



Best Practices in Drafting U.S. Government Subcontract Terms and Conditions

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Overview

- FAR Clauses vs. Uniform Commercial Code
- Battle of the Forms
- Terms and Conditions
 - Warranty
 - Changes
 - Terminations for Default
 - Terminations for Convenience
- Innovative Techniques for Reduction of Risk



FAR Clauses vs. Uniform Commercial Code



FAR Clauses vs. Uniform Commercial Code

■ Prime Contracts

- Formation and administration of U.S. Government prime 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)

FAR Clauses vs. Uniform Commercial Code



■ Prime's Perspective

- Prime Contractor (Prime) usually has the most bargaining power
- There are some clauses in the prime contract that must be flowed down, or the Prime 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's requirements, some provisions are likely not applicable

FAR Clauses vs. Uniform Commercial Code



■ Prime's Perspective

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

FAR Clauses vs. Uniform Commercial Code



■ Subcontractor's Perspective

- Subcontractor needs to accept the clauses the Prime 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's legitimate risk, or that cause a burden on the subcontractor
- Challenge for the subcontractor is to convince the Prime 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

FAR Clauses vs. Uniform Commercial Code



- U.S. Government subcontracts are also governed by commercial law such as the Uniform Commercial Code (U.C.C.), other statutory laws or the common law
 - Note Article 2 of the U.C.C. only applies to the sale of goods
 - The U.C.C. has been enacted in all 50 states and the District of Columbia, the Commonwealth of Puerto Rico, Guam and the U.S. Virgin Islands
 - The goal behind the U.C.C. is to harmonize state law because most transactions involving the sale of goods extend beyond one state
 - For example, the manufacture, storage, purchase and sale of goods may involve several states



Battle of the Forms



Battle of the Forms

- Contracting parties exchange form documents:
 - RFQs
 - Quotations
 - Purchase orders
 - Invoices
- Typically reference or attach each party's standard terms and conditions
 - Buyers include terms and conditions favorable to buyers
 - Sellers include terms and conditions favorable to sellers
 - Both may say that terms are "exclusive" and expressly reject other side's terms

Battle of the Forms



- The result is a “battle of the forms”
 - What constitutes the offer and acceptance?
 - U.C.C. 2-207 and additional terms
- **Key Take-Away:** If a term is essential, be sure to negotiate it explicitly and obtain the other party’s explicit agreement

Terms and Conditions



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 or law, to repair or replace the goods or Buyer's product incorporating the goods, if the goods are defective or nonconforming to any warranties

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
 - Good is reasonably fit for the ordinary purposes for which such items are used

Warranty



■ Subcontracts – Implied Warranties Under the U.C.C.

- 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 appropriate for such particular purpose
- Implied warranties apply to subcontracts governed by the U.C.C., unless they are disclaimed

Warranty



■ Prime Contracts – FAR Subpart 46.7

- “The use of warranties is not mandatory” (FAR 46.703)
- 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



■ Prime Contracts – 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



■ Prime Contracts – 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



■ Prime Contracts – 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

■ Prime Contracts – Cost-Reimbursement

- Contracting Officer (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 unless...
 - Contractor does not promptly repair/replace;
 - Nonconformance is due to fraud, lack of good faith, or willful misconduct on the part of the contractor’s managerial personnel; or
 - Nonconformance is due to a habitually careless or unqualified employee
- The contractor is **not** entitled to receive an additional fee on replacement supplies or services and the fee may be reduced if the contractor does not promptly repair/replace
- Failure to promptly repair/replace can also result in a termination for default of the contract

Warranty

■ Prime Contracts – Commercial Items

- 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



■ Prime Contracts – Commercial Items

- 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**
 - “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



■ Key Take-Away

- Scope and length of warranty from subcontractor should parallel the Prime’s warranty to the government

Changes



- Changes clauses in commercial contracts vary depending on leverage and, sometimes, attention to detail
- Generally set forth scope of permissible changes, and process for payment
 - Buyer discretion for adjustments for changes?
 - Equitable price adjustments for all changes?
 - Price adjustment for only “cost-impact” changes?
- If not addressed in the subcontract, then every change may open the door for negotiation of all terms

