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# The Clause

*A Quarterly Publication of the Boards of Contract Appeals Bar Association, Inc.*

## **The President's Column**

Dear BCABA Members:

Welcome to the March, 2013 edition of *The Clause*. Our Editor, Pete McDonald, has as usual assembled a fine collection of articles that should be of interest to our government contract law practitioners. It is a privilege to serve as the 2013 President of the Boards of Contract Appeals Bar Association, Inc. I would like to thank Chip Purcell and Judge Gary Shapiro for their leadership in 2012, and look forward to working with Judge Shapiro, the other officers, and our Board of Governors to maintain the extraordinary momentum that Chip gained for the BCABA, Inc last year.

When I started helping clients resolve government contract issues in controversy in 1995, I immediately felt at home with the federal procurement bar. Over the years, I have found our community of public contract law attorneys to be a collegial, professional, and welcoming group. Nowhere is this more evident than with the BCABA, Inc. We are association of judges, attorneys, legal assistants, and other professionals dedicated to supporting and improving the practice of law before the Boards of Contract Appeals of the Federal Government. We offer our members a wide variety of annual events focused to that end, including our Colloquium, BCA Judges Reception, Executive Policy Forum, and, mark your calendars now -- our Annual Program will be on October 17, 2013. We are also  
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**President's Column (cont'd):**

continuing our regular networking events -- so please keep an eye out for program announcements.

Our first event of 2013, the Annual Trial Practice Seminar, was held on February 15. Panel members, who included Judge Diana Dickinson of the Armed Services Board of Contract Appeals, Judge Allan Goodman of the Civilian Board of Contract Appeals, Judge C. Scott Maravilla of the FAA's Office of Dispute Resolution, and Robert Fitzgerald of Watt, Tieder, Hoffar and Fitzgerald, engaged in a wide-ranging conversation about issues relevant to the litigation processes before the boards of contract appeals. Congratulations to Shelly Ewald of Watt, Tieder and Alan Caramella, the Air Force Chief Trial Attorney, for putting on this well attended and well received event. We are also very thankful to The George Washington University Law School Government Procurement Law Program for partnering with us again.

With sequestration hitting on the heels of a seemingly unrelenting series of budget battles, continuing resolutions and debt ceiling squabbles, the uncertainty regarding federal budgets keeps on coming. Since the downstream impacts will play out throughout 2013 and beyond, we in the BCABA are uniquely armed with knowledge and expertise that should keep us busy for the foreseeable future. We recognize that our members -- especially government practitioners -- are also likely to feel the impacts of these challenging circumstances, and we are working to ensure our events are worth your professional time and an extraordinary value proposition.

I look forward to seeing you at BCABA events throughout the year, and encourage you to take advantage of the opportunity to continue developing relationships with members of the government contracts bar.

Best regards,

Donald M. Yenovkian  
President  
BCABA, Inc.



## **Bored of Contract Appeals (a.k.a. The Editor's Column)**

by

Peter A. McDonald

C.P.A., Esq.

(A nice guy . . . basically.)

Leading this issue is a discerning analysis of the standard indemnification clause by Jennifer Izzo. In the next article, Jay DeVecchio and Damien Specht highlight the legal hurdles contractors face when trying to challenge an adverse past performance evaluation. In her article, Krista Pages shows how the R&D market has significantly changed due to government cutbacks, i.e., the technology agencies now want was developed in the private sector. Finally, Kristen Ittig and myself discuss the similarities and differences among the various clauses that may be used to delay a contractor's performance, the costs for which the government may be liable.

*The Clause* will reprint, with permission, previously published articles. We are also receptive to original articles that may be of interest to government contracts practitioners. But listen, everybody: You really shouldn't take all this government contract stuff too seriously. And as usual, we received some articles that were simply unsuitable for publication, such as: "Pete 'Ghosted' Again!"; "Contractors Flood Firms with Work!!"; and "Anger Management Class Pommels Pete!!!"



## **Reminder of Cheap Annual Dues**

This is to remind everyone about the BCABA, Inc., dues procedures:

- ☺ Dues notices will be emailed on or about **August 1st**.
- ☺ Annual dues are **\$30** for government employees, and **\$45** for all others.
- ☺ Dues payments are due NLT **September 30th**.
- ☺ There are no second notices.
- ☺ Gold Medal firms are those that have all their government contract practitioners as members.
- ☺ Members who fail to pay their dues by September 30th do not appear in the Directory and do not receive *The Clause*.
- ☺ Members are responsible for the accuracy of their information in the Membership Directory, which is maintained on the website (bcaba.org).

**Members are reminded that they are responsible for maintaining the accuracy of their information in the BCABA Directory.**

## Anatomy of an Indemnification Clause

by  
Jennifer Izzo\*

[Note: Reprinted with permission of the National Contract Management Association, *Contract Management* magazine, January 2013.]

Nobody wants to admit that they don't understand indemnification. We all know, in the abstract, that indemnification clauses are important — they are the primary place in the contract where the parties hash out who will bear the risk of something goes wrong. Yet, when it comes down to it, do we truly understand what the words in the clause actually mean, or how to negotiate a clause that is fair and appropriate?

This article examines a typical indemnification clause in a government subcontract from the perspective of both the prime contractor and subcontractor. Although the focus is on government subcontracts, most of the material in this article is equally applicable to a commercial context. This article is not intended to offer legal advice; your organization's unique needs and concerns will dictate the appropriate language for the indemnification clause. Instead, this article will provide a general framework for the types of issues and compromises inherent in negotiating indemnification.

Indemnification is a promise by one party to assume the other party's risk for future damages. The party being indemnified is called the "indemnitee" and the party doing the indemnifying is called the "indemnitor." The scope and nature of the indemnification obligation will vary according to the exact words in the agreement.

The underlying goal in any indemnification negotiation should be to arrive at a fair allocation of risk between the two parties. As much as the parties would love to shift all their risk to the other, this tactic is not conducive to getting deals done efficiently. Ideally, the risk should be borne by the party best able to mitigate or avoid the risk in the first place. For example, if a subcontractor is hired because of its specialty of manufacturing unbreakable widgets, then the subcontractor should bear the risk of the widget's breaking and causing damage. If, on the other hand, the subcontractor is incorporating a critical component made by the prime contractor into the subcontractor's final deliverable, then the prime contractor should indemnify the subcontractor if its component causes the subcontractor's product to fail and harm is caused.

In reality, we know that more often than not, the allocation of risk reflects the relative bargaining power of the parties more than a rational calculation of roles and abilities. If the subcontractor wants to win the subcontract badly enough, it might be willing to indemnify the prime contractor no matter what the circumstances. Conversely, if the subcontractor feels strongly enough about avoiding liability, it may decide to forego the work altogether. Lack of understanding about the meaning of the contractual language can also be to blame for an

*(continued on next page)*

## **Anatomy of an Indemnification Clause (cont'd):**

irrational indemnity outcome. The subcontractor might not truly understand what it is signing up for, or the prime contractor might find it easier to refuse to change overly protective language in its standard form contract rather than muddling through complicated negotiations about indemnity.

Let's look at a typical indemnification clause that could be found in the standard contract template of a prime government contractor:

Subcontractor shall indemnify and hold harmless the prime contractor and its officers, directors, agents, employees and customers from and against claims, damages, losses, and expenses, including but not limited to attorneys' fees arising out of, relating to, or resulting from:

- A. The performance of the work by the subcontractor or its subcontractors;
- B. Any action by a third party that is based upon a claim or alleged claim that the work performed or delivered hereunder infringes or otherwise violates the intellectual property of any person or entity;
- C. Any violation of applicable laws, including, without limitation, violation of U.S. export control laws and regulations; and/or
- D. Any breach of the subcontract by subcontractor, including, without limitation, failure to deliver products that are free from defects in workmanship, materials, and design.

When faced with a provision like this, how might negotiations go between the contract administrators and/or counsel for the subcontractor and the prime contractor? What changes should the subcontractor seek to make to the prime's language?

This article will first look at the introductory paragraph of the clause, which applies to all of the types of harm against which the prime wants to be indemnified. It will then look at each of the paragraphs in the clause, one by one:

- Paragraph A deals with damages incurred by third parties outside of the contract;
- Paragraph B is about intellectual property infringement claims brought by third parties;
- Paragraph C addresses damages caused by the subcontractor's violation of applicable laws; and
- Paragraph D deals with the subcontractor's breach of the subcontract terms.

### **Introductory Paragraph of the Clause**

#### **- Limit to Third Party Claims**

The first thing the subcontractor should consider is inserting the words "third party"

*(continued on next page)*

## **Anatomy of an Indemnification Clause (cont'd):**

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in the first paragraph of this clause. This may seem like an innocuous change, but neglecting to do so can lead to unintended bad results. Without that language, the prime contractor could insist that the subcontractor must pay the prime contractor's own damages—and even its attorneys' fees in the event the prime contractor sues the subcontractor. The subcontractor should attempt to make the following edit to the clause: "...from and against all *third-party* claims...."

### **- Indemnify, Hold Harmless, and Defend**

The words "indemnify, hold harmless, and defend" usually go hand-in-hand in an indemnification clause, but they each have their own meaning. An indemnity requires the indemnitor to reimburse the indemnitee for liability to a third party. The duty to defend requires the indemnitor to pay the costs of preparing and defending a lawsuit brought against the indemnitee by a third party. The duty to indemnify arises only after the indemnitee's liability is determined, whereas a duty to defend exists as soon as a claim is alleged which, if proved, would trigger the duty to indemnify. Finally, the duty to "hold harmless" means that the indemnitor cannot sue the indemnitee for the harm contemplated in the clause. A "hold harmless" clause is defensive while an indemnification clause is offensive.<sup>1</sup>

The sample indemnification clause in this article requires the subcontractor to indemnify and hold harmless the prime contractor, but doesn't include the duty to defend. Sometimes, the prime contractor might not want the subcontractor to defend it in court, particularly if the prime contractor's legal resources are more sophisticated or substantial. Most of the time, however, the prime contractor will insist on having all three terms in the clause so as to grant itself the maximum amount of protection. Being defended by the subcontractor will shield the prime contractor from having to undertake expensive litigation before seeking reimbursement from the subcontractor. The prime contractor might suggest language like this: "...indemnify, hold harmless, *and defend*...."

The subcontractor would prefer to use as few phrases as possible to avoid liability in the event things go sour. If the subcontractor does agree to defend the prime contractor, then it may want to add additional language to keep its costs as low as possible. For example, the subcontractor might insist that the prime contractor promptly notify it of the claim and cooperate in the defense.

