



NNSA Policy Letter: BOP 540.2
Date: January 10, 2005

TITLE: Deviation to DEAR 970.1504, Contract pricing, and associated 970.5215 clauses

I. OBJECTIVES:

- A This Policy Letter provides an approved deviation to the Department of Energy Acquisition Regulation (DEAR) that allows NNSA Contracting Officers to negotiate more effective fee arrangements in Management and Operating (M&O) contracts. The deviation also eliminates the DEAR requirement for Cost Reduction Proposals. Copies of the Determination and Findings and of the deviation are attached.
- B This Policy Letter establishes procedures supporting NAP-4, Corporate Performance Evaluation Process for Management and Operating Contractors (as may be revised), needed to implement the fee deviation.

II. BACKGROUND:

- A. DEAR fee policies are appropriate for the broad range of diversified contracts administered by DOE e.g., site closure, Office of Science laboratories. However, they are neither optimal, nor are they efficient in motivating and rewarding NNSA contractors for excelling in performance of activities in support of the NNSA nuclear enterprise. The DEAR fee policies are of necessity complex in order to accommodate the diverse DOE mission. These complexities require the expenditure of substantial resources each year by both the Federal staff and the contractor staff. Yet, analysis of actual fees paid over a period of several years shows that there is little or no variance in the amount of fee actually paid to DOE contractors operating under the DEAR fee policies. NNSA's focused mission requires that senior NNSA management be able to address; and reward its various contractors from an enterprise-wide, corporate perspective based on, among other things, the importance to NNSA's mission of the desired outcomes being incentivized in the Performance Evaluation Plan (PEP), and the difficulty for the contractor to achieve those outcomes, which represents a risk to the contractor of not earning the available fee.

I. APPLICABILITY:

- A. This Policy Letter applies to NNSA's M&O contracts for the Kansas City, Pantex and Y-12 weapons plants and the Nevada Test Site. NNSA intends to issue a revision to this BOP to cover the M&O contracts for the Lawrence Livermore, Los Alamos and Sandia National Laboratories. This policy does not apply to NA-30.

IV. REQUIREMENTS:

- A. Contracting Officers for the NNSA Test Site and the three Weapon Plants contracts shall comply with the attached deviation in establishing fees for M&O contracts for fiscal years 2005 and beyond; except that contracts planned for competition within 24 months shall not include an award term feature.
- B. Maximum potential available fee on DOE work assigned to the NNSA Plants and Test Site M& O contracts is 7% of the total budget authority estimated to be allocated to the M&O contract on the basis of each year's President's Budget Request. The sources of this information are the Laboratory Tables in the Department of Energy Congressional Budget Request and the DOE PALS database, extracted by NNSA Headquarters and reviewed by the Site Office Manager. The amount in the applicable Laboratory Table(s) will be reduced by the budget for contracts that are not part of the site M&O contract and adjusted to ensure that fee is not aid on the available fee pool.
- C. The actual available fee for DOE work will be within a range of 50% to 100% of the maximum potential available fee, and will be established by NA-1 as the Fee Determining Official (FDO) based on the importance to NNSA of the desired outcomes being incentivized in the PEP, and the difficulty involved in achieving those outcomes and earning the fee. The Site Office Managers, Management Council, and Senior Procurement Executive will advise the FDO on the size of the available fee, and a final accounting of the fee base for each M&O will be conducted in November of each year when final budgetary obligations for the fiscal year are available in the DOE accounting reports, prior to determination of the final award.
- D. Currently, during budget formulation and also during the year of execution, the M&O contractors include an estimated amount in their overhead rates for the earned fee. Overhead rates are subsequently adjusted to reflect actual fee earned. Under the new fee policy, NNSA

may redirect surplus funds from the available fee pool to other activities. For FY 2005, the NNSA Site Offices will develop and implement a process to determine and document the difference between the amount included in the M&O overhead accounts for earned fee during budget execution and the final approved fee amount. Within 15 days of the final fee determination, the Site Offices will notify the FDO of this difference, identifying these funds by B&R code. NNSA management will determine further redirection of these funds, either to other activities at the site that can be appropriately funded by overhead, or to other higher priority activities (which may or may not require a reprogramming and/or appropriation transfer). In the event that the actual fee earned exceeds the estimated amount included in the overhead accounts, the NNSA Site Offices, in coordination with NNSA management, will either approve an adjustment in overhead rates or determine an alternative method of recovering the shortfall. NOTE: For FY 2006, NNSA is considering other budgeting alternatives for award fee, including direct funding.

