



ACQUISITION,  
TECHNOLOGY  
AND LOGISTICS

OFFICE OF THE UNDER SECRETARY OF DEFENSE

3000 DEFENSE PENTAGON  
WASHINGTON, DC 20301-3000

JUL 14 2004

DPAP/P

Ms. Lynn Y. Carroll  
Tidewater Community College  
Procurement and Acquisitions,  
Portsmouth Campus  
7000 College Drive  
Portsmouth, VA 23703

Dear Ms. Carroll:

In your letter dated January 15, 2004, you expressed concern regarding the application of paragraph (e) of FAR 52.222-43, "Fair Labor Standards Act and Service Contract Act -- Price Adjustment." Paragraph (e) of the subject clause reads as follows:

"Any adjustment will be limited to increases or decreases in wages and fringe benefits as described in **paragraph (c)** of this clause, **and** the accompanying increases or decreases in social security and unemployment taxes and workers' compensation insurance, but shall not otherwise include any amount for general and administrative costs, overhead, or profit."

In response to your concern, my office reviewed the application of this clause. Based on this review, I believe it is clear that, under the subject clause, there is no overhead, G&A, or profit applied to the wage adjustment. That is, if the wage adjustment is \$2.00 per hour, the contractor cannot add any percentage or dollar amount for overhead, G&A, or profit.

My office has also analyzed the basis for making a possible change to the subject clause. Based on this analysis, we do not believe a change is warranted.

To the extent that a particular indirect cost element increases or decreases as a result of the wage adjustment, a corresponding increase or decrease in contract price is appropriate. The clause recognizes this by providing for a price adjustment for **any** increases or decreases in social security, unemployment taxes, and workers' compensation insurance.



You note in your letter that the contractor should receive additional overhead to reflect increases in the cost of living for items such as electricity and rent. However, in pricing the contract, contractors should and generally do include any **anticipated increases** in indirect costs in the development of the proposed indirect rates. Thus, an increase in wages under the Service Contract Act, is not justification to increases other items such as electricity and rent, which are not within the Government's control and subject to normal market influences that a contractor should consider when pricing the original contract.

I recognize wage adjustments may also result in a shift of indirect costs between contracts. The amount of the **shift** for a particular contract will depend on how many of the workers on that contract are subject to the wage determination. While the indirect costs allocated to contracts with the wage adjustment clause may increase, the indirect costs allocated to contracts without the wage adjustment would decrease. When all contracts are considered, the total amount of indirect costs will not change; **i.e.**, the result is a re-allocation of indirect costs among contracts.

While it may be possible to write a clause to **require** contract price adjustments to reflect the shift in indirect costs resulting from the wage adjustments, such a clause would require a very complex formula that would be difficult to administer. The formula would have to consider which **contracts/workers** were subject to the wage adjustment, the type of contracts involved (Government versus non-Government, fixed price versus cost type), the percentage of cost type versus fixed price type contracts, and whether any increase in the labor rates was considered in developing the indirect rates used to determine the negotiated contract price. The clause would **require up** and down contract price adjustments to reflect the shift in indirect costs, **i.e.**; in some cases there will be more indirect costs allocated to contracts and in others there will be less. However, the total of all of the price adjustments would be zero, since there has been no change in total indirect costs.

Revising the clause to reflect the shift in indirect costs would also require coordination among each Contracting Officer for every contract of the contractor, to assure the contractor does not over or under recover the indirect costs. In addition, the complexity of the process and the formula itself would most likely result in a high **number/percentage** of disputes. Yet, in the end, the total amount of all the contract price adjustments would be zero.

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I appreciate your input on how we can improve our regulatory language; such language is a key to assuring we do business in the most effective and efficient manner possible. Should you have any additional questions or concerns regarding this issue, please contact Mr. David Capitano, at phone number (703) 847-7486 or via e-mail, david.capitano@osd.mil.

Sincerely,

*for Vincent J. Leck*  
Deidre A. Lee  
Director, Defense Procurement  
and Acquisition Policy