

## M&O Contractor Incentives – Fee, Rollover of Performance Fee, and Award Term

[Reference, [DEAR 970.1504-1](#)]



### Guiding Principle

DOE contractors are motivated in a variety of ways, depending on the nature of the firm, the Government's requirement, or other specific circumstances. No single method applies to all contractors. The goal of the Department is to obtain maximum return from its contractors by offering a rational mix of integrated, fair, and challenging incentives to its contractors.

### Overview

This chapter provides: (1) a synopsis of the M&O contractor fee policy (focused on the mechanics of the calculation and the key considerations of the policy); (2) guidance on a key aspect of the policy, linking performance fee to outcomes, including guidelines on allowing rollover of performance fee; and (3) guidance on the use of the non-fee incentive of award term. In this guide chapter, the term "DOE" refers to both DOE and NNSA.

### Background

M&O contractor fee policy, found at DEAR 970.1504-1, provides a comprehensive approach to determining an appropriate fee for contractors performing DOE M&O contracts and other contracts as determined by the DOE Senior Procurement Executive. Since the contractors and the work they perform cover a wide spectrum, the fee policy is necessarily complex. The first section of this guide chapter provides a straightforward articulation of basic mechanics and considerations of the policy.

Fee must be tied to contractor performance. The guidance in the second section of this guide chapter discusses rollover of performance fee (fee not earned in an evaluation period that is available for payment in a subsequent period), which requires careful consideration of its effect on the contractor's motivation, because it provides the opportunity to earn the same fee more than once.

The final section of this guide chapter provides guidance on the non-fee incentive of award term. Although recognized and used for a number of years by several Federal agencies, no Government-wide regulation or guidance currently addresses award term incentives. Within DOE, the Report of the Blue Ribbon Commission on the Use of Competitive Procedures for the Department of Energy Labs, titled "Competing the Management and Operations Contracts for DOE's National Laboratories," suggested that outstanding laboratory contractors could "be

rewarded with significant contract extensions, in most cases up to a maximum of 20 years.” It’s important to understand that this incentive has considerations that must be weighed carefully to ensure that DOE derives a meaningful benefit from its use. As a matter of DOE policy, award term incentives may only be used in management and operating (M&O) contracts for DOE laboratories and then only with the approval of the DOE Senior Procurement Executive or NNSA Senior Procurement Executive, as appropriate.

## Synopsis of M&O Fee Calculation and the Key Considerations of M&O Fee Policy

### How To Calculate Total Available Fee

There are four possible components in the fee calculation, depending on whether the site is a laboratory or a non-laboratory and whether the contract type is fixed-fee or cost-plus-award fee.

#### Non-Laboratory

##### Fixed-fee contract

1. Determine the fee base
2. Determine the maximum fee from the fee schedule for that fee base
3. Calculate the “appropriate fixed fee”
  - a. Evaluate the eight significant factors at 970.1504-1-5
  - b. Assign “appropriate fee values”

##### Cost-plus-award-fee contract

1. Multiply the “appropriate fixed fee” by the classification factor for the facility/task (from DEAR 970.1504-1-9 (c), (d), and (e)) to obtain total available fee

#### Laboratory

##### Fixed-fee contract

1. Determine if fee is appropriate at all (from the six considerations at 970.1504-1-3). If not, stop here!
2. If fee appropriate
  - a. Determine the fee base
  - b. Determine the maximum fee from the fee schedule tied to the fee base
  - c. Calculate the “appropriate fixed fee”
    - i. Evaluate the eight significant factors at 970.1504-1-5
    - ii. Re-evaluate the six considerations at 970.1504-1-3
    - iii. Consider benefits lab operator will receive due to its tax status
    - iv. Assign appropriate fee values
    - v. Ensure appropriate fixed fee is less than or equal to 75% of the fixed fee that would have been calculated for a non-laboratory

##### Cost-plus-award-fee contract

1. Determine if fee is appropriate at all (from the six considerations at 970.1504-1-3)
2. If fee appropriate
  - a. Multiply the “appropriate fixed fee” by the classification factor for the facility/task to obtain total available fee (970.1504-1-9 (c), (d), and (e))
3. Ensure the total available fee is less than or equal to 75% of the total available fee that would have been calculated for a non-laboratory.