### **- Attorneys' Fees**

Asking the indemnitor to cover legal fees is par for the course in contracts today. The best the subcontractor can do is demand that the fees be reasonable with language similar to the following: "...including but not limited to *reasonable* attorneys' fees...."

(continued on next page)

## **Anatomy of an Indemnification Clause (cont'd):**

### **- Who is the Subcontractor Indemnifying?**

The clause calls for the subcontractor to indemnify the prime contractor and its officers, directors, agents, employees, and customers. The subcontractor could think about striking the word “customer” from this clause. It does not want to be in the position of indemnifying the prime contractor’s customers, including the U.S. government or higher-tier subcontractors.

### **- Against Whose Behavior is the Prime Contractor Being Protected?**

The prime contractor will generally ask that the subcontractor indemnify it against damages caused not only by the subcontractor’s own acts and omissions, but also the acts or omissions of the subcontractor’s subcontractors. The prime contractor has absolutely no control over the behavior of the subcontractor’s subcontractors. The subcontractor may want to consider accepting the language and then pass on the indemnification obligations to its own subcontractors.

### **- Liability Cap**

The dollar amount of the subcontractor’s potential liability to the prime contractor is currently uncapped. The subcontractor may want to try to limit its liability with an overall cap similar to the following: *“The subcontractor’s total liability to prime contractor under this indemnification section shall not exceed \$5 million.”*

The subcontractor could also suggest that the cap be equal to the value of the contract, or the value of the subcontractor’s general liability insurance (which will likely be several million). Any such a cap would not apply to damages caused by the subcontractor’s intentional misconduct, nor would it limit the subcontractor or prime contractor’s liability to parties outside of the subcontract. Third parties who have not signed the subcontract are obviously not bound by the limitation on liability provisions. The subcontractor might also ask that the prime contractor have an affirmative obligation to mitigate its damages and/or look to its own insurance coverage as the first remedy.

The prime contractor, of course, prefers to avoid a liability cap because it erodes the value of the subcontractor’s indemnity. Then again, there are valid reasons why the prime contractor might agree to cap the subcontractor’s liability. Perhaps the prime contractor really needs the subcontractor’s special capabilities and is willing to take on some of the risk in order to get the subcontractor under contract, or perhaps the subcontractor’s price might be prohibitively high if the subcontractor is forced to bear all of the risk on its own.

### **- Insurance Provisions**

The promise to indemnify another party is only as good as the depth of the indemnitor’s

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## **Anatomy of an Indemnification Clause (cont'd):**

pockets. If the indemnitor lacks the funds to defend a claim or pay damages, then its promise to indemnify doesn't mean much. The prime contractor should demand that the subcontractor carry adequate insurance to protect its interests. This is generally addressed in another section of the contract.

### **- Exclude Indirect, Consequential, or Special Damages**

Excluding indirect damages from the subcontractor's overall liability is another technique that the subcontractor can utilize to minimize its risk. Unlike direct damages, which are directly related to failing to perform an obligation under a contract, indirect damages are one step removed from the contract breach. They occur when the contract breach has caused further losses in other transactions or activities that were dependent upon the contract being performed. Examples of indirect damages include loss of profits, loss of reputation or goodwill, and loss of business opportunity. The language that the subcontractor might seek could look like this:

*In no event shall the subcontractor be liable for any special, indirect, incidental, or consequential damages, regardless of the legal theory under which such damages are sought, and even if it has been advised of the possibility of such damages.*

The prime contractor, for its part, will likely insist that the limitation be made mutual. In addition, the prime contractor might agree to exclude indirect damages only with respect to contract breaches, not the subcontractor's indemnification obligations. Thus, the prime contractor would insert the phrase "*except for the subcontractor's indemnification obligations hereunder...*" in front of the subcontractor's proposed language.

### **- Mutuality**

The indemnification clause is one-sided in favor of the prime contractor. The subcontractor may ask to make the indemnification obligations mutual. However, getting the prime contractor to concede may not really offer much value. The subcontractor needs to ask itself if the prime contractor is actually *doing* anything under the subcontract, other than paying the subcontractor. Also, does the prime contractor have other subcontractors for the same program who could bring a claim against the subcontractor? If neither is true, then there may be little point in negotiating this issue because the prime contractor has no obligations where the breach of which could cause serious harm to the subcontractor. The prime contractor, for its part, will likely want to refuse to make the indemnification clause mutual because it will want to avoid questions of proof of who is responsible for the harm.

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## **Anatomy of an Indemnification Clause (cont'd):**

### **Paragraph A: Third-Party Claims for Personal Injury or Property Damage**

Paragraph A contemplates the classic harm that indemnification clauses are meant to avoid. The language protects the prime contractor against claims made by third parties for personal injury or property damage as a result of the subcontractor's work under the subcontract. Unless the subcontractor has a very strong bargaining position in the subcontract negotiation, it will likely have to accept some form of third-party indemnification. The following are techniques that the subcontractor can employ to minimize its liability.

#### **- Limit to Third-Party Claims for Personal Injury and Property Damage**

The prime contractor's intention here is likely to limit the subcontractor's liability to third-party claims to personal injury or property damage. However, that's not what the language actually says. One could read the language to include *any* claims for damages, whether brought by third parties or by the prime contractor itself. Such an interpretation could have the peculiar result of forcing the subcontractor to indemnify the prime contractor for claims brought by the prime contractor against it! If the subcontractor is successful in inserting the words "*third party*" in the introductory paragraph, as previously described, then this concern should be alleviated.

#### **- Limit to the Subcontractor's Negligent or Wrongful Acts**

Under the current language, the subcontractor is responsible for any harm to third parties, no matter how well or diligently the subcontractor performs. The subcontractor could try to limit its liability by agreeing to indemnify the prime contractor only for claims arising from the subcontractor's gross negligence or intentional misconduct. *Gross negligence* means a reckless disregard of the safety or rights of others. That is a very high bar to meet in a subcontract context, basically amounting to incompetence bordering on malpractice. Examples of gross negligence could be purposefully choosing to ignore safety regulations or testing dangerous equipment in the middle of a busy street.

If the prime contractor is unwilling to limit the subcontractor's liability to its grossly negligent acts, then the subcontractor could try for a simple (read: "ordinary") negligence standard. *Negligence* means a failure to use ordinary, reasonable care that is neither gross nor wanton. An example could be mere carelessness, like forgetting to "carry the one" while performing a math equation or inadvertently allowing a test sample to become contaminated despite having safeguards in place.

The prime contractor would prefer to keep the original language because its risks from third-party suits connected to the subcontract are greatly reduced. Imposing a negligence standard will force the prime contractor to bring the subcontractor to court to litigate the factual

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## **Anatomy of an Indemnification Clause (cont'd):**

question of whether the subcontractor acted negligently or reasonably. Nonetheless, at the end of the day, the prime contractor may give on this point because using a negligence standard conforms to industry practice. The language that the parties might add is: “*The performance of the work by negligent acts or omissions of the subcontractor or its subcontractors.*”

### **- Exclude the Prime Contractor’s Negligent Behavior**

Another change that the subcontractor might suggest is that the prime contractor’s negligent acts should be excluded from the subcontractor’s indemnification obligations: “...except to the extent caused in whole or in part by the prime contractor.” Speaking practically, this seems fair and reasonable—why should the subcontractor be liable for damages caused by the prime contractor? Of course, the subcontractor’s ability to convince the prime contractor depends on how much leverage the subcontractor has in the negotiation, and whether the contract administrator for the prime contractor is reasonable.

### **- Exclude Government Obligations**

Federal Acquisition Regulation (FAR) 52.228-7, “Insurance—Liability to Third Persons,” is a required clause for government cost reimbursement prime contracts. When included in a contract, it provides that the government will indemnify the contractor for liabilities that are not covered by its required insurance coverage (with certain exceptions). The subcontractor should consider clarifying that it will not indemnify the prime contractor in the event the U.S. government is contractually obligated to do so for the same injuries. Otherwise, the prime contractor could be in the enviable position of being able to look to either the subcontractor or the government to cover damages beyond its insurance coverage. The language that the subcontractor might seek is: “*Subcontractor’s obligation to defend, indemnify, and hold harmless prime contractor shall not apply to the extent FAR 52.228-7, ‘Insurance—Liability to Third Persons,’ applies to the prime contract.*”

The subcontractor may be tempted to ask the prime contractor to flow down FAR 52.228-7 in the subcontract. However, FAR 52.228-7 does not apply to subcontracts unless the government expressly consents. If the prime contractor agrees to incorporate FAR 52.228-7 into the subcontract without the government’s buy-in, then the prime contractor is essentially agreeing to indemnify the subcontractor itself. The prime contractor would then be free to turn around and seek indemnification from the government for the prime contractor’s own damages.

### **Paragraph B: Intellectual Property Infringement**

Paragraph B requires the subcontractor to indemnify the prime contractor in the event a third party makes a claim asserting infringement of a patent, copyright, trade secret, or other intellectual property rights. The subcontractor’s decision whether to indemnify the prime contractor for IP infringement is highly fact-dependent. It depends on the following:

*(continued on next page)*

## **Anatomy of an Indemnification Clause (cont'd):**

- The subcontractor's level of sophistication and its resources;
- The relative bargaining power of the parties;
- The nature of the product or service being delivered; and
- Whether the contract is paid for with government funds.

The following are measures that the subcontractor can use to minimize its liability in this area.

### **- Exclude Government Obligations**

Most government contracts include FAR 52.227-1, "Authorization and Consent." This clause brings the sovereignty of the U.S. government to bear to protect contractors and subcontractors using third-party patents to perform work for the government. FAR 52.227-1 states that the government authorizes and consents to all use and manufacture of any invention described in and covered by a U.S. patent that is a necessary part of the goods or services being delivered to the government.

FAR 52.227-1 is not an indemnification by the government for third-party IP infringement. Rather, it provides an affirmative defense to an infringement action by a private party. If a third party asserts that the contractor (or subcontractor) is infringing upon its patent rights, the patent owner's exclusive remedy for infringement actions will be against the United States.

Unlike FAR 52.228-7, which cannot be flowed down to subcontractors without the government's consent, the "Authorization and Consent" clause is a required flow down in all subcontracts that are expected to exceed the simplified acquisition threshold. Indeed, even if the clause is missing from the subcontract, subcontractors can still raise an affirmative defense if they can demonstrate that the government authorized and consented to the use of the patented technology.<sup>2</sup> Accordingly, FAR 52.227-1 can give comfort to both the prime contractor and the subcontractor. It might make the subcontractor more willing to provide an IP infringement indemnity, since it knows that it can count on the protection of the U.S. government. Conversely, the prime contractor might not be so insistent upon getting indemnification from the subcontractor if it knows the government is authorizing and consenting to the use of any patented technologies by it and its subcontractors. (Equally, the prime contractor would be doubly motivated to seek IP infringement indemnification from its subcontractors if the prime contract contains a clause such as FAR 52.227-3, "Patent Indemnity," which obligates the prime contractor to indemnify the government against IP infringement.)

