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# The Clause

*A Quarterly Publication of the Boards of Contract Appeals Bar Association*

## The President's Column J. Michael Littlejohn

Members of the BCABA:

This issue of *The Clause* begins the new year for the Boards of Contract Appeals Bar Association ("BCABA"), and I am honored to serve as your President for the 2007-2008 term. The BCABA serves an important role in advancing the practice of law in our world of federal contracting. The active participation of our membership helps to improve the civility and effectiveness our practice. I hope that each of you will consider taking on an active role in the BCABA either through attending our programs, contributing to *The Clause*, or taking on leadership positions in the association. I welcome all contributions.

This year, I hope to work with the Board of Governors to continue building on the success of our past programs and expanding our reach in the government contracts community. Our immediate past President, Judge Richard Walters, has placed the BCABA in a prime position to provide increased value to our members and the legal community. We have a strong, growing membership base that I hope will continue to expand. The best way to do that is to keep providing programs and services of value to our membership and the government contracts community.

As Chief Judge Michel reminded us at our Annual Meeting, the quality of the legal thought, dispute resolution, and advocacy in federal contracting law is vitally important to the operation of our government, our national security, and has a far-ranging impact on our economy. In the coming year, there are many  
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## **President's Column (cont'd):**

issues that will affect our practice from both the government and private perspectives. The Civilian Board of Contract Appeals will start their second year of resolving claims. The Armed Services Board of Contract Appeals has announced that they will propose and seek comment on changes to their rules. Congress and the executive branch will likely pass statutes or promulgate regulations that will be of interest to the government contracts community. And, as the federal government continues to contract-out more services here and abroad, the frequency and complexity of issues and disputes will likely increase. I hope to help the BCABA maintain and increase its position as an important voice in helping our members, the boards, and other stakeholders deal with such issues.

In the coming year, our members should be on the lookout for the following programs and publications:

\**The Clause*- The BCABA's quarterly publication of timely, scholarly articles on issues that impact government contracts practice. The Clause accepts articles from members and non-members. If you have an article to share or know someone who has written a relevant piece, please contact me or *The Clause* editor, Pete McDonald at [pete.mcdonald@rsmi.com](mailto:pete.mcdonald@rsmi.com).

\**BCABA Website* ([www.bcaba.org](http://www.bcaba.org)) – Our members are provided special access to the BCABA's website which includes updates of events, our membership directory, and other information beneficial to board practice.

\**Quarterly Meetings of the Board of Governors* – The Board of Governors meets every three months to discuss the BCABA's programs and other issues. This year, those meetings are tentatively scheduled for December 20, 2007, March 13, June 19, and September 18, 2008. All members are invited to attend.

\**BCABA Directory* – Our directory provides the names and contract information for all BCABA members, the boards of contract appeals, and other important information for government contracts practices.

\**BCABA Trial Practice Seminar* – A program focused on improving your litigation skills before the boards.

\**BCABA Annual Colloquium on Government Contracts* – A discussion of hot topics in government contracting with judges, lawyers, law professors, and policy makers.

\**BCABA Executive Policy Forum* – A lunch time program for our government members and Gold Medal Member firms on the issues of the day.

\**BCABA Annual Educational Program* – Our year-end/new-year educational seminar that looks back on topics of interest and looks forward to the next big issues for government lawyers, private attorneys, and judges.

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**President’s Column (cont’d):**

Again, I am looking forward to this year, and I welcome you all to become more involved in the BCABA. I would be grateful for your ideas on how we can improve the association. If you have any questions, comments, or friendly advice, please do not hesitate to give me a call at (703)790-8750 or email me at michael.littlejohn@akerman.com.

Sincerely,  
J. Michael Littlejohn  
President

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

by  
Peter A. McDonald  
C.P.A., Esq.

(A nice guy . . . basically.)

In this issue, we have Brent Armstrong’s article that makes an interesting case against the use of award-fee contracts. Also by way of stirring debate on current government contract issues is the article by Tom McGovern, Dan Graham, and Stu Nibley. They raise significant issues with the DOJ position that opposes a board’s subpoena power regarding federal agencies. Finally, Richard Pennington and Corey Sanchez provide well-considered pointers when negotiating allocations of liability in contracts involving intellectual property rights and obligations.

*The Clause* is not copyrighted and will reprint, with permission, previously published and copyrighted articles that warrant further exposure. We are receptive to original articles that may be of interest to government contracts practitioners. Remember people: Don’t take all this government contract stuff too seriously. As usual, we received some articles that were not suitable for publication, such as: “Demi Jilts Pete (*Friends Worried!*)”; “Hung Jury in Pete’s Felonious Coveting Trial!!”; and “Pete ‘Waterboarded’ at His Expert Witness Deposition!!!”

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## **Just Say No to Award-Fee Contracting**

by  
Brent Armstrong\*

[Reprinted with permission from the National Contract Management Association,  
*Contract Management*, Vol. 47, Issue 10, October 2007.]

*This approach is still performance-based contracting, but the motivation for contractors to excel is based on the opportunity to earn longer term contracts versus an award fee.*

As a former federal senior executive service manager and now as a senior executive in the private sector, I have seen award-fee contracting from both sides, and my feelings haven't changed—it is time to end it! Award-fee contracting has become a manpower-intensive, paper-gluttonous, administratively burdensome, and costly process for which the return is not worth the investment to the government. There is a better way.

### **What's Wrong with Award-Fee Contracts?**

As with any tool or process, award-fee contracting has to be properly used to obtain the benefit intended. Unfortunately, what has happened with award-fee contracting is that the process has not been consistently implemented in the manner necessary to achieve optimal results. Conceptually, it sounds great but, in practice, the results have not justified the means. The basic problems relate to application and execution. Award-fee contracting works best when it is specifically, rather than broadly, applied;

- When the government has a clear and comprehensive understanding of what is required from the contract in terms of results (products and services);
  - When these results can be measured against clear, unambiguous criteria, and
  - objectively evaluated;
  - When federal personnel are well trained in how to execute and administer
  - award-fee contracts;
  - Where these resources are adequate to do the job right and are available
  - throughout the life of the contract; and
- When there is conscientious and consistent implementation of the process throughout the entire contract period.

As is true for performance evaluations, award-fee contracting requires paying close attention to performance, consistently applying the established criteria for performance to the evaluation of actual results, and providing objective analyses (with an understanding that what one earns for one performance period has no bearing on what is earned for any subsequent period—i.e., each period is a “new start”). Regrettably, the application of award-fee contracting has not been consistent, resulting in much less than optimal results that have clearly not measured up to the initial high expectations for this theoretically better approach to evaluate  
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## **Just Say No to Award-Fee Contracting (cont'd):**

contractors and motivate them to improve performance.

Some of the “realities” of award-fee contracting are as follows:

- As might be expected, contractors will focus on those area(s) of performance that have the greatest potential award fee—i.e., not surprisingly, they follow the money. As a result, other areas that are not being so “incentivized” may suffer from lack of attention.

For example, training and preventative maintenance are often at the bottom of the priority list because the benefits of doing well in these two areas are not generally seen in the short term. However, for obvious reasons, this is a short-sighted approach that can have negative consequences in the longer term.

- The process is both manpower and paper intensive. Significant resources are necessary, for both the government and the contractor, to oversee and execute the process as well as to write the comprehensive evaluation reports that are required to justify the rating that determines the award fee to be paid to the contractor.

For the government and the contractor, these resources include both administrative and technical personnel. In the case of the government, which is controlled by staffing allocations, the result is that technical personnel are required to devote a significant portion of their time performing administrative work, which is not the best utilization of their time or talents.

Government procurement and other administrative staff are equally burdened by a process that requires, literally, a “ton of time” and a “mountain of paper” to execute and administer. The same is true for the contractor, for whom the costs for the award fee process constitute both direct and indirect charges, which are borne by the government.

- Often, the government provides “multiple” award-fee incentives that further ups the ante on what they will have to potentially pay...and often do pay. When this happens, different areas are incentivized for different reasons and at different levels, and the potential payout to the contractor increases. When this approach is used, it also increases the time and amount of paper required to document the various incentives and justify the award fees that are paid. In addition, unless these multiple incentives are carefully and constantly aligned, they will pull the contractor in different directions, resulting in less than optimum results.
- Frequently, the award-fee scores “settle” into a range, generally on the higher side of the curve. Although each performance period should be viewed as a “new start,” this is seldom the case. What generally occurs is that the score stays the same or inches upward—it rarely goes down from the previous period unless there is a major negative perturbation in performance (for example, a significant safety issue). In this way, the award-fee evaluation process bears a notable similarity to the

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## **Just Say No to Award-Fee Contracting (cont'd):**

individual performance appraisal process—specifically, once an individual achieves a rating of outstanding, it rarely goes below that mark in future evaluations.

- Self-assessments by the contractors are frequently tied to award-fee programs—i.e., submission is required by the government. This process allows the contractor the opportunity to provide performance specifics relative to the award fee criteria. What self-assessments usually amount to is an opportunity for the contractor to “toot its own horn” in an effort to influence the performance rating from the government and thereby the award fee earned.

Contractors tend to especially “blow their own whistle” in certain areas to draw attention away from questionable performance in other areas. Additionally, these self-assessments are often used with little change as the government’s evaluation of the contractor’s performance, thereby becoming a self-evaluation rather than a self-assessment. As a result, while these self-assessments are supposed to disclose the good and the bad, they are usually long on positives and short on those negative areas of performance that need improvement.

Further, the government pays for the labor that is used to prepare the self-assessments. If the government is doing diligent oversight and monitoring of contract performance, a self-assessment should be not be needed. The government should be very much aware of what their contractor is doing well and not doing well. If the contractor wants to provide inputs regarding its performance for “consideration” by the government in its evaluation process, and if the government is agreeable to receiving such input, then it should be at the contractor’s expense and not the government’s.

### **Who Is Pushing Award-Fee Contracting?**

The short answer is the government. At some point, it was determined that the government could get better results by providing cash incentives for contractors to perform well versus a fixed fee. In theory, the concept sounds good, but in practice it has proven not to work as good as it sounds.

In fact, it has turned out to be a very costly process in terms of both the actual cost outlays for the award fee payments as well as the costs associated with administering award fee programs. It is interesting to note that contractors have not generally complained about the award-fee approach when it was used by the government to evaluate their performance. Certainly, you don’t want to bite the hand that feeds you, but there is most likely another reason for their silence—i.e., many contractors have made, and are making, a great deal of money from award fee programs.

You can bet that if they had been hurting because of the process, they would be complaining that it was either not a reasonable and/or fair approach to recognizing and

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## **Just Say No to Award-Fee Contracting (cont'd):**

rewarding performance. For whatever reason, the government has been reluctant to admit that award-fee contracting has not turned out the way it was envisioned.

My own experience with award-fee contracting as a federal manager at two different field sites convinced me that it was a bad idea that wasn't getting any better with experience. At the first site, I was able to abandon the process after one year having concluded that the end did not justify the means by a long shot. I was not as fortunate at the second site where I tried to make the case to end award-fee contracting, but I was not successful in doing so. There were "external" influences and pressures, from outside my organization, which were driving use of the award fee process. You win some, and you lose some, but it was one that I really hated to lose because I felt very strongly that it was a bad investment for the government.

The only possible concession I would make where award-fee contracting could potentially be a consistently effective approach, both programmatically and cost-wise, would be in those situations where a specific product/result is required by a specific date to ensure the success of a project or other government requirement. In such cases, the contractor either provides the required product/result by the specified due date and earns the award fee, or they don't. In this case, there is little subjectivity involved in terms of the evaluation and minimal manpower and paperwork required to administer the process. Award-fee contracting might also have value for certain highly classified, national security, homeland security, or intelligence projects if carried out in a conscientious and consistent manner.

### **There Is a Better Way**

Contractors are entitled to make money for the work they do for the government, *if* they get the job done that they have been contracted to do. However, rather than award fees, a better option is to reward contractors for a job well done by providing them with the potential to earn a longer term contract. What is sometimes referred to as "award-term" or "award-term options" contracting has been used but not much. If they had a choice, it is my opinion that most contractors would opt for the potential to keep the contract for a longer period of time, even if they made less fee.

The benefit to contractors from this approach is stability, maintaining critical skills, using the contract to develop new managers and engineers for other competitive actions, and increasing financial security—i.e., the potential to maintain staff and revenue for a significantly longer period. In a government market that is increasingly characterized by constricting budgets and fewer contractual opportunities, this is a major benefit to contractors and provides a very attractive incentive for them to "delight" their federal customers and thereby extend their tenure. It also makes it possible for the contractor to reduce proposal costs, which can run into several hundred thousand dollars or even millions on large contracts.

The concept is simple. When soliciting for potential contractors, the government should provide an opportunity for the winning offeror to earn additional time on the contract, without

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## **Just Say No to Award-Fee Contracting (cont'd):**

competition, based on performance. For example, the traditional maximum term of five years on a contract could be doubled to 10 years or even longer—e.g., a contract with a three-base with seven, one-year options or a one-year base with nine, one-year options could be awarded. By doing so, the option years can be exercised without competition by the government.

