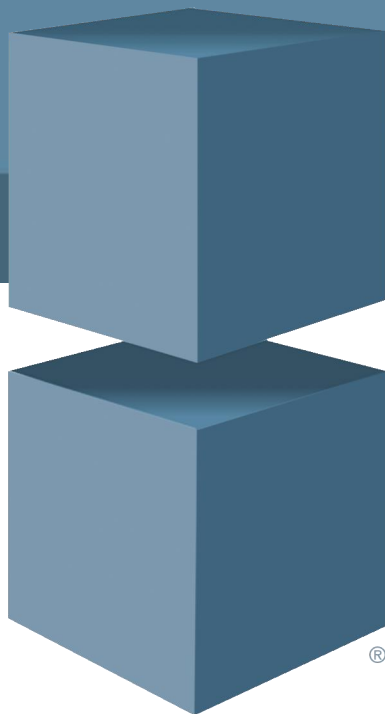




## ***05. Limiting Liability in Government Contracts***



# Limiting Liability in Government Contracts



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# Overview

- **FAR Clauses vs. Uniform Commercial Code**
- **Scope of Liability in U.S. Government Prime and Subcontracts**
  - Termination for Default
  - Liquidated Damages
  - Warranty
  - Liability for Loss or Damage to Government Property
  - Indemnification
- **Innovative Techniques For Prime Contractors and Subcontractors to Reduce Risk**
  - Subcontract Flowdowns
  - Limitation of Liability Clauses
  - Exclusion of Implied Warranties
  - Exclusion of Consequential, Incidental, and Special Damages
  - Procurement of Insurance
  - Maintaining Adequate Records



# FAR Clauses vs. Uniform Commercial Code

## ■ Prime Contracts

- Formation and administration of U.S. Government contracts is subject to and governed by the Federal Acquisition Regulation (FAR) and 20+ agency FAR supplements
  - e.g., Department of Defense FAR Supplement (DFARS), Department of Energy Acquisition Regulation (DEAR), etc.



# FAR Clauses vs. Uniform Commercial Code

## ■ Prime Contracts

### – FAR Subpart 52.2 Contract Clauses

- FAR Subpart 52.2 contains the text of the clauses that are included in government solicitations and contracts
- Policy citation before each clause dictates when the clause should be included in a solicitation or contract
- Application of clause depends on
  - Contract type (e.g., fixed-price, cost reimbursement, commercial item, etc.)
  - Type of work to be performed (e.g., sale of goods, provision of services, construction, architect-engineer, etc.)
  - Total anticipated contract value (inclusive of all options)



# FAR Clauses vs. Uniform Commercial Code

## ■ Subcontracts

- Government contract statutes, rules, regulations, and clauses apply to the extent they are incorporated into the agreement
  - “Christian” doctrine *G. L. Christian & Associates v. U.S.*, 312 F.2d 418 (Ct. Cl., 1963) does not apply to subcontracts
  - But see *UPMC Braddock v. Harris*, 2013 U.S. Dist. LEXIS 45953 (D.D.C. March 30, 2013)
- Subcontracts are also governed by commercial law such as the Uniform Commercial Code (U.C.C.), other statutory laws or the common law
  - Note the U.C.C. only applies to the sale of goods



# FAR Clauses vs. Uniform Commercial Code

## ■ Subcontracts

- Prime contractor / higher-tiered subcontractor usually has the most bargaining power
- There are some clauses in its contract with the government that must be flowed down, or the prime contractor will be in breach
- **But**, not all provisions **must** be or even **can** be flowed-down
  - EFT Payment Provisions through the System for Award Management (SAM)
  - Disputes Clause
- Since the subcontract is likely only for a subset of the prime contractor's requirements, some provisions are likely not applicable



# FAR Clauses vs. Uniform Commercial Code

## ■ Subcontracts

- There are other clauses which, while not mandatory, should be modified and flowed-down in order to protect the prime contractor's interests
- Examples include:
  - Termination for Default
  - Termination for Convenience
  - Stop-Work Order
  - Changes
  - Indemnification
  - Warranty





# FAR Clauses vs. Uniform Commercial Code

## ■ Subcontracts

- Subcontractor needs to accept the clauses the prime contractor must include to cover its legitimate risk (e.g., termination, warranty, etc.)
- Subcontractor needs to be able to identify the clauses that are not mandatory flow-downs, that do not cover a prime contractor's legitimate risk, or that cause a burden on the subcontractor
- Challenge for the subcontractor is to convince the prime contractor that these superfluous clauses add unnecessary costs, are overly burdensome to the subcontractor, or are just unfair
- Subcontractor needs to consider whether, once accepted, it will be able to flow-down clauses to its own lower-tier subcontractors



