THE EXCELL REPORT

EXCELL CONSULTING INTERNATIONAL, INC.

YES, YOU *CAN* RECOVER COSTS RELATING TO INFLATION

If Your Claim is Presented with the Right Strategy!

October 5, 2022

INTRODUCTION

As discussed in a previous Excell Report blog *(copy attached)*, on May 25, 2022, John M. Tenaglia, the Principal Director for Defense Pricing and Contracting at the United States Department of Defense (DoD) issued a memorandum entitled **"Guidance on Inflation and Economic Price Adjustments"**. This memorandum spurred quite a commotion throughout the Government Contracting world, and for good reason.

The May 25, 2022 Memo *(copy attached)* set forth the DoD's position that, facing the unprecedented rate of inflation and its economic impacts on contracts in the U.S. and around the world, contractors under existing fixed price contracts would need to bear the impacts of inflation as an unfortunate part of the risk a contractor assumes when entering into such a contract.

Excell took exception to that guidance and issued a blog post strongly questioning the position the DoD was taking in its memorandum. Evidently, Excell appears to have been on to something, as the DoD has now issued "updated" guidance on the matter.

Indeed, on September 9, 2022, Mr. Tenaglia issued a second memorandum to Contracting Officers on "**Managing the Effects of Inflation with Existing Contracts**." *(copy attached)*

The following is a summation of the DoD's memo, which represents **an almost complete reversal of prior positions** and is therefore worth a very serious read and understanding by industries and companies dealing with the Department of Defense on Federal Government contracting efforts.

OVERCOMING RECENT DoD GUIDANCE ON INFLATION AND ECONOMIC PRICE ADJUSTMENTS

The Department of Defense's first memorandum of May 25, 2022 provided official guidance to Contracting Officers regarding how to treat Requests for Equitable Adjustment (REAs) that were based on inflation and the resulting increase in the cost of materials and labor, among other factors (i.e., supply chain impacts, inflation, unanticipated effects stemming from COVID-19, etc.).

Indeed, the DoD instruction and guidance was that Contracting Officers should reject such claims submitted under existing contracts, while simultaneously instructing the Contracting Officers to incorporate the Economic Price Adjustment clause in future contracts (to include the exercise of option years on existing contracts, as discussed in the previous Excell blog), to allow for contractual adjustments to address spikes in inflation.

As discussed, this DoD guidance was short sighted and failed to recognize other alternative routes to recovery. Excell understands this full well, and knows that the key to recovery lies within the text of the clauses in the contract and how they interact and support one another.

Far too often the argument heard from contractors boils down to: "I spent it, therefore I am entitled to it." This approach is far too simplistic to be successful in the vast majority of situations in which the Government is inclined to provide pushback of any real magnitude, and ultimately leads to a monetary recovery of zero nearly every time.

In practice, a Request for Equitable Adjustment (and its eventual success or failure) cares not about the money being spent, but rather about the money being spent in a manner that is **justifiably recoverable** *via the language of the clauses found in the subject contract.* If the contractor actually understands what the contract's language says and its applicability to the situation at hand, the contractor can then make the money a **secondary issue** and recover its costs 100% of the time.

Thus, with Contracting Officers aggressively looking for ways to reject REAs related to inflation, an "outside the box" strategy may be required to have your REA accepted, understood, and approved. Contrary to popular belief, such a strategy is not actually all that far-fetched, but rather can be based on existing FAR clauses, existing contracting principles, and significant legal precedent, so long as it is prepared by a mind that truly understands these components.

Industry experts in this realm like Excell, Baker Tilly, Arcadis, and others (all firms who really understand and are able to traverse the pitfalls in the contract) know this, and that is why they exist and are successful. **Simply put:** A contractor's entitlement has to be established first, and then the money can follow with far less resistance.

NEW DoD MEMO WALKS BACK PRIOR DIRECTION AND OPENS DOOR TO PATH TO RECOVERY

In Excell's view, the DoD has acknowledged that its prior guidance was flawed when it recently issued its follow-on memorandum on September 9, 2022 titled, "Managing the Effects of Inflation with Existing Contracts."

