixed-Price; or
- Cost-Reimbursement.

The biggest difference between the two is the assignment of risk.

In **fixed-price contracts** , the contractor is required to deliver the product specified and there is a maximum limit on the amount of money the Government must pay.

In **cost-reimbursement contracts** , the contract is required to deliver a "best effort" to provide the specified product. All allowable costs must be reimbursed, regardless of delivery, up to the level specified in the contract.

*Risk, Contract Type, and Price.* Analysis of the risk inherent in the contracting situation is the key element in the selection of an appropriate contract type. The relationship between risk, contract type, and price can be demonstrated by the following examples.

**Examples:**

- Selection of a fixed-price contract when the risks are beyond the contractor's control, as in many development contracts, will increase price and reduce competition.
- Selection of a cost-reimbursement contract when the risks are well within the contractor's control, as in most production contracts, will reduce the contractor's motivation to control costs.

*Commercial Items.* When acquiring commercial items, agencies shall use firm-fixed-price contracts or fixed-price contracts with economic price adjustment for the acquisition of commercial items, except, a time-and-materials contract or labor-hour contract (see Subpart 16.6) may be used for the acquisition of commercial services when specified conditions are met. See FAR 12.207(b) .

*Major Types of Contracts.* The table below presents a comparison of the major contract types.

| Comparison of Major Types of Contracts | | | |
|---|---|---|---|
| | ***Firm Fixed-Price (FFP)*** | ***Indefinite Delivery (ID)*** | ***Fixed-Price Economic Price Adjustm (FPEPA)*** |
| Principal Risk to Be Mitigated | Costs of performance can be estimated with a high degree of confidence. Thus, the contractor assumes the risk. | At time of award, delivery requirements are not certain. | Market prices for required labor and/o materials are likely to be highly unstab over the life of contract. |
| Use When | The requirement is well-defined.<br><br>Commercial item<br><br>Contractors are experienced in the requirement.<br><br>Market conditions are stable.<br><br>Financial risks are otherwise insignificant. | **Definite Quantity:** The required quantity is known and funded at the time of award.<br>**Indefinite Quantity:** The minimum quantity required is known and funded at award.<br>**Requirements:** No commitment on quantity is possible at award. | Commercial item<br><br>The market prices at risk are severable and significant.<br><br>The risk stems from industry-wide contingencies beyond the contractor's control.<br><br>The dollars at risk outweigh the administrative burdens of an FPEPA. |
| Elements | Firm fixed-price for each line item or one or more groupings of line items. | Performance period.<br><br>Ordering activities and delivery points.<br><br>Maximum or minimum limit (if any) on each order.<br><br>Extent of each party's obligation on quantity. | A fixed-price, ceiling on upward adjustment, and a formula for adjustin the price up or down based on:<br><br>Established prices.<br><br>Actual costs of the labor or materials.<br><br>Labor or material indices. |
| Contractor Is Obliged To | Provide an acceptable deliverable at the time, place, and price specified in the contract. | Provide acceptable deliverables at the time and place specified in each order at the per unit price, within any ordering limits established by the contract. | Provide an acceptable deliverable at th time and place specified in the contrac the adjusted price. |
| Contractor Incentive *(Other Than Maximizing Goodwill)* [1] | Generally realizes an additional dollar of profit for every dollar that costs are reduced. | Incentive will depend on the contract pricing arrangement. | Generally realizes an additional dollar profit for every dollar that costs are reduced. |
| A Typical Application | Commercial supplies and services. | Long-term contracts for commercial supplies or support services. | Long-term contracts for commercial supplies during a period of high inflati |
| Principal Limitations<br><br>In FAR Parts 16 , 32 , 35 , and 52 | Generally not appropriate for R&D. Fixed-price arrangements may be used for R&D to the extent that goals, objectives, | May use any appropriate cost or pricing arrangement that complies with FAR Part 16. Multiple awards preferred for most indefinite quantity contract | Must be justified. |

| | | | |
|---|---|---|---|
| | specifications, and cost estimates are sufficient to permit such a preference. But see FAR 35. | items.<br>Single award required for requirements contract items. | |
| Variants | Firm Fixed-Price Level of Effort | Definite quantity, indefinite quantity requirements. | |

| **Comparison of Major Types of Contracts** | | | |
|---|---|---|---|
| | ***Fixed-Price Award Fee(FPAF)*** | ***Fixed-Price Prospective Redetermination (FPPR)*** | ***Fixed-Price Incentive (FPI)*** |
| Principal Risk to Be Mitigated | Acceptance criteria are inherently judgmental, with a corresponding risk that the end user will not be fully satisfied. | Costs of performance can be estimated with confidence only for the first year of performance. | Labor or material requirements for work are moderately uncertain. Hence, the Government assumes part of the risk. |
| Use When | Judgmental standards can be fairly applied. [2] The potential fee is large enough to both:<br><br>Provide a meaningful incentive and<br><br>Justify the administrative burdens of an FPAF. | The Government needs a firm commitment from the contractor to deliver the supplies or services during subsequent years. The dollars at risk outweigh the administrative burdens of an FPRP. | Ceiling price can be established that covers the most probable risks inherent in the nature of the work.<br><br>The proposed profit sharing formula would motivate the contractor to control costs and meet other objectives. |
| Elements | A firm fixed-price<br><br>Fee pool<br><br>Standards for evaluating performance.<br><br>Criteria for determining a "fee" based on performance against the standards. [2] | Fixed price for the first period.<br><br>Proposed subsequent periods (at least 12 months apart).<br><br>Timetable for pricing the next period(s). | Ceiling price<br><br>Target cost<br><br>Target profit<br><br>Delivery, quality, and/or other performance targets (optional)<br><br>Ratio for adjusting profit based on actual costs and/or performance. |
| Contractor Is Obliged To | Perform at the time, place, and the price fixed in the contract. | Provide acceptable deliverables at the time and place specified in the contract at the price established for each period. | Provide an acceptable deliverable at the time and place specified in the contract, at or below the ceiling price. |
| Contractor Incentive *(Other Than Maximizing Goodwill)* [1] | Generally realizes an additional dollar of profit for every dollar that costs are reduced; earns an additional fee for satisfying the performance standards. | For the period of performance, realizes an additional dollar of profit for every dollar that costs are reduced. | Realizes a higher profit by completing the work below the ceiling price and/or by meeting objective performance targets. |
| Principal | Must be negotiated. | Must be negotiated. Contractor | Must be justified. Must be |

| | | | |
|---|---|---|---|
| Limitations In FAR Parts 16 , 32 , 35 , and 52 | | must have an adequate accounting system that supports the pricing periods. Prompt redeterminations. | negotiated. Contractor must have an adequate accounting system. Targets must be supported by the cost data. |
| Variants | | Retroactive Redetermination. | Firm or Successive Targets. |

| **Comparison of Major Types of Contracts** | | | |
|---|---|---|---|
| | ***Cost-Plus-Fixed-Fee (CPFF)*** | ***Cost-Plus-Incentive-Fee (CPIF)*** | ***Cost-Plus-Award-Fee (CPAF)*** |
| Principal Risk to Be Mitigated | Labor hours, labor mix, and/or material requirements (among other things) necessary to perform are highly uncertain and speculative. Hence, the Government assumes the risks inherent in the contract, benefiting if the actual cost is lower than the expected cost; losing if the work cannot be completed within the expected cost of performance. Some cost type contracts include procedures for raising or lowering the fee as an incentive for the contractor to perform at lower cost and/or attain performance goals. | | |
| Use When | Formulas relating fee to performance (e.g. to actual costs) would be unworkable or of marginal utility. | Objective relationship can be established between the fee and such performance measures as actual costs, delivery dates, performance benchmarks, and the like. | Objective incentive targets are not feasible for critical aspects of performance. Judgmental standards can be fairly applied. [2] Potential fee would provide a meaningful incentive. |
| Elements | Estimated cost<br><br>A fixed fee | Target cost<br><br>Performance targets (optional)<br><br>Minimum, maximum, and target fee<br><br>Ratio for adjusting fee based on actual costs and/or performance | Estimated cost<br><br>Standards for evaluating performance<br><br>Base and maximum fees<br><br>Procedures for adjusting "fee" based on performance against the standards [2] |
| Contractor Is Obliged To | Make a good faith effort to meet the Government's needs within the estimated cost in the Schedule. | | |
| Contractor Incentive *(Other Than Maximizing Goodwill)* [1] | Realizes a higher rate of return (i.e., fee divided by total cost) as total cost decreases. [3] | Realizes a higher fee by completing the work at a lower cost and/or by meeting other objective performance targets. | Realizes a higher fee by meeting judgmental performance standards. |
| A Typical Application | Research study. | Research and development of the prototype for a major system. | Large scale research study. |
| Principal Limitation In FAR Parts 16 , 32 , 35 , and | ıst have an adequate accounting system. The Government must exercise surveillance ce to ensure use of efficient methods and cost controls. Must be negotiated. Must be y and regulatory limits on the fees that may be negotiated. Must include the applicable f Cost clause. | | |

| | | |
|---|---|---|
| 52 | | |
| Variants | Completion or Term. | |

| Comparison of Major Types of Contracts | | |
|---|---|---|
| | ***Cost or Cost Sharing (C/CS)*** | ***Time & Materials (T&M)*** |
| Principal Risk to Be Mitigated | Labor hours, labor mix, and/or material requirements (among other things) necessary to perform are highly uncertain and speculative. Hence, the Government assumes the risks inherent in the contract, benefiting if th actual cost is lower than the expected cost; losing if the work cannot be completed within the expected cost performance. | |
| Use When | The contractor expects substantial compensating benefits for absorbing part of the costs and/or foregoing fee, or<br><br>The vendor is a nonprofit entity. | Hourly labor rates can be firmly defined at contract award but hours required to complete the required task cannot. |
| Elements | Estimated cost<br><br>If cost sharing, agreement on the Government's share of the cost<br><br>No fee | Ceiling price<br><br>Per hour labor rate that also covers indirect costs and profit<br><br>Provisions for reimbursing direct material costs and applicable indirect costs. |
| Contractor Is Obliged To | Make a good faith effort to meet the Government's needs within the estimated cost in the Schedule. | Make a good faith effort to meet the Government's needs with the "ceiling price." |
| Contractor Incentive *(Other Than Maximizing Goodwill )* [1] | Cost sharing shares the cost of providing a deliverable of mutual benefit. | Fixed rate and flexible hours to perform a task with unknown elements. |
| A Typical Application | Joint research with educational institutions. | Emergency repairs to heating plants and aircraft engines. |
| Principal Limitations In FAR Parts 16 , 32 , 35 , and 52 | The contractor must have an adequate accounting system. The Government must exercise surveillance during performance to ensure use of efficient methods and cost controls. Must be negotiated. Must be justified. Must include the applicable FAR Limitation of Cost clause. | Contracting officer must determine in writing that no other contract type is suitable. Labor rate must be negotiated and justified. The Government must exercise appropriate surveilla to ensure efficient performance. Contract must include a ceilin price. |
| Variants | | Labor Hour |

**Notes to tables:**

Note 1 - Goodwill being the value of the name, reputation, location and other intangible assets of a firm.

Note 2 - Performance is evaluated by an Award Fee Panel with fee determined by a Fee Determining Official. Fee determinations are not subject to contract disputes provisions.

Note 3 - The CPFF contract is commonly used in situations where the Government is more interested in technical excellence than cost control. However, you must be aware that higher cost does not necessarily equal

technical excellence. Contractors may attempt to shift unnecessary resources to CPFF contracts to control costs on other contracts.

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### 2.2.2 - Review Applicability Of Socioeconomic Requirements

*Introduction.* The Government has established socioeconomic programs to achieve national social and economic goals, but these programs can also limit potential sources. As you implement these programs, always consider the probable effect on competition and contract pricing. See FAR 8 for information on required sources of supply and FAR 19 for information on Small Business Programs.

### 2.2.3 - Match Payment And Finance Terms To Market Conditions

*Introduction.* See FAR 32 for policies and procedures for contract financing and other payment matters. Under cost-reimbursement contracts, contractors are typically reimbursed for costs incurred on a monthly basis. Under fixed-price contracts, payment is made in a lump sum at contract completion unless other financing terms are provided for in the contract. Sometimes, you can attract a greater level of competition and lower-priced offers by providing financing. However the costs of extending such financing must be considered.

*Contractor Financing.* Requiring contractors to fund the entire contract may severely limit competition, particularly with large contracts and long performance periods. Any firm that does submit an offer will probably offer a higher price to cover the cost of working capital. Recognizing the potential effects of required contractor funding on competition and pricing, you may want to consider other financial terms.

However, there are negative aspects to Government funding. Government funds are not free. The Government must also pay interest on borrowed capital. In addition, when the Government provides working capital support, the contractor has both the funds and the product. In the event of contractor default or bankruptcy, the Government may lose both the product and the funds.

*Circumstances for Financing Commercial Items.* In some markets, commercial buyers commonly provide contract financing. You may include appropriate financing terms in contracts for commercial purchases when doing so will be in the best interest of the Government (see FAR 32.202-1 ).

Do not automatically include financing in commercial item contracts. Consider customary commercial financing arrangements as part of your market research. In particular, consider:

- The extent to which other buyers provide contract financing for purchases in that market;
- The overall level of financing normally provided;
- The amount or percentages of any payments equivalent to advance payments;
- The basis for any payments equivalent to commercial interim payments as well as the frequency, and amounts of percentages; and
- Methods of liquidation of contract financing payments and any special or unusual payment terms applicable to delivery payments.

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### 2.2.4 - Furnish Government Property

*Introduction.* Government-furnished property can be used in several ways to encourage competition and assure overall price reasonableness. See FAR 45 for information related to Government Property.

*Description.* The term propertyincludes facilities, material, special tooling, special test equipment, and agency peculiar property. Different types of property can be used to affect competition and pricing.

*Overview of Government Property.* The table below provides an overview of the various types of Government property and how each type can be used to affect competition and pricing.

| **Furnishing Government Property** | | |
|---|---|---|
| **Type of Property** | **Definition** | Competition and Pricing Considerations |
| Facilities ( FAR 45.302 ) | Plant equipment and real property for production, maintenance, research, or testing furnished as Government facilities under situations identified in FAR 45.302. | Making facilities available can significantly increase competition for major production efforts, while eliminating the need for duplicative investment by competitors. |
| Material ( FAR 45.301 ) | Property that may be incorporated into or attached to a deliverable end item or that may be consumed or expended in performing a contract. It includes assemblies, components, parts, raw and processed materials, and small tools and supplies that may be consumed in normal use in performing a contract. | Providing Government material can enhance competition in several situations. Breakout of key components can increase competition and reduce component prices. Furnishing proprietary components can increase effective competition on larger systems. |
| Special Tooling ( FAR 45.101 ) | Jigs, dies, fixtures, molds, patterns, taps, gauges, other equipment and manufacturing aids, components of these, all items, and replacement of these items, which are of such specialized nature that, without substantial modification, or alterations, their use is limited to the development or production of particular supplies or parts thereof, or to particular services. It does not include material, special test equipment, facilities (except foundations and similar improvements necessary for installing special tooling), general or special machine tools, or similar capital items. | Government provision of special tooling increases competition by reducing the need for investment that can only be used on one contract or project. Government ownership and right to move tooling limit producer ability to obtain a lock on the competition because of unique tooling capacity. |
| Special Test Equipment ( FAR 45.101 ) | Single or multipurpose integrated test units engineered, designed, fabricated, or modified to accomplish special purpose testing in performing a contract. It consists of items or assemblies of equipment including standard or general purpose items or components that are interconnected and interdependent so as to become a new functional entity for special testing purposes. It does not include material, special tooling, facilities (except foundations and similar improvements necessary for installing special test equipment), and plant equipment items used for general plant testing purposes. | Like special tooling, Government provision of special test equipment increases competition by reducing the need for investment that can only be used on one contract or project. Government ownership and right to move test equipment limit producer ability to obtain a lock on the competition because of unique tooling capacity. |

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### 2.2.5 - Optimize Price/Technical Trade-Offs

*Technical Factors that Can Reduce Competition.* The factors already considered in this chapter have the greatest effect on competition and contract price. There are, however, many other technical and business factors that can reduce competition and increase prices. These include:

- Security requirements;
- Payment provisions that increase contractor investment;
- Packaging requirements that require survival under extreme conditions;
- Unclear instructions, certifications, and notices to bidders/offerors;
- Unclear source selection criteria; and
- Conflicting and restrictive general contract clauses.

*Technical Factors and Price.* Technical factors could invite offerors to submit higher prices as the tradeoff for a technically superior offer. Key questions to ask regarding proposed technical evaluation factors:

- Will the technical evaluation factor unnecessarily force the acquisition into a higher-priced market segment?
- Will the technical factor constructively amend the specifications to require more than the Government's actual minimum needs?
- Given the likely effect on contract price, is the factor truly necessary to minimize the technical or business risks inherent in the contract requirements?
- Will use of the technical factor likely result in a "greater value" for the taxpayer?
- Are technical factors clear such that offerors understand the Government's priorities and how offerors will be evaluated in accordance with these priorities?

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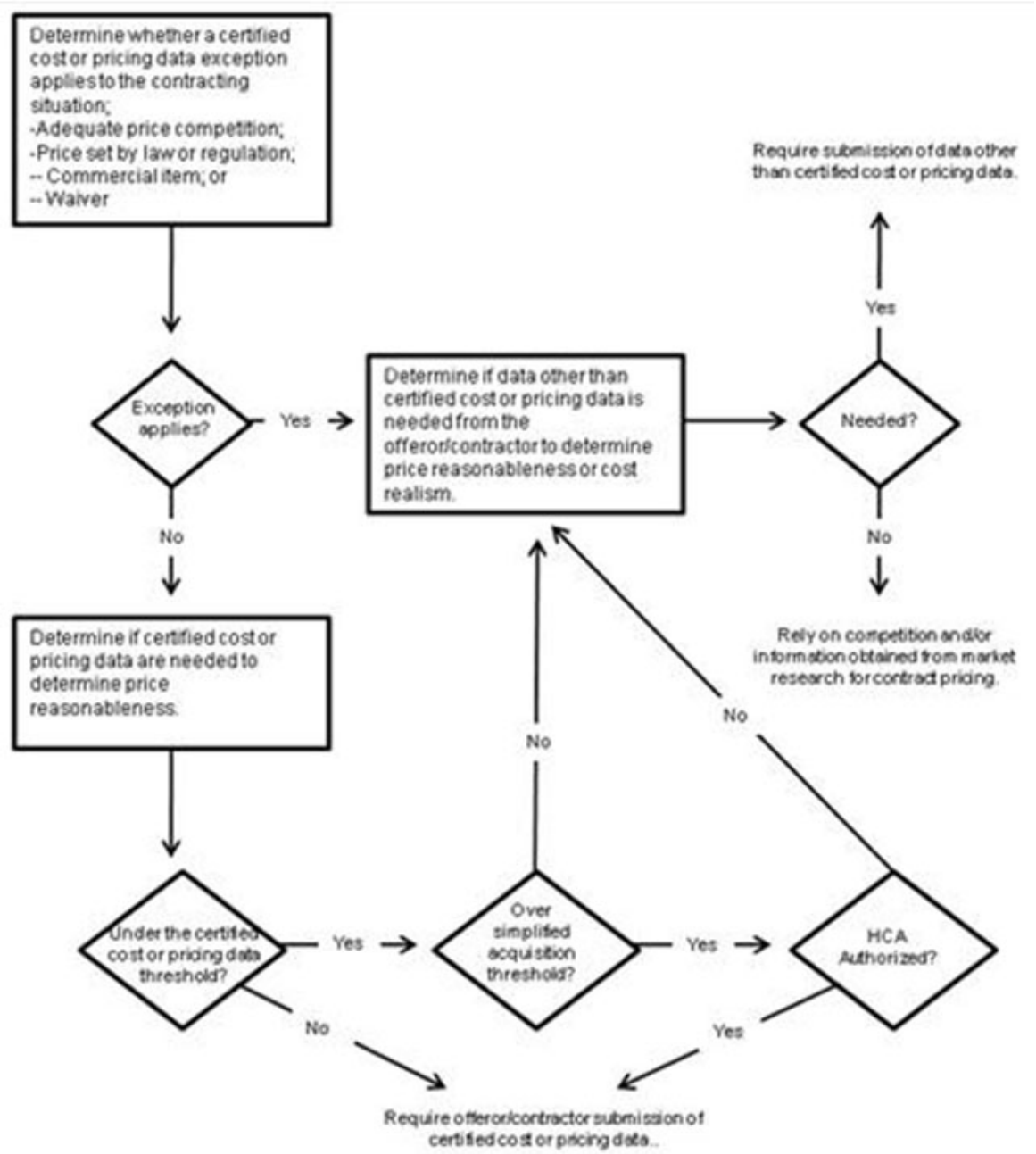
## 3.0 - Chapter Introduction

This chapter covers the steps you will take to determine what data will be needed from offerors to support the pricing decision.

The policies described in this chapter for obtaining and evaluating certified cost or pricing data or data other than certified cost or pricing data from offerors apply only to acquisition by negotiation including those below the Simplified Acquisition Threshold acquired using FAR 13 and those including commercial items acquired using FAR 12.

NEVER require offerors to submit certified cost or pricing data or data other than certified cost or pricing data with sealed bids. For sealed bidding, you may only require bidders to submit original worksheets and other data used in bid preparation when there is an alleged mistake in bid ( FAR 14.407-3(g)(2) ).

Flow Chart of the Decision Process. This flow chart outlines the decision process that you should follow to determine what (if any) information to require from offerors/contractors.



Cost or Pricing Data ( FAR 2.101 ). Cost or pricing data:

- Are all facts that, as of the date of price agreement or, if applicable, another date agreed upon between the parties that is as close as practicable to the date of agreement on price, prudent buyers and sellers would reasonably expect to affect price negotiations significantly.
- Are factual, not judgmental, and are therefore verifiable.
- Include the data that form the basis for the prospective offeror's judgment about future cost projections. The data do not indicate the accuracy of the prospective contractor's judgment.
- Are more than historical accounting data. They are all the facts that can be reasonably expected to contribute to the soundness of estimates of future costs and to the validity of determinations of costs already incurred.
- Include such factors as:
    - Vendor quotations;
    - Nonrecurring costs;
    - Information on changes in production methods and in production or purchasing volume;
    - Data supporting projections of business prospects and objectives and related operations costs;
    - Unit-cost trends such as those associated with labor efficiency;
    - Make-or-buy decisions;
    - Estimated resources to attain business goals; and
    - Information on management decisions that could have a significant bearing on costs.

Certified Cost or Pricing Data ( FAR 2.101 ). Certified cost or pricing data:

- Are cost and pricing data that were required to be submitted in accordance with FAR 15.403-4 and 15.403-5 and have been certified, or are required to be certified, in accordance with FAR 15.406-2 . This certification states that, to the best of the person's knowledge and belief, the cost or pricing data are accurate, complete, and current as of a date certain before contract award.

Data Other Than Certified Cost or Pricing Data ( FAR 2.101 ). Data other than certified cost or pricing data:

- Are pricing data, cost data and judgmental information necessary for the contracting officer to determine a fair and reasonable price or to determine cost realism that are not required to be certified as accurate, complete, and current, in accordance with FAR 15.406-2 .
- May include sales data and any data reasonably required to explain the offerors estimating process including but not limited to
    - The Judgmental factors applied and the mathematical or other methods used in the estimate, including those used in projecting from known data; and
    - The nature and amount of any contingencies included in the proposed price.
- Includes "cost or pricing data" but for which certification is not required.

Order of Preference for Information ( FAR 15.402 ). The contracting officer must obtain the minimum amount of information required to allow an adequate determination that a contract price is fair and reasonable. To the extent that certified cost or pricing data are not required by FAR 15.403-4 , the contracting officer must generally use the following order of preference in determining the type of information required:

(1) No additional data from the offeror, if the price is based on adequate price competition, except as provided by FAR 15.403-3(b ).

- You may require offerors to submit data other than certified cost or pricing data to determine the cost realism of competing offers or to evaluate competitive approaches.

(2) Data other than certified cost or pricing data:

(i) Data related to prices (e.g., established catalog or market prices or sales to governmental and non-governmental entities), relying:

(a) First on data available within the Government. For example, data in existing contract files for previous buys, data from market research, etc. Second, on data obtained from sources other than the offeror. For example, data from catalogs, vendor price lists, etc. If necessary, on data obtained from the offeror. When obtaining data from the offeror is necessary, unless an exception under FAR 15.403-1(b)(1) or (2) applies, such data submitted by the offeror shall include, at a minimum, appropriate data on the prices at which the same or similar items have been sold previously, adequate for evaluating the reasonableness of the price. For example, Government and non-Government sales data for the same item in similar quantities, company catalogs, discounts, etc.

(ii) Data related to cost (hours by labor category and direct and indirect rates, or possibly full cost data where absolutely necessary). Because the pricing action is exempt from TINA, the contractor would not be required to sign a certificate of current cost or pricing data.

(3) Cost or Pricing Data. The contracting officer should use every means available to ascertain whether a fair and reasonable price can be determined before requesting cost or pricing data. Contracting officers must not require unnecessarily the submission of cost or pricing data, because it leads to increased proposal preparation costs, generally extends acquisition lead time, and consumes additional contractor and Government resources.

Remember, this paragraph applies to actions when certified cost or pricing data are not required by 15.403-4 .

Rationale: When certified cost or pricing data are not otherwise required by FAR 15.403-4 , FAR 15.403-4(a)(2) provides that, unless prohibited because an exception at FAR 15.403-1(b) applies, the head of the contracting activity, without power of delegation, may authorize the contracting officer to obtain certified cost or pricing data for pricing actions below the pertinent threshold in FAR 15.403-4(a)(1) , provided the action exceeds the simplified acquisition threshold, because without certified cost or pricing data, there is no other means to determine price reasonableness. These should be rare circumstances.

EXAMPLE: A contractor has proposed to provide aircraft repair for $680,000, just under the TINA threshold. Based on technical input and market research the contracting officer does not think the subject repairs should be so costly, and the independent government cost estimate estimates the work at approximately $380,000. The contracting officer has no way to evaluate the reasonableness of the price without certified cost or pricing data. Because of the sensitivity of the program for which the solicitation was issued, the very tight budget constraints, and the fact that this is a sole source provider of this type of repair that has overcharged the government in the past, the contracting officer obtains the Head of the Contracting Activity's approval to require "Certified Cost or Pricing Data," obtains field pricing assistance in evaluating the certified cost or pricing data and requires a certificate of current cost or pricing data.

Solicitation Price-Related Information Requirements ( FAR 15.403-5 and FAR 15.408(l) and (m)).

<u>You may require offerors to submit pricing-related data at any time prior to the close of negotiations. However, identifying all requirements in the solicitation will permit offerors to gather and document the required data during proposal preparation. If you require data after proposals are received, the contracting process must be delayed while the offeror gathers and documents the data required.</u>

The solicitation must specify:

- Whether certified cost or pricing data are required;
- That, when certified cost or pricing data are required, the offeror may submit a request for exception from the requirement to submit certified cost or pricing data;
- Whether data other than certified cost or pricing data is required;
- Necessary preaward or post award access to the offeror's records;
- The format required for submission of certified cost or pricing data or data other than certified cost or pricing data (the FAR Table 15-2 format, a specified alternate format, or a format selected by the offeror).

Price-Related Data Requirements After Receipt of Offers ( FAR 15.403-4(c) ). Decisions on pricing-related information requirements continue after proposals are received:

- If offerors were required to submit certified cost or pricing data and:
  - An offeror submitted the data, but the contracting officer later finds that an exception applies, never require the offeror to certify that the data are accurate, complete, and current. Instead treat the data as data other than certified cost or pricing data.
  - No exception applies, but an offeror initially refuses to provide the required data, or the data provided are so deficient as to preclude adequate analysis and evaluation, the contracting officer must again attempt to obtain the data. If the offeror persists in refusing to provide the needed data, the contracting officer must withhold contract award or price adjustment and refer the contract action to higher authority, with details of the attempts made to resolve the matter and a statement on the practicality of obtaining the supplies or services from another source.
- If offerors are not required to submit certified cost or pricing data and the contracting officer later determines that the data are necessary, the contracting officer should require the offeror to submit the required data prior to the close of contract negotiations.
- If the Government does not require submission of certified cost or pricing data or data other than certified cost or pricing data, but the contracting officer later determines that data other than certified cost or pricing data are needed from the offeror to determine price reasonableness, the contracting officer should require the offeror to submit the necessary data prior to the close of contract negotiations.

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## 3.1 - Cost or Pricing Data

Decision Process for Requiring Cost or Pricing Data ( FAR 15.402(a)(3) , FAR 15.403-1(b) , and FAR 15.403-4(a) ). The Truth in Negotiations Act (TINA) requires that you obtain certified cost or pricing data in specific contracting situations, described in this section. However, the Act also provides exceptions to that requirement, also described in the next section. Never require an offeror to submit certified cost or pricing data unless the contracting officer concludes that none of the exceptions to the certified cost or pricing data requirement are appropriate. This refers to requesting "certified cost or pricing data," meaning that which is certified to be accurate, current and complete. The contracting officer can always obtain "data other than certified cost or pricing data," as defined at FAR 2.101 , to the extent the data is needed to determine fair and reasonable prices. Although the same type of pricing or cost data may be obtained, when required, the difference is that under "data other than certified cost or pricing data" certification of the data is not required.

Because you must consider the exceptions before requiring certified cost or pricing data, the decision to require certified cost or pricing data is the last determination in the flow chart presented at the beginning of this chapter. However, in the chapter, we present this section first to identify the general requirement from which contracting officers should consider possible exceptions.

