Defense Contracting

Regulations


Directorate of Small and Disadvantaged Business Utilization

Office of the Secretary of Defense

Washington, D.C. 20301
In this guide, we explain the basic purchasing rules and regulations of the Department of Defense (DoD). We do not offer direct assistance in locating sales opportunities, although the appendix lists several excellent sources of marketing information.

Every DoD purchasing office has at least one Small Business Specialist who can provide information on contracting and subcontracting opportunities with that office and at other DoD contracting offices. Those specialists can also assist you if problems arise during the performance of a contract.
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must be aware of aspects of both of these regulations.

Both the FAR and the DFARS are published in loose-leaf form. When needed, Federal acquisition circulars (FACs) and Defense acquisition circulars (DACs) issue changes in the FAR and the DFARS. Many public libraries subscribe to these regulations. DoD purchasing offices and contract administration offices maintain copies to which you may refer. Subscriptions to the FAR and the DFARS will provide you with the basic regulations, with all changes to date, and with any changes that may be issued until new editions of the FAR and the DFARS are published. Subscriptions may be obtained from

Superintendent of Documents  
P.O. Box 371954  
Pittsburgh, Pa., 15250-7954

To order by phone, call 202-783-3238. To order by FAX, use 202-512-2233 (24 hours a day, 7 days a week). The annual subscription rates (as of January 1994) are $160 for the FAR and $120 for the DFARS. (Subscription forms are included on page 29 of this guide.)

This guide introduces you to the basics of Defense contracting set forth in these regulations. They contain policies and procedures for purchases of products and services ranging from everyday household items to the most advanced weapon systems. Yet most DoD contracts—especially the procurements that small businesses are most likely to perform—are entered into and performed under fairly simple, standard procedures.

While explaining DoD's buying rules, this guide points out the potential pitfalls awaiting the unwary small business contractor. Read it carefully and understand what is expected of you. Do not fool yourself. If you cannot perform the job within the rules, then the government will not get the product it needs, and you may find yourself in financial straits as well. Remember, to be a successful Defense contractor, you must understand the basic rules.

Contents of This Guide

This guide is not a manual for marketing your product or service to DoD. Rather, it is designed simply to help you understand the regulations. Chapter 2 gives an overview of the regulations and explains the major differences between doing business in the private sector and doing business with DoD, and Chapter 3 introduces four basic principles underlying DoD's contracting process. Chapter 4 covers DoD's procedures for soliciting suppliers and entering into contracts, with special emphasis on small business aspects. Chapter 5 examines the types of contracts used by DoD, commonly used contract clauses, and procedures you may encounter during the course of contract performance. Additional sources of information that may be helpful to small business contractors are provided in the appendix. To assist you in locating relevant material in the regulations, references to
applicable FAR coverage (prefaced by an “F”) and DFARS coverage (prefaced by a “D”) are supplied throughout this guide.

A WORD OF CAUTION: This guide is not a substitute for the FAR or the DFARS. It does not provide total coverage of any topic. Its coverage is purposely limited to those regulations and procedures most frequently encountered by DoD’s small business suppliers. When it is necessary to refer to these regulations concerning contracting issues, you should refer to the current language of the regulation and seek clarification from the contracting officer. You may also want to seek professional advice.
Chapter 2

Background Information

Overview of the Regulations

The FAR is the primary document governing all DoD contracting. It consists of procurement policies and many detailed procedural and administrative requirements that apply to all procurements by Federal executive agencies. The DFARS, on the other hand, contains instructions for implementing the FAR within DoD and supplementary regulations that are unique to DoD. The DFARS is not a stand-alone document. It must be used in conjunction with the FAR.

The FAR has more than 1,000 pages and is divided into 53 parts (equivalent to chapters), each part dealing with a separate aspect of procurement. The first six parts deal with general government contracting matters and the next six parts deal with aspects of acquisition planning. Part 13 contains simplified procedures for contracts of $25,000 or less, while Parts 14 and 15 deal with procurement procedures for larger contracts. Other parts deal with such matters as labor laws, contract administration, standard clauses, and forms.

The DFARS is also more than 1,000 pages long and is divided into parts corresponding with those of the FAR. Each part contains the material needed to implement FAR policies and procedures within DoD and any additional policies, procedures, and contract clauses that are needed to meet specific DoD needs. In addition, the DFARS has seven appendices and two supplements.

The material in both of these regulations covers the complete range of Federal government procurements. Although standard clauses take up 500 pages and standard forms take up 250 pages, only a relatively few are used in any single procurement.

Certain policies and procedures apply to small businesses only. They include programs designed to match small business capabilities with DoD needs and procurement techniques designed to help small businesses with individual procurements and subcontracting opportunities. These small business aids are discussed in this guide.

Major Differences Between Commercial and Government Practices

Doing business in the private sector is in some ways similar to doing business with DoD, but government contracting also has some unique aspects that you should be aware of.

- The DoD conducts its business through authorized agents called contracting officers. In dealing with DoD, you may have to interact with more than one type of contracting officer.

Procurement contracting officers (PCOs) enter into contracts, administrative contracting officers (ACOs) supervise contract performance, and sometimes the same person fills both functions.

- Unlike your commercial customers, DoD has the unilateral right to revise its contracts. While you are entitled to equitable adjustments in price and/or delivery time resulting from such revisions, you are committed to fulfill the contract as changed.

- The DoD is given extensive audit and work surveillance rights under its contracts. You are obligated to maintain and retain certain contract records and to submit them for audit on demand. Should such audits reveal a failure to conform to contract requirements, you may be subject to penalties or price adjustments.

- The DoD uses its procurement program to attain numerous national, social, and economic goals. If you participate in a DoD contract, you may have to cooperate and comply with various programs to achieve those goals.

- Certain types of contracts limit the amount of profit you can earn and the amounts and types of costs you may recover.

- The DoD has an absolute right to terminate all or any part of your contract at any time either for the convenience of DoD (with appropriate compensation to you) or for default if your performance is unsatisfactory.
Chapter 3

Basic Contracting Principles

Before looking at the regulations in detail, you should be aware of four basic principles underlying DoD’s contracting process.

First, to ensure reasonable prices, contracts are awarded competitively whenever possible. This practice reflects the theory that full and open competition results in fair and reasonable prices and that such competition avoids favoritism by assuring that all qualified suppliers have the opportunity to sell to the government.

In most instances, full and open competition for government procurements is best accomplished by using the sealed-bid method (see page 9 for more on this method). When sealed bids are not appropriate, competitive proposals must generally be solicited and negotiated (see page 10 for more on this method). In very limited, specific situations only, the government can procure goods or services by other-than-competitive procedures. In such cases, the contracting officer must justify the action in writing. [F-6.401, F-6.302, F-6.303]

Second, contracts are awarded only to contractors found to be “responsible.” Regardless of the procurement method used, the regulations require that, before the contract is awarded, the contracting officer must assure that a prospective contractor is “responsible.” [F-9.103, F-9.104-1]

To be considered responsible, the contractor must meet the following conditions:

- Have, or be able to obtain, adequate financial resources
- Be able to comply with the delivery requirements
- Have a satisfactory record of performance
- Have a satisfactory record of integrity and business ethics
- Have, or be able to obtain, the necessary organization, experience, accounting and operational controls, and technical skills
- Have, or be able to obtain, the necessary production, construction, and technical equipment and facilities
- Be otherwise qualified and eligible to receive an award under applicable laws and regulations.

These determinations are generally based on the contracting officer’s evaluation of contractors’ data and records of prior performance.

In the case of small business, special rules apply. If a contracting officer finds that the small business that offered the lowest price is not responsible, the case must be referred to the Small Business Administration (SBA). The SBA then notifies the small business of the contracting officer’s finding and offers it an opportunity to apply for a Certificate of Competency (COC). If the small business applies for a COC, the SBA reviews the findings and makes its own determination as to whether the small business is responsible. If it finds the small business responsible, the SBA issues a COC to the contracting officer. Except in some unusual circumstances, the contracting officer must then abide by the SBA’s decision and award the contract to the small business firm. [F-9.104-3(e), F-19.602]

Third, the type of contract issued must be appropriate for the particular procurement. The regulations authorize the use of several different types of contracts and describe the circumstances appropriate for the use of each. The type of contract used in each procurement should be determined by the circumstances of the procurement and the degree of risk associated with performance of the contract. See Chapter 5 for more on types of contracts. [F-16.104]

Fourth, the DoD procurement program is used to help implement various national social and economic policies. Some of those policies are implemented by mandatory contract provisions, such as those requiring that minimum standards for wages, hours, and working conditions be met in producing supplies or performing services under a DoD contract. Other policies are furthered by laws requiring contracts to be awarded to certain contractors or prohibiting their award to others. For example, certain items must be purchased from Federal Prison Industries, Inc., and contracting with a company convicted of violating air pollution standards is prohibited. A third method of implementing national policies is the use of special procurement techniques, such as set-asides for small businesses and for firms located in labor surplus areas. [F-8.602, F-19.501, F-22.301, F-23.103, F-20.201]
Chapter 4

Contract Formation

Contracting Opportunities

The DoD enters into millions of contracts each year. The regulations mention several methods of assuring that all prospective contractors are aware of contracting opportunities. The most common ways in which DoD alerts prospective contractors to its requirements are notices in the Commerce Business Daily (CBD) and use of solicitation mailing lists (SMLs).

