



Department of Energy  
Acquisition Regulation

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# ACQUISITION LETTER

## AUTHORITY

This Acquisition Letter (AL) is issued by the Procurement Executive pursuant to a delegation from the Secretary and under the authority of the Federal Acquisition Regulation (FAR), Section 1.301(a)(2).

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### CITATION

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- I. **Purpose.** The purposes of this AL are to: (1) provide guidance on structuring performance-based incentive (PBI) arrangements in the Department of Energy Performance-Based Management Contracts (PBMCs) and management and integration (M&I) contracts; (2) establish general requirements for formal administrative processes and procedures at each contracting activity relating to performance-based incentives; and (3) provide guidance on the requirements pertaining to Heads of Contracting Activity (HCA) waiver requests from Headquarters performance-based incentive approvals.
- II. **Background.** The October, 1997, Report to the Secretary of Energy entitled Assessment Of The Use of Performance-Based Incentives In Performance Based Management And Management and Integration Contracts, identified areas where improvements were needed in the Department of Energy's processes and practices relating to the development and administration of performance-based objectives and associated incentives in PBMCs and M&I contracts. Pertinent to this AL, the report concluded that:
- performance objectives and associated incentives were, in some cases, excessive in number, did not directly relate to the critical strategic or tactical objectives of the program or site, or represented areas not suited for the application of incentives;

- the amount of fee allocated to a specific objective was not always reflective of the actual value or importance of the work; and,
- performance objectives were sometimes focused on process milestones or the development of internal systems rather than outcomes.

The report made a number of recommendations with the objective of strengthening the Department's activities in these areas, including: (1) instituting a more structured management approach to the development of performance-based objectives, measures, and incentives; and (2) strengthening the Department's framework of directives and instructional information on the use of PBIs. In this regard, the report recommended a strengthening of policies and guidance to be used in developing performance objectives and incentives.

Regarding administration of PBIs, the report recommended that each field office institute a structured process for the development of performance objectives and incentives, including the establishment a single authority to coordinate the development of performance objectives and related incentives. The report also recommended that HCAs identify mechanisms, responsibilities, and authorities for ensuring that contractor performance against objectives is appropriately monitored and verified.

**III. Guidance.** The guidance set forth in this AL shall be used in conjunction with existing policy and other requirements set forth in DEAR 970.1001 and Acquisition Letters 95-04, 97-06, and 97-09.

**A. Structuring Performance Objectives and Incentives**

1. **Developing Performance Objectives.** Consistent with Department of Energy Acquisition Regulation 970.1001 and OFPP Policy Letter 91-2 entitled "Service Contracting," the central premise of performance-based contracting is the expression of contractor performance expectations in terms of desired outcomes, results, or a final work product, as opposed to methods, processes, designs, or a level of effort. Accordingly, performance objectives should reflect, or be related to, critical strategic or tactical performance objectives of the program or site. AL 95-04 provides additional considerations in establishing performance objectives (see paragraph 4 of the Attachment to the AL.)

In all cases, the achievement of performance objectives should demonstrate value (as may be expressed in terms of criticality to mission achievement, relative importance of the work performed, and/or cost) to the Government and incentives should be structured to reflect that value. In developing performance objectives, key activities include determining:

- the full scope of the work effort;
- the performance characteristics or levels critical to contract success;

- the minimum level of performance and the highest level of performance desired;
- the levels of performance that are appropriate for objective or subjective measurement;
- the performance characteristics or levels best suited for the application of an incentive(s);
- the amount of incentive that may be needed to achieve the desired levels of performance and its distribution within an incentive area; and
- the appropriate technical, schedule, and cost baselines from which to establish performance levels and monitor their achievement.

Regardless of the incentive structure developed for the contract (i.e., incentive fee or award fee), efforts should be directed at maximizing the use of results-oriented performance expectations that can be measured by objectively based criteria.

2. Selecting Contract Types. The Federal Acquisition Regulation provides policies and guidance on the selection of contract types and should be relied on in determining the appropriate contract type. The application of performance-based contracting approaches does not, in and of itself, result in the selection of one type of contract over another. However, the Department primarily relies on cost-reimbursement contracts for its PBMC and M&I contract requirements.

In order to shift more performance responsibility and risk to the contractor, the Department is seeking to award more contracts or portions of contracts on other than a cost reimbursement type basis. The desired objective is to award them on a fixed price basis where appropriate. While the entire scope of work contracted for may not lend itself to other than a cost type contract, specific work may be extracted and separately costed or priced under an alternative arrangement. To this end the operations and field offices are to work aggressively with their contractors to ensure that the scope of work, and associated costs, are as clearly defined as possible and identify that work which lends itself to other than cost type contracting.

3. Developing Incentives. Because of the complexity and multi-faceted requirements under PBMCs and M&I contracts, there is a need to attain both performance and cost objectives, that is, to achieve technical progress, timely performance, and effective cost control. Accordingly, incentive structures used in PBMCs and M&I contracts typically will consist of a multiple fee structure using a combination of an incentive fee component for objective performance requirements and an award fee component for subjective performance requirements. This multiple fee approach permits the use of both objective and subjective performance goals with tailored fee structures designed to motivate high-quality contractor performance, meet schedule requirements, control or reduce costs, and discourage poor performance.