# Termination for Default

- **Justifications for Termination Under the FAR**
  - **Fixed-Price Supplies and Services**
    - **Failure to deliver the supplies or to perform the services within the time specified in the contract or any extension**
    - **Failure to make progress so as to endanger performance of the contract**
    - **Failure to perform any of the other provisions of the contract**
  - **Cost-Reimbursement**
    - **Defaults in performing the contract (includes failure to make progress in the work so as to endanger performance)**



# Termination for Default

- **Justifications for Termination Under the FAR**
  - **Commercial Item**
    - Any default by the contractor
    - Failure to comply with any contract terms and conditions
    - Failure to provide the government, upon request, with adequate assurances of future performance
  - **Construction**
    - Refusal or failure to prosecute the work or any separable part, with the diligence that will insure its completion within the time specified in the contract
    - Failure to complete the work within the time specified in the contract



# Termination for Default

## ■ Notice Under the FAR

- Show cause notice / cure notice is required prior to the government's termination for default
- Contractor typically has 10 days to respond / cure the identified deficiencies



# Termination for Default

## ■ Fixed-Price FAR Clauses

- FAR 52.212-4, “Contract Terms and Conditions – Commercial Items”
  - (m) Termination for cause. . . . In the event of termination for cause, the Government shall not be liable to the Contractor for any amount for supplies or services not accepted, and the Contractor shall be liable to the Government for any and all rights and remedies provided by law.



# Termination for Default

## ■ Fixed-Price FAR Clauses

### – FAR 52.249-8, Default (Fixed-Price Supply and Services)

- (b) If the Government terminates this contract in whole or in part, it may acquire, under the terms and in the manner the Contracting Officer considers appropriate, supplies or services similar to those terminated, and the Contractor will be liable to the Government for any excess costs for those supplies or services.
- (e) If this contract is terminated for default, the Government may require the Contractor to transfer title and deliver to the Government, as directed by the Contracting Officer, any (1) completed supplies, and (2) partially completed supplies and materials, parts, tools, dies, jigs, fixtures, plans, drawings, information, and contract rights (collectively referred to as “manufacturing materials” in this clause) that the Contractor has specifically produced or acquired for the terminated portion of this contract.
- (h) The rights and remedies of the Government in this clause are in addition to any other rights and remedies provided by law or under this contract.



# Termination for Default

## ■ Fixed-Price FAR Clauses

### – FAR 52.249-10, Default (Fixed-Price Construction)

- (a) ...the Government may take over the work and complete it by contract or otherwise, and may take possession of and use any materials, appliances and plant on the work site necessary for completing the work. The Contractor and its sureties shall be liable for any damage to the Government resulting from the Contractor's refusal or failure to complete the work within the specified time, whether or not the Contractor's right to proceed with the work is terminated. This liability includes any increased costs incurred by the Government in completing the work.
- (d) The rights and remedies of the Government in this clause are in addition to any other rights and remedies provided by law or under this contract.



# Termination for Default

## ■ Fixed-Price FAR Clauses

- Contractor only receives payment for work accepted by the government prior to the termination
  - For the manufacture of goods, the contractor is not entitled to payment for “work in process” unless the Contracting Officer (CO) requests delivery of “manufacturing materials”
  - Government is entitled to the repayment of unearned advance or progress payments applicable to the work
- Requirement to deliver “manufacturing materials” could result in competitor access to contractor’s intellectual property
  - Requirement to deliver partially completed plans, drawings, information and contract rights “produced or acquired” for the terminated portion of the contract
  - Price for manufacturing materials to be negotiated





# Termination for Default

## ■ Fixed-Price FAR Clauses

- “Similar” goods and services
  - Not identical; if not identical, excess costs can be adjusted to account for the differences in the items
  - Similar in “physical and mechanical characteristics as well as functional purpose”
- No “similarity” requirement in the Construction FAR clause, but Boards have held that a similarity determination exists
- Cannot “materially alter” the terms and conditions of the original contract
  - For construction, cannot make “material changes” in the procurement specifications that would result in “substantial alterations” in the work
- If the replacement goods and services are not “similar,” the government loses its right to recover excess costs from the contractors
  - The Boards do not permit the Government to adjust the excess costs to account for the differences



# Termination for Default

## ■ Fixed-Price FAR Clauses

### ■ Reprocurement costs

- Government has a duty to mitigate its damages
  - Government must act reasonably in selecting the reprocurement contractor
  - Government must act reasonably in establishing the reprocurement price
- Government must show costs were incurred (*i.e.*, the reprocurement contract is complete and the replacement contractor has been paid)
- Government can recover reprocurement costs incurred during the entire reprocurement period, including option years, if the contractor agreed to perform for that duration
- If the contract permits the government to recover liquidated damages, these are in addition to any excess reprocurement costs