Situations Requiring Certified Cost or Pricing Data ( FAR 15.403-4(a) ). When no exception is appropriate, obtain certified cost or pricing data before accomplishing any of the following actions when the price is expected to exceed the certified cost or pricing data threshold:

- The award of any negotiated contract (except for undefinitized actions such as letter contracts).
- The award of a subcontract at any tier, if the contractor and each higher-tier subcontractor were required to furnish certified cost or pricing data.
- The modification of any sealed bid or negotiated contract (whether or not cost or pricing data were initially required). This requirement also applies to subcontracts if the contractor and each higher-tier subcontract have been required to furnish cost or pricing data (but see waivers at 15.403-1 (c)(4) ).
    - When deciding whether certified cost or pricing data are required, sum the value of related increases and decreases in contract requirements. For example, a $200,000 modification resulting from a reduction of $500,000 and an increase of $300,000 is an $800,000 price adjustment when determining the need for certified cost or pricing data.
    - Do not sum the value of unrelated and separately priced changes for which certified cost or pricing data would not otherwise be required. Such changes may be included in the same contract modification for administrative convenience.

Contract Certified Cost or Pricing Data Threshold. For a new contract, the applicable certified cost or pricing data threshold is the threshold that is in effect on the date of agreement on price, or the date of award, whichever is later. The certified cost or pricing data threshold is contained in FAR 15.403-4(a)(1) . The amount is subject to review and possible adjustment every five years.

Subcontract And Modification Certified Cost or Pricing Data Threshold. For prime contract modifications, new subcontracts at any tier, and subcontract modifications, the applicable certified cost or pricing data threshold is established by the prime contract.

- For most contracts, the applicable certified cost or pricing data threshold is the current threshold on the date of agreement on price, or the date of award, whichever is later.
- Some older contracts specify a dollar threshold that does not automatically change as the current threshold changes. However, a specific dollar threshold can be updated using a bilateral contract modification.

HCA-Approved Certified Cost or Pricing Data Below the Threshold ( FAR 2.101 , FAR 15.403-1 , and FAR 15.403-4(a)(2) ). The contracting officer may require certified cost or pricing data submission at or below the certified cost or pricing data threshold, but only if all three of the following requirements are met:

- The estimated value of the contract action exceeds the simplified acquisition threshold.
    - The simplified acquisition threshold for most noncommercial acquisitions is currently $150,000.
    - For contracts awarded and performed, or purchases to be made, outside the United States in support of contingency operations, the simplified acquisition threshold is $1,000,000.
    - For contracts awarded and performed, or purchases to be made, inside the United States in support of contingency operations, the simplified acquisition threshold is $300,000.
    - See the definition for Simplified Acquisition Threshold at FAR 2.101 for the current thresholds.
- No exception to obtaining certified cost or pricing data applies. (For example, never require certified cost or pricing data when contracting for a commercial item.)

- The head of the contracting activity (without power of delegation) authorizes the certified cost or pricing data requirement.
    - The head of the contracting activity must justify the certified cost or pricing data requirement.
    - File documentation must include a written finding that certified cost or pricing data are necessary to determine whether an offered price is fair and reasonable and the facts supporting that finding.

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## 3.2 - Cost or Pricing Data Exceptions

Section Introduction. This section will present a brief review of points to consider in determining whether an exception applies to certified cost or pricing data requirements. Topics that will be covered include:

- 3.2.1 - Adequate Price Competition Exception
- 3.2.2 - Price Set By Law Or Regulation Exception
- 3.2.3 - Commercial Item Exception
- 3.2.4 - Waiver Exception

General Guidelines on Exceptions ( FAR 15.403-4(a) ). Never require certified cost or pricing data when an exception to certified cost or pricing data requirements applies. In determining whether a specific exception applies, consider the conditions for granting that exception and the special issues associated with granting that exception. Keep in mind, however, that the contracting officer can obtain "data other than certified cost or pricing data," which could include full cost supporting data, to the extent that the data is required in order to determine that prices are fair and reasonable. In the case of "data other than certified cost or pricing data," certification of the data is not required.

Contract Options ( FAR 15.403-2(a) ). Never require certified cost or pricing data when exercising an option at the price established at contract/subcontract award or initial contract/subcontract negotiation.

Funding Adjustments ( FAR 15.403-2(b) ). Never require certified cost or pricing data for proposals used solely for overrun funding or interim billing price adjustments.

Actions at or Below the Certified Cost or Pricing Data Threshold. ( FAR 15.403-4(a)(2) ) Never require certified cost or pricing data for contract or subcontract actions priced at or below the certified cost or pricing data threshold unless the requirement is authorized by the head of the contracting activity in accordance with FAR 15.403-4(a)(2).

Never require certified cost or pricing data for contract or subcontract actions priced at or below the simplified acquisition threshold FAR 15.403-1(a) .

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### 3.2.1 Adequate Price Competition Exception

The contracting officer should keep in mind that, competition can exist and not be adequate; or can be "adequate" but not truly effective and hence not be adequate. The Government is seeking adequate & effective competition.

Conditions for New Contract or Subcontract Exception ( FAR 15.403-1(b)(1) and FAR 15.403-1(c)(1)) . Never require certified cost or pricing data when the contracting officer determines that the agreed-upon prices are based on adequate price competition. A price is based on adequate price competition if:

- Two or more responsible offerors, competing independently, submit priced offers that satisfy the Government's expressed requirement and both of the following conditions are met:
    - Award will be made to the offeror whose proposal represents the best value to the Government where price is a substantial factor in the source selection;
    - There is no finding that the price of the otherwise successful offeror is unreasonable. Any finding that a proposed price is unreasonable must be supported by a statement of the facts and approved at a level above the contracting officer;
- Per USD AT&L memorandum dated 24 Nov 2010 re: Improving Competition in Defense Procurements , contracting officers will no longer use the standard at FAR 15.403-1(c)(ii)or (iii) to determine that the offered price is based on adequate competition when only one offer is received.
    - If a solicitation was open for less than 30 days and only one offer was received, the contracting officer shall re-advertise the solicitation for a minimum of an additional 30 days, unless a waiver is obtained from the head of the contracting activity. Further, if the solicitation was open for at least 30 days, or has been re-advertised and still only one offer is received, the contracting officer shall conduct negotiations with the offeror unless this requirement is specifically waived by the head of the contracting activity. The basis for these negotiations shall be either certified cost or pricing data or data other than certified cost or pricing data, as appropriate. In no event, should the negotiated price exceed the price originally offered.

Certified Cost or pricing data when modifying a contract ( FAR 52.215-21(a)(ii) ).

Never require certified cost or pricing data for a modification of a contract or subcontract for a commercial item if:

- The original contract or subcontract was granted an exception from certified cost or pricing data requirements because:
    - The price agreed upon was based on adequate price competition or prices set by law or regulation, or
    - The contract or subcontract was for a commercial item; and
- The modification would not change the contract or subcontract from a contract or subcontract for acquisition of a commercial item to a contract or subcontract for acquisition of an item other than a commercial item.

To have adequate price competition, price must be a substantial factor in the contract award decision, but neither the FAR nor the law define what weight price must have to be considered a substantial factor.

- In general, the weight assigned must be large enough to cause offerors to seriously consider price in preparing their offers.
- The Comptroller General (CGEN) has found adequate price competition in cases where price was assigned a weight of only 20 percent in the award decision. However, price is usually assigned a weight that is higher than 20 percent.

Recent Competition. The FAR does not provide any guidelines on how recent competition must be to be considered as a basis for excepting an offeror from submitting certified cost or pricing data. The term "recent" must be judged subjectively.

- The price must be recent enough to use as a basis for determining price reasonableness.
- Normally, competition is considered recent if it took place within the last 12 months.
- However, be careful.
    - Before you except an offeror from submission of certified cost or pricing data based on recent competition, examine the market to see how market conditions have changed since the last competitive acquisition.
    - If the product market is extremely volatile, a price that is only a few months old may not be recent enough to use as a basis for determining price reasonableness.

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### 3.2.2 Price Set By Law or Regulation Exception

Conditions for Exception ( FAR 15.403-1(b)(2) , FAR 15.403-1(c)(2) , and FAR 52.215-21(a)(1) ). Never require certified cost or pricing data for a new contract, new subcontract, or a contract or subcontract modification when the contracting officer determines that the agreed-upon prices are based on prices set by law or regulation. Pronouncements in the form of periodic rulings, reviews, or similar actions of a governmental body, or embodied in the laws, are sufficient to set a price.

Applicable Items. To apply this exception, the price of the item that you are acquiring must be set by law or regulation. You are not permitted to use this exception for items similar to those priced by law or regulation.

Request for Exception ( FAR 52.215-20(a)(1) and FAR 52.215-21(a)(1) ). When a solicitation or contract clause requires submission of certified cost or pricing data, an offeror/contractor may request an exception using prices set by law or regulation. The request for exception must (as a minimum):

- Identify the law or regulation that establishes the price offered.
- Include a copy of any periodic ruling, review, or similar action of a governmental body used to establish the offered price, unless it was previously submitted to the contracting office.

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### 3.2.3 Commercial Item Exception

Conditions for Exception ( FAR 15.403-1(b)(3), FAR 15.403-1(b)(5), and FAR 15.403-1(c)(3) ). Never require certified cost or pricing data for a new contract, new subcontract, or contract or subcontract modification when you are acquiring a commercial item.

- Any acquisition for an item that meets the FAR definition of a commercial item is excepted from certified cost or pricing data requirements.
- Any contract modification that does not change the item from a commercial item to a noncommercial item is also excepted from certified cost or pricing data requirements.

Commercial Item Identification The definition of a commercial item is found at ( FAR 2.101 ).

The concept behind the commercial items pricing exception is that the item, its value, and its price are results of product & pricing supply and demand, disciplined by the commercial marketplace where buyers and sellers have other commercial alternatives which compete with the commercial item(s) being procured.

In some situations when a commercial item is to be modified as a part of the contract, and the modification fits the minor modification portion of the commercial item definition, the cost/price related to that modification of the commercial item is not excepted from the TINA requirement to obtain certified cost or pricing data. The cost/price related to the basic commercial item is excepted. These situations are addressed in FAR 15.403-1(c)(3)(ii). For acquisitions funded by DoD, NASA, or Coast Guard, such modifications of a commercial item are exempt from the requirement for submission of certified cost or pricing data provided the total price of all such modifications under a particular contract action does not exceed the greater of the threshold for obtaining certified cost and pricing data in 15.403-4 or 5 percent of the total price of the contract at the time of contract award.

*Request for Exception* ( FAR 52.215-20(a)(1) and FAR 52.215-21(a)(1) ). When a solicitation or contract clause requires submission of certified cost or pricing data, a firm may request a commercial item exception. At a minimum, the request for exception must include information on prices at which the same or similar items have previously been sold in the commercial market that is adequate for evaluating the reasonableness of the current acquisition price.

- For catalog items, the firm should include:
  - A copy of or identification of the catalog and its date, or the appropriate pages for the offered items, or a statement that the catalog is on file in the buying office to which the proposal is being submitted;
  - A copy or description of current discount policies and price lists (published or unpublished) (e.g., wholesale, original equipment manufacturer, or reseller); or
  - An explanation of the basis of each offered price and its relationship to the established catalog price, including how the proposed price relates to the price of recent sales in quantities similar to the proposed quantities.
- For market-priced items, the firm should include:
  - The source and date or period of the market quotation or other basis for market price, the base amount, and applicable discounts; and
  - A description of the nature of the market.
- For items included on an active Federal Supply Service Multiple-Award Schedule contract, the firm should include proof that an exception has been granted for the schedule item.

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### 3.2.4 Waiver Exception

*Conditions for Exception* ( FAR 15.403-1(b)(4) and FAR 15.403-1(c)(4) ). Never require certified cost or pricing data for a new contract, new subcontract, or contract or subcontract modification when the head of the contracting activity waives the requirement for certified cost or pricing data.

- The authorization for the waiver and the supporting rationale must be in writing.
- The head of the contracting activity (without power of delegation) may consider waiving the certified cost or pricing data requirement in exceptional cases ( see FAR 15.403-1(c)(4) ). DoD contracting activities must follow more stringent criteria for granting of exceptional case TINA waivers. Section 817 of Public Law 107-314 (NDAA 2003) established the criteria that must be met in order for DoD to grant a TINA waiver under the exceptional circumstances exception (See DFARS 215.403-1(c)(4) ). The criteria are:
    1. The property or services cannot reasonably be obtained under the contract, subcontract, or modification, without the granting of the waiver;
    2. The price can be determined to be fair and reasonable without the submission of certified cost or pricing data; and
    3. There are demonstrated benefits to granting the waiver.

It is DoD policy to apply this waiver authority only to situations where the Government could not otherwise obtain the needed product or service without the waiver. An example would be when a commercial business segment offers a non-commercial item that is essential to DoD's mission but is not available from other sources, and the company refuses to accept the TINA requirements. In such cases, a TINA waiver may be granted, provided the price can be determined fair and reasonable without submission of the certified cost and pricing data. However, in such cases, the procuring activity shall also develop a strategy for procuring the item in the future (e.g., develop a second source, develop an alternative product that satisfies the department's needs, have the Government produce the product, continue to use this source with a TINA waiver because the business case does not support any other alternative).

It is important for DoD to apply the TINA waiver authority in a judicious manner. For example, TINA waivers should not be granted to contractor business segments that normally perform Government contracts subject to TINA. In addition, a waiver should not be granted simply because the waiver could allow the parties to execute the contract at an earlier date than if TINA was applied.

*Special Issue for Waivers* ( FAR 15.403-1(c)(4) ). For all other exceptions to certified cost or pricing data requirements, granting the exception to a prime contractor or higher-tier subcontractor means that lower-tier subcontractors are also excepted from submitting certified cost or pricing data.

Under the waiver of certified cost or pricing data requirements, the contractor or higher-tier subcontractor to whom the waiver applies must be considered as having been required to submit certified cost or pricing data. Consequently, lower-tier subcontract actions that are expected to exceed the certified cost or pricing data threshold require the submission of certified cost or pricing data unless:

- An exception otherwise applies to the lower-tier subcontract; or
- The prime contract waiver specifically includes the subcontract and the rationale supporting the waiver for that subcontract.

## 3.3 Data Other Than Certified Cost or Pricing Data

*Policy on Requiring Data Other Than Certified Cost or Pricing Data* ( FAR 15.403-3 ). The contracting officer is responsible for obtaining data other than certified cost or pricing data to the extent necessary to determine price reasonableness or cost realism. See the definition of "data other than certified cost or pricing data" at FAR 2.101 , and in section 3.0 above.

- When certified cost or pricing data are required, contractors are required to use the format in FAR 15.408, Table 15-2.
- When the pricing action is not subject to TINA and the contracting officer has no other means for determining price reasonableness, data other than certified cost or pricing data may be required. The contracting officer must determine the amount and format of additional data that will be needed in order to determine price reasonableness. To the maximum extent practicable, limit the requirement to data in a form regularly maintained by the offeror in commercial operations.
- Read the referenced definition of data other than certified cost or pricing data carefully. Although we want to limit requests for data to only that which is necessary to determine fair and reasonable prices, there is virtually no limit on the type of data the contracting officer can require. The type of data that may be required include: prior sales; catalog pricing and discounts; limited cost data such as: hours by labor category and direct and indirect rates, or possibly full cost data where absolutely necessary. Because the pricing action is exempt from TINA, the contractor would not be required to sign a certificate of current cost or pricing data.
- The key differences between "certified cost or pricing data" and "data other than certified cost or pricing data" is that "certified cost or pricing data" requires the contractor to also submit a Certificate of Current Cost or Pricing Data and requires the use of Table 15.2 ( FAR 15.408 ). On the other hand, "data other than certified cost or pricing data," although it could be made up of the same data, does not require a Certificate of Current Cost or Pricing Data and does not require submission of data in the format at Table 15.2. Also, while under TINA requirements the offeror/contractor is required to disclose all facts that a prudent buyer or seller would expect to have a significant impact on price, under "data other than certified cost or pricing data" the contracting officer may only require limited cost information from the offeror/contractor.
- Generally, you should not require firms to submit data other than certified cost or pricing data when there is adequate price competition.
    - If you need additional information to determine price reasonableness, to the maximum extent practicable, the contracting officer must obtain the necessary information from sources other than the offeror.
    - However, the contracting officer may require data other than certified cost or pricing data to determine the cost realism of competing offers or to evaluate competing approaches.
- Unless price reasonableness will be determined by adequate price competition or a price set by law or regulation, obtain (as a minimum) appropriate information on prices at which the same item or similar items have previously been sold that is adequate for determining price reasonableness.
- For commercial items:
    - Limit requests for sales information to data for the same or similar items during a relevant time period. **When using sales information for similar items, the contracting officer may also request cost information to help determine the impact, on price, of the differences between the item being procured and the similar item being used for comparison.**
    - To the maximum extent practicable, limit the requirement to information in a form regularly maintained by the offeror in commercial operations.
- As specified in FAR 15.403-3(a)(4) (Section 808 of Public Law 105-261), an offeror who does not comply with a requirement to submit data that the contracting officer has deemed necessary to determine price reasonableness or cost realism is ineligible for award unless the Head of the Contracting Activity

determines that it is in the best interest of the Government to make the award to that offeror, based on consideration of the following:
    - The effort made to obtain the data.
    - The need for the item or service.
    - Increased cost or significant harm to the Government if award is not made.
- Contractor refusals to submit requested information, and all actions taken by the contracting officer and at levels above the contracting officer to address those refusals, must be fully documented.

*Price Data Other Than Certified Cost or Pricing Data* . The contracting officer may require the offeror/contractor to provide price data under the requirements of "data other than certified cost or pricing data." Price data will be particularly important for commercial items purchased noncompetitively.

| **Price Data Other Than Certified Cost or Pricing Data** | | |
|---|---|---|
| **Information Element** | **Consider Requiring Offerors/Contractors To...** | **Related Analysis Questions** |
| Catalog pricing | Identify any relevant offeror commercial catalog, its date, catalog prices, and related discounts. Also require the offeror/contractor to explain any differences between the offered price, the established catalog price, and price of recent sales in quantities similar to the proposed quantities. | Does the firm have a commercial catalog price?<br><br>How do the prices for recent commercial sales compare with the catalog price?<br><br>How does the price offered compare to the catalog price and the circumstances of the commercial sales? |
| Market pricing | Describe the nature of the relevant market and how that market affects the offered price including the source and date or period of any relevant market quotation or other basis for market price, the base market price, and applicable discounts or other price adjustments. | Is there a commercial market for the item?<br><br>Is there an independent and verifiable record of the market price?<br><br>How does the price offered compare to the market price and the circumstances of the commercial sales? |
| Other evidence of prices charged | Provide evidence of prices charged other customers under similar circumstances. For example, the firm could provide copies of contracts with other customers to document the prices charged. | Can the offeror provide evidence of the prices paid by commercial customers?<br><br>Do commercial customers verify the prices paid?<br><br>How does the price offered compare with the prices paid by other customers under similar circumstances? |
| Services | Describe the services provided by the | What services are provided other |

| | | |
|---|---|---|
| normally provided | offeror/contract to the firm's buying at the prices provided as bases for price analysis. Different firms and industries provide different levels of support services for their products, including product warranties, set-up, and financing. | customers?<br><br>Based on services provided, should the Government price be different than the price charged commercial customers? |
| Normal order size | Document the normal order size for firms paying prices provided by the offeror/contractor as bases for price analysis. Prices may relate to the total size of each order, not just the price of the item involved. For example, an order could include 100 units of the item and nothing else, or the order could include 100 units of the item and thousands of units of other items. Presumably, the larger order should merit a lower price. | What was the total dollar value of orders with other customers? Based on the relative order size, should the Government price be different than the price charged other customers? |
| Annual Volume of Sales to Similar Customers | Document the sales volume to similar customers and the prices paid by those customers. For example, commercial firms often negotiate total volume discounts with major customers, over and above normal order quantity discounts. In comparing total volume of purchases, you should normally consider known acquisitions from all Government activities as a group. | Under similar circumstances, does the firm sell at lower prices to firms with larger total annual purchases?<br><br>What prices are charged other customers with total annual purchases similar to that of the Government? |
| Lowest Price Charged Other Customers | Document the lowest prices recently charged other customers for the same or similar products. The Government procurement may not this most favored customer treatment, however this information will provide useful information on the lowest prices paid by any customer under any circumstances. What is recent will vary based on the type of item and the market. Generally, it will vary from three months to a year. | What is the lowest recent price paid for the same or similar product?<br><br>How do the circumstances of the Government procurement differ from the circumstances of the lowest priced sale? |

*Cost Data Other Than Certified Cost or Pricing Data* . You may require an offeror/contractor to provide cost data under the requirements of "data other than certified cost or pricing data" to support your analysis of price reasonableness or cost realism. The table below examines situations in which additional cost data under "data other than certified cost or pricing data" might be needed. Examples of the type of questions that cost data could help answer are also provided. Government technical, field pricing, and audit assistance may be required to analyze the cost information and answer related questions.

| **Contracting Situation** | **Analysis Purpose** | **Analysis Questions** |
|---|---|---|
| You expect a single offer at or below the certified cost or pricing data threshold, and you do not expect to be able to determine price reasonableness using price analysis alone. | Support determination of price reasonableness | Does the proposed price appear reasonable based on its relationship with estimated costs? |
| You expect a single offer greater than the cost or pricing data threshold that will be excepted from cost or pricing data requirements, but you do not expect to be able to determine price | | |

| | | |
|---|---|---|
| reasonableness using price analysis alone. | | |
| You expect competitive offers, but because of technical differences, you do not expect to be able to determine price reasonableness using price analysis alone. | | |
| You find that there are too few or outdated sales of commercial item to use as a basis for price analysis and cost analysis is the only reasonable method for determining price reasonableness. | | |
| You expect competitive offers for a cost-reimbursement contract. | Cost realism analysis to determine probable final cost to the Government. | Are proposed costs realistic for the work to be performed? |
| You expect competitive offers for a fixed-price contract, but new requirements may not be understood by all offerors. | Cost realism analysis to determine an offeror understands all contract requirements. | Do proposed costs reflect a clear understanding of contract requirements? |
| You expect competitive offers for a fixed-price contract, but you have concerns about the performance quality that will result from each offeror's proposal. | Cost realism analysis to determine an offeror's ability to deliver proposed quality at the proposed price. | Are proposed costs consistent with the offeror's technical proposal? |
| You expect competitive offers for a fixed-price contract, but market analysis leads you to believe that some offerors may propose unrealistic prices that would jeopardize contract performance. | Cost realism analysis to determine an offeror's ability to meet all contract requirements at the proposed price. | Do proposed costs reflect a clear understanding of contract requirements? |

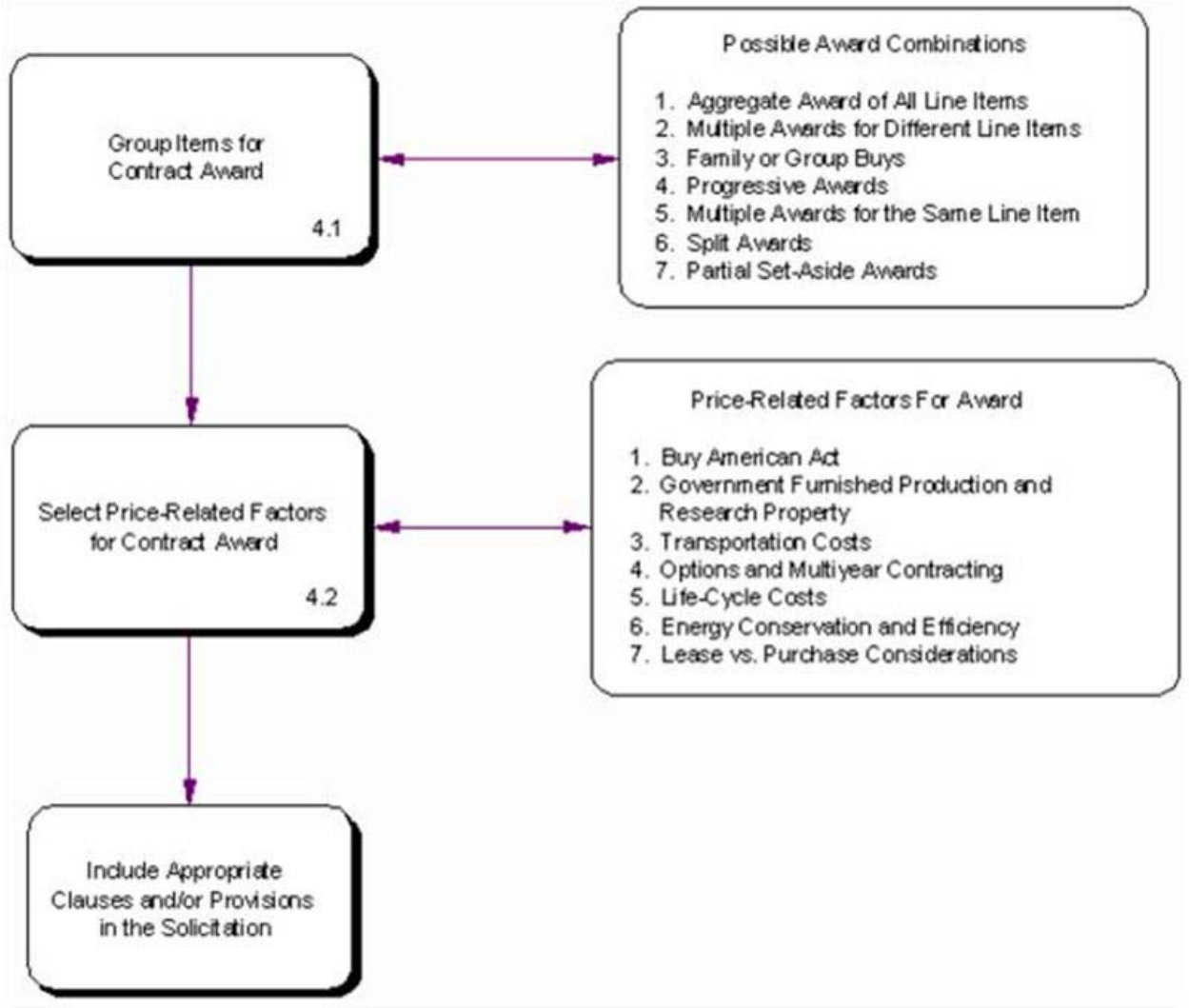
*Information Requirement* ( FAR 15.403-3(a) , FAR 15.408(l), FAR 15.408(m) , FAR 52.215-20 , and FAR 52.215-21 ).

The solicitation/contract must specify the data and the format required:

- Tailor the requirement to the data essential for your analysis (e.g., do not require cost data if price data is adequate).
- Permit the firm to select the format for submitting the data unless the contracting officer determines that use of a specific format is essential.
- Ensure that the data used to support price negotiations is sufficiently current to permit negotiation of a fair and reasonable price.
- Limit requests for updated offeror/contractor data to data that affects the adequacy of the proposal for negotiations (e.g., changes in price lists).
- Never require a certificate of current cost or pricing data for any data other than certified cost or pricing data.

## 4.0 Chapter Introduction

*Criteria Development Process* . The figure below depicts the sequence of events or steps that you should follow in developing contract award criteria for contract pricing.



*Identify Most Advantageous Award Strategy* . As you prepare any solicitation, you must clearly define the groupings and possible award combinations that will be considered in evaluating offers for contract award. When you solicit offers to provide one unit of a single product, only one firm can receive a contract award to provide that unit. However, as the number of different items and the number of units of each item increase, the number of award possibilities also increases. Theoretically, the award possibilities could become almost infinite.

There is no one method of grouping items for contract award that will always result in effective competition and reasonable prices. However, each method described in this chapter can improve competition and lower prices when used in the appropriate acquisition situation.

As you decide which method to use in a particular acquisition situation, consider both the product that you are acquiring and the potential offerors. Use market research to learn about the customary practices used by Government and industry.