Multiple incentives should be structured in a manner which provides appropriate balance to the diverse performance goals of the contract. Primarily, this balance should be achieved between the objective and subjective technical requirements and the cost of performance. The purpose of striking a balance between these multiple incentive components is to ensure that the necessary trade-offs have been addressed between performance and cost so that the contractor will dedicate adequate resources to accomplish the full work scope of the contract.

Incentive fees are appropriate where it is desired to provide the contractor with a financial, or other reward, for meeting or exceeding a specific objective or predetermined result, and/or a penalty in the form of a reduced profit or fee for failure. Under this approach, the amount of incentive that can be earned by the contractor is derived from largely objective criteria and measures. Fee payment is based on validation of specific performance levels and payment against a formula. Accordingly, when structuring incentive fees, it is important to ensure that performance expectations are accurate and understood by the parties, that fee associated with the achievement of specific levels of performance is reflective of the value of the work, and that validation mechanisms exist to ensure that the work was actually accomplished at the desired performance levels.

When selecting performance objectives that will be subject to an incentive fee, consideration should be given to following factors:

- criticality of the requirement to the achievement of the overall contract and mission objective;
- ability of the contractor to influence the level of performance of the requirement;
- extent to which DOE will obtain different levels of benefit from different levels of performance;
- potential to adversely impact total contract performance if poorly performed;
- ability to associate cost constraints with the performance to be subject to an incentive;
- ability to measure and validate achievement;
- ability to establish and maintain technical, schedule and cost baselines;
- ability to express, to the maximum extent practicable, the objective in terms of an outcome or a result; and,
- ability to establish performance objectives which both meet and exceed the

baseline requirements.

Multi-year performance objectives associated with major programs and projects may require the use of a phased approach to the incentive structure. In structuring incentives for these types of requirements, the following guidelines should be followed:

- the desired end point should occur within the current term of the contract;
- the result and the associated baseline should be well-defined;
- interim milestones should have progressive values such that fee amount increases as the likelihood of achieving the desired result increases;
- a significant amount of the total incentive fee should be placed on the final result; and,
- the incentive fee for each year typically should be funded from within the total available fee pool for that year;

Award fee largely relies on subjective evaluation factors that are determined judgmentally and unilaterally on the part of the Department. This approach provides greater flexibility to: (1) take into consideration both the contractor's actual performance and extenuating facts and circumstances affecting performance; and (2) adjust performance emphasis during the contract term to reflect changing Departmental needs. Award fee structures are appropriate when a level of effort is anticipated and/or the objective (or end result) cannot be articulated in quantifiable terms and measured through other than subjective means. Further, the use of an award fee approach may be appropriate when variables associated with successful performance are either not well-defined or outside of the contractor's control. Award fee can be used effectively for such activities as program management, safety and health, general management, and technical areas unsuited for objective measurement.

As a general rule, work efforts or requirements that do not lend themselves to a specific incentive fee, should be included in the award fee. However, there may be certain requirements that are inappropriate for both the incentive fee and the award fee because, for example: (1) performance is already at acceptable levels and cannot be improved through the use of an incentive; (2) the performance objective is not critical; or (3) other administrative controls over performance exist. In such cases, it may be appropriate to condition the payment of any earned fee on the contractor's satisfactory performance of these requirements. Accordingly, contract language should be included to provide this important remedy to the Government. The sample clause entitled "Conditional Payment of Fee or Incentives," which addresses performance of requirements not specifically subject to an incentive, may be included in PBMCs and M&I contracts to accomplish this purpose. A copy of the sample clause is attached hereto.

4. Determining Total Available Fee: The total available fee for PBMCs and M&I contracts may consist of a base fee amount and a performance fee amount. The base fee amount will normally be zero unless prior approval of the Procurement Executive is obtained. The performance fee amount may consist of either an incentive fee component for objective performance requirements and an award fee component for subjective performance requirements, or both.

5. Change control processes. There should be a formal process for adjusting performance objectives, baselines, and incentive amounts as a result of changes in expectations as a result of circumstances beyond the control of the contractor that may not have been evident when the performance objective and associated incentive were established. The change control process may be identified in the Performance Evaluation Plan (or similar document) for the contract and should be appropriately integrated in contract-specific quality assurance surveillance plan.

#### B. Development and Administration of Performance Based Incentives

HCA's shall establish formal processes for the development and administration of performance-based requirements, objectives, measures and incentives used in performance-based award fee contracts. Such processes shall, at a minimum:

- (1) ensure appropriate, timely, and integrated participation by key operations/field office program, technical, functional and procurement personnel in the identification of applicable DOE strategic, program, and site plan goals and objectives that should drive contract performance requirements;
- (2) ensure adequate high-level management involvement in the development and administration of performance-based requirements, objectives, measures and incentives, particularly with regard to establishing critical performance objectives for the contract;
- (3) identify key operations/field office organizational and individual roles and responsibilities pertaining to the identification and development of performance-based requirements, objectives, measures and incentives;
- (4) ensure that a specific individual(s) or organizational components accountable for final selection and approval of contract-specific performance-based requirements, objectives, measures and incentives are designated;
- (5) establish documentation requirements sufficient to support the selection of performance-based requirements, objectives, measures and incentives; and,
- (6) identify, through a quality assurance surveillance plan for the contract, the critical contract administration functions, and the specific roles, responsibilities and authorities, needed to ensure that contractor performance against objectives is appropriately monitored and that performance accomplishments are adequately documented and

verified.