In conjunction with Excell's stance as described above, the updated Memo seeks to "**advise Contracting Officers about the range of approaches available to them**" in resolving REAs **to adjust for inflation costs**.

For contractor's having their projects impacted by inflation, the importance of the DoD' shifting of opinion really cannot be understated. The DoD has now acknowledged that "***there may be circumstances where an accommodation can be reached by mutual agreement of the contracting parties***" to address acute inflation-related impacts, especially where a **small business** is involved.

Notably, while the DoD does not spell out the exact contractual access points they are referencing, Excell knows that there are several available clauses within the FAR and the Contract itself that can be utilized by contractors to request a recovery. These include the Changes Clause (which encapsulates Excusable Issues, Non-Excusable Issues, Compensable Issues, Concurrent and Nonconcurrent, Payment Provisions, Site Availability Provisions, Impossibility of Performance, Defective Plans and Specifications, Seasonal Weather Changes, Strikes/Lack of Manpower, Failure of Owner to Furnish Items, Superior Knowledge Arguments, Notice Arguments, Non-Responsiveness Issues, Lack of Response Issues, etc.), as well as the Differing Site Condition Clause, the Suspension of Work Clause, the *Spearin* Doctrine, the *Bromley* decision(s), and more.

In its updated guidance memo, the DoD also raises the issue of **Public Law 85-804**, a lesser-known and (in Excell's

opinion) severely underutilized remedy that has been available to contractors for decades. This law allows for **Extraordinary Contractual Relief** where **fairness and equity** demand – but the contractual provisions do not readily provide – the relief requested by a contractor.

It now appears that, given the DoD's guidance to its Contracting Officers concerning this law, Pub. L. 85-804 may finally be receiving the attention it deserves. especially with the DoD's declared intent to assimilate, study, and advise on behalf of the contracting parties when a clause does not fit the exact situation being encountered.

THUS, where an REA for inflation-related costs under a Firm Fixed-Price (FFP) contract would have been denied under the DoD's first Guidance Memo, **the updated Guidance Memo is now cracking open the door to recovery**.

The DoD has acknowledged that the issue needs to be looked at again, and the new guidance has effectively reversed the prior guidance. The issue is now wide open, and the key to entry is knowledge of how to persuasively package your REA.

In addition to the literal language of the updated Guidance Memo, the DoD's choice of words in the updated memo's second paragraph is also telling to Excell specifically with regard to the use of words such as "Generally", "However", and "Perhaps."

For example, the DoD states in its memo that contractors on a Firm-Fixed Price contract "*generally*" bear the risk of cost increases. The use of the word "*generally*" reflects a substantial softening of its prior (May 25, 2022) hardline guidance to contracting officers to flatly deny REAs for inflation-related cost impacts on these types of contracts.

"However," the DoD goes on to write, "there may be circumstances" where exceptions to the general rule should apply, as in the case of the ongoing, once-in-a-generation inflation impacts. This shift from its previous position comes after an upswell of input from industry; asserting that continued performance on FFP contracts with no reasonable cost adjustment is simply untenable and unfair, and that the inevitable failure of performance on said contracts would most certainly undermine the DoD's larger and critical mission.

Finally, the DoD's use of the word "perhaps" indicates that the matter is now **open for discussion**, and that reasonable heads should prevail in order to keep DoD contracts moving toward successful completion, all while keeping both contractors and the Government equitably whole.

INSIGHTS FROM THE DoD'S NEW 'CORRECTION' MEMORANDUM

The DoD's issuance of the second guidance Memorandum is as close to a reversal of a formal position as you may ever see in the world of Government Contracting. Contractors need to understand that the situation over the last few years (to include "Acts of God" such as the pandemic, and its unexpected associated inflation, supply chain impacts, and inconsistent direction from those in charge in the contracting arena) are now finally coming to the surface, and now is the time in which they need to be addressed and accounted for in the interest of fairness and equity.

In summation, industry needs to understand, in the simplest of terms, that the rules and regulations as they relate to delays, disruptions, and ripple effects, caused or not caused by Government action or inaction, can all present areas of recoverability. Importantly, just a few months ago, the Government's official position was essentially, "Sorry you made the mistake of entering into our contract that is fixed-price in nature. You took the risk, and you lose." Not only has that position softened, but in many ways it has been reversed, and U.S. Government contracting personnel across the world have been formally instructed to act accordingly moving forward.