What does it mean to have both FAR 52.227.1 and a private indemnification agreement between the subcontractor and the prime contractor in the same subcontract? The private indemnification clause is irrelevant to the obligations of the government. The liability of the prime contractor and the government for IP infringement will be as set forth in the prime

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## **Anatomy of an Indemnification Clause (cont'd):**

contract. However, to the extent that FAR 52.227.1 does not apply to the subcontractor's activities for whatever reason—if, for example, the patented technology is determined to not be a necessary part of the goods or services being delivered to the government—then a court would look to the indemnification arrangement between the subcontractor and the prime contractor to determine liability between the two parties.

The language that the subcontractor might suggest is:

*Subcontractor's obligation to defend, indemnify, and hold harmless prime contractor and its customers shall not apply to the extent the government has authorized and consented to use of a third party's Intellectual property rights pursuant to FAR 52.227-1, "Authorization and Consent."*

### **- Require Knowledge**

Another technique that the subcontractor might try is to only agree to indemnify the prime contractor if the subcontractor *willfully* infringes another party's IP rights. The prime contractor may want to reject this suggestion, however, because most reputable companies will not knowingly and intentionally infringe another party's IP rights. The real risk is that the subcontractor won't know that it is infringing until it is too late.

### **- Exclude Certain Uses of the Intellectual Property**

The subcontractor may want to carve out exceptions to its liability in case the prime contractor uses the subcontractor's intellectual property in unanticipated ways. The subcontractor could suggest language similar to the following:

*Subcontractor will not be obligated to defend or be liable for costs or damages to the extent the infringement arises out of:*

- i. Required compliance with prime contractor specifications, or*
- ii. Prime contractor's combining with, adding to, or modifying the product beyond such combinations, additions, or modifications that are:*
  - a) Contemplated under this agreement;*
  - b) Necessary for the operation of the product; or*
  - c) Are otherwise proposed by subcontractor.*

### **- Exclude Non-U.S. Patents**

The subcontractor may ask that its indemnification only apply to U.S. patents by adding the following language: *"Subcontractor extends no indemnity whatsoever against infringement*

*(continued on next page)*

## **Anatomy of an Indemnification Clause (cont'd):**

*claims against non-U.S. patents, copyrights, or other intellectual property.”*

### **- Get Rid of the Word “Alleged”**

The subcontractor may wish to clarify that it will not be obligated to indemnify the prime contractor in the case of an *alleged* breach. After all, anyone can raise a baseless, nonsensical claim. Yet, once a suit is filed, the subcontractor is obligated to defend itself just to get rid of the ridiculous claim. The subcontractor may take the position that unless it actually does something wrong, it should not be on the hook for legal fees in connection with the defense.

### **Paragraph C: Violation of Laws that Apply to the Subcontractor’s Performance of Work under the Subcontract**

It is hard for the subcontractor to argue with the indemnification request in Paragraph C. The subcontractor should be held accountable if it violates a law while performing the subcontract. If the subcontractor is concerned about changes in the law, then it could clarify that it is only willing to indemnify the prime contractor for violations of law in effect as of the time the subcontract is executed by the parties.

### **Paragraph D: Breach of Contract and Product Defects**

Paragraph D requires the subcontractor to indemnify the prime contractor if the subcontractor breaches any of its subcontract obligations or if the products or services delivered are defective. The subcontractor will want to reject this language if the parties have already negotiated appropriate remedies for contract breaches elsewhere in the subcontract. For example, the parties may have already agreed to limit the remedy for breach of warranty to repair, replacement, or credit. By incorporating the rest of the subcontract terms into the indemnification section, the prime contractor gets an additional remedy beyond the more limited remedy provided for in other sections. Moreover, an indemnity for contract breach can render every other liability limitation in the contract meaningless if indemnification is excluded from such limitations. For instance, consider the case where a subcontractor carefully negotiates an overall liability cap in the subcontract. If indemnification is excluded from the liability cap, then the consequence of the subcontractor agreeing to indemnify the prime contractor for contract breaches is that the liability cap will not, in fact, apply to anything at all.

### **Conclusion**

Employing the changes discussed in this article, the final outcome of our initial indemnification clause would look something like this:

*(continued on next page)*

## **Anatomy of an Indemnification Clause (cont'd):**

1. Subject to the limitations set forth in Section 2 below, the subcontractor shall indemnify, ~~and~~ hold harmless, and defend the prime contractor and its officers, directors, agents, and employees, ~~and customers~~ from and against all *third party* claims, damages, losses, and expenses, including, but not limited to, *reasonable* attorneys' fees arising out of, relating to, or resulting from:

A. The *negligent acts or omissions of performance of the work by* the subcontractor or its subcontractors, *provided that*:

1) The subcontractor's indemnification obligations shall not apply to the extent FAR 52.228-7, "Insurance-Liability to Third Persons," applies to the prime contract, and

2) The subcontractor shall not be liable for injury to persons or damage to or loss of property caused by the sole negligence of the prime contractor, its subcontractors, agents, or employees;

B. Any action by a third party that is based upon a claim ~~or alleged claim~~ that the work performed or delivered hereunder *knowingly* infringes or otherwise violates the intellectual property of any person or entity, *provided that*:

1) The subcontractor's indemnification obligations shall not apply to the extent the government has authorized and consented to the use of a third party's intellectual property rights pursuant to FAR 52.227-1, "Authorization and Consent";

2) The subcontractor shall not be obligated to defend or be liable for costs or damages to the extent the infringement arises out of:

i. Required compliance with the prime contractor's specifications; or

ii. The prime contractor's combining with, adding to, or modifying the product beyond such combinations, additions, or modifications that are:

a) Contemplated under this agreement;

b) Necessary for the operation of the product; or

c) Are otherwise proposed by the subcontractor;

and

3) The subcontractor extends no indemnity whatsoever against infringement claims against non-U.S. patents, copyrights, or other intellectual property; and/or

C. Any violation of applicable laws *that are in effect at the time the subcontract is executed by the parties*, including, without limitation, violation of U.S. export control laws and regulations; ~~and/or~~

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## **Anatomy of an Indemnification Clause (cont'd):**

~~*D. Any breach of the subcontract by the subcontractor, including, without limitation, failure to deliver products that are free from defects in workmanship, materials, and design.*~~

*Notwithstanding the foregoing,*

*A. In no event shall the subcontractor's liability hereunder exceed Five million dollars (\$5,000,000); and*

*B. In no event shall either party be liable to the other party for any special, exemplary, incidental, consequential, punitive, or other indirect damages of any kind, even if such party has been advised in advance of the possibility of such damages, or such damages could have been reasonably foreseen by such party.*

These edits do not reflect everything that the parties might want to change, and of course other clauses in the contract would likely need to be changed to be made consistent with the edits in this indemnification clause. However, this language demonstrates the types of things that the parties might agree upon in the course of negotiations.

This was a brief look at how a prime contractor and subcontractor can reach an acceptable outcome when negotiating an indemnification clause in a government subcontract. The goal in any negotiation over indemnification should be to calculate who is in the best position to avoid harm, and then to assign liability to such party in an amount that makes sense in that particular context. The parties should be aware of the hidden meaning of seemingly boilerplate language.

By carefully considering the indemnification language, along with other provisions dealing with liability, such as warranty, insurance, and inspection and acceptance, the parties will streamline negotiations and arrive at an appropriate allocation of risk.

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## **Endnotes**

1. The distinction between indemnification and the duty to "hold harmless" is not universally understood. Some authorities suggest that the terms are synonymous. (See, e.g., *Winchester Repeating Arms Co. v. United States*, 51 Ct. Cl. 118 (Ct. Cl., 1916); and *Black's Law Dictionary*, ninth ed. (2009).) Other authorities assert that the terms carry separate, distinct meanings. (See, e.g., *Queen Villas Homeowners Ass'n v. TCB Property Mgmt.*, 56 Cal. Rptr. 3d 528, 533 (Cal. Dist. Ct. App. 200) (a hold harmless clause is "defensive" whereas an indemnification clause is "offensive").)

2. See *Advanced Software Design Corp. v. Federal Reserve Bank of St. Louis*, 583 F.3d 1371, 1376 (Fed. Cir., 2009).



## **Challenging Past Performance Evaluations Under the Contract Disputes Act**

*by*  
*W. Jay DeVecchio*  
*and*  
*Damien Specht\**

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At some point, nearly every government contractor has received a negative past performance evaluation. These evaluations, whether accurate or not, can adversely affect a contractor's ability to win or retain contracts. Sometimes, negative reviews are justified. In other cases, they result from the lack of a neutral forum to correct the record. There is Government Accountability Office ("GAO"), Court of Federal Claims, and Federal Circuit case law indicating that past performance ratings cannot be challenged in the context of a bid protest.<sup>1</sup> Moreover, although the Federal Acquisition Regulation ("FAR") currently includes provisions for challenging these evaluations before the agency, contractors have to be diligent about providing rebuttals and explanations; and even a diligent contractor will often fail to convince an agency to revise its initial conclusions. More recently, however, the Armed Services Board of Contract Appeals ("ASBCA") and Court of Federal Claims have recognized, and the Court of Appeals for the Federal Circuit has endorsed, an avenue for contractors to challenge adverse past performance through the Contract Disputes Act of 1978 ("CDA"), 41 U.S.C. §§7101-7109. The case law in this area is still developing. But these decisions provide some guidance for contractors seeking to litigate past performance evaluations before the evaluations badly affect a contract award. And even if you do not litigate, it is increasingly important for contractors to understand the administrative challenge process, given the increasing number of bid protests being filed and the likelihood of even greater protest activity in the future.