C. Administrative Requirements for PBI Waiver Requests

Acquisition Letter 97-06 requires that performance objectives and associated incentives used in performance-based management contracts and management and integration contracts be submitted to the Office of Management Systems (HR-52) for review and approval prior to commencement of negotiations with an offeror or incumbent contractor. However, the Procurement Executive may waive the review and approval requirements upon an affirmative demonstration by the HCA that internal processes are adequate to ensure that performance measures and associated incentives are properly developed and administered. To be considered for a waiver to the approval requirement for fiscal year 1999 PBIs, HCAs shall submit their waiver request and supporting documentation to the Office of Management Systems (HR-52) within the Office of the Deputy Assistant Secretary for Procurement and Assistance Management not later than May 15, 1998.

- IV. **Effective Date.** This AL is effective on the date of issuance.
- V. **Expiration Date.** This AL will remain in effect until its content is incorporated, as appropriate, in regulation or directive coverage, or unless otherwise superseded or canceled.

### CONDITIONAL PAYMENT OF FEE OR INCENTIVES (Month and Year TBE)

In order for the Contractor to receive all otherwise earned fee, profit, or share of cost savings under the contract in an evaluation period, the Contractor must meet the minimum requirements in paragraphs (a) through (d) of this clause. If the Contractor does not meet the minimum requirements, the DOE Operations Office Manager or his/her designee may reduce the evaluation period's otherwise earned fee, profit or share of cost savings as described in paragraphs (a) through (d) of this clause. Any determination under this clause is not subject to the Disputes clause of this contract. This clause does not apply to any Base Fee included in the contract.

(a) Minimum requirements for Environment, Safety & Health (ES&H) Program. The Contractor shall develop, obtain DOE approval of, and implement a Safety Management System across the appropriate Environment, Safety, and Health functional areas in accordance with the provisions of the clause entitled, "Integration of Environment, Safety and Health into Work Planning Execution," if included in the contract, or as otherwise agreed to with the Contracting Officer. The minimal performance requirements of the system will be set forth in the approved Safety Management System, or similar document. If the Contractor fails to obtain approval of the Safety Management System, or fails to achieve the minimum performance requirements of the system during the evaluation period, the DOE Operations Office Manager or his/her designee, at his/her sole discretion, may reduce, any otherwise earned fees, profit or share of cost savings, for the evaluation period by an amount up to the amount earned.

(b) Minimum requirements for catastrophic event. If, in the performance of this contract, there is a catastrophic event (such as a fatality, hazardous material exposure exceeding regulatory limits, loss of control over classified or special nuclear material, or an event that causes significant damage to the environment), the DOE Operations Office Manager or his/her designee, may reduce any otherwise earned fee for the evaluation period by an amount up to the fees earned. In determining any diminution of fee resulting from a catastrophic event, the DOE Operations Office Manager or his/her designee will consider whether willful misconduct and/or negligence contributed to the occurrence and will take into consideration any mitigating circumstances presented by the contractor or other sources. This clause is in addition to any other remedies available to the Government that may be contained in this contract.

(c) Minimum requirements for specified level of performance.

(1) At a minimum the Contractor must perform the following at the level of performance set forth in the Statement of Work, Work Authorization Directive, or similar document:

(i) the requirements specifically incentivized;

(ii) all of the performance requirements directly related to the incentivized requirements to a degree that the overall performance of such is at an acceptable level; and

(iii) all other requirements to a degree that the total performance of the contract is not jeopardized.

(2) The evaluation of the Contractor's achievement of the level of performance shall be unilaterally determined by the Contracting Officer. To the extent that the Contractor fails to achieve the minimum performance levels specified in the Statement of Work, Work Authorization Directive, or similar document, during the evaluation period, the DOE Operations Office Manager or his/her designee, may reduce any otherwise earned fee, profit, or share of cost savings for the evaluation period, by an amount up to the amount earned.

(d) Minimum requirements for cost performance.

(1) Requirements incentivized by other than cost incentives must be performed within their specified cost and must not adversely impact the costs of performing unrelated activities.

(2) The performance of requirements with a specific cost incentive must not adversely impact the costs of performing unrelated requirements.

(3) The Contractor's performance within the stipulated cost performance levels for the evaluation period shall be determined by the Contracting Officer. To the extent the Contractor fails to achieve the stipulated cost performance levels, the DOE Operations Office Manager or his/her designee, at his/her sole discretion, may reduce in whole or in part any otherwise earned fee, profit, or share of cost savings for the evaluation period by an amount up to the amount earned.