If you believe that your contract environment is now open for discussion, you merely need to understand how to parlay that belief into a monetary recovery. Large organizations specializing in cost accounting, as well as consulting and law firms that have their ears to the ground in the world of government contracting are all waking up to this fact and stand ready to assist contractors that wish to seek said recoveries. In fact, **some have already started the process**, and **Excell clients have already begun to see victories in this area**.

RECENT VICTORIES FOR EXCELL CLIENTS

Excell not only *believes* all of the above to be true, but has **proven it to be true** with recent victories on behalf of its clients.

Recent victories for two of Excell's clients demonstrate that **contractors CAN recover their cost impacts associated with the COVID-19 pandemic and related shutdowns**, as well as impacts to profitability due to inflation. The key to both types of claims lies in how the claim is argued and presented.

Recently, two separate contractors, both of whom found themselves in similar contractual situations, submitted formal REAs to Government in an attempt to recover COVID-19 and inflation-related cost impacts to their projects. In both cases, the Government initially denied the contractors' REAs, nearly in their entirety.

However, after engaging Excell and repackaging their REAs and supporting arguments in conjunction with the knowledge and principles discussed herein, both clients were successful in convincing the Government to reconsider their initial denials. Both clients were able to convince the Government to enter into further discussions and negotiations on their respective projects, and both eventually were granted their requested recovery. In essence, the key to recovery for both clients was in convincing the Government's contracting personnel that recovery was indeed allowable via a combination of Federal Acquisition Regulation clauses, an approach that the DoD has now formally directed its Contracting Personnel to follow moving forward.

The key for both clients, and for contractors in similar situations, is to determine (contractually) how the Government's direction(s) ultimately caused a **Change** in the terms and conditions of their contracts that was different from the performance planned, bid upon, and awarded. Excell has long known precisely how to go about this, and was able to prove this fact in both of these cases, much to the satisfaction of its clients.

CONCLUSION

Contractors absolutely should not give up on REAs and claims for cost impacts resulting from COVID-19 and/or inflation, even in situations where initial requests related to compensation for these items have been denied. The Government has now formally issued direction that contradicts a denial of such requests, and would naturally love nothing more than for contractors to believe that previous denials remain valid when the complete opposite is now really the case.

Excell has long held that a well strategized and well-crafted submission can set the foundation for a successful REA/claim under most sets of facts and circumstances. Before throwing in the towel, Excell highly recommends that contractors consult a professional for an analysis of their situation; preferably one who has had very recent success dealing with exactly these types of issues.

Aside from the obvious potential cost/time recovery, contactors who do so will also stand to gain a valuable education on how to assemble and argue successful REAs/claims under circumstances where many contractors

before them may have given up before they even began.

Ultimately, the door to recovery of COVID-19 and inflation-related costs has now been opened, and fiscal recoveries to contractor's bottom-lines (both on current AND future contracts) is sure to be substantial. Let Excell Consulting International share with you the knowledge it has gained over 30+ years of experience, and place your company on the path to a successful recovery of these costs today!

If you have any questions about these recent developments, or would like to discuss your specific situation, Excell Consulting is ready and able to assist. And remember…

Initial consultation calls to Excell are always ***FREE!***

Call (719) 599-8336 today!

Attachments:

Excell Blog Post: "DoD ISSUES QUESTIONABLE GUIDANCE ON INFLATION", published June 14, 2022

Department of Defense Memorandum, May 25, 2022, "Guidance on Inflation and Economic Price Adjustments"

Department of Defense Memorandum, September 9, 2022, "Managing the Effects of Inflation with Existing Contracts"

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DOD ISSUES *QUESTIONABLE* GUIDANCE ON INFLATION

Economic Price Adjustment Clause in New, Existing, and Option Contracts

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INTRODUCTION

In the midst of decades-high inflation, the Department of Defense (DOD) recently advised its industry partners on who *they believe* will be **SHOULDERING THE BURDEN OF INCREASED COSTS IN EXISTING AND NEW CONTRACTS.**

On May 25, 2022, the DOD finally issued its much-needed **Guidance on Inflation and Economic Price Adjustment** *(copy attached)* ("Guidance Memorandum"). The Memorandum comes as inflation is steadily rising, forcing contractors with fixed-price contracts to bear the risk and result of skyrocketing supply costs. Consequently, many contractors are finding their profit margins eroding and even falling into a loss position, without much sympathy or cooperation from Contracting Officers.