CBD Announcements

One way to find out about contracting opportunities is to read the CBD, which is published every weekday by the Department of Commerce. The regulations require notice of virtually every proposed government procurement over $25,000 to be publicized in the CBD at least 15 days before issuance of a solicitation. The solicitations must allow at least 30 days (45 days for research and development work) for prospective contractors to respond.

Government agencies are also required to publish information on subcontracting opportunities. That information must include the names and addresses of firms awarded contracts over $25,000 that are likely to result in subcontracts, except under certain circumstances such as when the information is classified. In addition, procuring agencies are required to search continually for sources competent to perform research and development work. This effort includes publicizing the agency’s R&D requirements in the CBD as early as possible. [F-5.201, F-5.203, F-5.205, F-5.206, F-5.301, F-35.004]

Solicitation Mailing Lists

A second way to find out about prime contracting opportunities is to be included on an SML of a contracting office or organization (called an “activity”) likely to have a need for your product or service. Purchasing activities have to establish and maintain lists of prospective suppliers. You should submit a Standard Form (SF) 129, “Solicitation Mailing List Application,” to each purchasing activity with which you hope to do business. Each activity has its own procedure for SMLs. Be sure to contact the small business specialist at each activity to be sure you do what is necessary to be listed on the appropriate SMLs. The activity is required to notify you of your acceptance or rejection for the SML. When your name is placed on an SML, solicitations for requirements will automatically be issued to you. However, you must respond to each solicitation with either an offer or a request for retention on the list; otherwise, your name may be deleted. When the SML is extremely long, the purchasing activity may use only a portion of it for a particular acquisition and rotate the other segments of the list for other acquisitions. However, in such situations, the regulations require that a prorated number of small businesses be solicited. [F-14.205, F-19.202-4]

Contracting for architect-engineering (A-E) services follows a special procedure and does not use SMLs. For DoD contracts, A-E firms are selected on the basis of the professional qualifications necessary to perform the required services satisfactorily. Firms interested in such work should file SF 254, “Architect-Engineer and Related Services Questionnaire” (attainable from any military or other Federal government construction office) with the agency and activity responsible for the geographic area(s) or specialized area of construction in which the firm desires to work. [F-36.602, F-36.603]

Qualification Lists

A less common way to find out about contracting opportunities is to be included on a qualified products list, a qualified manufacturers list, or a qualified bidders list. These qualification lists are used only for products that require lengthy or costly testing to determine whether they meet the government’s requirements. The lists identify the specifications and the manufacturers or distributors of each qualified item. When the government wishes to procure a product for which a qualification list exists, bids or proposals are usually accepted only for products or from concerns on the list.

To have your product or your concern listed on a qualification list, you should contact the small business specialist at the activity.
identified in the product specification as responsible for the qualification requirement. [F-9.202]

Subcontracting Directory

Information about subcontracting opportunities is provided by DoD's Subcontracting Opportunities with DoD Major Prime Contractors, issued annually by the Office of Small and Disadvantaged Business Utilization. It lists, by state, those DoD prime contractors with established plans and goals for subcontracting with small businesses and small disadvantaged businesses. For each contractor, the directory provides the address, the product or service line, and the name and telephone number of the company's small business liaison officer. You should be aware that as a subcontractor, your contractual agreement is with the prime contractor, not with DoD. DoD has no contractual relationship with subcontractors to its prime contractors.

Small Business Innovation Research

Small business research and/or development firms should become familiar with DoD's small business innovation research (SBIR) program. Each year DoD publishes a list of research and/or development topics that it is interested in exploring through contracts with small businesses. The goals of the program include strengthening the role of small business in meeting DoD's R&D needs, fostering and encouraging participation by minority and disadvantaged persons in technological innovation, and increasing the commercial application of DoD-supported research or R&D results.

The SBIR program consists of three distinct phases. In Phase I the Military Services and other major DoD organizations make awards to small businesses selected on the basis of proposals they submit in response to two annual solicitations. Selection criteria are included in the solicitation, and awards can be up to $100,000 for usually no more than 6 months of effort. The purpose of Phase I is to determine, insofar as possible, the scientific or technical merit and feasibility of the ideas or concepts in the proposal.

Phase II awards are made to Phase I firms selected on the basis of their Phase I efforts and the technical and scientific merit of their Phase II proposals. Phase II awards can be up to $750,000 for typically 2 years. Phase III generally involves private-sector investment to help bring the innovation to the marketplace. Or DoD may award follow-on contracts to a company to further develop its concept for DoD's benefit.

Unsolicited Proposals

Sometimes you can create your own contracting opportunities by submitting an unsolicited proposal. Such a proposal is a written offer to the government to perform a task or effort that you initiate. To be considered, an unsolicited proposal must offer a unique and innovative concept to the government. You can learn about an agency's R&D needs from advance notices in the CBD and from informal contacts with agency personnel. [F-15.503, F-15.504]

The FAR provides general guidance for submitting an unsolicited proposal. It should contain an abstract of the proposed effort, the method of approach, and the extent of the effort. It should also include a proposed price or estimated cost. You should clearly mark any proprietary data you wish to protect from possible release to others. [F-15.505, F-15.509]

The regulations authorize DoD to use other-than-competitive procurement procedures to make an acquisition on the basis of a favorably evaluated unsolicited proposal. They also require that offerors be notified of the disposition or intended disposition of material submitted as an unsolicited proposal. [F-15.506, F-15.507]

Promotion of Small Business Contracting

Certain factors limit DoD's ability to contract directly with small businesses. For example, vast amounts of facilities and working capital are required to produce major weapon systems, and in many cases those requirements strain even the resources of large businesses. To offset such potential disadvantages for small business contractors, DoD has implemented a major program to place a fair proportion of its contracts with small businesses. Its activities to promote maximum small business participation include the following:

- Seeking additional qualified small business suppliers
- Including all qualified small business suppliers on SMLs
- Permitting offers on less than the total requirements
• Allowing the maximum time possible for preparation of offers

• Assigning small business specialists to each contracting activity and contract administration office

• Making provision for SBA representatives at all major procurement offices

• Measuring and reporting the extent of small business participation in Defense contracts to the President and the Congress

• Setting aside certain procurements for award only to small businesses

• Encouraging large DoD contractors to subcontract with small businesses, including small disadvantaged businesses and women-owned small businesses. [F-19.201, F-19.202]

The small business set-aside is a major procurement practice that DoD uses to promote small business participation. Contracting officers must set aside procurements solely for small businesses whenever they reasonably expect that at least two responsible small businesses will offer the products of different small business concerns, and that an award can be made at a reasonable price. This is called a total set-aside. Certain classes of procurements (for example, all purchases $25,000 or under and construction contracts under $2 million) are automatically reserved or set aside for small business awards. Contracting officers must justify in writing any failure to award such procurements to small businesses. Once a product or service has been successfully purchased as a small business set-aside, all future purchases must also be on a set-aside basis unless the contracting officer determines that this practice will probably not result in offers from at least two responsible small business concerns offering products of different small business concerns at reasonable prices. [F-19.501, F-19.502-2, F-13.105, D-219.502-2]

Sometimes a procurement not suitable for a total set-aside is large enough to be divided into two or more economic production lots. If it is likely that a small business can furnish one or more lots at a reasonable price, the regulations require a partial set-aside. Under a partial set-aside, a portion of a requirement is set aside for award to small business. Any business (large or small) can compete for the portion not set aside. The process (1) allows competition to determine a reasonable price for one portion and (2) gives small businesses the opportunity to receive a contract for the set-aside portion at the price of the fully competed portion. [F-19.502-3]

**Promotion of Small Disadvantaged Business Contracting**

In addition to these efforts to encourage contracting with small business firms in general, DoD tries to maximize the number of small disadvantaged business (SDB) concerns participating in its prime contracts and subcontracts through special activities such as:

• Seeking to identify the maximum number of SDBs before issuing solicitations and setting aside for such firms those awards where there is an expectation of obtaining from among the respondents adequate performance, reasonable competition, and a fair price [D-219.502-2-70]

• Contracting directly with the SBA for subcontracting with small disadvantaged businesses in the SBA's 8(a) program

• Encouraging large DoD contractors to subcontract with SBDs.

