

Risk Mitigation in Government Contracting: Drafting Indemnification and Limitation of Liability Clauses

Guidance for Primes and Subcontractors

WEDNESDAY, AUGUST 28, 2019

1pm Eastern | 12pm Central | 11am Mountain | 10am Pacific

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***Risk Mitigation in Government
Contracting: Drafting Indemnification
and Limitation of Liability Clauses***

Strafford Webinar
August 28, 2019

**Devon E. Hewitt
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and
Kevin Learned
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Devon. E. Hewitt

Protora Law, PLLC

Ms. Hewitt represents government contractors of every size and stripe. She is a nationally recognized bid protest lawyer, having filed over 200 protests over her twenty-year career with federal agencies, including SBA and FAA, the Government Accountability Office and the U.S. Court of Federal Claims. While she handles protests for Fortune 500 companies, Ms. Hewitt's primary client base is small business contractors. She counsels these clients on FAR and subcontract compliance, such as the rules and regulations applicable to the SBA's and VA's preferential contracting programs for small businesses. When not handling protests, Ms. Hewitt regularly drafts, reviews and negotiates teaming agreements, non-disclosure agreements, subcontracts, joint venture agreements, Other Transactions Agreements and similar documents.

Kevin R. Learned

McMahon, Welch and Learned, PLLC

Mr. Learned's practice focuses on advising clients on general corporate and securities matters, including company formation and governance, buy-sell agreements, operating and stockholder agreements, mergers and acquisitions, private offerings of debt and equity securities (including friends and family, angel, venture capital and private equity investments), corporate divorces and other reorganizations, joint ventures, small business certifications (including 8(a), SDVO, WOSB, HUB Zone and MBE/DBE certifications), executive employment and equity matters, deferred compensation plans, franchise agreements, trademarks, and other commercial contracts and agreements.

Agenda

- **Government Liability**
- **Government Indemnification**
- **Government/Prime Scope of Liability**
- **Prime/Sub Scope of Liability**
- **Prime/Sub Scope of Indemnification**
- **Mergers/Acquisitions**
- **Best Practices**

Government Contracting Risks

- **Government**

- Products/services won't be of satisfactory quality
- Products/services won't be performed or delivered on time
- Products/services will cost more than the contract price or estimated costs

- **Contractor**

- Timely payment
- Performance costs more than anticipated
- Unknown future liability

Government Liability

What is the scope of the Government's liability to government contractors?

- **Sovereign Immunity**
- **Waiver of Sovereign Immunity**
 - The Tucker Act
- **Government Contract**
 - Authority
 - Appropriations

Government Indemnification

What does it mean to indemnify?

- **Allocation of risk of a certain type of loss**
 - Contractual indemnity is an agreement by one party (the indemnifying party) to hold harmless or assume another contracting party's (the indemnified party) liability for loss, damage, or harm resulting from the indemnifying party's fulfillment of that contract

Enforceable Indemnification Language

- **Prerequisites**

- Where the potential liability of the Government
 - was limited to a definite amount known at the time of the agreement,
 - was within the amount of available appropriations, and
 - was not otherwise prohibited by statute;
- Where the indemnification agreement
 - is a legitimate object of an appropriation,
 - the agreement specifically provides that the amount of liability is limited to available appropriations, and
 - there is no implication that Congress will, at a later date, appropriate funds to meet deficiencies; or
- Where Congress has specifically authorized the agency to indemnify

Government/Prime Liability

Government/Prime Scope of Liability

- **Payment of Purchase Price**
 - Depends on agency's "acceptance" of goods or services
 - Payment submission of a "proper invoice"
- **Other Protections**
 - Right of set off
 - Retention

Government/Prime Scope of Liability

- **Changes**

- Unilateral v. Bilateral
- Time limit
- Certification of Claim
- Disputes/Continued Performance

Government/Prime Scope of Liability *cont.*

- **Terminations**

- For Convenience
 - What will be Paid?
- Default
 - What will be paid?

Government/Prime Scope of Liability

- **Government's right to audit and accept**
- **Sub's compliance with socio-economic contract provisions**
- **Sub's satisfactory performance**
 - Warranties
 - Approval of Subcontractor
 - Default
- **Sub's timely Performance**
 - Liquidated Damages
 - Default

Prime/Sub Scope of Liability

Prime/Sub Scope of Liability

- **FAR clause “flow-down” procedure**
 - Mandatory v. Discretionary
 - Methods of accomplishing “flow-down”
- **FAR clause vs. Commercial Contract clause**
 - Consistency in meaning
 - UCC
- **Order of Precedence**
 - Strictest standard applies

Prime/Sub Scope of Liability *cont.*

- **Payment of Purchase Price**
 - FAR clause vs. Commercial Contract clause
 - Invoicing Requirements
 - Acceptance
 - Set Off
 - Right to Audit
 - Retention

Prime/Sub Scope of Liability *cont.*

- **Changes**

- FAR Clause v. Commercial Contract clause
 - Unilateral vs. Bilateral
 - Limited Scope v. Unlimited Scope
 - Contingent on Government unilateral action
 - Time limit
 - Sponsorship of claim
 - Certification of Claim

Prime/Sub Scope of Liability *cont.*

- **Termination**

- For Convenience
 - FAR clause vs. Commercial Contract clause
 - What will be paid?
- For Default
 - FAR clause vs. Commercial Contract clause
 - What will be paid?