# Termination for Default

## ■ Fixed-Price FAR Clauses

### – Additional damages

- Actual damages that have not been recovered through an excess cost assessment
  - Actual damage recovery limited if the government has recovered liquidated damages
- Administrative costs of repurchase
  - Defense Logistics Agency clause requires the contractor to pay a sum of \$1,155.00 as payment for administrative costs of the repurchase



# Termination for Default

- **Cost Reimbursement FAR Clauses**
  - **FAR 52.249-6, Termination (Cost-Reimbursement)**
    - (h)(4)(ii) If the contract is terminated for default, the total fee payable shall be such proportionate part of the fee as the total number of articles (or amount of services) delivered to and accepted by the Government is to the total number of articles (or amount of services) of a like kind required by the contract.
  - Contractor receives reimbursement for all costs incurred prior to the termination
  - Contractor is not liable for reprocurement costs
  - The government may reduce the fixed fee
  - The costs of preparing a contractor's termination settlement proposal are unallowable



# Termination for Default

- **Consequences Under the FAR**
  - Under FAR 52.209-5, Certification Regarding Responsibility Matters, contractors must disclose all terminations for default in the prior three (3) years
  - “Black mark” on the contractor’s record
- **Contesting a Termination for Default Under the FAR**
  - Contractor can argue that the termination for default was improper if the contractor can demonstrate
    - It was not in default; or
    - Its failure to perform was excusable (*i.e.*, arose out of causes beyond the control and without the fault or negligence of the contractor and its subcontractors)
  - If a contractor successfully demonstrates that the government’s termination for default was improper, the termination is converted to one for convenience
    - Contractor will not be liable for reprocurement costs
    - Contractor entitled to submit a termination for convenience settlement proposal
    - Contractor will be “made whole”, but will not receive lost profits



# Termination for Default

## ■ Subcontract Clauses

- Same negotiation dynamic as prime contracts
  - Buyer wants unbridled discretion
  - Seller wants as many limitations as possible
- Clearly identify the events that support a default of the subcontractor
  - Breach
  - Insolvency
  - Cost-competitiveness
  - Change in control



# Breach of Contract

## ■ Subcontract Clauses

- Subcontractors should seek to limit the prime contractor's ability to terminate for default to those bases included in the FAR clauses in the prime contract
- Subcontractors should limit default-terminations to those for a material breach
- Subcontracts should include a viable dispute resolution process for disputes regarding the default action



# Termination for Default

- Broad range of potential damages in subcontracts
  - Expectation Damages (e.g., reprocurement costs or “cover” costs)
    - Make the injured party whole
  - Consequential Damages (e.g., lost profits) (U.C.C. 2-715)
    - Losses that result from general or particular requirements and needs of which the seller at the time of contracting had reason to know and that could not be reasonably prevented by cover or otherwise
    - Injury to person or property proximately resulting from a breach
    - They must “flow from the breach” and be reasonably foreseeable upon entering into the contract
  - Incidental Damages (e.g., cost of inspection, receipt, transportation, care, and custody of goods rejected) (U.C.C. 2-715(1))
    - Damages that result from the Seller’s breach





# Termination for Default

- **Broad Range of Potential Damages in Subcontracts**
  - **Punitive Damages**
    - Intended to punish the breaching actors and to deter them from committing future breaches
    - Fairly rare in contract cases
  - **Liquidated Damages**
  - **Can also seek equitable remedies**
    - Injunction
    - Specific performance



# Liquidated Damages

- FAR Subpart 11.5
  - The CO must consider the potential impact on pricing, competition, and contract administration before using a liquidated damages clause
  - Use liquidated damages clauses only when
    - The time of delivery or timely performance is so important that the government may reasonably expect to suffer damage if the delivery or performance is delinquent; and
    - The extent or amount of such damage would be difficult or impossible to estimate accurately or prove
  - Liquidated damages are not punitive and are not negative performance incentives



# Liquidated Damages

## ■ FAR Subpart 11.5

- Liquidated damages are used to compensate the government for probable damages
- The liquidated damages rate must be a reasonable forecast of just compensation for the harm that is caused by late delivery or untimely performance of the particular contract
- CO can use a maximum amount or a maximum period for assessing liquidated damages if these limits reflect the maximum probable damage to the government
- The CO may use more than one liquidated damage rate when the CO expects the probable damage to the government to change over the contract period of performance
- The CO must take all reasonable steps to mitigate liquidated damages



# Liquidated Damages

## ■ FAR Clauses

- FAR 52.211-11, Liquidated Damages - Supplies, Services, or Research and Development
  - If the government terminates for default the contract, the contractor is liable for liquidated damages accruing until the government reasonably obtains delivery or performance of similar supplies or services
  - These liquidated damages are in addition to excess costs of repurchase under the Termination clause
  - The contractor will not be charged with liquidated damages when the delay in delivery or performance is beyond the control and without the fault or negligence of the contractor