### **The FAR Process**

The regulatory process for initially challenging a past performance evaluation is described in FAR 42.1503. When an evaluation is completed, agencies are required to provide a copy to the contractor "as soon as practicable" and allow the contractor a minimum of 30 days to submit comments, rebutting statements, or additional information for the agency to review. Agencies also are required to provide a review at a level above the contracting officer to consider disagreements between the contractor and the contracting officer regarding the evaluation. As a practical matter, this process frequently offers no relief because the "[u]ltimate conclusion on the performance evaluation is a decision of the contracting agency."<sup>2</sup> In other words, there is infrequently a neutral view of the issue. Moreover, the very existence of review above the level of the contracting officer is currently in doubt because the FAR Council recently requested comments on a proposal to remove this appeal process entirely to

*(continued on next page)*

## **Challenging Past Performance Evaluations (cont'd):**

“improve economy and efficiency.”<sup>3</sup>

Nonetheless, as long as a FAR appeal is available, contractors may first want to utilize the FAR process to dispute evaluations. If successful, it affords the contractor a much faster and less expensive solution than pursuing a CDA claim. Further, if properly worded, a contractor’s FAR response can be used as the basis for a CDA claim that can be appealed to the ASBCA or Court of Federal Claims. In all events, a rebuttal can and should be incorporated into the Federal Awardee Performance And Integrity Information System (“FAPIIS”), which is the repository of past performance information.

### **The ASBCA and Court of Federal Claims Have Recognized Jurisdiction Over “Matters Related To the Contract,” Including Past Performance Evaluations**

In the past, a contractor dissatisfied with an agency’s final evaluation had no recourse after exhausting the FAR process. This was because both the ASBCA and the Court of Federal Claims refused to recognize performance evaluation challenges as valid claims under the CDA. To the contrary, for many years both the Court and the ASBCA held that performance evaluations were administrative in nature and not, therefore, matters related to the contract cognizable under the CDA.<sup>4</sup> This analysis has changed during the past two years. In 2010, the ASBCA asserted jurisdiction over a performance evaluation claim in *Colonna’s Shipyard, Inc.*, ASBCA No. 56940, 10-2 BCA ¶34,494 (2010) (“*Colona’s Shipyard*”), finding that the claim was “relating to a contract” as required by the CDA. The Board explained that reviewing past performance evaluations has always been part of its jurisdiction to evaluate and declare the parties’ rights concerning contract provisions. As a result, when contract provisions state or imply that the contractor will receive an accurate and fair past performance report, the Board has jurisdiction over a claim where “[a]ppellant has alleged that the government breached its contract by issuing arbitrary and capricious [Contractor Performance Assessment Report (“CPAR”)] scores in contravention of the performance assessment clause’s procedures and its incorporated requirement for an accurate and fair rating, and by violating the duty of good faith and fair dealing implicit in every contract.”<sup>5</sup>

The Court of Federal Claims had taken a similar position in *Todd Constr., L.P. v. United States*, 85 Fed. Cl. 34 (2008) (“*Todd F*”). Judge George Miller, ruling on the Government’s motion to dismiss a claim challenging an unfavorable evaluation, reasoned that performance evaluations are issues of contract performance, not contract administration, and thus fall within the Court’s jurisdiction. Judge Miller wrote:

This creation of mandatory performance reviews, databases archiving those reviews, and the requirement to consider those archived materials in future contract awards means that a negative review is potentially devastating to a contractor, who may have no opportunity—or very little opportunity—to mitigate the impact that review will have on future

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## **Challenging Past Performance Evaluations (cont'd):**

awards. There are sound reasons... to address performance evaluations as issues of contract performance rather than as part of a bid protest when the contractor seeks future government contracts.<sup>6</sup>

On appeal, the Federal Circuit endorsed the CDA process for challenging past performance evaluations. In *Todd Constr., L.P. v. United States*, 656 F.3d 1306, 1312 (Fed. Cir. 2011) (“*Todd IV*”), the Federal Circuit affirmed Judge Miller, explaining

“we have previously held that to be a claim ‘relating to the contract’ under the CDA, the claim ‘must have some relationship to the terms or performance of a government contract.’ The performance evaluations at issue have a direct connection and association with Todd’s government contracts and . . . appear to be ‘relat[ed] to the contract.’”

## **The CDA Process Must Start With A Formal Claim, Not a Mere Expression of Frustration**

Just as for other claims, a past performance evaluation challenge must follow the CDA’s requirements. Before the claim can be heard by the ASBCA or the Court of Federal Claims, it must be submitted in writing to the contracting officer and, of course, be the subject of a final decision. Although the claim need not seek monetary relief, the claim must include: (1) a written demand seeking other contract relief as a matter of right and (2) a request for the contracting officer’s final decision.<sup>7</sup> As a result, the claim cannot be a mere expression of frustration or disagreement with the agency’s evaluation. For example, in *Kemron*, the Court of Federal Claims held that a letter to the contracting officer expressing dissatisfaction with a CPAR did not constitute a valid claim because it did not reflect a “clear and unequivocal statement providing adequate notice of the basis of a claim.”<sup>8</sup>

This does not mean that a CDA claim cannot be filed as part of the FAR process. The Court of Federal Claims has explained that a contractor’s FAR 42.1503(b) response may be sufficient to be considered a claim if it properly demands relief and a final decision from the contracting officer. In *BLR Group of America*, the court found the contractor’s written comments in response to a CPAR to be a valid claim as they “concerned both the inaccuracies contained in the CPAR and the possible biases of the lead QAP who prepared the CPAR” and “requested that the Assessing Official exercise her discretion to re-evaluate the CPAR and correct the initial ratings and narrative.”<sup>9</sup>

In turn, a contracting officer’s final decision on the claim can be accomplished either by a written decision or by the contracting officer’s failure to issue a decision within a reasonable time (generally 60 days or such other time as the contracting officer specifically identifies within 60 days).<sup>10</sup> Importantly, the issuance of a final CPAR, even after extensive discussions on draft CPARs, is not considered a final decision for purposes of the CDA, and an appeal on

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## **Challenging Past Performance Evaluations (cont'd):**

that basis may well be premature. *Konoike Constr. Co.*, 91-3 BCA ¶24,170.

### **Contractors Should Wait For A Final CPAR Before Filing a Claim**

Although it may be tempting to file a claim when a contractor first becomes aware of a draft evaluation with negative comments, such claims are almost certain to be dismissed as premature.<sup>11</sup> As a result, when presented with a draft evaluation, contractors should continue to work with their government customer to address inaccuracies and to resolve any concerns before issuance of the final document. This may solve the problem without the need for litigation, a far more preferable outcome than a costly appeal. Moreover, a contractor's written response to a past performance evaluation must be included in FAPIIS and, as a result, typically will be considered by the Government during future proposal evaluations. Thus, even if a contractor is not considering a legal challenge to a past performance evaluation, it should always submit a response to help clarify the record and defend its performance. This response may positively influence future contract award evaluations without the need for litigation.

### **Review Will Be Deferential To The Agency**

If a contractor does pursue an appeal, the matter will be reviewed under a deferential standard.<sup>12</sup> That is, because the decision to assign past performance ratings is subjective and requires the exercise of a contracting officer's discretion, it will be reviewed only to assess whether it is reasonable (i.e., not arbitrary or capricious) and not *de novo*.<sup>13</sup> Similar to the approach taken in bid protests at the GAO, the review will be done "only to ensure that it was reasonable and consistent with the stated evaluation criteria and applicable statutes and regulations, since determining the relative merits of the offerors' past performance is primarily a matter within the contracting agency's discretion."<sup>14</sup>

If, however, the contractor is challenging procedural aspects of the Government's performance rather than the substance of the evaluation -- for example failing to follow statutory procedures in conducting the evaluation or not providing the contractor with an opportunity to comment on the evaluation -- the Court of Federal Claims will engage in *de novo* review.<sup>15</sup>

### **It Is Not Yet Clear What Relief Can Be Achieved**

In all events, it is not yet clear whether either the Court of Federal Claims or ASBCA currently have the authority to provide a useful remedy in these cases. Contractors seeking an injunction on a past performance evaluation appeal are likely to be disappointed. The ASBCA does not have jurisdiction to grant specific performance or injunctive relief.<sup>16</sup> The Court of Federal Claims has also declined to issue an injunction in past performance appeal cases based

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## **Challenging Past Performance Evaluations (cont'd):**

on the limits of the Court's Tucker Act jurisdiction:

“The parties correctly agree that, as a general matter, this Court lacks authority to provide injunctive and equitable relief. See *Brown v. United States*, 105 F.3d 621, 624 (Fed. Cir. 1997); *Wheeler v. United States*, 11 F.3d 156, 159 (Fed. Cir. 1993); *Doe v. United States*, 372 F.3d 1308, 1313-14 (Fed. Cir. 2004); *Lion Raisins, Inc. v. United States*, 51 Fed. Cl. 238, 244 (2001) (“[O]ur general jurisdiction under the Tucker Act does not include an action for ‘specific equitable relief.’”) (quoting *Carney v. United States*, 462 F.2d 1142, 1145 (1972)).”<sup>17</sup>

Both the Court and ASBCA have also struggled with the efficacy of issuing a declaratory judgment. For example, in *Todd II*, Judge George Miller stated that “a pure declaratory judgment on these facts would serve little purpose” and “[e]ven if the Court could say ‘the performance evaluation should be set aside,’ but had no power to require any entity to take any action on that conclusion, the declaratory relief would be meaningless.”<sup>18</sup> To remedy the inadequacy of pure declaratory relief, Judge Miller concluded that the Court could remand to the Agency with “proper and just” directions. Although Judge Miller held that the court could not “mandate a particular factual determination,” it could “use its power to issue a declaratory judgment to assist the agency, on remand, to address the identified concerns.”<sup>19</sup>

Given the recent effort to eliminate the FAR appeal process and the Court of Federal Claims' and ASBCA's expressed concerns about the limited relief available to contractors through the CDA process, this will be an area to watch closely in the future. In the present, though, contractors must be alert to all adverse past performance evaluations, and be prepared promptly to address, explain, or rebut them. Doing so could be the difference between winning and losing a contract.

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## **Endnotes**

1. *Ocean Tech. Servs., Inc.*, B-288659, Nov. 27, 2001, 2001 CPD ¶193 at 5 (“Our bid protest forum is not the place for a firm to first complain of not having received an assessment, nor do we serve as a forum for a firm to dispute the substance of an agency's assessment of the firm's work . . . .”); *Bannum, Inc. v. United States*, 60 Fed. Cl. 718, 729 (Fed. Cl. 2004) (“any issue with the evaluation process itself is not appropriate for a bid protest, which examines whether the agency examined properly all documentation before it in making the contract award determination.”). *Bannum, Inc. v. United States*, 404 F.3d 1346, 1353 (Fed. Cir. 2005) (“[A] bid protest is not the proper forum, under FAR §42.1503(b), to litigate [performance evaluation] disputes.”)