Key Considerations For Determining M&O Total Available Fee

- A. Coordinate all M&O fee determinations with the Procurement Executive, whether or not using the maximum fee allowed or a lesser amount and whether adhering to fee policy or not
- B. Procurement Executive approval is required for the following
  1. Establishing fees outside the annual funding cycle
  2. Establishing fee amount greater than that derived from the fee schedules
  3. Establishing total available fee greater than normal due either to the contractor using its own facilities or other resources or to the contractor being assigned objective performance incentives that are of unusual difficulty or performance incentives whose completion would provide extraordinary value
  4. Including allowable costs as proposed fee in a laboratory contract
  5. Establishing total available fee for a laboratory greater than 75% of that which would have been calculated for a non-laboratory
  6. Not establishing the fee for the life of a laboratory contract
  7. Using a cost-plus-fixed fee contract type for other than a laboratory contract
  8. Using a fee schedule more than once in determining fee
  9. For a cost-plus-award-fee contract, establishing a total available fee greater than the product of: the fee that would be calculated for a fixed fee contract and the appropriate classification factor
- C. Assess whether fee motivated contractor performance
  1. Dramatic increases in total available fee over historical levels generally not warranted
- D. Consider the Fee Base/Fee Schedule
  1. Generally, use only one fee base/fee schedule, that of the predominant work, for a contract
  2. If unusual circumstances exist and considering using more than one fee base/fee schedule
    - a. Prepare rationale
    - b. Coordinate as soon as practical with procurement executive
      - i. Approval criteria are the significant differences between the nature, scope, risk, and dollar value of the other work and that of the predominant work
- E. Additional constraints on laboratories for determining fee
  1. Six considerations (970.1504-1-3) to determine if any fee is appropriate; if fee is appropriate, use the six considerations again in determining appropriate fee
  2. Consider tax status of contractor in determining fee
  3. Fee must be less than or equal to 75% of the fee that would have been calculated for a non-laboratory

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4. Fees for laboratories may be significantly less than fees for non-laboratories

## **Linking Performance Fee to Acquisition Outcomes and Allowing Rollover of Performance Fee**

### Linking Performance Fee to Acquisition Outcomes

A cost-plus-award-fee (CPAF) contract is generally the appropriate contract type for an M&O contract. Total available fee in this case is the sum of base fee and performance fee. Base fee is not generally appropriate. Performance fee can comprise both objective and subjective fee components.

Performance fee must relate to clearly defined performance objectives and performance measures. Where feasible, the performance objectives and measures should be expressed as desired results or outcomes. The specific measures used to determine the contractor's achievement must be stated as concretely as possible. Following these principles will increase the probability that the contractor will only receive performance fee for government negotiated acquisition outcomes. This is especially important to keep in mind in evaluating the contractor's performance against its objectives and measures for subjective fee components.

Using subjective fee components is less desirable than using objective fee components because there is not as clear a link between performance and reward. Only when it is not feasible to use objective measures of performance should subjective fee components be used, and they should be tied to identifiable interim outcomes, discrete events, or milestones to the maximum extent practicable. When using subjective fee components it is especially important to ensure that the contract/award fee plan clearly defines how the Government will measure the contractor's performance. Fee payment must depend upon only one thing--the contractor's providing the acquisition outcomes for which DOE negotiated.

### Rollover of Performance Fee

Some performance evaluation and measurement plans contemplate the rollover of unearned performance fee—typically the subjective fee component—from one period to another. (Rollover is defined on page 58 of the DOE Performance-Based Contracting Guide, which is located in the DOE Acquisition Guide chapter 70.8, as fee not earned in an evaluation period that is available for payment in a subsequent period.) Since this practice gives the contractor more than one chance to earn the same fee, its use could violate the principles discussed above. Consequently, the following limitations apply when applying rollover (these limitations do not apply to the extent a clearly identifiable Government action or inaction caused the contractor to fail to earn performance fee):

- The DOE Senior Procurement Executive or the NNSA Senior Procurement Executive, as appropriate, must approve use of a rollover provision. Because the use of a rollover is an exception rather than the rule, convincing rationale addressing both benefits and costs

must accompany any request for use. The DOE Senior Procurement Executive or the NNSA Senior Procurement Executive, as appropriate, will consider the following, among other things related to the benefits and costs of the proposed rollover, in determining whether rollover is appropriate:

- The contractor may only earn a portion of the unearned performance fee— regardless of how well the contractor performs in the subsequent period. The size of this portion depends on
  - how close the contractor came to delivering the originally negotiated performance (for example, a contractor failing to reach a milestone by a year must earn significantly less than a contractor that fails by a week) and
  - how much DOE still desires the originally negotiated performance, some other performance, or both.
- The performance expectations must be in place before the contractor starts work on the effort associated with the rollover fee.
- The performance expectations must be of such rigor and evident nexus to the value of the “new” work as to be clearly equitable to the Department.