Changes



- Most written agreements contain a requirement that all modifications must be in a writing signed by authorized representatives from each of the parties
- A requirement that modifications be in writing will not always bar enforcement of an oral modification
- Modifications may also be evidenced by the conduct of the parties
- **Key Take-Away:** If a party presents clear and convincing evidence establishing mutual agreement to modify the contract, the change to the written agreement will be enforced

Changes



■ Prime Contracts

- In **non-commercial item contracts**, the government has the right to unilaterally issue change orders within the general scope of the prime contract
 - Prime can submit a request for equitable adjustment (REA) in terms of cost or schedule extension (or both) due to the change
 - Contractor has a duty to proceed with the contract as changed, even if the parties have not yet agreed on the amount of the REA (FAR 52.243-1(e))
- For **commercial item contracts**, all changes must be mutually agreed upon between the parties (FAR 52.212-4(c))

Changes



■ What Constitutes a “Change” Under the Changes Clause?

- Goods
 - Drawings, designs, or specifications when the supplies to be furnished are to be specially manufactured for the government in accordance with the drawings, designs, or specifications
 - Method of shipment or packing
 - Place of delivery
- Services
 - Description of services to be performed
 - Time of performance (i.e., hours of the day, days of the week, etc.)
 - Place of performance of the services
- **Does not include:**
 - Unilateral changes to the contract terms and conditions
 - Cardinal changes – outside the scope of the contract

Changes



■ Notice of Intent to Submit an REA

- Written notice should be submitted 30 days from the date of receipt of the written order
- The CO retains the right to receive and act upon a proposal submitted before final payment of the contract
- It is also well settled that oral requests for an equitable adjustment will not be barred based on the lack of written notice
- Where the government is “aware of the operative facts” that give rise to the REA, the contractor will not be barred from recovery because of lack of written notice
- Best practice is to give notice and avoid the issue, if possible

Changes



■ Prime's Perspective

- Prime needs to flow down the ability to make unilateral changes with its subcontractors in the event of a government unilateral change
 - Flowdown applicable FAR Changes clause
 - Shorten the notice time periods to permit the Prime to include subcontractors' REAs in Prime's REA to the government
 - Require subcontractors to proceed with performing the subcontract as changed while the REA is pending
 - Failure to agree on a REA is a dispute under the Disputes clause of the subcontract
- In event of government bilateral change, changes may be mutually agreed upon between the Prime and its subcontractors
- Prime's receipt of final payment is a bar to the subcontractor's submission of REAs or claims

Changes

■ Subcontractor's Perspective

- Subcontracts should draw a distinction between a government-directed change and a Prime-directed change with respect to:
 - Unilateral vs. bilateral nature
 - Cost and schedule adjustments
 - Utilization of the Disputes clause
 - The nature of the change the subcontractor is willing to consider
 - Requirement to proceed with the change as directed by the Prime
 - Final payment as a bar to submission of claims

Termination for Default

■ Prime Contracts – Justifications for Termination

- 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 or comply with any terms and conditions in the contract

Termination for Default



■ Prime Contracts – Notice

- Show cause notice / cure notice is required prior to the government's termination for default
 - No notice required to terminate for default for a delay in delivery / performance
 - Commercial item prime contracts do not contain a show cause notice / cure notice requirement
- Contractor typically has 10 days to respond / cure the identified deficiencies

Termination for Default



■ Prime Contracts – Commercial Item

- FAR 52.212-4(m)
 - Government not liable to Contractor for supplies or services not accepted
 - Contractor shall be liable to the Government for any and all rights and remedies provided by law

Termination for Default



■ Prime Contracts – Fixed-Price, Non-Commercial Item

- 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 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



■ Prime Contracts – Reprocurement Requirements

- Government can procure “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 reprocurement 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 contractor
 - The Boards have **not** permitted the government to adjust the excess costs to account for the differences

Termination for Default



- Prime Contracts – Reprourement Costs
 - Government has a duty to mitigate its damages
 - Government must act reasonably in:
 - Selecting the reprourement contractor
 - Establishing the reprourement price
 - Government must show costs were incurred
 - i.e., the reprourement contract is complete and the replacement contractor has been paid
 - Government can recover reprourement costs incurred during the entire reprourement 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 reprourement costs