- E. Up to 35 % of the actual available annual fee may be paid to the contractor provisionally in equal monthly increments of 1/2th. This provisional fee payment is the only fee payment that will be made prior to the final fee determination.
- F. Fee on work for non-DOE customers, i.e., Work For Others (WFO), will be a fixed fee of 85% of the calculated fee percentage for DOE work in IV above.
- G. Example -- a production plant has an FY 2005 budget in its Laboratory Table of \$100M and expects to do \$10M of WFO. The maximum potential available fee on the DOE work would be 7% of (\$100M- the available fee), or $\$7M/1.07 = \$6.542M$, and the actual available fee would be set between 50% to 100% of that based on the importance and difficulty of the outcomes incentivized in the PEP. Were the contractor unwilling to accept difficult incentives in the PEP that are deemed important to NNSA, it would be placed toward the low end of the available fee range. Assuming the available fee was set at 70% of the maximum available fee, the fee percent on DOE work would be $.70 \times 7\%$ or 4.9% and the contractor would apply a fixed fee of $.85 \times 4.9\%$ or 4.165% to all of its FY2005 WFO projects.
- H. Award Term Incentives. New and extended M&O contracts, including laboratory contracts, will include an award term incentive. Existing M&O contracts, including laboratory contracts, will be reviewed by the Site Office to determine if it is practical to include an award term incentive. The determination to include or not include an award term feature will be made by the Senior Procurement Executive. A model


clause is at attachment 2. Contracting Offices should modify this model to suit the unique circumstances of the individual M&O contract.

- I. Cost Reduction Proposals (CRP). The deviation eliminates the use of CRPs in M&O contracts. Instead, M&O contracts will include "shared savings" incentive arrangements. A model clause is included in the deviation at 970.5215-4 DEVIATION.

IV. POINT OF CONTACT FOR ADMINISTRATION OF POLICY LETTER; Walt Lips, NA-63.

BY ORDER OF THE SENIOR PROCUREMENT EXECUTIVE:




Robert C. Braden
Senior Procurement Executive
National Nuclear Security Administration

NATIONAL NUCLEAR SECURITY ADMINISTRATION

DETERMINATIONS AND FINDINGS

DEPARTMENT OF ENERGY ACQUISITION REGULATION (DEAR) CLASS
DEVIATION REGARDING
DEAR 970.1504 and associated 970.5215 clauses

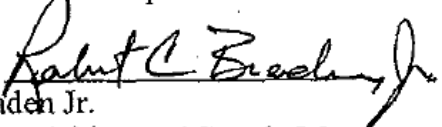
FINDINGS

1. DEAR fee policies may be appropriate for the broad range of diversified contracts administered by DOE e.g., site closure, Office of Science laboratories. However, they are neither optimal, nor are they efficient in motivating and rewarding NNSA contractors for excelling in performance of activities in support of the NNSA nuclear enterprise.
2. The DEAR fee policies are of necessity complex in order to accommodate the diverse DOE mission. These complexities require the expenditure of substantial resources each year by both the Federal staff and the contractor staff. Yet, analysis of actual fees paid over a period of several years shows that there is little or no variance in the amount of fee actually paid to DOE contractors operating under the DEAR fee policies.
3. NNSA's focused mission requires that senior NNSA management be able to address and reward its various contractors on, among other things, the basis of their contribution to the overall success of the NNSA mission. Such flexibilities are precluded by the DEAR fee policies. The DEAR "one-size-fits-all" approach to fee policy has resulted in fee payment to NNSA contractors that distort the relative value and difficulties of performing certain functions within the NNSA complex.
4. "Work for Others" is a valuable program at NNSA facilities. It allows NNSA to expand the scope of and improve its expertise in science and manufacturing. It also helps defray administrative and fixed expenses at our facilities. DEAR fee policies fail to recognize and reward facilities that expand the work for others program to new customers.