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## 4.1 Aggregate Award Of All Line Items To One Contractor

*Aggregate Awards* . The table below presents descriptions and pricing considerations for making aggregate awards.

| **Aggregate Awards** | |
|---|---|
| **Description** | **Use When...** |
| Award to the single responsible offeror whose offer provides the best value to the Government. | Award on an "all or none" basis would probably result in a total price that is lower than the sum of low offers from a line-item by line-item competition. This method would be especially appropriate when firms regularly sell the contract items as an integrated package to realize economies of scale that are not possible when selling each component independently.<br><br>**For example:** Many firms offer computer systems that are cheaper than buying the separate components (e.g. disk drives, monitors, printers, etc.) one by one. |
| ***Example of a Method of Award Provision:***<br><br>Award will be made in the aggregate for all items. The low aggregate offeror will be determined by multiplying the unit price submitted on each item by the quantity specified, and adding the resultant extensions. In order to qualify for an award, prices must be submitted on all items. | |

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## 4.2 Multiple Awards For Different Line Items

*Multiple Awards for Different Line Items* ( FAR 52.214-22 and FAR 52.215-1(f)(6) ). The table below presents descriptions and pricing considerations for making multiple awards for different line items.

| **Multiple Awards**<br><br>**(Line Item by Line Item)** | |
|---|---|
| **Description** | **Use When...** |
| Base award(s) on the line items or groups of line items that provide the lowest aggregate cost to the Government, including the assumed administrative costs for awarding and administering each contract. | Awarding line item by line item is likely to result in a lower total price than awarding on an aggregate "all or none" basis. This method would be especially appropriate if prospective offerors are likely to perceive no significant economies of scale from an aggregate award.<br><br>**For example:** Some firms may sell computer peripherals at much lower prices than are typically offered by computer manufacturers. However, such firms might not be able to compete to provide the peripherals if the solicitation requires award based on the aggregate price for all line items (including the peripherals) that comprise a microcomputer system. |
| ***Example 1 of a Method of Award Provision:***<br><br>The Government reserves the right to make multiple awards if, after considering the additional administrative costs, it is in the Government's best interest to do so | |
| ***Example 2 of a Method of Award Provision:***<br><br>In addition to other factors, bids will be evaluated on the basis of advantages and disadvantages to the Government that might result from making more than one award (multiple awards). It is assumed, for the purpose of evaluating bids, that $500 would be the administrative cost to the Government for issuing and administering each contract awarded under this solicitation, and individual awards will be for the items or combinations of items that result in the lowest aggregate cost to the Government, including the assumed administrative cost. | |

## 4.3 Family Or Group Buys

*Family or Group Buys* ( FAR 52.214-22 and FAR 52.215-1(f)(6) ). The table below presents descriptions and pricing considerations for family or group buys.

| **Family or Group Buys** | |
|---|---|
| **Description** | **Use When...** |
| Award for identified families, or groups, of line items | Offerors are likely to submit a total price for a group of |

| | |
|---|---|
| that provide the lowest aggregate cost to the Government, including the assumed administrative costs of awarding each contract. | line items that would be lower than the sum of their offers on the individual items. This method would be especially appropriate if offerors are likely to perceive significant economies of scale from being awarded all line items in a particular group as a package.<br><br>**For example:** Firms that manufacture ink cartridges for printers also tend to manufacture ink cartridges for fax machines. Line items for different ink cartridges might be included in a single family of items. |
| ***Example of a Method of Award Provision:***<br><br>Award will be made in the aggregate for each identified group of items. The low offeror for the group will be determined by multiplying the unit price submitted on each item in the group by the estimated quantity specified, and adding the resultant extensions. In order to qualify for an award on a group of items, an offeror must submit prices for each item within the group. | |

## 4.4 Progressive Awards For Portions Of Total Line Item Requirement

*Progressive Awards* . The table below presents descriptions and pricing considerations for making progressive awards.

| **Progressive Awards (Each Line Item)** | |
|---|---|
| **Description** | **Use When...** |
| If the offeror with lowest evaluated unit price for a line item offers less than the total quantity required by the Government, award up to the quantity offered. Follow the same procedure with the next lowest evaluated unit price and continue until the entire line item requirement is awarded. | Some of the potential competitors do not have the capability to supply the entire quantity required by the Government, but might be in a position to offer the lowest price for some of the needed units.<br><br>**For example:** Some firms specialize in reconditioning laser printer cartridges and offer those cartridges at a fraction of the price of new units. If such a firm did not have enough reconditioned cartridges to fill the entire requirement, a progressive award would allow the firm to compete for the quantities that it can supply -- with other firms competing for the balance of the requirement. |
| ***Example of a Method of Award Provision:***<br><br>a) Award will be made on an item-by-item basis to the lowest responsive offerors up to their stated monthly quantity allocations. Awards to any offeror will not be made for quantities in excess of the firm's stated monthly quantity allocation.<br><br>b) If the low responsive offeror offers a monthly quantity allocation which, when multiplied by the number of | |

months representing the contract period, totals less than the Government's estimated annual requirements, the Government may make progressive awards to the extent necessary to meet its estimated annual requirements. In such cases, awards will be made to the low responsive offeror up to that offeror's stated monthly quantity allocation, and then progressively to other offerors to the extent necessary to cover all Government requirements. Within the limits prescribed by the offeror, the Government will apply offeror's monthly quantity allocation to any items offered, as the Government's interests require.

c) If progressive awards are made, orders will be placed first with the contractor offering the lowest price on each item normally up to the contractor's monthly quantity allocation and then in the same manner, successively to other contractors. However, to avoid the placement of unduly small orders or the splitting of a single requirement between two contractors, the Government reserves the right to place orders with back-up contractors whenever the orders placed with lower priced contractors equal or exceeds 95 percent of their monthly quantity allocation for the item or group of items being ordered. In no case will orders be placed with any contractor in excess of its monthly quantity allocation.

## 4.5 Multiple Awards For The Same Line Item

*Multiple Awards for the Same Line Item* ( FAR 16.504(c) ). The table below presents descriptions and pricing considerations for making multiple awards for the same line item under an indefinite quantity contract.

| **Multiple Awards (Estimated Requirements for Individual Line Items)** | |
|---|---|
| **Description** | **Use When...** |
| Make multiple awards for the same indefinite requirement in situations where multiple firms are capable of delivering similar, but not necessarily identical, products to meet the needs of the Government and provide alternatives for ordering offices. Ordering offices then have the choice of selecting the product and firm that best meet their needs. | Appropriate to meet the needs of the Government. If you are using an indefinite quantity contract for:<br>• Supplies or services other than advisory and assistance services, give preference to making multiple awards, unless you determine that a single award is appropriate.<br>• Advisory and assistance services that will not exceed three years and $10 million, including all options, you may give preference to making multiple awards.<br>• Advisory and assistance services that will exceed three years and $10 million, you must give preference to making multiple awards, unless:<br>• The contracting officer, or other person designated by the agency head, determines in writing prior to solicitation that the services are so unique or highly specialized that it is not practical to award more than one contract. This determination may also be appropriate when contract tasks are so integrally related that only a single contractor can reasonably perform the |

| | |
|---|---|
| | work, or<br>• The contracting officer, or other person designated by the agency head, determines in writing, after evaluation of offers, that only one offeror is capable of providing the services required, or<br>• You only receive one offer. |
| ***Example 1 of a Method of Award Provision:***<br><br>The Government may elect to award a single delivery order contract or task order contract or to award multiple delivery order contracts or task order contracts for the same or similar supplies or services to two or more sources under this solicitation. | |
| ***Example 2 of a Method of Award Provision:***<br><br>The Government intends to award multiple contracts for the same or similar advisory and assistance services under this solicitation unless the Government determines, after evaluation of offers, that only one offeror is capable of providing the services at the level of quality required. | |

## 4.6 Split Awards

*Split Awards* ( FAR 6.202 ). The table below presents descriptions and pricing considerations for making split awards.

| **Split Awards**<br>**(Estimated Requirements for Individual Line Items)** | |
|---|---|
| **Description** | **Use When...** |
| Award of requirements for an individual line item may be split between two or more sources. The size of each portion of the split or a method for calculating the split should be established in the solicitation. Every possible effort should be made to assure that any amount awarded is an economic production quantity. | • Multiple sourcing is necessary to maintain competitive sources for a product that would otherwise be available only from one source. The split may be on a percentage share basis, with the most favorable offer receiving the largest percentage of the requirement; or<br>• Multiple source development will be facilitated at relatively low risk to the Government. For example, a partial set-aside is a form of split award. |
| ***Example of Method of Award Provision:***<br><br>The Government intends to make split awards from this solicitation. Sixty percent of the total quantity will be awarded to the offeror that the Government determines to have submitted the proposal that offers the best value to the Government, considering primarily technical scores and secondarily, offered prices. Forty percent will be awarded to the remaining competitor provided that the technical evaluation determines that the technical proposal is acceptable and the offered prices are determined to be fair and reasonable. | |

## 4.7 Partial Set-Aside Awards

*Partial Set-Aside Awards* ( FAR 19.502-3 and FAR 52.219-7 ). The table below presents descriptions and pricing considerations for making partial set-aside awards.

| **Partial Set-Aside Awards** | |
|---|---|
| **Description** | **Use When...** |
| A portion of the solicitation requirement is set-aside for small business. Any small business can submit an offer to provide the set-aside portion, the non-set-aside portion, or both.<br><br>Note: If a small business is awarded the non-set-aside portion of the requirement, do not attempt to negotiate a lower price with the firm for the set-aside portion. However, accept voluntary reductions. | All of the following are true:<br><br>• A total set-aside is not appropriate.<br>• The requirement is severable into two or more economic purchase lots.<br>• One or more small business concerns is expected to have the technical competence and productive capacity to satisfy the set-aside portion of the requirement at a fair market price.<br>• The acquisition is not made under small purchase procedures.<br><br>Unless authorized by the head of the contracting activity, do not use a partial set-aside if there is a reasonable expectation that only two capable concerns (one large and one small) will respond. |
| ***Method of Award Provision Requirements:***<br><br>The set-aside portion of the requirements must be specifically identified. Any acceptable method of award may be used to award the set-aside portion, including aggregate, line item by line item, or family buys. Solicitations must include FAR 52.219-7 , Notice of Partial Small Business Set-Aside. | |

- 5.10 - HUBZone Price Evaluation Preference

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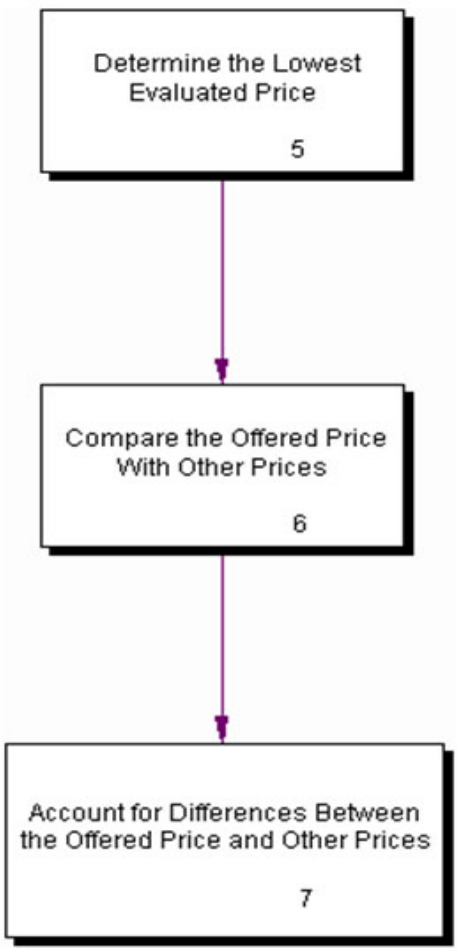
## 5.0 Chapter Introduction

*Procedural Steps* . The figure below shows where this chapter fits into the conduct of a price analysis.

**Steps in Analyzing Prices(Chapters 5-7)**

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*Identify Price-Related Factors* ( FAR 14.201-5(c) and FAR 15.204-5(e) ). As you prepare any solicitation, you must identify the price-related factors to be considered in the contract award decision **. Assure that contract award criteria address all price-related factors that will have a significant and quantifiable effect on the**

**total cost of the acquisition** . The price-related factors identified in this chapter are not meant to provide an exhaustive list of price-related factors that you could consider during offer evaluation. However, the chapter does address several key price-related factors that may be applicable to your contracting situation.

If you identify other price-related factors that may affect the total cost of a particular acquisition, you should consider those factors as you develop your contract award criteria.

*Use Price-Related Factors* ( FAR 14.201-6(q) and FAR 52.215-1(f)(6) ). Once you identify price-related criteria for offer evaluation, you must consider those criteria in offer evaluation. Generally, your evaluation should follow this 4-step procedure:

**Step 1.** Determine solicitation provisions.

**Step 2.** Determine total price offered.

**Step 3.** Evaluate award combinations.

**Step 4.** Make award decision **.**

---

## 5.1 Assumed Administrative Cost Factors In Sealed Bids

*When to Consider Administrative Cost Factors.* When multiple award of different line items in the solicitation is possible, you must consider the effect of different award combinations on the total cost to the Government **.** Since it will cost more to administer each additional contract, you must consider that cost in your evaluation **.**

*General Evaluation Requirements* ( FAR 14.201-6(q) , FAR 52.214-22 , and FAR 52.215-1(f)(6) ).

### Step 1. Determine Solicitation Provisions.

In sealed bidding, if the contracting officer determines that making multiple awards might be economically advantageous to the Government, you must consider the costs of making multiple awards in offer evaluation **.** FAR prescribes an assumed administrative cost of $500 for issuing and administering each contract ( FAR 14.201-8(c) ) **.**

When using negotiation procedures, other contract objectives may preclude consideration of the cost of multiple awards (e.g., multiple awards are preferred for most indefinite-quantity indefinite-delivery contracts) **.** If consideration is appropriate, you could use the same $500 cost estimate or a different reasonable estimate supported by a documented rationale.

### Step 2. Determine Offered Price(s).

Determine the price(s) in each offer for each item or group of items being considered for contract award.

### Step 3. Evaluate Possible Award Combinations.

In your evaluation of offers, consider the estimated administrative cost for each contract (e.g . $500) when evaluating the possible award combinations . In relatively simple award situations, you might be able to determine the proper award decision without detailed calculations . In most situations, however, you must evaluate all possible award combinations . If the number of offerors is so large that evaluation of all possible methods of award would be prohibitive, you may exclude offerors that obviously have no chance of receiving the award . When determining which offerors do have a chance of receiving an award, consider the following:

- A successful offeror will NORMALLY be low on one or more items.
- If there are many offerors who are low on different items, it MAY BE POSSIBLE for a firm with offers close to the low offer on many items to win an award when the cost of contract administration value is considered.

**Step 4. Make Award Decision.**

Select the responsible bidder whose bid, conforming to the invitation, will be most advantageous to the Government, considering only price and the price-related factors (see FAR 14.201-8 and FAR 14.408-1 ).

*Evaluation Example* ( FAR 52.214-22 ).

**Step 1. Determine Solicitation Provisions.**

As an example of the evaluation process, consider an award under sealed bidding procedures . Assume that the invitation for bids states that award will be made to the responsive and responsible bidder with the lowest evaluated price and includes the following clause:

EVALUATION OF BIDS FOR MULTIPLE AWARDS
(MAR 1990)

In addition to other factors, bids will be evaluated on the basis of advantages and disadvantages to the Government that might result from making more than one award (multiple awards) . It is assumed, for the purposes of evaluating bids, that $500 would be the administrative cost to the Government for issuing and administering each contract awarded under this solicitation, and individual awards will be for the items or combinations of items that result in the lowest aggregate cost to the Government, including the assumed administrative costs.

**Step 2. Determine Offered Price(s).**

In your evaluation of bids, consider the possible award combinations . Bids on the three different line items in the solicitation were received from two bidders . The extended line item totals, unit price multiplied by quantity, are shown in the table below.

| Item | Bid 1 | Bid 2 |
|---|---|---|
| 1 | $74,000 | $74,450 |
| 2 | $94,750 | $94,250 |
| 3 | $22,125 | $21,500 |

**Step 3. Evaluate Possible Award Combinations.**

Given the evaluation criteria and the bids, there are three possible methods of contract award:

- Multiple Awards
- Award All Items to Bidder 1
- Award All Items to Bidder 2

**Multiple Awards.** Awards to both Bidders 1 and 2 **.** Looking at the bids without considering the $500 evaluation factor, making multiple awards appears to be the logical decision **.** Following this procedure, the total evaluated price would be:

| **Item** | **Bidder 1 Award** | **Bidder 2 Award** | **Total Price** |
|---|---|---|---|
| 1 | $74,000 | | $ 74,000 |
| 2 | | $ 94,250 | $ 94,250 |
| 3 | | $ 21,500 | $ 21,500 |
| Admin **.** Cost | $ 500 | $ 500 | $ 1,000 |
| Evaluation Price | $74,500 | $116,250 | $190,750 |

**Award All Items to Bidder 1.** If all items were awarded to Bidder 1, the total evaluated price would be:

| **Item** | **Bidder 1 Award** | **Bidder 2 Award** | **Total Price** |
|---|---|---|---|
| 1 | $ 74,000 | | $ 74,000 |
| 2 | $ 94,750 | | $ 94,750 |
| 3 | $ 22,125 | | $ 22,125 |
| Admin **.** Cost | $ 500 | | $ 500 |
| Evaluation Price | $191,375 | | $191,375 |

**Award All Items to Bidder 2.** If all items were awarded to Bidder 2, the total evaluated price would be:

| **Item** | **Bidder 1 Award** | **Bidder 2 Award** | **Total Price** |
|---|---|---|---|
| 1 | | $ 74,450 | $ 74,450 |
| 2 | | $ 94,250 | $ 94,250 |
| 3 | | $ 21,500 | $ 21,500 |
| Admin **.** Cost | | $ 500 | $ 500 |
| Evaluation Price | | $190,700 | $190,700 |

**Step 4. Make Award Decision.**

In this case, your decision should be to award the entire requirement to Bidder 2, because that decision would result in the lowest aggregate evaluated price to the Government **.** Although multiple awards appears to offer the lowest total contract price, you can see that, when the assumed administrative cost was factored in, the total evaluated price is lowest if all items are awarded to Bidder 2.

## 5.2 Buy American Act Criteria

*In This Section* . The Independent Government Estimate is only one preliminary estimate of contract price. As a minimum, your research, should consider the data sources identified in this section.



*Buy American Act Requirement* ( FAR 25.101 and DFARS 225.101 ). The Buy American Act requires that only domestic end products be acquired for public use, except articles, materials, and supplies-

- For use outside the United States;
- For which the agency head determines that domestic preference would be inconsistent with the public interest;
- That are not mined, produced, or manufactured in the United States in sufficient and reasonably available commercial quantities, of a satisfactory quality; or
- For which the cost would be unreasonable, as determined in accordance with FAR or agency guidance;
- Purchased specifically for commissary resale.
- For the acquisition of information technology that is a commercial item, when using fiscal year 2004 or subsequent fiscal year funds.

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### 5.2.1 FAR Criteria

*Applicability of FAR Guidance.* FAR 25.1 Provides the overview, policy and exceptions of the Buy America Act. Key terms are defined at FAR 25.003 .

- To implement Buy American Act requirements, insert FAR Buy American Act--Supplies clause, FAR 52.225-1 , as well as the FAR Buy American Certificate, FAR 52.225-2 , into any solicitation for supplies, or for services involving the furnishing of supplies, within the United States, unless the solicitation is restricted to domestic end products, the acquisition is made under the European Community Agreement or Trade Agreements Act, or another exception to the Buy American Act applies. This clause requires the contractor to deliver only domestic end products, unless one of the FAR 25.103 exceptions apply.

*Distinguishing Domestic from Nondomestic End Products* ( FAR 52.225-2) . The FAR Buy American Certificate requires each offeror to identify any product being offered that is not a known domestic end product.

*Determining reasonableness of costs: See* FAR 25.105 .

Evaluating foreign offers: See FAR 25.5 .

**Step 1. Determine Solicitation Provisions.**

Decide whether to consider the FAR Buy American Act criteria in offer evaluation.

- Determine whether the FAR Buy American Act--Supplies clause was required for the acquisition and incorporated in the solicitation.
- If the clause was required you must examine the American Certificate submitted by each offeror to determine if any firm is offering a foreign product. If any offeror lists an Excluded End Product on the Certificate, the Buy American Act criteria would apply **unless** :
    - The country of origin or the product is covered by one of the many exceptions to application of those criteria, or

- o No competing firm has offered a domestic product (i.e., an "unexcluded" end product) in response to your solicitation.

**Step 2. Determine Offered Price(s).**

Identify the price(s) in each offer for each item or group of items being considered for contract award. Identify the duty applicable to each foreign offer.

**Step 3. Evaluate Possible Award Combinations.**

Evaluate each item or group of items for which award may be made in accordance with solicitation contract award criteria. Use the criteria at FAR 25.105 to determine price reasonableness.

**Step 4. Make Award Decision.**

Award to the offeror with the offer that provides the best value for the Government under the criteria established in the solicitation. Settle ties in favor of domestic offers.

*Evaluation Example.*

**Step 1. Determine Solicitation Provisions.**

Assume that a solicitation states that award will be made to the responsible offeror with a technically acceptable offer and the lowest evaluated price. The Buy American Act applies to the acquisition, with no applicable exception to the Act for the acquisition or the end product **.**

Examining the Buy American Certificate in each offer, you discover that Offeror 2 and Offeror 3 left their respective certificates blank, meaning (presumably) that they are offering domestic end items **.** Offeror 1 states that the country of origin for its product is Greater Aquatica.

Since no exception applies to products from Aquatica, you must apply the FAR Buy American Act criteria.

**Step 2. Determine Offered Price(s).**

The table below lists the evaluated price of each offer. The price for the foreign end product includes all applicable duties.

| **Offeror** | **End Product** | **Business Size** | **Offer** |
|---|---|---|---|
| 1 | Foreign | Small | $168,000* |
| 2 | Domestic | Large | $179,000 |
| 3 | Domestic | Small | $180,000 |

* Item is not duty exempt . The price includes a $1,900 duty.

**Step 3. Evaluate Possible Award Combinations.**

All offers are technically acceptable . Offeror 2 is a large business and Offeror 3 is a small business.

Since the foreign offer is low, you must use Buy American Act requirements to evaluate the low offer and the low domestic offer . Because the low domestic offeror is a large business, you must use the 6-percent factor to adjust Offer 1 as follows:

| Offeror | Offer | Apply 6-Percent Factor | Evaluated Offer |
|---|---|---|---|
| 1 | $168,000 | .06 x $168,000 = $10,080 | $178,080 |
| 2 | $179,000 | N/A | $179,000 |
| 3 | $180,000 | N/A | N/A |

**Step 4. Make Award Decision.**

Based on the evaluation above, you should award to Offeror 1, the offeror with the low evaluated price .

*Evaluation Example Note:* Offer 1 was not compared with Offer 3, because Offer 3 was not the low domestic offer.

If Offeror 1 had been in competition ONLY with Offeror 3, Offer 3 would have won the competition, because the adjustment factor would have been 12 percent for a small business.

Also, see examples at FAR 25.504 .

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**5.2.2 DFARS Criteria**

*Applicability of DFARS Criteria* . If your organization is subject to Defense Federal Acquisition Regulation Supplement (DFARS) guidance, use the DFARS evaluation factor instead of the FAR evaluation factors, to determine when the cost of a domestic end product is unreasonable under the Buy American Act. DFARS 225.105 provides the overview, policy and exceptions of the Buy America Act. Key terms are defined at DFARS 225.003 .

*Solicitation Requirement* . To implement Buy American Act requirements, insert DFARS Buy American Act and Balance of Payments Program clause, DFARS 252.225-7000 , into any solicitation for supplies, or for services involving the furnishing of supplies unless an exception at DFARS 225.103 applies.

*Distinguishing Domestic from Nondomestic End Products* . The DFARS Buy American, Act--Balance of Payments Program Certificate, ( DFARS 252.225-7000 ), requires each offeror to identify any product being offered that is not a known domestic end product.

*Determining reasonableness of costs* : See DFARS 225.105 .

*Evaluating foreign offers* : See DFAR 225.5

*General Evaluation Requirements* .

**Step 1. Determine Solicitation Provisions** .

Decide whether to consider the FAR Buy American Act criteria in proposal evaluation.

- Determine if the Buy American Act and Balance of Payments Program clause was required for the acquisition and incorporated in the solicitation.
- If the clause was required, examine the Buy American Certificate-Balance of Payments Program Certificate submitted by each offeror to determine if any firm is offering a foreign product and if any firm identifies a nonqualifying country end product on the Certificate.

**Step 2. Determine Offered Price(s).**

Identify the price(s) in each offer for each item or group of items being considered for contract award. Identify the duty applicable to each foreign offer.

**Step 3. Evaluate Possible Award Combinations.**

If the Act applies to the acquisition, add 50 percent to the price of the lowest offer of a product from a nonqualifying country. Qualifying country offers are specifically excluded from application of the requirements of the Buy American Act because of the provisions of memoranda of understanding or other international agreements.

As you evaluate nonqualifying country offers, consider the following:

- When a nonqualifying country offer includes more than one item, apply the 50-percent factor:
  - On an item-by-item basis; or
  - On a group basis, if the solicitation specifically provides for award on a group basis.
- When application of the factor would not result in the award of a domestic end product (e.g. when no domestic offers are received or when a qualifying country offer is lower than the domestic offers) evaluate nonqualifying country offers without the 50-percent factor.
- If duty is to be exempted through the inclusion of the FAR Duty-Free Entry clause, you must still evaluate the nonqualifying country offer inclusive of duty. If award is made on the nonqualifying country offer, award at the offered price minus the duty.
- If the evaluation procedures result in a tie between a nonqualifying country offer and a domestic offer, make award on the domestic offer.
- If an offer is for a U.S. made end product, domestically produced end product, product of a small business, but is not a domestic end product, treat the offer as a nonqualifying country offer.

**Step 4. Make Award Decision.**

Award to the offeror with the lowest evaluated price, after application of the Buy American criteria in Step 3 **.** Settle ties in favor of domestic offers.

*Evaluation Example* ( DFARS 252.225-7000 ).

**Step 1. Determine Solicitation Provisions.**

Assume that the solicitation states that award will be made to the responsible offeror with a technically acceptable offer and the lowest evaluated price. The Buy American Act applies to this acquisition, with no applicable exception to the Act for the lens assembly or the end product .

You examine the Buy American--Balance of Payments Program Certificates submitted by Offeror 2 and Offeror 3 and find that they left their certificates blank, indicating that the items are domestic end products. Offeror 1 states that the country of origin for its product is Lower Aquatica (a nonqualifying country).

**Step 2. Determine Offered Price(s).**

The following table lists the evaluated price of each offer, after applying all other price-related factors in the RFP.

| Offeror | End Product | Offer |
|---|---|---|
| 1 | Nonqualifying | $168,000* |
| 2 | Domestic | $179,000 |
| 3 | Domestic | $180,000 |

* Item is not duty exempt . The price includes a $1,000 duty.

**Step 3. Evaluate Possible Award Combinations.**

You have investigated and found that the Buy American Act applies to this acquisition . Use the Buy American criteria to evaluate offers as follows:

| Offeror | Offer | Apply 50-Percent Factor | Evaluated Offer |
|---|---|---|---|
| 1 | $168,000 | .50 x $168,000 = $84,000 | $252,000 |
| 2 | $179,000 | N/A | $179,000 |
| 3 | $180,000 | N/A | $180,000 |

**Step 4. Make Award Decision.**

Based on the evaluation above, you should select Offer (the low evaluated offer) for contract.

*Evaluation Example Note* ( DFARS 225.872-1 ). Note that the decision would have been different if Offer 1 had been a product produced in a qualifying country, a country for which the DoD has determined it inconsistent with the public interest to apply the restrictions of the Buy American Act-Balance of Payment Program.

If Offer 1 had been a qualifying country offer, you would not apply the 50 percent adjustment factor . As a result, you would evaluate all offers without the adjustment factor:

| Offeror | Offer | 50-Percent Factor | Evaluated Offer |
|---|---|---|---|

| | | | |
|---|---|---|---|
| 1 | $168,000 | N/A | $168,000 |
| 2 | $179,000 | N/A | $179,000 |
| 3 | $180,000 | N/A | $180,000 |

Without the adjustment factor, you select Offeror l for contract award.

Also, see examples at DFARS/PGI 225.504 .

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## 5.3 Government Furnished Production And Research Property Factors

This section examines the factors that you must consider when soliciting and evaluating offers that may involve Government furnished production and research property:

- 5.3.1 - Eliminate Competitive Advantage
- 5.3.2 - Consider Costs And Savings To The Government

*Government Production and Research Property* ( FAR 45.301 ). The term "Government production and research property" means Government-owned facilities, Government-owned special test equipment, and special tooling to which the Government has title or has the right to acquire title.

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### 5.3.1 Eliminate Competitive Advantage

*Factors in Offer Evaluation* ( FAR 45.201 ). When evaluating offers, you must make the maximum practical effort to:

- Eliminate any competitive advantage accruing to a contractor possessing Government furnished production and research property.
- Consider any costs or savings to the Government related to providing such property, regardless of any competitive advantage that may result.

*When to Consider as a Price-Related Factor* ( FAR 45.201 and FAR 52.245-9 ). To eliminate the competitive advantage that may result when an offeror offers to perform a contract with Government furnished production and research property, you can:

- **Adjust the offers of contractors proposing to use Government furnished production and research property.**

- This is the **preferred method** for eliminating the competitive advantage. During offer evaluation, adjust any offers proposing the use of furnished production and research property using a factor equal to the rent that would be charged for use of the property under the requirements of the FAR Use and Charges clause. Only use the adjusted price in your evaluation. Do not include the adjustment in the price of any resulting contract award.
- Do not adjust proposals using a rental equivalent factor when the contracting officer determines that using the factor would not affect the choice of contractor.

- **Charge the contractor rent for using Government furnished production and research property.** Only charge contractors rent **when adjustment of offers for offer evaluation is not practical** . Any offeror or subcontractor may use Government furnished production and research property after obtaining the written approval of the cognizant contracting officer. Charge rent in accordance with the provisions of the FAR Use and Charges clause.

*Solicitation Requirements* ( FAR 45.201 ). When you anticipate that Government production and research property will be offered for use in a competitive acquisition, the solicitation:

- Should normally require the contractor to assume all costs related to making the property available for use (such as payment of all transportation or rehabilitation costs).
- The solicitation must describe offer evaluation procedures, including rental charges or equivalents to be evaluated, and require all offerors to submit with their offers the following information:
  - A list or description of all Government production and research property that the offeror or its subcontractors propose to use on a rent-free basis. The list must include property offered for use in the solicitation, as well as property already in possession of the offeror and its subcontractors under other contracts.
  - Identification of the facilities contract or other instrument under which property already in possession of the offeror and its subcontractors is held and written permission for its use from the cognizant contracting officer.
  - The dates during which the property will be available for use (including the first, last, and all intervening months) and, for any property that will be used concurrently in performing two or more contracts, the amounts of the respective uses in sufficient detail to support proration of the rent.
  - The amount of rent that would otherwise be charged, computed in accordance with FAR requirements.
- The solicitation must provide that using Government production and research property (other than as described and permitted in the solicitation) will not be authorized under the contract unless such use is approved in writing by the contracting officer with property cognizance, and either rent (calculated in accordance with the FAR Use and Charges clause) is charged, or the contract price is reduced by an equivalent amount.