The basic premise of this approach is that “if you do a good job, you get to keep it.” If you do not, you’re history. My specific recommendation is to provide an appropriate fixed fee along with the opportunity to earn a longer term contract based on performance that meets, and preferably exceeds, the customer’s expectations.

The amount of the fixed fee would also be subject to reduction if there were any notable performance deficiencies, as defined in the contract, during a performance period. The primary “carrot” is obviously not the fixed fee, but the real opportunity for a contract life that is double, or more than double, the customary five years. If you did a survey among contractors, I am betting that if given a choice of an award-fee contract or a potentially longer contract term, they will select the latter. I am very certain that most of those federal managers and other administrative and technical staff who have the responsibility and accountability for administering award-fee programs would absolutely prefer this approach.

### **Conclusion**

It is long overdue to “just say no” to award-fee contracting. Except in certain circumstances, it has proven to be a waste of resources (time, money, and paper) with questionable benefits. Unfortunately, the level of knowledge, capability, and consistency required to make award-fee contracting an effective tool has simply not been achieved in a substantive way governmentwide. In fact, what could be characterized as successful award-fee contracting experiences have been sporadic and, often, where it has been successful, it is the result of exceptional and sustained leadership and commitment to ensure that it is done in the right way to achieve the desired results.

There *is* a better way. The government can get more “bang for their bucks” and reduce the workload on their diminishing staffing resources by providing the opportunity for companies to earn longer term contracts.

There will be longer intervals between contract competitions and less technical and administrative personnel resources will be required to compete and administer contracts. Fee costs and paperwork will be reduced significantly.

This approach is still performance-based contracting, but the motivation for contractors to excel is based on the opportunity to earn longer term contracts versus an award fee. The result is better performance, certainly as good as is obtained from the award-fee process, but at a much reduced cost to the government in terms of both actual fee paid and resources required for contract execution and administration.

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This way of doing business *will* “work better and cost less” than the award-fee approach. It is a winning proposition for the agencies and the companies competing for their business and, most importantly, it represents a better deal for U.S. taxpayers. It is long overdue to make a change. Let’s get on with it!

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\* - Brent Armstrong, CPCM, CFCM, Fellow, is vice president, Energy, Environment and Health Services, for EG&G Technical Services, Inc. He retired from the federal government in 2001 as a member of the Senior Executive Service. Mr. Armstrong has authored and co-authored more than 20 articles, including several for *Contract Management (CM)*, and was the co-recipient of NCMA’s Charles J. Delaney Memorial Award for the best *CM* article of 2004. He is currently serving his 13<sup>th</sup> year as a member of the NCMA’s Board of Advisors and is a member of the NCMA Northern West Virginia Chapter.

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**A Level Playing Field:  
Why Congress Intended the Boards of Contract Appeals To Have  
Enforceable Subpoena Power Over Both Contractors and the Government**

by

Thomas L. McGovern III, Daniel P. Graham, and Stuart B. Nibley\*

[Note: “*A Level Playing Field: Why Congress Intended the Boards of Contract Appeals To Have Enforceable Subpoena Power Over Both Contractors and the Government*,” by Thomas L. McGovern III, Daniel P. Graham, and Stuart B. Nibley. American Bar Association Public Contract Law Journal, Volume 36, No. 4, Summer 2007. ©2007 by the American Bar Association. Reprinted with permission.]

## **I. Introduction and Summary**

The Contract Disputes Act of 1978<sup>1</sup> (CDA) gave the Boards of Contract Appeals authority to authorize depositions and discovery proceedings and to require by subpoena the attendance of witnesses and production of documents. The CDA further provides a mechanism for the enforcement of subpoenas in the case of contumacy or refusal to obey a subpoena:

A member of an agency board of contract appeals may administer oaths to witnesses, authorize depositions and discovery proceedings, and require by subpoena the attendance of witnesses, and production of books and papers, for the taking of testimony or evidence by deposition or in the hearing of an appeal by the agency board. In the case of contumacy or refusal to obey a subpoena *by a person* who resides, is found, or transacts business within the jurisdiction of a United States district court, the court, upon application of the agency board through the Attorney General; or upon application by the board of contract appeals of the Tennessee Valley Authority, shall have jurisdiction to issue the person an order requiring him to appear before the agency board or a member thereof, to produce evidence or to give testimony, or both. Any failure of any such person to obey the order of the court may be punished by the court as a contempt thereof.<sup>2</sup>

Although the first sentence of section 610 does not limit to whom a subpoena may be issued, the second sentence describes the enforcement procedure as applicable to “persons.”

The Department of Justice (DOJ), which is charged by the CDA to enforce subpoenas in the district court when requested by a board, recently has taken the position that “a person” in this context does not include an agency of the Federal Government. Based on DOJ’s objections, the Office of Federal Procurement Policy reportedly delayed the release of rules for the newly created Civilian Board of Contract Appeals (CBCA).<sup>3</sup> When the CBCA’s rules were finally issued on July 5, 2007, the Federal Register notice announcing the new rules explained:

Questions have been raised about the scope of the Board’s subpoena authority over federal agencies. The Department of Justice has recently provided advice concluding that the statute that granted subpoena authority to the separate agency  
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### **A Level Playing Field (cont'd):**

boards of contract appeals, and that provides such authority to the consolidated Board, does not provide the necessary legal authority for a board to enforce a subpoena against a federal agency. Therefore, the agency does not interpret the term “person” where it is used in section 6101.16 to include the United States or component federal agencies.<sup>4</sup>

Assuming DOJ is correct that there is no ability to petition a district court to compel compliance with the subpoena when an agency official simply refuses to comply, responding to a board subpoena, in effect, becomes optional at the discretion of the agency. This situation would be most acute in the case of a *nonparty* agency that has no immediate stake in the outcome of the litigation before the board. There is reason to doubt that nonparty agencies will be motivated to comply with a board subpoena simply because the board might draw an adverse inference on a factual matter in the absence of subpoenaed evidence — particularly if the nonparty agency in possession of the documents is not directly affected by the ruling and has other motivations not to comply.

In considering this issue, we have (a) examined relevant legal authority regarding the issue of whether the term “person” for purposes of the contumacy provision might include an agency (or agency custodian) and (b) reviewed the legislative history of the CDA to determine whether it offers a relevant context for interpreting the meaning of “person” as used in section 610.

As discussed more fully below, the dispute regarding the proper interpretation of section 610 of the CDA is part of a broader question of statutory interpretation as to whether the term “person” when used in a statute includes the sovereign and the sovereign’s officials acting in their official capacities. In fact, the controversy regarding the CDA arose as DOJ was litigating the related issue of whether the United States is a “person” within the meaning of Federal Rule of Civil Procedure 45(a)(1)(C)(Rule 45), which provides that “every subpoena shall . . . Command each person to whom it is directed to attend and give testimony.” In this dispute, DOJ relied primarily on an established interpretive presumption, discussed below, that the term “person” does not include the sovereign or its officials when used in a statute.

Our review of the relevant statutes and case law, discussed in Part II.B below, indicates the DOJ’s focus on the interpretive presumption as to the meaning of the term “person” as used in the contumacy provisions of the CDA has some validity. However, the case law is also clear that the presumption is not meant to be conclusive. The Supreme Court has long recognized that it is a rebuttable presumption that is negated if the context, legislative history, or executive interpretation of a specific statute indicates a broader or narrower meaning of the term.<sup>5</sup> In fact, a recent analysis concerning whether the Federal Government is a “person” for purposes of being subject to a district court’s subpoena power under Rule 45 resulted in a decision that the Federal Government, indeed, was a “person” for that purpose. Although the case law on this subject is complicated and susceptible to varying interpretations, we believe that the meaning  
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### **A Level Playing Field (cont'd):**

of the term “person” as used in section 610 cannot be settled without a close examination of the statutory intent and context of this provision.

Accordingly, Part II.C of this article examines the context in which the term “person” was used in section 610 of the CDA and, in particular, the legislative history surrounding section 610. Although the CDA does not define the term “person,” there is substantial evidence in the legislative history that the boards’ subpoena powers, like Rule 45, were intended to (1) provide a liberal opportunity for discovery; (2) ensure due process by treating contractors and agencies equally and fairly in the discovery process, and (3) vest in the boards discovery and subpoena powers comparable to those of the courts. Moreover, the legislative history most directly relevant to DOJ’s role in securing enforcement of subpoenas in district court indicates that DOJ assumed it would be enforcing boards’ powers in an efficient and neutral way to effectuate the purposes of the CDA. Thus, while we do not suggest that the CDA’s legislative history is dispositive on the subject, we believe it provides a substantial basis to believe that the term “person” in section 610 of the CDA was intended to include the Federal Government, just as that term has been interpreted to apply to the Federal Government in Rule 45 subpoena enforcement cases.

### **II. Analysis of Case Law Regarding Whether the Term “Person” in Statutes Authorizing Issuance of Subpoenas Includes Federal Agencies**

The CDA does not expressly define the term “person,” and although that term is used in several other sections of the CDA,<sup>6</sup> these usages do not specify whether the term was meant to include the Federal Government or its officials. Given the absence of an express definition of “person” in the statute, we have conducted research that identifies two lines of cases relevant to the issue of whether the term “person” was meant to include a federal agency or an officer of a federal agency. The first line of cases addresses the application of the Dictionary Act,<sup>7</sup> to which the courts turn when the meaning of a term is not defined in a statute they are interpreting. As discussed below, the Dictionary Act defines “person” in a way that generally *excludes* the United States; however, it also specifically envisions that the context in which a term is used in a statute may compel a different meaning.

The second source of authority is a line of Supreme Court decisions that establish a presumption that “person” does not include the sovereign or its officials acting in their official capacity. Again, however, the case law provides that this presumption can be overcome where the context, the legislative history, or the executive branch’s past interpretation of the statute indicate an intent to include the Federal Government within the meaning of that term.

Finally, this section also addresses a recent decision of the D.C. Circuit regarding the question of whether the Federal Government is a “person” under Rule 45 for purposes of being subject to the district court’s subpoena power. In *Yousuf v. Samantar*,<sup>8</sup> the court ruled that the Government indeed was a “person” in part because the Federal Rules were designed to provide  
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## **A Level Playing Field (cont'd):**

a “liberal opportunity” for discovery and because, using normal rules of statutory construction, the court concluded that the term “person” should be given the same meaning it carries in other sections of the Rules, in which the term “person” is clearly meant to include the Federal Government.

### *A. Summary of the Cases Underlying the Present Controversy*

The present controversy regarding a board’s subpoena power under the CDA has its origins in discovery disputes that arose last year in two appeals at the former Department of Agriculture Board of Contract Appeals (AGBCA): *Mountain Valley Lumber, Inc.*<sup>9</sup> and *Shawn Montee, Inc.*<sup>10</sup>. Both appeals involved the Forest Service’s suspension of timber contracts during litigation in several federal courts over whether the Forest Service’s issuance of the contracts had violated the Agency’s obligations under federal environmental law. The Forest Service suspended the timber contracts and the timber contractors filed CDA appeals at the AGBCA, claiming that the Forest Service suspension of the contracts was unreasonable because the Forest Service knew or should have known when it awarded the contracts that the contracts would not withstand judicial scrutiny.<sup>11</sup>

In both *Shawn Montee* and *Mountain Valley*, appellants propounded traditional discovery requests directed to DOJ, which had represented the Forest Service in prior federal court litigation, and to the Council on Environmental Quality (CEQ), an agency that advises other agencies with regard to their compliance with federal environmental law. DOJ responded to the contractor’s discovery requests on its own behalf, and on behalf of CEQ. Initially, it refused to comply voluntarily with the discovery requests on the basis that DOJ and CEQ were not parties to the proceedings at the AGBCA.<sup>12</sup> DOJ insisted that appellant “present a subpoena to DOJ or CEQ and not to the [Forest Service].”<sup>13</sup> The board, accordingly, issued subpoenas to both agencies, first in *Mountain Valley* and later in *Shawn Montee*. When DOJ refused to comply with the subpoena, the board requested that the U.S. Attorney for the District of Columbia seek enforcement of the subpoena in the district court pursuant to the provisions of the CDA.

The U.S. Attorney for the District of Columbia refused to initiate an enforcement action on the subpoena on the basis that the Federal Government is not “a person” for purposes of section 610 of the CDA.<sup>14</sup> The AGBCA rejected DOJ’s position, finding both that the board had the authority under the CDA to issue subpoenas to federal agencies and the right to expect enforcement of subpoenas by DOJ.<sup>15</sup> The AGBCA stated that it would impose sanctions, including drawing adverse inferences against the Forest Service, due to DOJ’s contumacy and the resulting lack of evidence on an issue central to the appeal.<sup>16</sup> This article does not address the appropriateness of sanctions or the propriety of drawing adverse inferences, but rather focuses exclusively on the question of whether an agency or official of the Federal Government is “a person” for purposes of section 610 of the CDA.