The contract file must include complete documentation of the use of rollover.

## Award Term

### I. General

- a. In establishing appropriate incentives for contractors, it is well-founded Government policy that fee is to be reasonable, reflecting effort (the complexity of the work and the resources required for contract performance), cost risk (the degree of cost responsibility and associated risk the contractor assumes under the contract type and the reliability of the cost estimates in relation to the complexity of the task), and several other factors (for example, support of Federal socioeconomic programs, investment in capital, and independent development).
- b. An award term incentive provides a new dimension in contractor incentives. An award term incentive has similarities to award fee, with the major difference being the contractor earns additional periods of performance instead of award fee. An award term incentive rewards the contractor with additional contract term if: (1) the performance of the contractor meets specific contractually required criteria; and (2) any contract specified conditions are met. The process for administering award term can be similar to, or separate from, the process for administering award fee, but the award term performance objectives must be distinct and separate from the award fee performance objectives. Typically, the contractor's superlative performance in meeting award fee performance objectives will be the only gateway to the contractor's being eligible to earn award term. Additionally, the award term performance objectives will be higher, broader, or further reaching in scope (or perhaps all three) than the award fee performance objectives.
- c. If an award term incentive is used, it must be integrated with other contract incentives, for example, fee. Consequently, while the value of an award term incentive can not be easily quantified, it must be considered in determining a reasonable fee. That is, if a fee of x dollars is reasonable for a contract that includes no other incentives, then a fee of less than x dollars would be reasonable for a contract that includes an award term incentive. A 5 to 15 percent reduction (to the amount of total available fee for the contract that would be reasonable if no award term incentive were included) would usually be appropriate. An example of a reasonable reduction would be a 1 percent reduction to each annual available fee amount (that would be reasonable if there were no award term incentive) for each additional year that the contractor can earn over the course of the contract. In this example if the contract includes a base term of five years and 15 additional years that the contractor can earn, the 1 percent reduction per additional year results in a 15 percent reduction to each annual available fee amount. The formula for this example is:



- i.  $[(1 \text{ percent reduction in annual available fee amount}) / (\text{each additional year that the contractor can earn})] \times$ 
  1. [15 possible additional years that the contractor can earn] =
  2. 15 percent reduction to each annual available fee amount.
- d. To avoid creating commitments that the Government does not want to make and expectations of contractors that will not be fulfilled, the award term clause must specify clearly that if certain conditions (which may be outside the control of the contractor) are not met the contractor will lose (1) the opportunity to earn additional award term and (2) any award term benefits it may already have earned. The clause must also state that the Department has no further obligation to the contractor if this happens and that the determination of whether the conditions have been met is at the sole discretion of the contracting officer. These and other conditions and terms are listed in the subsequent section titled, "Award Term Clause: Required Conditions and Terms."

## II. Applicability

- a. Award term incentives may only be used in performance-based M&O contracts for laboratories where it is clear that the potential benefit to the Department from the contractor's increased motivation exceeds the potential impact on future competitions and the additional administrative burden/cost.

## III. Limitations

- a. The Head of Departmental Element must obtain the approval of the DOE Senior Procurement Executive or the NNSA Senior Procurement Executive, as appropriate, prior to initiating any plan to apply award term incentives.
- b. Award term incentives may not be used in conjunction with contract options to extend the contract period of performance.
- c. Award term incentives may be used only in contracts that have been awarded pursuant to full and open competition for the basic contract award.
- d. Award term incentives may be used only if all of the criteria for the contractor's earning of award term are discussed in the RFP and defined clearly in the contract before the start of each evaluation period for award term.
- e. Award term incentives may only be used in M&O contracts for DOE's national laboratories and only with the approval of the DOE Senior Procurement Executive or the NNSA Senior Procurement Executive, as appropriate.