# Liquidated Damages

## ■ FAR Clauses

- FAR 52.211-12, Liquidated Damages – Construction
  - If the government terminates the contractor's right to proceed, liquidated damages will continue to accrue until the work is completed
  - These liquidated damages are in addition to excess costs of repurchase under the Termination clause



# Liquidated Damages

## ■ FAR Clauses

- FAR 52.219-16, Liquidated Damages – Small Business Subcontracting Plan
  - Failure to make a good faith effort to comply with the subcontracting plan
  - The amount of damages attributable to the contractor's failure to comply is equal to the actual dollar amount by which the contractor fails to achieve each subcontracting goal
- FAR 52.222-4, Contract Work Hours and Safety Standards Act
  - When an overtime computation discloses under-payments, the responsible contractor or subcontractor must pay the affected employee any unpaid wages and pay liquidated damages to the government
  - The CO must assess liquidated damages at the rate of \$10 per affected employee for each calendar day on which the employer required or permitted the employee to work in excess of the standard workweek of 40 hours without paying overtime wages required by the Act



# Liquidated Damages

## ■ Subcontracts

- Parties may agree in a contract to the amount of damages owed by either party in the event of a breach by either party
- Primary limit is the requirement of reasonableness based on the conditions at the time of contracting (not when the breach occurs)
- Unenforceable if it constitutes a penalty
- Must fix damages in advance for a sum certain
- U.C.C. expressly recognizes the concept of liquidated damages (2-718(1))



# Liquidated Damages

## ■ Subcontractor Considerations

- Only accept if the higher-tiered contractor's contract contains a liquidated damage clause
- Limit the liquidated damage sum to that the higher-tiered contractor is required to pay to the government or its customer
- Agree to pay liquidated damages only if delay or other breach was solely caused by the subcontractor, its employees, agents, or lower-tier subcontractors





# Warranty

## ■ FAR Subpart 46.7

- “The use of warranties is not mandatory” (FAR 46.703)
- Warranty clauses do not limit the government’s rights under an inspection clause in relation to latent defects, fraud, or gross mistakes that amount to fraud (FAR 46.705(c))
- If the government specifies the design, the contractor’s obligation to correct defects only extends to defects in material and workmanship or failure to conform to the specifications
- If the contractor specifies the design, the warranty extends to the usefulness of the design
- Except for commercial item contracts, an express warranty negates any implied warranties



# Warranty

## ■ FAR Subpart 46.7

- Government acceptance is “final and conclusive except for latent defects, fraud, gross mistakes amounting to fraud, or the Government’s rights under any warranty or guarantee.” (FAR 52.246-12)
  - No such language for commercial item prime contracts or service contracts
- Latent Defects
  - Defects exist at the time of acceptance but cannot be discovered by a reasonable inspection (FAR 2.101)



# Warranty

## ■ FAR Subpart 46.7

### – Fraud

- Government has the burden of proving
  - Its acceptance was induced by reliance on
  - A misrepresentation of fact, actual or implied, or the concealment of a material fact
  - Made with knowledge of its falsity or in reckless or wanton disregard of the facts
  - With intent to mislead the government into relying on the misrepresentation
  - As a consequence of which the Government has suffered injury (*Dale Ingram, Inc.*, ASBCA 12152, 74-1 BCA ¶ 10,436 at 49,331)

### – Gross Mistake Amounting to Fraud

- Same as fraud, but no requirement to show intent to mislead
- Mistake that cannot be reconciled with good faith (*Catalytic Eng'g & Mfg. Corp.*, ASBCA 15257, 72-1 BCA ¶ 9342)



# Warranty

## ■ FAR Subpart 46.7

- Acceptance of work containing patent defects precludes all remedies, regardless of whether the government has knowledge of the defects
  - Patent defect defined as “any defect which exists at the time of acceptance and is not a latent defect” (FAR 46.101)
  - Under the U.C.C., acceptance precludes rejection of goods with patent defects, but permits the buyer to recover damages from the seller



# Warranty

## ■ FAR Subpart 46.7

- Warranty shall permit the government to, at a minimum
  - Obtain an equitable adjustment of the contract; or
  - Direct the contractor to repair or replace the defective items at the contractor's expense
- If repair/replacement is not practical or does not provide a sufficient remedy, the government may
  - Retain the defective item and reduce the contract price by an amount equitable under the circumstances; or
  - Arrange for the repair or replacement of the defective item, by the government or another source, at the contractor's expense



# Warranty

## ■ FAR Subpart 46.7

- Duration of warranty must be specified based on factors such as
  - The estimated useful life of the item (e.g., 30,000 miles)
  - The nature of the item including storage or shelf-life (e.g., batteries that lose their charge after a certain period of time)
  - Trade practice