Prime/Sub Scope of Liability

- **Compliance with law**

- FAR clauses vs. Commercial Contract clause

- **Satisfactory Performance**

- Right to Inspection
- Warranties
- Indemnification
- Force Majeure
- Subcontract Performance

- **Timely Performance**

- Liquidated Damages
- Indemnification

Prime/Sub Scope of Liability

- **Limitation of Liability**
- **No Consequential Damages**
- **Liquidated Damages**
- **Disputes**

Prime/Sub Indemnification Responsibilities

Prime/Sub Indemnification Responsibilities

- **Damage to property/Personal Injury**
- **Intellectual Property**
- **Contract performance**
- **Notice**
- **Right to Counsel/Settlement**

Prime/Sub Scope of Indemnification

- **Third party claims**
- **Agents and affiliates**
- **Loss vs. claim**
- **Defend vs. Indemnify vs. Hold Harmless**
- **Directly vs. Indirectly**

Mergers and Acquisitions

Mergers and Acquisitions – Form of Acquisition

- **Asset Purchase**

- Limits Assumption of Liabilities
- Difficulties
 - Novation of Prime Contracts
 - Non-Transferability of FCL (Security Clearance)
 - Non-Transferability of Past Performance

- **Equity Purchase/Merger**

- Assumes all Liabilities
- Requires Additional Diligence and Reliance on Representations and Warranties and Indemnity Clauses

Mergers and Acquisitions – Representations and Warranties

- **Types of Representations and Warranties**
 - Fundamental
 - Ownership of Company
 - Authority
 - Title to Assets
 - Statutory
 - Taxes
 - Employee Benefits (ERISA)
 - Environmental
 - General
 - Everything Else
 - Government Contracts??
 - Can Fit Into Any Category
 - Treated Separately

Mergers and Acquisitions – Indemnity Survival Periods

- **Survival Periods**

- Fundamental
 - 3-7 Years
 - Statute of Limitations
 - Forever
- Statutory
 - Statute of Limitations
- General
 - 12-24 Months

Mergers and Acquisitions – Indemnity Survival Periods

- **Survival Periods**

- Government Contracts??

- Can Fit Into Any Category

- Treated Separately

- 41 U.S. Code § 7103(a)(4) (Time for Submitting Claims)

- 6 Years After the Accrual of the Claim

- Federal Acquisition Regulation (FAR) 4.705 (Contractor Records Retention)

- 2-4 Years After Final Payment

Mergers and Acquisitions – Limitations of Liability

- **Limitations of Liability**
 - Fundamental
 - Purchase Price
 - Percentage of Purchase Price
 - Statutory
 - Purchase Price
 - General
 - Percentage of Purchase Price

Mergers and Acquisitions – Limitations of Liability

- **Limitations of Liability**
 - Government Contracts??
 - Can Fit Into Any Category
 - Treated Separately
 - Big Ticket Items
 - Claims
 - Pending Termination
 - Remaining Profitability

Mergers and Acquisitions – Watering Down Representations

- **Watering Down Representations and Warranties**
 - Materiality
 - Material Adverse Effect
 - Knowledge

Mergers and Acquisitions – Security for Indemnity Claims

- **Security for Indemnity Claims**
 - Escrow Fund
 - Seller Note
 - Earn-Out
 - Personal Guaranty (if Seller isn't an individual)

Best Practices

Best Practices - Contracts

- **Determine if Government has requisite authority to enter into government contract**
- **Do not expect that any language that purports to make the Government indemnify a contractor will be enforceable**
- **Understand that the Government has placed obstacles in front of the contractor in enforcing any liability provisions**
- **Realize that subcontracts are hybrids that combine government contract provisions and commercial provisions, often leading to confusion and unanticipated results**
- **Understand that a mutual indemnification clause does not protect a subcontractor**
- **Ensure that a subcontract indemnification clause and limitation liability clause work together**

Best Practices – Mergers/Acquisitions

- **Ensure that your contractual provisions match the deal**
- **Consider the size of the transaction**
- **Consider how much security is involved**
- **If a buyer, don't expect to get money back from the seller**
- **If a seller, don't count on receiving post-closing payments**

Questions?

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