performance is attainable and highly desirable to the Government).

(d) Technical performance incentives may involve a variety of specific characteristics that contribute to the overall performance of the end item. Accordingly, the incentives on individual technical characteristics must be balanced so that no one of them is exaggerated to the detriment of the overall performance of the end item.

(e) Performance tests and/or assessments of work performance are generally essential in order to determine the degree of attainment of performance targets. Therefore, the contract must be as specific as possible in establishing test criteria (such as testing conditions, instrumentation precision, and data interpretation) and performance standards (such as the quality levels of services to be provided).

(f) Because performance incentives present complex problems in contract administration, the contracting officer should negotiate them in full coordination with Government engineering and pricing specialists.

(g) It is essential that the Government and contractor agree explicitly on the effect that contract changes (e.g., pursuant to the Changes clause) will have on performance incentives.

(h) The contracting officer must exercise care, in establishing performance criteria, to recognize that the contractor should not be rewarded or penalized for attainments of Government-furnished components.


16.403 Fixed-price incentive contracts.

(a) Description. A fixed-price incentive contract is a fixed-price contract that provides for adjusting profit and establishing the final contract price by application of a formula based on the relationship of total final negotiated cost to total target cost. The final price is subject to a price ceiling, negotiated at the outset. The two forms of fixed-price incentive contracts, firm target and successive targets, are further described in 16.403-1 and 16.403-2 below.

(b) Application. A fixed-price incentive contract is appropriate when—

(1) A firm-fixed-price contract is not suitable;

(2) The nature of the supplies or services being acquired and other circumstances of the acquisition are such that the contractor’s assumption of a degree of cost responsibility will provide a positive profit incentive for effective cost control and performance; and

(3) If the contract also includes incentives on technical performance and/or delivery, the performance requirements provide a reasonable opportunity for the incentives to have a meaningful impact on the contractor’s management of the work.
Billing prices. In fixed-price incentive contracts, billing prices are established as an interim basis for payment. These billing prices may be adjusted, within the ceiling limits, upon request of either party to the contract, when it becomes apparent that final negotiated cost will be substantially different from the target cost.

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—