# Warranty

## ■ FAR Subpart 46.7

### – Warranty costs include:

- The costs of furnishing all labor and material to:
  - Reinspect items that the government reasonably expected to be defective
  - Accomplish the required repair or replacement of defective items
  - Test, inspect, package, pack, and mark repaired or replaced items
- Transportation costs of returning the defective item to the contractor's plant from the designated place of delivery in the contract (not necessarily the F.O.B. point) and the cost of returning the items to the government



# Warranty

## ■ Commercial Items Under the FAR

- The FAR requires COs to take advantage of commercial warranties, including extended warranties, where appropriate and in the government’s best interests (FAR 12.404; FAR 46.709)
- CO may include in the solicitation the parameters for an express warranty (e.g., minimum duration)
- FAR 52.212-4(o): “The contractor warrants and implies that the items delivered hereunder are merchantable and fit for use for the particular purpose described in this contract.”
  - Warranty of merchantability means that the item is reasonably fit for the ordinary purposes for which such items are used
  - Warranty for a particular purpose requires:
    - The government to inform the contractor of the government’s intended purpose for the item; and
    - The government relied on the contractor’s skill and judgment that the item would be appropriate for that particular purpose





# Warranty

## ■ Commercial Items Under the FAR

- Warranty clause in FAR 52.212-4(o) can be “tailored” (FAR 12.302)
  - Implied warranties only apply to the sale of goods so the clause should be tailored to an appropriate warranty for the provision of services
    - Example from FAR 52.246-20: “the Contractor warrants that all services performed under this contract will, at the time of acceptance, be free from defects in workmanship and conform to the requirements of the contract”
  - “In some markets, it may be customary commercial practice for contractors to exclude or limit the implied warranties contained in 52.212-4” (FAR 12.404(b)(2))
  - CO shall ensure the express warranty provides for repair or replacement of defective items discovered within a reasonable period of time after acceptance



# Warranty

## ■ FAR Clauses

- **FAR 52.246-17, Warranty of Supplies of a Noncomplex Nature**
  - The government should insert the specified warranty period (e.g., 3 years, 30,000 miles, etc.)
  - Contractor warrants the supplies will:
    - Be free from defects in material or workmanship
    - Conform will all requirements of the contract
  - Contractor warrants the preservation, packaging, packing, and marking, and the preparation for, and method of, shipment of such supplies will conform with all requirements of the contract
  - Excludes implied warranties of merchantability and fitness for a particular purpose
  - The rights and remedies of the government in this clause are in addition to and do not limit any rights afforded to the government by any other clause of the contract



# Warranty

## ■ FAR Clauses

- FAR 52.246-17, Warranty of Supplies of a Noncomplex Nature
  - CO may require:
    - Prompt correction or replacement of nonconforming supplies
    - Retain nonconforming supplies and reduce the contract price by an amount “equitable under the circumstances”
    - Correct or replace the nonconforming supplies with similar supplies from another source and charge to the contractor the government’s replacement costs, provided the contractor:
      - Fails to make redelivery of the corrected or replaced supplies within the time established for their return; or
      - Fails either to accept return of the nonconforming supplies or fails to make progress after their return to correct or replace them so as to endanger performance of the delivery schedule
      - 10 day cure period in both instances
    - Require an equitable adjustment of the contract price
  - Warranty on corrected or replaced supplies runs from the date of delivery of the corrected or replaced supplies



# Warranty

## ■ FAR Clauses

- FAR 52.246-18, Warranty of Supplies of a Complex Nature
- FAR 52.246-19, Warranty of Systems and Equipment Under Performance Specifications or Design Criteria
- FAR 52.246-20, Warranty of Services
- FAR 52.246-21, Warranty of Construction



# Warranty

- **Cost-Reimbursement FAR Clauses**
  - CO should not include warranties in cost-reimbursement contracts, unless authorized in accordance with agency regulations, except for those in
    - FAR 52.246-3, “Inspection of Supplies – Cost Reimbursement”
    - FAR 52.246-8, “Inspection of Research and Development – Cost Reimbursement”
  - Under both of those clauses, the contractor must replace nonconforming parts and the replacement costs are allowable costs under the contract
  - The contractor is not entitled to receive an additional fee on replacement supplies or services



# Warranty

## ■ Cost Reimbursement FAR Clauses

- If the contractor fails to proceed with reasonable promptness to repair/replace, the government may
  - Perform the replacement or correction, charge to the contractor any increased cost, or make an equitable reduction in any fixed fee paid or payable under the contract
  - Require delivery of any undelivered articles and make an equitable reduction in the fixed fee paid or payable under the contract
  - Terminate for default the contract