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## **Challenging Past Performance Evaluations (cont'd):**

### **Endnotes (cont'd)**

2. FAR 52.1503(b).
3. 77 Fed. Reg. 54867.
4. See, e.g., *TLT Constr. Corp.*, ASBCA No. 53769, 02-2 BCA ¶ 31,969 (2002); *Konoike Constr. Co.*, ASBCA No. 40910, 91-3 BCA ¶24,170 (1991) (“Konoike”).
5. The ASBCA in *Colonna’s Shipyard* relied in part on language in FAR 42.1502(b) that has since been revised. Given the Federal Circuit’s decision in *Todd Construction, L.P v. United States*, 656 F.3d 1306 (Fed. Cir. 2011), however, this change in the FAR should not affect ASBCA jurisdiction over this type of appeal.
6. *Todd Constr., L.P. v. United States*, 85 Fed. Cl. 34, 44 (2008).
7. *Kemron Envtl. Servs., Inc. v. United States*, 93 Fed. Cl. 74 (2010).
8. *Id.* at 95.
9. *BLR Group of Am., Inc. v. United States*, 84 Fed. Cl. 634, 637 (2008).
10. 41 U.S.C. §7103(d) (2012); FAR 33.211(c).
11. See *Extreme Coatings v. United States*, No. 11-895C (Fed. Cl. Oct. 3, 2012), (noting without objection that the Government had summarily denied a claim related to a draft CPAR).
12. *Todd II*, 88 Fed. Cl. 235 (2009); *Colonna’s Shipyard*, 10-2 BCA ¶34,494 (2010).
13. *Todd II*, 88 Fed. Cl. 235 at 247.
14. *Id.*
15. *Id.*
16. See *Colonna’s Shipyard*, 10-2 BCA ¶34,494; *Versar, Inc.*, ASBCA No. 56857, 10-1 BCA ¶34,437 (2010) (dismissing Versar’s request to rescind a poor evaluation rating, stating that the Board does not have jurisdiction to grant specific performance or injunctive relief).
17. *Todd II*, 88 Fed. Cl. 235, 243 (2009).
18. 88 Fed. Cl. at 245.
19. *Id.* at 247.



## **Rights in Technical Data and Computer Software**

by  
*Krista L. Pages\**

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Eleven years ago, then Under Secretary of Defense Jacques Gansler announced that “the technologies that shape the economy are largely funded by commercial industry.”<sup>1</sup> Therefore, the U.S. Government, he advised, “must find ways of acquiring research services from the broadest possible scope of industry so the Department [of Defense] can leverage industry’s advances and ultimately acquire the best commercial products and technology for insertion into defense systems.”<sup>2</sup>

For many, Gansler’s memo officially recognized the end of the age of “spin-off” and the emergence of a new “spin-on” paradigm. In the past, many new innovations (e.g., the jet engine, the internet, etc.) emerged after massive infusions of federal dollars produced new technologies that were spun out into the commercial world. Today, these trends are reversed, with most new innovations developed in the private sector and later used by government customers.

In 2000, Gansler and his colleagues recognized that to obtain this leverage, the government needed to recognize and protect the intellectual property rights of industry because intellectual property was their lifeline to the future. This sentiment was shared by many civilian agencies. Today, however, the tide seems to be turning in a new direction, with government seeking greater rights in contractor technical data and computer software than necessary to carry out government business.

These policy shifts create significant challenges for contractors as intellectual property control may be compromised via more recent changes in procurement regulations. Proactive steps to protect intellectual property and data rights are required to ensure that government customers receive quality technologies and services, and that contractors retain the ability to sell similar technologies in the commercial marketplace.

### **Overview of Technical Data and Computer Software — Understanding the Rights of the Parties**

The right of contractors to protect the intellectual property they create is given by the U.S. Constitution, Article 8, Clause 8, which states: “The Congress shall have the power . . . to promote the progress of science and useful arts, by securing for limited times to authors and inventors the exclusive right to their respective writings and discoveries . . .” From this principle springs the laws for patent, copyright, and trademark. The constitutional and statutory

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## **Rights in Technical Data and Computer Software (cont'd):**

rights given to authors and inventors are recognized by the government, and are reflected in the patent and rights in data and computer software clauses in the Federal Acquisition Regulation (FAR), Defense FAR Supplement (DFARS), and many other agency-specific regulations. This article looks at the parties' rights under government contracts containing the FAR and DFARS rights in data and computer software clauses.<sup>3</sup>

### **FAR Part 27 and FAR 52.227-14, "Rights in Data — General"**

Rights in technical data and computer software for agencies other than the Department of Defense (DOD) are addressed in FAR 27.4. FAR 27.402 sets forth the government's policy with regard to government agencies' requirements for data to carry out their missions and programs.

The agencies' challenges include:

- Balancing their needs to data to establish competition among suppliers;
- Fulfilling publishing and information dissemination of the results of their activities; and
- Fostering future technological developments and meeting programmatic needs with the contractor's proprietary interests in this data.

Meanwhile, the contractor's challenges include:

- Protecting its rights; and
- Delivering only the data required to meet the government's needs.

These competing pressures create challenges in cases related to the tangible contract deliverables — e.g., manufactured products. The challenges grow even more complex when they relate to intangible deliverables such as technical data and software.

FAR 27.401 defines *data* to include "recorded information, regardless of form or media on which it may be recorded." It includes technical data and computer software.<sup>4</sup> FAR 27.403, "Data Rights — General," provides that:

[A]ll contracts that require data to be produced, furnished, acquired, or used in meeting contract performance requirements must contain terms that delineate the respective rights and obligations of the government and the contractor regarding the use, reproduction, and disclosure of that data.

These data rights clauses are found at FAR 52.227-14, "Rights in Data — General," and also use the provision at 52.227-15, "Representation of Limited Rights Data and Restricted Computer Software."<sup>5</sup>

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## **Rights in Technical Data and Computer Software (cont'd):**

FAR 52.227-14 was revised in December 2007 and, among other changes, added five alternate clauses to 52.227-14. These alternate clauses addressed:

- Limited rights data;<sup>6</sup>
- Restricted rights in computer software;<sup>7</sup>
- Copyright to data first produced in performance of the contract;<sup>8</sup> and
- Inspection of data not delivered under the contract for up to three years after acceptance of all deliverables.<sup>9</sup>

Another important 2007 FAR change to clause 52.227-14 was a rewrite of the definition of “computer software.” The 1987 FAR clause defined computer software as “computer programs, computer data bases, and documentation thereof.” The 2007 FAR Rewrite changed how software, databases, and documentation are classified, marked, and distinguished from technical data. “The change also had the effect of giving the government unlimited rights in certain software documentation in which the government for the prior 20 years obtained only ‘restricted rights.’”<sup>10</sup> Computer databases and computer software documentation is not included in the definition and must be marked as technical data.

The government’s rights regarding the use, disclosure, and reproduction of the data depend on whether the data is first produced in the performance of the government contract. If the data is first produced in the performance of the contract (or in other words the development was paid for by the government), then the government acquires unlimited rights to that data.<sup>11</sup> If the contractor develops the technical data at private expense, the government’s rights are limited. FAR 52.227-14 allows the contractor to protect this data and deliver only form, fit, and function data that the government receives with unlimited rights. However, if the government requires delivery of the limited rights data, it will include FAR 52.227-14, Alternate II, and the contractor must deliver the data with the “Limited Rights Notice” that sets forth the government’s rights with regard to its use, disclosure, and reproduction.

If the data developed at the contractor’s expense is computer software, and the government requires it to be delivered under the contract, the government will include FAR 52.227-14, Alternate III. The computer software will be delivered with a “Restricted Rights Notice” setting forth the government’s rights with regard to the software data delivered.<sup>12</sup>

It is important to understand that the data rights clauses do not specify the type, quantity, or quality of data that is to be delivered, but only the respective rights of the government and the contractor regarding the use, disclosure, or reproduction of the data delivered.<sup>13</sup> The requirements for the delivered data must be addressed in the contract terms. The government should not require delivery of data that is not necessary to meet its needs. As will eventually be discussed, it is important that contractors and contracting officers clearly delineate in the contract what the technical data and computer software deliverables are in the request for proposal and in the contract at the time of final contract negotiation.

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## **Rights in Technical Data and Computer Software (cont'd):**

### **DFARS 227.71, “Rights in Technical Data (September 2007)”**

DFARS 227.71, “Rights in Technical Data (Revised September 6, 2007),” sets forth the rights in data for all DOD contracts requiring delivery of technical data. While there are many similarities between the FAR and DFARS, there are also important differences. The DFARS provisions have undergone significant changes since 1984. In 1995, several new clauses were added specifically addressing commercial clauses, as well as clause DFARS 252.227-7013, “Rights in Technical Data—Noncommercial Items (Nov. 1995).” Importantly, the definition of *technical data* in the DFARS includes only “recorded information” and does not include computer software or the physical item itself.

The 1995 DFARS regulations also made important changes to the analysis of “at private expense.” The regulation adopted the position that only development activities direct-charged to a government contract would disqualify the activities from being “at private expense.” Any development accomplished entirely with costs charged to indirect cost pools, or costs not allocated to a government contract, or any combination thereof are considered developed at private expense. The DFARS was again revised in 2007 and new proposed changes were published in 2010<sup>14</sup> and in section 824 of the Fiscal Year 2011 National Defense Authorization Act (NDAA)<sup>15</sup> and section 815 of the Fiscal Year 2012 NDAA.<sup>16</sup> With all of these changes, the DOD is attempting to expand and better clarify the rights of the government to technical data and computer software. For contractors, it requires due diligence to stay abreast of the changes and adequately protect their ownership of proprietary data and software.

### **DFARS 227-72, “Rights in Computer Software and Computer Software Documentation (September 2007)”**

The DFARS provision relating to DOD’s rights in computer software and computer software documentation differs somewhat from the FAR. In addition to the clause for unlimited rights in software and software documentation developed exclusively with government funds, it also creates “government purpose rights” in software development accomplished with mixed-funding, as well as restricted rights and special license rights. The government purpose rights give the contractor (and subcontractors developing software) a five-year period under which the government may not use, or authorize other persons to use, computer software marked with the government purpose rights legend for commercial purposes.<sup>17</sup>

Restricted rights are given to the government for noncommercial computer software required to be delivered or otherwise provided to the government that is developed “exclusively at private expense.”<sup>18</sup> The restricted rights given are similar to the FAR rights and require specific marking as set forth in DFARS 252.227-7014, “Rights in Noncommercial Computer Software and Noncommercial Computer Software Documentation (June 1995).” However, the DFARS restriction specifically prohibits the government or any other government contractor from decompiling, disassembling, or reverse engineering the software, or to use software that has been decompiled, disassembled, or reverse-engineered.<sup>19</sup>

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## **Rights in Technical Data and Computer Software (cont'd):**

Special license rights, or “specifically negotiated license rights,” can be negotiated between the government and the contractor when the three other categories of rights (unlimited, government purpose, or restricted) do not satisfy the government’s needs or when the government may be willing to accept lesser rights as the parties deem appropriate,<sup>20</sup> as long as the government obtains the minimum rights it is entitled to in technical data (limited rights) or in computer software and documentation (restricted rights). A license agreement must be negotiated and made part of the contract.