### *B. The Dictionary Act’s Definition of “Person” (continued on next page)*

### **A Level Playing Field (cont'd):**

Absent a definition of the term “person” in the CDA, the starting point for interpreting that term is the Dictionary Act, which provides:

In determining the meaning of any Act of Congress, unless the context indicates otherwise —

. . .

The words “person” and “whoever” include corporations, companies, associations, firms, partnerships, societies, and joint stock companies, as well as individuals.<sup>17</sup>

The Supreme Court and the courts of appeals have recognized that the Dictionary Act’s definition of the term “person” notably omits any mention of the Federal Government, its agencies, or its officers and employees. In *United States v. United Mine Workers of America*,<sup>18</sup> the Court held that the United States is not a person within the meaning of the provisions of the Norris-LaGuardia Act, which divests courts of jurisdiction to issue injunctions prohibiting “any person or persons” involved in a “labor dispute” from engaging in certain acts,<sup>19</sup> and defined “labor dispute” to include any case that “involves persons who are engaged in the same industry, trade, craft, or occupation; or have direct or indirect interests therein; or who are employees of the same employer; or who are members of the same or an affiliated organization of employers or employees.”<sup>20</sup> The Court reasoned that

Congress made express provision, 1 U.S.C. §1, for the term to extend to partnerships and corporations, and in §13 of the [Norris-LaGuardia] Act itself for it to extend to associations. The absence of any comparable provision extending the term to sovereign governments implies that Congress did not desire the term to extend to them.<sup>21</sup>

Similarly, in *Al Fayed v. CIA*,<sup>22</sup> the D.C. Circuit held that the United States is not a person under 28 U.S.C. §1782(a), which provides for discovery in the federal courts at the behest of foreign and international tribunals:

The district court of the district in which a person resides or is found may order him to give his testimony or statement or to produce a document or other thing for use in a foreign or international tribunal . . .<sup>23</sup>

The court turned first to the Dictionary Act and the Supreme Court’s holding in *United Mine Workers* and concluded that the definition of the term “person” in 28 U.S.C. §1782(a), absent some contrary indication, excludes the United States.<sup>24</sup>

These cases notwithstanding, the Dictionary Act specifically envisions that the context in which the term “person” is used may compel a different meaning.<sup>25</sup> Moreover, the courts (*continued on next page*)

## **A Level Playing Field (cont'd):**

in both *United Mine Workers* and *Al Fayed* held that the term “person” in the statutes before them did not include the United States because of the absence of any persuasive evidence of contrary legislative intent. Both courts recognized, however, that the term could be capable of other meanings in different contexts.<sup>26</sup>

### *C. The Judicial Presumption That the Term “Person” Does Not Include the Sovereign*

The Supreme Court has consistently recognized that in the absence of evidence to the contrary, there exists a “longstanding interpretive presumption that the term ‘person’ does not include the sovereign or its officials acting in their official capacity.”<sup>27</sup> This presumption generally parallels the definition of the term “person” in the Dictionary Act — i.e., absent evidence of congressional intent to the contrary, the term “person” does not include the Government. Applying this presumption, the Court has held:

- Several states are not “persons” within the meaning of the provisions of the federal civil False Claims Act,<sup>28</sup> allowing private parties to bring *qui tam* civil actions against “[a]ny person” who, *inter alia*, “knowingly presents . . . to . . . the . . . Government . . . a false or fraudulent claim for payment.”<sup>29</sup>
- States and state officials acting in their official capacity are not “persons” within the meaning of 42 U.S.C. §1983, which provides that “every person who, under color of any statute, ordinance, regulation, custom or usage . . . subjects, or causes to be subjected, any citizen of the United States or other person within the jurisdiction thereof to the deprivation of any rights, privileges, or immunities secured by the Constitution and laws, shall be liable to the party injured in an action at law. . . .”<sup>30</sup>
- The United States is not a “person” entitled to sue under section 7 of the Sherman Act.<sup>31, 32</sup>

Importantly, where the context does not indicate otherwise, the presumption excludes not only the sovereign from the meaning of the term “person,” but also officials acting in their official capacity. As the Court recognized in *Will*, “[o]bviously, state officials literally are persons. But a suit against a state official in his or her official capacity is not a suit against the official but rather is a suit against the official’s office.”<sup>33</sup>

While presumption discussed above is an important starting point for interpreting what was intended by the term “person” in any particular instance, three aspects of its application substantially limit the appropriateness of relying exclusively on the presumption. First, and perhaps most important, the presumption is “not a ‘hard and fast rule of exclusion.’”<sup>34</sup> Instead, the

Convenient reading of “person” may . . . be disregarded if “[t]he purpose, the subject matter, the context, the legislative history, [or] the executive interpretation of the statute . . . indicate an intent, by the use of the term, to bring state or nation within the scope of the law.”<sup>35</sup>

*(continued on next page)*

### **A Level Playing Field (cont'd):**

In this manner, the presumption offers little more than a “default” rule of statutory interpretation and operates in the same manner as the Dictionary Act, which expressly recognizes that context may dictate a broader or narrower interpretation of particular instances of the term “person.”<sup>36</sup>

Second, most of the cases that have applied the presumption involve instances “where it is claimed that Congress has subjected the states to liability to which they had not been subject before.”<sup>37</sup> When states’ rights are implicated, courts invoke the “clear statement rule,” which essentially requires that legislation be more explicit when federal-state powers are implicated, that is, when a statute is interpreted so as to subject the states to liability. In *Will*, for example, the Court felt it did not find such a clear statement when interpreting “person” in 42 U.S.C. §1983, stating:

The language of §1983 also falls far short of satisfying the ordinary rule of statutory construction that if Congress intends to alter the “usual constitutional balance between the States and the Federal government,” it must make its intention to do so “unmistakably clear in the language of the statute.” . . . Congress should make its intention “clear and manifest” if it intends to pre-empt the historic powers of the States . . .<sup>38</sup>

Unlike section §1983, the CDA does not implicate the Federalism concerns raised by statutes that provide federal rights at the expense of state sovereignty and, therefore, does not trigger the heightened clear statement rule followed in *Vermont Agency of Natural Resources and Will*.<sup>39</sup> That said, the D.C. Circuit has held that “the Supreme Court applies the constitutional principle against finding ‘person’ to include a sovereign even in the absence of sovereign immunity or comity concerns.”<sup>40</sup>

Finally, the presumption appears to have had its greatest utility in interpreting statutes enacted prior to the enactment of the current version of the Dictionary Act in 1947.<sup>41</sup> For the most part, that cases that have grappled with the presumption that person does not include a sovereign have dealt with statutes enacted under prior versions of the Dictionary Act.<sup>42</sup> Therefore, the term “person” in section 610 of the CDA — enacted under the current version of the Dictionary Act — presumably first would be interpreted under the Dictionary Act and secondarily under the line of cases dealing with the presumption. In either case, however, the outcome will likely turn on whether an examination of the context and legislative history of the CDA provides an “affirmative showing of statutory intent” to include the United States and its agencies.<sup>43</sup>

#### *D. Application of Federal Rule of Civil Procedure 45 to the United States When It Is Not a Part to the Litigation*

Recent litigation over whether the United States is a “person” for purposes of subpoena  
(continued on next page)

### **A Level Playing Field (cont'd):**

enforcement under Rule 45 is instructive with respect to whether a court might view the Federal Government to be a person for purposes of enforcing a subpoena under CDA section 610. Rule 45 provides:

Every subpoena shall:

...  
command each person to whom it is directed to attend and give testimony or to produce and permit inspection, copying, testing, or sampling of designated books, documents, electronically stored information, or tangible things in the possession, custody or control of that person . . .<sup>44</sup>

In fact, it was not DOJ but the D.C. Circuit that first questioned whether the United States is a person under Rule 45. The court raised the issue *sua sponte* in *Linder v. Calero-Portocarrero*,<sup>45</sup> an action to compel compliance with third-party subpoenas issued in a state court wrongful death suit.<sup>46</sup> The court in *Linder*, however, declined to answer its own question. After determining that the issue was not jurisdictional, *Linder* held that the Government had waived the issue by not raising it before the district court.<sup>47</sup>

DOJ, not surprisingly, began to raise and litigate the issue and obtained a number of district court rulings that found that the United States was not a “person” under Rule 45.<sup>48</sup> Following the suggestion in *Linder*, these courts based their rulings on the “longstanding interpretive discussion that person does not include the sovereign,”<sup>49</sup> Other decisions, however, rejected the Government’s position and held that the United States is a “person” under Rule 45.<sup>50</sup> Given this activity, it is not surprising that DOJ would take essentially the same position that the Federal Government is not a “person” for purposes of enforcement of CDA section 610.

In June 2006, the D.C. Circuit addressed the issue in connection with Rule 45, resolving it against the Government.<sup>51</sup> *Yousuf* looked even further back in time than previous cases had to examine the history of the presumption that the term “person” does not include the Government, specifically to the Supreme Court’s decision in *Nardone v. United States*.<sup>52</sup> In *Nardone*, the Court held that federal agents of the United States were “persons” under 47 U.S.C. §605, which provides that “no person” receiving or transmitting wire or radio communications shall divulge or publish contents of the communication to anyone other than the addressee, except in limited circumstances.<sup>53</sup> Applying *Nardone*, *Yousuf* held:

[A]t common law the Government was presumed not to be a “person” bound by statute in only two types of cases: (1) where the statute, “if not so limited, would deprive the sovereign of a recognized or established prerogative title or interest,” such as a statute of limitations; and (2) where deeming the Government a “person” would “work obvious absurdity as, for example, the application of a speed law to a policeman pursuing a criminal or the driver of a fire engine responding to an alarm.”<sup>54</sup>

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### **A Level Playing Field (cont'd):**

The *Yousuf* court concluded that Rule 45 does not fall into either category described in *Nardone*. First, the court held that the Government has no “established prerogative” not to respond when subpoenaed, noting that the Government had conceded in earlier cases that records requested for a suit in which it was not a party “could be secured by a subpoena duces tecum to the head of the Treasury Department.”<sup>53</sup> Second, *Yousuf* concluded that application of Rule 45 to the Government would work no “obvious absurdity.”<sup>56</sup> the court reasoned that “[t]he Rules were designed to provide a ‘liberal opportunity for discovery’” and that “there is no indication the Government should be exempt from the obligation of a nonparty to provide its evidence pursuant to subpoena.”<sup>57</sup>

Having concluded that the presumption did not apply, the court in *Yousuf* turned to “customary tools of statutory interpretation” to answer the question whether the United States is a “person” under Rule 45.<sup>58</sup> Following the “normal rule of statutory construction that identical words used in different parts of the same act are intended to have the same meaning,” the court observed that the term “person” in Federal Rules of Civil Procedure 4 and 30 expressly includes the Government and that the term as used in Rules 14, 19, and 24 has been interpreted to include the Government.<sup>59</sup> Moreover, DOJ had a long history of *complying* with Rule 45 subpoenas and this was strong evidence of a consistent and longstanding “executive interpretation” of Rule 45. Accordingly, the *Yousuf* court concluded that “the ‘purpose, the subject matter, the context, [and] the . . . history [of Rule 45] . . . indicate an intent, by the use of the term [‘person’], to bring [the government] within the scope’ of the Rule.”<sup>60</sup>

Thus, the *Yousuf* court affirms the proposition that the presumption that the Federal Government is not a “person” does not always apply and, more importantly, presumption or no presumption, statutory interpretation questions of this nature require a careful analysis of the context, legislative history, and executive interpretation of the CDA. Careful review of the case law that has addressed the issue of whether the Federal Government or its officials can properly be considered a “person” for purposes of application of a variety of statutes confirms that reference to available legislative history and contextual information, including the historical context that prevailed at the time a particular act was passed, is always considered important. This is so even in instances in which courts ultimately determined that legislative history and context relevant to interpretation of a particular statute did *not* signal congressional intent to bring the Government and its officials within the meaning of the term “person.” Thus, in *Al Fayed*, for example, even while finding that the movant had failed to offer persuasive evidence of the requisite congressional intent and contextual evidence to show that the Government should be found to be a “person” under the terms of 28 U.S.C. §1782, the D.C. Circuit quoted the Supreme Court in stressing the importance of examining available legislative history and contextual information to interpret each statute:

The Court has identified a range of sources for grounds to overcome the presumptions: “[O]ur conventional reading of ‘person’ may therefore be disregarded if ‘[t]he purpose, the subject matter, the context, the legislative history, [or] the executive interpretation of the statute . . . indicate an

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### **A Level Playing Field (cont'd):**

intent, by the use of the term, to bring state or nation within the scope of the law.” *Int’l Primate*, 500 U.S. at 83 (internal citation omitted). In this case none of these sources indicates an intent to override the presumption.<sup>60</sup>

The legislative history and context of the CDA, in contrast to that of the statute at issue in *Al Fayed*, is rich with discussion regarding what the architects of the CDA’s subpoena provisions intended when they granted the boards enhanced subpoena powers, and this discussion is highly relevant to interpreting the term “person” in the contumacy provision of the CDA.