# Warranty

## ■ Cost Reimbursement FAR Clauses

- Contractor must correct or replace, without cost to the government, nonconforming supplies if the nonconformances are due to
  - Fraud, lack of good faith, or willful misconduct on the part of the contractor's managerial personnel; or
  - The conduct of one or more of the contractor's employees selected or retained by the contractor after any of the contractor's managerial personnel has reasonable grounds to believe that the employee is habitually careless or unqualified



# Warranty

- **Subcontracts – Express Warranty Clauses**
  - **What is scope of warranty?**
    - **Strict compliance with specifications, samples, drawings, designs or other requirements (including performance specifications)**
    - **Goods made of new and not used materials**
    - **Goods merchantable and of good material and workmanship and free from all defects**
    - **Goods selected, designed, manufactured and assembled by Seller based on Buyer’s intended use**
    - **Strict compliance with applicable industry standards, quality control and inspection standards, and all statutes, rules and regulations, of any kind or nature**
    - **Free from all liens and encumbrances**
    - **Free from all patent, trademark, copyright, trade secret or other intellectual property right infringement or claims**





# Warranty

- **Subcontracts – Express Warranty Clauses**
  - Length of Warranty Period
    - Can be modified by contract
    - For example, can extend until
      - Expiration of all warranties made by Buyer to its customer concerning Buyer’s product incorporating the goods; or
      - Expiration of the longest time period which Buyer’s customer may be required, by contract of law, to repair or replace the goods or Buyer’s product incorporating the goods, if the goods are defective or nonconforming to any warranties
  - Scope and length of warranty from subcontractor should parallel the prime contractor’s warranty to the government



# Warranty

- **Subcontracts – Implied Warranties Under the U.C.C.**
  - **Implied Warranty of Merchantability (U.C.C. 2-314(1))**
    - **Goods sold are merchantable if the seller is a merchant with respect to goods of that kind**
  - **Implied Warranty of Fitness for a Particular Purpose (U.C.C. 2-315)**
    - **Seller has reason to know any particular purpose for which the goods are required**
    - **Buyer is relying on the Seller's skill or judgment**
    - **Seller warrants the goods will be fit for such purpose**
  - **Implied warranties apply to subcontracts governed by the U.C.C., unless they are disclaimed**



# Loss or Damage to Government Property

## ■ FAR Subpart 46.8

- The government will generally act as a self-insurer by relieving contractors of liability for loss of or damage to property of the government that
  - Occurs after acceptance of supplies delivered or services performed under a contract; and
  - Results from defects or deficiencies in the supplies or services
- The government will not relieve the contractor of liability for loss of or damage to the contract end item itself, except for high-value items
- Does not apply to commercial item contracts



# Loss or Damage to Government Property

## ■ FAR Subpart 46.8

### – High-Value Items

- “High-value item” is a contract end item that
  - Has a high unit cost (normally exceeding \$100,000 per unit), such as an aircraft, an aircraft engine, a communication system, a computer system, a missile, or a ship; and
  - Is designated by the CO as a high-value item
- The government will relieve contractors of contractual liability for loss of or damage to high-value items occurring after acceptance
- This relief does not limit the government’s rights arising under the contract to
  - Have any defective item or its components corrected, repaired, or replaced when the defect or deficiency is discovered before the loss of or damage to a high-value item occurs; or
  - Obtain equitable relief when the defect or deficiency is discovered after such loss or damage occurs



# Loss or Damage to Government Property

## ■ FAR Subpart 46.8

- Subject to the specific terms of the limitation of liability clause included in the contract, the contractor will not have relief from liability
  - To the extent that contractor liability is expressly provided under a contract clause authorized by the FAR;
  - When a defect or deficiency in, or government's acceptance of, the supplies or services results from willful misconduct or lack of good faith on the part of the contractor's managerial personnel; or
  - To the extent that any contractor insurance, or self-insurance reserve, covers liability for loss or damage suffered by the government through purchase or use of the supplies delivered or services performed under the contract



# Loss or Damage to Government Property

## ■ FAR Subpart 46.8

- “Contractor’s managerial personnel” defined as the contractor’s directors, officers, and any of the contractor’s managers, superintendents, or equivalent representatives who have supervision or direction of
  - All or substantially all of the contractor’s business;
  - All or substantially all of the contractor’s operations at any one plant, laboratory, or separate location at which the contract is being performed; or
  - A separate and complete major industrial operation connected with the performance of the contract



# Loss or Damage to Government Property

## ■ FAR Clauses

- FAR 52.212-4(p): “Except as otherwise provided by an express warranty, the Contractor will not be liable to the Government for consequential damages resulting from any defect or deficiencies in accepted items.”
- FAR 52.246-23, Limitation of Liability
- FAR 52.246-24, Limitation of Liability – High Value Items
- FAR 52.246-25, Limitation of Liability – Services



