

16.401 General.

(a) Incentive contracts as described in this subpart are appropriate when a 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) A determination and finding, signed by the *head of the contracting activity*, shall be completed for all incentive- and award-fee contracts justifying that the use of this type of contract is in the best interest of the Government. This determination shall be documented in the contract file and, for award-fee contracts, shall address all of the suitability items in [16.401\(e\)\(1\)](#).

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

(1) *Application*. An award-fee contract is suitable for use when-

(i) The work to be performed is such that it is neither feasible nor effective to devise predetermined objective incentive targets applicable to cost, schedule, and technical performance;

(ii) The likelihood of meeting *acquisition* objectives will be enhanced by using a contract that effectively motivates the contractor toward exceptional performance and provides the Government with the flexibility to evaluate both actual performance and the conditions under which it was achieved; and

(iii) Any additional administrative effort and cost required to monitor and evaluate performance are justified by the expected benefits as documented by a risk and cost benefit analysis to be included in the Determination and Findings referenced in [16.401\(e\)\(5\)\(iii\)](#).

(2) *Award-fee amount*. The amount of award fee earned shall be commensurate with the contractor's

overall cost, schedule, and technical performance as measured against contract requirements in accordance with the criteria stated in the award-fee plan. Award fee *shall* not be earned if the contractor's overall cost, schedule, and technical performance in the aggregate is below satisfactory. The basis for all award-fee determinations *shall* be documented in the contract file to include, at a minimum, a determination that overall cost, schedule and technical performance in the aggregate is or is not at a satisfactory level. This determination and the methodology for determining the award fee are unilateral decisions made solely at the discretion of the Government.

(3) *Award-fee plan.* All contracts providing for award fees *shall* be supported by an award-fee plan that establishes the procedures for evaluating award fee and an *Award-Fee Board* for conducting the award-fee evaluation. Award-fee plans *shall*-

- (i) Be approved by the FDO unless otherwise authorized by agency procedures;
- (ii) Identify the award-fee evaluation criteria and how they are linked to *acquisition* objectives which *shall* be defined in terms of contract cost, schedule, and technical performance. Criteria *should* motivate the contractor to enhance performance in the areas rated, but not at the expense of at least minimum acceptable performance in all other areas;
- (iii) Describe how the contractor's performance will be measured against the award-fee evaluation criteria;
- (iv) Utilize the adjectival rating and associated description as well as the award-fee pool earned percentages shown below in Table 16-1. *Contracting officers may* supplement the adjectival rating description. The method used to determine the adjectival rating *must* be documented in the award-fee plan;

Table 16-1

Award-Fee Adjectival Rating	Award-Fee Pool Available To Be Earned	Description
Excellent	91%-100%	Contractor has exceeded almost all of the significant award-fee criteria and has met overall cost, schedule, and technical performance requirements of the contract in the aggregate as defined and measured against the criteria in the award-fee plan for the award-fee evaluation period.
Very Good	76%-90%	Contractor has exceeded many of the significant award-fee criteria and has met overall cost, schedule, and technical performance requirements of the contract in the aggregate as defined and measured against the criteria in the award-fee plan for the award-fee evaluation period.

Award-Fee Adjectival Rating	Award-Fee Pool Available To Be Earned	Description
Good	51%-75%	Contractor has exceeded some of the significant award-fee criteria and has met overall cost, schedule, and technical performance requirements of the contract in the aggregate as defined and measured against the criteria in the award-fee plan for the award-fee evaluation period.
Satisfactory	No Greater Than 50%	Contractor has met overall cost, schedule, and technical performance requirements of the contract in the aggregate as defined and measured against the criteria in the award-fee plan for the award-fee evaluation period.
Unsatisfactory	0%	Contractor has failed to meet overall cost, schedule, and technical performance requirements of the contract in the aggregate as defined and measured against the criteria in the award-fee plan for the award-fee evaluation period.

(v) Prohibit earning any award fee when a contractor's overall cost, schedule, and technical performance in the aggregate is below satisfactory;

(vi) Provide for evaluation period(s) to be conducted at stated intervals during the contract period of performance so that the contractor will periodically be informed of the quality of its performance and the areas in which improvement is expected (*e.g.* six months, nine months, twelve months, or at specific milestones); and

(vii) Define the total award-fee pool amount and how this amount is allocated across each evaluation period.

(4) *Rollover of unearned award fee.* The use of *rollover of unearned award fee* is prohibited.

(5) *Limitations.* No award-fee contract *shall* be awarded unless-

(i) All of the limitations in 16.301-3, that are applicable to cost-reimbursement contracts only, are complied with;

(ii) An award-fee plan is completed in accordance with the requirements in 16.401(e)(3); and

(iii) A determination and finding is completed in accordance with 16.401(d) addressing all of the suitability items in 16.401(e)(1).

(f) *Incentive- and Award-Fee Data Collection and Analysis.* Each agency *shall* collect relevant data on award fee and incentive fees paid to contractors and include performance measures to evaluate such data on a regular basis to determine effectiveness of award and incentive fees as a tool for improving contractor performance and achieving desired program outcomes. This information

should be considered as part of the *acquisition planning* process (see [7.105](#)) in determining the appropriate type of contract to be utilized for future *acquisitions*.

(g) *Incentive- and Award-Fee Best Practices*. Each *agency head* shall provide mechanisms for sharing proven incentive strategies for the *acquisition* of different types of *products* and services among *contracting* and program management officials.

Parent topic: [Subpart 16.4 - Incentive Contracts](#)