*General Evaluation Requirements* ( FAR 45.201 ).

**Step 1. Determine Solicitation Provisions.**

The solicitation must describe the evaluation procedures to be used, including the rental charges or equivalents to be evaluated, and information the offeror must submit with its offer **.**

**Step 2. Determine Offered Price(s).**

**Step 3. Evaluate Possible Award Combinations.**

Before you evaluate the pricing aspects of contractor use of Government production and research property on the contract, contact the contracting officer with property cognizance to confirm that the property is available for use on the contract . Follow the offer evaluation procedures set forth in the solicitation .

**Step 4. Make Award Decision.**

Whichever method you use, select the offer that provides the best value for the Government under the criteria established in the solicitation.

Determine the price(s) in each offer for each item or group of items being considered for contract award. Also identify what property each offeror is proposing to use on the contract and the estimated period of use.

*Evaluation Example* ( FAR 45.201 and FAR 52.245-9 ).

**Step 1. Determine Solicitation Provisions.**

Assume that the solicitation states that award will be made to the responsible offeror with a technically acceptable offer and the lowest evaluated price. It also includes the following provision:

For purposes of offer evaluation, any offer predicated on rent-free use of Government production and research property will be adjusted to eliminate possible competitive advantage . The adjustment will be made using a rental equipment adjustment factor equal to the allocable rent that would otherwise be charged for use of the Government property . Rent will be computed in accordance with FAR 52.245-9 , Use and Charges.

**Step 2. Determine Offered Price(s).**

Two offers were received in response to the solicitation.

| Offeror | Offer |
|---|---|
| 1 | $352,000 |
| 2 | $347,000 |

Only Offer 2 proposes rent-free use of GFP. It proposes rent-free use of one APEX Model 5209, Serial #14345089, machine tool, for a period of one month during production.

**Step 3. Evaluate Possible Award Combinations**

Contact the contracting officer responsible for the GFP to ensure that the proposed GFP will be available for use on your contract, as requested by the offeror.

Assume that the contracting officer with property cognizance further advises you that it is less than two years old and cost $200,000 . Using the FAR Use and Charges clause, you determine that a fair and reasonable rental cost is $6,000.

Using the $6,000 in evaluation, you find:

| Offeror | Offer | GFP Rental Equivalent | Evaluated Price |
|---|---|---|---|
| 1 | $352,000 | N/A | $352,000 |

| | | | |
|---|---|---|---|
| 2 | $347,000 | $6,000 | $353,000 |

**Step 4. Make Award Decision.**

Based on the evaluation above, you should award to Offeror 1 **.** This will result in the lowest evaluated price to the Government.

---

**5.3.2 Consider Costs And Savings To The Government**

*When to Consider as a Price-Related Factor* ( FAR 45.201 ). When evaluating offers, consider any other costs or savings to the Government that will result from providing production or research property, regardless of any competitive advantage that may result.

*Solicitation Requirements Related to Costs* ( FAR 45.202 and FAR 45.201 ). The solicitation:

- Should normally require the contractor to assume all costs related to making the property available for use (such as payment of all transportation or rehabilitation costs).
- Must describe these costs or savings will be considered in offer evaluation.
- Must specify any costs to the Government related to furnishing Government production and research property either as dollar amounts or as formulas.
    - Limit consideration to the cost of:
    - Reactivation from storage;
    - Rehabilitation and conversion; and
    - Making the property available on an f.o.b. basis.
    - If (under the terms of the solicitation) the contractor will bear the transportation cost of furnishing Government production and research property or the cost or making it suitable for use, do not use additional evaluation factors related to those costs.
- Specify the dollar amount of any savings to the Government related to contractor use of Government production and research property. Examples of such savings include any savings that result from avoiding the costs of deactivating tools and them in layaway, storage, or idle status.

*General Evaluation Requirements* ( FAR 45.202 ).

**Step 1. Determine Solicitation Provisions.**

The solicitation must specify savings that will be considered in offer evaluation as dollar values. Costs must be stated using dollar values or formulas. Do not provide for any adjustment to consider costs that will be borne by the contractor **.**

**Step 2. Determine Offered Price(s).**

Determine the price(s) in each offer for each item or group of items being considered for contract award. Review each offer to determine whether it specifies use of the identified property.

**Step 3. Evaluate Possible Award Combinations.**

In offer evaluation, identify the costs and savings in each offer related to Government production and research property . Use the costs and savings specified in the solicitation .

**Step 4. Make Award Decision.**

Make award to the firm whose offer is most advantageous to the Government under the terms of the solicitation . Include consideration of the costs and savings to the Government that result from the use of the Government production and research property.

*Evaluation Example* ( FAR 45.202 ).

**Step 1. Determine Solicitation Provisions.**

Assume that the solicitation states that award will be made to the responsible offeror with a technically acceptable offer and the lowest evaluated price. It also includes the provision below. The amount of $9,000 represents the cost of deactivating and placing the tools in storage and maintaining them there for the period of the contract . A complete list of the tools involved is included elsewhere in solicitation.

In addition to any other proposal adjustments, $9,000 will be deducted from any offers proposing to use the GFP identified in Solicitation Paragraph L-XX . The $9,000 represents the costs that the Government will avoid if the identified GFP is not placed in storage.

**Step 2. Determine Offered Price(s).**

You have received two offers . Both propose use of the tooling described in the solicitation . Offer 1 includes the estimated costs of relocating the tooling from the plant of Offeror 2 . Offer 2 does not propose relocation costs because the tooling is already located at the offeror's plant.

| Offeror | Offer |
|---|---|
| 1 | $364,000 |
| 2 | $370,000 |

**Step 3. Evaluate Possible Award Combinations.**

Both offers propose use of the tooling described in the solicitation . As a result, the $9,000 savings identified in the solicitation will be deducted from the price offered by each of the offerors. No additional adjustment is required to consider the cost to the Government related to relocating the equipment. The relocation cost is included in Offer 1 and there is no relocation cost associated with Offer 2, because the property is already located at Offeror 2's facility.

| Offeror | Offer | Government Savings | Offer Evaluation |
|---|---|---|---|
| 1 | $364,000 | $9,000 | $355,000 |
| 2 | $370,000 | $9,000 | $361,000 |

**Step 4. Make Award Decision.**

In your evaluation, you should deduct $9,000 from both offers **.** As a result, there would be no change in the dollar difference between the two offers. You should award to Offeror 1.

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## 5.4 Transportation Costs

*When to Consider as a Price-Related Factor* ( FAR 47.301, FAR 47.301-1, and FAR 47.301-2 ). When transportation costs are not included in item purchase price, you must consider them as part of any supply contract award decision. Your objective is to ensure that acquisitions are made on the basis most advantageous to the Government, and that supplies arrive in good order, in good condition, on time, at the required place.

Work with your agency transportation officer during solicitation and evaluation of offers to ensure that all necessary transportation factors are considered, including transportation costs.

*F.o.b. Definition* ( FAR 2.101 ). The term **free on board (f.o.b.)** is used in conjunction with a physical point to determine:

- The responsibility and basis for payment of freight charges; and
- Unless otherwise agreed to, the point at which title for goods passes to the buyer or consignee.

**For example:** Contracts with **"f.o.b. origin" generally require the Government to pick up the deliverable** at the contractor's warehouse, with the Government responsible for shipping costs from the warehouse. In contrast **, "f.o.b. destination" contracts generally requires the contractor -- at the contractor's expense -- to ship the contract item** to a Government loading dock.

Usually, the f.o.b. point is either the place of shipment origin or final shipment destination but it can be anywhere in between. For example, the f.o.b. point could be an airport or dock where the shipment will be consolidated with other items for transport to a final destination.

*Solicitation Requirements* ( FAR 47.304-1 , FAR 47.303 , FAR 47.305-1 , FAR 52.247-45, FAR 52.247-46, FAR 52.247-47, FAR 52.247-49, FAR 52.247-50, and FAR 52.247-51 ). As you prepare each supply solicitation, the contracting officer must generally determine the contract f.o.b. terms on the basis of lowest overall cost. The solicitation must:

- describe how offers will be evaluated for contract award, such as:
    - F.o.b. Origin and/or F.o.b. Destination Evaluation;
    - Evaluation -- F.o.b. Origin;
    - Shipping Point(s) Used in Evaluation of F.o.b. Origin Offers;
    - Destination Unknown;
    - Evaluation of Export Offers; or
    - No Evaluation of Transportation Costs.

*General Evaluation Requirements* ( FAR 47.304-1, FAR 47.304-1(a), FAR 47.304-1(b) , and FAR 47.306 ).

**Step 1. Determine Solicitation Provisions.**

The solicitation must specify the acceptable f.o.b. terms and the basis for offer evaluation.

- If the solicitation requires that all offerors be made **f.o.b. destination** , transportation must be included in the offered. No further consideration of transportation costs is required.
- When offers are quoted **f.o.b. origin** , consider the following factors along with purchase price when evaluating prices:
  - The cost of transportation from the offeror's designated point of origin to the destination defined in the solicitation. The Government normally uses land transportation rates in proposal evaluation.
  - When provided for in the solicitation, proposed cost-reimbursable differentials based on possible routing conditions. These contingencies may be included by offerors to compensate for an unfavorable routing condition. Evaluation is based on the routing conditions anticipated at the time of award.
- When offers may be quoted **either f.o.b. origin or f.o.b. destination** , your evaluation of:
  - F.o.b. destination offers will not require adjustment to consider the cost of transportation.
  - F.o.b. origin offers must consider the factors described above.

**Step 2: Determine Offered Price(s).**

Determine the price(s) in each offer for each item or group of items being considered for contract award. You must also examine each offer to identify the f.o.b. terms and to determine whether the offered terms comply with solicitation requirements.

**Step 3. Evaluate Possible Award Combinations.**

Evaluate offers using the specific criteria set forth in the solicitation **.** In evaluating transportation costs

- You must use the lowest available freight rates and related accessorial and incidental charges that are **:**
  - In effect on, or become effective before, the expected date of initial shipment; and
  - On file or published on the date of bid opening or due date for offers.
- If rates or related charges become available after the bid opening or the due date of offers, do not use them in evaluation unless they cover transportation for which no applicable rates were in effect at the time of bid opening or the due date of offers. ( FAR 47.306-2 )

*Evaluation Example* ( FAR 47.305-2 , FAR 47.306-2 , and FAR 52.247-45 ).

**Step 1. Determine Solicitation Provisions.**

Assume that the solicitation states that award will be made to the responsible offeror with a technically acceptable offer and the lowest evaluated price. It also includes the following provision:

Offers are invited on the basis of both f.o.b. origin and f.o.b. destination, and the Government will award on the basis the contracting officer determines to be most advantageous to the Government. An offer on the basis of f.o.b. origin only or f.o.b. destination only is acceptable, but will be evaluated only on the basis submitted.

**Step 2. Determine Offered Price(s).**

Three offers were received **.** One offers the item f.o.b. destination **.** The others offer the item f.o.b. origin.

| **Offeror** | **F.O.B. Point** | **Offer** |
|---|---|---|

| | | |
|---|---|---|
| 1 | Origin | $435,000 |
| 2 | Destination | $450,000 |
| 3 | Origin | $436,000 |

**Step 3. Evaluate Possible Award Combinations.**

From the cognizant transportation officer, you obtain information on the lowest available transportation cost and incidental charges. Specific shipping costs are shown below, for each offer:

| Offeror | F.O.B. Point | Offer | Transportation Cost | Evaluated Price |
|---|---|---|---|---|
| 1 | Origin | $435,000 | $2,600 | $437,600 |
| 2 | Destination | $450,000 | N/A | $450,000 |
| 3 | Origin | $436,000 | $1,500 | $437,500 |

**Step 4. Make the Award.**

Make award to the offeror with the lowest evaluated price, Offeror 3.

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## 5.5 Options And Multi-Year Contracting

This section examines the factors that you must consider when soliciting and evaluating offers involving options and multi-year contracting.



*Longer-Term Business Relationships* . Contracts are normally written to acquire supplies and services in support of identified requirements. Funded contracts include funds approved by Congress for the current year.

Options and multi-year contracting are two methods of establishing longer-term relationships with contractors. Either of these techniques may be used in sealed bidding or negotiation.

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### 5.5.1 Options

*Contract Options* ( FAR 17.201 and FAR 17.207 ). Options are unilateral rights prescribed in a contract, which, for a specified time, permit the Government to elect to purchase additional supplies or services called for in the contract or to elect to extend the term of the contract. The Government is under no obligation to exercise any options prescribed in a particular contract.

*Solicitation Requirements* ( FAR 17.203 ). When you expect that the contract(s) will include an option clause, include the clause and the related evaluation provision in the contract solicitation. Solicitations containing an option clause:

- Must:
  - State the basis of evaluation, either exclusive or inclusive of the option;
  - Inform offerors that the Government may exercise the option at time of award (when appropriate).
  - State that offerors may offer varying prices for options, depending on the quantities actually ordered and the dates (when appropriate).
  - Specify the price at which the Government will evaluate the option (e.g., highest option price offered or option price for specified requirements), whenever:
  - Offerors may offer varying prices for options, depending on the quantities actually ordered and the dates when ordered; and
  - The Government may exercise an option at the time of award.
  - When the solicitation requires that option price(s) not exceed those of the initial requirement:
  - Specify that the Government will accept an offer containing an option price higher than the base price only if the acceptance does not prejudice any other offeror; and
  - Limit option quantities for additional supplies to not more than 50 percent of the initial quantity of the same contract line item. In unusual circumstances, an authorized person at a level above the contracting officer may approve a greater percentage of quantity.
- Should normally not limit option prices. If prices will be considered in the evaluation for contract award, never limit option prices.
- May (in unusual circumstances) require that options be offered at prices no higher than those for the initial requirement (e.g., when the option cannot be evaluated for contract award or future competition for the option is impracticable).

*Evaluation* ( FAR 17.206 ).

**Step 1. Determine Solicitation Provisions.**

The solicitation must specify the option requirements and how option offers will be evaluated. Based on the evaluation provisions, your evaluation must either include or exclude option offers in your evaluation.

**Step 2: Determine Offered Price(s).**

Determine the price(s) in each offer for each item or group of items being considered for contract award. Also identify the price for any option that will be consider in evaluating offers for contract award.

**Step 3. Evaluate Possible Award Combinations.**

Evaluate offers using the specific criteria set forth in the solicitation **.**

**Step 4. Make Award Decision.**

Award to the firm whose offer provides the best value to the Government under the terms of the solicitation.

## 5.5.2 Multi-Year Contracting

*Multi-Year Contracting* ( FAR 17.103 , FAR 17.104 , and FAR 17.105-1(d) ). Multi-year contracting is a special contracting method used to acquire known requirements in quantities and total cost not exceeding planned requirements for up to five years (unless otherwise authorized by statute).

This contracting method can be employed even though the total contract funds ultimately to be obligated are not available at the time of contract award. However, if funds are not appropriated to support the succeeding year's requirements, the agency must cancel the contract. The multi-year contract may provide for a cancellation payment to be made to the contractor if appropriations are not made.

The key difference between a multi-year contract and a multiple year contract is that the multi-year contract buys more than one year's requirement without establishing and having to exercise an option for each program year after the first.

*Solicitation Requirements* ( FAR 17.106-2 ). Solicitations for multi-year contracts must identify all the factors that will be considered in offer evaluation, including:

- Requirements by item of supply or service for the:
  - First program year; and
  - Each program year of the multi-year contact.
- Criteria for comparing the lowest evaluated offer for the first program year requirements to the lowest evaluated offer on the multi-year requirements.
- A provision that permits the Government to only consider offers for the first-year requirement , if the Government determines before award that only those requirements are needed.
- A provision specifying a separate cancellation ceiling (on a percentage or dollar basis) and applicable dates for each program year subject to cancellation.
- A statement that award will not be made on less that the first year program requirements.
- If Government administrative costs of annual contracting will be considered in offer evaluation, they must be reasonably estimated and stated in the solicitation.

Never use the cancellation ceiling as an offer evaluation factor.

*General Evaluation Requirements.*

**Step 1. Determine Solicitation Provisions.**

The solicitation must identify all the factors related to multi-year contracting that will be considered in offer evaluation. Because the factors can be complex and vary substantially from contract to contract, you should take special care to assure that you understand all factors before you begin offer evaluation.

**Step 2: Determine Offered Price(s).**

Determine the price(s) for each offer for the first program year and each program year of the multi-year contact.

**Step 3. Evaluate Possible Award Combinations.**

Evaluate offers using the specific factors set forth in the solicitation **,** including criteria for comparing the lowest evaluated offer for the first program year requirements to the lowest evaluated offer on the multi-year requirements.

**Step 4. Make Award Decision.**

Award to the firm whose offer provides the best value to the Government under the terms of the solicitation.

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## 5.6 Life-Cycle Costs

*Life-Cycle Cost (* FAR 7.101 ). Life-cycle cost is the total cost to the Government of acquiring, operating, supporting, and (if applicable) disposing of the items being acquired.

- Acquisition costs are all costs, including contract costs, associated with acquiring an item for Government use. For complex items, several contracts may be required and costs may involve research and development as well as production, delivery, and installation of the item.
- Operating and support costs are all costs, including contract costs, associated with equipment, supplies, and services needed to operate and maintain an operational system.
- Disposal costs are all costs, including contract costs, associated with removing equipment from service and disposing of it. Evaluations that consider life-cycle cost should also consider any significant salvage or resale value at the time of disposal.

*When to Consider as a Price-Related Factor* . Consider life-cycle cost in acquisition planning whenever the costs of item of system operation, support, and disposal are significant in comparison with the cost of acquisition. Consideration is particularly important when you expect that offers will include items that have substantially different operation, support, and disposal costs.

Source selection consideration can be appropriate for an item as simple as an automobile tire or as complex as a major weapon system. For more complex systems, planning should also address:

- Factors with a significant effect on life-cycle cost results, and implement tradeoff studies to evaluate alternative actions which could reduce costs related to those factors.
- Life-cycle costs in product design.
- Contract commitments (when appropriate) that will affect control of life-cycle cost results.

Follow-on efforts subsequent to purchase to further reduce life-cycle cost.

*Solicitation Requirements* . If you intend to consider life-cycle costs in offer evaluation, the solicitation must:

- Advise prospective offerors how life-cycle costs will be considered in making the contract award decision.

    - Award may be made based on lowest evaluated cost, including life-cycle costs, or life-cycle costs may be considered as a factor in an award decision that also considers other characteristics of the item or system.
    - When life-cycle costs continue over a period of years, solicitations will often provide for adjustments to consider one or more of the following:
    - Time value of money.
    - Cost uncertainty.
    - Inflation.
- Require offerors to estimate key elements of life-cycle cost. To estimate preparation, the solicitation must provide relevant information (e.g., projected item usage, operating environment, and the operating period that will considered in offer evaluation).
- Require offerors to provide relevant cost estimates along with appropriate information to support life-cycle cost estimates.
    - Estimate requirements typically include elements such as:
    - Average unit price, including (when appropriate) recurring and nonrecurring production costs;
    - Unit operating and support costs (e.g., manpower, energy, and parts requirements);
    - Unit disposal costs (e.g., the cost of removing equipment from the Government facility);
    - Unit salvage or residual value.
    - Related information should provide estimate support (e.g., test or operational data).

*General Evaluation Requirements .*

**Step 1. Determine Solicitation Provisions.**

When life-cycle costs will be considered as a price-related factor in offer evaluation, the solicitation must identify life-cycle cost estimate requirements, the information needed to support those estimates, and how those estimates will be considered in making the contract award decision.

**Step 2: Determine Offered Price(s).**

Determine the price(s) for each offer. Also identify and evaluate life-cycle cost estimates required for offer analysis. Ask questions such as the following:

- ***Is the estimating methodology reasonable* and suppor *ted by the information provided?***
- ***Are the costs realistic when compared with other known information, including past cost performance?***
- ***Is the estimate complete in its consideration of all identified cost elements?***

**Step 3. Evaluate Possible Award Combinations.**

Evaluate offers using the specific criteria set forth in the solicitation, including any adjustments for:

- Time value of money;
- Cost uncertainty; or
- Inflation.

**Step 4. Make Award Decision.**

Award to the firm whose offer provides the best value to the Government under the terms of the solicitation.

## 5.7 Energy Conservation And Efficiency Factors

*When to Consider as a Price-Related Factor* ( FAR 23.203 ). The cost of energy is an important cost of operating many items and systems. Accordingly, agencies must consider energy efficiency in the procurement of products and services. In particular:

- Acquisition team members must consider energy conservation and efficiency data along with estimated cost and other relevant factors in the preparation of plans, drawings, specifications, and other product descriptions.

Contracting officers should consider energy efficiency as a price related factor when the results would be meaningful, practical, and consistent with agency programs and needs. Consideration will typically be most meaningful when you are contracting for items or systems that consume substantial amounts of energy.

*Solicitation Requirements* ( FAR 23.202 ). When you intend to consider energy efficiency as price-related factor in offer evaluation, the solicitation:

- Must advise prospective offerors how energy efficiency will be considered in making the contract award decision.
    - Award may be made based on lowest evaluated cost, including energy cost, or energy cost may be considered as a factor in an award decision that also considers other technical characteristics of the item or system.
    - When energy costs continue over a period of years, solicitations will often provide for adjustments to consider one or more of the following:
    - Time value of money.
    - Cost uncertainty.
    - Inflation.
- Should (when applicable) advise prospective offerors about energy efficiency standards that prescribe a minimum level of energy efficiency for covered contract items.
- Should (when applicable) require offerors to provide product information from the energy use and efficiency labels that provide information on covered contract items (e.g., central air conditioners, clothes dryers, clothes washers, freezers, and room air conditioners).

*General Evaluation Requirements* ( FAR 23.203 ).

**Step 1. Determine Solicitation Provisions.**

When energy cost will be considered as a price-related factor in offer evaluation, the solicitation must identify any cost information required from each offeror and state how energy costs will be considered in making the contract award decision.

**Step 2. Determine Offered Price(s).**

Determine the price(s) in each offer for each item or group of items being considered for contract award. Also assure that the offer contains the information required by the solicitation to evaluate energy-related factors in price analysis.

**Step 3. Evaluate Possible Award Combinations.**

Evaluate offers using the specific criteria set forth in the solicitation, including any adjustments for:

- Time value of money;
- Cost uncertainty; or
- Inflation.

**Step 4. Make Award Decision.**

Award to the firm whose offer provides the best value to the Government under the terms of the solicitation.

*Evaluation Example.*

**Step 1. Determine Solicitation Provisions.**

Assume that you are acquiring 1,000 hot water heaters with a 50 gallon capacity **.** Because of extreme hard water conditions in area water systems, technical personnel estimate useful life at five years **.**

The solicitation states that award will be made to the responsible offeror with a technically acceptable offer and the lowest evaluated price. It also includes the following provision:

Award will be made to the firm whose offer will provide the lowest total discounted cost of acquisition and ownership to the Government during the first five years of operation, considering price and energy cost. Estimates of energy cost will be based on the energy use and efficiency label provided by the manufacturer under 42 U.S.C. 6296

**Step 2. Determine Offered Price(s).**

You received two offers **.** The prices shown below are for 1,000 units. Annual energy costs are total estimated costs for the 1,000 units. Energy costs are based on the projected hours of operation and the energy use and efficiency label figures provided by each offeror and are calculated as follows:

| **Offeror** | **Offer** | **Annual Energy Cost** |
|---|---|---|
| 1 | $360,000 | $560,000 |
| 2 | $370,000 | $520,000 |

**Step 3. Evaluate Possible Award Combinations.**

As stated in the solicitation provision, expenditures and receipts must be "discounted." In terms of your analysis, discounting refers to the financial concept of the time value of money. Under that concept, the net present value of a dollar paid (received) today is more than the net present value of dollar paid (received) at any future time, because the holder of the money can collect interest.

Net present value, will depend on the amount of the payment (receipt), the discount (interest) rate, and the time when the payment (receipt) will take place. For example:

- If you must pay one dollar today, the net present value of the payment is one dollar;

If you must pay one dollar one year from now and the discount (interest) rate is 10 percent, the net present value is $.90909. In other words, $.90909 invested at 10 percent interest will be worth approximately $1.00 at the end of one year.

Net present value analysis allows you to consider the time value of money in comparing alternatives with different expenditures/receipts at different points in time. Using net present value analysis, financial experts in your organization have calculated that the net present value of an annual energy cost for five years is the annual cost multiplied by 3.97581 **.** The net present value of an annual cost of $1.00 for five years would be $3.97581 ($1 x 3.97581).The net present value of $100 for five years would be $397.581 ($100 x 3.97581).The net present value of $1,000 would be $3,957.81 ($1,000 x 3.97581).

In accordance with the solicitation provision, evaluate the offers by summing proposed price and net present value of the 5-year energy cost **.** Note that the energy cost for one year is greater than the price of the heaters.

| **Offeror** | **Offer** | **Net Present Value of 5-Year Energy Cost** | **Evaluated Price** |
|---|---|---|---|
| 1 | $360,000 | $560,000 x 3.97581 = $2,226,453.60 | $2,586,453.60 |
| 2 | $370,00 | $520,000 x 3.97581 = $2,067,421.20 | $2,437,421.20 |

**Step 4. Make Award Decision.**

Make award to the offeror with the lowest evaluated price, including consideration of annual energy-related costs for five years **.** In this case, Offeror 2 should receive the contract award.

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## 5.8 Lease Vs. Purchase Factors

*Lease vs. Purchase Decision* ( FAR 7.401 ). Agencies should consider whether to lease or purchase equipment based on a case-by-case evaluation of comparative costs and other factors.

- As a minimum, the acquisition team should consider the following factors:
  - Estimated length of time that the equipment will be used and the extent of use during that period;
  - Financial and operating advantages of alternative types of equipment;
  - Cumulative rental payments for the estimated period of use;
  - Net purchase price;
  - Transportation and installation costs;
  - Maintenance and other service costs; and
  - Potential obsolescence of the equipment because of imminent technological improvements.

- In addition, the acquisition team should consider the following factors (as appropriate) depending on the type, cost, complexity, and estimated period of equipment use:
    - Availability of purchase options;
    - Potential for use of the equipment by other agencies after its use by the acquiring agency;
    - Trade-in or salvage value;
    - Imputed interest; and
    - Availability of a servicing capability, especially for highly complex equipment.

*When to Purchase* ( FAR 7.402(a) ). Generally, the purchase method is appropriate if the equipment will be used beyond the point at which cumulative leasing costs exceed purchase costs. The acquisition team should not rule out equipment purchase, in favor of leasing, merely because future technological advances might make the selected equipment less desirable.

*When to Lease* ( FAR 7.402(b)(2) ). The lease method is appropriate when it is advantageous to the Government. The lease method may also serve as an interim measure when the circumstances:

- Require immediate equipment use to meet program or system goals; but
- Do not currently support acquisition by purchase.

*When to Consider as a Price-Related Factor* . Generally the lease vs. purchase decision is not made as part of an evaluation of competitive offers. Rather, it is made based on data collected especially for that purpose.

However, there are situations in which it may make sense to solicit such competition. For example, if equipment requires a unique maintenance capability, you might solicit competition to determine which alternative offers the best value, lease including maintenance or purchase with contract or in-house maintenance.

*General Evaluation Requirements.*

**Step 1. Determine Solicitation Provisions.**

The solicitation should define what costs you will consider in the award decision and how you will consider those costs **.** For example:

- Will you adjust a flow of expenditures over time for an imputed (assumed) cost of money?
- Will you adjust expenditure estimates to consider the probability of incurrence?

**Step 2. Determine Offered Price(s).**

Determine the price(s) in each offer for each item or group of items being considered for contract award. Also assure that each offer includes any other information required for offer evaluation.

**Step 3. Evaluate Possible Award Combinations.**

Evaluate offers using the specific criteria established in the solicitation.

**Step 4. Make the Award.**

Award to the firm whose offer provides the best value to the Government under the terms of the solicitation.

*Evaluation Example .*

**Step 1. Determine Solicitation Provisions.**

Assume that you have a requirement for material handling equipment to replace existing equipment that is beyond repair . Even with the new equipment, the present operating facility will close in 24 months . At that time, purchased equipment will be sold at auction . Rental equipment will be returned to the vendor . Because of the limited period of use, you are soliciting offers for lease as well as for purchase . You expect the operation and maintenance cost to be the same with all items offered, as a result you will only consider the costs related to acquisition and disposal.

The solicitation states that award will be made to the responsible offeror with a technically acceptable offer and the lowest discounted cost to the Government. It also includes the following provision:

The Government will acquire the equipment identified in Section B by either lease or purchase . The method of acquisition and the successful offeror will be determined based on the lowest discounted total cost to the Government for acquisition and disposal . Operation and maintenance costs will not be considered in offer evaluation.

**Step 2. Determine Offered Price(s).**

Offers were received from two firms . One offer was based on Government purchase of the item, the other on Government lease . The proposed lease is for a two-year period.

| Offer | Government Expenditure Beginning of Year 1 | Government Expenditure End of Year 1 |
|---|---|---|
| 1<br><br>(Purchase) | $146,000 | N/A |
| 2<br><br>(Lease) | $70,500 | $70,500* |

* The lease payment is due at the beginning of each year . For analysis purposes, the beginning of Year 2 is the same as the end of Year 1.