Restricting competition to SBDs is comparable to small business set-asides and is done under similar circumstances; DoD’s goal is to award at least 5 percent of its total procurement dollars to small disadvantaged businesses, historically black colleges and universities (HBCUs) and minority institutions (MIs). Contracts with the SBA for subcontracting to small disadvantaged business are called 8(a) contracts (named for the section of the Small Business Act that authorizes them). The objectives of the 8(a) program are (1) to foster business ownership by socially and economically disadvantaged individuals and (2) to give such businesses opportunities for full participation in the free enterprise system. To participate in the 8(a) program, a small disadvantaged firm must receive SBA approval of a business development plan for attaining the above objectives. In cooperation with DoD's small business specialists, the SBA identifies the supplies or services 8(a) companies can provide.
If feasible, DoD contracts, on a noncompetitive basis, for these supplies and services with SBA. The SBA, in turn, subcontracts with the 8(a) company. If the costs for the supplies or services are in excess of DoD’s estimated current fair market prices, the excess is eligible for funding by SBA as a business development expense. [F-19.803, D-219.000]

In order to reach its SDB contracting goals, DoD also gives SDB companies (and HBCUs and MIs) an evaluation preference when competing against most U.S. non-SDB companies. Under this evaluation preference, the contracting officer adds 10 percent to the price of all non-SDB company offers when award is to be based on price or price-related factors. The preference is not used if the resulting award would be for a price that is more than 10 percent above fair market price. [D-219.7001, D-219.7002, D-252.219-7006]

Because much of DoD’s contracting (in dollar value) is for major weapon systems, great emphasis is placed on providing subcontracting opportunities for small businesses. Virtually every DoD contract over $25,000 contains a clause committing the contractor to use small firms and small disadvantaged firms to the fullest practicable extent. Before a contract over $500,000 ($1 million for construction) can be awarded to a large contractor, a plan must be submitted showing how the contractor intends to meet subcontracting obligations to small businesses and to small businesses owned and controlled by socially and economically disadvantaged individuals. In contracting for research and development, major systems, and other complex procurements, the degree of offerors’ commitments to subcontracting with SDBs, HBCUs, and MIs is an evaluation factor in selecting the eventual contractor. The regulations require that actual performance under these plans be reviewed by the contracting officer. Failure to comply in good faith with the requirements of the subcontracting plan is a material breach of the contract that could result in sanctions against the contractor. [F-19.702, D-219.705, D-252.219-7003]

To further encourage major contractors to subcontract with small businesses, SDBs, HBCUs, and MIs, DoD includes in every negotiated contract that requires a subcontracting plan a bonus to the contractor for exceeding its agreed target of subcontracts with such firms. The bonus incentive can be from 1 to 10 percent of the amount by which the contractor exceeds the target. However, the contracting officer will not award the bonus if the contractor exceeded the target for reasons not due to its own effort (for example, due to subcontractor cost overruns). [D-219.708, D-252.219-7005]

The DoD is currently conducting a test program (1) to see whether small businesses can compete successfully in certain industrial categories without relying on small business set asides, (2) to enhance contract awards to a new category of businesses known as “emerging small businesses” (ESBs—companies that are half or less the normal small business size for an industrial category), and (3) to expand small business participation in certain other industry categories. Under the first part of the program, acquisitions in four industry groups (construction, refuse systems, A-E work, and non-nuclear ship repair) may not use small business set-asides during the test period, unless the agency needs to do so to meet its small business award goals. However, acquisitions in the four categories may be set aside for SDBs, although the evaluation preference for SDBs may not be used. Furthermore, acquisitions of $25,000 or less in any of the four groups must be set aside for emerging small businesses if the contracting officer determines that there is a reasonable probability that at least two responsible ESBs will make offers that are competitive in terms of market price, quality, and delivery. Finally, DoD has designated 10 additional industrial categories in which small businesses will be encouraged and helped to compete for awards through teaming and joint ventures with other small businesses.

The DoD also encourages assistance to SDBs through its Mentor-Protege Program. Under this program, contractors are encouraged to enter into agreements with SDB firms (and qualifying firms employing severely disabled workers) as subcontractors to provide those subcontractors with assistance that will upgrade their capabilities and thereby help them
to compete more successfully in government and commercial contracting. DoD may reimburse assistance costs of the mentor firm through modification of the company's cost reimbursement contracts or may grant credit toward the firm's SDB subcontracting goals for development assistance costs incurred.

**Contracting Procedures**

The Department of Defense policy requires that full and open competitive procedures be followed in virtually all its procurements. That policy establishes the following priority for procurement procedures:

1. Sealed bids [used when (a) time permits, (b) award will be based on price or price-related factors, (c) discussions are not necessary, and (d) more than one bid is expected]
2. Competitive proposals (used when sealed bids are not appropriate)
3. Combination of competitive procedures
4. Other competitive procedures
5. Other than full-and-open competition. [F-6.302]

Under some circumstances, competitive procedures may be used even though they exclude some potential sources. For example, procurements by sealed bids or by competitive proposals may be restricted to small business sources only.

The use of other than full-and-open competition is limited to specific circumstances and must be justified in detail. The justification must be approved at senior levels within the procuring activity.

**Sealed Bids**

Sealed bidding is a strictly controlled, formal process designed to protect the integrity of the competitive bidding system. Although its procedures must be strictly followed, the courts, the Comptroller General of the United States, and the Armed Services Board of Contract Appeals have created many precedents for interpreting certain aspects of the process. Those precedents are far too numerous and specialized to be covered here. The information in this section provides general guidance only.

**Procedures**

Procurement by sealed bids begins with the issuance of an invitation for bids (IFB), which contains all the information bidders need to respond. The IFB states the needs of the procuring activity and defines the work or product in sufficient detail to permit all bidders to compete on the same basis. It also states all significant factors to be considered in evaluating the bids and the relative importance of each factor. (Cost to the government is usually the main factor.) Prospective bidders are provided standard forms on which to submit bids, and a specific time is established for public opening of the bids. [F-14.101]

When necessary, the IFB may be modified by the government before the bid opening. Once issued, it may be cancelled only when cancellation is clearly in the public interest; for example, when the supplies or services are no longer needed. [F-14.208, F-14.209]

Interested firms respond to the IFB by submitting sealed bids, which are stored unopened in a locked box or safe until the time set for opening. Bid opening is designed to ensure secrecy of the bids and to prevent manipulation by the bidders. The opening is held in public at the time specified in the IFB, and each bid is read aloud. As a rule, late bids (those received after bid opening time) may not be considered for award. [F-14.304, F-14.401, F-14.402]

The contract is awarded to that responsible bidder whose bid is most advantageous to the government. Unless other factors are identified in the IFB, award is based on price alone. Prompt payment discounts are not considered in evaluating the bids. The actual award must be made within a time specified in the IFB, usually 60 days from the opening date. [F-14.407]

**Requirements for Award**

To be considered for award, your bid (and any modifications to it) must be where the bids are to be opened before the time set for the opening. It must be submitted on the bid form (or must repeat every essential provision of the bid form) and must offer what is called for in the IFB. Any bids that fail to meet any essential requirement of the IFB will be rejected. The bid will also be rejected if the bidder takes exception to any material provision
of the IFB, such as offering a different product or delivery schedule or refusing to accept a contract provision. However, bidders must be given the opportunity to correct any minor failure to comply with the IFB, such as failure to furnish required information concerning the number of company employees. [F-14.404-2, F-14.405]

Bid Mistakes

Mistakes in bids occur frequently. A bidder may change or withdraw a bid (and thereby correct any mistakes) at any time before the opening of the bids. After the opening, contracting officers must examine all bids for mistakes. Obvious clerical mistakes in a bid may be corrected before a contract is awarded.

Treatment of other mistakes found after opening, but before award, depends on the circumstances. In all cases, the evidence available to support the claimed mistakes must be reviewed by a senior official of the purchasing activity. The official may require the bid to stand as submitted or, if appropriate, may allow a bidder to correct or withdraw a bid. After award of a contract, relief from a bid mistake must be handled as a claim in accordance with the disputes clause included in every contract. You should probably seek legal assistance in any case other than that of an obvious clerical mistake. [F-14.303, F-14.406, F-33.205, F-52.233-1]

Bid Protests

An actual or prospective bidder whose direct economic interests would be affected has the right to protest the proposed award of a contract if it appears that an improper procedure was followed. After award, only an actual bidder may protest. Protests must be made in writing. You may submit a protest to the contracting officer or higher authority in the procuring activity, to the Comptroller General of the United States, the United States Court of Federal Claims (preaward protests only), a Federal district court, or, if the procurement is for automated data processing equipment or services, to the General Services Administration Board of Contract Appeals. A successful protest can result in a change in the planned award, in cancellation of an award already made, or in a monetary award to reimburse the successful protestor for the costs of preparing disputed bids and for the cost of the protest. [F-14.407-8, F-33.101-.105]

Two-Step Sealed Bids

Two-step sealed bidding is a method of contracting designed to obtain the benefits of sealed bidding when adequate specifications are not available. [F-14.501]

In Step 1, technical proposals are solicited, and no pricing is involved. The proposals are evaluated as (1) acceptable, (2) reasonably susceptible of being made acceptable, or (3) unacceptable. If there are enough category (1) proposals to ensure adequate competition, the contracting officer may proceed to Step 2, in which IFBs are sent only to the firms that made acceptable proposals. Each firm submits a bid price covering its own technical proposal, and the award is made to the lowest bidder. [F-14.503]

If there are not enough category (1) proposals, those in category (2) are discussed with the proposers in an attempt to make them acceptable. If that process results in enough acceptable technical proposals to ensure adequate competition, Step 2 is followed. If not, the sealed bidding process ends, and negotiation is conducted with the firm that submitted an acceptable technical proposal. In extreme cases, the solicitation may be cancelled.