### **III. Review of CDA Legislative History**

As noted above, DOJ appears not to take issue with the boards’ power to issue subpoenas to agencies and government officials, but rather contends that the Federal Government cannot be compelled to obey a board subpoena because the contumacy provisions of section 610 make reference to refusal to obey a subpoena by “a person” a term DOJ argues excludes the Federal Government and its officials. Unfortunately, there is no clear-cut discussion or explanation in the legislative history as to why the contumacy provision employed the word “person” and was worded the way it was. However, as detailed below, there is plentiful discussion of why it was believed to be vitally important to grant the boards enhanced discovery and subpoena powers, including statements to the effect that the subpoena power was intended to aid the *contractor* in developing its case.

Our review of the legislative history of the CDA indicates that subpoena power was extended to the boards to permit them to develop a full evidentiary record, limit any additional fact finding “on appeal,” and put the parties on equal footing in terms of discovery. Three issues that were debated extensively in connection with the CDA were (1) whether contractors would have “direct access” to the courts (versus being required to proceed initially in all cases before the boards), (2) the extent to which the boards were perceived to be impartial forums that afford due process to contractors, and (3) the extent to which reviewing courts should consider the facts de novo and supplement the factual record. The discussion regarding discovery and subpoena powers for the boards was directly relevant to all three issues insofar as expansion of the “due process,” that is, discovery and subpoena powers, at the boards put the parties on equal footing in development of a factual record and, as important, permitted development of a full factual record that would not require supplementation on appeal and that would be entitled to deference. In order to achieve that end, a consensus emerged that the boards needed discovery and subpoena powers comparable to those of the courts. Failure to apply the enforcement provisions to nonparty federal agencies would frustrate that purpose and result in the boards having very diminished discovery powers relative to the Court of Federal Claims. This difference, in fact, could become a significant factor in forum selection.

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### **A Level Playing Field (cont'd):**

During consideration of the CDA and a number of competing bills, the most relevant testimony concerning this issue was offered by a DOJ witness, Mr. Irving Jaffe, Deputy Assistant Attorney General, Civil Division, who testified before Senate and House committees concerning his department's position on the legislation. As discussed more fully below, DOJ was very supportive of extending subpoena powers to the boards and asserted that expansion of the boards' powers was a viable alternative to opening up already "over-crowded" federal courts to appeals of contracting officer decisions. Significantly, all of the bills offered to amend the contract disputes process (and there were several competing House and Senate bills) initially included the same language allowing the *boards* to directly petition the district courts in the event of a failure to comply. However, DOJ took the position that the boards must work through the department to enforce subpoenas, reasoning that situations invariably would arise where it might not be appropriate for agency counsel to handle such matters. DOJ, in contrast, would be in a position to efficiently and neutrally carry out this task.

Thus, although there is nothing in the legislative history of the CDA that directly addresses the question as to why the statute uses the term "person" in relation to contumacy, the legislative history does generally support the conclusion that the subpoena and enforcement powers were intended to apply equally to both parties. Moreover, there is nothing in the legislative history that would suggest that the boards' powers were somehow intended to be limited in the case of discovery involving nonparty federal agencies (or more limited than under the preexisting system where boards petitioned district courts to issue subpoenas). The legislative history of the CDA supports the view that the overall intent of the CDA subpoena provisions appears to be that boards should have subpoena powers comparable to the courts and that this subpoena power was intended to provide both the Government and the contractor with procedural due process needed to develop a full factual record.

#### *A. Board Practice Prior to the Contract Disputes Act*

In order to understand the changes to the boards' discovery practices brought about by the CDA, it is instructive to review the board's discovery practices prior to its enactment. Before passage of the CDA, boards had no authority to issue subpoenas, but regularly applied to the district courts under the provisions of 5 U.S.C. §304 to request that a district court issue a subpoena to compel the testimony of a *nonparty* witness.<sup>61</sup> This statute, which is still in effect, provides:

- (a) The head of an Executive department or military department or bureau thereof in which a claim against the United States is pending may apply to a judge or clerk of a court of the United States to issue a subpoena for a witness within the jurisdiction of the court to appear at a time and place stated in the subpoena before an individual authorized to take depositions to be used in the courts of the United States, to give full and true answers to such written interrogatories and cross-interrogatories as may be submitted with the application, or to be orally examined and cross-examined on the subject of the claim.

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### **A Level Playing Field (cont'd):**

(b) If a witness, after being served with a subpoena, neglects or refuses to appear, or, appearing, refuses to testify, the judge of the district in which the subpoena issued may proceed, on proper process, to enforce obedience to the subpoena, or to punish for disobedience, in the same manner as a court of the United States may in case of process of subpoena ad testificandum issued by the court.<sup>62</sup>

Clearly, these subpoenas issued pursuant to 5 U.S.C. §304 had “teeth” because, once issued, the subpoenaed party was subject to the court’s contempt powers.

We are unaware of any pre-CDA decisions in which a board relied on 5 U.S.C. §304 to request a subpoena for a current government employee. It appears that the boards instead relied on the inherent authority of the head of an agency to compel testimony of employees of the agency. The following passage from *Carl W. Olson & Sons Co.*<sup>63</sup> suggests that prior to the CDA, boards would simply direct depositions of agency employees under their own rules:

Only the depositions of Messrs. Paul, Leaming, and Arthur are allowed, however. Messrs. Weide, Weinberg and Rippon have retired and the board has no authority to require their depositions to be taken. This board has no power to issue subpoenas compelling their testimony. Implicit in the language of Section 4.115 of our rules empowering the board to order depositions of “any person” is a condition that such persons be employed by or under the control of the parties.

Records of the Armed Services Board of Contract Appeals reveal instances in which the ASBCA invoked 5 U.S.C. §304 to obtain an “administrative subpoena” to compel testimony for former government employees. This is significant because, as discussed below, if the Federal Government is not considered a “person” for purposes of the contumacy provisions, neither, arguably, are retired officials of the Federal Government. Although no statutory language mandated it, these requests were made through the DOJ, specifically, the Assistant Attorney General, Civil Division.

#### *B. Justice Department Testimony on Board Subpoena Powers*

The testimony offered by DOJ witness Mr. Irving Jaffe, Deputy Assistant Attorney General, Civil Division, and a statement submitted by the General Accounting Office<sup>64</sup> appear to have been very influential with respect to how the drafters of the CDA elected to frame the Act’s subpoena provisions.<sup>65</sup> The thrust of Mr. Jaffe’s testimony was that the Boards should be independent of contracting agencies, invested with power to provide full due process for both parties, including the power to order ample discovery and issue subpoenas.<sup>66</sup> This, in turn, would permit appeals from board decisions that would not be de novo, but rather, would be based on a fully developed factual record that was entitled to substantial deference on appeal.<sup>67</sup>

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### **A Level Playing Field (cont'd):**

Mr. Jaffe testified, “[I]t seems to me that a full-scale due-process hearing ought to be had once, and then it ought to be reviewed under traditional judicial standards. . .”<sup>68</sup>

A central theme of Mr. Jaffe’s testimony was the importance of procedural safeguards that protected *both* parties’ rights to fully litigate the issues and develop a full factual record for appeal. Mr. Jaffe’s prepared statement cited and commented on the following passage of the Report of the Commission on Government Procurement:

[The] present system often fails to provide the procedural safeguards and other elements of due process that should be the right of litigants. Contractors are now forced to process most disputes through a system of agency boards of contract appeals that, while essentially independent and objective forums, *do not possess the procedural authority or machinery to ensure that all of the relevant facts and issues in complicated cases are brought before the boards and given adequate consideration. The boards lack adequate discovery and subpoena powers.*<sup>69</sup>

Mr. Jaffe’s statement goes on to state:

[A]ccepting the view espoused by the Commission that the major problem is that the Boards of Contract Appeals as now constituted lack adequate discovery and subpoena powers and consist of members who are appointed by the agencies or depend on them for career advancement, the logical solution would appear to be to increase board status and independence rather than opening the federal courts (and, particularly, the over-crowded United States District Courts) to a potential substantial increase in direct “appeals” taken from numerous contracting officer “decisions” under Government contracts.<sup>70</sup>

DOJ’s position with regard to expansion of board discovery and subpoena powers of the boards appears to have been motivated by several considerations. First, extending such powers to the boards would ensure that factual issues were settled at the trier-of-fact level and not relitigated on appeal.<sup>71</sup> Second, by granting these powers to the boards, Congress would eliminate any need for contractors to seek direct access to the courts, something that DOJ at the time opposed, because contractors would be assured due process and a fair de novo hearing before the boards.<sup>72</sup> (As a compromise, DOJ advocated access to the court of federal claims only for claims that were “certified” as appropriate, not based solely on the contractor’s election.)<sup>73</sup>

A careful review of the testimony offered by DOJ reveals no suggestion that either Board subpoena power—or the mechanism for enforcement of Board subpoenas—should be dependent in any significant way upon the identity of the party subpoenaed. In fact, the testimony suggests the opposite, stating:

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### **A Level Playing Field (cont'd):**

Improvements can be made and we favor . . . [provisions] which strengthen the existing disputes procedures by granting increased status to the Boards of Contract Appeals. We favor placing these boards on a statutory footing and would favor provisions ensuring their independence. We favor increasing the status and compensation of board members in order to obtain the most qualified persons. *We favor granting the boards the authority to compel the production of documents and testimony and, through the Department of Justice to use the courts to enforce subpoenas, where necessary.*<sup>74</sup>

With respect to the issue of enforcement of subpoenas in the event of contumacy or refusal to obey, the language in the several competing versions of the legislation, as originally introduced, was identical:

In case of contumacy or refusal to obey a subpoena by a person who resides, is found, or transacts business within the jurisdiction of a United States district court, the court, upon application of the agency board, shall have jurisdiction to issue the person an order requiring him to appear before the agency board or a member thereof, to produce evidence or to give testimony or both.<sup>75</sup>

Thus, all of these competing bills originally contemplated that the board judges, or perhaps their designees, would have the power to directly petition district courts to enforce board subpoenas. In prepared testimony commenting on the above-quoted language in section 11 of S. 3128, DOJ stated:

This provision permitting boards to apply to a district court in a case of the contumacy or refusal of a person to comply with a subpoena should include the phrase: “. . . upon application of the agency board, *through* the Attorney General, . . .” Agency boards should be required to utilize the Attorney General for this purpose. . . [I]t would be most inappropriate for the agency counsel, who is defending against the claim before the board, to undertake this task, which could involve his opponent’s evidence.<sup>76</sup>

This suggested change to the language was incorporated into the final version of the bill, and the above-quoted prepared statement appears to be the only evidence in the legislative history of the CDA that explains the rationale for this change.<sup>77</sup> This testimony, however, also seems to accept the possibility that government counsel might be placed in the position of having to advocate the enforcement of a subpoena against his or her own agency. Moreover, this testimony can be read to suggest that DOJ would impartially enforce board requests for subpoena in situations where agency counsel might not be expected to do so.

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### **A Level Playing Field (cont'd):**

In addition to Justice Department testimony, the General Accounting Office (GAO) also was supportive of broad subpoena powers for the boards, stating:

All of the bills grant discovery and subpoena powers to the board of contract appeals. We agree that the boards should have this authority. This will ensure that the tools to make complete and accurate findings are available, and would minimize the need for a court to supplement the board on review.<sup>78</sup>

The House Report on the bill found this GAO testimony, and that of the Department of Justice, quite significant in connection with enactment of section 610 of the CDA.<sup>79</sup>

#### *C. Statements for the Record on Board Subpoena Powers*

During hearings and in floor debate on the Contract Disputes Act, and predecessor bills, several statements by members indicate the importance they placed on vesting the boards with subpoena power, specifically for the purpose of developing a complete record and, in particular, to help *contractors* in the development of their cases before the boards. For example, when introducing Senate Bill S. 2292, Senator Packwood stated, "Section 11 provides the administrative boards greater subpoena power by compelling the attendance of witnesses and requiring the submission of evidence through deposition and discovery techniques. These procedures will, in turn, aid the contractor in developing his case."<sup>80</sup>

Bestowing powers on the boards to compel testimony and develop a full record also was viewed as critical to enhancing credibility and effectiveness of the boards. As stated by Senator Metzenbaum upon introducing Senate Bill S. 3178 (95th Cong. 1978):

[The 1972] report [of the Commission on Government Procurement] found that too often agency boards [ ] charged under the existing system with reviewing contract disputes had very little credibility with the parties to those disputes. Frequently, the boards were perceived by the parties as excessively responsive to the contracting agencies whose disputes they decided. Furthermore, the boards often were viewed as lacking the authority and prestige needed to make sound and objective decisions and the procedures established by the boards have been widely criticized for failing to provide the necessary procedural safeguards and due process. . . [This] bill . . . addresses each of those problems. . . In addition the bill improves the fact-finding ability of boards by providing them with subpoena and discovery power.<sup>81</sup>

Likewise, in extended remarks on the Harris-Kindness Bill, Rep. Harris explained:

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### **A Level Playing Field (cont'd):**

The present system does not provide due process for litigants because the agency boards of contract appeals do not possess the procedural authority of machinery to ensure that all the relevant facts are brought before the boards and are given adequate consideration. Even though boards lack adequate legal powers for taking evidence and making decisions, the boards' findings of fact are essentially final on subsequent judicial review.<sup>82</sup>

These statements underscore the importance of procedural due process to the parties and, in particular, the contractor's ability to develop a full and complete factual record before the board and obtain "sound and objective" decisions. Moreover, it is reasonable to conclude from these statements that Congress and the administration believed that the boards should have discovery and subpoena power on par with the courts.<sup>83</sup>

#### *D. Report Language on Board Subpoena Powers*

The House and Senate Reports on the Contract Disputes Act provide little additional insight concerning the subpoena powers or enforcement mechanisms. The House Report states that "[a]gency boards are given authority to administer oaths, authorize depositions and discovery proceedings, and may require the attendance of witnesses and the production of books and papers by subpoena."<sup>84</sup> The Senate Report's discussion is somewhat more expansive, stating:

Section 11 effectuates recommendation No. 3 of the Procurement Commission and gives the boards of contract appeals of the agencies power to administer oaths, authorize depositions, and discovery, and issue subpoenas. It further provides a mechanism for enforcing these orders through the courts. It is the intent of this increased authority to improve upon the quality of the board records, *and to insure that the tools are available to make complete and accurate findings, thus minimizing the need for a court to supplement the board record on review.*<sup>85</sup>

The foregoing legislative history of the CDA strongly suggests that Congress intended that section 610's subpoena powers were to apply equally to the Government and contractors, and specifically that the term "person" was meant to include persons employed by both the Government and the contractor.