**Step 3. Evaluate Possible Award Combinations.**

To evaluate the cost to the Government, you must consider all of the relevant costs and receipts that would result from purchase or lease of the equipment.

- **For the purchase** , there would be an expenditure of $146,000 at the beginning of Year 1 to purchase the equipment . There would also be a receipt at the end of Year 2 when the equipment is sold at auction . Your best estimate of the sale value is $6,000.

**For the lease** , there would be an expenditure at the beginning of Year 1 for the first 12-month lease cost . There would be a second expenditure at the end of Year 1 for the second 12-month lease cost . There would be no receipt or expense at the end of Year 2.

| Offeror | Government Expenditure Beginning of Year 1 | Government Expenditure End of Year 1 | Government Receipt End of Year 2 |
|---|---|---|---|
| 1 (Purchase) | $146,000 | N/A | $12,000 |
| 2 (Lease) | $70,500 | $70,500 | N/A |

As stated in the solicitation provision, expenditures and receipts must be "discounted." In terms of your analysis, discounting refers to adjustment for the net present value of a dollar expenditure or receipt at a later time.

- A dollar spent at the beginning of Year 1 would not be adjusted.
- If the interest rate is 10 percent:
  - The net present value of $1.00 spent at the end of Year 1 would be $.90909 (i.e., $.90909 invested at 10 percent will be worth approximately $1.00 at the end of one year).

The net present value of a dollar to be spent or received at the end of Year 2 is $ .82645 (i.e., $.82645 invested at 10 percent will be worth approximately $1.00 at the end of two years) **.**

Using the established values for net present value at the end of one year and at the end of two years, the net present value of the purchase and lease options would be:

| Offeror | Government Expenditure Beginning of Year 1 | Government Expenditure End of Year 1 | Government Receipt End of Year 2 | Evaluated Price |
|---|---|---|---|---|
| 1 (Purchase) | $146,000 | N/A | $9,917 ($12,000 x .82645) | $136,083 |
| 2 (Lease) | $70,500 | $64,091 ($70,500 x .90909) | N/A | $134,591 |

**Step 4. Make Award Decision.**

Make award to the offeror with the lowest evaluated cost to the Government, Offeror 2.

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## 5.9 Small Disadvantaged Business Price Evaluation Adjustment

*Small Disadvantaged Business Price Evaluation Adjustment* . ( FAR 19.201(b) and FAR 19.1101 ).

The small disadvantaged business price evaluation adjustment (PEA) is a price-related factor that may be applied in contract award decisions where a small disadvantaged business (SDB) concern is competing with one or more concerns that are not SDB. Joint ventures that include an SDB may also qualify for a price adjustment if they meet requirements identified in the FAR.

The Department of Commerce will annually determine the applicable PEA factor(s). A factor may apply to all SDB concerns offering items in a North American Industry Classification System (NAICS) Industry Subsector or it may only apply to SDB concerns from identified regions of the country.

- The determination affects solicitations issued on or after the effective date of the determination. Ongoing acquisitions are not affected.
- The effective date of the determination must be no less that 60 days after its publication date.

Determinations are summarized on the Internet at Subpart 19.11-Price Evaluation Adjustment for Small Disadvantaged Business Concerns .

*When to Consider as a Price-Related Factor* ( FAR 19.1102 and DoD Class Deviation ).

All competitive solicitations must provide for consideration of the applicable PEA set by the Department of Commerce (DoC) unless one of the following exemptions applies:

- The acquisition is:
    - Less than or equal to the simplified acquisition threshold;
    - Awarded pursuant to the 8(a) program;
    - Set aside for small business concerns;
    - Set aside for HUBZone small business concerns **;**
    - Set aside for service-disabled veteran-owned small business concerns;

- Also,
    - Where price is not a selection factor so that a price evaluation adjustment would not be considered; or
    - Where all fair and reasonable offers are accepted.

Your agency may also have the authority to deviate from the PEA requirement. For example, Subsection 2323(e) of title 10, United States Code, as amended by section 801 of the Strom Thurman Defense Authorization Act for Fiscal Year 1999 and section 816 of the Bob Stump National Defense Authorization Act for Fiscal Year 2003, requires the Department of Defense to suspend the regulation implementing the PEA requirement if the Secretary of Defense at the beginning of the fiscal year determines that the DoD achieved the 5 percent goal for SBD awards in the most recent fiscal year for which data are available.

*Solicitation Requirements* . ( FAR 19.308 , FAR 19.1104 , FAR 52.219-1 , and FAR 52.219-23 ).

Assure that the FAR Small Business Program Representations provision is inserted in any solicitation that exceeds the micro-purchase threshold when the contract is to be performed inside the United States, its territories or possessions, Puerto Rico, the Trust Territory of the Pacific Islands, or the District of Columbia. Among other things, this provision permits each offeror to represent that it is an SDB. Review Subpart 19.11-Price Evaluation Adjustment for Small Disadvantaged Business Concerns to determine if a PEA applies to the NAICS of one or more of the items included in a solicitation and the amount of the required adjustment. When a PEA applies to any solicitation item and the solicitation is not otherwise exempted from the requirement:

- Insert the FAR Notice of Price Evaluation Adjustment for Small Disadvantaged Business Concerns clause in the solicitation. If a PEA is authorized on a regional basis, insert the clause even if the place of performance is not in an authorized region.
    - Use Alternate I of the clause when the contracting officer determines that there are no SDB manufacturers that can meet the requirements of the solicitation. This alternate permits the contractor to provide end items manufactured by any small business instead of end items manufactured by an SDB as required by the basic FAR clause.
    - Use Alternate II of the clause when a price evaluation adjustment is authorized on a regional basis. This alternate only permits a PEA adjustment when it might affect award to an SDB in the designated region.

Assure that the appropriate PEA percentage is inserted into the FAR Notice of Price Evaluation Adjustment for Small Disadvantaged Business Concerns clause.

*General Evaluation Requirements* . ( FAR 19.1103 and 52.219-1(b)(2) ).

**Step 1. Determine Solicitation Provisions.**

The solicitation must identify all factors that will be considered in offer evaluation. In particular:

- Assure that the solicitation includes the FAR Notice of Price Evaluation Adjustment for Small Disadvantaged Business Concerns clause and the Small Business Program Representations provision.
- Review offeror representations to identify any SDB offerors.
- Identify the PEA percentage cited in the FAR Notice of Price Evaluation Adjustment for Small Disadvantaged Business Concerns clause.
- Identify any SDB offerors that have waived PEA use in offer evaluation. Offerors may waive use for many different reasons (e.g., inability to comply with requirements to obtain manufactured items from an SDB).

**Step 2. Determine Offered Prices**

Determine the price(s) in each offer for each item or group of items being considered for contract award.

**Step 3. Evaluate Possible Award Combinations.**

Evaluate offers using the specific criteria set forth in the solicitation. Add other evaluation factors (e.g., transportation costs or factors to consider rent-free use of Government facilities) to the offers before applying the price evaluation adjustment. In applying the PEA:

- As you evaluate offers, add the PEA factor cited in the FAR Notice of Price Evaluation Adjustment for Small Disadvantaged Business Concerns clause to all offers, except offers from:
    - SDB concerns that have not waived the PEA; or if the PEA for small disadvantaged business concerns is authorized on a regional basis, offers from small disadvantaged business concerns, whose address is in such a region, that have not waived the PEA;
    - otherwise successful offers from historically black colleges and universities or minority institutions
- Apply the PEA factor on a line item or a group of line items on which award may be made.
- Do not evaluate offers using the PEA when it would cause award, as a result of this adjustment, to be made at a price that exceeds fair market price by more than the factor as determined by the Department of Commerce.

**Step 4. Make Award Decision.**

Award to the firm whose offer provides the best value to the Government under the terms of the solicitation.

(FAR FAR 19.1103 and FAR 52.219-23(c) , DFARS 225.000-70 and DFARS 252.225-7001 )

*Evaluation Example* ( FAR 19.1103 , FAR 52.219-1(b)(2), and FAR 52.219-23(c) ).

**Step 1. Determine Solicitation Provisions.**

Assume that the solicitation states that award will be made to the responsible offeror with a technically acceptable offer and the lowest evaluated price.

- It also includes the FAR Notice of Price Evaluation Adjustment (PEA) for Small Disadvantaged Business Concerns clause and the Small Business Program Representations provision.
- The PEA cited in the solicitation is 10 percent.

**Step 2. Determine Offered Price(s).**

Three domestic offers were received. Offeror 1 is a large business, but not an SDB concern. Both Offeror 2 and Offeror 3 are SDB concerns. However, Offeror 3 has waived PEA use in offer evaluation.

| Offeror | Evaluation Status | Offer |
|---|---|---|
| 1 | Large Business | $365,000 |
| 2 | SDB -- No PEA Waiver | $401,500 |
| 3 | SDB -- Waived PEA | $396,000 |

**Step 3. Evaluate Possible Award Combinations.**

Using the 10 percent PEA factor cited in the solicitation, the evaluated price for each offer is shown below:

| Offeror | Offer | Price Evaluation Adjustment | Evaluated Price |
|---|---|---|---|
| 1 | $364,000 | $365,000 x .10 = $36,400 | $400,400 |
| 2 | $401,500 | - 0 - | $401,500 |
| 3 | $396,000 | $396,000 x .10 = $39,600 | $435,600 |

**Step 4. Make the Award.**

Make award to the offeror with the lowest evaluated price, Offeror 1.

## 5.10 HUBZone Price Evaluation Preference

*HUBZone Program* ( FAR 19.1301 , FAR 19.1305 , FAR 19.1306 , and FAR 19.1307 ).

The Historically Underutilized Business Zone (HUBZone) Act of 1997 created the HUBZone Program (sometimes referred to as the HUBZone Empowerment Contracting Program). The purpose of the Program is to provide Federal contracting assistance for qualified small business concerns located in historically underutilized business zones, in an effort to increase employment opportunities, investment, and economic development in those areas.

*Participating Agencies* . Until September 30, 2000, only following agencies will participate in the HUBZone Program:

- Department of Agriculture.
- Department of Defense.
- Department of Energy.
- Department of Health and Human Services.
- Department of Housing and Urban Development.
- Department of Transportation.
- Department of Veterans Affairs.
- Environmental Protection Agency.
- General Services Administration.
- National Aeronautics and Space Administration.

On or after September 30, 2000, all Federal agencies that employ one or more contracting officers will participate in the Program.

*Solicitation Requirements* ( FAR 13.307(a) , FAR 19.1308 , FAR 52.219-1, and FAR 52.219-4 ).

If you are in a participating agency:

- Assure that the FAR Small Business Program Representations provision with its Alternate II is inserted in any solicitation that exceeds the micro-purchase threshold when the contract is to be performed inside the United States, its territories or possessions, Puerto Rico, the Trust Territory of the Pacific Islands, or the District of Columbia. Among other things, this provision permits each offeror to represent that it is a HUBZone small business concern.
- When you anticipate full and open competition, assure that the FAR Notice of Price Evaluation Preference for HUBZone Small Business Concerns clause is inserted in any solicitation that exceeds the micro-purchase threshold. This clause:
    - Informs prospective offerors that a 10-percent PEP will be considered in contract award;
    - Establishes guidelines that an offeror must meet to qualify for the evaluation preference, including related contract performance requirements; and
    - Permits the offeror to waive PEP consideration.

*General Evaluation Requirements* ( FAR 19.1307 and FAR 52.219-1(b) ).

**Step 1. Determine Solicitation Provisions.**

The solicitation must identify all factors that will be considered in offer evaluation. In particular:

- Assure that the solicitation includes the FAR Notice of Price Evaluation Preference for HUBZone Small Business Concerns clause and the Small Business Program Representations provision with its Alternate II.
- Review offeror representations to identify any offeror representing that it is a HUBZone small business concern.
- Identify any HUBZone concern that has waived PEP consideration. Offerors may waive PEP consideration for many different reasons (e.g., inability to comply with requirements that at least 50 percent of all manufacturing cost (excluding materials cost) will be performed by the contractor or another HUBZone small business concern).

**Step 2. Determine Offered Prices**

Determine the price(s) in each offer for each item or group of items being considered for contract award.

**Step 3. Evaluate Possible Award Combinations.**

Evaluate offers using the specific criteria set forth in the solicitation. As you evaluate offers consider the following PEP requirements:

- For each offer, calculate the base offer (BO). The BO is the total evaluated price considering **all** price-related evaluation factors (e.g., transportation cost, small disadvantaged business concern price evaluation adjustment (PEA), etc.) except the PEP.
- Calculate the final evaluated price.
    - For the following offers, the Base Offer (BO) is the final evaluated price:
    - Offers from HUBZone small business concerns that have not waived the PEP;
    - Otherwise successful offers from small business concerns;
    - Otherwise successful offers of eligible products under the Trade Agreements Act when the acquisition equals or exceeds the applicable FAR dollar threshold; and
    - Otherwise successful offers where application of the factor would be inconsistent with a Memorandum of Understanding or other international agreement with a foreign government.
- For other offers:
    - If a PEA was added to the offered price in calculating the BO, calculate the final evaluated price as follows:

Final Evaluated Price = BO + [.10 x (BO - PEA)]

    - If a PEA was not added to the offered price in calculating the BO, calculate the final evaluated price as follows:

Final Evaluated Price = BO + [.10 x BO]

**Step 4. Make Award Decision.**

Award to the firm whose offer provides the best value to the Government under the terms of the solicitation.

*Evaluation Example* ( FAR 19.1103 and FAR 52.219-1(b) ).

**Step 1. Determine Solicitation Provisions.**

Assume the solicitation states that award will be made to the responsible offeror with a technically acceptable offer and the lowest evaluated price. It also includes the FAR:

- Notice of Price Evaluation Preference for HUBZone Small Business Concerns clause;
- Notice of Price Evaluation Adjustment for Small Disadvantaged Business Concerns; and
- Small Business Program Representations provision with its Alternate II.

**Step 2. Determine Offered Price(s).**

Four domestic offers were received. Offeror 1 is an SBD concern located in a HUBZone. Offeror 2 is an SDB not located in a HUBZone. Offeror 3 is a small business not located in a HUBZone. Offeror 4 is a large business. The HUBZone concern did not waive the PEP.

| Offeror | Evaluation Status | Offer |
|---|---|---|
| 1 | HUBZone SBD | $220,000 |
| 2 | SBD | $231,000 |
| 3 | Small Business | $240,000 |
| 4 | Large Business | $223,200 |

**Step 3. Evaluate Possible Award Combinations.**

A 10-percent PEA is only price-related factor that must be considered before PEP evaluation. The calculation of the final evaluated price is shown below:

| Offeror | Offer | Base Offer (After PEA) | Final Evaluated Price |
|---|---|---|---|
| 1 | $220,000 | $220,000 | $220,000 |
| 2 | $210,000 | $210,000 | $210,000 + [.10 x $210,000) = $231,000 |
| 3 | $200,000 | $200,000 + (.10 x $200,000) = $220,000 | $220,000 + [.10 x ($220,000 - $20,000)] = $240,000 |
| 4 | $186,000 | $186,000 + (.10 x $186,000) = $204,600 | $204,600 + [.10 x $186,000) = $223,200 |

**Step 4. Make the Award.**

Make award to the offeror with the lowest evaluated price, Offeror 1.

*Evaluation Example Note* . Suppose that the contracting officer rejected Offer 4 because Offeror 4 was nonreponsible. That would affect the remainder of the analysis because you must not add the PEP to an otherwise successful offer from a small business concern. The calculation of the final evaluated price is shown below:

| Offeror | Offer | Base Offer (After PEA) | Final Evaluated Price |
|---|---|---|---|

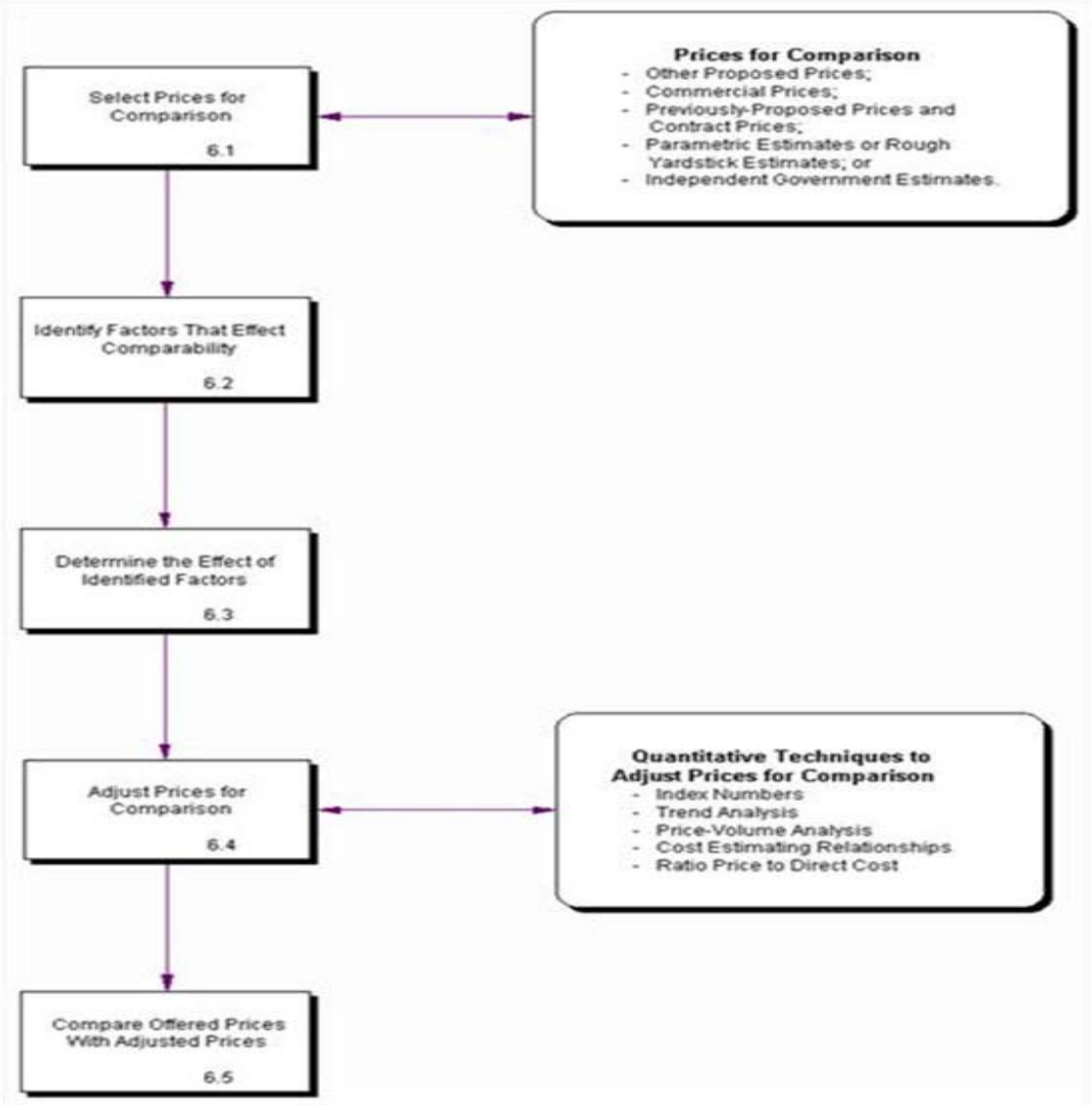
| | | | |
|---|---|---|---|
| 1 | $220,000 | $220,000 | $220,000 |
| 2 | $210,000 | $210,000 | $210,000 |
| 3 | $200,000 | $200,000 + (.10 x $200,000) = $220,000 | $220,000 + [.10 x ($220,000 - $20,000)] = $240,000 |

Now Offeror 2 has the lowest evaluated price after all other price-related factors are considered.



## 6.0 Chapter Introduction

The figure below depicts the process involved in making price comparisons for price analysis.

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*Comparisons in Price Analysis for commercial and non-commercial items* ( FAR 15.404-1(b)(1) ). Price analysis:

- Is the process of examining and evaluating a proposed price to determine if it is fair and reasonable without evaluating its separate cost elements and proposed profit. Price analysis may, however, be supported by cost analysis of cost elements and/or profit when price analysis alone cannot determine a fair and reasonable price necessary.
- Always involves some form of comparison with other prices.

Hence, you compare prices to determine whether the price from the apparent successful offer is fair and reasonable. The basis for your comparison should be a price that has been determined a reasonable estimate of the price a reasonable person is willing to pay.

*Should-Pay Price.* The should-pay price, used for comparison, is the price that, in your best judgment, the Government should reasonably expect to pay for the deliverable based on available information concerning competitive offers, historical prices previously paid, validated commercial prices, pricing yardsticks, and Independent Government Estimates (IGE).

Bear in mind the that your should-pay price is an estimate and therefore just an approximation of the price the Government can expect to pay. Being an estimate, it is by definition inexact. If the estimate was developed using validated and supported information, with sound rationale, and you have done a good job of price analysis, your should-pay price should be sufficient for negotiations. Still, don't be dogmatic about your the estimate - to the point of rejecting offers that are close to, but not exactly at, your should-pay price estimate.

If the apparent successful offer is significantly higher or lower than your the developed Government estimate:

- Determine Investigate the possible reasons why there is a significant variance between the should-pay price and that offered price, document you findings, and then determine if the Government should open communications or discussions, which ever is relevant.

Make the critical price-related decisions in awarding contracts through sealed bidding or negotiations.

*Comparability* . Comparability is the quality or state of being comparable and having features in common with something else to permit or suggest comparison. Products do not have to be alike to be compared. Any two things can be compared, but the comparison may show that they have no characteristics in common. However, If you are attempting to evaluate price reasonableness, the comparison will not be of any value if the items are unlike in every way.

For price analysis, the items being compared must have enough similar characteristics or qualities to make the comparison useful. The more similar the items are, the easier the comparison. If your examination discloses significant differences, you may need to quantify the effect of those differences (e.g., acquisition of different products, at different times, or in different places, or under differnt terms and conditions) and make adjustments before you can reach valid conclusions about price reasonableness. The greater the dissimilarities and the more subjective your adjustment, the greater the possibility for doubts about your conclusions and the less likely that your analysis will be persuasive.

*Multiple Comparisons* . Use the information gathered during your market research to make multiple comparisons in determining price reasonableness and increase confidence in your pricing decision.

**For example, adequate price competition is normally considered one of the best bases for price analysis.** However, you can have apparent competition and still have prices that are unreasonably high. How would you know? You must consider other bases for price analysis (e.g., historical prices, catalog prices, or market prices).

The number of comparisons that you consider should depend on the availability of information and the pricing risk involved in the acquisition.

- If the information is readily available in a form that can be used for price analysis, why not consider it? A quick comparison will increase your confidence of price reasonableness.

If the price is to high, to low, or you still have concerns about price reasonableness after your initial comparison, the risk involved makes it particularly important to consider other comparisons.

*Comparison Steps* . Each different comparison will involve different information and some bases will require substantial adjustment prior to making your analysis. However, the comparison process is described in five steps outlined below.

| **Step** | **Action** | **Questions to Consider** |
|---|---|---|
| 1 | Select prices for comparison:<br><br>• Other proposed prices;<br>• Commercial prices;<br>• Previously-proposed prices and contract prices;<br>• Parametric estimates or rough yardstick estimates; or<br>• Independent Government Estimates | Would this comparison be valid?<br><br>Are more comparable prices available?<br><br>Were previously proposed prices considered from reasonable sources and can be validated?<br><br>Was the validity of the comparison and the reasonableness of the previous price(s) paid established and supported? It is not adequest to just compare the price to a previous contract unless the contract used for comparison can establish price resonableness to include supporting rational. |
| 2 | Identify factors that affect comparability. | Have I considered all potentially significant factors, including differences in:<br><br>• Market and economic conditions;<br>• Quantity or size;<br>• Geographic location;<br>• Purchasing power of the dollar;<br>• Extent of competition;<br>• Technology; or<br>• Terms and conditions under contracts (e.g., differences in features or capabilities, delivery lead-times, one-time costs, etc.) resulting from adequest competition. |
| 3 | Determine the potential impact of these factors on prices selected for comparison. | How substantial is the impact? In view of these factors and their impact, will the contemplated comparison have any credibility? |
| 4 | Adjust prices selected for comparison. | Have I accounted for all factors that can impact the price?<br><br>What techniques should be applied in making the adjustment?<br><br>How much reliance can I place on the resulting estimate? |
| 5 | Compare adjusted prices to the offer in line for award. | How much weight should I place on each comparison?<br><br>If adjusted prices differ substantially from the apparent successful offer, what price should the Government reasonably expect to pay?<br><br>Are significant factors identified and are the substantial |

| | | |
|---|---|---|
| | | differences accounted for? |

## 6.1 Selecting Prices For Comparison

This section identifies and defines five potential bases for various price analysis techniques. After defining each base technique, special considerations for using each technique base are outlined.

- 6.1.1 - Other Proposed Prices
- 6.1.2 - Commercial Prices
- 6.1.3 - Previously-Proposed Prices And Contract Prices
- 6.1.4 - Parametric And Rough Yardsticks Estimates
- 6.1.5 - Independent Government Estimates

*Price Analysis Techniques Potential Bases* ( FAR 15.404-1(b) ). You may select any of the following techniques bases for price analysis:

- Comparison of Other proposed prices received in response to the solicitation;
- Comparison with commercial prices including competitive published price lists, published commodity market prices, similar indexes, and discount or rebate arrangements;
- Comparison to previously-proposed prices, historical prices paid by the Government or other than the Government, and contract prices for the same or similar end items, if you can establish both the validity of the comparison and the reasonableness of the previously proposed prices;
- Parametric estimates or estimates developed using rough yardsticks; or
- Independent Government Estimates.

One of the techniques basis for price analysis identified in the FAR is "prices for the same or similar items obtained through market research." Because market research can span commercial prices, previously-proposed prices, contract prices, parametric or rough yardstick estimates, and Independent Government Estimates, this technique basis for price analysis will not be considered separately.

Types of comparisons used in price analysis typically vary with the estimated dollar value of the contract.

**Micro-purchases.** (FAR 13.2) Micro-purchases may be awarded without soliciting competitive quotes if the contracting officer or individual appointed in accordance with FAR 1.603-3(b) considers the price to reasonable. The administrative cost of verifying the reasonableness of the price may more than offset potential savings from the effort, so verifying price reasonableness need only be taken if -

- You suspect or have information to indicate that the price may not be reasonable; or
- Purchasing a supply or service for which no comparable pricing information is readily available.

**Other Simplified Acquisitions** ( FAR 13.1 ) **.** Comparing competitive quotes is the preferred method for pricing these acquisitions.

- If you only receive one quote, consider the following bases for price analysis **[(13.106-3(a)(2)** ]:
    - Prices identified during market research;
    - Prices found reasonable for previous purchases;

- Current price list, catalog, or advertised prices;
- Prices for similar items in a related industry;
- Price estimates developed during value analysis;
- Personal knowledge of item prices;
- The Independent Government Estimate; or
- Any other reasonable base for price analysis.

**Contracts over the Simplified Acquisition Threshold.** Consider every type of comparison which you believe provides a valid should-pay price.

- For example, if you have data on previous or historical contract prices paid and have reason to believe that these data reflect good prior decisions on price reasonableness or the data has been validated, then compare the apparent successful offer to those prices. If you have reason to believe that previous contract prices were not reasonable, then give little or no weight to those prices as you perform your price analysis. If you have no price history, you must rely on other comparison techniques bases for your price analysis. If you do compare to previous or historical contract prices, make sure that you adjust those prices to reflect differences in quantity, economic conditions, and the differning terms & conditions.

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### 6.1.1 Other Proposed Prices

*Proposed Prices* ( FAR 15.404-1(b)(2) ). Comparison of a proposed price with other proposed prices received in response to the same solicitation is generally considered one of the preferred techniques best bases for price analysis, because all offers were submitted to meet the same requirement during the same time period.

*Using Proposed Prices* ( FAR 15.403-1(c)(1) ). Any proposed price used as a base for prices analysis must meet the following general requirements:

- The price must be submitted by a firm competing independently for contract award.
- The price must be part of an offer that meets Government requirements.
- Award must be made to the offeror whose proposal represents the best value to the Government.

If you have more than one competitive offer, you could use more than one offer in your analysis.

**Do not** use the price from any offer that you would not consider for contract award as a basis for price analysis.

- Never use an offer from a firm that you have determined is nonresponsible.
- In sealed bidding, never use a nonresponsive bid.

In negotiations, never use a price from a proposal that is technically unacceptable.

You should normally place less reliance on comparisons with other proposed prices when:

- The solicitation was made under conditions that unreasonably denied one or more known and qualified offerors an opportunity to compete.

- The apparent successful offeror has such a decided advantage that it is practically immune from competition.
- The apparent successful offeror's price is significantly different (higher or lower) than the next rated offeror. This could indicate that there is a mistake in bid, a misunderstanding of the contract requirements, etc. In this situation, you should take steps to verify the offeror's bid and/or use another technique to analyze the price.
- Another price comparison, cost analysis, or a cost realism analysis indicates that the apparent successful offer may be unreasonable (too high or too low).
- Government requirements permit offerors to propose widely different technical approaches to contract performance. For example, a ceramic mug and a paper cup may both meet a requirement to hold 8 ounces of coffee, but that does not mean that $1.00 price for a paper cup is reasonable because it is less than a $5 price for a ceramic mug. Even if no other offeror is proposing to provide a paper cup, the key element of your price analysis should be to compare the paper cup offer with prices paid for similar paper cups.
- Price is not a substantial factor in the evaluation of offers for contract award. However, the Comptroller General (CGEN) has found adequate price competition in cases where price was assigned a weight of only 20 percent in the award decision.
- All offerors are expected receive contract awards. In such cases, there may not be sufficient competitive pressure to foster fair and reasonable pricing.