## IV. Conditions For Use

- a. Trade-off with fee--
  - i. Award term incentives replace, in whole or in part, monetary fee incentives. Accordingly, award term incentives are not permitted if the resultant contract would provide the contractor with a total available fee equal to the amount calculated under the DEAR fee policy. As the contemplated length of the potential award term periods increases, a corresponding decrease must occur in the contemplated total available fee.
- b. Length and Number of Terms--
  - i. The cumulative length of the contract's base term and all possible award terms shall not exceed the lesser of: 20 years; the approved length of the M&O form of contract and term (DEAR 970.1706 and any approved deviations); or the approved length of the use and need of a Federally Funded Research and Development Center (DEAR 970.3501 and any approved deviations), if applicable.
  - ii. The length of award term periods and the number of such periods shall vary depending upon how effort under the contract is best facilitated by a potentially long contract term.
  - iii. The contract's award term clause shall limit the maximum amount of additional term that the contractor can earn for a year of performance to one year.
- c. Distinction from Award Fee--
  - i. Performance objectives for earning award term shall be distinct from those for earning award fee.
  - ii. The Head of the Departmental Element must approve the objectives. Performance objectives for earning award term must be stated in the contract prior to the start of the evaluation period. Annually, the award term determining official shall report his/her assessment of the contractor performance of award term performance objectives to the Head of the Departmental Element.
- d. Award Term Clause: Required Conditions and Terms
  - i. Conditions: The contract's award term clause (or other clauses of the contract) must include the following conditions 1 through 7. Conditions 1 through 5 apply to both the contractor's right to earn award term and to the contractor's right to perform any term earned. Conditions 6 and 7 apply only to the contractor's right to perform any term earned.

1. The Department has a continuing need for the supplies/services.
  2. The Department has sufficient funds to reimburse the contractor.
  3. The Department must not have terminated the contract for convenience or default.
  4. The Department has a continuing need for the M&O form of contract.
  5. The Department has not concluded that it does not have a continuing need for the use of a Federally Funded Research and Development Center.
  6. The contractor agrees to contract modifications applicable to the award term period earned to implement any significant new Department or government requirements.
  7. The contractor agrees to contract modifications applicable to the award term period earned that reflect monetary performance incentives (performance measures, fee policy, etc.) similar to the base period, unless otherwise stated.
- ii. Terms: The contract's award term clause must include the following terms:
1. The contracting officer will at his or her sole discretion determine if the contractor has met the conditions to earn award term and to perform any award term earned.
  2. If the conditions and terms to earn award term are not satisfied, the Department has no additional obligation under the clause to the contractor; that is, cancellation of the opportunity to earn award term or cancellation of the award term earned for any reason, term, or condition set forth in the award term clause does not entitle the contractor to an equitable adjustment or any other compensation.
  3. Before the start of any award term evaluation period the Government may modify both: the criteria the contractor must meet to earn award term extensions; and the conditions to which the contractor's being able to earn award term or to perform award term extensions earned are subject.
  4. The Department has the same right to terminate for convenience or default any portion of the contract (base term or earned award term) as it would have if the contract did not contain its award term cause.
  5. If at the end of an evaluation period after the contractor has received credit for any earned award term extension, two or fewer years remain on the term of the contract: (i) the Government, at its sole discretion, may end the contract as early as the end of the remaining term of the contract or as late as two years from the end of the evaluation period; and (ii) the contractor must continue to perform up to the point in time decided by the Government in (i) above.

6. The contracting officer must modify the contract to reflect any earned award term extension before the contractor proceeds.

V. Sample Clauses

- a. Two sample award term clauses are provided as Attachments A and B. These are not mandatory clauses. They are provided simply to aid contracting officers in developing clauses that match their particular situations.
  - i. The **Attachment A clause** conforms generally to the guidelines above and includes additional conditions for consideration: the contractor loses some contract term for poor performance (using this feature necessitates stating a minimum contract term); the contractor must earn an outstanding rating for two consecutive periods to earn any award term extension; the contractor loses the ability to earn further award term extensions if the remaining contract term falls below two years (with certain exceptions); the Government may reduce any earned Award Term extension for contractor performance failures under the “Conditional Payment of Fee, Profit, and Other Incentives—Facilities Management Contracts” clause (DEAR 970.5215-3); and specific discussion of how and when changes to the Award Term Plan can be made.
  - ii. The **Attachment B clause** also conforms generally to the guidelines above. It uses simpler mechanics than the clause at Attachment A, and it uses the term “Award Term Determining Official.” It also includes conditions under the “Conditional Payment of Fee, Profit, and Other Incentives—Facilities Management Contracts” clause (DEAR 970.5215-3) and the “Management Controls” clause (DEAR 970.5203-1).