Competitive Proposals

When use of sealed bids is not appropriate, competitive proposals are solicited. Procurement by competitive proposals begins with the issuance of a request for proposals (RFP).

Procedures

The RFP, like the IFB, is a request for offers. When you submit your completed RFP, you make an offer to DoD, which DoD may accept without change. This offer and acceptance creates a binding contract between you and DoD. [F-15.402(d)]

The regulations for RFPs are almost the same as those for IFBs. A standard form is used, and a specific date for submission of offers is established. Although RFPs are not opened publicly, proposals or modifications of proposals received after the deadline generally will not be considered. The rules for protesting awards and correcting mistakes are almost identical to those for sealed bids. [F-15.412, F-15.607, F-15.1004, F-15.1005]
If the most favorable proposal submitted in response to an RFP is accepted without any discussion, written or oral, with any offeror, the award portion of Standard Form 33 is completed and sent to that offeror, creating a binding contract. [F-15.414]

If discussions or negotiation with any offeror are necessary, the regulations require the contracting officer to conduct written or oral discussions with all responsible offerors whose proposals are within a competitive range as determined by the contracting officer. That range must encompass all proposals with a reasonable chance of being selected for award, considering price or cost and other factors stated in the solicitation. The discussions may not disclose any information about competing proposals or the relative standing of an offeror’s prices, but they may indicate any deficiencies in the technical proposal or the cost proposal. At the conclusion of discussions, all offerors still within the competitive range are requested to submit, by a given date, best and final offers. Award is made to that source whose best and final offer is most advantageous to the government. [F-15.609, F-15.610, F-15.611]

**Contract Price and Cost Analysis**

All procurements require some form of price or cost analysis to establish the reasonableness of the contract price or cost. Price can be analyzed by comparing quoted prices with other offers, prior prices, established price lists, government estimates of reasonable prices, or by applying rough yardsticks. Price analysis is generally used in the purchase of competitive items, commercial items, or relatively small-dollar-value items. [F-15.804-2, F-15.805-2]

When price analysis alone is not sufficient, DoD uses cost analysis to establish the reasonableness of contract price or cost. Cost analysis is an examination of each cost element in a proposal to determine whether the amounts are appropriate and reasonable. The data used to prepare the proposal form the basis for cost analysis. [F-15.805-3]

When the price of any contract or contract modification more than $500,000 is not set by adequate competition, by established catalog or market prices, or by law or regulation, the contracting officer is required to obtain from the prospective contractors the cost or pricing data used to support their proposals. The contractor must also certify in writing that these data are accurate, complete, and current at the time of agreement on contract price. The same requirements exist for all subcontracts greater than $500,000 under such contracts. Both prime contracts and subcontracts must contain clauses entitling the government to appropriate price or fee reductions should the cost or pricing data subsequently be found inaccurate, incomplete, or noncurrent. [F-15.804-2, F-15.804-3, F-15.804-4, F-15.804-7, F-52.215-22]

**Profit**

The DoD uses profit to stimulate efficient contract performance, and the regulations contain guidelines for developing profit and fee objectives. Contracting officers are directed to establish those objectives before conducting contract negotiations. Those objectives should provide contractors the opportunity to earn profits while motivating them to undertake difficult work, provide their own facilities and financing, perform independent development work, and increase productivity. DoD generally uses a technique called the weighted guidelines method to balance these factors in establishing negotiation objectives. You should be familiar with this technique since it directly affects your negotiations. [F-15.902, D-215.903]

The regulations limit fees (profit) that may be paid under cost-reimbursement contracts, as defined in Chapter 5 of this guide, to the following:

- Fifteen percent of estimated cost for experimental, developmental, or research work.
- Ten percent of estimated cost for all other types of work. [F-15.903]

The regulations also provide that the contract price (or estimated cost plus fee) for A-E services for public works or utilities may not exceed 6 percent of the estimated cost of construction.

**Other Than Full-and-Open Competition**

Contracting without full and open competition is authorized only
for cases such as sole-source situations, unusual and compelling urgency of the need, maintenance of a mobilization source, purchases on behalf of foreign governments, brand-name items for resale, and when disclosure would compromise national security. Contracts resulting from unsolicited proposals are considered sole-source procurements. Contracts for follow-on orders for continued development or production of major systems or highly specialized equipment are generally considered sole-source procurements. To the extent possible, competitive proposals must be obtained when using the exceptions to full-and-open competition for compelling urgency or national security considerations. [F-6.302]

Contracting without full and open competition often begins with the issuance of a request for quotations (RFQ). The RFQ is simply an invitation to prospective contractors to provide information to the government. It sets forth the terms and specifications desired by the government. It differs from the RFP in that your response does not constitute an offer. [F-15.402]

In the absence of competition or other factors to establish the reasonableness of proposed prices, detailed cost analysis will normally be performed by the contracting officer. Contract prices are established by negotiations. Any such contract in excess of $500,000 will require the contractor to certify as to the accuracy, completeness, and currency of all cost or pricing data used to establish the price.

**Small Purchases**

The DoD uses simplified procedures for making small purchases—those not over $25,000. They include simpler contract forms and fast payment procedures. Purchases of $2,500 or less may be made without competitive quotations if the contracting officer considers the prices to be reasonable. For purchases between $2,500 and $25,000, the general rule is that competitive quotations are solicited orally from potential suppliers in the local trade area. Written solicitations are used for construction contracts over $2,000 or when oral quotes are considered to be not economical or practical. Reasonableness of price is generally determined by the competitive process. [F-13.106]

For repetitive purchases of small quantities of supplies or services, a blanket purchase agreement (BPA) is used. A BPA is much like a charge account. The agreement is issued on DD Form 1155, “Order for Supplies or Services,” which contains general terms and conditions. Usually BPAs are placed with two or more suppliers of the same type of item. Orders are generally placed orally, and payments are made monthly on a summary invoice submitted by the contractor. [F-13.201, F-13.203-1, F-13.204]

The DoD also uses DD Form 1155 as a purchase order form for nonrepetitive small purchases. When necessary, additional clauses are added to the printed form. Oral or written quotations are solicited, as appropriate, and reasonableness of price is established through the competitive process. DD Form 1155 is also used as the public voucher (invoice) for payment in all small purchases. [F-13.501, F-13.503, D-213.505-2, D-213.507]

The fast payment procedure is authorized for use for all purchases of $25,000 or less. It provides that suppliers may submit their invoices for payment as soon as the supplies are delivered to a post office or common carrier or to the government. The supplier must agree to replace, repair, or correct any supplies that are not received by the government, are damaged in transit, or do not conform to purchase requirements. [F-13.301, F-13.302]
The Contract

Contract Types

The DoD uses two basic contract types: fixed-price and cost-reimbursement. Fixed-price contracts may involve substantial risk while cost-reimbursement contracts place very little risk on the contractor.

Fixed-Price Contracts

Under a fixed-price contract, you agree to provide a product or accomplish specific work for a preset price, and you must perform the work called for in the contract regardless of what it actually costs you. You should be very careful in pricing such work. You should take into account potential cost increases caused by inflation, material shortages, or difficulties in meeting performance requirements, particularly if your contract contains options. Options give the government the right to require you to perform, at stipulated prices, additional work that may extend your performance over a long period of time.

Firm-Fixed-Price Contracts

The firm-fixed-price (FFP) contract is the most common type of fixed-price contract. With it, the price is firm for the duration of the contract and the only adjustments that can be made are authorized changes. Under this type of contract, you can receive the maximum profit, but you also assume the maximum risk of profit, or loss, including the risk of unexpected costs such as those that might result from inflation, material shortage, etc. [F-16.202]

The DoD uses FFP contracts when the costs of performance are reasonably predictable and when adequate functional or detailed specifications are available. Such contracts are particularly suitable for standard or modified commercial items and previously purchased military items where past experience permits prediction of costs.

Economic Price Adjustment

Some fixed-price contracts contain economic price adjustment clauses that protect you and the government against wide fluctuations in labor or material costs when market conditions are unstable. Economic price adjustment clauses may provide for adjustment of the contract price for increases or decreases from an agreed-upon level measured against the following:

- Published or established prices of specific items
- Specified costs of labor and material actually experienced during performance
- Specified labor or material cost standards or indexes, such as the producer price indexes.