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### 6.1.2 Commercial Prices

( FAR 15.404-1(b)(2) ). Commercial prices are prices being paid by the general public for a product. **These prices can be used for comparison purposes when purchasing that product or one that is similar to that product.** The circumstances of your purchase may be different from the commercial sales, but data on commercial sales can provide valuable information for use in contract pricing.

*Using Commercial Prices* ( FAR 15.404-1(b)(2) ). You can classify the sources of commercial pricing information into three categories:

- **Competative Published price list** -- prices taken from a catalog, price list, schedule, or other verifiable and established record that is regularly maintained by a manufacturer or vendor and is published or otherwise available for customer inspection. For pricing purposes (but not cost or pricing data exception purposes), you can consider published pricing information from the firm submitting the offer and/or published pricing information from other firms offering similar products.
- **Competative Published market prices of Commodities** -- prices established in the course of ordinary and usual trade between buyers and sellers free to bargain that can be substantiated from sources independent of the offeror. Normally, market pricing information is taken from independent market reports, but a market price could be established by surveying the firms in a particular industry or market.
- **Similar indexes** -- commercial item prices established using a means other than those described above. For example, an offeror might provide information on the

prices charged commercial customers over a period of time. Such a record would not qualify as published price list or market price since the price was not independently verifiable, but it would provide a good record of the firm's commercial pricing practices.

*Discounts Arrangements* . Commercial sales typically include discounts for different types of customers. Discount amounts typically depend on the product and the marketing strategy of the firm. Common factors affecting discounts include, services provided by the seller (e.g., wholesale and retail sales) and the importance of the sale (e.g., dollars involved or the relationship to other sales).

*Rebate Arrangements* . Rebates are often offered to various customers based on the customer's total purchases over a specific period of time. For example, automobile manufacturers typically offer dealers rebates, based on total sales. That is one reason why dealers can advertise sales "at invoice." Dealer profit is based on the rebate amount.

*Contracting Situation Differences* . Remember that your contracting situation may be different than the situation in the commercial market. For example, the offeror may provide services to commercial customers that are not required by the Government. If the Government is receiving less, you should expect to pay less. You must identify these differences and determine what impact, if any, they have on the price of the item. This analysis will form the basis of both the negotiation of the terms and conditions (including price) related to your contract and the associated price reasonableness determination.

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### 6.1.3 Previously-Proposed Prices And Contract Prices

*Historical Prices* ( FAR 15.404-1(b)(2) ). Previously-proposed prices and validated contract prices that were paid (weather by the Government or other than the Governmet) are historical prices paid for same or similar items-- prices related to past purchasing activity. The purchase associated with a particular price may have been made by your office or another office with similar requirements. **Note: The prior price used for comparison must be validated and reasonably cuurent in order to be used for comparison analysis.**

*Using Historical Prices* . Whenever you consider using historical prices to analyze price reasonableness, ask the following questions:

- ***Has the product been purchased before?***

The purchase may have been made by your procuement office or by another purchasing office.

- ***What was the historical price?***

You can obtain price information from purchase files, computer data files, or manual inventory item records.

- ***Was the historical price fair and reasonable?***

For a historical price to be useful in determining the reasonableness of an offered price, you must know that the historical price was fair and reasonable. Be careful! It is not uncommon to review an item purchase history and find that no other than that the last price paid has a significant time lapse between the last acquisition and the present one, the terms and conditions are significantly differnet, been used for years to determination of price reasonableness may be uncertain. In one study, the entire pricing histories for several items were reviewed and analysts found that for every acquisition except the first, the determination of price reasonableness was based on the last price paid. Analysts also found that the first acquisition was a multiple-item acquisition and while there was an analysis of the reasonableness of the overall acquisition price, no one ever examined the reasonableness of individual item prices. In other words, for years contracting officers found prices reasonable based on an arbitrary decision made during the first acquisition. The analysis You must ensure that the prior price was determined fair and reasonable based on an adequate price or cost analysis and the basis can be validated. Often, this may only require a phone call to the other contracting activity to obtain assurance that an adequate price/cost analysis was previously performed.

- ***Is the comparison valid?***

For the comparison to be valid, you must be able to identify and consider any item or market differences that might significantly affect contract price. A proper analysis validates the basis on which the prior price paid was determined fair and reasonable by examining the prior price to ensure there has not been a significant time lapse, the terms and conditions are not significantly different, and the reasonableness of the price is not uncertain. If these conditions cannot be met or information is lacking in documentation then the prior price may not be a valid basis for comparison.

- ***Was the Price Adjusted?***

The prior price must be adjusted to account for materially differing terms and conditions, quantities and market and economic factors. For similar items, the contracting officer must also adjust the prior price to account for material differences between the similar item and the item being procured (FAR 14.404-1(b)(2)(ii)(B)). The analysis must also account for minor modifications.

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### 6.1.4 Parametric And Rough Yardsticks Estimates

*Cost Estimating Relationships* ( FAR 15.404-1(b)(2) ). Cost estimating relationships (CERs) are used to develop parametric estimates or rough yardstick estimates. A CER is a formula for estimating prices based on the relationship of past prices with one or more product physical or performance characteristics (e.g., dollars per pound or dollars per horsepower). Whenever you can relate item price with the value of one or more physical or performance characteristics, you can use the relationship to estimate the price of a similar product. For example, builders commonly estimate the price of a planned building by multiplying the number of square feet in the building by an estimated cost per square foot. However, watch out for material differences or conditions such as a steel building vs. a stick building or a building meant to withstand harsh weather conditions. Significant differences may warrant additional pricing inquiry leading to possible discussions with offerors. Parametric estimating can only be done if these items are within range of the data used to establish the CER.

For more detailed information related to parametric estimating, see the **Parametric Estimating Handbook .**

*Using Cost Estimating Relationships.*

Whenever you consider using a CER to determine price reasonableness, ask the following questions:

- ***Has the CER been widely accepted in the market place?***

Determine whether both buyers and sellers agree on the validity of a particular relationship/yardstick and the reasonableness of values used in estimating. Sellers may use a relationship/yardstick that produces an estimate higher than that normally accepted by buyers.

- ***Does the CER produce reasonable results?***

The user of the relationship/yardstick has the burden of demonstrating that the relationship/yardstick produces reasonable estimates. The user should be able to demonstrate the data and calculations used to develop the relationship/yardstick.

- ***How accurate is the CER?***

Validate the using known product data and prices. Examine the accuracy of the results. Remember that even a properly developed pricing relationship/yardstick will not always predict price exactly. Some relationship/yardsticks are very accurate others will only give you a rough approximation of the proper price. If the variation is wide and there is no other means to determine price reasonableness then data other then certified cost or pricing data may be required from the offeror. As relationship/yardstick accuracy decreases, the weight that you place on the relationship/yardstick in your pricing decision should also decrease.

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**6.1.5 Independent Government Estimates (IGE)**

*Independent Government Estimates* . As the name implies, an Independent Government Estimate is an estimate made by the Government. This section will define and consider three types of Independent Government Estimate.

- The most common is the Independent Government Estimate, also known as the Independent Government Cost Estimate (IGCE), that accompanies the **purchase request.**
- A **value analysis estimate** results from a specialized analysis of the function of a product and its related price. It may literally involve taking the item apart to determine how it is made and why it costs what it does.
- A **visual analysis estimate** results from a visual inspection of an item, or drawing of an item, to estimate its probable value.

*General Guidelines on Using Independent Government Estimates* . The IGE is a useful tool used for comparison to the proposed price. The IGE is developed based on the most recent data determined to fulfill the Governments requirement and should accompany the procurement request. The submitted cost estimate shall include a basis for the Governments estimate using current validated data whether at the price level or at the cost element level. If an industry standard is used for validation then state why the selected industry standard is

the most appropriate authority. The dollar value, type procurement, and the complexity of the procurement will determine how detailed the IGE is to be. Cost element or price values alone are not adequate without a basis to support the estimated values. The cost estimate does not have to be an exact match to the offerors proposal to be used as a comparison, but should have adequate information to determine how the Governments approach to the estimate compares to the offerors understanding of the requirement. Differences in the comparison shall be analyzed and documented. The IGE should not be adjusted to the offerors price as the offerors approach may have differences the Government did not account for and may warrant additional pricing inquiry. The analyst must provide an adequate narrative validating the source or the basis of the information comprising the estimate. The details of the IGE are significantly more critical in a sole source environment where no competition exists and or where an exemption may exist from obtaining cost or pricing data from the offeror. The IGE may also be used as a comparison where two or more offers are received but only one offer is considered technically acceptable. Earlier in this text , you learned five questions to ask when analyzing the reliability and validity of Government purchase request estimates. Ask the same questions of any Independent Government Estimate before using it as a basis for comparison with offered prices.

- ***How was the estimate developed made?***
- ***What assumptions were made?***
- ***Were any differences in the comparison work statement accounted for?***
- ***What information and tools were used?***
- ***Where was the information obtained?***
- ***How did previous estimates compare with prices paid?***
- ***Were unique conditions applied to the prior procurments and do not apply now?***

*Special Considerations for Using Value Analysis* . You may apply the techniques of value analysis to any product, regardless of its complexity. However, generally consider only those products offering potential cost reductions that merit the time and cost of the analysis required.

Value analysis provides information on product value in comparison with possible substitutes. It is particularly useful when:

- The Independent Government Estimate is the only price analysis technique base available; or
- The product does not seem to be worth the price quoted.

To be effective, value analysis must be performed by individuals familiar with the product, or product material differences, and its use by the Government. Actual analysis should follow a 5-step process:

1. Determine acquisition costs based on current proposal or other estimates.
2. Assure Government requirement documents reflect the minimum needs of the Government.
3. Identify alternative products or methods of meeting the minimum needs of the Government. This is typically the key step in the analysis. The following are examples of questions you should consider:

    - ***Can any part of the product be eliminated?***
    - ***Can a standard part replace a special part?***
    - ***Can a lower cost material or method be used?***
    - ***Can paperwork requirements be reduced?***
    - ***Can the product be packaged more economically?***

4. Estimate the costs associated with alternative products or methods that would meet the minimum needs of the Government.
5. Document the reasonableness of the current prices or recommend appropriate changes. Assure that the process and results of the value analysis are clearly documented and include a copy of the documentation in the contract file. When you are satisfied that the value received supports the offered price, use that information to support your determination of price reasonableness. When you are not satisfied, use the information to document efforts to bring price in line with perceived value.

**For example:** Suppose you are purchasing a pair of shoes. Shoes are used to walk in, to protect the feet, to keep the feet warm, and to enhance appearance. If shoes are to be attractive, they must be made of certain types and quality of material. If appearance is not important to the Government, a less attractive, less expensive, but possibly more durable material can be used. By changing the quality of material required, price will change.

*Special Considerations for Using Visual Analysis* . In visual analysis, the analyst examines obvious external features of the product to determine value and related price. This technique is nothing more than technical experts comparing the product with other products by sight.

Consider using visual analysis as a pricing tool:

- In place of value analysis for products that do not offer potential cost reductions that merit the time and cost of analysis required for detailed value analysis.
- To review large numbers of products to identify any that appears to offer potential cost reductions that merit the time and cost associated with detailed value analysis.

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## 6.2 Identifying Factors That Affect Comparability

*Introduction.* When comparing prices, you must attempt to account for any factors that affect comparability. The following factors deserve special consideration because they affect many price analysis comparisons:

- Market conditions;
- Quantity or size;
- Geographic location;
- Purchasing power of the dollar;
- Extent of competition;
- The specific terms and conditions of the acquisition **;**
- Technology; and
- Government unique requirements.

*Market Conditions* . Market conditions change. The passage of time usually is accompanied by changes in supply, demand, technology, product designs, pricing strategies, laws and regulations that affect supplier costs, and other such factors. An effort to equate two prices, separated by five years, through a simple inflation adjustment may not be successful. Too many characteristics of the market are likely to have changed. Do not stretch data beyond their limits.

Generally select the most recent prices available. The greater the time lapse between the last acquisition and the current one difference, the greater the likelihood and impact of differences in market conditions. If you are comparing a current offer with a prior price, the ideal comparison would be with a contract price agreed to yesterday. That comparison would limit the effects of time on market conditions.

However, do not select a price for comparison merely because it is the most recent. **Look instead for prices that were established under similar terms and market conditions.** For instance, if you are buying commodity in the month of October, offers from the previous years month of October may be more comparable to current offers than prices paid last February, given the cyclical pattern of supply and demand in the market for a particular commodity.

Consider the most current available data on trends and patterns in market conditions. Remember that lags often occur between data collection and contract award. Changes in market conditions over that period can reduce the usefulness of the data assembled.

*Quantity or Size.* Variations in quantity can have a significant impact on unit price. A change in quantity can have an upward effect, a downward effect, or no effect at all.

In **supply and equipment** acquisitions, we usually assume that larger supply acquisitions command lower unit prices. Where economies of scale are involved, that should be the case. However, economies of scale do not always apply.

- Increases in order size beyond a certain point may tax a supplier's capacity and result in higher prices.
- Market forces may impose opportunity costs on a supplier which result in higher unit costs for greater volumes. For example, if the price of oil is expected to increase 20 percent over a 12-month period, a supplier may choose to withhold a portion for a sale at a later date when the price is higher. In such a market, the effect of purchase quantity on price may not be as expected; at some point, increases in volume will result in higher unit prices as the supply of the lower priced oil is exhausted.
- Finally, if a price comparison is based on standard commercial items that are produced at a regular rate, variations in quantity may have no effect at all.

A meaningful comparison of prices requires that the effect of volume on price be accounted for. The best way to do this is to select prices for comparison based on equal volumes. If that is not possible, examine the specific suppliers and the nature of the market at the time of the purchase.

In **service acquisitions** , the issues or problems are different. Variations in size can sometimes be neutralized by reducing the comparison to price per square foot or price per productive labor hour. Because these approaches are not always effective, try to factor out size or quantity variations as much as possible. If you don't succeed, the price comparison will have little value.

*Geographic Location* . Geography can have a range of effects on comparability. Prices for many nationally advertised products will not vary much from place to place. Nevertheless, because geographic location can affect comparability, you should first try to compare offered prices with prices obtained from the same area. In major metropolitan centers, you should generally be able to identify comparable bases for price analysis in the region. In more remote, less urban areas, you must often get pricing information from beyond the immediate area.

When you must compare prices across geographic boundaries, take the following actions to enhance comparability.

- Check for differences in the level competition that may affect price comparisons.

- Identify labor rate differences that must be neutralized for valid price comparisons. You cannot compare labor rates for U.S. labor with similar labor of a foreign nation unless you account for the economic differences and neutralize them using a constant variable.
- Check freight requirements and accompanying costs. These can vary considerably, especially for chemicals and other hazardous materials.

Identify geographic anomalies or trends. For example, an item may be more expensive on the West Coast than in the East Coast or more localized, rent for office space within the city central business district is higher as opposed to other locations within the same city for the same type office and square footage.

*Purchasing Power of the Dollar* . Inflation undermines comparability by eroding the real value of money. Because prices over time are expressed in the same currency (dollars and cents), the denominations must have comparable purchasing power if comparison is to be meaningful. You can normally use price index numbers to adjust for the changing value of the dollar over time.

*Extent of Competition* . When comparing one price with another, assess the competitive environment shaping the prices. For example, you can compare last year's competitive price with a current offer for the same item. However, if last year's procurement was made without competition, the analyst will need to understand the terms and conditions to ensure they are not significantly different to be valid basis for comparison. A poorly written specification and an urgent need may have combined to make competition impossible last year, but now the specifications have been rewritten and the delivery is not urgent. Given these circumstances, a current offer could be the same as (or less than) last year's best price and still not be reasonable.

*Terms and Conditions* . The terms and conditions related to a contract include things like packaging, delivery, financing, discounts, payment terms, etc. The analysis must account for these differences prior to examining the price. This is so the analysis does not produce a premise that the price is determined unreasonable. Prices on contracts for delivery in 90 days may well be higher than those for delivery in 180 days because the contractor may have to hire additional employees or pay overtime to expedite manufacturing to meet the shorter delivery date. A requirement that is not within the normal production line lot output and delivery constraints or when the Government has other complex demands or urgent delivery requirements may cause the price to be significantly higher than usual. An example would be the Government solicits for ten widgets and demands immediate delivery prior to a full lot size of fifty being produced which may account for a full load onto a single rail car. In this instance, the contractor has to account for the special circumstances and adjust the price upward to account for taking ten widgets out of the normal production line and paying for an entire rail car. Ten widgets are 20% of the rail car capacity, but the railcar rates and any tariffs remain unchanged. The cost per widget is now increased to account for all of this. Based on the Governments requirements the contractor is proposing a price based on those conditions and therefore may be determined reasonable.

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*Technology* . Prices from dying industries can rise because the technologies don't keep pace with rising costs. Conversely, technological advances in growth industries can drive prices down. The computer industry is an example. Technological advances have been made so fast that a comparison of prices separated by only a few weeks must account for these advances if the comparison is to have any value.

Engineering or design changes must also be taken into account. This means you must identify the new or modified features and estimate their effect on price.

*Government-Unique Requirements* . Often, the Government's requirements vary to some degree from the commercial requirements for similar products. The question is the impact these variations have on price. For example, the Government may require that the carpet in a Navy ship be fireproof to a far greater extent than any

commercial carpet. That may justify a substantial difference in price over otherwise comparable commercial carpets.

Similarly, you must often incorporate clauses in contracts that are not required in commercial market transactions. For example, contracts between buyers and sellers in the private sector do not include provisions relating to the Davis-Bacon Act, the Service Contract Act, clean air and water, and many other special conditions. Consequently, comparison of an offer with commercial prices may be difficult. Unique terms and conditions affect prices, but it is often extremely difficult to assign a dollar value to their effects.

Just as Government requirements may be different from commercial requirements, Government requirements at a specific time and place may be different than requirements at another time and place. These differences will also affect price comparisons.

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## 6.3 Determining The Effect Of Identified Factors

*Introduction* . Once you have identified the factors that may affect comparability, you must determine the effect on each specific comparison with the offered price. As you determine the effect of various factors on price comparisons, you must ask yourself the following questions:

- **What factors affect this specific comparison?**
- **How do these factors affect the comparison?**
- **Does this comparison, even with its limitations, contribute to the price analysis?**

*Other Proposed Prices* . In sealed bidding, all bids are priced against the contract requirements. Comparison with competitive prices is a straight forward comparison that normally requires no adjustments unless the evaluation process involves the use of price-related factors.

Comparing proposals may not be as simple as comparing bids, when:

- The offer in line for award departs from the stated solicitation requirements. If the departure does not meet stated contract requirements, but is acceptable to the Government, provide other offerors the opportunity to submit a revised proposal based on the revised requirements. However, you must not reveal any information about the proposed solution or any other offeror information entitled to protection.
- Offers differ in their basic approaches to meeting performance or functional requirements. Remember, the price of a ceramic mug is little help in determining if the price of a paper cup is reasonable, even though both can satisfy a requirement for a container that will hold eight ounces of coffee.

*Commercial Prices* . Any of the general factors identified earlier in this chapter could affect the comparability of commercial prices (i.e., market conditions may have changed since the effective date of published prices; the purchasing power of the dollar may have changed; the published prices may have been based on different terms and conditions than solicited by the Government).

During your analysis, you should give special consideration to asking how the following have affected price analysis comparisons:

- Is there a difference between the services provided commercial and Government customers? Are published prices retail, wholesale, or distributor prices?
- Is there a difference between the catalog (or suggested price) and the price paid by commercial customers with requirements similar to the Government's requirements?
- Are there different prices for different customer classes (e.g., are there different prices for different classes of customers-public vs. brokers vs. retailers?)
- What special rebates or discounts are offered commercial customers?
- Are published prices within a competative market that have already generated sales?

What is the value of extras provided commercial customers for promotional purposes (e.g., free packaging, free transportation, free insurance, etc.) without extra charge?

*Previously Proposed Prices and Contract Prices* . Consider all general factors identified earlier in the chapter. At minimum, ask the following:

- ***How have the specific changes in the contracting situation affected contract price?***

You need to understand the acquisition situation as it existed in the previous situation and how the current acquisition situation differs. Important data elements include:

  - Sources
  - Quantities
  - Production/Delivery Rates
  - Start-up Costs
  - Terms of Purchase

- ***How have changes in the general economic situation affected contract price?***

Economic changes are reflected in the general level of inflation or deflation related to the product that you are acquiring. Have prices gone up or down. If they have, how much have they changed?

*Parametric and Rough Yardstick Estimates.* Consider all general factors identified earlier in the chapter. In particular consider the questions above that apply to historical prices. After all pricing yardsticks are based on historical pricing information.

In addition, you must ask if the historical relationship remains valid. As a minimum, consider the following questions:

- **How have changes in market conditions affected the estimating relationship?**
- **How have changes in technology affected the estimating relationship?**
- **How have changes in production efficiency affected the estimating relationship?**
- **How have changes in the purchasing power of the dollar affected the estimating relationship?**

*Independent Government Estimates* . Consider all general factors identified earlier in the chapter for possible effects on comparability.

Independent Government Estimates, especially those developed previously for such purposes as preparing budgets, may no longer be valid. Budget optimism or pessimism can have a significant effect on budget estimates. In addition, many estimates are developed years before the actual contract action is initiated and may not be current. Ensure the IGE utilized in the analysis has current supporting information validating the data.

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## 6.4 Adjusting The Prices Selected For Comparison

*Introduction* . If you have a price analysis comparison technique base that does not require adjustment, use it! If you must make an adjustment, try to make the adjustment as objectively as possible. You may need to use statistical techniques or algebraic formulas to establish a common basis for comparison.

You must complete two basic tasks in order to establish comparability:

- Identify and document price-related differences, taking into account the factors affecting comparability.
- Factor out price-related differences.

Restoring comparability by establishing a common basis for comparison requires that you assign a dollar value to each identified difference. However, you cannot always do this. The cost of terms and conditions peculiar to Government contracts is hard to estimate, so exercise discretion in such cases.

*Other Proposed Prices* . Apply any price-related factors established in the solicitation, to adjust the offered prices for comparison with one another.

*Other Information* . The challenge is to use the available information and to estimate the price that the Government should pay.

Use available information to estimate the effect of each factor on contract price. In this effort use appropriate quantitative analysis techniques.

If you cannot objectively adjust the prices for the factor involved, you may need to make a subjective adjustment. For example, estimating the effect on price of unique Government terms and conditions. Remember, even a subjective adjustment should have a supported basis for its unique purpose to the particular procurement.

Every acquisition situation will be different. Whatever method you use, always document the information that you used and how you used it in making the adjustment.

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## 6.5 Comparing Adjusted Prices

*Introduction* . Use adjusted prices to estimate range of reasonable prices. Use the price that appears most reasonable as your should-pay price.

If the should-pay price departs significantly from the apparent successful offer, analyze the differences. You will then be ready to make the price-related decisions required to determine the successful offeror and make contract award.

*Other Proposed Prices* . Comparing competitive offers is normally the easiest form of price analysis. It also tends to be the most valid, because you are comparing offers prepared for the same requirement under the same market conditions within the competative market. However, the weight placed on this type of comparison depends on the circumstances of the acquisition. Place less weight on competitive prices (relative to other price comparisons) when:

- Adequate price competition does not exist (regardless of the number of offers) - in which case the weight should be zero.
- Relatively few of the responsible firms in the industry submitted responsive offers (especially if the conditions of the solicitation unreasonably denied such firms a chance to compete).
- The apparent offeror appears to enjoy an unfair competitive advantage.
- Having used a performance or functional specification, the apparent successful offeror's proposed approach is less comparable to other proposed approaches than (a) to work performed under prior contracts or (b) commercial contracts.
- The deliverable in line for award is less comparable to other offered deliverables than to (a) those acquired under prior contracts or to (b) commercial contracts.
- The apparent successful offer is significantly out of line with other offers.
- The apparent successful offer is significantly out of line (either lower or higher) with estimates of the should-pay price from other types of comparisons (to the extent that other comparisons are reliable and valid indicators of the should-pay price).
- The cost of the acquisition is substantial. The larger the dollar value of the contract, the more importance you should place on sizable differences in dollars between different types of comparisons (even if the differences are modest when expressed as percentages).

*Commercial Prices* . Ask the following questions to determine the weight that should be placed on comparisons with commercial prices.

- ***Can the offeror explain any differences between the offered price and its own commercial prices?***

The offeror must be able to explain any differences between the offered price and commercial prices. You may base prices for a family of products on a single base product. For example, a radio transceiver may require different connectors and adapters to work with different systems. The part number may even be different for each system, but the basic component is the same. If the offeror can support the price of the various related products by using the price of the basic component, plus the cost of the additional devices, you can use that data to price the entire family of products.

- ***Is your purchase situation different from the typical commercial market situation?***

Even when you grant an exception from the submission of cost or pricing data based on commercial pricing, you do not have to accept the commercial price as the contract price. If you feel that the circumstances of your purchase are different, you should attempt to negotiate a different price.

- ***Do other price analysis techniques bases confirm that the offered price is reasonable?***

If other techniques bases indicate that the offered price is fair and reasonable, use that information in preparing your price negotiation objectives.

*Previously Proposed Prices and Contract Prices* . Ask the following questions to determine the weight that should be placed on comparisons with historical prices.

- ***How does the offered price compare with the historical prices paid, considering changes in the contracting situation?***

You may be able to use quantitative techniques to adjust prices for changes in the contracting situation. If you cannot, you must subjectively analyze the changes.

- ***Do other types of price comparisons confirm that the offered price is reasonable?***

Because of the changes in the acquisition situation, historical prices typically do not provide a precise base for determining price reasonableness. If possible, use other bases of price analysis to confirm that the offered price is fair and reasonable.

*Parametric and Rough Yardstick Estimates* . Ask the following questions to determine the weight that should be placed on comparisons with parametric or rough yardstick estimates.

- ***How does the offered price compare with the price developed using the pricing relationship?***

Use the appropriate price analysis technique(s) to estimate the should-pay price. Compare the offered price with the estimated price, and carefully document the techniques and the judgment you used in your analysis.

- ***Do other types of price comparisons confirm that the offered price is reasonable?***

Because of item differences, pricing relationships typically cannot precisely confirm or refute price reasonableness. If possible, use other price comparisons to confirm that the offered price is fair and reasonable.

*Independent Government Estimates* . Remember that your reliance on Independent Government Estimates should always be tempered by your answers to the following questions:

- ***How Was the Estimate Made?***
- ***What Assumptions Were Made?***
- ***What Information and Tools Were Used?***
- ***Where Was the Information Obtained?***
- ***How Did Previous Estimates Compare with Prices Paid?***
- ***Is theIGE supported with validated informtion if used in the analysis?***

Place no weight on an Independent Government Estimate that originated with an offeror or is a sheer guess. It is vital to validate the basis of the IGE to ensure it was developed using realistic and relevant data that can be supported. If the Independent Government Estimate turns out to be a historical past contract price, analyze and validate the price(s) as you would any historical price.

On the other hand, you might place great confidence in Independent Government Estimates built through detailed analysis - depending on how well that analysis was done.



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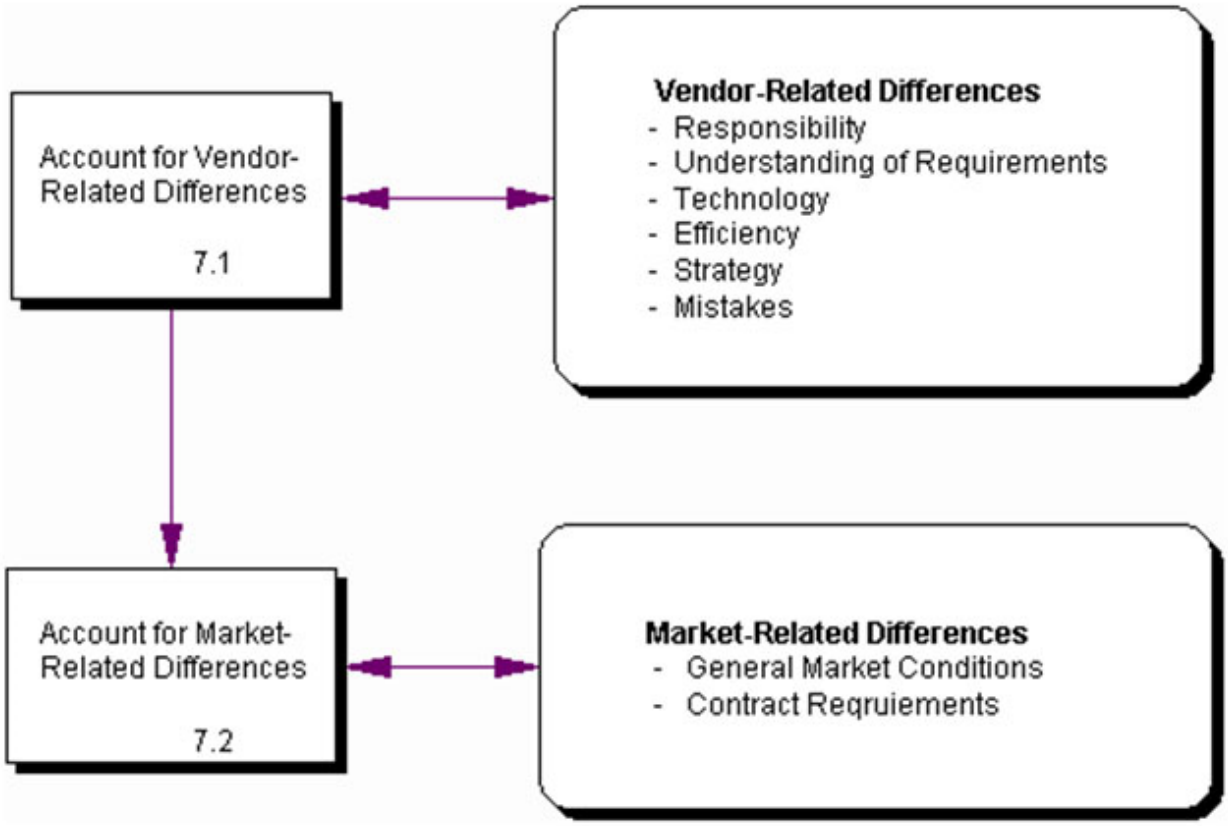
## 7.0 Chapter Introduction

*Identification and Accounting Process* . The figure below depicts the process involved in identifying and accounting for differences between the offered price and the should-pay price **.**




*When to Account for Differences* . Your price analysis should compare the offered price with available estimates of a reasonable price -- should-pay price estimates. The offered price may not be the same as any single should-pay price estimate. However, the offered price should fall within the range of should-pay estimates.