### **IV. "Executive Interpretation" and Past Practice**

As noted above in connection with the discussion of the *Yousuf* case, "executive interpretation" of a law over the course of time also is a relevant consideration in statutory interpretation. Although we have not exhaustively examined DOJ's past practice with respect to board subpoenas, select decisions by the boards issued after the CDA was enacted confirm that *(continued on next page)*

### **A Level Playing Field (cont'd):**

DOJ in the past has acted as if it were bound to comply with board subpoenas. For example, in *Heritage Reporting Corporation*,<sup>86</sup> a contractor requested that the GSBCA issue a subpoena to DOJ as one of the user agencies under a federal supply schedule contract administered by the GSA. DOJ moved to quash the subpoena on a number of bases, including that DOJ's compliance with the subpoena would be unduly burdensome. In *Heritage Reporting*, just as in *Linder* (involving Rule 45 subpoenas), DOJ did not argue that the agency was not a "person" and, therefore, could not be compelled to comply with a board subpoena.

In denying DOJ's motion to quash, Judge Williams noted the appellant's arguments in favor of enforcement:

Heritage replied that the documents were critical to its appeal in that DOJ is the only source of the documents, the amount of money involved in the alleged breach is substantial, and denying access to documents held only by user agencies would undermine the discovery process and preclude actions for breach of Federal supply contract.

For the reasons stated below, we deny the motion to quash the subpoena, and permit DOJ to develop the record further on its request for costs.

. . .

Militating against DOJ's valid concerns is one overriding circumstance—Heritage's unquestionable need for these documents to pursue this appeal. The documents indicating what orders, if any, were placed outside the schedule are the heart of appellant's proof. They are clearly relevant. Moreover, since respondent does not possess this information, subpoenaing them from mandatory user agencies like DOJ is the only way appellant can secure them. Thus, we will not quash the subpoena.<sup>87</sup>

Thus, just as in the case of the Rule 45 subpoena, there is a history of DOJ compliance with board subpoenas. The fact that it took nearly 40 years for this issue to surface and that DOJ in the meantime appears not to have asserted that it could not be compelled under section 610 to produce documents are relevant to the interpretation of this law. Moreover, as noted above, the CDA was enacted to enhance pre-CDA practice. Under pre-CDA practice, DOJ attorneys routinely sought enforcement of subpoenas issued by district courts on behalf of the boards. These subpoenas, issued under the provisions of 5 U.S.C. §304, were issued to be enforced against former government officials in their official, rather than personal, capacities. In other words, even pre-CDA practice included a mechanism for issuance and enforcement of subpoenas to former officials of nonparty government agencies to develop evidence in board proceedings. It is unlikely that Congress in enacting the CDA intended to frustrate or curtail this practice.

### **V. Conclusion**

*(continued on next page)*

### **A Level Playing Field (cont'd):**

As noted above, prior to the passage of the CDA, the Boards of Contract Appeals did not have authority to issue subpoenas. Rather, they were required to apply to district courts for issuance of subpoenas. This practice, as a practical matter, would have been time-consuming and cumbersome and the 1972 Commission on Government Procurement concluded that it was not good enough for the boards. Significantly, however, the superseded process nevertheless involved DOJ, obtaining subpoenas to compel testimony or document production from, *inter alia*, retired government agency personnel with regard to their official duties while employed by the Federal Government. Moreover, these subpoenas had “teeth” because former government employees who did not comply were subject to the court’s contempt powers. Thus, if DOJ’s position stands with respect to enforcement of board subpoenas issued under the CDA, it arguably would represent a step *backward*.

The CDA was introduced in 1978 to improve and enhance board practice. To that end, section 610 vested the boards with subpoena authority to compel testimony and the production of documents and provided an enforcement mechanism that applies to any “person.” The CDA does not define the term “person,” but statutes and other case law tell us how this statute should be interpreted absent a definition. The Dictionary Act, a fundamental tool used in interpreting statutory language, does not include governmental entities in its definition of the term “person,” but it also requires courts to examine the context, including legislative history, in which the term “person” is used in a specific statute. Similarly, the Supreme Court has held that, absent persuasive contextual information to the contrary, the term “person” is *normally* not meant to apply to the Federal Government or its officials. Even when so ruling, however, it has cautioned that a contrary interpretation may be warranted where legislative history or other contextual information reveals a different legislative intent.

Here, the legislative history of the CDA reveals an intent to allow for liberal and complete discovery in line with what would be available in a court: provide due process for *both* parties and a process for development of a full and complete record that would be entitled to deference on appeal. This same legislative history also stresses the importance of permitting the *contractor* to develop its case in an independent and impartial forum, a board with greatly enhanced status. A DOJ witness, in fact, offered the most compelling testimony that it was imperative for the boards to have full, independent discovery and subpoena powers to ensure due process at the boards and allow for complete development of a factual record at the board level. DOJ also testified, and convinced Congress, that DOJ should be made responsible for enforcement of subpoenas so that they would be enforced in an efficient and even-handed manner. Accordingly, the goals of the CDA cannot be fully achieved unless the contumacy provisions of section 610 are interpreted to apply equally to Government and contractors. The term “person” must include every party with relevant evidence.

*(continued on next page)*

## A Level Playing Field (cont'd):

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## Endnotes

<sup>1</sup> - Pub. L. No. 95-563, 92 Stat. 2383 (codified as amended at 41 U.S.C. § 610 (2000)).

<sup>2</sup> - 41 U.S.C. §610 (emphasis added).

<sup>3</sup> - The process of promulgating rules for the newly created Civilian Board of Contract Appeals (CBCA) reportedly has been delayed as a result of the Office of Federal Procurement Policy's questions concerning the scope of the boards' subpoena power. See Paul R. Hurst & Andrew D. Irwin, *DOJ's Noncompliance Stymies Approval of New Contract Boards' Procedural Rules*, 49:3 GOV'T CONTRACTOR ¶ 21 (2007). At present, the CBCA is operating pursuant to the rules of the former General Services Administration Board of Contract Appeals (GSBCA), which continue to provide for the board to issue subpoenas. See GSBCA R. P. 120, available at <http://www.gsbca.gsa.gov/Rules.pdf>.

<sup>4</sup> - In similar fashion, the Dictionary Act, 1 U.S.C. §1 (2000), also suggests that the term "person" may not include the Federal Government. However, the Dictionary Act also expressly contemplates that, in interpreting a statute, one must consider a word's "context" and the possibility that this context may sometimes result in a different interpretation. *Id.*

<sup>5</sup> - 41 U.S.C. §§601, 605, 613 (2000).

<sup>6</sup> - 1 U.S.C. §1.

<sup>7</sup> - 451 F.3d 248, 254 (D.C. Cir. 2006).

<sup>8</sup> - AGBCA No. 2003-171-1, 06-1 BCA ¶33,173 (2006).

<sup>9</sup> - AGBCA Nos. 2003-132-1 through 2003-136-1, 04-1 BCA ¶32,564 (2004).

<sup>10</sup> - *Id.*

<sup>11</sup> - *Mountain Valley Lumber, Inc.*, 06-1 BCA ¶33,173.

<sup>12</sup> - *Id.*

<sup>13</sup> - *Id.* at ¶ 33,339.

<sup>14</sup> - *Id.*

<sup>15</sup> - *Id.*

<sup>16</sup> - 1 U.S.C. §1 (2000).

<sup>17</sup> - 330 U.S. 258, 275 (1947).

<sup>18</sup> - 29 U.S.C. §104 (2000).

<sup>19</sup> - 29 U.S.C. §113 (2000).

<sup>20</sup> - *United Mine Workers*, 330 U.S. at 275.

<sup>21</sup> - 229 F.3d 272 (D.C. Cir. 2000).

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## **A Level Playing Field (cont'd):**

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

<sup>22</sup> - *Id.* at 273 (quoting 28 U.S.C. §1782(a)).

<sup>23</sup> - *Id.* at 274 (citing *United States v. United Mine Workers*, 330 U.S. 258, 275 (1947)).

<sup>24</sup> - The Dictionary Act provides that its definitions apply “unless the context indicates otherwise.” 1 U.S.C. §1 (2000).

<sup>25</sup> - *United Mine Workers*, 330 U.S. at 275; *Al Fayed*, 229 F.3d at 274.

<sup>26</sup> - *Vt. Agency of Natural Res. v. United States ex rel. Stevens*, 529 U.S. 765, 766 (2000); *Will v. Mich. Dep’t of State Police*, 491 U.S. 58, 65 (1989) (“[I]n common usage, the term ‘person’ does not include the sovereign, [and] statutes employing the [word] are ordinarily construed to exclude it.” (internal quotation omitted)); *Al Fayed*, 229 F.3d at 274.

<sup>27</sup> - 31 U.S.C. §3730(a), (b)(1).

<sup>28</sup> - *Vt. Agency of Natural Res.*, 529 U.S. at 780–88; *see also Galvan v. Fed. Prison Indus., Inc.*, 199 F.3d 461, 468 (D.C. Cir.1999) (holding that use of the word “person” in the False Claims Act does not constitute waiver of the Federal Government’s sovereign immunity).

<sup>29</sup> - *Will*, 491 U.S. at 64–66; *see also Inoye County v. Paiute-Shoshone Indians*, 538 U.S. 701, 708–12 (2003) (holding that a Native American Tribe is not a “person” authorized to sue under section 1983).

<sup>30</sup> - Act of July 2, 1890, ch. 647, 26 Stat. 210.

<sup>31</sup> - *United States v. Cooper Corp.*, 312 U.S. 600, 604–06 (1941), *superseded by statute*, 15 U.S.C. §15a.

<sup>32</sup> - *Will v. Mich. Dep’t of State Police*, 491 U.S. 58, 71 (1989) (citing *Brandon v. Holt*, 469 U.S. 464, 471 (1985)).

<sup>33</sup> - *Vt. Agency of Natural Res. v. United States ex rel. Stevens*, 529 U.S. 765, 781 (2000) (quoting *Cooper Corp.*, 312 U.S. at 604–05).

<sup>34</sup>—*Int’l Primate Prot. League v. Admin’rs of Tulane Ed. Fund*, 500 U.S. 72, 83 (1991) (quoting *Cooper Corp.*, 312 U.S. at 605); *Wilson v. Omaha Indian Tribe*, 442 U.S. 653, 667 (1979) (“[M]uch depends on the context, the subject matter, legislative history, and executive interpretation.”).

<sup>35</sup> - 1 U.S.C. §1 (2000).

<sup>36</sup> - *Vt. Agency of Natural Res.*, 529 U.S. at 781 (quoting *Will*, 491 U.S. at 64).

<sup>37</sup> - *Will*, 491 U.S. at 65 (quoting *Atascadero State Hosp. v. Scanlon*, 473 U.S. 234, 242 (1985), and *Rice v. Santa Fe Elevator Corp.*, 331 U.S. 218, 230 (1947)).

<sup>38</sup> - Importantly, applicability of the presumption is not dependent upon the existence of Federalism concerns. In *Cooper Corp.*, for example, the Supreme Court applied the presumption to hold that the United States was not a “person” entitled to bring treble damage actions under section 7 of the Sherman Act, and that case did not involve issues of Federalism or even an extended discussion of sovereign immunity. *United States v. Cooper Corp.*, 312 U.S. 600, 604–05 (1941).

<sup>39</sup> - *Al Fayed v. CIA*, 229 F.3d 272, 275 (D.C. Cir. 2000).