While the Memorandum reinforces bad news for contractors on existing fixed-price contracts, the Guidance Memorandum provides contractors with **valuable insight on how Contracting Officers *may* address sharing or shifting the risk of inflation** on new contracts. The Guidance Memorandum is currently silent on how Contracting Officers should treat contract options, although applicable FAR clauses offer a path forward on most contracts.

This blog post summarizes the impacts of the Guidance Memorandum for (1) **new contracts**, (2) **existing contracts**, and (3) the impact on **option contracts**.

NEW CONTRACTS

The Guidance Memorandum specifically encourages Contracting Officers **to include** economic price adjustment (EPA) clauses in new contracts now being solicited.

In this way, the Guidance Memorandum does offer some hope to contractors currently negotiating contracts. It highlights that "DOD contractors and contracting officers alike have expressed renewed interest in using Economic Price Adjustment (EPA) clauses." Additionally, it confirms that "an EPA clause may be an appropriate tool to equitably balance the risk of inflation between the Government and contractor."

HOWEVER, this direction does not provide Contracting Officers with new authority, as FAR 16.203-2 already allows adding an economic price adjustment clause when (i) there is serious doubt about the stability of market or labor conditions that will exist during an extended period of contract performance, and (ii) contingencies that would otherwise be included in the contract price can be identified and covered separately in the contract. Nonetheless, the newly issued Guidance Memorandum will likely make convincing Contracting Officers to use that authority a much easier proposition. The Guidance Memorandum also offers direction to Contracting Officers regarding how to **appropriately craft** an EPA clause, including direction to include an allowance for both upward and downward adjustments in price.

As such, contractors should evaluate new solicitations (for fixed-price contracts) to ensure they contain an EPA clause. If the solicitation does not, **contractors must account for the possibility of an increase in inflation** or other market forces driving supply prices higher and avoid contracts that would leave them overly exposed to such conditions.

Importantly, if a new solicitation contains an EPA clause, contractors should evaluate whether that clause is adequately flexible to account for **unforeseen price increases during the life of the project.** This should include, just as the DOD urged to its Contracting Officers, **(1)** considerations for selecting an index to measure inflation that is linked to cost **components that are most unstable**; **(2)** identifying limitations regarding the scope of the EPA clause to exclude costs that are unlikely to be affected by inflation; and **(3)** taking the time and internal effort to develop pre-established formulas for calculating the **new pricing**, instead of merely reopening price negotiations should the need arise.

EXISTING CONTRACTS

Conversely, the Guidance Memorandum encourages Contracting Officers to continue to effectively **stonewall** contractors with existing fixed-price contracts without an EPA clause. It reiterates the position used by many contracting officers that "[i]n the absence of an applicable contract clause, such as an EPA clause authorizing a contract price adjustment as a result of inflation, there is no authority for providing contractual relief for unanticipated inflation under an FFP contract." In Excell's experience, while this is technically accurate in a narrow sense, a detailed understanding and appropriate analysis of applicable Federal Acquisition Regulation (FAR) clauses often allows an access point to recovery of additional incurred costs in most scenarios.

Based on the present-day position being taken by the DoD, this newly issued Guidance Memorandum goes on to reiterate that, without an applicable contract clause or change, contracting officers may not (and arguably should not) agree to a contractor's requests for equitable adjustment to account for inflation.

Obviously, this published guidance now mandates that contractors look to **other contractual means** to recover their unpredictably high incurred costs.

Accordingly, it is Excell's position that, based upon years of experience in this arena, contractors should base any requests for adjustments in **(a)** an economic price adjustment clause, if available; **(b)** an alternative contract clause that authorizes price adjustments; or **(c)** by identifying established (written) government direction that can be utilized as a factual changed condition or a government-caused matter affecting time, money, or both.