If the apparent successful offer is substantially above or below your best should-pay price estimate(s), you should attempt to account for differences. Remember that performance risk associated with a firm fixed-price that is too low may be as unacceptable as a price that is too high. In cost-reimbursement contracting, an unreasonably low cost estimate may result in a substantially higher final price, because the Government must reimburse all allowable costs.

*Accounting for Differences* . Accounting for differences between offered prices and should-pay estimate(s) should be part of your continuing market research during the contracting process.

You should attempt to collect additional information about the apparent successful offeror or the market in general that will account for apparent differences between an offered price and should-pay price estimate(s). Then consider your findings as you make the price-related decisions identified in the next two chapters.

Based on your findings, you might eventually determine that:

- The price of the apparent successful offer is reasonable despite the identified differences;

- The price of the apparent successful offer is unreasonable;
- The differences result from problems with the solicitation or other mistakes that require solicitation cancellation; or
- Some other course of action is appropriate.

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## 7.1 Identifying Vendor-Related Differences

*Introduction* . In this section, you will learn the most common vendor-related reasons for differences between the low offer, other offers, and various estimates of reasonable prices.



*Vendor-Related Differences* . Vendor differences are circumstances that result primarily from the action or inaction of an individual firm. Buyers often look at a source list as a homogenous group of firms. However, individual firms have personalities, just like people do, with different needs and wants. These differences manifest themselves in the prices offered, as well as in the way each firm will perform any contract awarded.

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### 7.1.1 Responsibility

*Price Analysis and Offeror Responsibility* ( FAR 9.103(c) ). There may be a direct connection between the apparent successful offer and the firm's ability to perform. The firm's price may be very attractive because the firm does not understand the contract requirements, or because it does not have the required investment in technology and equipment to perform the contract.

**Always remember that a contractor who cannot perform is never a good deal at any price.** In the words of the FAR:

The award of a contract to a supplier based on lowest evaluated price alone can be false economy if there is subsequent default, late deliveries, or other unsatisfactory performance resulting in additional contractual or administrative costs. While it is important that Government purchases be made at the lowest price, this does not require an award to a supplier solely because that supplier submits the lowest offer. A prospective contractor must affirmatively demonstrate its responsibility...

Hence, if the low offer is significantly lower than other offers or your estimate of the should-pay price, the burden is on the offeror to affirm its ability to perform at that price. Anytime you find this situation, you must take affirmative action to ensure that the low price is fair and reasonable. In sealed bidding, a "mistake in bid" procedure has been established in part to provide you with an opportunity to verify that a bidder can perform at a price that is greatly out of line with other bids. In negotiated procurements, you can directly ask the offeror to affirm its ability to perform at the proposed price during discussions. When a low price is significantly lower that other offers or your should-pay price, this indicates that the low offeror may have misunderstood the requirements, that the requirements were not clear, that the low offeror has a competitive advantage over its competitors, etc.

*Effect on Contract Pricing* . You cannot make a determination of price reasonableness based on a price comparison with an offer that is technically unacceptable or an offer submitted by a firm that is not responsible.

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### 7.1.2 Understanding Of Requirements

*Introduction* . The price offered by a firm represents the firm's **understanding of the contract requirements** . Even with a responsible firm and well-defined contract requirements, misunderstandings and varying interpretations are possible.

*Misunderstandings* . Misunderstandings are particularly likely when the solicitation contains unusual requirements that are different from what the offerors typically see in solicitations for similar requirements. The unusual requirement could be the inclusion of unique requirements or a change in requirements since the last similar contract. For example, there could be a change from a Federal Specification to a commercial purchase description for an item. Some firms may not recognize the change and continue to price based on the superseded Federal Specification. Others will recognize the change and price based on the actual solicitation requirements.

*Varying Interpretations* . Varying interpretations are particularly likely to occur in situations where performance requirements are used. For example, remember the "8-ounce coffee container" requirement. One offeror could interpret the requirement to mean "provide an 8-ounce ceramic mug." Another could interpret it to mean "provide an 8-ounce paper cup."

*Effect on Contract Pricing* . The effect of either misunderstandings or varying interpretations of specification requirements may be wide differences in prices. Not only will prices be different from each other, they may also be different from other comparison bases used for price analysis.

- **Misunderstandings.** A firm that does not understand that the solicitation requirements have changed will offer a price based on its expectations about the contract requirements. In the example above, a firm that continued to price based on the Federal Specification will likely offer a higher price than a firm that did identify the change to a commercial specification~~s~~ .
- **Varying Interpretations.** A firm that devises a more costly solution to meet the requirements of a performance specification will normally offer a higher price than a firm with a less expensive solution. In the example above, the paper cup will be

substantially cheaper than the ceramic mug. However, the reasonableness of the price of the paper cup cannot be based on a competitive price comparison with the price of a ceramic mug. Comparisons with other bases for price analysis may also be complicated by similar differences in interpretation of the specification.

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### 7.1.3 Technology

*Introduction* . Pricing differences may involve technology in differences related to:

- Costs associated with special technology requirements; or
- Cost patterns associated with different technologies.

*Special Technology Requirements* . If an offeror must have a special product or production technology to meet Government requirements, there may be an effect on contract price. Some firms may have the required technology, while others may not.

- **Product Technology.** If the product technology is within a firm's existing capabilities, it will not need to conduct expensive research and development or purchase the technology from other firms.
- **Production Technology.** If a unique production technology, required for contract performance, is currently available to a firm, it will not need to invest in new plant and equipment to perform the contract. If the technology is not available, investment, or possibly expensive subcontracting, will be required. There may also be schedule delays during the period that the firm is acquiring the new technology. Dealing with the effects of schedule delays may further increase the cost of the contract.

*Different Cost Patterns Associated with Different Technologies* . Differences in the cost patterns associated with different production technologies can also affect contract price. Firms can produce the same product with different types of equipment and different related costs. One firm may use a labor-intensive method of production, and, as a result, have a low fixed cost of production. Another firm might have an automated facility with high fixed costs of production and high set-up costs. For small quantities, the labor intensive firm will have the lower cost per unit. For large quantities, the automated firm will have the lower cost per unit because the fixed costs of production are spread over more units.

*Effect on Contract Pricing* . Technology can have a substantial effect on the prices offered by different firms:

- **Special Technology Requirements.** If costs are increased by the need to acquire a special product or production technology, prices are likely to increase because of the increased costs. If the required investment in technology has application to other products produced by the firm, the costs may be shared. If the technology requirements are unique, the costs will have to be charged to a single product.

If only one firm has access to the necessary technology, that firm may have a lock on the competition. If that happens, prices may be held at an artificially high level and expected price reductions from continuing production may not occur.

- **Different Technology Cost Patterns.** Differences in production technology may produce prices that are substantially different from what would be expected from analysis of historical prices for substantially different quantities. For smaller quantities, the labor intensive firms may have a competitive advantage. For larger quantities, the automated firm may have a competitive advantage.

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### 7.1.4 Efficiency

*Introduction* . Firms with exactly the same equipment and technology can have substantially different cost structures, even when they are producing exactly the same products.

*Efficiency Differences* . The differences in cost structures result from operating at different levels of efficiency. Measures of efficiency examine the input, labor, materials, and equipment, required to obtain a given level of output. When compared with less efficient firms, more efficient firms can produce the same amount of product with less input, or more output with the same amount of input.

These efficiency differences are a direct result of the organization and operation of the firm. Over the past several decades, many new management theories and concepts have been developed and implemented that identify non-value-added tasks and processes. The overarching goal of these theories and concepts is to increase efficiency thus leading to lower costs of production.

*Effect on Contract Pricing* . As stated above, efficiency is a comparison of input and output. When you examine a firm's efficiency in producing a product, the comparison is normally made in terms of dollars per unit of output. More efficient firms can produce a product at a lower cost than less efficient competitors. A firm that is substantially more efficient than its competitors can produce a unit of a product at a substantially lower cost. If the firm can produce at a substantially lower cost, it can sell for less and still make a greater profit than its competitors.

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### 7.1.5 Strategy

*Introduction* . Most firms have the same general pricing objectives, to:

- Cover costs; and
- Contribute to attaining corporate operational objectives.

However, different firms have different pricing strategies. And pricing strategies within a single firm can change with changes in the product and the market situation.

*Strategie* s. Some offerors pursue **cost-based pricing strategies** and others pursue **market-based pricing strategies** . A single firm may follow different pricing strategies in different acquisition situations. Three cost-based and seven market-based pricing strategies are described in detail in the text Introduction.

*Effect on Contract Pricing* . Firms pursuing different pricing strategies may offer different prices, even when they have essentially the same production costs. As a result, you should consider differences between these strategies as you analyze price differences.

Be particularly careful if you believe that the apparent successful offeror's pricing strategy involves pricing the contract below cost. The Comptroller General has repeatedly dismissed protests against alleged below-cost, buy-in offers. In one case, the Comptroller General noted that a "bidder, for various reasons, in its business judgment may decide to submit a below-cost bid; such a bid is not invalid. Whether the awardee can perform the contract at the price offered is a matter of responsibility."

Hence, when confronted with what appears to be a buy-in price, your challenge is to determine whether the price represents an unacceptable performance risk (i.e., to judge the degree of risk by calculating the extent to which the proposed price falls short of the amount the agency believes is required to perform as proposed).

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### 7.1.6 Mistakes

*Introduction* . Like individuals, businesses, even major corporations, are not perfect, and can make mistakes.

*Types of Mistakes* . You have already considered one form of mistake as part of your consideration of offeror understanding of the Government requirement. In pricing, you may also see mistakes that involve simple mathematical errors. The more complex the task, the more opportunity there is for error.

Mathematical mistakes may occur, even when prices are prepared by computer. Computers only do what they are programmed to do. If the programming is incorrect, the answer will also be incorrect.

*Effect on Contract Pricing* . Even a simple mathematical error can have a significant effect on contract pricing. Pricing is usually the last step in offer development. In the pressure to submit the offer, the mistake may be missed by the offeror's review process.

**For example:** A construction task requires remodeling of 20 identical buildings. The bidder estimates the price for one building and multiplies the price by 2 instead of 20. The bid price is one-tenth what the estimator meant it to be.

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## 7.2 Identifying Market-Related Differences

*Introduction* . In this section, you will learn about the most common market-related reasons for differences between the low offer, other offers, and various estimates of reasonable prices.



*Market-Related Differences* . Market-related differences are circumstances that are beyond the control of an individual firm and that affect all firms, but not always in the same way. Just like vendor differences, market differences can also affect price comparisons.

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### 7.2.1 General Market Conditions

*Introduction* . A general market condition is any factor that affects the general industry conditions under which products are bought and sold.

*Differences in General Market Conditions* . Consider changes in the contracting situation and in general economic conditions, whenever you are using historical prices as a comparison base for determining price reasonableness.

Three circumstances are worthy of special consideration:

- Changes in the level of competition;
- Limited competition and collusion; and
- Differing economic conditions.

*Changes in the Level of Competition* . Changes in the level of competition can affect offeror pricing strategies. If competition decreases from historical levels, firms typically will be less concerned about the threat of price competition. If the level of competition increases, firms will be more concerned.

*Limited Competition and Collusion* . In Government contracting, you normally assume that you have adequate price competition whenever there are two or more sources. However, you must be careful in assuming competition, particularly in situations where there are only two or three firms that can meet Government requirements.

Limited competition encourages collusion. Any agreement or mutual understanding among competing firms that restrains the natural market forces should be considered collusion. The understanding does not have to be the result of an active agreement. It can be a passive understanding that aggressive competition will lower profit margins for all competitors without increasing volume for any single competitor. As long as each firm gets its "fair share" of the business, all the firms can increase profit by not competing aggressively.

You may find it is often difficult to detect collusion and antitrust law violations. Practices or events that may evidence violation of antitrust laws include ( FAR 3.303(c) ):

- The existence of an "industry price list" or "price agreement" to which contractors refer when formulating offers.
- A sudden change from competitive bidding to identical bidding.
- Simultaneous price increases or follow-the-leader pricing.
- Rotation of offers or proposals, so that each competitor takes a turn in sequence as low offeror, or so that certain competitors submit low offers on some sizes of contracts and high on other sizes.
- Division of the market, so that certain competitors only offer low prices for contracts let by certain agencies, or for contracts in certain geographical areas, or on certain products, and offer high prices on all other contracts.
- Establishment by competitors of a collusive price estimating system.
- The filing of a joint bid by two or more competitors when at least one of the competitors has sufficient technical capability and productive capacity for contract performance.
- Any incidents suggesting direct collusion among competitors, such as the appearance of identical calculation or spelling errors in two or more competitive offers or the submission by one firm of offers for other firms.
- Assertions by the employees, former employees, or competitors of offerors, that an agreement to restrain trade exists.

*Differing Economic Conditions* . A firm can have a competitive advantage because of the economic conditions in the area in which it operates. Expect production costs to be different in different parts of the country. You may be able to use index numbers to consider the effect that different area costs will have on contract price.

*Effect on Contract Pricing.* General market conditions can have a substantial effect on prices:

- **Changes in the Level of Competition.** Changes in the level of competition will affect the accuracy of price estimates based on historical prices. As firms become less concerned about competition, prices may be expected to increase faster than national averages. As firms become more concerned about competition, price increases may be slower than national averages.
- **Limited Competition and Collusion.** Collusion, active or passive, will increase prices. Carefully review any of the practices or events that may indicate evidence of violation of the antitrust law. Some events such as certain competitors being low only for contracts let by certain agencies, or for contracts in certain geographical areas, or on certain products, and high on all other jobs, may have economic explanations other than collusion. If your review confirms collusion, you should report your conclusions to the U.S. Department of Justice.
- **Differing Economic Conditions.** Differences in the area economic conditions can have a significant effect on production costs, including labor rates and material costs. Depressed economic conditions (e.g., high local unemployment rates) in an area can lower costs. Depressed sales can make suppliers more willing to cut prices to make a sale. Lower labor and material costs will permit a firm to produce a product more cheaply than its competitors operating in areas with better general economic conditions.

### 7.2.2 Contract Requirements

*Introduction* . Contract requirements include more than just product requirements. They include any element of the solicitation or contract that defines what the contractor must do to complete the contract successfully. Changes in requirements and defective requirements can both affect price analysis comparisons.

*Defective Requirements* . The different elements of the solicitation/contract are termed defective when they do not adequately describe contract requirements. A contract should define, **who, what, when, where, and how** for any task that must be performed under the contract. If the contract is not clear, or the requirements are open to interpretation, widely different interpretations may result. If contract terms conflict, the contract may be impossible to perform.

*Changes in Contract Requirements* . Changes in contract terms can be particularly important when you use historical prices as a comparison base to determine price reasonableness. Changes in type of contract, f.o.b. point, delivery requirements, quantities, and other terms can affect the contractor's cost and risk.

*Effect on Contract Pricing* . Contract requirements have a substantial effect on contract pricing:

- **Defective Requirements.** If requirements are unclear or conflict, firms may attempt to guess what the Government really wants. Some may underestimate, and others may overestimate actual requirements. The result may be a wide range of prices, depending on the interpretation of the individual offeror.

Some firms may even attempt to "game" the offer by assuming the lowest requirement possible in the belief that a contract change will be required to correct the conflict. Remember, judges normally interpret disputes over contract ambiguities and conflicts against the writer of the contract. In Government contracting, the Government writes the contract.

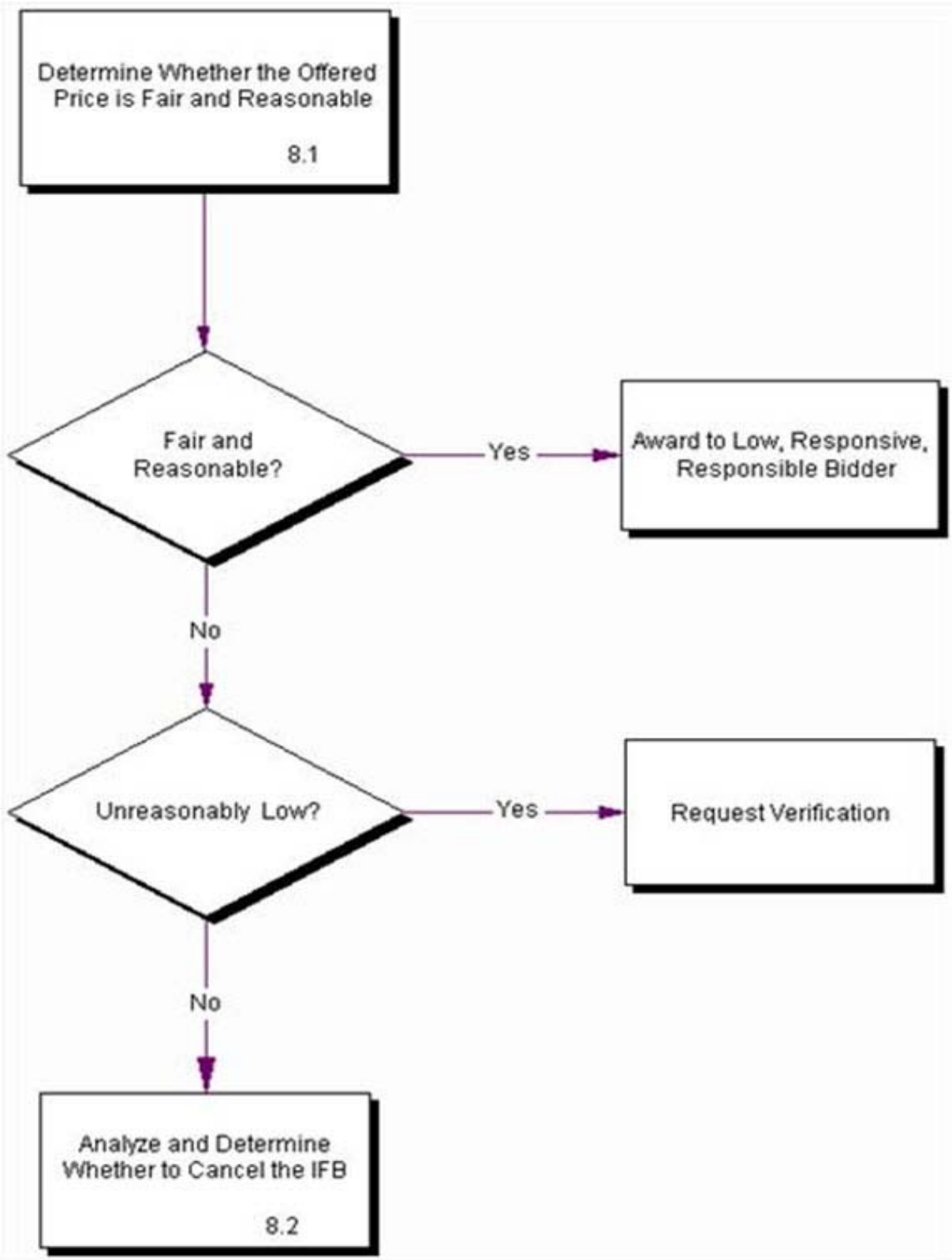
- **Requirements Changes.** Any element that will affect contractor cost or risk will also affect contract price. Changes from historical contract terms that increase cost or risk should increase price. Changes from historical terms that decrease cost or risk should decrease contract price.

## 8.0 Chapter Introduction

*Introduction* ( FAR 14.404-1 and FAR 14.404-2 ). To maintain the integrity of sealed bidding as a method of procurement, you must award to that responsible bidder which submitted the lowest responsive bid, as determined by applying the IFB's price-related factors. However, this general rule does not hold if you have reason to believe that the low bid is:

The result of a mistake by the bidder, materially unbalanced, or ~~O~~ [ **o** ]therwise unreasonable as to price.

*Price-Related Decision Process* . The figure below depicts the process involved in making price-related decisions in sealed bidding.


Determine Whether the Offered Price is Fair and Reasonable
8.1
Fair and Reasonable?
Yes
Award to Low, Responsive, Responsible Bidder
No
Unreasonably Low?
Yes
Request Verification
No
Analyze and Determine Whether to Cancel the IFB
8.2

## 8.1 Examine Individual Bids

This section covers the following topics:



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### 8.1.1 Suspected Mistakes In Bids

*Unexpectedly Low Bids* ( FAR 14.404-2(f) ). What if the low bid is well below all other bids? What if the low bid is well below your estimate of the should-pay price? The FAR states that "any bid may be rejected if the contracting officer determines in writing that it is unreasonable as to price. Unreasonableness of price includes not only the total price of the bid, but the prices for individual line items as well." To determine whether an unexpectedly low bid is unreasonable, use the FAR "mistake in bid" procedure.

*Examining Bids for Mistakes* ( FAR 14.407 ). After the bid opening, examine all bids for mistakes. Look for two kinds of mistakes:

- Apparent clerical errors; and
- Other indications of error -- such as a bid price that is far out of line with other bids or with the dollar amount determined by the contracting officer to be reasonable.

If you suspect that the bidder has erred, request verification of the bid from the bidder. This is your opportunity to talk with (and even meet) the bidder to find out why the bid price is so low. The bidder may, at this point, admit to having made a mistake in preparing the bid. Or the bidder may stand by the bid price. In either case, the burden of proof is on the bidder.

*Correcting Apparent Clerical Mistakes* ( FAR 14.407-2 ). When you examine bids, you may spot a clerical error apparent on the face of the bid. Examples of apparent clerical errors:

- Obvious misplacement of a decimal point.
- Obviously incorrect discounts (e.g., 1% 10 days, 2% 20 days, 5% 30 days).
- Obvious reversal of the price f.o.b. origin, and the price f.o.b. destination.

The contracting officer may correct, before award, any clerical error which is apparent on the face of the bid. Follow this 3-step process:

1. Ask the bidder to verify the intended bid.

2. Attach the bidder's verification to the original bid and a copy of the verification to the duplicate bid.

3. Reflect the corrected price in the award document.

*Other Suspected or Alleged Mistakes* ( FAR 14.407-3(g)(1) ). If you suspect that the bidder made a less obvious mistake, such as grossly underestimating the cost of doing the work, immediately ask the bidder to verify the

bid. Your action must be sufficient to reasonably assure that the bid is correct or to elicit an admission of a mistake by the bidder.

To put a bidder on notice of the suspected mistake, advise the bidder, as appropriate:

- That its bid is so much lower than the other bids or the Government's estimate as to indicate the possibility of error.
- Of important or unusual characteristics associated with the Government requirements,
- Changes in the requirements from those of previous acquisitions, or
- Any other information, proper for disclosure, that leads you to suspect a mistake.

After you have raised the possibility of a mistake to the bidder, the bidder may take one of three courses of action:

- Allege that a mistake was made and request permission to correct the mistake.
- Allege that a mistake was made and request permission to withdraw the bid.
- Verify the original bid.

*Clear and Convincing Evidence* ( FAR 14.407-3(g)(2) ). If a bidder alleges that a mistake was made, the bidder must submit a written request to withdraw or modify the bid supported by statements (sworn, if possible) and by clear and convincing evidence of the mistake.

***What constitutes clear and convincing evidence?***

All pertinent evidence establishing the existence of the error, the manner in which it occurred, and the bid actually intended. Examples of such evidence include:

- The bidder's file copy of the bid.
- The original work sheets and other data used in preparing the bid.
- Subcontractors' quotations, if any.
- Published price lists.

*Determine the Reasonableness of a Low Bid* . Bid verification gives you the opportunity to investigate the reasons for a bid that is "far out of line" with other bids or your should-pay estimate. Reject such a bid when the evidence supports a finding that the bidder is nonresponsible, misunderstands the requirement, or has underestimated the costs and risks of performance. Accept the bid when the evidence establishes that the bidder can ably perform at the price bid (e.g., because the bidder is the most efficient performer or has knowingly submitted a below-cost bid and has the financial reserves to cover probable losses). You may have to cancel the IFB if your investigation uncovers a Government mistake (e.g., a defective requirement).

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## 8.1.2 Unbalanced Bids

*Identify Unbalanced Pricing* ( FAR 14.404-2(g) and FAR 15.404-1(g) ). Analyze all bids with separately priced line items or subline items to determine if prices are unbalanced.

Unbalanced pricing exists when, despite an acceptable total evaluated price, the price of one or more contract line items is significantly over or understated as indicated by application of cost or price analysis techniques.

*Consider Risk to the Government* . Whenever you identify unbalance pricing, you must consider the probability that award to the bidder with the unbalanced price will:

- Increase contract performance risk; or
- Result in payment of unreasonably high prices.

The risk is normally greatest when:

- Startup work, mobilization, first articles, or first article testing are separate line items;
- Base quantities and option quantities are separate line items; or
- The evaluated price is the aggregate of estimated quantities to be ordered under separate line items of an indefinite-quantity contract.

*Reject Bids with Unacceptable Risk* . You may reject a bid if the contracting officer determines that the lack of balance poses an unacceptable risk to the Government. Such bids are generally described as materially unbalanced. A bid is **materially unbalanced** IF it is **mathematically unbalanced** AND one of the following is true:

- There is reasonable doubt that the lowest evaluated bid will actually result in the lowest cost to the Government.
- The offer is so grossly unbalanced that its acceptance would be tantamount to allowing an advanced payment.

A bid is **mathematically unbalanced** IF it is based on prices that are significantly less than cost for some line items AND significantly more than cost for other line items.

*Identification of Materially Unbalanced Bids* . In sealed bidding, you must normally use price analysis to determine if bids are materially unbalanced.

**For example.** You could use the following price analysis comparisons to determine if bid prices for a contract requiring both first article testing and production are materially unbalanced:

- Compare all bids to determine if the structure of any bid differs significantly from the structure of other bids concerning the pricing for first articles and production units. (Does one bid contain a first article price that is significantly greater than other bids, while production units are significantly cheaper?)
- Compare the production unit price with the price of similar production units.
- Compare the difference between the first article price and the production unit price, with the price differences experienced between first article and production units on contracts for similar items.
- Compare the difference between the first article price and the production unit price, with the Independent Government Estimate of the price of first article test effort, excluding the price of the units required for test.
- Compare the price for the first article and the price for production units with the Independent Government Estimates.

*Document Analysis of Unbalanced Bids* . Carefully document your analysis of bids that appear to be materially unbalanced. This documentation will form the basis for any determinations and Government actions.

- If analysis supports a determination that unbalanced pricing poses an unacceptable risk to the Government, the documentation will serve as a basis for rejecting the bid.
- If analysis shows that the risk is acceptable, the documentation will provide information on the facts as they were considered during analysis.