# Indemnification

## ■ FAR Clauses

- No FAR clause requiring contractors in fixed-price contracts to indemnify the government for loss or damage to person or property, similar to what is typically included in a commercial contract
  - Recall the contractor liability obligations for loss or damage to government property in the limitation of liability clause for willful misconduct or lack of good faith on behalf of managerial personnel
- Contractors must carefully review solicitations and contracts for indemnification clauses





# Indemnification

## ■ FAR Clauses

### – FAR 52.228-7, Insurance – Liability to Third Persons

- Applies to cost-reimbursement contracts, other than construction or architect-engineer contracts
- Requires the contractor to maintain insurance in a form, amount and duration required by the CO
  - Worker's Compensation
  - Employer's Liability
  - Comprehensive General Liability (bodily injury)
  - Comprehensive Automobile Liability (bodily injury and property damage)
  - Other insurance required by the CO under the contract
  - Contractor may maintain self-insurance with the CO's approval



# Indemnification

## ■ FAR Clauses

- FAR 52.228-7, Insurance – Liability to Third Persons
  - Contractor shall be reimbursed
    - For that portion of the reasonable cost of insurance allocable to the contract and required or approved under the clause; and
    - For certain liabilities (and expenses incidental to such liabilities) to third persons not compensated by insurance or otherwise without regard to and as an exception to the limitation of cost/fund clauses
      - Liabilities must arise out of performance of the contract
      - Regardless of whether the liabilities are caused by the negligence of the contractor or the contractor's agents, servants or employees
      - Must be represented by final judgments or settlements approved in writing by the government
      - Includes loss of or damage to property (other than that owned, occupied, used, rented, or in the possession of contractor) and death or bodily injury



# Indemnification

## ■ FAR Clauses

- **FAR 52.228-7, Insurance – Liability to Third Persons**
  - **Contractor shall not be reimbursed for liabilities**
    - For which Contractor is otherwise responsible under another contract clause
    - For which Contractor has failed to insure or maintain insurance required by the CO
    - Resulting from the willful misconduct or lack of good faith on the part of any of the contractor's directors, officers, managers, superintendents, or other representatives
  - **Notice to the government required if suit/claim filed and risk is uninsured or insured for less than the amount claimed**



# Indemnification

## ■ FAR Clauses

- FAR 52.228-8, Liability and Insurance – Leased Motor Vehicles
  - Applies to contracts for the leasing of motor vehicles
  - Government responsible for loss or damage to
    - Leased vehicle, except normal wear and tear and loss or damage caused by the contractor
    - Property of third persons or injury or death of third persons if government is liable under the Federal Tort Claims Act
  - Contractor required to indemnify the government against claims for loss or damage to property or the injury or death of persons resulting from the fault, negligence, or wrongful act or omission of the contractor, its agents, or employees



# Indemnification

## ■ FAR Clauses

### – FAR Subpart 27.2

- The exclusive remedy for patent or copyright infringement by or on behalf of the government is a suit for monetary damages against the government
- No injunctive relief available
- No direct cause of action against a contractor infringing a patent or copyright with the authorization or consent of the government while performing a contract

### – FAR Clauses

- FAR 52.227-1, Authorization and Consent
- FAR 52.227-2, Notice and Assistance Regarding Patent and Copyright Infringement



# Indemnification

## ■ FAR Clauses for Commercial Item Contracts

- FAR 52.227-3, Patent Indemnity
  - Only applies to commercial item contracts
  - Contractor required to indemnify the government and its officers, agents, and employees against liability, including costs, for infringement of any United States patent arising out of
    - The manufacture or delivery of supplies;
    - The performance of services;
    - The construction, alteration, modification, or repair of real property (“construction work”) under this contract; or
    - Out of the use or disposal by or for the account of the Government of such supplies or construction work
  - This indemnity shall not apply unless the Contractor shall have been informed as soon as practicable by the Government of the suit or action alleging such infringement and shall have been given such opportunity as is afforded by applicable laws, rules, or regulations to participate in its defense



# Indemnification

- **FAR Clauses for Commercial Item Contracts**
  - **FAR 52.227-3, Patent Indemnity**
    - **This indemnity shall not apply to**
      - Infringement of a patent issued upon an application that is withheld from issue pursuant to a Secrecy Order;
      - An infringement resulting from compliance with specific written instructions of the CO directing a change in the supplies to be delivered or in the materials or equipment to be used, or directing a manner of performance of the contract not normally used by the Contractor;
      - An infringement resulting from addition to or change in supplies or components furnished or construction work performed that was made subsequent to delivery or performance; or
      - A claimed infringement that is unreasonably settled without the consent of the Contractor, unless required by final decree of a court of competent jurisdiction



# Indemnification

## ■ FAR Clauses for Fixed-Price Construction Contracts

### – FAR 52.227-4, Patent Indemnity – Construction Contracts

- Applies to fixed-price construction contracts for dismantling, demolition, or removal of improvements
- Contractor indemnifies the government and its officers, agents, and employees against liability, including costs and expenses, for infringement of any United States patent arising out of performance of the contract or use or disposal by or for the account of the government of supplies furnished or work performed under the contract