IMPLICATIONS FOR CONTRACTS WITH OPTION YEARS

Notably, the current DOD guidance remains **silent** as to contracts containing **options** to extend the contract for additional periods of time ("option contracts"). Thus, under the precepts of the Guidance Memorandum the question is simple: **Should Contracting Officers treat options for additional contract periods as part of the existing contract or as a new contract?**

To be clear, while the answer ultimately depends on the language of each individual contract, contractors facing an exercise of option years with pricing based on a pre-inflation price analysis conducted in the evaluation of the original contract may find relief under **FAR 17.207 "Exercise of Options"**.

> *Specifically, that provision requires that, for the Government to validly exercise an option, "the option must have been evaluated as part of the initial competition and be exercisable at **the amount specified** in or **reasonably determinable** from the terms of the basic contract." FAR 17.207(f).*

In fact, based upon existing rulings, the Government's evaluation of pricing in the original solicitation becomes **no longer binding** at

the time the option is exercised, the Government may not rely upon the initial reasonableness determination to show the option is legally exercised. See *Magnum Opus Techs., Inc. v. United States*, 94 Fed. Cl. 512, 538 (2010). In *Magnum*, base rates and pricing in the awarded contract included escalation rates for each of 10 potential option years. However, after award, the base rates and pricing were changed by modification, which made the **originally awarded pricing and escalation rates** non-binding upon the option years.

Historically, FAR 17.207 has also been interpreted to mean that, once the government acknowledges that the **market has changed** since the initial price evaluation of the solicitation occurred, the government cannot rely upon its evaluation at the time of the initial award to establish the reasonableness of pricing in exercising its options. See *Magnum Opus Techs., Inc. v. United States*, 94 Fed. Cl. 512, 538 (2010). Accordingly, **relying upon the price evaluation at the time of award despite changed market conditions violates FAR 17.207(d).** See *Magnum Opus* at 539 (internal citations omitted). In essence, given the current market conditions, it is now evident that the DoD has acknowledged via its Memorandum that **the market has materially changed**.

Finally, if the Government's exercise of an option on a multiyear contract is improper in any way, contractors may have a remedy for additional costs by treating the exercise as a Constructive Change under the Changes clause.

Thus, whether the rates established for option years have been rendered inapplicable by Changes or modifications to the contract, by changed market conditions, or the defective exercise of an option, contractors should carefully scrutinize every available recourse to **ensure option pricing is modified to adequately protect the contractor's profitability**, as well as the profitability of its shareholders, while simultaneously treating the Government to the level of fairness it contracted for.

If you have any questions about this recent development, or would like to discuss your specific situation, Excell Consulting is ready and able to assist. And remember, initial consultation calls to **Excell** are always ***FREE! Call (719) 599-8336 today!***

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ACQUISITION
AND SUSTAINMENT

MEMORANDUM FOR COMMANDER, UNITED STATES CYBER COMMAND (ATTN: ACQUISITION EXECUTIVE)
COMMANDER, UNITED STATES SPECIAL OPERATIONS COMMAND (ATTN: ACQUISITION EXECUTIVE)
COMMANDER, UNITED STATES TRANSPORTATION COMMAND (ATTN: ACQUISITION EXECUTIVE)
DEPUTY ASSISTANT SECRETARY OF THE ARMY (PROCUREMENT)
DEPUTY ASSISTANT SECRETARY OF THE NAVY (PROCUREMENT)
DEPUTY ASSISTANT SECRETARY OF THE AIR FORCE (CONTRACTING)
DEFENSE AGENCY AND DOD FIELD ACTIVITY DIRECTORS

SUBJECT: Guidance on Inflation and Economic Price Adjustments

The current economic environment requires we understand the impacts of inflation to existing contracts and consider various approaches to manage risk of inflation to prospective Department of Defense (DoD) contracts. We acquire a wide range of goods and services to fulfill the Department's mission requirements; inflation is impacting several segments of our economy in varying degrees. Against this backdrop, DoD contractors and contracting officers (COs) alike have expressed renewed interest in using economic price adjustment (EPA) clauses. This memorandum provides guidance to assist COs to understand whether it is appropriate to recognize cost increases due to inflation under existing contracts as well as offer considerations for the proper use of EPA when entering into new contracts.