### **Rights in Commercial Computer Software**

The government’s rights in “commercial computer software” is also addressed in the FAR and DFARS. FAR 52.227-19, “Commercial Computer Software License (December 2007),” provides that “notwithstanding any contrary provisions contained in the contractor’s standard commercial license or lease agreement,” the government will have restricted rights to the commercial computer software delivered under the contract essentially the same as those under FAR 52.227-14, Alt. III, “Rights in Data—General.” However, the drafters of the FAR Rewrite in 2007 seem to have recognized that commercial computer software suppliers were not keen on this language—granting license rights more liberal than those provided in their license agreements. This is reflected in the language at FAR 27.405-3, “Commercial Computer Software,” which emphasizes the use of commercial license agreements:

When contracting other than from [General Services Administration] Multiple Award Schedule contracts for the acquisition of commercial computer software, no specific contract clause prescribed in this subpart need be used, but the contract shall specifically address the government’s rights to use, disclose, modify, distribute, and reproduce the software.<sup>21</sup>

The DFARS takes a more business-like approach to the acquisition of commercial computer software. DFARS 227-7202, “Commercial Computer Software and Commercial Computer Software Documentation,” provides that:

Commercial computer software or commercial computer software documentation shall be acquired under licenses customarily provided to the public unless such licenses are inconsistent with federal procurement law or do not otherwise satisfy user needs.

It further provides that offerors and contractors shall not be required to furnish technical information related to commercial computer software or commercial computer software documentation that is not customarily provided to the public and was developed at private expense. It further states that contractors are not required to relinquish to the government rights to use, modify, reproduce, release, perform, display, or disclose commercial computer software and related documentation, except for a transfer of rights as mutually agreed upon.<sup>22</sup>

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## **Rights in Technical Data and Computer Software (cont'd):**

### **FAR 52.227-17, “Rights in Data—Special Works Clause (December 2007)”**

One additional FAR clause regarding rights in data for “special works” is available to the government for contracts that are primarily for the production or compilation of data (other than limited rights data or restricted computer software) for the government’s own use, or when there is a specific need to limit distribution and use of the data or to obtain indemnity for liabilities that may arise out of the content, performance, or disclosure of the data.<sup>23</sup> Some examples given in FAR Part 27 for inclusion include:

- Contracts for the production of audiovisual works;
- Histories of the respective agencies, departments, or units thereof;
- Surveys of the government;
- Collection of data containing personally identifiable information such that the disclosure thereof would violate the right of privacy of the individual to whom the information relates;
  - Investigatory reports; and
  - The development of computer software programs, where the program may give a commercial advantage or is agency mission sensitive (and its release could prejudice agency mission programs or follow-on acquisitions).

FAR 52.227-17, “Rights in Data—Special Works,” gives the government unlimited rights “in all data delivered” under the contract or first produced in performance of the contract and allows the government to take copyright to the data. However, FAR 27.405-1(c) instructs that the contracting officer may delete this provision if he or she determines that such assignment is not needed to further the objectives of the contract. If this clause is included in the contract and the contractor delivers intellectual property it created at its own expense, the contractor may lose its copyright to such data as well as the right to limit the rights of the government unless it specifically negotiates terms with the government to this data.

In the face of budget cuts and program cancellations, government funds for development of intellectual property are dwindling. This presents a challenge for both the government and contractors—reaching the appropriate balance between their competing interests to the rights in technical data and computer software delivered under government contracts.

As is apparent in comparing the various rights government agencies obtain under either the FAR or DFARS clauses in technical data and computer software, contractors should carefully consider the options for protecting the intellectual property that will be delivered in their government contracts. Careful planning in the development of the intellectual property and the negotiation of license rights with the government is the key to a good intellectual property protection strategy. As will now be discussed, this planning process should occur even before the government’s request for proposal is advertised.

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## **Rights in Technical Data and Computer Software (cont'd):**

### **Protection of Contractor Intellectual Property (Technical Data and Computer Software)**

#### **Step 1: Properly Catalog and Track Intellectual Property Development**

The first step in protecting technical data and computer software is to understand what intellectual property your company owns and who paid for its development. For some companies, the answer is easy if they maintain adequate processes and procedures to track newly created intellectual property. For other firms, whose intellectual property falls into the category of “trade secrets” such as methodologies and “know how” developed over many years of project performance, there are no processes, or at best inadequate processes, in place to track intellectual property. When these companies bid on and enter into government contracts containing the FAR or DFARS rights in technical data and computer software clauses, they face a difficult challenge to deliver to the government data with other than “unlimited rights.” Unlimited rights offer little to no protection of the contractor’s trade secrets. For example, computer source code delivered under a government contract with unlimited rights means the government can put the code out to the public (“open source”) to all of a contractor’s competitors. In this case, the fact that the contractor maintains “ownership” over that code or has a copyright to it is of little value.

#### **Step 2. Funding of Intellectual Property Development and Improvements**

Contractors wishing to develop intellectual property for the government market must decide whether to accept government funding or develop it at private expense (charged to indirect cost pools or other funding). If mixed funding is going to be used, the contractor should have a way to specifically track the intellectual property developed with each funding source. For computer software development and other tools, such as methodologies and “know how,” this may be difficult to separate out. Consideration must also be given to whether the development was required for the performance of a government contract. It is not allowable for the contractor to charge labor for the development of the data or software to indirect cost pools, rather than direct cost pools, if the work is part of contract performance. In addition, the FAR requires that computer software developed at private expense must be either a “trade secret” maintained as privileged and confidential or that it is “commercial” for it to be restricted computer software.<sup>24</sup>

#### **Step 3. Proper Marking and Notice**

All intellectual property developed at private expense should be properly marked and if delivered, must include the required notices. For data delivered under agency contracts to which FAR 52.227-14, “Rights in Data—General,” applies, the “Limited Rights Notice” in Alternate II of this FAR provision should be included on all data delivered.<sup>25</sup> If restricted computer software is delivered as provided in Alternate III of the clause, it must be marked with the “Restricted Rights Notice.”<sup>26</sup> For data delivered under DOD contracts, the legends to be

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## **Rights in Technical Data and Computer Software (cont'd):**

marked on the data delivered depend on whether the data was exclusively developed at private expense—“Limited Rights” legend—or developed with mixed funding—“Government Purpose Rights” legend.<sup>27</sup> If a special license is negotiated, there is also a legend for this under the DFARS.<sup>28</sup>

### **Step 4. Copyright Protection**

Consideration should be given regarding copyright of technical data. If the data is to be delivered to the government under limited rights, or government purpose rights, or under special license rights, the addition of a copyright notice on the data may be advisable. The added protection of registering the intellectual property created in the copyright office may also be taken. It is important to note that under the FAR 52.227- 14(c), the contractor “shall not, without the prior written permission of the contracting officer, incorporate in data delivered under this contract any data not first produced in the performance of this contract” unless the contractor identifies the data and grants the government, or acquires on its behalf, a license to the data or software.

Copyright protection is also available, with government approval, even when technical data or software are generated entirely in the performance of a government contract or at government expense. “This copyright protection may well preclude third parties, who otherwise have access to a contractor’s information through the government, from using technical data and software for anything other than government purposes.”<sup>29</sup>

Taking these steps to protect intellectual property developed at private expense or with mixed funding is important before providing a proposal to the government and entering into a government contract. With protection in place and proper documentation to support the development chain, the contractor and the government can fairly and openly negotiate the proper rights the government should have in the contract deliverables.

### **Getting it Right—Meeting the Government’s Needs and Preserving the Contractor’s Interest in Technical Data and Computer Software in the Government Contract**

Understanding the FAR and DFARS clauses regarding the government’s rights in the delivered data and software is essential to ensuring that the contract language meets dual objectives: serving the needs of the contracting agency while also protecting the contractor’s ability to benefit from key intellectual property assets over the longer term. Getting to this win-win solution starts before the request for proposal is released. The contractor must continually monitor its product and technology portfolio to assess whether it has data and/or software that it wants to develop at its own expense either for commercial or noncommercial purpose. If it has sufficient research and development dollars for this effort, “developed at private expense” will allow the contractor to sell and deliver to the government valuable technical data and computer software while preserving its rights to proprietary intellectual

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property. If the contractor must use government funds to develop the data and software, then the contractor's ownership rights will likely have limited protection; e.g., through the copyright provisions of the regulations or the government purpose rights provisions.

Government agencies face their own decision criteria: They must assess if they can meet agency needs with unrestricted rights or allow contractors to retain proprietary data and software. Many contracting officers believe that the government should acquire unrestricted rights, providing agencies with the means to share key technical data and create more open competitive future markets. As a result, agencies are more likely to include not only the clauses with unrestricted rights, but also the special works clause in requests for proposals and contracts. In addition, they include the deferred delivery clauses<sup>30</sup> and deny copyright requests. This approach, as previously discussed, can be detrimental to the government's long-term interests to stimulate innovations in the private sector.

Contractors and the government should have open dialogue to understand each other's needs. For example, questioning the inclusion of the special works clause is one step to get consideration of what the government really wishes to acquire. Asking the contracting officer for copyright on the contract deliverables, as provided in the FAR and DFARS clauses, is also important. Reaching an understanding in the proposal phase and contract negotiation as to precisely what technical data and computer software will and will not be delivered under the contract, and what rights will be attached to it, will preserve a good working relationship between the parties from the beginning of contract performance. Finally, do not overlook any subcontractor deliverables in the negotiations.

### **Final Thoughts**

Moving beyond adversarial relationships is essential to the successful resolution of challenging issues related to intellectual property and technical data rights. Government agencies want high-quality products and technologies that meet their needs. Contractors seek business opportunities that do not hamstring their ability to capture new markets and contracts.

Proactive steps to protect intellectual property and data rights are required to ensure that government customers receive quality technologies and services, and that contractors retain the ability to sell similar technologies in the commercial marketplace.