# Indemnification

## ■ Subcontracts

- Consider the most common bases for indemnification
  - Breach of warranty
  - Product recall
  - Product liability
  - Intellectual property infringement
  - Third-party claims, personal injury, property damage, etc.
  - Failure to comply with applicable laws and regulations
- Conduct that requires indemnification
  - All acts or omissions of the subcontractor and its agents, employees, and lower-tier subcontractors
  - Negligence
  - Gross negligence
  - Exclude claims arising from the Prime's own negligence



# Indemnification

## ■ Subcontracts

- Who will be indemnified?
  - Buyer
  - Buyer's affiliates
  - Buyer's customer
- Scope of costs recovered through the indemnification clause
  - All liability, loss, claims, actions, suits, judgments, settlements, costs and expenses
  - Attorneys' fees/costs of litigation and settlement
- Requirement to notify the higher-tiered contractor of the third party claims within a reasonable period of time
  - Address the Prime's involvement in the litigation, retaining of counsel, etc.
  - Address control of settlement



# Techniques to Reduce Risk

## ■ Subcontract Flowdowns

- Can include same FAR Clauses that are in the prime contract
  - Same version of clause as that in the prime contract
  - Include a statement replacing references
  - Shorten notice periods to permit the prime contractor to incorporate the subcontractor's input into responses to the government
- Can develop own clauses
  - Include all risks and potential liability to the government
  - Ensure enforceability in applicable jurisdiction
- If include both FAR clauses and commercial clauses, consider potential conflicting provisions



# Techniques to Reduce Risk

## ■ Limitation of Liability Clauses

- THE MAXIMUM LIABILITY, IF ANY, OF SELLER FOR ALL DAMAGES, INCLUDING WITHOUT LIMITATION CONTRACT DAMAGES AND DAMAGES FOR INJURIES TO PERSONS OR PROPERTY, WHETHER ARISING FROM SELLER'S BREACH OF CONTRACT, BREACH OF WARRANTY, NEGLIGENCE, STRICT LIABILITY, OR OTHER TORT, IS LIMITED TO AN AMOUNT NOT TO EXCEED THE PURCHASE PRICE OF THE PRODUCTS AT ISSUE IN THE CLAIM.



# Techniques to Reduce Risk

- **Exclusion of Implied Warranties**
  - **THE FOREGOING WARRANTIES ARE IN LIEU OF ALL OTHER EXPRESS AND IMPLIED WARRANTIES.**
  - **SELLER MAKES NO WARRANTIES OF MERCHANTABILITY OR FITNESS FOR A PARTICULAR PURPOSE, OR ANY OTHER EXPRESS OR IMPLIED WARRANTY, EXCEPT AS PROVIDED IN THIS PARAGRAPH.**
  - **SELLER EXPRESSLY DISCLAIMS AND EXCLUDES ANY IMPLIED WARRANTY OF MERCHANTABILITY OR FITNESS FOR A PARTICULAR PURPOSE AND ANY WARRANTY ARISING FROM USAGE OF TRADE OR COURSE OF DEALING.**



# Techniques to Reduce Risk

- **Exclusion of Consequential, Incidental, Special, and Punitive Damages**
  - **IN NO EVENT SHALL SELLER BE LIABLE TO BUYER FOR ANY SPECIAL, INCIDENTAL, INDIRECT, CONSEQUENTIAL, OR PUNITIVE DAMAGES, INCLUDING WITHOUT LIMITATION LOST REVENUES AND PROFITS, LOSS OF VEHICLE OR EQUIPMENT, LOSS OF TIME, AND/OR MONETARY REQUESTS RELATING TO RECALL EXPENSES AND REPAIRS TO PROPERTY INCLUDING THIRD PARTY CLAIMS, EVEN IF IT HAS BEEN ADVISED OF THE POSSIBILITY OF SUCH DAMAGES.**



# Techniques to Reduce Risk

## ■ Procurement of Insurance

### – General Liability

- Does not cover damage to the product itself resulting from a defect in the product
- Requires allegation of injury to person or damage to property resulting from the product defect
- Includes advertising injury
- Does not cover intentional torts or criminal conduct

### – Directors & Officers Liability (D&O)

- May cover defense costs in a defective product claim

### – Carefully review all policies to understand what is and is not covered



# Techniques to Reduce Risk

- **Maintaining Adequate Records (e.g., critical path schedules)**
  - **Documentation critical to demonstrate that you are not at fault**
    - **Goods are not defective**
    - **Services conform to contract requirements**
    - **Delays are caused by the government, the higher-tiered contractor, or one of the government's other contractors**





# Questions

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