You are entitled to a price adjustment (or required to make a refund) only if the price levels specified in the contract change. Frequently, the contract will contain a ceiling price that the government will not exceed, no matter what the cost fluctuations may be. [F-16.203]

Fixed-Price Redetermination Contracts

Under a fixed-price redetermination contract, you and the contracting officer establish an initial price, a ceiling price, and a time for price redetermination. At the time of redetermination, you submit a proposal based on actual costs of performance and the estimated cost of any incomplete work. After a government audit, you negotiate a revised price, which may be higher or lower than the initial price but may not exceed the ceiling price. [F-16.205, F-16.206]

Fixed-Price Incentive Contracts

A fixed-price incentive contract is similar to a redetermination contract. The difference is that a fixed-price incentive contract contains a target cost, a target profit, a price ceiling, and a formula by which you and DoD will share any differences between target costs and actual final costs, as negotiated. The formula rewards you with more profit if final costs are less than the target cost, and it takes profit away if final costs exceed the target. For example, a typical sharing arrangement would be one whereby DoD would keep 70 percent of the savings and pay you the remaining 30 percent. Similarly, if final costs were higher than the target cost, DoD would pay 70 percent of the excess costs, and you would have to bear 30 percent of the excess costs as a reduc-
tion of profit. An infinite variety of sharing arrangements is possible, but you must remember that you cannot be paid more than the ceiling price. [F-16.204, F-16.403]

Cost-Reimbursement Contracts

Under a cost-reimbursement contract, DoD reimburses you for the allowable incurred costs of performance. You are paid your costs no matter what you have produced and no matter how far the task is from completion. You are required to perform only as long as the contract provides money to pay you for costs incurred. However, you can be reimbursed for costs only in accordance with the provisions of Part 31 of the FAR. There are several different types of cost-reimbursement contracts, but all have this common feature: your obligation to perform the work ceases when your costs of performance equal the funds provided under the contract. [F-16.301]

Cost-Plus-Fixed-Fee Contracts

One of the simplest types is the cost-plus-fixed-fee (CPFF) contract. You and DoD agree on the estimated cost of contract performance and a fixed fee (profit) that you will receive for doing the work. You will receive the same fee, regardless of whether your actual costs are greater or lesser than the estimated cost. [F-16.306]

Cost-Plus-Incentive-Fee Contracts

Under a cost-plus-incentive-fee (CPIF) contract, you and the contracting officer agree on a target cost, a target fee, and an incentive formula for determining the final fee. The formula provides for an adjustment in the fee, based on any difference between the target cost and the total allowable cost of performing the contract. Unlike the fixed-price incentive contract, however, the contract will provide both a minimum and maximum limit on the fee adjustment. [F-16.304, F-16.404-1]

Cost-Plus-Award-Fee Contracts

The cost-plus-award-fee contract is another type of cost-reimbursement contract. The fee consists of a base amount (which may be zero) that does not vary with performance and an award amount. The award amount paid varies according to the government’s judgmental evaluation of the contractor’s performance in such areas as quality, timeliness, ingenuity, and cost-effective management. [F-16.305, F-16.404-2]

Time-and-Materials Contracts

Another contract type frequently used by DoD is the time-and-materials contract. Under this type of contract, you negotiate a fixed hourly rate for direct labor. That rate includes all appropriate wages, overhead, general and administrative expenses, and profit, and you are reimbursed at the fixed rate for each labor hour worked on the task. Any material costs incurred in performing the work are reimbursed at actual cost, including, if appropriate, material handling costs. The time-and-materials contract is used when it is not possible to estimate the extent or duration of the work, especially in cases of repair, maintenance, or overhaul work. [F-16.601]

Parts of the Contract

The uniform contract format used by DoD for most procurements (excluding construction, subsistence items, and shipbuilding) has four parts: the schedule; the contract clauses; the list of documents, exhibits, and other attachments; and the representations and instructions. The list of documents identifies all attachments to the solicitation or contract. The representations and instructions are those solicitation provisions required from offerors, and information and instructions to guide offerors in preparing proposals, such as evaluation factors for award. The majority of pages of every contract are the schedule and the standard contract clauses (often referred to as the “boilerplate”). [F-14.201-1, F-15.406-1]

The Contract Schedule

The schedule is tailored to each transaction and represents the substance of the deal. It begins with a cover sheet, usually SF 33, “Solicitation, Offer and Award” and follows with a statement of the work to be done or the supplies to be furnished and prices; the specifications; the packaging and marking requirements; the inspection and acceptance requirements; the delivery schedule; any necessary contract administration data not included on the SF 33; and any special
conditions pertaining to the contract. Different items being purchased are listed separately as contract line items. Every DoD contract uses a uniform numbering system for line items. This means that the first item listed in a schedule will be Item No. 0001. [F-14.201-2, F-15.406-2, D-204.7103-2]

The list of supplies or services is followed by the specifications or other descriptions to which the work must conform. You should be familiar with the government's system of specifications. Federal specifications cover materials, products, or services used by two or more Federal agencies or new items of potential general application. Military specifications cover items or services intrinsically military in character or commercial items modified to meet special requirements of the military. Commercial item descriptions concisely describe the key physical and/or performance characteristics of available commercial products. Two publications listed in the appendix of this guide—Selling to the Military and A Guide for Private Industry—provide detailed information on how to obtain both individual specifications and indexes of all available specifications.

Careful reading of the specifications is essential because many of them refer to other requirements, generally known as referenced documents. You must comply with all contract requirements, including any referenced documents, to complete the contract satisfactorily.

Both the packaging and marking requirements and the inspection and acceptance requirements may also include referenced documents. You should be aware of any obligations that might be imposed by such documents.

The delivery section of the schedule specifies the time, place, and method of delivery for supplies or the place of performance of services. Most contracts require that delivery be f.o.b. origin or f.o.b. destination. When f.o.b. origin is required, you deliver the goods to the carrier and the government pays the shipping charge. When f.o.b. destination is required, you deliver the goods to the government and you pay all shipping charges. Your contract prices should include any shipping charges you may incur. Special attention should be given to the delivery point stipulated in IFBs since offers submitted on a basis other than that called for in the IFB must be rejected. [F-14.404-2, F-47.303]

Finally, the schedule contains any special provisions applicable to the specific contract. Examples include use of government-owned property, options for additional quantities of supplies, special test procedures, and agreements on payment of fees under CPFF contracts.

Contract Clauses

The second part of DoD contracts consists mainly of clauses required by statute or regulation. Deviations from the requirements of these clauses involve tedious procedures and are the exception rather than the rule. A sealed-bid contract is similar to an insurance policy in that you have no control over the clauses included.

However, in contracts awarded by other than sealed-bid procedures you may be able to influence some of the terms. Certain clauses require particular attention because they expose you to many of the peculiarities associated with government contracting. These clauses have few or no counterparts in commercial dealings. They relate to changes, disputes, terminations, patent rights, examination of records, government inspection, and correction of defects. [D-201.403, D-201.404]

The regulations contain more than 500 pages of contract clauses, and it would be impractical to cover every one of them in this guide. Fortunately, many clauses cover similar topic areas. We have arranged these areas in six major groups: performance, payments, contract cost principles, contract changes, terminations, and public policies.

Performance

The DoD has many procedures and clauses that affect your performance of a contract. While performing the contract, you may face issues such as DoD inspection and acceptance; subcontracts; use of government property; patents, data, and copyrights; and bonds, insurance, and taxes. In addition, every DoD contract contains a provision for resolving disputes that may arise under the contract.

Inspection and Acceptance

As a contractor, you are responsible for delivering products or providing services on schedule and for assuring that they conform.
to contract requirements. The contract administration office is responsible for assuring that you fulfill your contract quality requirements. The government may conduct inspections and tests to determine whether the goods are in conformity. The type and extent of inspection and testing depend largely on what is being procured. The contract schedule will designate the place of inspection. If the goods are to be shipped from the plant before they are accepted, the contract will contain a clause assigning the risk of loss if the goods are damaged in transit. [F-46.104, F-46.105, F-46.201, F-46.401, F-52.246-16]

Generally, when each delivery is made, the contractor must prepare and submit a “Material Inspection and Receiving Report,” DD Form 250. This lists the goods delivered, quantities, contract number, and other necessary information. You may obtain copies of DD Form 250, at no cost, from the contract administration office. If the contract contains a fast payment procedure, you may submit your invoice in lieu of a DD Form 250. [F-13.301, D-246.671]

While the inspection clause has many versions, it also has certain uniform features. The standard clause used in fixed-price contracts provides that items to be delivered under the contract are subject to inspection and test by DoD before acceptance. DoD has the right to reject nonconforming items, have the defects corrected at the contractor’s expense, or accept the nonconforming items at a reduced price. Acceptance by DoD is final, except as regards hidden defects or fraud. [F-46.302, F-52.246-2]

You are required to provide facilities for, and assistance to, DoD inspectors at your own expense. You must also maintain an acceptable inspection system, and you are responsible for providing appropriate quality assurance controls. If the government inspection or test is made somewhere other than on your premises or those of your subcontractor, it is done at DoD’s expense. The inspection and test must not unduly delay your work. [F-52.246-2]

The clause governing inspection and correction of defects in cost-reimbursement contracts differs from the standard fixed-price clause in two major respects. First, you will be reimbursed for correcting any nonfraudulent defects and, second, the government may require you to remedy any defective items up to 6 months after acceptance. [F-52.246-3]

Subcontracts

Subcontracts affect the price and performance of prime contracts. DoD frequently requires that you obtain the contracting officer’s consent to proposed subcontracts. The regulations require prime contractors to select subcontractors and suppliers on the most competitive basis possible. The terms and conditions of a subcontract generally are subject to negotiation between the subcontractor and the prime contractor. However, the regulations do stipulate certain mandatory provisions in subcontracts. Remember, as a subcontractor you have a contractual agreement with the prime contractor, not with DoD. DoD cannot intervene in the relationship between you and the prime contractor. [F-52.244-1, F-52.244-5]

In many instances, contractors must require prospective subcontractors to furnish complete, current, and accurate cost or pricing data before awarding a subcontract. DoD reserves the right to reduce a prime contractor’s price because of a subcontractor’s defective cost or pricing data. If a prime contractor suffers such a reduction, the subcontractor may have to reimburse the prime contractor. [F-15.804-2]

Use of Government Property

In general, you must furnish all the property required to perform your contract. However, sometimes your contract may require DoD to supply you with government property. [F-45.102]

Government property can be either government-furnished or contractor-acquired. Government-furnished property is property the government possesses or acquires directly and then makes available to a contractor. Contractor-acquired property is property that a contractor provides for the performance of a contract but to which the government has title. [F-45.101]

Government property includes materials, special tooling, special test equipment, and facilities. Materials are property that may be incorporated into or attached to an end item to be delivered under the contract or that may be consumed or expended in performing a contract. Special tooling and special
test equipment are manufacturing aids designed for use in producing and testing the product under contract. Facilities are industrial property used for production, maintenance, research, development, or testing (other than material, special tooling, and special test equipment), and they include real property, such as buildings and other permanent structures.