<sup>40</sup>—*See Yousuf v. Samantar*, 451 F.3d 248, 253–54 (D.C. Cir. 2006). Although the current version of the Dictionary Act omits any reference to governments or public entities in its definition of the term “person,” earlier versions included “bodies politic and corporate” in that definition. *Id.*; *see also Will v. Mich. Dep’t of State Police*, 491 U.S. 58, 77–79 (1989) (Brennan, J., dissenting). While this amendment confirms that the term “person” in the current version of the Dictionary Act does not ordinarily include government agencies, the Act nevertheless expressly requires an examination of context to determine whether a broader meaning should apply in any given statute. 1 U.S.C. §1 (providing that the definitions apply “unless the context indicates otherwise”).

<sup>41</sup> - *E.g.*, *Vt. Agency of Natural Res. v. United States ex rel. Stevens*, 529 U.S. 765, 781–83 n.12 (2000) (False Claims Act); *Cooper Corp.*, 312 U.S. at 604–06 (Sherman Act).

<sup>42</sup>—*Vt. Agency of Natural Res.*, 529 U.S. at 781; *Int’l Primate Prot. League v. Admin’rs of Tulane Ed. Fund*, 500 U.S. 72, 83 (1991) (quoting *Cooper Corp.*, 312 U.S. at 605) (The court must examine “[t]he purpose, the subject matter, the context, the legislative history, [or] the executive interpretation of the [CDA] [to] indicate an intent, by the use of the term, to bring state or nation within the scope of the law.”).

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## **A Level Playing Field (cont'd):**

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

<sup>43</sup> - FED. R. CIV. P. 45(1), (1)(C).

<sup>44</sup> - 251 F.3d 178, 179–80 (D.C. Cir. 2001).

<sup>45</sup> - *Id.* at 179–80.

<sup>46</sup> - *Id.* at 181–82.

<sup>47</sup> - *E.g.*, *Robinson v. City of Phila.*, 233 F.R.D. 169, 172 (E.D. Pa. 2005); *Ho v. United States*, 374 F. Supp. 2d 82, 84 n.4 (D.D.C. 2005); *see also In re Vioxx Prods. Liab. Litig.*, 235 F.R.D. 334, 339 (E.D. La. 2006) (collecting cases).

<sup>48</sup> - *Robinson*, 233 F.R.D. at 172 (quoting *Vt. Agency of Natural Res. v. United States ex rel. Stevens*, 529 U.S. 765, 780 (2000)).

<sup>49</sup> - *In re Vioxx*, 235 F.R.D. at 339–42.

<sup>50</sup> - *Yousuf v. Samantar*, 451 F.3d 248, 248, 254 (D.C. Cir. 2006).

<sup>51</sup> - 302 U.S. 379 (1937).

<sup>52</sup> - *Id.* at 382–85.

<sup>53</sup> - *Yousuf*, 451 F.3d at 254 (quoting *Nardone*, 302 U.S. at 383–84); *accord In re Vioxx Prods. Liab. Litig.*, 235 F.R.D. 334, 340–41 (E.D. La. 2006) (explaining Supreme Court decisions issued subsequent to *Nardone* under the framework described in that case).

<sup>54</sup> - *Yousuf*, 451 F.3d at 254 (quoting *United States ex rel. Touhy v. Ragen*, 340 U.S. 462, 468–70 (1951) (Frankfurter, J., concurring)).

<sup>55</sup> - *Id.* at 254.

<sup>56</sup> - *Id.* (quoting *Conley v. Gibson*, 355 U.S. 41, 47 (1957)). DOJ argued before the AGBCA in *Mountain Valley* that applying the presumption was “the only way to avoid placing the Attorney General in the obviously paradoxical position of prosecuting an action that he would simultaneously be obligated to defend pursuant to 28 U.S.C. § 516.” *Mountain Valley Lumber, Inc.*, AGBCA No. 2003-171-1, 06-2 BCA ¶ 33,339 (2006). However, DOJ is called on to litigate against the Federal Government in other contexts and, on occasion, has found itself representing adverse parties in the same litigation. *See generally* Michael Herz, *United States v. United States: When Can the Federal Government Sue Itself?* 32 WM. & MARY L. REV. 893, 896 (1991) (observing that “the Supreme Court has never dismissed an action as nonjusticiable because it could be characterized as *United States v. United States*”); William C. Tucker, *The Mangled Octopus: The Unitary Executive and EPA Enforcement Involving Federal Agencies*, 16 VILL. ENVTL. L.J. 149, 163–68 (2005) (discussing the justiciability of enforcement actions by the Environmental Protection Agency involving federal agencies). The issue is ultimately one of justiciability under Article III of the Constitution—not merely one of statutory interpretation—and court decisions addressing this issue indicate that its resolution in any given case is highly dependent on the individual circumstances of that case. *See United States v. Nixon*, 418 U.S. 683, 686 (1974) (concerning president’s efforts to quash the subpoena issued by special prosecutor).

The test established by the Supreme Court in the *Nixon* case was “(1) whether the controversy is one that is typically justiciable, and (2) whether the setting of the case is one that demonstrates concrete adversity between the parties.” *Id.* at 696; *accord TVA v. EPA*, 278 F.3d 1184, 1196 (11th Cir. 2002) (concluding that *Nixon* establishes the same two-part test); *United States v. Fed. Mar. Comm’n*, 694 F.2d 793, 810 (D.C. Cir. 1982) (same). The cases discussed in this section involving the enforcement of subpoenas under Fed. R. Civ. P. 45 demonstrate that actions to enforce subpoenas are “traditionally justiciable.” Moreover, the setting of these disputes do involve two adverse parties: the CBCA seeking documents or witnesses necessary to adjudicate a dispute on the one hand and a federal agency that does not wish to produce those documents or witnesses on the other. Here again, the Court’s reasoning in *Nixon* is particularly apposite: “The demands of and the resistance to the subpoena present an obvious controversy in the ordinary sense. . . . The independent Special Prosecutor [acting

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## A Level Playing Field (cont'd):

### Endnotes (cont'd)

under authority delegated to him by the Attorney General through regulation] with his asserted need for the subpoenaed materials in the underlying criminal prosecution is opposed by the President with his steadfast assertion of privilege against disclosure of the material. This setting assures there is that concrete adverseness which sharpens presentation of issues upon which the court so largely depends for illumination of difficult constitutional questions.” *Nixon*, 418 U.S. at 696–97 (internal quotation omitted).

Finally, the fact that DOJ may be involved in both enforcing and defending against the subpoena is not dispositive. The Supreme Court addressed a similar situation in *United States v. ICC*, 337 U.S. 426 (1949), where the United States brought an action in federal district court to set aside an ICC order. In addition to being the named plaintiff, “[t]he United States was also made a defendant because of a statutory requirement that any action to set aside an order of the [ICC] ‘shall be brought . . . against the United States.’” *Id.* at 429 (quoting 28 U.S.C. § 46). The Court dismissed the attorney general’s entry of appearance on behalf of the ICC as a “surface anomaly,” observing that the ICC’s counsel had vigorously defended the ICC’s interests. *Id.* at 32; *see also* *Plaintiffs in All Winstar-Related Cases at the Court v. United States*, 44 Fed. Cl. 3, 7 n.5 (1999) (finding a justiciable controversy where the Federal Deposit Insurance Corp. acted as both plaintiff and defendant, represented in each capacity by different lawyers with an internal firewall allowing the attorneys to be “as separate as if they worked for different law firms”). In an action to enforce a subpoena against a federal agency under the CDA, agency counsel presumably can adequately defend the interests of the subpoenaed agency (as in *Nixon*) or different attorneys at DOJ could represent each party (as happened with the FDIC in *Plaintiffs in All Winstar-Related Cases*).

<sup>57</sup> - *Yousuf v. Samantar*, 451 F.3d 248, 255 (D.C. Cir. 2006).

<sup>58</sup> - *Id.* at 255–56 (quoting *Gustafson v. Alloyd Co., Inc.*, 513 U.S. 561, 570 (1995)).

<sup>59</sup> - *Id.* at 257 (quoting *United States v. Cooper Corp.*, 312 U.S. 600, 605 (1941)). Notably, the pertinent language in Rule 45 was introduced in 1937, prior to the enactment of the current version of the Dictionary Act, 1 U.S.C. § 1. *Id.* at 253. This fact allowed the court in *Yousuf* to distinguish its earlier decision in *Al Fayed* on the ground that the statute at issue in *Al Fayed*, 28 U.S.C. § 1782, unlike Rule 45, postdated and was therefore governed by the Dictionary Act: “In *Al Fayed*, therefore, the Dictionary Act as amended in 1947 required that § 1782 be interpreted so as to exclude the Government.” *Id.* at 254–55. This was because the movant in *Al Fayed* did not present persuasive contextual information (legislative history) as to the meaning Congress intended to assign to the term “person” when it enacted section 1782. The Dictionary Act and case law, including the *Al Fayed* decision, continue to stand for the proposition that the term “person” must be read in the context of other language in the statute under review and the legislative history of the statute.

<sup>60</sup> - *Al Fayed v. CIA*, 229 F.3d 272, 285 (D.C. Cir. 2000). *But see* *Rowland v. Cal. Men’s Colony, Unit II Men’s Advisory Council*, 506 U.S. 194, 199–200 (1993) (suggesting that “context” generally does not include legislative history), *with Int’l Primate Prot. League v. Admin’rs of Tulane Ed. Fund*, 500 U.S. 72, 83 (1991) (examining legislative history to determine the meaning of the term “person”).

<sup>61</sup> - *See, e.g.*, *Carl W. Olson & Sons Co.*, IBCA No. 930-9-71, 73-2 BCA ¶ 10,269, at 10,269 n.6 (1973) (“There is . . . a procedure available under 5 U.S.C. § 304 by which the head of an agency may request a Federal Court to issue a subpoena ordering a witness to give testimony.”); *Gen. Dynamics Corp., Elec. Div.*, ASBCA No. 14466, 73-1 BCA ¶ 9960 (1973) (witness compelled to testify through request to federal court under 5 U.S.C. § 304); *Gen. Instrument Corp.*, DOTCAB No. 67-9A, 72-1 BCA ¶ 9389 (1972) (witness compelled to testify through request to federal court under 5 U.S.C. § 304); *The Chemithon Corp.*, GSBCA No. 4525, 77-1 BCA ¶ 12436 (1977) (requesting voluntary cooperation of witnesses through written correspondence but noting that, if witnesses refuse to cooperate, the board may seek action in a court of the United States for subpoenas pursuant to 5 U.S.C. § 304).

<sup>62</sup> - 5 U.S.C. § 304 (2000).

<sup>63</sup> - IBCA No. 930-9-71, 73-2 BCA ¶ 10,269 (1973).

<sup>64</sup> - Subsequently renamed the Government Accountability Office.

<sup>65</sup> —*See Contract Disputes: Hearings Before the Subcomm. on Admin. Law and Gov’t Relations of the H. Comm.*

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## A Level Playing Field (cont'd):

### Endnotes (cont'd)

*on the Judiciary*, 95th Cong. (1977) (statement of Irving Jaffe, Deputy Assistant Attorney General, Civil Division, U.S. Department of Justice) [hereinafter DOJ House Testimony]; *see also Contract Disputes Act of 1978: Joint Hearings Before the Subcomm. on Fed. Spending Practices and Open Gov't of the S. Comm. on Governmental Affairs and the Subcomm. on Citizens' and Shareholders' Rights and Remedies of the S. Comm. on the Judiciary*, 95th Cong. 175–241 (1978) (statement of Irving Jaffe, Deputy Assistant Attorney General, Civil Division, U.S. Department of Justice) [hereinafter DOJ Senate Testimony].

<sup>66</sup> - DOJ House Testimony, *supra* note 65, at 100 (“We, of course, have always favored the investiture of the board with subpoena [sic] and discovery powers. We have supported that for many, many years. We had even offered to draft a bill for that purpose many years ago, but the bar did not cooperate.”).

<sup>67</sup> - *Id.* at 98. Notably, the decision of the Supreme Court in *United States v. Bianchi*, 373 U.S. 709 (1963), brought an end to the ability of contractors to obtain *de novo* trials in the court of claims following an adverse board decision. As a result, court of claims litigation following *Bianchi* was limited to the record before the board with certain limited exceptions. The concern with inadequate due process at the board level created pressure for reform that culminated in passage of the CDA.

<sup>68</sup> - An interesting aside is that DOJ also advocated consolidation of the boards into two boards: one for the armed services and the other for civilian agencies. DOJ House Testimony, *supra* note 65, at 87 (statement of Mr. Jaffe) (“the current multiple agency appeals boards [should] be consolidated into two full time boards, one generally for the armed services, and a second generally for the civilian agencies, and . . . these two boards be given subpoena and discovery powers,” citing *Disputes in Connection with Contract Administration*, 41 Fed. Reg. 10,488 (Mar. 11, 1976) [hereinafter *Disputes*] (stating administration position on Procurement Commission findings)). The executive branch position departed from the Commission recommendation by proposing “detaching the boards from individual agencies and vesting them directly with authority to decide appeals. If the boards, in the words of the Commission, are to be treated as ‘independent quasi-judicial tribunals’ and strengthened ‘to ensure independence and objectivity of the Board members,’ consolidation is the most effective and appropriate means of doing so.” *Id.* at 10,489.

