

## 16.402

firm-fixed-price contract is not appropriate and the required supplies or services can be acquired at lower costs and, in certain instances, with improved delivery or technical performance, by relating the amount of profit or fee payable under the contract to the contractor's performance. Incentive contracts are designed to obtain specific acquisition objectives by—

(1) Establishing reasonable and attainable targets that are clearly communicated to the contractor; and

(2) Including appropriate incentive arrangements designed to (i) motivate contractor efforts that might not otherwise be emphasized and (ii) discourage contractor inefficiency and waste.

(b) When predetermined, formula-type incentives on technical performance or delivery are included, increases in profit or fee are provided only for achievement that surpasses the targets, and decreases are provided for to the extent that such targets are not met. The incentive increases or decreases are applied to performance targets rather than minimum performance requirements.

(c) The two basic categories of incentive contracts are fixed-price incentive contracts (see 16.403 and 16.404) and cost-reimbursement incentive contracts (see 16.405). Since it is usually to the Government's advantage for the contractor to assume substantial cost responsibility and an appropriate share of the cost risk, fixed-price incentive contracts are preferred when contract costs and performance requirements are reasonably certain. Cost-reimbursement incentive contracts are subject to the overall limitations in 16.301 that apply to all cost-reimbursement contracts.

(d) Award-fee contracts are a type of incentive contract.

[48 FR 42219, Sept. 19, 1983, as amended at 62 FR 12695, Mar. 17, 1997]

### **16.402 Application of predetermined, formula-type incentives.**

#### **16.402-1 Cost incentives.**

(a) Most incentive contracts include only cost incentives, which take the form of a profit or fee adjustment formula and are intended to motivate the contractor to effectively manage costs.

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No incentive contract may provide for other incentives without also providing a cost incentive (or constraint).

(b) Except for award-fee contracts (see 16.404 and 16.405-2), incentive contracts include a target cost, a target profit or fee, and a profit or fee adjustment formula that (within the constraints of a price ceiling or minimum and maximum fee) provides that—

(1) Actual cost that meets the target will result in the target profit or fee;

(2) Actual cost that exceeds the target will result in downward adjustment of target profit or fee; and

(3) Actual cost that is below the target will result in upward adjustment of target profit or fee.

[48 FR 42219, Sept. 19, 1983, as amended at 62 FR 12696, Mar. 17, 1997; 62 FR 51379, Oct. 1, 1997]

#### **16.402-2 Performance incentives.**

(a) Performance incentives may be considered in connection with specific product characteristics (e.g., a missile range, an aircraft speed, an engine thrust, or a vehicle maneuverability) or other specific elements of the contractor's performance. These incentives should be designed to relate profit or fee to results achieved by the contractor, compared with specified targets.

(b) To the maximum extent practicable, positive and negative performance incentives shall be considered in connection with service contracts for performance of objectively measurable tasks when quality of performance is critical and incentives are likely to motivate the contractor.

(c) Technical performance incentives may be particularly appropriate in major systems contracts, both in development (when performance objectives are known and the fabrication of prototypes for test and evaluation is required) and in production (if improved performance is attainable and highly desirable to the Government).

(d) Technical performance incentives may involve a variety of specific characteristics that contribute to the overall performance of the end item. Accordingly, the incentives on individual