Generally, the contractor assumes the risk of loss or damage to government property in its possession. In certain procurements, however, the government assumes liability for that risk, such as when the property is provided under a cost-reimbursement contract. You may use the government property in your possession only for performance of the contract for which it is provided. Use for any other purpose must be approved by the contracting officer. If DoD furnishes property that is unsuitable for its intended use or that creates production difficulties resulting in extra costs, you are entitled to an appropriate price adjustment.

Contractors already possessing government property suitable for use in an upcoming award could have a competitive advantage. To eliminate any such advantage, DoD applies evaluation or rental factors to the offers of these contractors when reviewing bids and proposals.

Part 45 of the FAR sets forth requirements for contractors to follow in establishing and maintaining control over government property. These include recordkeeping, control of scrap and salvage, property identification requirements, and the contractor's duties and responsibilities with respect to the property.

You must agree that any exclusive right to use or sell any invention in the United States will provide that any product embodying the invention will be manufactured substantially in the United States. The patent rights clause also provides “march-in rights” to the government. Under that provision, you may be required to grant a license to a responsible applicant if the government determines you have not taken steps to achieve practical application of an invention or if the public interest otherwise dictates such action.

The standard practice with respect to existing patent rights is to include an “authorization and consent” clause in every contract except when small purchase procedures apply. That clause authorizes you to use in the performance of the contract any invention patented by others in the United States. Its purpose is to prevent disruption of contract performance by court injunctions against patent infringement. In the event of an infringement, the patent owner must sue DoD rather than you.
infringement. You are required to notify DoD of any infringement claims arising from the performance of your contracts and to assist the government in its defense against such claims. [F-27.202, F-27.203, F-52.227-3]

Technical data are recorded forms of information of a scientific or technical nature pertaining to products sold to the government. Product specifications, engineering drawings, and operating or maintenance manuals are all examples of technical data. The term does not include computer software or financial, administrative, cost or pricing, or other management data. [D-227.401, D-227.402-71]

The DoD policy is to acquire only those technical data rights essential for meeting its needs. Generally, if the government provides all the funds to develop the product associated with the data, DoD acquires “unlimited rights” in the technical data. This means that DoD can do virtually anything it wants to with the data. If DoD provides some of the development money and you provide some, then the rights are negotiated; but usually DoD will take “government purpose license rights” in the data. Under these rights, DoD can use the data for government purposes only (but this includes competing the item for resupply by other vendors) for a set period of time. At the end of the period, DoD will automatically take unlimited rights. If you have developed the product and its data completely at private expense, then DoD will take “limited rights,” enabling it to use the data only internally within the government. Such data may only be released outside the government in certain emergencies and special exceptions. [D-227.401, D-227.402-72]

The DoD’s policy on rights to computer software generally parallels that on technical data. DoD acquires unlimited rights to software developed directly under or as a necessary part of a contract. Software developed at private expense may be acquired with “restricted” rights. Restricted rights enable DoD to use the software with its computer and to make archive backup copies. [D-227.403-77]

In general, the copyright law gives the owner of a copyright exclusive rights to do the following:

- Reproduce the copyrighted work
- Prepare derivative works
- Distribute copies or phonorecords to the public
- Perform the copyrighted work publicly
- Display the copyrighted work publicly.

Although a contractor may copyright data originated under a government contract, the government retains a nonexclusive, paid-up license to reproduce, translate, publish, and use those data. [D-227.403-76]

Bonds, Insurance, and Taxes

Contracting officers may require performance or payment bonds in appropriate circumstances. In practice, those bonds are generally required only in fixed-price construction contracts that exceed $25,000. When performance bonds are required, bid guarantees (usually 20 percent of the bid price but not more than $3 million) are also usually required. [F-28.101, F-28.102, F-28.103]

On a fixed-price contract, the government is not ordinarily concerned with the contractor’s insurance coverage. Contractors are required to carry insurance under fixed-price contracts only in special circumstances. Under cost-reimbursement contracts, however, you are normally required to carry workers’ compensation, employer’s liability, comprehensive general liability (bodily injury), and comprehensive automobile liability (bodily injury and property damage) insurance while performing the contract. [F-28.306, F-28.307]

Contracts for R&D may provide for indemnification against unusually hazardous risks for you and your subcontractors, including claims by third parties (including employees) for death, bodily injury, or loss of, or damage to, property. The indemnification also covers your property to the extent such liability, loss, or damage (1) results from a risk that the contract defines as “unusually hazardous,” (2) arises from the direct performance of the contract, and (3) is not compensated by insurance or otherwise. [D-235.070]

The tax aspects of government contracting are many and varied. Only two basic points can be made
Remember that you are required to continue performing under the contract except when DoD breaches the contract.

Payments

One of the most important provisions of a contract deals with payments. How you receive payment for your work depends on the type of contract you have. Payments under cost-reimbursement contracts are entirely different from those under fixed-price contracts. Your contract will specify the DoD office responsible for payments and will also contain invoicing instructions. Regardless of the type of contract, the time it takes to be paid is directly related to the accuracy of your invoices, so it is worthwhile to understand the payment process thoroughly. Every fixed-price contract contains a clause entitled “Prompt Payment” that sets forth the information to be included in each invoice.

Under cost-reimbursement contracts, you are reimbursed for the allowable costs you incur in performing the work. Any costs you incur that are not allowable under DoD’s rules will be omitted from your payments. (The following subsection, Contract Cost Principles, provides an explanation of allowable costs.) Every 2 weeks, or more frequently if warranted, you may submit an invoice (or a public voucher form obtained from your contract administration office) for costs incurred. Your contract should specify a payment date, expressed as a number of days after receipt of your invoice. Otherwise you may not be paid until 30 days after receipt of your invoice, with rare exceptions. [F-32.905, F-52.216-7]

In addition to payments for costs, you are entitled to be paid the negotiated profit or fee. However, you must negotiate the way in which the fee will be paid. This should be set forth in the contract schedule under the section entitled “Special Contract Requirements.” After you have received 85 percent of any fee under a contract, the contracting officer may withhold a reserve to protect the government’s interest pending completion of the work. This reserve may not exceed 15 percent of the total fee or $100,000, whichever is less. [F-52.216-8, F-52.216-9, 52.216-10]

Under fixed-price contracts, the method of payment can vary with the dollar value of the contract. For relatively small contracts with a single item of work, you will generally be paid the total contract price in one lump sum. Payment is made after you deliver the products or services and DoD accepts them. For larger contracts with many items, you can invoice and receive partial payments. For example, in a contract for 120 units with a delivery rate of 10 per month, you can invoice each month for the price of delivered (and accepted) items. A payment date, expressed as a number of days after receipt of a proper invoice, should be included in the “payments” clause of the contract. In the absence of such a date, you will be paid 30 days after receipt of a proper invoice. However, DoD payment offices are encouraged to pay SDB concerns as quickly as
possible after proper invoices are received. [F-32.111(a)(1), F-32.903, F-52.232-1, D-232.903, D-232.905] When the value of a fixed-price contract (or group of contracts) to be performed by a small business concern exceeds $100,000 and the first delivery is at least 4 months after award, DoD recognizes your need for working capital. To help finance the work, these contracts may contain a clause allowing you to obtain progress payments monthly. Progress payments to small businesses are usually made at 85 percent of costs incurred. Payments upon delivery are adjusted to reflect previous progress payments. [F-32.502-1, F-52.232-16]

Because progress payments are an advance for work to be performed, you must repay them if you fail to complete the work. To protect its interest, DoD takes title to your work in process for which progress payments have been made. [F-52.232-16]

To qualify for progress payments, you must have an accounting system and controls adequate for proper administration of the payments. Also, the contracting officer must be satisfied that your financial condition is sound enough to protect the government against loss of progress payments. To receive progress payments, you submit an SF 1433, "Contractor's Request for Progress Payment," to your administrative contracting officer.