<sup>69</sup> - U.S. COMM’N ON GOV’T PROCUREMENT, 4 FINAL REPORT FOR THE COMMISSION ON GOVERNMENT PROCUREMENT 3 (1979) (emphasis added). The CDA was one of several reform measures that adopted the 1972 recommendations of the Commission on Government Procurement.

<sup>70</sup> - DOJ House Testimony, *supra* note 65, at 86 (statement of Mr. Jaffe); *see also* DOJ Senate Testimony, *supra* note 65, at 178 (statement of Mr. Jaffe) (“We have long advocated, and I testified before a Senate select committee in 1964 or 1965, submitting a draft of legislation to give the boards of contract appeals, subpoena [sic] power and broader discovery power. We certainly endorse that. *We believe that if the board is going to be the chief trier of the facts, it should have available by statute all the tools necessary to arrive at all the facts. We support that. We support anything that would make the boards of contract appeals independent and independent [sic], even of the agency who is the contracting agency. We want to eliminate any appearance of unfairness or partiality.*”) (emphasis added).

<sup>71</sup>—*See, e.g.*, DOJ Senate Testimony, *supra* note 65, at 226 (statement of Mr. Jaffe) (advocating that a reviewing court should not be able to consider evidence but for “newly discovered evidence,” which presumes the ability to get all evidence before the boards).

<sup>72</sup>—In opposing use of the “clearly erroneous” standard of review of board decisions, Mr. Jaffe testified that if the trier of fact cannot fairly adjudicate the facts, “Congress should be considering . . . abolishing administrative procedures altogether *because if they can’t make them fair, we shouldn’t have them at all. Make them fair. If you can’t make them fair, abolish them, but don’t have two trials.*” *Id.* at 181 (emphasis added).

*See* DOJ House Testimony, *supra* note 65, at 86 (statement of Mr. Jaffe) (instead of permitting contractors direct access to U.S. district courts [a Commission on Government Procurement recommendation], problems would be better addressed by increasing discovery and subpoena powers of the boards as an alternative to opening (*continued on next page*))



## **Negotiating Liability Allocation Terms: Risk, Indemnity, and Intellectual Property**

by

Richard Pennington and Corey Sanchez\*

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*Seller shall hold harmless and indemnify buyer against any claims, damages, liability, cost or expenses (including attorneys' fees) arising out of actions or claims of intellectual property infringement. . . . The remedy specified herein shall be the buyer's sole and exclusive remedy for breach of the warranty against infringement, and all other implied warranties are hereby disclaimed.*

*Neither party shall be liable for indirect, special, consequential, incidental, multiple, or punitive damages, including anticipated lost profits or lost revenues from business interruption.*

*In no event shall seller's liability exceed the purchase price.*

If you negotiate contracts or subcontracts for the purchase of goods or services, you no doubt have encountered various versions of the sample liability disclaimers and indemnity provisions found at the beginning of this article. To any contract negotiator, one of the most frustrating aspects of negotiation is weaving through the concerns raised by other contracting professionals and legal counsel about contract terms relating to liability.

In this article, we address the legal concerns raised by the negotiation of liability provisions and how these clauses work together. We cannot tackle all aspects of liability allocation in the space permitted here, so this article will emphasize intellectual property rights—an important aspect of government contracts that raises particular concerns about liability allocation.<sup>1</sup>

### **Risk and Liability**

Any negotiated contract involves a give-and-take that changes as the parties begin to understand the risks associated with contract performance. In risk management, risk is generally defined as those events that adversely impact an organization's ability to achieve its objectives. Risk is a combination of likelihood of occurrence and potential impact. The relationship between contract negotiation and risk management involves similar considerations; although from a legal perspective the impact primarily is measured in terms of potential legal liability. In the intellectual property setting, potential liability may arise from the buyer's unauthorized use of the intellectual property of the seller; or in some cases, by either party's infringement of the rights of a third party or a breach of a license. So, for example, a seller's integration of a third party's patented invention or process in its deliverable creates potential liability and increases the buyer's risk. A buyer making multiple copies of delivered manuals  
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## **Negotiating Liability Allocation Terms (cont'd):**

and distributing them internally may violate copyrights owned by the seller. A buyer furnishing the seller's technical data to a third party (like another company operating as a team member in a procurement involving the government) may violate the seller's trade secrets (i.e., where there were only limited rights to the data). Any of these scenarios can involve violation of intellectual property rights where inventions, restricted computer software, copyrights, limited rights data, or other trade secrets owned by a third party are wrongfully included in deliverables, or rights are otherwise infringed by either the buyer or seller.<sup>2</sup> All of these events involve potential liability and risk of damages.

Intellectual property risk is commonly mitigated by contractually defining in advance ownership rights and appropriate license rights. But there is risk here, as well. Under contracts governed by the *Federal Acquisition Regulation (FAR)*, intellectual property rights are defined in terms of invention, limited rights, restricted rights, etc. These definitions provide some certainty when negotiating intellectual property clauses. However, the definitions are not always so clear when dealing with parties that are unfamiliar with the *FAR* or with definitions that use commercial terms having various meanings. The variety of terms can create confusion by making the meaning of license terms and associated liability allocation provisions subject to different interpretations.

Even where terms are well defined, parties still encounter risk that intellectual property rights may be violated or are inadequate to permit performance. This is particularly problematic when the licensor provides a license that does not cover the deliverables as used by the buyer. Further, a licensor can only license what rights it has, so there may be risk that the licensor infringed a third party's rights or had only a limited right to license the intellectual property to another.

On the other hand, a licensee's abuse of license rights may infringe the seller's intellectual property rights or those of a third party that licensed rights to the seller. Like other issues involved in contract performance, intellectual property issues can pose risk of liability for both buyers and sellers.

### **Assessing Risk**

Like other contract provisions, intellectual property ownership and licensing provisions involve a bundle of rights and obligations, breach of which can lead to law suits and potential liability. Any decision to negotiate liability provisions, then, involves some element of risk assessment and reallocation. It is easiest to understand how to assess the risk if you understand the type of risks that could arise.

The types of damages that can flow from contract performance—and that are typically limited and excluded in contract language—are defined using terms that differ among states. Like terms used in intellectual property, confusion stems from different terms often used to describe liability and damages that can arise out of contract performance.

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## **Negotiating Liability Allocation Terms (cont'd):**

Damages, for example, are broadly classified as (1) direct, (2) indirect, and (3) punitive. Direct damages from breach of sales contracts are the difference between the value of the goods as accepted and the value as warranted by the seller.<sup>3</sup> Indirect damages consist of those damages that are not directly related to breach of the “bargain” represented by the contractual transaction. Lost productivity from defective software is a common example. Consequential and special damages fall in the category of indirect damages under most common uses of the term. The last major form of damages is punitive (or exemplary) damages. Punitive damages—rare in contract breach actions—generally are awarded when the court intends to punish or make a public example of the party, e.g. in connection with commission of egregious torts.

In contrast, some states use the term “general damages” to define basic entitlement to damages. Jury instructions provide different standards for recovery of damages in contract breach actions and civil actions arising out of personal injury and property damages. Generally, though, contract breach damages represent the “loss of the benefit of the bargain,” while tort damages typically are defined in terms of the foreseeability of the damages considering the particular wrongdoing or negligence that is involved.

Intellectual property infringement and misappropriation actions tend to look more like actions involving rights in property, with damages approximating the value of property and its use over time. Intellectual property damages are particularly difficult to assess, due to the uncertainty in valuation of the intellectual property, making proper licensing and liability allocation critical. The differing terms used to define theories of liability and types of recoverable damages further complicate the task of contract drafting, particularly when the parties intend to limit damages that can be recovered.

### **Understanding Liability in the Absence of Contract Language Reallocation**

One of the first considerations in assessing negotiation risk is understanding generally what the law provides in the case of contract breach or other events that give rise to liability. If the parties are silent on liability allocation, the law provides a legal remedy—usually damages. Some understanding of the measure of damages is helpful when negotiating intellectual property and other liability allocation clauses.

The legal standards regarding damages provide insight into potential risk. Direct or general damages for breach of contract by the seller normally are measured by the difference between the value of performance as contracted and the value of performance as delivered. In the case of buyer breach, the direct damage to the seller may be the difference between the actual cost of performance and the contract price.

Damages measures differ with regard to the kinds of claims that can arise out of contract performance. A software copyright infringement claim by a major software manufacturer could include as damages customary royalties during the period of infringing use. A patent infringement action might include royalty revenues lost by the owner of the patent. Trade secret infringements (or misappropriation) likewise can include lost profits or revenues  
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## **Negotiating Liability Allocation Terms (cont'd):**

attributable to wrongful disclosure of trade secrets, and these can be sizeable. In some cases, statutes provide treble (or other multiple) damages for willful infringement. These actions also can involve injunctions against use by the buyer, so a buyer also may be facing the prospect of contract breach by a seller who furnished infringing products and that left the buyer without a product its business or customer needed.

Many states require proof of economic damages with a “reasonable certainty.” Further, the party claiming breach generally has the burden of proving what those damages are in connection with the suit. The foreseeability of damages often becomes relevant as liability risk moves from what is known as a general or direct damage into other indirect damages (consequential or special damages).

One of the threshold questions with counsel should be, “What happens if the contract is silent with respect to remedies?” However imprecise they are, the rules for recovery of damages are defined by law. There is risk, though, given the fact that different states may be involved. What might be treated as a general damage in one jurisdiction may have a different definition and burden of proof in another state. This is one of the more significant outcomes of specifying choice of law in contracts and illustrates the value of the parties’ definition of damages or remedies.

While attorneys can provide general guidance about likely legal damages, the variety of locations of business incorporation, contracting, and performance makes the conflict of law issues very complex. Consequently, there is some comfort in plainly defining key constraints on liability. Otherwise, developing all the hypothetical outcomes for possible damages that could arise under the contract is at best uncertain. Negotiations might be delayed while parties analyze potential liabilities in all the states that might be involved. So as a practical matter, liability allocation provisions are used as an efficient way of reasonably allocating liability related to contract performance.

### **Litigation and the Uncertainty of Costs and Outcomes**

There is risk also from the uncertainty of outcomes of the legal process. There often are jury trial rights, and jury verdicts in commercial transactions may be unpredictable. Further, there are significant costs associated with litigation. Attorneys’ fees in the United States are largely unrecoverable, and other costs of litigation generally are born by the party incurring them, unless expressly made recoverable by contract. The prospects of incurring these litigation costs all represent risks. Your organization’s counsel can provide general guidelines about how damages are computed and litigation costs awarded under the law of the relevant jurisdiction(s).

### **Using Contract Terms to Allocate Risk**

There are many contract terms and conditions that help to manage the types of risks previously discussed. For example, a party might manage its exposure to certain liabilities under a government contract through its own insurance or requiring the other party to maintain

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## **Negotiating Liability Allocation Terms (cont'd):**

insurance—an analysis beyond the scope of this article. This article will discuss other common contractual techniques for allocating liability risk and will explore interrelationships between those provisions, with particular emphasis on intellectual property rights and obligations.

### ***Aligning Liability Risk with a Higher-Tier Contract***

The considerations in negotiating liability allocation clauses are unique in subcontracts arising out of an overarching higher-tier contract (e.g., a government prime contract). Just like the scope of work and other requirements, prime contracts may involve liability scenarios that need to be aligned between the prime contract and the subcontract.

Not only do prime contract provisions define the requirements for government rights in intellectual property, they may affect subcontract allocation of risk relating to intellectual property infringement. For example, FAR 52.227-14 (Rights in Data—General) and other similar data rights clauses provide a scheme for defining the government's rights in data. A subcontract under a prime contract with that clause would have to flow down the provision in order ensure the government receives rights consistent with prime contract requirements. Obtaining *unlimited* rights in data of another party indirectly mitigates risk of infringement claims (essentially eliminating them) as between the parties to the contract. FAR 52.227-14, however, does not directly provide a license to a buyer (other than the government), nor does it allocate liability risk among prime contractors and subcontractors.

Other FAR clauses tie payment to specific performance requirements and otherwise allocate liability risk. For example, FAR 52.227-21 (Technical Data Declaration, Revision, and Withholding of Payment—Major Systems) authorizes withholding of payment for failure to properly deliver technical data. Similarly, FAR 52.227-13 (Patent Rights—Acquisition by the Government) permits payment withholding for failure to disclose inventions or make required reports. Those clauses ultimately may create liability for the prime contractor. Therefore, some alignment with provisions in a subcontract is required where the subcontractor is responsible for performance that the clauses require.

