



OFFICE OF THE UNDER SECRETARY OF DEFENSE

3000 DEFENSE PENTAGON
WASHINGTON, DC 20301-3000

OCT 20 2004

ACQUISITION,
TECHNOLOGY
AND LOGISTICS

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

I hereby authorize a class deviation from FAR Part 31 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 contracts must meet the conditions detailed in Attachment A.

This class deviation applies to all qualifying contracts awarded from the date of this deviation through April 30, 2007. This class deviation supercedes the class deviation for interest costs issued on April 15, 2002.

The Head of the Contracting Agency shall report to this office, on a quarterly basis (beginning with the quarter ended December 31, 2004), 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 the Contract Award

If you have any questions regarding this memorandum, please contact Mr. David J. Capitano, Senior Procurement Analyst, at 703-847-7486.

Deidre A. Lee
Director, Defense Procurement
and Acquisition Policy

Attachments:

- A. Deviation to FAR Part 31 - Contract Price Principles and Procedures
- B. CAS Waiver
- C. 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) as provided for at Attachment B of this memorandum, 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 redetermination (i) comply with 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 C 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 at 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 (41 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. The deviation permits (but does not require) the Head of the Contracting Agency (HCA) to allow the 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 market 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 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 Internal Revenue Service in assessing the tax.