Meeting these mutual goals requires advance planning and foresight on both sides of the government/contractor relationship. For contractors, understanding the regulations, and taking adequate steps to plan and protect innovations in advance of government contracting, is essential. For agencies, contracting officers should focus on appropriately applying the regulations to obtain only the rights in data required and maximizing government funds to promote innovation to meet agency needs. These steps will create a balance that meets key government needs while also preserving essential private intellectual property rights.

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## **Rights in Technical Data and Computer Software (cont'd):**

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### **Endnotes**

1. Jacques Gansler, Under Secretary of Defense, "Memorandum for Secretaries of the Military Departments Directors of the Defense Agencies" (September 5, 2000).
2. *Ibid.*
3. For an understanding of the patent rights clauses, see Tamir Damari, "Buying the Better Mousetrap: Patent Law Issues in Federal Acquisition," *Contract Management Magazine* (July 2012): 52.
4. "Data" does not include information incidental to contract administration, such as financial, administrative, cost or pricing, or management information.
5. FAR 27.404, "Basic Rights in Data Clause."
6. Alt. I and II.
7. Alt. III.
8. Alt. IV.
9. Alt. V.
10. W. Jay DeVecchio, "Rights in Computer Software," *Rights in Technical Data and Computer Software Course Manual* (Federal Publications Seminars, 2012): 171.
11. The government also obtains unlimited rights to form, fit, and function data paid for by the contractor that is delivered under the contract, and to data (other than data delivered with restricted computer software) that constitute manuals or instructional and training material for installation, operation, or routine maintenance and repair of items, components, or processes delivered or furnished for use under the contract. (FAR 27.404-1 and FAR 52.227-14.)
12. *See* FAR 27.404(b).
13. *See* FAR 27.403, "Data Rights—General."
14. 75 Fed. Reg. 59412 (September 27, 2010).
15. Pub. L. 111-383, §824, 124 Stat. 4137, 4269 (2011); *see also* W. Jay DeVecchio, "Rights in Technical Data & Computer Software Under Government Contracts: Key Questions & Answers (Including §815)/Edition II," *Briefing Papers*, Second Series, No. 12-6 (West Publications, May 2012).
16. Pub. L. 112-81, §815, 125 Stat. 1297, 1491 (2011) (amending 10 U.S.C. §§2320–2321); *see also* DeVecchio, *ibid.*
17. DFARS 227.7203-7(b)(4), "Government Rights."
18. DFARS 227-7203-7(c).
19. *Ibid.*, at "Definitions" ((a)(14)(v)(C)).
20. FAR 252.227-7013(b)(4).
21. FAR 27.405-3, "Commercial Computer Software."
22. DFARS 227.7202-1(c), "Commercial Computer Software and Commercial Computer Software Documentation" Policy.
23. *See* FAR 27.405-1, "Special Works."
24. *See* DeVecchio, note 10, at 210.
25. *See* FAR 52.227-14, Alt. II(g)(3).
26. *Ibid.*, at Alt III(g)(4)(i).

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**Rights in Technical Data and Computer Software (cont'd):****Endnotes (cont'd)**

27. *See* DFARS 252.227-7013(f)(3) (1995), "Limited Rights Marking"; and DFARS 252.227-7013(f)(2)(1995), "Government Purpose Rights Marking."
28. *See* DFARS 252.227-7013(f)(4) (1995), "Special License Rights Marking."
29. DeVecchio, *see* note 10.
30. DFARS 252.227-7026, "Deferred Delivery of Technical Data or Computer Software"; FAR 52.227-16, "Additional Data Requirements."



## Government Delay Claims

by  
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### I. Background

Because of the continuing political impasse over debt ceiling and sequestration issues, the prospect of significant budget cutbacks looms and government programs are again at risk. Many contractors, and nearly all services contractors, are at risk for performance disruptions this year, with consequent cash flow interruptions and the possibility that some invoices may not be processed and paid.

This does not mean, however, that the ultimate risk for these delays (however long) shifts to contractors. To the contrary, the Federal Acquisition Regulation (FAR) provides several relief-giving clauses for delays of performance. Contractor recovery of the costs related to these delays will vary depending on the contract clause to which the contracting officer resorts. Although the titles of the clauses used are well-known to experienced government contractors, their specific provisions are less familiar. This article will explore the rights of contractors to reimbursement by examining the similarities, differences, and nuances of the various relief-granting clauses related to work delays.

### II. FAR Clauses

#### a. FAR 52.242-14, Suspension of Work (APR 1984)

The Suspension of Work<sup>1</sup> clause applies only to fixed-price construction or architectural-engineering (A&E) contracts. Although its applicability is limited, under the clause the contracting officer may "...suspend, delay, or interrupt all or any part of the work of [the] contract for the period of time that the Contracting Officer determines appropriate for the convenience of the Government."<sup>2</sup> The contractor may assert a claim for costs if the work suspension, delay or interruption is for an unreasonable period of time or longer than periods specified in the contract.<sup>3</sup> The clause also specifies strict timelines for filing claims for the work disruption.<sup>4</sup>

In general, construction contractors are accustomed to handling government work delays, and usually have project-specific performance and cost templates in place. Inasmuch as the relevant data is being collected on an on-going basis, determining the impact of a delay is usually a straightforward matter of simply compiling those data.

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## **Government Delay Claims (cont'd):**

The Boards of Contract Appeals ("BCAs") have considerable experience in applying the Suspension of Work clause. As a typical example, in *Tidewater Contractors, Inc.*, CBCA 50, 07-1 BCA ¶ 33525, the civilian board explained: "[t]he Suspension of Work clause contemplates equitable adjustments for unreasonable delays in the performance of the contract. *Triax-Pacific v. Stone*, 958 F.2d 351, 354 (Fed. Cir. 1992). In order to recover under the Suspension of Work clause, a contractor must show that: (1) contract performance was delayed; (2) the Government directly caused the delay; (3) the delay was for an unreasonable period of time; and (4) the delay injured the contractor in the form of additional expense or loss. *John A. Johnson & Sons, Inc., v. United States*, 180 Ct. Cl. 969, 986 (1976). . . . However, a contractor is only entitled to recover under the Suspension of Work clause when the Government's actions are the *sole* proximate cause for the contractor's additional loss, and the contractor would not have been delayed for any other reason during that period. *Triax-Pacific v. Stone*, 958 F.2d at 354."

Many non-A&E or non-construction contractors informally refer to all work stoppages as "suspension of the work," implying that the clause may apply, when in fact the clause does not apply and another clause may have been used to discontinue work. For non-A&E or fixed-price construction contracts, contracting officers must resort to other clauses for work delays or stoppages.

### **b. FAR 52.242-15, Stop-Work Order (AUG 1989)**

The Stop-Work Order clause is used for "solicitations and contracts for supplies, services, or research and development."<sup>5</sup> For cost reimbursement contracts, the contracting officer must insert the Alternate clause.<sup>6</sup> By its terms, a contracting officer can direct that all or part of the work cease for any period less than 90 days.<sup>7</sup> After the ninety day period, any further extension requires the agreement of the contractor.<sup>8</sup> Within the ninety (90) day period, the contracting officer must either: 1) cancel the stop-work order and resume the work; or 2) terminate the work covered by the order.<sup>9</sup> If the work is resumed, the contracting officer must make an equitable adjustment to the delivery schedule, price, or both.<sup>10</sup> In this regard, the contractor must assert its right to a contract adjustment within thirty (30) days of the work stoppage.<sup>11</sup> On the other hand, if the work is terminated for convenience, then the contracting officer *must allow* reasonable costs in the proposal resulting from the work stoppage.<sup>12</sup>

Additionally, the contractor is responsible under subparagraph (b) to resume the work as soon as the order is canceled.<sup>13</sup> While the contractor is required to "minimize the incurrence of costs allocable to the work covered by the order during the period of work stoppage," the contractor must nonetheless maintain the capability to re-commence performance. Even while idle, there are costs associated with contractor down-times and the burden is on the contractor to substantiate its costs during the delay period.

As under the Suspension of Work clause, it is the contractor's burden to document its

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## **Government Delay Claims (cont'd):**

delay costs. Unabsorbed overhead, additional labor and material costs, and other expenses that cannot be mitigated, must be accounted for. Thus, even under fixed-price contracts, a contractor must carefully track its costs.

The BCAs have routinely provided relief under this clause even where no formal stop-work order was issued. For example, in *Dynamics Research Corp.*, ASBCA No. 53788, 04-2 BCA ¶ 32747, a contractor was entitled to recover suspension costs for payments related to data entry personnel during three periods when the Air Force's computers had crashed. The Air Force program manager had sent the employees home without using the Stop Work Order clause. Notwithstanding this oversight, the Board found that the government's actions constituted constructive stop-work orders within the meaning of the Stop-Work Order clause.

### **c. FAR 52.242-17, Government Delay of Work (APR 1984)**

The Government Delay of Work clause is routinely incorporated by reference in non-commercial fixed-price supply and service contracts, and for that reason has wide applicability for work stoppages.<sup>14</sup> The contracting officer inserts the Government Delay of Work clause "when a fixed-price contract is contemplated for supplies other than commercial or modified-commercial items."<sup>15</sup> The clause is optional for services contracts.<sup>16</sup>

A significant aspect of this clause is the 20-day notice requirement: "A claim under this clause shall not be allowed unless for any costs incurred more than 20 days before the contractor shall have notified the contracting officer in writing of the act or failure to act involved . . ." <sup>17</sup> Accordingly, in the event of work stoppage, the contractor should immediately send in the written notice, and await events, in order to comply with the relatively short twenty (20) day requirement.

The clause may be activated by delays or interruptions caused by: 1) an act of the Contracting Officer in the administration of [the] contract that is not expressly or impliedly authorized by [the] contract, or (2) by a failure of the Contracting Officer to act within the time specified in [the] contract. . . "<sup>18</sup> Despite its wide applicability, these triggers, involving acts outside the scope of the contract or even *failures to act* on the part of the contracting officer, may incentivize the use of any other clause but this one in order to avoid internal blame or embarrassment for such acts or failures. In a case involving the applicability of the clause, the Labor BCA noted that FAR 52.242-17 is mandatory for a fixed-price contracts for supplies and optional for a fixed-price contracts for services, but has no application to construction contracts. *Wu and Associates, Inc.*, LBCA No. 2003-BCA-1, 07-2 BCA ¶ 33595.