Attachment A

SAMPLE AWARD TERM CLAUSE

Award Term

**Contract Length.** The Government may extend or reduce the initial five (5) year contract term based on the contractor's performance. The minimum contract term is three (3) years. The maximum contract term is twenty (20) years.

**Contractor Performance.** The Government will evaluate the contractor's performance per the clause in Section H entitled, "Award Term Plan."

Award Term determinations.

The term "remaining term of the contract" as used in this clause means the period of contract performance to which the contractor is entitled at the end of a performance evaluation period, after receiving credit of any earned award term extension. If at the end of an evaluation period the remaining term of the contract does not equal or exceed two years: (1) the Government, at its sole discretion, may end the contract as early as the end of the remaining term of the contract or as late as two years from the end of the performance evaluation period; and (2) the contractor must continue to perform up to the point in time decided by the Government in (1) above.

The contractor must earn an overall performance rating of "Outstanding" during two (2) consecutive annual performance evaluation periods in order to begin earning Award Term extensions, beginning with the first two years of this contract. Once two consecutive "Outstanding" ratings have been earned the contract shall be extended for two (2) years (one for each "Outstanding" performance rating earned) and shall continue to be extended an additional one (1) year for each "Outstanding" performance rating earned in consecutive years

Should the contractor earn an overall performance rating of "Excellent" during any annual performance evaluation period, the contract term will neither be extended nor reduced.

Should the contractor earn an overall performance rating of "Good" during any annual performance evaluation period, the contract term shall be reduced by one (1) year.

Should the contractor earn an overall performance rating of "Marginal" or less, the contract term shall be reduced by one (1) year and the Government may, at its sole discretion, start a new acquisition.

Conditions.

The Contracting Officer shall unilaterally modify the contract to reflect any extension or reduction of the contract term. In the case of extensions, the contractor shall not proceed until this modification is executed.

Nothing in this clause shall diminish or remove any rights afforded the Government regarding contract termination as may be set forth elsewhere within this contract.

The contractor's earning of award term extensions and the contractor's right to perform earned award term extensions are subject to:

- The Government's continuing need for the contract's work;
- The availability of funds;
- The Government's continuing need for the management and operating form of contract;
- The Government has not concluded that it does not have a continuing need for the use of a Federally Funded Research and Development Center;
- The contractor's agreement to incorporate contract modifications that reflect significant new DOE policy;
- The contractor's agreement to reasonable monetary performance incentives; and
- Termination for convenience or default.

The Government may reduce any earned award term extensions by up to three years if the contractor's performance results in a first degree performance failure under the clause of this contract entitled "Conditional Payment of Fee, Profit, and Other Incentives—Facility Management Contracts."

Bilateral changes may be made to the Award Term Plan at any time during contract performance. If the Government or the contractor desires to change the Award Term Plan and agreement cannot be reached, the Government may make unilateral changes before the start of an award term evaluation period.

The contractor is not entitled to any cancellation charges, termination costs, equitable adjustments, or any other compensation if its earning of award term extensions, or its right to perform earned award term extensions, or both, are cancelled due to any of the conditions stated above.

Before the start of any award term evaluation period, the Government may modify both: (1) the criteria the contractor must meet in order to earn award term extensions; and (2) conditions affecting the contractor's ability to earn award term or to perform under any earned award term extensions.

The contracting officer will at his or her sole discretion determine if the contractor has met: the criteria to earn award term; the conditions to earn award term; and the conditions to perform any award term earned.

