

ALERT

# DOD Signals Potential Inflation Relief for Fixed Price Contracts

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September 12, 2022

**WHAT:** The U.S. Department of Defense (DOD) is now signaling that it may be more willing to consider requests for equitable adjustment to firm-fixed-price contracts to compensate contractors for the effects of inflation. As reflected in a September 9, 2022 memo from DOD Principal Director, Defense Pricing and Contracting (DPC), the Department is responding to “feedback” from its acquisition executives about the impact of inflation and how it is affecting the Defense Industrial Base and contractors’ ability to perform under existing contracts. The Memo states that where there are “extraordinary circumstances,” DOD will entertain upward adjustments to the contract price based on the current economic conditions under Part 50 of the Federal Acquisition Regulation (FAR) governing relief under Public Law 85-804, subject to available funding. The Memo notes that “acute impacts on small business and other suppliers” may be one example warranting relief, although the Memo does not limit the guidance to only those circumstances.

**WHEN:** The Memo was issued on September 9, 2022. The DOD policy reflected in the Memo is effective immediately.

**WHAT DOES IT MEAN FOR INDUSTRY:** Contractors with firm-fixed-price contracts experiencing the impact of inflation may finally have better prospects for relief. This is a significant change from prior DOD guidance that left firm-fixed-price contractors assuming the risk of this unforeseeable economic environment. [See here.] While DOD has, in limited circumstances, provided relief to contractors on an individual basis, most companies have had a hard time in light of the prior guidance and reluctance among contracting officers to upwardly adjust fixed-price contracts. And before now, contracting officers have not had uniform, high-level direction for how to partner with

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contractors as both parties navigate this challenging economic environment. While this guidance is a welcome development, it remains to be seen how contracting officers will implement it.

Historically, contractors seeking relief under Public Law 85-804 carry a heavy burden. The relevant FAR provisions in FAR Part 50 authorize contracting officers to request detailed information in support of contractor requests for relief, including how any proposed adjustment was determined, the impact on profits of an approval or denial of the adjustment, relevant financial statements, and contemporaneous evidence, among other information. Contracting officers can also request identities of personnel who have factual knowledge of the impact as well as an explanation of steps taken to reduce the loss and keep the claim to a minimum.

To obtain 85-804 relief for inflation, contractors should be prepared to demonstrate how their costs have increased following award or the agency's exercise of an option. Agencies will likely require that information, at a minimum, before making an equitable adjustment, and, especially for larger adjustments, contractors should anticipate rigorous DCAA audit. For instance, if a firm-fixed-price contract assumed a 2% escalation over five years of performance, that fact may be persuasive to a contracting officer given the current rate of inflation of 8% or more. Other metrics may also be helpful, and any contractor seeking relief following the new guidance would be wise to assess what evidence they can provide that substantiates their increased costs and be prepared to defend the reasonableness of any assumptions underlying their proposals. To go back to the prior example, if a 2% escalation factor at the time of the proposal should have been 3% based on market/economic conditions, agency pushback should be expected.

And, per the guidance, adjustments are "subject, of course, to available funding." Thus, companies desiring an adjustment should engage early with their agency customers to determine whether funding is accessible and look out for special opportunities, such as fiscal year-end funding availability.

Cautious optimism is warranted based on the DPC memo, and contractors significantly affected by inflation should understand existing agency 85-804 policy and procedure, and stay abreast of follow-on guidance going forward.