



OFFICE OF THE UNDER SECRETARY OF DEFENSE
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WASHINGTON, DC 20301-3000

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ACQUISITION,
TECHNOLOGY
AND LOGISTICS

In reply refer to
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MEMORANDUM FOR ASSISTANT SECRETARY OF THE ARMY (ACQUISITION,
LOGISTICS AND TECHNOLOGY)
ASSISTANT SECRETARY OF THE NAVY (RESEARCH,
DEVELOPMENT AND ACQUISITION)
ASSISTANT SECRETARY OF THE AIR FORCE
(ACQUISITION)
DIRECTORS OF DEFENSE AGENCIES

SUBJECT: Utilities Privatization - Class Deviation from FAR Part 31

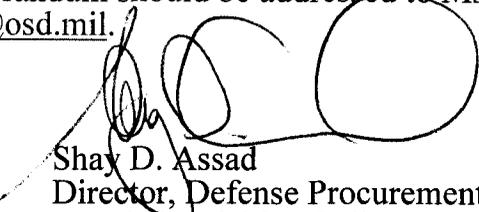
Under the authority in FAR 1.402 and 1.404(b), and DFARS 201.404, I hereby authorize a class deviation for certain contracts awarded in conjunction with the conveyance of a utility system under 10 U.S.C. 2688, "Utility Systems, Conveyance Authority." To qualify for the deviation, the contract must meet the conditions detailed in Attachment A.

This class deviation applies to all qualified contracts awarded for the date of this deviation through August 31, 2010. This class deviation supersedes the class deviation issued on October 20, 2004.

The Head of the Contracting Agency shall report to this office, on a quarterly basis (beginning with the quarter ending September 30, 2007), any contracts awarded that use this deviation in accordance with this memorandum. The report shall be submitted within 30 days of the end of the quarter and shall include, at a minimum, the following information:

1. Contract number
2. Contractor name
3. Date of contract award
4. Amount of contract award

Any questions concerning this memorandum should be addressed to Ms. Pat West, at 703-602-8387 or via e-mail at Pat.West@osd.mil.


Shay D. Assad
Director, Defense Procurement
and Acquisition Policy

Attachments:

- A. Deviation from FAR Part 31 - Contract Price Principles and Procedures
- B. 10 U.S.C. 2324(e) - Specific Costs Not Allowable



Deviation from FAR Part 31 - Contract Cost Principles and Procedures

Section 1. **General Deviation from FAR Part 31.** This deviation applies to Government contracts awarded in conjunction with the conveyance of a utility system under 10 U.S.C 2688, provided all of the conditions listed in this section are met. This deviation permits, but does not require, the head of the Contracting Agency to waive the requirements of FAR Part 31.

The Head of the Contracting Agency may exclude from the contract some or all of the requirements of FAR Part 31 provided all of the following conditions are met:

- a. The contract is fixed price with prospective price redetermination;
- b. The contract either:
 - (i) Is exempt from the application of the Cost Accounting Standards (CAS);

or

- (ii) Meets the criteria for a waiver from the Cost Accounting Standards (CAS) in accordance with the waiver granted by the CAS Board on September 2, 2004, and CAS has been waived for the contract;

c. If the contract is exempt or waived from CAS, the contract requires that the accounting practices used to prepare the proposal for the initial contract and/or the price determination (i) comply with the pronouncements of the Federal Energy Regulatory Commission (FERC), the National Association of Regulatory Utility Commissioners (NARUC), the Rural Utility Service (RUS), or the American Water Works Association (AWWA) and (ii) are consistent with the contractor's written and established practices for measuring, assigning and allocating costs;

d. The business segment performing the contract is not, at the time of contract award, currently performing on any other contract that is subject to the provisions of FAR Part 31;

e. The contract requires that the actual costs used for purposes of establishing the initial fixed price and/or the price redetermination:

- (i) Meet the limitations specified in Section 2 for any deviation granted from FAR 31.205-20, Interest and other financial costs;
 - (ii) Meet the limitations specified in Section 3 for any deviation granted from

FAR 31.205-41, Taxes;

- (iii) Exclude the types of costs listed at 10 U.S.C. 2324(e) (and any revisions to this statute as of the date of contract award), which is included as Attachment B to this memorandum. Any reasonable method of estimating such costs is sufficient to meet this requirement; and
- (iv) Exclude the types of costs that are not normally considered as reimbursable by the applicable regulatory body that oversees the utility rate determinations of the business segment performing the contract.

f. The contract provides the Government with access to all records related to the accounting practices used to determine the costs and the supporting data for any estimates of unallowable costs.

Section 2. **FAR 31.205-20 - Interest and other financial costs.** This deviation from the requirements of FAR 31.205-20 applies to all Government contracts awarded in conjunction with a conveyance of a utility system under 10 U.S.C. 2688, provided that all of the conditions listed in this section are met. This deviation permits (but does not require) the Contracting Officer to allow external interest and/or directly related financial costs in lieu of cost of money. The deviation does not apply to any imputed interest on the contractor's own funds.