DETERMINATION

I hereby authorize a class deviation from the requirements of DEAR 970-1504 and associated 970-5215 clauses in order to allow NNSA Contracting Officers to negotiate more appropriate fee arrangements with NNSA Management and Operating contractors. NNSA Contracting Officers shall comply with the attached NNSA fee policy in lieu of the DEAR fee policies.

APPROVAL


Robert C. Braden Jr.

Director of Acquisition and Supply Management
National Nuclear Security Administration

DATE

1/10/2005

DEAR 970.1504 - Contract pricing. DEVIATION

970.1504-1 - Price Analysis.

970.1504-1-1 - Fees for management and operating contracts.

This subsection sets forth NNSA's policies on fees for management and operating (M&O) contracts.

970.1504-1-2 - Fee policy.

- (a) Three basic principles underlie NNSA's fee policy:
 - (1) Fee arrangements should not be overly complex, must be clearly stated, and easily understood.
 - (2) The total amount of available fee should reflect the importance to NNSA of the outcomes incentivized in the Performance Evaluation Plan and the difficulty the contractor faces in accomplishing those outcomes and earning the fee.
 - (3) M&O contracts should include an award term incentive.
- (b) Available fee, if any, as well as the type of fee arrangement, will normally be established on a fiscal year basis. Both will be established at the time of award, at the time of option exercise, or at the start of the fiscal year. Once established, fee is subject to adjustment only in the event of a significant change (greater than +/-25%) to a single year budget or work scope established at the beginning of a fiscal year.
- (c) In order to meet cash flow and other contractor management needs, 35% of the total fee pool is available for provisional payment to the contractor at the rate of 1/12 of the available amount per month. No other fee payments will be made prior to the final fee determination.
- (d) thru (h) Removed and reserved,
- (i) No deviation from DEAR.

970.1504-1-3 -Fee Arrangement.

- (a) Consistent with the concept of a performance-based management contract, contract types that incentivize superior performance, increased efficiency, cost control, and contractor assumption of risk are preferred. Generally, this requires that the total fee pool be at risk.
- (b) The maximum fee amount for M&O contracts is * % of the estimated annual budget for that contract. The Senior Procurement Executive may approve other empirical measures to establish the fee; e.g., a factor that considers the number of full time equivalent employees devoted to direct mission accomplishment versus the number devoted in indirect support functions. Great care must be exercised in using nontraditional factors to avoid the

possibility of contractor manipulation of the factors and to ensure that no aspects of contract performance are slighted or sacrificed.

* Separate percentages for the FFRDCs and the plants and site are determined periodically by the Senior Procurement Executive.

- (c) The maximum fee amount for each M&O contract will be adjusted annually prior to the performance assessment period by the Fee Determining Official.
- (d) Work for Others that the contractor generates from non-DOE sources can help defray facility-operating expenses, retain critical skills, and advance NNSA's mission in other ways. Innovative fee arrangements that recognize the contractor's contribution to developing new sources of work for others are encouraged. Such work must:
 - Be performed on a noninterference basis,
 - Be within the existing scope and purpose of the contract, and
 - Cannot be undertaken if the work would place the contractor in competition with the private sector.

970.1504-1-4 -- Special considerations: fee limitations.

If objective performance incentives are of unusual difficulty or if successful completion of the performance incentives would provide extraordinary value to NNSA, fees in excess of those allowed under 48 CFR 970.1504 1-3 DEVIATION may be permitted with the approval of the Senior Procurement Executive. In no case can the total available fees exceed the statutory limitations imposed by 10 U.S.C. 2306(d) and 41 U.S.C. 254(b).