For purposes of existing DoD contracts, the treatment of cost increases as a result of economic conditions is dependent on contract type. Under cost reimbursement type contracts, the Government bears the risk of increased costs, including those due to inflation. Contractors are responsible for promptly notifying the CO that the costs incurred are approaching the limits specified in the applicable clause, as applicable under Federal Acquisition Regulation (FAR) clause 52.232-20, Limitation of Cost, or FAR clause 52.232-22, Limitation of Funds. Upon receipt of notice, the Government may increase the contract funding to allow for continued contract performance; the contractor is not obligated to continue performance beyond what can be accomplished within the contract's funded amount. Under fixed-price incentive (firm target) (FPIF) contracts, the contractor's actual (allowable and allocable) costs are recognized up to the contract ceiling. To the extent the actual cost differs from the target cost, the target profit will be adjusted by application of the contract share ratio to the costs over or under the target cost. Under fixed-price contracts with economic price adjustment (FPEPA), the EPA clause normally establishes a mechanism to mitigate specifically covered cost risks to both parties as a result of industry-wide contingencies beyond any individual contractor's control; the Government will bear the cost risk up to the limit specified in the clause (if any).

Unlike contractors performing under cost-reimbursement, FPIF, or FPEPA contracts, contractors performing under firm-fixed-price (FFP) contracts generally must bear the risk of cost increases, including those due to inflation. In the absence of an applicable contract clause, such as an EPA clause authorizing a contract price adjustment as a result of inflation, there is no authority for providing contractual relief for unanticipated inflation under an FFP contract. We are fielding questions about the possibility of using requests for equitable adjustment (REAs) under FFP contracts to address unanticipated inflation. REAs entail a contractor's proposal to the CO seeking an equitable adjustment to the contract terms based on a contracting officer-directed change within the scope of the contract, in the areas defined by the applicable Changes clause, or by another contract clause that authorizes an equitable adjustment based on specific actions taken. Since cost impacts due to unanticipated inflation are not a result of a contracting officer-directed change, COs should not agree to contractor REAs submitted in response to changed economic conditions.

For contracts being developed or negotiated during this period of unusually high inflation, an EPA clause may be an appropriate tool to equitably balance the risk of inflation between the Government and contractor. Including an EPA clause may enable a contractor to accept a fixed-price contract without having to develop pricing based on worst case projections to cover the cost risk attributable to unstable market conditions because of the EPA clause's built-in mechanism to mitigate such risk. COs should consider contract length as one of the primary considerations when deciding whether to use an EPA clause. Defense FAR Supplement (DFARS) 216.203-4(1)(ii) indicates EPA clauses based on established prices or on the actual cost of labor and material should only be used when delivery or performance will not be completed within six months after contract award. FAR 16.203-4(d)(1)(i) limits use of EPA clauses based on cost indices of labor and material to contracts with an extended period of performance, with significant costs to be incurred beyond one year after performance begins.

In crafting an EPA clause, COs must be mindful that the impacts of inflation vary widely, depending on the nature of costs. Therefore, when selecting indices to be used to measure inflation for purposes of an EPA clause, the CO should take care to use an index that is closely related to the cost components judged to be most unstable. Further, the CO should limit the scope of the EPA clause to those costs most likely to be impacted by economic fluctuations and should exclude costs that are not likely to be impacted by inflation from adjustment under the clause, such as FFP negotiated subcontracts with no EPA provisions, depreciation, or labor costs for which a definitive union agreement exists. In accordance with DFARS Procedures, Guidance, and Information (PGI) 216.203-4, economic price adjustments do not normally apply to the profit portion of the contract.

It is important to use independent, recognized sources as the basis for measurement of inflation in EPA clauses. The index (or indices) selected to measure inflation should not be so large and diverse that the inflation measurement is significantly affected by fluctuations not relevant to contract performance, but the selected index (or indices) must also be broad enough such that the measured inflation rate is not significantly affected by a single company. For example, DFARS PGI 216.203-4 cites the Bureau of Labor Statistics (BLS) Producer Price Index series; the Employment Cost Index for wages and salaries, benefits, and compensation

costs for aerospace industries; and the North American Industry Classification System (NAICS) Product Codes.