Fast-payment procedures normally apply to contracts of $25,000 or less. You submit an invoice showing that the supplies have been delivered to a post office, common carrier, or the point of first receipt by the government. You agree to replace, repair, or correct supplies not received at destination, damaged in transit, or not conforming to purchase requirements. When DoD receives the invoice, you may be paid without waiting for actual receipt and acceptance of the supplies. Again, DoD payment offices will try to pay SDB concerns as soon as possible after receipt of invoice. [F-13.302, F-52.213-1, D-232.903, D-232.905]

To minimize the need for financial assistance to contractors, DoD emphasizes prompt payment on all contracts. This prompt payment includes both DoD payments to prime contractors and prime contractor payments to subcontractors. If the government fails to pay amounts due on valid invoices within the prescribed time limit, you may be entitled to interest on such amounts. [F-32.907, D-232.905]

**Contract Cost Principles**

The DoD's cost principles are applied in the following situations:

- Pricing contracts when cost analysis is performed,
- Determining reimbursements under cost-reimbursement contracts,
- Negotiating indirect cost rates,
- Negotiating termination settlements,
- Revising prices on redeterminable and fixed-price incentive contracts, and
- Pricing contract modifications. [F-31.103]

In those situations, you cannot necessarily recover all costs incurred, but you can recover those costs deemed "allowable."

To be allowable, an individual item of cost must be:

- Reasonable
- Allocable
- Computed in accordance with generally accepted accounting principles and practices appropriate to the particular circumstances
- Consistent with any other limitation or exclusion set out in the regulations or the contract. [F-31.201-2]

A cost is reasonable if, in its nature and amount, it does not exceed that which would be incurred by a prudent person in the conduct of competitive business. Generally, a cost is allocable if it can be charged to a contract, product, product line, etc., according to the relative benefits received. Specifically, a cost is allocable if any of the following conditions apply:

- It is incurred directly for the contract.
- It benefits both the contract and other work and can be distributed among all work in reasonable proportion to the benefits received.
- It is necessary to the overall operation of your business. [F-31.201-3, F-31.201-4]

The regulations do not discuss every type of cost. Approximately 50 selected items of cost are defined and designated as allowable or unallowable. For example, depreciation of plant and equip-
ment is an allowable cost; interest on borrowings is unallowable. Allowability of costs not explicitly covered by the regulations is based on the general principles stated above and on the treatment of similar or related cost items. \[F-31.205\]

In any given contract, the reasonableness and allocability of special or unusual items of cost may be difficult to determine. To avoid disallowances, you should seek advance agreement with DoD as to the treatment of these costs. The advance agreement should be negotiated before the costs are incurred and should be incorporated into the contract. The advance agreement cannot allow treatment of costs inconsistent with the cost principles set forth in FAR Part 31. \[F-31.109\]

The regulations list 17 specific cost items in which advance agreements may be particularly important:

- Compensation for personal services
- Use charge for fully depreciated assets
- Deferred maintenance costs
- Precontract costs
- Independent R&D and bid and proposal costs
- Royalties and other costs for use of patents
- Selling and distribution costs
- Travel and relocation costs, as related to special or mass personnel movements; travel on contractor-owned, leased, or chartered aircraft; or maximum per diem rates
- Costs of idle facilities and idle capacity
- Costs of automated data processing (ADP) equipment
- Severance pay to employees on support service contracts
- Plant reconversions
- Professional services, such as legal or accounting
- Allocations of general and administrative costs
- Costs of construction plant and equipment (under construction contracts)
- Costs of public relations and advertising
- Training and education costs. \[F-31.109(h)\]

**Contract Changes**

Because DoD's needs change frequently, most DoD contracts contain a changes clause. That particular clause varies according to the type of contract, but all changes clauses have certain common elements. \[F-43.205\]

A changes clause authorizes the contracting officer to order you to make changes "within the general scope of the contract." A change is considered to be within the scope of the contract if it can be regarded as fair and reasonable within the contemplation of the parties when the contract was entered into.

This definition means that DoD cannot use a change order to change the nature of the contract. In supply contracts, the changes are limited to drawings, designs, or specifications (if the goods are specially manufactured for DoD); the method of shipment or packing; and the place of delivery. If the change causes an increase or decrease in the cost of, or the time required for, the performance of any part of the work under the contract, an equitable adjustment will be made in the contract price, delivery schedule, or both. \[F-52.243-1\]

Change orders are issued in writing. You must submit your claim for an equitable adjustment to the contracting officer within 30 days after receipt of a written change order.

You must proceed to perform the contract as changed unless the change is beyond the general scope of the contract. If you fail to proceed under a proper change order, you are liable for breach of contract.

**Terminations**

Virtually every DoD contract contains a clause allowing termination for convenience of the government. In addition, most contracts in excess of $25,000 contain a default clause.

**Terminations for Convenience**

The DoD may terminate all or part of a contract for its convenience. This type of termination protects DoD's interests by allowing cancellation of contracts for products that become obsolete or unneeded. The termination does not arise from any fault on the part of the contractor.

The DoD must give you written notice of termination for convenience. The notice of termination will state the following:

- The effective date of the termination
- The extent of the termination
Any special instructions. [F-49.102]

The notice and the clause generally require the contractor to stop work immediately on the terminated portion, to terminate all affected subcontracts, to perform any unterminated portion of the contract, and to proceed promptly to settle termination claims, both its own and those of its subcontractors. If you fail to follow these directions, you do so at your own risk and expense. You should also receive detailed instructions as to the protection and preservation of all property that is, or may become, government-owned.

After termination, DoD is required to make a fair and prompt settlement with you. Generally speaking, settlement takes the form of a negotiated agreement between the parties. The idea is to agree on an amount that will compensate you fully and fairly for the work you have done and for any preparation you have made for the terminated portion of the contract. A reasonable allowance for profit is also included. The settlement of cost-reimbursement contracts is somewhat simpler than that of fixed-price contracts since you will have been reimbursed on a cost basis from the beginning of the contract. [F-49.105]

You are entitled to recover all allowable costs incurred in settling a termination for convenience. Those costs may cover the following, among other things--
- Preparation and presentation of claims
- Termination and settlement of subcontracts
- Storage, transportation, protection, and disposition of property acquired or produced for the contract
- Other termination activities. [F-31.205-42]

The DoD retains the right to approve or ratify any settlements made with subcontractors. When you and DoD agree to all or part of your claim for compensation as a result of the termination, a written amendment (known as a settlement agreement) is made to the contract. [F-49.108-3, F-49.109]

Generally, termination halts regular payments to you under the contract. However, since you may have money tied up in finished and unfinished products, materials, and labor, most termination clauses provide you with interim financing through partial payments. [F-49.112]

Terminations for Default

The DoD may terminate all or part of a contract for default if you fail to--
- Deliver the supplies or perform the services within the time specified in the contract
- Perform any other provisions of the contract
- Make progress, and that failure endangers performance of the contract. [F-52.249-8]

Before terminating a contract for default because of your failure to make progress or to perform other provisions of the contract, the contracting officer will usually give you a written notice, called a “cure notice.” That notice allows you at least 10 days to cure any defects.

Unless the failure to perform is cured within the 10 days, the contracting officer may issue a notice of termination for default. [F-49.607]

If there is not time for a cure, the contracting officer will usually send a show-cause notice. That notice directs you to show why your contract should not be terminated for default. It ensures that you understand your predicament, and your answer can be used in evaluating whether circumstances justify default action. [F-49.402-3, F-49.607]

Upon termination for default, you are entitled only to payment at the contract price for items accepted by DoD. Under a default clause, DoD has the right to repurchase the item elsewhere and charge any excess reprocurement costs to you. [F-49.402-2]

If you can show that your failure to perform the contract is excusable, your contract cannot be terminated for default. To be excusable, the failure must be beyond your control and not caused by your fault or negligence. Examples of excusable delay include the following:
- Acts of God
- Acts of the public enemy
- Acts of government
- Fires
- Floods
- Epidemics
- Quarantine restrictions
- Strikes
- Freight embargoes
- Unusually severe weather.
If, after termination, you are found not to be in default or the default is found to be excusable, the termination will be treated as one for the convenience of the government. [F-52.249-8]

Public Policies

Other national goals, besides the promotion of small businesses, are reflected in DoD contract clauses. As a DoD contractor, you need to be aware of these additional requirements. We have grouped the clauses under six headings and summarized key points about each below. You should, of course, become more familiar with their specific requirements before entering into a contract.