Termination for Default



- Prime Contracts – 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 reprourement
 - 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



■ Prime Contracts – Cost Reimbursement

- 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 for All Types of Contracts

- 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
- May adversely impact responsibility determinations in future procurements

Termination for Default



- 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



- Subcontracts - Broad Range of Potential Damages
 - 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

Termination for Default



- **Prime's Perspective**
 - Same negotiation dynamic as prime contracts
 - Prime wants unbridled discretion
 - Subcontractor wants as many limitations as possible
 - Clearly identify the events that support a default of the subcontractor
 - Breach
 - Insolvency
 - Cost-competitiveness
 - Change in control
 - Shorten the subcontractor's cure period to less than 10 days (e.g., 7 days)

Termination for Default



■ Subcontractor's Perspective

- Subcontractors should seek to limit the Prime's ability to terminate for default to those bases included in the FAR clauses in the prime contract
- Delays caused by Force Majeure events should not provide the Prime with a basis to terminate for default
- 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 Convenience



- One of the most hotly contested provisions in most commercial contracts
- Outcome depends on leverage
 - Long-term Agreement vs. Order-by-Order
 - Recovery of Capital, Tooling, Investment Costs
 - Be wary of disclaimers
 - Permissible obsolescence claims typically are limited

Termination for Convenience



■ Prime Contracts

- Government may unilaterally terminate for convenience the prime contract at any time, including commercial item contracts
- Only limitation is that the Government may not do so in bad faith

■ Fixed-Price, Non-Commercial Item (FAR 52.249-2)

- When a Prime receives a notice of termination for convenience, the Prime must:
 - Stop all work on the portion of the contract terminated;
 - Place no further subcontracts;
 - Cancel existing subcontracts; and
 - Deliver to the government all completed work and all material acquired for the work terminated
- The Prime has a duty to mitigate costs (e.g., use materials purchased for the terminated contract for other contracts)
- The Prime must submit termination inventory schedules within 120 days after the effective date of the termination

Termination for Convenience



■ Prime Contracts – Fixed-Price, Non-Commercial Item (FAR 52.249-2)

- Final termination settlement proposal due within 1 year from the effective date of the termination
 - Prime entitled to receive:
 - Contract price for completed work (includes profit unless the Contractor was in a loss position)
 - Costs incurred for work terminated (initial costs and preparatory expenses)
 - Cost of subcontract termination settlement proposals
 - Reasonable costs of settlement (accounting, legal, clerical, and other expenses incurred to submit proposal), storage, and transportation
 - Total may not exceed the total contract price less the amount of payments previously made and the contract price of the work not terminated, plus settlement costs
- Calculations subject to cost principles in FAR Part 31
 - For Fixed-Price contracts, FAR Part 31 used as a guide, but not strictly applied

Termination for Convenience



- Prime Contracts – Commercial Item (FAR 52.212-4(l))
 - No requirement to submit inventory schedules or a termination settlement proposal within a specified period of time
 - Entitles the Prime to receive:
 - A percentage of the contract price reflecting the percentage of work performed prior to the termination; and
 - Reasonable charges resulting from the termination
 - The Prime can support these figures with documents from its standard recordkeeping system
 - The Prime does not need to comply with cost accounting standards or cost principles

Termination for Convenience



- Prime's Perspective
 - Not a required flowdown **BUT** Primes should flowdown the clause to all subcontractors
 - Provide subcontractors with the right to submit a termination settlement proposal to recover for work performed prior to the termination, as well as termination settlement expenses
 - Shorten the 1-year termination settlement proposal period, so that the Prime can include any subcontractor proposals in the Prime's proposal to the government
 - Note that subcontractors do not have to accept terminations for the Prime's convenience
 - Limit Subcontractor's recovery to the amount the Prime receives from the government, less the Prime's mark-up

Termination for Convenience



■ Subcontractor's Perspective

- The subcontractor may want to distinguish between a government-directed termination for convenience and a Prime-directed termination for convenience
 - Note the Prime-directed termination right may arise from the inclusion of the FAR termination for convenience clause with a general "change the government to contractor" incorporation
- The subcontractor wants to have the same rights and recoveries as the Prime if the government terminates for convenience

Innovative Techniques for Reduction of 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 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 includes both FAR clauses and commercial clauses, consider potential conflicting provisions