This deviation applies only when all of the following conditions are met:

- a. The Contracting Officer determines, in writing, that:
 - (i) Allowing the costs will significantly reduce the costs of the United States for the utility services provided under the subject contract;
 - (ii) The interest costs and directly related financial costs incurred to obtain loans or borrow capital from third-party financial institutions are reasonable based on the particular facts and circumstances involved; and
 - (iii) The interest and directly related financial costs are associated with capital expenditures to acquire, renovate, upgrade and/or expand utility systems under the subject utilities privatization contract.
- b. The contract states that cost of money is an unallowable contract cost under FAR 31.205-10, Cost of money, either during or after the period of the loan for all assets to which the loan relates; and
- c. Interest rates used to calculate allowable costs are limited to 600 basis points above the Contract Disputes Act interest rate (10 U.S.C. 611) in effect at the time the

contractor makes the capital expenditure.

Section 3. *FAR 31.205-41 - Taxes.* This deviation from the requirements of FAR 31.205-41 applies to Government contracts awarded in conjunction with a conveyance of a utility system under 10 U.S.C. 2688, provided that all of the conditions listed in this section are met. This deviation permits (but does not require) the Head of the Contracting Agency (HCA) to allow Federal income tax directly related to a Contribution in Aid of Construction (CIAC tax).

To the maximum extent practical, contracts should be structured in a manner that will not result in a CIAC tax. However, there may be cases where incurrence of the CIAC tax is necessary to achieve the most beneficial business case for the Government. In those cases, the HCA may determine that the CIAC tax is an allowable cost provided all of the following conditions are met:

a. Based on the particular facts and circumstances involved, the HCA determines that allowing the CIAC tax will result in significant benefits to the Government that outweigh the cost of allowing the tax.

b. The HCA has adequately documented, in writing:

- (i) The basis for the DoD determination of fair value using a generally accepted valuation methodology.
- (ii) The basis for the determination that the benefits to the Government outweigh the estimated cost of the tax (this requires an estimate of the expected corporate tax rate of the contractor, the marginal tax liability caused by the CIAC, and the anticipated difference in fair market value between the DoD and Internal revenue Service (IRS) valuations).

c. The contract limits the allowable cost to the portion of the actual CIAC tax attributable to the difference between:

- (i) The fair market value determinations of DoD using a generally accepted valuation methodology; and
- (ii) The fair market value determination of the IRS in assessing the tax.

10 U.S.C. 2324(e) Specific Costs Not Allowable.

(1) The following costs are not allowable under a covered contract:

(A) Costs of entertainment, including amusement, diversion, and social activities and any costs directly associated with such costs (such as tickets to shows or sports events, meals, lodging, rentals, transportation, and gratuities).

(B) Costs incurred to influence (directly or indirectly) legislative action on any matter pending before Congress, a State legislature, or a legislative body of a political subdivision of a State.

(C) Costs incurred in defense of any civil or criminal fraud proceeding or similar proceeding (including filing of any false certification) brought by the United States where the contractor is found liable or has pleaded nolo contendere to a charge of fraud or similar proceeding (including filing of a false certification).

(D) Payments of fines and penalties resulting from violations of, or failure to comply with, Federal, State, local, or foreign laws and regulations, except when incurred as a result of compliance with specific terms and conditions of the contract or specific written instructions from the contracting officer authorizing in advance such payments in accordance with applicable provisions of the Federal Acquisition Regulation.

(E) Costs of membership in any social, dining, or country club or organization.

(F) Costs of alcoholic beverages.

(G) Contributions or donations, regardless of the recipient.

(H) Costs of advertising designed to promote the contractor or its products.

(I) Costs of promotional items and memorabilia, including models, gifts, and souvenirs.

(J) Costs for travel by commercial aircraft which exceed the amount of the standard commercial fare.

(K) Costs incurred in making any payment (commonly known as a "golden parachute payment") which is--

(i) in an amount in excess of the normal severance pay paid by the contractor to an employee upon termination of employment; and

(ii) is paid to the employee contingent upon, and following, a change in management control over, or ownership of, the contractor or a substantial portion of the contractor's assets.

(L) Costs of commercial insurance that protects against the costs of the contractor for correction of the contractor's own defects in materials or workmanship.

(M) Costs of severance pay paid by the contractor to foreign nationals employed by the contractor under a service contract performed outside the United States, to the extent that the amount of severance pay paid in any case exceeds the amount paid in the industry involved under the customary or prevailing practice for firms in that industry providing similar services in the United States, as determined under the Federal Acquisition Regulation.

(N) Costs of severance pay paid by the contractor to a foreign national employed by the contractor under a service contract performed in a foreign country if the termination of the employment of the foreign national is the result of the closing of, or the curtailment of activities at, a United States military facility in that country at the request of the government of that country.

(O) Costs incurred by a contractor in connection with any criminal, civil, or administrative proceeding commenced by the United States or a State, to the extent provided in subsection (k).

(P) Costs of compensation of senior executives of contractors for a fiscal year, regardless of the contract funding source, to the extent that such compensation exceeds the benchmark compensation amount determined applicable for the fiscal year by the Administrator for Federal Procurement Policy under section 39 of the Office of Federal Procurement Policy Act (41 U.S.C. 435).