970.1504-1-5-Shared savings.

Aggressive pursuit of operational efficiencies without sacrificing mission needs can result in substantial savings and program benefits. Much like traditional value engineering, operational efficiencies can have a savings impact beyond the immediate task or project. Contractors should be encouraged to maximize such savings through "shared savings" arrangements that are not part of the fee structure.

Cost and operational efficiencies arising from, for example, innovative product designs, process improvements, supply chain management initiatives, or integration of life cycle cost approaches for the design and development of systems that minimize maintenance and operations costs can save NNSA substantial program funds. This fact should be recognized and shared savings arrangements should be included in contracts to reward contractors that generate better ideas and management improvements that will benefit the NNSA contract or program.

Shared savings arrangements require the approval of the Senior Procurement Executive.

970.1504 2 - Price negotiation. No deviation to DEAR.

970.1504-3 - Documentation. No deviation to DEAR.

970.1504-4 - Special cost or pricing areas. No deviation to DEAR.

970.1504 - 5 Solicitation provision and contract clauses.

(a) Removed and reserved.

(b) No deviation to DEAR.

(c) No deviation to DEAR.

(d) The Contracting Officer shall insert a clause, substantially the same as the clause at 48 CFR 970.5215-4 Shared Savings, in M&O contracts if the Senior Procurement Executive has approved inclusion of cost savings programs.

(e) The Contracting Officer shall insert the provision at 48 CFR 970.5215-5, Limitation on Fee, DEVIATION in solicitations for M&O contracts.

Subpart 970.52 Solicitation Provisions and Contract Clauses for Management and Operating Contracts.

970.5215-1 Removed and reserved.

970.5215-2 - Make-or-buy plan. No deviation to DEAR.

970.5215-3 – Conditional payment of fee, profit, or incentives. No deviation to DEAR

970.5215-4 – Shared savings.

As prescribed in 48CFR 970.1504-5(d) DEVIATION, the contracting officer shall insert the following clause in M&O contracts.

Shared Savings (JAN 2005)

(a) General. NNSA's facilities and laboratories must be operated in an efficient and effective manner. The Contractor shall assess its operations and identify areas where cost and operational efficiencies arising from, for example, innovative product designs, process improvements, supply chain management initiatives, or integration of life cycle cost approaches for the design and development of systems that minimize maintenance and operations costs can bring cost efficiencies to its operations without adversely affecting the level of performance required by the contract.

(b) Definition.

"Shared savings" means a reduction in the total amount of the cost of performing the effort where the savings revert to NNSA direction or control and may be available for other program priorities. Shared savings can result from a design, process, method change, or other initiative occurring in the fiscal year in which the change is accepted and may apply in subsequent fiscal years. They are the difference between the estimated cost of performing an effort as originally planned and the actual

allowable cost of performing that same effort using an approved revised approach intended to reduce costs. Savings resulting from formal or informal direction given by NNSA or changes in the mission, work scope, or routine reorganization of the Contractor due to changes in the budget are not shared savings and do not qualify for incentive sharing.

(c) Shared savings proposals (S2P).

S2Ps shall be submitted to the Contracting Officer and shall contain:

(1) Current Method (Baseline)-A description of the current scope of work, cost, and schedule to be impacted by the initiative with supporting documentation.

(2) New Method (New Proposed Baseline)-A description how the initiative will be accomplished, the new scope of work, detailed cost/price estimate, and schedule with supporting documentation.

(3) Feasibility Assessment-A description and evaluation of the proposed initiative and benefits, risks, and impacts of implementation. This evaluation shall include an assessment of the difference between the current method and the proposed new method including all related costs.

(4) The proposed contractual arrangement.