Appropriate EPA clauses will not be one-sided, but will be fair to both parties. For example, an equitable EPA clause will: 1) allow for both upward and downward revision of the stated contract price upon the occurrence of specified contingencies; 2) use the same index to establish the negotiated price and to adjust the negotiated price under the terms of the clause; and 3) incorporate a ceiling and a floor on adjustments that are of the same magnitude (if a ceiling and floor are included). COs should ensure that EPA clauses allow for contract price adjustments based on pre-established formulas rather than simply reopening price negotiations.

It is critical that COs ensure that the contingency allowances covered by the EPA clause are excluded from the base contract price. Additionally, each EPA clause must clearly present and explain the mechanics of calculating the price adjustments authorized under the clause, as well as specifically identifying the timeframes or events that will trigger a price adjustment.

COs must be cognizant that any clause addressing potential contract cost or price changes due to economic conditions, e.g. inflation, is effectively an EPA clause, whether or not the term EPA appears in the clause. The guidance contained in this memo is applicable to any clause that results in cost or price changes due to changed economic conditions.

As a best practice, COs should request assistance from their local pricing and policy offices, the Defense Contract Management Agency, or the Defense Contract Audit Agency when contemplating using of an EPA clause. COs should also review the guidance contained in DFARS PGI 216.203-4. Of course, as is prudent in most cases, COs should consult their legal counsel before deciding to use an EPA clause.

Finally, COs and financial managers should take into account that contingent liabilities arise when EPA clauses are used in contracts. Such liabilities should be administratively reserved as commitments pending determination of actual obligations. Chapter 8 of the DoD Financial Management Regulation, section 0802, addresses estimation of amounts that should be carried as commitments, and provides for conservative estimation sufficient to cover the obligations that probably will materialize.

The challenges presented in this period of economic uncertainty require us to employ appropriate solutions to both protect Government interests and ensure the continued health of the defense industrial base to support our mission. To the extent those solutions include use of the FPEPA contract type or inclusion of an EPA clause, COs must work with contractors to ensure EPA clauses provide appropriate risk mitigation while being fair to all parties to the contract.

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DEFENSE AGENCY AND DOD FIELD ACTIVITY DIRECTORS

SUBJECT: Managing the Effects of Inflation with Existing Contracts

Based on feedback from the Department's acquisition executives about how inflation is presently affecting the Defense Industrial Base and contractors' ability to perform under existing firm-fixed-price contracts, this guidance advises Contracting Officers about the range of approaches available to them.

As indicated in my guidance memo dated May 25, 2022, the ability to recognize any cost increases is largely dependent on contract type. Contractors performing under firm-fixed-price contracts that were priced and negotiated before the onset of the current economic conditions generally bear the risk of cost increases. However, there may be circumstances where an accommodation can be reached by mutual agreement of the contracting parties, perhaps to address acute impacts on small business and other suppliers. For example, provided adequate consideration is obtained for the Government, such an accommodation may take the form of schedule relief or otherwise amending contractual requirements.

For extraordinary circumstances where contractors have sought or may seek an upward adjustment to the price of an existing firm-fixed- price contract to account for current economic conditions, each of the Secretaries of Defense, Army, Navy and Air Force has authority under Public Law 85-804, as implemented by Part 50 of the Federal Acquisition Regulation (FAR) and the Defense FAR Supplement (DFARS), to afford Extraordinary Contractual Relief. While the law and regulation have established stringent criteria, the Department will consider contractor requests to employ this authority, subject, of course, to available funding. To ensure the Defense Acquisition Executive is made aware of any such Public Law 85-804, Part 50 requests that are attributed to inflation, DoD Components shall forward any such request within 10 business days of contractor submission to Defense Pricing and Contracting via osd.pentagon.ousd-a-s.mbx.asda-dp-c-contractpolicy@mail.mil.

As conditions warrant, we will continue to adapt our approach to meet the Department's mission requirements through the current economic environment, considering information from the Components.

John M. Tenaglia
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