16.403–1 Fixed-price incentive (firm target) contracts.

(a) Description. A fixed-price incentive (firm target) contract specifies a target cost, a target profit, a price ceiling (but not a profit ceiling or floor), and a profit adjustment formula. These elements are all negotiated at the outset. The price ceiling is the maximum that may be paid to the contractor, except for any adjustment under other contract clauses. When the contractor completes performance, the parties negotiate the final cost, and the final price is established by applying the formula. When the final cost is less than the target cost, application of the formula results in a final profit greater than the target profit; conversely, when final cost is more than target cost, application of the formula results in a final profit less than the target profit, or even a net loss. If the final negotiated cost exceeds the price ceiling, the contractor absorbs the difference as a loss. Because the profit varies inversely with the cost, this contract type provides a positive, calculable profit incentive for the contractor to control costs.

(b) Application. A fixed-price incentive (firm target) contract is appropriate when the parties can negotiate at the outset a firm target cost, target profit, and profit adjustment formula that will provide a fair and reasonable incentive and a ceiling that provides for the contractor to assume an appropriate share of the risk. When the contractor assumes a considerable or major share of the cost responsibility under the adjustment formula, the target profit should reflect this responsibility.

(c) Limitations. This contract type may be used only when—

1. The contractor’s accounting system is adequate for providing data to support negotiation of final cost and incentive price revision; and
2. Adequate cost or pricing information for establishing reasonable firm targets is available at the time of initial contract negotiation.

(d) Contract Schedule. The contracting officer shall specify in the contract schedule the target cost, target profit, and target price for each item subject to incentive price revision.


16.403–2 Fixed-price incentive (successive targets) contracts.

(a) Description. (1) A fixed-price incentive (successive targets) contract specifies the following elements, all of which are negotiated at the outset:

(i) An initial target cost.
(ii) An initial target profit.
(iii) An initial profit adjustment formula to be used for establishing the firm target profit, including a ceiling and floor for the firm target profit. (This formula normally provides for a lesser degree of contractor cost responsibility than would a formula for establishing final profit and price.)
(iv) The production point at which the firm target cost and firm target profit will be negotiated (usually before delivery or shop completion of the first item).
(v) A ceiling price that is the maximum that may be paid to the contractor, except for any adjustment under other contract clauses providing for equitable adjustment or other revision of the contract price under stated circumstances.

(2) When the production point specified in the contract is reached, the parties negotiate the firm target cost, giving consideration to cost experience under the contract and other pertinent factors. The firm target profit is established by the formula. At this point, the parties have two alternatives, as follows:

(i) They may negotiate a firm fixed price, using the firm target cost plus the firm target profit as a guide.
(ii) If negotiation of a firm fixed price is inappropriate, they may negotiate a formula for establishing the
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final price using the firm target cost and firm target profit. The final cost is then negotiated at completion, and the final profit is established by formula, as under the fixed-price incentive (firm target) contract (see 16.403–1 above).

(b) Application. A fixed-price incentive (successive targets) contract is appropriate when—
(1) Available cost or pricing information is not sufficient to permit the negotiation of a realistic firm target cost and profit before award;
(2) Sufficient information is available to permit negotiation of initial targets; and
(3) There is reasonable assurance that additional reliable information will be available at an early point in the contract performance so as to permit negotiation of either (i) a firm fixed price or (ii) firm targets and a formula for establishing final profit and price that will provide a fair and reasonable incentive. This additional information is not limited to experience under the contract, itself, but may be drawn from other contracts for the same or similar items.

(c) Limitations. This contract type may be used only when—
(1) The contractor’s accounting system is adequate for providing data for negotiating firm targets and a realistic profit adjustment formula, as well as later negotiation of final costs; and
(2) Cost or pricing information adequate for establishing a reasonable firm target cost is reasonably expected to be available at an early point in contract performance.

(d) Contract Schedule. The contracting officer shall specify in the contract Schedule the initial target cost, initial target profit, and initial target price for each item subject to incentive price revision.


16.405 Cost-reimbursement incentive contracts.

See 16.301 for requirements applicable to all cost-reimbursement contracts, for use in conjunction with the following subsections.


16.405–1 Cost-plus-incentive-fee contracts.

(a) Description. The cost-plus-incentive-fee contract is a cost-reimbursement contract that provides for the initially negotiated fee to be adjusted later by a formula based on the relationship of total allowable costs to total target costs. This contract type specifies a target cost, a target fee, minimum and maximum fees, and a fee adjustment formula. After contract performance, the fee payable to the contractor is determined in accordance with the formula. The formula provides, within limits, for increases in fee above target fee when total allowable costs are less than target costs, and decreases in fee below target fee when total allowable costs exceed target costs. This increase or decrease is intended to provide an incentive for the contractor to manage the contract effectively. When total allowable cost is greater than or less than the range of costs within which the fee-adjustment formula operates, the contractor is paid total allowable costs, plus the minimum or maximum fee.

(b) Application. (1) A cost-plus-incentive-fee contract is appropriate for services or development and test programs when—
(i) A cost-reimbursement contract is necessary (see 16.301–2) and
(ii) A target cost and a fee adjustment formula can be negotiated that are likely to motivate the contractor to manage effectively.

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