



Shaun Kennedy

Partner
303.295.8377
Denver, Washington, DC
sckennedy@hollandhart.com



Thomas Morales

Associate
303.295.8277
Denver
TAMorales@hollandhart.com

DoD OUSD Memorandum Provides Guidance on Addressing Inflation Cost Impacts

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Key Takeaways:

1. In a fixed-price contract, increased costs caused by market inflation alone will not entitle the contractor to an equitable adjustment.
2. Contracting Officers are advised to utilize contract provisions that include an Economic Price Adjustment (EPA) as a tool to appropriately balance the risk of inflationary concerns.
3. Contractors should remain vigilant when seeking equitable adjustments permitted under various contract provisions (i.e., Changes, Government Delay of Work, Suspension of Work, etc.) to ensure that the increase in the cost of performance takes into consideration rising inflation.

Contractors are experiencing the impact of significant market inflation in recent months, resulting in increased costs for labor, materials, fuel, and equipment. On May 25, 2022, the Department of Defense (“DoD”), Office of the Under Secretary of Defense (“OUSD”) issued a memorandum, Guidance for Inflation and Economic Price Adjustments (the “Memorandum”).

Citing a “period of unusually high inflation,” OUSD recently issued instructive guidance to contracting officers regarding the treatment of excess costs caused by market inflation, as well as the use of Economic Price Adjustment (“EPA”) clauses. The Memorandum notes that current economic conditions make it appropriate to adjust contracts which already have some form of EPA clause, but that fixed-price contracts will not be adjusted for changed economic circumstances without an underlying “contracting officer-directed” change to the contract.

The Memorandum specifically notes that EPA clauses “may be an appropriate tool to equitably balance the risk of inflation between the Government and contractor” for new contract actions, especially for longer term contracts. In those circumstances, the EPA clause should be tailored to: (i) allow for both upward and downward revision of the stated contract price based upon specified contingencies; (ii) utilize the same indices to adjust the contract price that were used to establish the negotiated contract price; and (iii) incorporate a ceiling and a floor on adjustments to the contract price. OUSD also directs contracting officers to seek assistance from various levels of review within DoD when implementing an EPA clause, such as the Defense Contract Management Agency and/or

Defense Contracting Audit Agency.

While the Memorandum directs contracting officers to deny equitable adjustments based solely upon changed economic conditions, contractors should consider whether increased costs of performance may be recovered through other contract provisions. To the extent Government action changes or delays contract performance, several clauses (*i.e.*, Changes, Government Delay of Work, Suspension of Work, etc.) permit the contractor to seek an equitable adjustment that may include increased labor and material costs. Contractors should review their contracts and assess whether they can recover increased performance costs caused by market inflation through other provisions.

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