Indemnification



- Prime Contracts
 - 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
 - **BUT**, the Prime has 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



■ 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/government's own negligence

Indemnification



■ Subcontracts

- Who will be indemnified?
 - Prime
 - Prime's affiliates
 - Prime's customer / government
- 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

Limitation of Liability and Remedies, In General



- The parties to a contract may agree to fix or limit liability, remedies or damages
- This is accomplished by using one of two methods:
 - First, the parties may agree to limit remedies that would otherwise be available
 - Second, the parties at the time of contracting may agree to fix the damages that will be owed in the event of a breach by either party

Limitation of Liability and Remedies, In General



- There are several important and interrelated reasons to include such limitations in a contract for the sale of goods
 - The seller may include limitations to reduce risk
 - For example, by including a damages cap or by excluding certain categories of damages, the seller may reduce or, in some cases, eliminate its liability for certain damages in the event of breach
 - The seller also may want to enhance predictability
 - By including a liquidated damages provision, an uncertain and indefinite exposure for breach of contract can be turned into a known quantity
 - Finally, limitations of both kinds are important for business planning purposes
 - A seller may rely on these provisions in pricing its goods, performing financial forecasting and even obtaining insurance coverage

Limitation of Remedies



- Under the U.C.C., parties may limit or alter remedies
- The contract should explicitly state that such remedies are the exclusive remedies
- Otherwise, there may be a presumption that the remedies are cumulative to other remedies available under the U.C.C.

Limitation of Remedies



- There are two common types of limited remedy provisions:
 - First, a seller may restrict the buyer's remedies to repair or replacement of the nonconforming goods or services
 - Second, a seller may limit the remedy to the buyer to credit for the goods returned or defective services performed

Limitation of Remedies



- If an exclusive limited remedy fails of its essential purpose, it is unenforceable and a buyer is then entitled to all available remedies under the U.C.C.
 - Ex: A remedy will be deemed to fail of its essential purposes where there is an exclusive repair remedy, but repeated attempts to repair do not fix the issues
- **Key Take-Away:** As long as minimum adequate remedies are left for the aggrieved party, the limitation of remedies will not be deemed to fail of its essential purpose

Exclusion of Implied Warranties



- Once an express warranty is made, it cannot be disclaimed
- Conversely, sellers can and often do disclaim implied warranties
- A disclaimer may contain the term “as is” or similar language to disclaim any implied warranty

Exclusion of Implied Warranties



- Disclaimers of implied warranties generally are enforceable, as long as the requirements set forth in the U.C.C. have been met
- To disclaim the implied warranty of merchantability through express language in the contract, the disclaimer must specifically mention merchantability and must be conspicuous
- Similarly, to disclaim the implied warranty of fitness, the exclusion must be in writing and must be conspicuous
- **Key Take-Away:** Although a court will view the disclaimer of implied warranties in the context of all of the sales documentation, often a disclaimer that is bold-faced and in all capitalized font will be sufficient to meet the conspicuousness requirement

Exclusion of Damages



- Exclusion of Consequential, Incidental, Special, and Punitive Damages
- Damages caps

Setoff



- Setoff allows parties with mutual claims to offset such claims against one another – even different transactions and possibly affiliates
- Setoff rights can be defined by contract
- Can allow for setoff across different contracts between parties and affiliates
- **Key Take-Away:** Setoff rights specified in terms and conditions are critical

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



■ Prime Contracts – 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
- FAR 52.211-12, Liquidated Damages - Construction
- FAR 52.219-16, Liquidated Damages - Small Business Subcontracting Plan
- FAR 52.222-4, Contract Work Hours and Safety Standards Act

Liquidated Damages



■ Prime Considerations:

- Include in subcontract the right to assess liquidated damages incurred by the Prime as a result of the subcontractor's delay or default
- Use the rate included in the prime contract, or a higher rate to compensate the Prime for additional damages

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 or other reasonable cap
- Agree to pay liquidated damages only if delay or other breach was solely caused by the subcontractor, its employees, agents, or lower-tier subcontractors

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

Maintaining Adequate Records



- Documentation critical to demonstrate that you are not at fault (e.g., critical path schedules)
 - 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?



Questions



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