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## 8.2 Determine Need To Cancel The IFB



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### 8.2.1 Price-Related Reasons For Canceling The IFB

*Reasons for Canceling IFBs* ( FAR 14.404-1(b) and FAR 14.404-1(c) ). FAR 14.404-1(c) provides ten possible reasons for canceling an invitation for bid (IFB) after bid opening. Five of ten, shown below are clearly pricing-related. Other reasons for cancellation (e.g., cancellation clearly in the public interest) could also be related to pricing concerns.

| Pricing related factors from FAR 14.404-1(c) |
|---|
| (4) The invitation did not provide for consideration of all factors of cost to the Government, such as cost of transporting Government-furnished property to bidders' plants; |
| (5) Bids received indicate that the needs of the Government can be satisfied by a less expensive article differing from that for which the bids were invited; |
| (6) All otherwise acceptable bids received are at unreasonable prices, or only one bid is received and the contracting officer cannot determine the reasonableness of the bid price; |
| (7) The bids were not independently arrived at in open competition, were collusive, or were submitted in bad faith; |
| (9) A cost comparison as prescribed in OMB Circular A-76 and [ **FAR** } Subpart 7.3 shows that performance by the Government is more economical~~; or~~ [.] |

*Situations Requiring Cancellation* ( FAR 14.404-1(b)&(c) ). The following table summarizes the five price-related reasons for canceling the solicitation after bid opening, how to avoid each situation and analyze it when it occurs.

| Possible Cancellation Situation | Avoiding the Situation | Analyzing the Situation When It Occurs |
|---|---|---|
| IFB Did Not Consider All Factors of Cost | In earlier chapters, you learned about selecting and applying price-related factors in making the award decision. In preparing a solicitation, you should consider those principles. Doing so should help you avoid most situations in which you must cancel an IFB for failing to properly consider all factors of cost to the Government.<br><br>During the solicitation period, you must be alert to price-related factors that are not considered in the solicitation. Carefully review comments and questions received from potential bidders to identify such factors. | In price analysis, you must apply the price-related factors included in the award criteria.<br><br>During your analysis, you must be alert to identifying price- related factors that were not properly considered in developing the award criteria and to identifying important price- related factors that were not considered at all. |
| Government Needs Can Be Satisfied with Less Expensive Product | Establish a best estimate of price or value as part of acquisition planning. In that process, you should carefully review the purchase request estimate, analyze market data and acquisition histories, and identify and collect other related pricing data. During that review, you must be alert to alternative products that will meet Government needs at a lower total cost.<br><br>If you identify a lower priced product, coordinate with the requiring activity to assure that the product is acceptable. If it is, assure that the solicitation is modified to permit bidders to furnish the product identified.<br><br>Develop solicitations that:<br><br>• Maximizes competition;<br>• Maximizes use of commercial products; and<br>• Eliminates unnecessary costs.<br><br>During the solicitation period, you must be alert to alternative products. | During your efforts to determine price reasonableness, you should consider pricing yardsticks and cost estimating relationships based on the prices of similar items. You may also request Government technical personnel to perform a visual or value analysis.<br><br>Analysis could identify a product, other than the product for which bids were solicited, that will meet Government requirements at a lower price.<br><br>Review the impact of the specification on bids, bearing in mind that revising the specification can be a reason for canceling the solicitation. |
| Unacceptable Prices for Otherwise Acceptable Bids | Maximize price competition. Efforts such as source development, proper selection of business terms, and appropriate publicizing of the purchase should maximize price competition. Adequate price competition should encourage bidders to submit fair and reasonable prices. | Analyze significant differences between different estimates of price reasonableness and between the estimates and actual prices. Both vendor differences and market differences must be carefully explored before you determine that a price is so unacceptably high as to justify cancellation. |
| Bids Not Arrived at Independently | Encourage independent bid development. | Earlier in the text, you learned about practices and events that indicate |

| | | |
|---|---|---|
| | Take special care to avoid brand name purchase descriptions and contract requirements that require all bidders to use a key component or technology controlled by one of the competitors. Such requirements make independent bid development a practical impossibility.<br><br>During the solicitation period, be alert to potential bidder comments concerning specifications that will restrict independent competition. | collusive practices and potential antitrust violations. You also learned about the importance of thorough review before making any allegation of collusive practices. |
| More Economical Government Performance<br><br>( FAR 7.3 and FAR 52.207-1 ) | The Government is always a potential competitor to perform required services. If you have reason to believe that the bid price will be higher than the cost of Government performance, request that Government personnel prepare a cost estimate and include the FAR Notice of Cost Comparison (Sealed-Bid), in the IFB. This action will put potential bidders on notice that the requirement may be performed in-house and encourage price competition. | If a cost estimate has been prepared and the appropriate notices included in the IFB:<br><br>Open the cost comparison form containing the Government performance cost estimate at the time of bid opening.<br><br>After evaluation of bids and determination of low bidder responsibility, provide the low bid price to the organization that prepared the Independent Government Estimate for final cost comparison.<br><br>Provide cost comparison results to the agency authority responsible for deciding between Government and contract performance.<br><br>If the cost estimate has not been prepared under FAR requirements and the appropriate notices have not been included in the IFB, the solicitation cannot be formally compared with the cost of Government performance.<br><br>The contract price must still be determined reasonable based on other bases of price analysis. If the price cannot be determined to be reasonable, consider canceling the solicitation based on unreasonable prices.<br><br>If you believe that Government |

| | | |
|---|---|---|
| | | performance would be more economical, schedule the requirement for a formal cost comparison. |

*Decision to Cancel the Invitation* . In some circumstances, when you are determining if the invitation should be canceled, you will need to consider the relative advantages and disadvantages to the Government. In other circumstances, the pricing concern is so great that you should cancel the solicitation whenever the situation is confirmed to exist.

| **Possible Cancellation Situation** | **Recommend Invitation Cancellation If ...** |
|---|---|
| IFB Did Not Consider All Factors of Cost | One of the following statements about the IFB is true:<br><br>• It did not consider all price-related factors, or<br>• It did not properly consider all price-related factors<br><br>**AND**<br><br>The lack of proper consideration will affect selection of the successful bidder,<br><br>**AND**<br><br>The anticipated total cost to the Government for canceling the solicitation and soliciting new bids with revised award criteria is less than the cost for proceeding with award under the current award criteria. |
| Government Needs Can be Satisfied with Less Expensive Product | An alternative product will satisfy the needs of the Government at a lower price,<br><br>**AND**<br><br>The total cost to the Government for canceling the solicitation and resolicitation is less than the cost for proceeding with award under the current award criteria. |
| Unacceptable Prices for Otherwise Acceptable Bids | The Government's requirement can be deferred,<br><br>**OR**<br><br>There is reason to believe that canceling and resoliciting or negotiating would result in an acceptable price [1] |
| Bids Not Arrived at Independently | Available information demonstrates that bids were not arrived at independently. |
| More Economical Government Performance<br><br>( FAR 7.3 , FAR 7.305 , and OMB Circ A-76 ) | The cost estimate for Government performance was prepared prior to bid opening,<br><br>**AND**<br><br>The appropriate notices were included in the solicitation,<br><br>**AND**<br><br>Cost comparison demonstrates sufficient savings, to warrant in-house Government |

| | |
|---|---|
| | performance,<br><br>**AND**<br><br>The responsible agency official determines that performance by the Government is in the Government interest. |

[1] Because you expect demand to decline relative to supply, or you expect to reenter the market at a more favorable point in the cycle, or you have plans for source development, or you plan to resolicit under business terms and conditions which are more in keeping with market norms, etc.

*Document Your Decision* . Whenever you consider an invitation cancellation, you should document your analysis and decision process. Documentation is essential to support the decision by the agency head, or delegated official, to cancel an invitation for bids.

Documentation is also necessary when a determination is made not to cancel the solicitation. Buyers will later be able to use the information provided in acquisition planning to prevent similar situations and possible solicitation cancellations.

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### 8.2.2 Negotiation After Cancellation

*Introduction* . Negotiation after IFB cancellation is authorized in two of the situations where the invitation may be canceled for pricing-related reasons. To use negotiations to complete the sealed-bid acquisition, the agency head, or delegated official, must determine that the invitation is to be canceled and that the use of negotiations is appropriate to complete the acquisition.

*Possible Cancellation Situations* ( FAR 14.404-1(e) and DFARS 214.404-1 ). The table below identifies five possible cancellation situations and describes whether acquisition through negotiation is authorized after IFB cancellation.

| Possible Cancellation Situation | Is completion of the Acquisition through Negotiation Authorized after IFB Cancellation? |
|---|---|
| IFB Did Not Consider All Factors of Cost | No, acquisition completion through negotiation is not authorized. Proceed with a new acquisition. |
| Government Needs Can be Satisfied with Less Expensive Product | No, acquisition completion through negotiation is not authorized. Proceed with a new acquisition. |
| Unacceptable Prices for Otherwise Acceptable Bids | Yes, if authorized by the agency head, or delegated official, in the determination to cancel the IFB. |
| Bids Not Arrived at Independently | Yes, if authorized by the agency head, or delegated official, in the determination to cancel the IFB. |
| More Economical Government Performance | Not applicable. |

*Make Award without Issuing a New Solicitation* ( FAR 14.404-1(f) ). When the agency head has determined that the IFB should be canceled and that the use of negotiations is in the Government's interest, the contracting officer may award the contract without issuing a new solicitation, provided:

- Each responsible bidder in the sealed bid acquisition has been given notice that negotiations will be conducted and has been given an opportunity to participate in the negotiations; and
- The award is made to the responsible bidder offering the lowest negotiated price.



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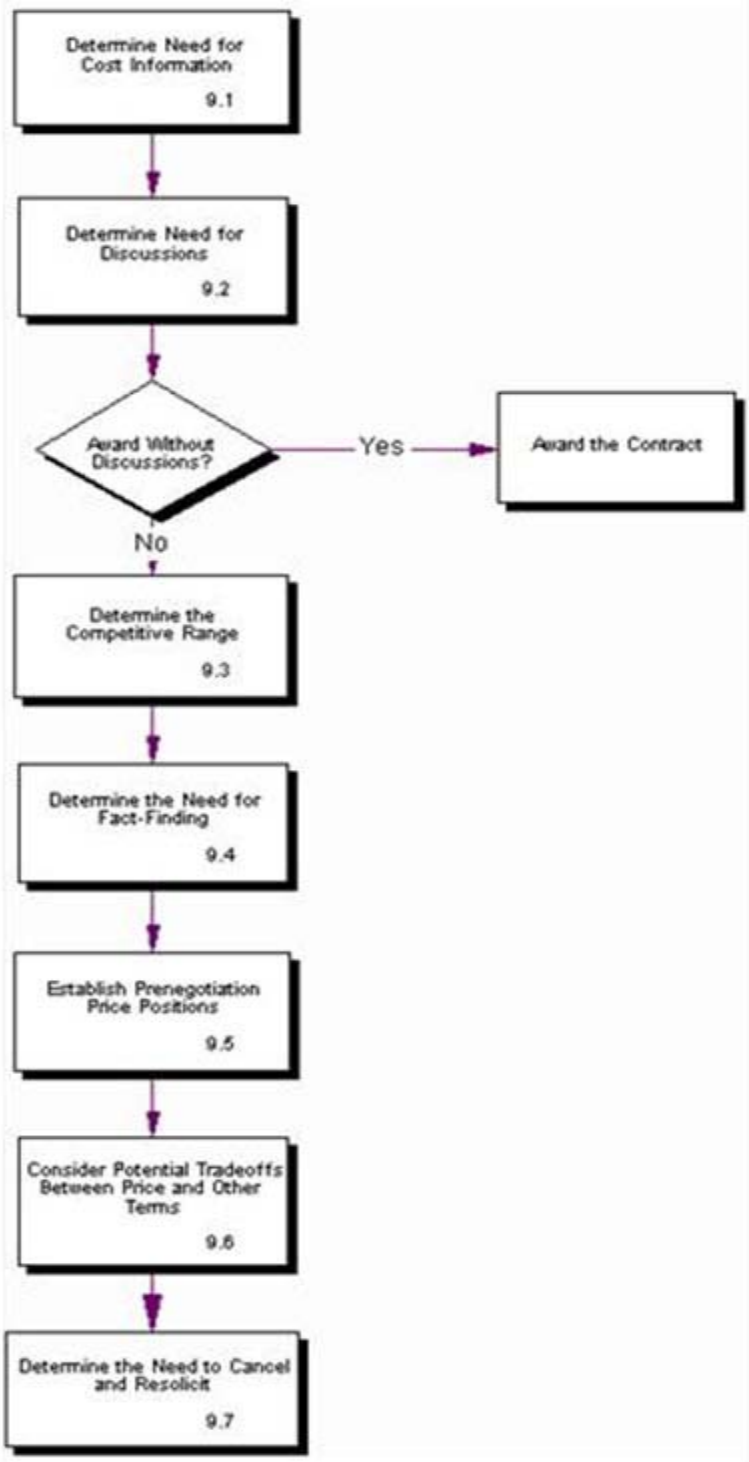
## 9.0 Introduction

*Price-Related Decision Process* . The figure below depicts the process involved in making price-related decisions in negotiation.




## 9.1 Determine The Need For Cost Information

The contracting officer must obtain the minimum amount of data required to determine a fair and reasonable price for the acquisition. That information may come from internal government sources, market sources, or the

offeror. The amount of the supporting data required, and the source of that data, will depend upon the acquisition situation.

*Requiring Cost or Pricing Data* ( FAR 15.403 , and FAR Table 15-2 at FAR 15.403-8 ). You have already learned that you:

- MUST NOT REQUIRE cost or pricing data when an exception applies.
- MUST REQUIRE an offeror to submit cost or pricing data for non-competitive contract actions over the cost or pricing data threshold, when no exception applies.
- MAY REQUIRE an offeror to submit cost or pricing data for acquisitions below the cost or pricing data threshold but over the simplified acquisition threshold, when no exception applies and you have approval from the head of the contracting activity.

When you require cost or pricing data, the data should meet the general requirements of FAR Table 15-2 . Table 15.2 addresses the types of data that the contractor should disclose to the government in support of the proposed price. The contractor will need to certify to any of that data if it meets the definition of cost or pricing data. Depending on the situation, the contracting officer may require data submission in:

- The format prescribed by Table 15-2;
- Another format prescribed by the contracting officer; or
- A format selected by the offeror.

*Requiring Information Other Than Cost or Pricing Data* ( FAR 15.403-3 and FAR 15.403-5(b) ).

For noncompetitive acquisitions where the price is not set by law or regulation, information other than cost or pricing data **submitted** must include appropriate information on the prices at which the same or similar items have been sold that is adequate to support price analysis. Requirements for cost information should be limited to specific areas of concern (e.g., the cost of high-cost material items or information related to differences between similar items.

Permit offerors to submit information other than cost or pricing data in a format selected by the offeror, unless the contracting officer decides that a specific format is essential.

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## 9.2 Determine The Need For Discussions

*When Not to Conduct Discussions with Offerors* ( FAR 15.209(a)(1) and FAR 52.215-1(f)(4) ). The standard FAR instructions to offerors for competitive acquisitions notify offerors that the Government intends to evaluate proposals and award a contract without discussions. As the contracting officer, you must determine the need for negotiations. **Do not conduct discussions with offerors unless they are necessary to identify the proposal that offers the best value to the Government based on the offer evaluation criteria.** For example, do not conduct discussions to squeeze lower prices from offerors when initial offers appear fair and reasonable.

If offerors know that award is likely to occur without negotiations, they will be encouraged to submit better offers initially. If they know that you will always negotiate, they may wait until your request for a final proposal

revision (FPR) to submit a truly competitive price. Many offerors actually distrust the security of the competitive negotiation process and fear that their price will leak to competitors.

*When to Conduct Discussions with Offerors* ( FAR 15.209(a)(1) and FAR 52.215-1 Alt 1 ). If the solicitation instructions to offerors notified offerors that the Government intends to evaluate proposals and award a contract after conducting discussions with offerors in the competitive range, you must conduct discussions.

If the solicitation instructions to offerors notified offerors that the Government intends to evaluate proposals and award a contract without discussions, you can conduct discussions if the contracting officer determines that discussions are necessary and documents the rationale for that decision in the contract file. Generally, the contracting officer should only consider such a determination when there is a question about which proposal truly offers the best value to the Government. For example, negotiations might be necessary to resolve concerns about the cost realism of a proposal that appears substantially under priced.

*Clarifications and Award without Discussions* ( FAR 15.306(a) and FAR 14.407-2(a) ). Clarifications are limited exchanges, between the Government and offerors, that may occur when award without discussions is contemplated.

When award will be made without conducting discussions, you may give offerors an opportunity to clarify:

- Certain proposal aspects (e.g., the relevance of an offeror's past performance information and adverse past performance information to which the offeror has not previously had an opportunity to respond); or
- Apparent minor or clerical errors. Examples of minor or clerical errors include, but are not limited to:
    - Obvious misplacement of a decimal point;
    - Obviously incorrect discounts (e.g., 1 percent, 20 days, 5 percent, 30 days);
    - Obvious reversal of the price f.o.b. destination and price f.o.b. origin; or
    - Obvious mistake in designation of the unit.

Carefully document any proposal aspects or apparent errors requiring clarification and the actions taken to clarify the proposal. If any clarification would prejudice the interest of another offeror, you should conduct discussions with all offerors in the competitive range.

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## 9.3 Determine The Competitive Range

*Competitive Range* ( FAR 15.306(c) ). Once you make the decision to negotiate, you must determine which firms will participate in discussions.

Identify firms to be included in the competitive range by evaluating each offer against the evaluation criteria enumerated in the solicitation.

- Establish a competitive range comprised of all the most highly rated proposals, unless the competitive range is further limited for purposes of efficiency.
- If the solicitation provides that the competitive range can be limited for purposes of efficiency, the contracting officer may determine that the number of most highly rated proposals that might otherwise

be included in the competitive range exceeds the number at which an efficient competition can be conducted. Then the contracting officer may limit the number of proposals in the competitive range to the greatest number that will permit an efficient competition among the most highly rated proposals.

*Steps for Determining the Competitive Range* ( FAR 15.306(c) ). When you determine the competitive range, you should follow these steps:

1. **Evaluate All Proposals.** Evaluate all proposals considering all award criteria (price and technical) established in the solicitation.

2. **Identify Evaluation Score Groupings.** Identify the grouping, or arrangement, of evaluation scores for all proposals. This may be done by arranging the proposals from highest to lowest score and then looking for breaks in the scores such that natural groupings of similar scores may be identified.

3. **Identify the Most Highly Rated Proposals.** Look for breaks in the evaluation ratings that separate the most highly rated proposals from the others. Identify the most highly rated proposals for possible inclusion in the competitive range. If all proposals are tightly grouped, you could include all proposals as highly rated. However, you must exclude proposals that are not highly rated.

4. **Determine Whether To Limit The Competitive Range.** When permitted by the solicitation, the contracting officer may determine to limit the number of most highly rated proposals that might otherwise be included in the competitive range to support more efficient competition. This determination should depend on the number of offerors initially included in the competitive range and the issues involved in the competitive discussions. For example, it may be possible to efficiently conduct discussions with 20 offerors if the issues are relatively simple. When complex issues are involved, efficient competition may require limiting the competitive range to five firms or less. The number of firms actually included should not be set arbitrarily (e.g., to five), but should be set after an evaluation of the proposal ratings and the complexity of the issues involved in the discussions.
5. **Notify Unsuccessful Offerors.** You must notify an unsuccessful offeror in writing as soon as practical after determining that the proposal is no longer eligible for award.

*Consider Price Reasonableness* ( FAR 15.305(a) and FAR 15.306(c) ). As you evaluate proposals to establish the competitive range, consider price reasonableness based on your should-pay price estimate(s). However, remember that price ~~may~~ [ **is** ] only ~~be~~ one element in the proposal evaluation criteria.

*Consider Cost Realism* ( FAR 15.404-1(d) ). You must consider cost realism in evaluating proposal for any cost-reimbursement contract. For these contracts, your analysis should center on developing an estimate of most probable cost. Remember that, for these contracts, final price will depend on final cost. An unrealistically low proposal could result in a[ **n** ] unreasonably high final contract price.

You may consider cost realism in evaluating proposals for fixed-price contracts, particularly fixed-price incentive contracts. For these contracts, your analysis should center on evaluating the performance risk associated with an unrealistically low price. Proposed prices must not be adjusted, because the final contract price is either firm or limited on price~~,~~ [ **.** ] ~~c~~ [ **C** ]ontract performance risk can increase substantially.

*Evaluation Practices to Avoid* . When determining the competitive range, you **should not** :

- Establish arbitrary limits on the competitive range based on comparisons with the proposal with the most favorable evaluation. For example, do not arbitrarily determine that all proposals with prices within 20 percent of the most favorably evaluated proposal will be included in the competitive range and all others excluded.

- Establish arbitrary limits on the competitive range based on the Independent Government Estimate or a preset evaluation score.
- Include any proposal in the competitive range if it is not among the most highly rated.

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## 9.4 Determine The Need For Prenegotiation Exchanges

*Prenegotiation Exchanges* ( FAR 15.306 ). Prenegotiation exchanges include any dialogue between the Government and the contractor after proposal receipt and prior to contract negotiation. The Government objective is to identify and obtain available contractor information needed to complete proposal analysis. In addition, most types of prenegotiation exchanges also provide the contractor an opportunity to seek clarification of the Government's stated contract requirements.

*Information Already Available* . As you determine the need for a prenegotiation exchange, consider the information already available, including:

- The solicitation, unilateral contract modification, or any other document that instigated the contractor's proposal;
- The proposal and all information submitted by the contractor to support the proposal;
- Information from your market research concerning the product, the market, and any relevant acquisition history;
- Any relevant field pricing or audit analyses;
- In-house technical analyses; and
- Your initial analysis of the proposed price and, where appropriate, specific elements of cost.

*Clarifications* ( FAR 15.306(a) ). Clarifications are limited exchanges, between the Government and contractors, that may occur when the Government contemplates a contract award without discussions. Remember that award may only be made without discussions when the solicitation states that the Government intends to evaluate proposals and make award without discussions.

Consider giving one or more contractors the opportunity to clarify certain aspects of proposals that may have an effect on the award decision. For example, a request for clarification might give the contractor an opportunity to:

- Clarify the relevance of a contractor's past performance information;
- Respond to adverse past performance information if the contractor has not previously had an opportunity to respond; or
- Resolve minor or clerical errors, such as:
    - Obvious misplacement of a decimal point in the proposed price;
    - Obviously incorrect prompt payment discount;
    - Obvious reversal of price f.o.b. destination and f.o.b. origin; or
    - Obvious error in designation of the product unit.

*Communications* ( FAR 15.306(b) ). Communications are exchanges, between the Government and contractors, after receipt of proposals, leading to establishment of the competitive range. Communications with a contractor

are only authorized when the contractor is not clearly in or clearly out of the competitive range. Specifically, communications:

- Must be held with contractors whose past performance information is the determining factor preventing them from being placed within the competitive range. Such communications must address adverse past performance information to which the contractor has not had a prior opportunity to respond.
- May be held with other contractors whose exclusion from, or inclusion in, the competitive range is uncertain. They may be used to:
    - Enhance Government understanding of the proposal;
    - Allow reasonable interpretation of the proposal; or
    - Facilitate the Government's evaluation process.
- Must not be held with any contractor not in one of the situations described above.

The purpose of communications is to address issues that must be explored to determine whether a proposal should be placed in the competitive range.

- Use communications to address any adverse past performance information to which the contractor has not previously had an opportunity to comment.
- You may use communications to address:
    - Ambiguities in the proposal or other concerns (e.g., perceived deficiencies, weaknesses, errors, omissions, or mistakes); and
    - Information relating to relevant past performance.
- You must not use communications to permit the contractor to:
    - Cure proposal deficiencies or material omissions;
    - Materially alter the technical or cost elements of the proposal; and/or
    - Otherwise revise the proposal.

*Exchanges After Establishment of the Competitive Range* . You should normally not need to conduct any exchanges after establishment of the competitive range but before negotiations. Proposals included in the competitive range should be adequate for negotiation. However, there may be situations when you need additional information to prepare reasonable negotiation objectives.

The purpose of such exchanges is to obtain additional information for proposal analysis and to eliminate misunderstandings or erroneous assumptions that could impede objective development. Never use this type of exchange to give a contractor an opportunity to modify its proposal.

*Fact-Finding* ( FAR 15.406-1 ). In a noncompetitive procurement, fact-finding may be necessary when information available is not adequate for proposal evaluation. It will most often be needed when:

- The proposal submitted by the contractor appears to be incomplete, inconsistent, ambiguous, or otherwise questionable; and
- Information available from market analysis and other sources does not provide enough additional information to complete the analysis.

The purpose of fact-finding is to obtain a clear understanding of the contractor's proposal, Government requirements, and any alternatives proposed by the contractor. Typically, fact-finding centers on:

- Analyzing the actual cost of performing similar tasks. This analysis should include such issues as whether:
    - Cost or pricing data are accurate, complete, and current;
    - Historical costs are reasonable; or

    - Historical information was properly considered in estimate development.
- Analyzing the assumptions and judgments related to contract cost or performance, such as:
    - The reasonableness of using initial production lot direct labor hours and improvement curve analysis to estimate follow-on contract labor hours;
    - Projected labor-rate increases; or
    - Anticipated design, production, or delivery schedule problems.

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## 9.5 Establish Pre-Negotiation Price Positions

This section covers the following topics:



*Prenegotiation Objectives* ( FAR 15.406-1(a) ). Prenegotiation objectives establish the Government's initial negotiation position and assist in determining whether a price is fair and reasonable. They should be based on the results of proposal analysis, taking into consideration all pertinent information including:

- Field pricing assistance;
- Audit reports;
- Technical analyses;
- Fact-finding results;
- Independent Government Estimates; and
- Price histories.

In addition to your price objective, your prenegotiation positions should also consider the range of reasonable prices around that objective.

### 9.5.1 Analyze Risk

*Risk in Pricing* . As you begin to develop your price negotiation positions, you must analyze the risk involved. The acquisition may be the 99th acquisition of a standard commercial item or it may be the first acquisition of complex state-of-the-art equipment manufactured to precise Government specifications.

Acquisition of the standard commercial item may involve little pricing risk. You have price histories, commercial item price comparisons, and competition. All will likely lead you to the same should-pay price or very similar should-pay prices.

The state-of-the-art item will likely have a much higher level of pricing risk. You may have only the Independent Government Estimate. Commercial items may permit only very general comparisons. These different price estimates may lead you to a wide range of prices that appear reasonable.

*Risk Assessment and Should-Pay Prices* . You must begin to estimate should-pay prices when you begin acquisition planning, and you should continue to refine your estimate as information is collected throughout the

acquisition process. Use judgment in evaluating the reliability of each estimate when developing the total estimate of the price the Government should pay.

*Judgment in Risk Assessment* . It is likely that, given the same data, buyers and sellers will develop different judgments on which price is most reasonable. These judgments will be based on different perspectives and different assessments of the risk involved. Sellers are concerned about being able to complete contracts, cover costs, and make a profit. Buyers are concerned about their customer's needs , contract completion, budgets limitations, fairness to all offerors, and the public perception of their actions.

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**9.5.2 Develop Negotiation Positions**

*Price Positions in Noncompetitive Negotiations* . In noncompetitive negotiations, you should define the range of reasonable prices using three pricing positions. These positions should be based on your should-pay estimates developed during the acquisition process. As you prepare these positions, remember that:

- **The minimum price position** should be your starting place in negotiations and your first offer. Never offer a price that cannot be supported by reasoned analysis.
- **The objective (or target) price position** should be the price that you think is most reasonable, based on your analysis of the reliability of different price estimates. It should be the price that you think the Government should pay.
- **The maximum price position** should be the highest price that you can reasonably accept, given the information you have at the beginning of negotiations. The maximum price may change during negotiations if additional information is presented by the offeror that changes the situation.

Both parties to a negotiation expect movement by the other party. If you offer one price throughout the negotiation, you may appear inflexible and that appearance could jeopardize agreement. Different positions also provide you with an opportunity to collect information needed to understand the offeror's perspective on a reasonable price, and to sell the reasonableness of your negotiation positions.

*Price Positions in Competitive Discussions* ( FAR 15.306(d) ). Before entering into competitive discussions, develop separate minimum, objective, and maximum positions for each proposal. Use these positions in identifying the strengths, weaknesses, deficiencies, and uncertainties in the offeror's proposal.

As you prepare these positions, remember that they will be used to advise the offeror of deficiencies in its proposal so that the offeror is given an opportunity to improve its proposal.

- Include your reasons (if any) for believing that the offeror's pricing is deficient based on comparisons with historical prices, commercial prices, parametric estimates, rough yardstick estimates, or the Independent Government Estimate.
- Be prepared to point out any indicators that the proposed price is too high or too low.

Remember that you will not be able to engage in offers and counteroffers during discussions. The offeror must determine how to modify its proposal in order to increase the value offered.

## 9.6 Consider Potential Trade-Offs Between Price And Other Terms

*Introduction* ( FAR 15.206 ). The price positions described in the last section should be based on the requirements stated in the original solicitation, unless Government requirements changed after proposals were received. If requirements have changed, all offerors must be notified of the change.

*Requirement Changes* **In noncompetitive negotiations** , all elements of the contract are subject to negotiated change during the negotiation process. In preparing for such negotiations, you should identify any changes in terms and conditions that you are willing to trade for certain related changes in price. The potential requirements changes could be either additions or deletions. The potential price changes should correspond with the value to the Government of the change in technical requirements. A technical requirements increase should result in a higher price objective, while technical requirements decrease should result in a lower price objective. A change in requirements that is neither an increase or decrease in overall technical requirements should result in no change to the price objective.

**In competitive discussions** ,you must not change minimum contract requirements unless all offerors remaining in the competitive range have an opportunity to revise their proposal based on the change. If the proposed change is so substantial that additional sources would likely have submitted offers had the amendment been known, the contracting officer must cancel the solicitation.

You must obtain approval from appropriate Government technical personnel before suggesting or agreeing to any change in technical requirements. As you and the appropriate Government technical personnel agree on requirements changes that you would be willing to consider, develop an estimate of the related objective price change.

*Format for Analyzing Potential Tradeoffs* . The following chart provides a format for analyzing potential tradeoffs during negotiations. A data page containing the type of information described below will greatly speed negotiations and enable you to concentrate on the important issues involved.

| **Type Of Change In Requirements** | **Related Objective Increase** | **Related Objective Decrease** |
|---|---|---|
| Technical Requirements: | | |
| Inspection and Acceptance Terms: | | |
| Delivery or Performance Terms: | | |
| Contract Type: | | |
| Socioeconomic Terms: | | |
| Payment Terms: | | |
| Government Furnished Property: | | |
| Warranties: | | |
| Patents and Rights in Data: | | |

| | | |
|---|---|---|
| Other Terms and Conditions: | | |

## 9.7 Determine The Need To Cancel And Resolicit

*Authority to Reject All Proposals* ( FAR 15.303(a) and FAR 15.305(b) ). The source selection authority may reject all proposals received in response to a solicitation, if doing so is in the best interests of the Government. The source selection authority is the contracting officer unless the agency head appoints another individual for a particular acquisition or group of acquisitions.

*Examples of Reasons to Reject All Proposals*

Consider canceling and resoliciting anytime that you expect such action will increase competition or reduce cost to the Government.

Common price-related reasons for canceling a solicitation include the following:

- All otherwise acceptable proposals have unreasonable prices.
- Proposals were not independently priced.
- A cost comparison shows that in-house performance by the Government is more economical.

Pricing concerns may also lead the contracting officer to cancel a solicitation based on the potential for increased competition or cost savings.