Attachment B

SAMPLE AWARD TERM CLAUSE

AWARD TERM INCENTIVE

(a) Definitions. For purposes of this clause:

- (1) “Outstanding” means the highest rating available to the contractor under the performance evaluation process used to assess contractor performance against stated contract performance objectives. The term “outstanding” may be expressed using numbers, adjectives, or any other assessment approach deemed appropriate by the Government.
- (2) “Satisfactory” means the rating available to the contractor under the performance evaluation process where the contractor has met the stated contract performance objectives. The term “satisfactory” may be expressed using numbers, adjectives, or any other assessment approach deemed appropriate by the Government.
- (3) “Award Term Determination Official (ATDO)” means the Department of Energy official designated to determine whether the contractor has met contractual requirements to earn any award term extension during an evaluation period
- (4) “Initial contract term,” for purposes of this clause only, means the period of performance commencing on the date the contractor assumes full responsibility for a site pursuant to the provisions of Clause H XXXX through the end date specified in the initial contract period of performance.

(b) Eligibility for Award Term Extensions. In order for the contractor to earn a contract term extension pursuant to the award term incentive, the contractor must:

- (1) Have been assessed by the ATDO to have achieved an annual average overall rating of “outstanding” for each performance evaluation period (except as provided in (2) below), and, meet contract performance objectives, standards, or criteria and other contract requirements applicable to earning additional award term, defined in the Performance Evaluation and Measurement Plan (or equivalent document), as determined by the ATDO.
- (2) With respect to the evaluation periods for the first award term extension, the Contractor must achieve a minimal rating of satisfactory for the first and an overall rating of outstanding for each of the next two.

(c) Award Term Evaluation and Determination

- (1) The Government may extend the initial contract term up to a total of twenty years through operation of this award term incentive clause. The evaluation periods for the first award term extension will be the first three performance evaluation periods of the initial contract term. Evaluations for subsequent award term extensions will be conducted annually.
- (2) The ATDO will unilaterally determine if the contractor: (i) meets eligibility requirements to earn an award term extension; and (ii) has earned additional contract term.
- (3) The amount of award term that may be earned by the contractor for performance during the first evaluation periods will not exceed 36 months. The amount of award term that may be earned by the contractor for each subsequent evaluation period is 12 months.
- (4) If the ATDO determines that the contractor has earned additional award term, the Contracting Officer must modify the contract to extend the term of the contract before the contractor may begin work on the extended term.
- (5) If the Contractor fails either (i) to earn the first award term extension, or (ii) to earn the award term during three consecutive evaluation periods, the contractor becomes ineligible to earn any additional award term extension(s) under the contract.
- (6) If at the end of an evaluation period after the contractor has received credit for any earned award term extension, two or fewer years remain on the term of the contract: (i) the Government, at its sole discretion, may end the contract as early as the end of the remaining term of the contract or as late as two years from the end of the evaluation period; and (ii) the contractor must continue to perform up to the point in time decided by the Government in (i) above.

(d) Conditions.

- (1) This clause does not confer any other rights to the Contractor other than the right to earn additional contract term as specified herein. Any additional contract term awarded under this clause remains subject to all other terms and conditions of this Contract. Should the terms of this clause conflict with any other terms of this Contract, then this clause shall be subordinate.
- (2) The contractor's earning of and right to perform any award term extension are subject to:
  - (i) The Government's continuing need for the contract's work;
  - (ii) The availability of funds;



- (iii) The Government's continuing need for the management and operating form of contract;
  - (iv) The Government not having concluded that it does not have a continuing need for the use of a Federally Funded Research and Development Center;
  - (v) Its agreement to contract modifications that incorporate changes to, or new, DOE policy or contract clauses;
  - (vi) Its agreement to maintain monetary performance standards (performance measures, fee policy, etc.) consistent with the base period; and
  - (vii) The Government's not having terminated the contract for convenience or default.
- (e) Cancellation of the opportunity to earn award term or cancellation of the award term earned for any reason set forth in this award term clause does not entitle the contractor to an equitable adjustment or any other compensation.
- (f) Prior to the start of an award term evaluation period, the Government may make unilateral changes to both the Performance Evaluation and Measurement Plan (or equivalent document) and the conditions for award term.
- (g) A significant failure to meet the requirements specified in the clause entitled "Management Controls" or a first degree performance failure as defined in the clause entitled "Conditional Payment of Fee, Profit, or Incentives" may result in the forfeiture of up to 3 years of earned award term. This is in addition to other remedies provided for in the contract.