(5) A discussion of the extent to which acceptance of the S2P may:

(i) Pose a risk to the health and safety of workers, the community, or to the environment;

(ii) Result in a waiver or deviation from NNSA requirements, such as DOE/NNSA Orders and joint oversight agreements;

(iii) Require a change in other contractual agreements;

(iv) Result in significant organizational or personnel impacts;

(v) Create a negative impact on the cost, schedule, or scope of work in another area or to other contractors in the NNSA Complex; and

(vi) Impact successful and timely completion of any of the work in the cost, technical, and schedule baseline.

S2Ps that may exceed \$5M in savings shall be submitted through the Contracting Officer to the Senior Procurement Executive, NNSA.

(d) Acceptance or Rejection of S2P. Acceptance or rejection of an S2P is a unilateral determination of the Contracting Officer. The Contracting Officer will notify the Contractor that an S2P has been accepted, rejected, or deferred within (Insert Number) days after receipt. To be acceptable, an S2P must:

(1) Result in net savings (in the sharing period if a design, process, or method change);

(2) Not reappear as costs in subsequent periods; and

(3) Not result in impairment of essential functions.

(e) **Sharing Arrangement.** If an S2P is accepted, the Contractor may share in the net savings. For an S2P negotiated as a cost savings incentive resulting from a design, process, or method change, the Contractor's share shall not to exceed 25% of the shared net savings, unless approved in advance by the Senior Procurement Executive. The specific percentage and sharing period will be set forth in the contractual document.

(f) **Subcontracts.** The Contractor may include a clause similar to this clause in any subcontract. In calculating any estimated shared net savings in an S2P under this contract, the Contractor's administration, development, and implementation costs shall include any subcontractor's allowable costs, and any S2P incentive payments to a subcontractor. The Contractor may choose any arrangement for subcontractor S2P incentive payments, provided that the payments do not reduce NNSA's share of net savings.

(End of Clause)

970.5215-5 -- Limitation on fee.

As prescribed in 48 CFR 970.1504- 5 (e) DEVIATION, the contracting officer shall insert the following provision in solicitations for Management and Operating contracts:

Limitation on Fee DEVIATION (JAN 2005)

(a) For the purpose of this solicitation, fee amounts shall not exceed the total available fee allowed by the fee policy at 48 CFR 970.1504-1-1 DEVIATION, or as specifically stated elsewhere in the solicitation.

(b) The Government reserves the unilateral right, in the event an offeror's proposal is selected for award, to limit total available fee to an amount not to exceed an amount established pursuant to 48 CFR 970.1504-1-1 DEVIATION or to an amount as specifically stated elsewhere in the solicitation.

(End of Provision)

Attachment #2 to BOP 540.2

AWARD TERM

- (a) Commencing in the second year of contract performance, the contract's term as set forth in the Section F clause entitled "Period of Performance" may be extended if: the Contractor is rated "Outstanding" on the performance objectives contained in its annual NNSA Performance Evaluation Report and meets or exceeds the performance objectives set forth in the award term section of the Performance Evaluation Plan (PEP). If the Contractor does not receive an "Outstanding" rating, this clause is inoperable for the associated evaluation period.
- (b) The Contractor's performance in the areas described in the award term section of the PEP will be subjectively evaluated as part of the annual performance evaluation. The Site Office Manager will make an award term recommendation to the Fee Determination Official (FDO). The award term decision will be made in conjunction with the annual performance incentive fee determination.
- (c) The award term decision is a unilateral determination of the FDO.
- (d) If the FDO determines to award additional term, the Contracting Officer shall modify the contract unilaterally to extend the contract term by one year.
- (e) The contract term, including all earned award term, shall not exceed 20 years.
- (f) If the Contractor fails 3 times to earn award term, the operation of this clause shall cease.
- (g) A significant failure of the Contractor's management controls, as defined in the clause entitled "Management Controls," or a catastrophic event, as defined in the clause entitled "Conditional Payment Of Fee, Profit, Or Incentives," may result in the forfeiture of up to 3-years of previously earned award term in addition to the other remedies provided for in the contract.

(End of clause)