

ALERT

# DoD Provides Guidance on Economic Price Adjustments Amidst Growing Concerns Over Inflation

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June 2, 2022

**WHAT:** The U.S. Department of Defense (DoD) issued a memorandum to provide guidance on the use of economic price adjustments (EPAs) in existing and prospective DoD contracts in response to contracting officers' (COs) and contractors' concerns over inflation.

**WHAT DOES IT MEANS FOR INDUSTRY:** According to the U.S. Bureau of Labor Statistics, the consumer price index (CPI), a measure of inflation, has risen 8.3% over the last 12 months. Inflation is an issue that impacts all contractors, especially those performing on fixed-price contracts. The effects of inflation have even driven some contractors to consider requesting that the Government terminate their long-term contracts for convenience. In light of the rising costs of supplies and labor, contractors should be cognizant of provisions in their existing and prospective contracts with the Government that may enable them to increase their prices to combat inflation.

The Federal Acquisition Regulation (FAR) and Defense Federal Acquisition Regulation Supplement (DFARS) both include EPA clauses that COs can include in fixed-price contracts. See, e.g., FAR 52.216-4; DFARS 252.216-7000. The clauses provide for upward and downward revision of the stated contract price(s) upon the occurrence of specified contingencies. Adjustments are based on established prices, actual costs of labor or material, or cost indexes of labor or material. The regulations, however, provide relatively limited guidance as to when and how COs should use EPA clauses in fixed-price contracts.

## Practice Areas

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Government Contracts

In a memo issued on May 25, 2022 to the procurement and acquisition leadership of DoD departments, DoD provided much needed guidance on the use of EPAs. The guidance is meant both to help COs understand when it is appropriate to recognize cost increases due to inflation under existing contracts and to offer considerations for the proper use of EPA clauses when entering into new contracts. The memo states that EPA clauses serve to “mitigate specially covered cost risks to both parties as a result of industry-wide contingencies beyond any individual contractor’s control,” including contingencies like inflation.

The memo emphasizes that EPA clauses should be used in a manner that is fair to both the Government and the contractor. DoD states that EPA clauses “may be an appropriate tool to equitably balance the risk of inflation” for contracts that are currently “being developed or negotiated during this period of unusually high inflation.”

The memo provides the following guidance that contractors should note:

- As required by DFARS 216.230-4-70, COs must consider contract length as a primary consideration when deciding whether to use an EPA clause. The DFARS also requires the total contract price to exceed the simplified acquisition threshold.
- For adjustments based on indexes of labor or material, COs should select an index that is closely related to the cost components judged to be most unstable, and limit the scope of the EPA clause to costs that are most likely to be impacted by economic fluctuations. COs should exclude costs that are not likely to be impacted by inflation. Further, the index selected as the basis for measurement of inflation in EPA clauses should be from an independent, recognized source. COs should be careful to select an inflation index that covers fluctuations that are relevant to contract performance.<sup>1</sup>
- Contractors performing under fixed-price contracts that do not have EPA clauses must bear the risk of cost increases due to inflation. There is no authority for providing contractual relief for unanticipated inflation under Firm-Fixed-Price (FFP) contracts.
- Impacts due to unanticipated inflation are not a result of a CO-directed change. Thus, COs should not agree to contractor requests for equitable adjustments (REAs) in response to changed economic conditions.

This additional DoD guidance could be a welcomed development for contractors if it prompts COs to more frequently insert EPA clauses in new procurements. Contractors should be proactive in submitting pre-RFP questions and otherwise encouraging COs to include EPA clauses in new solicitations.

Contractors should also review their existing contracts for EPA or similar clauses. As the memorandum provides, the term “EPA” does not have to appear in the contract, as any clause that addresses potential contract cost or price changes due to economic conditions is effectively an EPA clause. If a contract does not have such a clause, contractors should ask their CO to add one.

Wiley’s Government Contracts Practice has the expertise to assist contractors navigating these adjustments and other developments from changing economic conditions.

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1 Additional guidance can be found at Procedures, Guidance, and Information (PGI) 216.203-4.