Labor Standards

Under the Contract Work Hours and Safety Standards Act, certain government contractors who employ laborers or mechanics are required to pay them at least time-and-a-half for work in excess of 40 hours a week. This requirement also extends to all subcontracts. [F-22.301, F-52.222-4]

Contractors who receive supply contracts over $10,000 and are manufacturers of, or regular dealers in, the supplies must comply with the regulations issued by the Secretary of Labor under the Walsh-Healey Public Contracts Act. That Act governs minimum wages, maximum hours, and working conditions and prohibits the use of child and convict labor. [F-22.602, F-52.222-20]

Contracts not subject to the Walsh-Healey Act must include a clause prohibiting the use of convict labor. Contracts involving construction work must contain several additional clauses relating to construction industry labor standards. Contracts for services other than personal services are generally subject to the Service Contract Act. This Act provides minimum standards for wages, fringe benefits, and working conditions for service employees. [F-22.202, F-22.402, F-37.107, F-52.222-3]

Labor Surplus Areas

The government encourages placing contracts with firms located in areas of unemployment or underemployment. In all contracts greater than $25,000 (except those for personal services or with foreign firms), contractors must try to place subcontracts in accordance with this policy. If the contract exceeds $500,000, the contractor must organize and carry out a program for placing subcontracts with firms located in areas of high unemployment or underemployment. [F-20.102, F-20.301, F-20.302, F-52.220-3, F-52.220-4]

Equal Employment Opportunity

The government ensures equal opportunity for all qualified persons employed by, or seeking employment with, government contractors, regardless of race, color, religion, sex, or national origin. Unless exempted by the Director, Office of Federal Contract Compliance Programs, all DoD contracts and subcontracts must contain an equal opportunity clause. Individual contracts and subcontracts are exempt from application of the clause unless the aggregate value of such business exceeds $10,000 in any 12-month period. This clause obligates the contractor to ensure nondiscrimination in hiring, as well as in the terms and conditions of employment. If the contractor does not comply, the contract may be terminated. [F-22.802, F-22.809, F-52.222-26]

In contracts greater than $1 million, offerors are subject to preaward equal opportunity review to determine their eligibility for contract award. Offerors on a contract exceeding $10,000 must certify that they maintain nonsegregated facilities. [F-22.805, F-52.222-21]

Contracts and subcontracts exceeding $2,500 must contain a clause prohibiting discrimination against, and requiring affirmative action for, any employee or applicant for employment having a physical or mental handicap, if that person is otherwise qualified for the position. Contracts and subcontracts exceeding $10,000 must contain a clause prohibiting discrimination against, and requiring affirmative action for, any employee or applicant for employment who is a disabled veteran or veteran of the Vietnam era if that person is otherwise qualified for the position. [F-52.222.35, F-52.222-36]

An Executive Order prohibits discrimination by government contractors and subcontractors because of age. No contract clauses are used to implement this policy. [F-22.901]
Preferred Products and Services

Many DoD contract clauses reflect public policies requiring that preference be given to certain products or services. For example:
- U.S. private vessels shall be used for shipment of certain supplies. [F-47.502]
- Contractors must purchase jewel bearings from domestic sources. [F-8.202]

The most frequently encountered preferred product procedures involve the Buy American Act. Under that Act, the government favors domestic products over foreign products. A product is considered to be domestic if the cost of the domestic materials used in the product is more than 50 percent of the cost of all materials used in the product. The Act requires that only domestic products be acquired for public use except when (1) the articles, materials, or supplies are for use abroad or for commissary resale, (2) domestic products of a satisfactory quality are not available in sufficient quantities, or (3) a domestic purchase would be either contrary to public interest or its cost would be unreasonable. [F-25.101, F-25.102]

To determine the reasonableness of the lowest acceptable domestic offer when both domestic and foreign products are offered, the foreign offer is adjusted by adding 6 percent of the offer inclusive of duty. If the low domestic offeror is either a small business or a labor surplus area business, a 12-percent factor is used instead of 6 percent. If the adjusted foreign offer is lower than the lowest acceptable domestic offer, the domestic offer is considered unreasonable and award is made to the foreign offeror. [F-25.105]

The requirements of the Act are waived when the government purchases certain Defense items from companies in NATO countries. They are also waived on certain U.S. purchases from countries with which the United States has trade agreements. Prospective contractors are advised in the solicitation that information about exceptions under the Act is available upon request. [F-52.225-1, D-225.000-71, D-225.872]

Sanctions Against Improper Conduct

Several standard clauses protect the integrity of the government procurement process.

The "officials not to benefit" clause prohibits members of Congress or resident commissioners from participating in any share or part of the contract. [F-52.203.1]

The "gratuities" clause provides that a contractor may not offer or give any gratuity (such as entertainment or a gift) to a government employee to obtain a contract or favorable treatment regarding contract awards and determinations. [F-52.203-3]

A clause entitled "covenant against contingent fees" requires contractors to warrant that no persons other than employees or established commercial or selling agencies have been employed to solicit business upon a commission, percentage, brokerage, or contingent-fee basis. [F-52.203-5]

The "anti-kickback procedures" clause prohibits subcontractors from paying any fee, commission, or compensation to any prime contractor or higher tier subcontractor as an inducement or acknowledgment for the award of a subcontract or order. [F-3.502, F-52.203-7]

The regulations prescribe sanctions against those who violate or otherwise fail to conform to the standards required of government contractors. These sanctions consist of debarment, suspension, and ineligibility for award of contracts. Debarment is the most serious penalty. It generally results from conviction of a serious offense or willful violation of contract requirements and can last up to 3 years (or 5 years for violation of the Drug-Free Workplace Act of 1988). Suspension is temporary, pending completion of investigation and legal proceedings. It is used when serious evidence of wrongdoing exists but has not been proven. Contractors may become ineligible for, that is, they may be excluded from, government contracting as a result of violations of laws or regulations such as the Buy American Act, the Walsh-Healey Act, the Service Contract Act, etc.


Examination of Records and Audits

To ensure accuracy and honesty in the pricing, costing, and reporting under contracts awarded
without benefit of full and open competition, the government often reserves the right to examine or to audit contractors’ records and the data supporting cost proposals, claimed costs of performance, reports required by the contract, and similar items.

Virtually all contracts except small purchases and those awarded by sealed bids must contain a clause granting the Comptroller General the right to examine the contractor’s records related to the contract for up to 3 years after final payment. A similar clause must be included in subcontracts under these contracts. [F-52.215-1]

All contracts other than small purchases and those that are awarded by sealed bids also contain a clause requiring the contractor to maintain, and give the contracting officer the right to examine and audit, books; records; documents and other data relating to the claimed costs of performance; the cost or pricing data used to support the pricing of the contract; and any cost, funding, or performance reports required under the contract. [F-52.215-2].
Conclusions

This guide is not a substitute for any requirement or provision of any regulations. It is simply an introduction to Defense contracting. In this guide you have been exposed to those DoD policies and procedures most frequently encountered by small businesses. You are now aware of some of the major differences between commercial and government procurement. You understand what a government contract contains and how it is formed. Finally, now that you know the basics of Defense contracting, you will find that doing business with DoD is not as difficult as you may have thought.

If you want additional information or assistance, seek the small business specialist at the nearest DoD contracting activity.
Additional Sources of Information

Marketing Information

Selling to the Military

Provides offices, addresses, and telephone numbers of major buying activities of the Army, Navy, Air Force, and Defense Logistics Agency, with summaries of the procurement responsibilities and types of major purchases for each activity.

For sale by the Superintendent of Documents, U.S. Government Printing Office, Washington, D.C. 20402 (Stock No. 008-000-00607-5) or may be obtained from the nearest DoD contracting office. The price is $8.50 (Jan. 1994).

Commerce Business Daily

A daily list of proposed Federal government procurements estimated to exceed $25,000. Also contains lists of subcontracting leads, sales of surplus property, and foreign business opportunities.

Subscriptions may be obtained through the Superintendent of Documents, U.S. Government Printing Office, Washington, D.C. 20402. The price is $324.00 per year (first class) and $275.00 per year (second class) (Jan. 1994).

U.S. Government Purchasing and Sales Directory

Provides a listing of products and services bought by all Federal agencies, keyed to the purchasing offices that buy them. Also provides information on government sales of surplus property.

Available from the nearest Small Business Administration office or write to: SBA Publications, P.O. Box 30, Pueblo, Col. 80201.

Subcontracting Opportunities with DoD Major Prime Contractors

Provides company name and address, product or service line, and name and telephone number of company's small business liaison officer for DoD prime contractors that have plans and goals (set forth in their prime contracts) for subcontracting with small business and small disadvantaged business concerns. Published annually.

For sale by the Superintendent of Documents, U.S. Government Printing Office, Washington, D.C. 20402 (Stock No. 008-040-00199-7) or may be obtained from the nearest DoD contracting office. The price is $10.00 (Jan. 1994).

SBA Master Small Business Innovation Research Program Solicitation Release Schedule

Each fiscal year the Small Business Administration will publish the list of topics upon which research effort will be sought by all major government agencies. This list will include names, addresses, and telephone numbers of agency contact points for the program and the estimated dates when solicitations will be issued and proposals required, together with the estimated number and average amounts of awards planned for that fiscal year.

Available from SBA Publications, P.O. Box 30, Pueblo, Col. 80201.

A Guide for Private Industry

Tells how to obtain information regarding specifications and standards from the DoD Single Stock Point for Specifications and Standards.


Aids for Small Business

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To be listed in the PASS, contact the nearest Small Business Administration office for SBA Form 1167 or call the SBA Answer Desk: 1-800-8ASK-SBA. (Participation in PASS is free.)

Management Aids
Short papers providing specific guidance on various topics.
Available from the nearest Small Business Administration office.

For a complete list of available management aids, ask for the Small Business Directory. The directory and aids can also be requested from SBA Publications, P.O. Box 30, Pueblo, Col. 80201.
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