### **d. FAR 52.243-1, Changes**

One of the clauses to which contracting officers may resort (perhaps when seeking to avoid the self-incrimination of the Government Delay of Work clause) is the Changes clause.<sup>19</sup> Whether the Changes clause is in a fixed-price contract (FAR 52.243-1) or cost reimbursement

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## **Government Delay Claims (cont'd):**

contract (FAR 52.243-2), there are five alternate versions of the Changes clause depending on whether the contract is for supplies, services, A&E, transportation, or research and development (R&D). FAR 52.243-3 is used in labor hour or time-and-materials contracts, while FAR 52.243-4 applies to construction contracts. FAR 52.243-5, Changes and changed conditions, is reserved for construction contracts that do not exceed the simplified acquisition threshold. For whatever reason, Changes clauses are invoked each year for a wide variety of contract modifications, and are also used to cover constructive changes. For these reasons, claims under the Changes clause are heavily litigated.<sup>20</sup>

The Changes clause, taken as a whole, authorize the contracting officer unilaterally to make changes within the scope of the contract, and allow relief in the form of an equitable adjustment to compensate for such changes.

Use of the Changes clauses triggers significantly different requirements on contractors that are not found in any of the other clauses discussed above. One of those requirements relates to change order accounting, a subject about which many contractors are unaware.<sup>21</sup> Change order accounting essentially requires contractors to track separately their additional costs related to the change:

The contracting officer may require change order accounting whenever the estimated cost of a change or series of related changes exceeds \$100,000. The contractor, for each change or series of related changes, shall maintain separate accounts, by job order or other suitable accounting procedure, of all incurred, segregable direct costs (less allocable credits) of work, both changed and not changed, allocable to the change. The contractor shall maintain such accounts until the parties agree to an equitable adjustment for the changes ordered by the contracting officer or the matter is conclusively disposed of in accordance with the Disputes clause.<sup>22</sup>

Note that this clause establishes two new requirements. First, the contractor must reorganize its accounting system to accumulate separately the costs related to the changed work. Second, the contractor must rearrange its recordkeeping practices to maintain the documents related to these accounts until the “matter is conclusively disposed of.”

As a general rule, it is advisable for a contractor to identify and separately accumulate its costs related to changed work, regardless of the estimated costs, because (again) the contractor bears the burden of proving its costs, either to the contracting officer or on appeal under the Disputes clause. To the extent that a contractor commingles its change order costs

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## **Government Delay Claims (cont'd):**

with its contract costs, it increases the likelihood of cost duplication in its claim and unwisely increases its burden of proof. While it is always a good idea for the contractor to establish separate accounts to track costs for delays or suspensions of work, the Changes clause specifically provides for the contracting officer to direct that such separate accounts be established.

To recover under the Changes clause, a contractor will rely on its accounting system for the information necessary to achieve full recovery of its additional costs of performance. Hence, it is important that the accounting system be adequate to segregate and track the changed costs.

The Changes clause has been described as one of the most litigated clauses in government contracts.<sup>23</sup> Examples of the many diverse matters contested under the Changes clause include the following: *Logics, Inc.*, ASBCA No. 46914, ASBCA No. 49364, 97-2 BCA ¶ 29125 (where contract specifications were defective, contractor was entitled to an equitable adjustment under the Changes clause); *IBI Sec. Service, Inc. v. U.S.*, 19 Cl.Ct. 106 (1989) (government did not exercise strict control over wages so as to entitle contractor to a price adjustment under changes clause); *ThermoCor, Inc. v. U.S.*, 35 Fed.Cl. 480 (1996) (where the cost of performance greatly differs from the stated unit price due to changes ordered by the government, the Changes clause may override the variations in estimated quantity clause); *L.G. Lefler, Inc. v. U.S.*, 6 Cl.Ct. 514 (1984) (where there was no evidence that change order effected a decrease in a contractor's cost of performance so as to warrant claimed equitable adjustment, changes clause in contract, by itself, did not entitle Government to an equitable adjustment in contract price for contractor's use of foreign steel in project); *M.A. Mortenson Co. v. U.S.*, 843 F.2d 1360 (Fed. Cir. 1988) (contractor's receipt of notice to proceed 77 days after the assumed date of receipt as stated in the contract did not constitute a change in contract for purposes of changes clause, and did not entitle the contractor to an equitable adjustment for winter work, where the contractor unreasonably relied on the assumed date in extending its bid); *In re LA Ltd.*, ASBCA No. 52179, 01-1 BCA ¶ 31319 (government changed the contract work when it required appellant to purchase a computer, which entitled it to an equitable adjustment in the price of the contract under the Changes clause); *Arvol D. Hays Construction Co.*, ASBCA No. 25122, 84-3 BCA ¶ 17661 (where government failed immediately to furnish correct information to the contractor when it was needed to perform work in its planned construction sequence, which caused it to perform in a less efficient and more costly manner, the loss in efficiency entitled contractor to an equitable adjustment under the Changes clause).

### **III. Analysis**

Entitlement to compensation is usually a given in delay claims, except where there are delays occurring during the same period that are unrelated to the government's actions. Concurrent delay matters can be very complex, and may require technical experts to sort out who should be held responsible for what delay period(s).

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## **Government Delay Claims (cont'd):**

While all of the above clauses have broadly similar provisions, there are also unique and significant differences. For example, profit is not allowed for the costs of a delay under the Suspension of Work clause. As briefly mentioned above, the written notice requirements are different as well, i.e., 30 days for Stop-Work Order and Change Order delays, but 20 days for delays under the Suspension of Work and Government Delay of Work clauses. Finally, the impact of the delay is also very significant. In some contracts, the length of the delay is merely added to the end of the period for performance. However, this is not always done. There are occasions when the original due date must still be met, regardless of the delay. In these cases, the contractor suffers a delay followed by a constructive acceleration of performance, which can result in added costs of performance.

Many non-accountants assume that the term “fixed costs” refers to costs that are uniform from one period to the next. However, this is incorrect. Actually, most fixed costs are just similar in amount from one accounting period to the next. While there are some fixed costs that are exactly the same in each period, such as lease payments or depreciation expense, most fixed costs fluctuate within a narrow range. Regardless of the amount, though, accountants consider fixed costs to be those that are unaffected by variations in work activity. Variable costs, on the other hand, rise (and fall) in a manner that is directly commensurate with the volume of work being done, although the relationship between variable costs and work output may not be mathematically precise. However, there are normally comparable trends, i.e., when the workload increases, the variable costs increase, and when the workload decreases, the variable costs decrease as well.

Fixed and variable costs in indirect cost pools (such as overhead and G&A) may be affected when the time allowed for completing the work changes, as well as when the costs of performance change. Mathematically speaking, fixed costs operate as a function of time, while variable costs are a function of work activity. In plain language, this means that fixed costs increase when the contract schedule (or period of performance) increases, and variable costs increase when the intensity of the contractor’s performance increases. Stated differently, a change only in the period of performance affects the fixed costs but not the variable costs, while a change only in the level of work output affects the variable costs but not the fixed costs.

The classification of expenses as fixed or variable is important in understanding a company’s operations from a financial perspective. Fixed expenses do not normally require much attention, unless they are disproportionately large (such as when office rent is too high). Instead, astute financial managers usually focus their attention on the variable costs because they tend to be the most volatile. Such costs can quickly exceed budgeted limits, and thus threaten profitability. Of course, a company cannot perform too many contracts at a loss before its very existence is endangered. Interestingly enough, there are no FAR or FAR Supplement clauses on the categorization of expenses as fixed or variable. Instead, costs are defined factually, i.e., a cost is fixed or variable depending on whether it responds to changes in the performance period or work activity.

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## **Government Delay Claims (cont'd):**

### **IV. Conclusion**

Contractors are well advised to be prepared for the coming fiscal storms. Indeed, most government contractors have long been actively engaged in cost-cutting initiatives as a means of building their cash reserves. However, as discussed above, more action will be needed. Specifically, a contractor must have an accounting system that can track and segregate suspension, delay or change costs, and the contractor's legal, accounting, and contract administration staffs must be vigilant in documenting all performance- and cost-related impacts of government directives. Depending on the nature and complexity of the work, as well as the length of the delay, the pertinent documents must be assembled into a detailed, coherent request for an equitable adjustment (REA). This process should be accomplished with the understanding that the contractor's submission is likely to be unsympathetically audited. Thereafter, the contractor's submission and the government audit report will serve as the basis for bilateral negotiations.

To the extent that a REA is unsuccessful, either in whole or in part, contractors need to be fully prepared to pursue recovery through the claims process. At a minimum, contractors should assess their contracts for the types of clauses that provide the Government the right to suspend, delay, interrupt or modify work described in the contract. For less sophisticated contractors, an immediate assessment of the firm's accounting system is essential to ensure that change or delay costs can be properly identified and substantiated.

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### **Endnotes**

1. FAR 42.1305(a): "The contracting officer shall insert the clause at 52.242-14, Suspension of Work, in solicitations and contracts when a fixed price construction or architect-engineer contract is contemplated."
2. *Id.*
3. FAR 52.242-14(b).
4. FAR 52.242-14(c).
5. FAR 42.1305(b)(1).
6. FAR 42.1305(b)(2). The Stop-Work Order clause may also apply to contracts for the leasing of motor vehicles. *See* FAR 52.301.
7. FAR 52.242-15(a): "The Contracting Officer may, at any time, by written order to the Contractor,

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## **Government Delay Claims (cont'd):**

### **Endnotes (cont'd)**

require the Contractor to stop all, or any part of the work called for by [the] contract for a period of ninety (90) days after the order delivered to the Contractor...". Note that we are aware of recent instances in which Contracting Officers have unilaterally extended the 90-day period, without Contractor assent.

8. *Id.*

9. *Id.* at (a)(1)-(2).

10. *Id.* at (b).

11. *Id.* at (b)(2).

12. *Id.* at (c).

13. *Id.* at (b).

14. FAR 52.242-17.

15. FAR 42.1305(c).

16. FAR 52.242-17.

17. *Id.* at (b).

18. *Id.* at (a).

19. FAR 52.243-1-5.

20. *See, e.g.*, FAR 52.243-1, Changes -- Fixed-Price ("The Contracting Officer may at any time, by written order, and without notice to sureties, if any, make changes within the general scope of [the] contract...").

21. FAR 52.243-6. While contracting officers may include it in change orders where the costs are expected to exceed \$100,000, it is wise policy to implement change order accounting whenever actual or constructive changes occur, regardless of the estimated amount.

22. FAR 52.243-6, Change order Accounting. *See also* FAR 43.203 ("Contractors' accounting systems are seldom designed to segregate the costs of performing changed work. Therefore, before prospective offerors submit offers, the contracting officer should advise them of the possible need to revise their accounting procedures to comply with the cost segregation requirements of the Change Order Accounting clause at 52.243-6.").

23. Gov't Cont. Under Fed. Acquisition Reg. §43.11 (3d ed.).

