

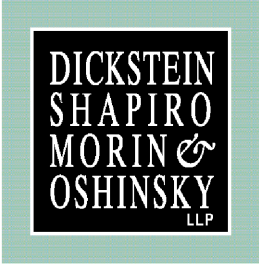


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GSA REVISES ECONOMIC PRICE ADJUSTMENT CLAUSE

Recent revisions (effective January 2002) to the Economic Price Adjustment ("EPA") clause likely will result in increased flexibility and greater price stability for contractors selling services under the General Services Administration's ("GSA") Federal Supply Service ("FSS") Multiple Awards Schedules program. For years, the Federal Acquisition Regulation ("FAR") has authorized the use of fixed-price contracts with economic price adjustments, thereby allowing for upward or downward adjustments of a contractor's rates upon the occurrence of a given contingency. Allowable FAR contingencies that trigger application of EPA clauses include changes in: cost indices, catalog or market prices, and the contractor's established prices.

Under GSA's new EPA clause, contractors may be able to negotiate two additional types of EPAs. The two kinds of adjustments can be based on:

- (1) "escalation rates" negotiated before award; and
- (2) a market indicator that is agreed upon prior to award.

These classes of adjustments are also referred to as "negotiated contingencies." The revised clause also gives contractors the benefit of requesting an EPA for "unforeseeable major changes in market conditions." These latter adjustments require the Contracting Officer to examine industry-wide market conditions and determine whether an EPA is warranted.

Mechanics of the Revised EPA Clause

The new clause applies only to contracts that are not based on commercial catalogs or commercial price lists. In order for the negotiated contingencies to potentially apply, a contractor must satisfy four conditions:

- (1) A contractor is limited to three price increases during each succeeding twelve-month period of the contract;
- (2) A contractor must request an increase prior to the last sixty (60) days of any given contract period (including options or extensions);
- (3) A contractor must allow thirty (30) days to elapse between requests for EPA price increases; and
- (4) During any one-year period, a contractor's total price increases are subject to a percentage cap negotiated prior to contract award. However, the government reserves the right to increase the cap if market conditions warrant.

The government can accept or reject the contractor's requested price increase or negotiate a different price increase.

The Price Reduction Clause

Other contractual provisions that specifically benefit the government limit the scope and benefits of the revised EPA Clause. The revised EPA clause does not alter or limit

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the preferential pricing reserved to the government under the Price Reduction Clause. The Price Reduction Clause provides that, after award of the contract, the contractor is required to provide the government with price reductions or increased discounts when it affords price reductions or increased discounts to certain commercial customers or categories of customers designated in the contract.

The purpose of the clause is clear: prices under an FSS contract are based on discounts given to the government from the contractor's pricing to comparable customers. The Price Reduction Clause mandates that the contractor maintain the price relationship between the government's price and the price granted to customers or categories of customers identified in the contract. Examples of identified customers or categories of customers include: wholesale customers, customers who purchase a specified number of units, or a selected pool of specific commercial customers.

In short, the EPA Clause can be viewed as a pricing "floor," allowing a contractor to request a price increase in certain specific circumstances, while the Price Reduction Clause serves as a pricing "ceiling," applying downward pressure on a contractor's prices through reference to commercial pricing.

The EPA and Price Reduction Clauses in Action

The mechanics of the EPA and Price Reduction clauses can be illustrated in the following example. General Security Corp. ("GSC") provides building and facilities

security to the government through an FSS contract. GSC's prices to the government are not based on commercial catalogs or price lists and are typically based on the square footage of the facility. GSC's FSS contract contains both the revised EPA and the standard Price Reduction Clauses. GSC's Price Reduction Clause specifies that GSC's prices to the government must be as favorable as its commercial pricing for facilities that are 500,000 square feet or greater. As a result of the events of September 11th, Congress passed emergency legislation that prohibits certain classes of individuals from working in "sensitive" positions, including security guards at federal facilities. As a consequence of the legislation, approximately forty percent of GSC's work force is precluded from working on GSC's government contracts. The company is required to engage in significant recruiting efforts to satisfy its obligations to the government, and GSC's costs have risen by approximately twenty-five percent.

Given GSA's revisions to the EPA clause, GSC can request a price adjustment from the Contracting Officer, citing "unforeseen major changes in market conditions" as a result of the emergency legislation. GSC can obtain a price adjustment only if:

- (1) it has received no more than two price adjustments in the preceding twelve-month period;
- (2) the last requested price adjustment was made at least thirty (30) days prior; and
- (3) the request was made before the last sixty (60) days of its contract period.

GSC's requested increase must also remain within the predetermined cap negotiated with the government. The Contracting Officer is then required to assess GSC's request in light of market conditions throughout the facilities security industry and determine whether the events of September 11th constitute extraordinary circumstances that warrant an adjustment. It remains to be seen what type of market analysis the Contracting Officer will conduct. At the same time, the government reserves its right to invoke the Price Reduction Clause, and either deny or modify the request for an adjustment if the requested price adjustment would exceed GSC's commercial pricing for facilities that are 500,000 square feet or greater. It also remains to be seen how GSA would handle such a situation.

In conclusion, GSA's revisions to the EPA clause could provide significant opportunities to FSS contractors that are attempting to receive price increases from the federal government. Savvy government contractors must keep the EPA and Price Reduction clauses in mind during both contract negotiation and performance. Prior to contract performance, contractors should take care in negotiating escalation rates, selecting market indicators, setting percentage adjustment caps, and defining the class of comparable commercial customers for price reduction purposes. During contract performance, contractors must consider carefully when and how often to request a price adjustment and the relationship between a requested price increase and the prices offered to identified commercial customers. fi

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