Importantly, FAR 52.227-1 (Authorization and Consent) directly limits liability risk for patent infringement. That clause provides that the government authorizes and consents to use or manufacture of inventions, and the government assumes liability for infringement of related patents. FAR 52.227-3 (Patent Indemnity), on the other hand, requires a government contractor to indemnify the government against liability, including costs, arising out of patent infringement claims. Both of these clauses affect potential liability of the prime contractor with respect to third-party infringement claims, and should be considered in the negotiation of any subcontractor provisions that allocate liability.

One important issue, however, is the scope of these kinds of provisions and their effect on potential liability. Some contract terms deal only with patent infringement, for example. Significant liability, however, also can arise between contractors from infringement of rights to technical data, computer software, and copyright, as well as misappropriation of trade secrets.  
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## **Negotiating Liability Allocation Terms (cont'd):**

So accommodating only FAR clauses dealing with patent infringement may not eliminate the need to allocate liability in subcontracts for other types of intellectual property infringement.

### ***The Enforceability of Contract Liability Terms***

Under federal government contract programs, subcontracts are subject to state law, causing further uncertainty to the interpretation of a contract. Most states enforce a party's right to manage its liabilities in a contract, but there are exceptions that are heavily dependent on the specific state law being applied.

For example, when circumstances cause the exclusive or limited remedy to fail of its essential purpose, courts may limit the application of the specified contractual remedy. In *RRX Indus. v. Lab-Con, Inc.*, for example, a California court invalidated a software license clause in which the licensor agreed to correct programming bugs, but limited the liability to an amount not in excess of the actual amounts paid as the license fees.<sup>4</sup> The software never functioned as intended, and the seller failed to correct the programming errors. RRX Industries had no other means of recovering under the contract. The Ninth Circuit held that the seller's default was so total and fundamental that the court "expunged" the consequential damages limitation from the contract. Thus, the consequential damages that had been disclaimed in the contract were given to the buyer due to the failure of the remedy.

Another example explains this point further. The "failure of the essential purpose" doctrine is similarly applied by states in warranty situations. One common technique in contracts is to define a warranty (e.g., a 12-month repair warranty) and then specify the remedies that the seller will provide in the alternative. The options commonly include repair or replacement. The clauses often are written to make the contractual warranty remedy the "exclusive remedy," which might eliminate the right to pursue monetary damages for breach of warranty.

In the event of performance problems, the buyer argues that the exclusivity provision makes sense only so long as repair or replacement is accomplished consistent with seller's promises. Some courts find that serious failures by the seller to repair defects make the remedy fail of its essential purpose, relieving the buyer from the limiting effect of an exclusive remedy provision. State courts are not consistent in their application of the doctrine, however, and the sophistication of the parties (as is the case in government contracts) may make it more difficult for a buyer to escape the effects of such a clause.

Generally, state courts enforce clauses that limit damages; at least between sophisticated contracting parties where no special relationship exists (e.g., one party is not a consumer). Courts on occasion have struck damage limitation provisions where they were unconscionable—a rare finding (where, for example, one of the parties is a minor or not represented by counsel)—or when behavior demonstrated intentional wrongdoing or reckless indifference to the rights of others. As a practical matter, however, it is not good practice during negotiation to rely on legal doctrines that *might* strike a provision. It is better to try to negotiate reasonable liability allocation terms.

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## **Negotiating Liability Allocation Terms (cont'd):**

### **Exclusion of Damages: Do You Know What Rights You are Limiting?**

*Neither party shall be liable for indirect, special, consequential, incidental, multiple, or punitive damages, including anticipated lost profits or lost revenues from business interruption.*

Exclusion of damages language (like that above) is commonly used to limit potential liability. The exclusion of consequential damages, for example, generally means that the parties are limiting the damages to those costs arising directly from the breach of the contract.

As has already been suggested, there is no common glossary generally applicable to all states that define these terms. The Uniform Commercial Code (UCC) defines incidental and consequential damages for transactions in goods, but even the UCC uses language that is not the model of precision, couched in terms of foreseeability, for example.

In negotiating these provisions, there may be endpoints in terms of what is commonly accepted. First, regardless of how the term “direct damage” is defined, there is general agreement that it is unreasonable to exclude remedies for direct damages for breach of contract. Many courts, when faced with these provisions, use strict construction principles and attempt to interpret ambiguous contract language so a party is not left without any effective remedy for breach of contract. As a general rule, however, it is not advisable to agree to provisions that exclude direct damages.

On the other end of the spectrum, concerning indirect damages (consequential or special), there may be general agreement about the reasonableness of excluding tenuous damages theories related to claims of lost productivity or revenues that are grossly disproportionate to the value of the products or services. Off-the-shelf software is one example. A defect in a new release of a \$300 word processing software package conceivably could cause a loss of productivity (i.e., consequential damages) for everyone across an enterprise that had a license to use it. Or a reseller may argue that it lost potential profits during the period that the software manufacturer recalled the product. Further, the buyer may need to procure new software that requires additional time and expense to implement an alternative. There probably is general agreement that there should be some limit to the amount of potential recovery on these kinds of claims, at least with respect to standard commercial sales of off-the-shelf products and simple services.

Between those two boundaries there often is little agreement. As a general matter, the law imposes limits based on the legal standards for awarding damages and the associated proof requirements. Consequently, one should be cautious when negotiating damages exclusions that will have the effect of limiting rights to damages.

Even the simple exclusion of consequential damages may have unintended consequences. The UCC defines consequential damages as:

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## **Negotiating Liability Allocation Terms (cont'd):**

1. Any loss resulting from general or particular requirements and needs of which the seller at the time of contracting had reason to know and which could not reasonably be prevented by cover or otherwise; and
2. Injury to person or property proximately resulting from any breach of warranty.<sup>5</sup>

A contractual exclusion of consequential damages raises a question—was the provision intended to exclude the ability of a buyer to claim contribution under state law for tort liability caused by the seller? Probably not, but these kinds of exclusions demonstrate the importance of contract interpretation. A better solution is to limit a consequential damages exclusion so that it does not apply broadly to claims, damages, or liability arising out of personal injury and damage to tangible property.

Other common damage exclusions are lost profits, lost revenues, or other economic loss; exclusions that may be reasonable when limiting contract breach damages, but that may cause some confusion in intellectual property infringement circumstances. Technology contracts often include intellectual property indemnification provisions that make the seller responsible for defending third-party claims of infringement against the buyer. The UCC also has a warranty against infringement in the case of transactions in goods. In intellectual property infringement actions, lost profits typically are a significant element of damages. Does a damages exclusion in the contract affect the seller's liability for lost profits in intellectual property infringement actions brought against the buyer by third parties? The answer again is unclear, so it is better to address the issue by making the exclusion of damages provision inapplicable to claims, damages, or liability arising out of a contract's intellectual property infringement indemnification provision—a common practice.

The nature of the contract performance affects the risk analysis and the importance of clarifying liability allocation issues. A small contract for office automation software may involve mature technology and little risk from infringement actions. In that case, legal precision in negotiating damages exclusion provisions may not be necessary. Contracting professionals, however, must understand the interplay between damages exclusions and the various theories of liability most likely to operate in any given contract.

### **Liability Caps: Does a Cap Make Sense?**

Liability caps seem to be a common technique to limit contract liability. As a matter of compromise, caps on liability “arising under the contract” are often expressed in relation to the contract price or other specified amount.

There are several considerations when evaluating limitations on the amount of damages. In general, state law determines not only the elements of damages, but whether there are limits on the amount of damages or the ability of the parties to define remedies. The California Commercial Code, for example, allows remedies to be limited “to the return of the goods and repayment of the price or to repair and replacement of nonconforming goods or parts.”<sup>6</sup> The  
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## **Negotiating Liability Allocation Terms (cont'd):**

statute does not address stipulated amounts less than the price, but California cases have suggested that damages limitation provisions less than contract value can be enforced. There may be other specific state law provisions that are relevant to contractual definition of remedies, again demonstrating the importance of state law.

The specific contract language used in the liability cap provision is important. A liability cap equal to the contract price will operate differently than a cap based on payments made, especially in early phases of contract performance where progress or milestone payments have not been made. Literally applied, the latter cap can be interpreted to mean that the parties agreed that no damages could be claimed unless payments had been made, an interpretation that may unreasonably favor the seller.

Liability caps equal to contract price may limit the buyer's ability to achieve "cover" or reimbursement for the extra costs of going to a substitute seller. State courts appear to apply liability cap language very literally. If all contract payments have been made, an action for contract breach usually involves a request for return of those payments because performance was defective, in addition to the damages associated with achieving acceptable performance by another supplier. If the contract liability cap is equal to contract price, this may have the effect of limiting the buyer's remedy to a refund. While a seller still has an incentive to perform the contract—and not have to refund payments after performance costs have been incurred—the buyer still may be forfeiting some portion of the damages to which it otherwise would be entitled. A better approach might be to limit a liability cap to reserve the right also to claim refund of payments made for supplies or services that did not meet contract requirements.

Warranty provisions also can operate as a liability cap. Normally under the UCC, for a breach of warranty, a buyer may be permitted to revoke acceptance and have a right to "cover" its damages by making, in good faith and without unreasonable delay, any reasonable purchase to substitute for goods due from the seller. But when a contract's exclusive warranty remedy is "repair, replace, or refund," often at the election of the seller, the language may eventually limit available remedies to refund of the buyer's payments. The downside of this result, of course, is that a seller may choose refund as an option in lieu of having to spend more than the contract amount correcting defects. Unless carefully worded, exclusivity-of-remedy limitations can have unexpected results.

A further caution with liability caps—like that required in damages exclusions—relates to theories of liability other than contract breach. In some contracts, considerable effort goes into defining liability allocation for torts (i.e., personal and property damage) and intellectual property infringement. None of the liability for either is necessarily tied to contract value, so a party can inadvertently agree to a liability cap for claims and damages arising out of contract performance that is unreasonably limiting. One state court decision, for example, involved a home inspection contract with the contractor arguing (unsuccessfully) that the contract's liability cap of \$200 precluded a home buyer from recovering its \$190,000 in damages from

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### **Negotiating Liability Allocation Terms (cont'd):**

needed home repairs after a negligent home inspection failed to disclose underlying defects. These cases often involve consumers, though, and may not reflect the expected outcome between more sophisticated contracting parties.

Use special caution in agreeing to contract liability limits on actions “relating to” contract performance, as they can limit remedies in cases like personal injury actions that were not specifically considered by the parties to the contract. It is common that contract liability caps and damage exclusion clauses in general include an exception for claims arising out of bodily injury (including death) and damage to tangible property, normally insurable risks.

Likewise, intellectual property infringement can involve damages and litigation defense costs that exceed the contract amount. Intellectual property infringement indemnification provisions are commonly excluded from more global liability limitations where there is significant risk from intellectual property-related infringement actions. Again, in small-dollar purchases, or those involving mature technology having commercial alternatives where refund of price is considered a reasonable remedy, this may not be a concern.

Contracting and legal professionals help management understand the potential effect of liability caps, but accepting a liability cap and establishing the amount of the cap likely is a business decision. A seller might choose to set its initial cap at the value of the contract, and only increase the amount when requested by a favored buyer or to close a lucrative deal. Companies often view the value of the contract as an acceptable damage limitation compromise in the case of contract breach. Consider in appropriate cases, though, limiting the operation of liability caps so they do not apply to intellectual property infringement, and claims and liability arising out of personal injury (including death) and damage to tangible property.

### **Indemnification**

The preceding sections introduced the concept of indemnification but focused on limitation of damages available to a party. Indemnification provisions, by contrast, operate to create (not limit) a party’s obligation to pay the damages and liability (and often litigation costs) suffered by another party to the contract.

Indemnification clauses are not unique to commercial contracting. They are used by the federal government in government contracts (as in FAR 52.227-3, Patent Indemnity) and state and local contracts as well. For example, the State of Colorado requires an indemnity in state contracts:

The contractor shall indemnify, save, and hold harmless the state, and its employees and agents, against any and all claims, damages, liability, and court awards, including costs, expenses, and attorney fees incurred as a result of any act or omission by the contractor, or its employees, agents, subcontractors, or assignees pursuant to the terms of this contract.<sup>7</sup>

If a third party claims that a delivered product infringes its patent, for example, and demands the State of Colorado to cease use, the state could look to the contractor for a defense and to pay any ultimate liability.

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## **Negotiating Liability Allocation Terms (cont'd):**

### **Federal and State Law and Indemnification by Governments**

The federal Anti-Deficiency Act essentially prohibits indemnification by the federal government unless expressly authorized by statute. This limitation precludes the federal government from committing to uncertain contingent liabilities. Similarly, state constitutions or statutes typically limit the authority of state and local governments to agree to indemnify private parties. The result is that government contractors cannot rely upon the government for coverage for the indemnification of liabilities that may arise out of performance of a government contract.

There are exceptions. For example, a party may request indemnification by the United States under Public Law 85-804 or pursuant to the Space Act and other statutes. The Department of Defense provides indemnification for contracts requiring research and development pursuant to 10 U.S.C. §2354. Such indemnifications may include their own limitations, however, usually indemnifying for “unusually hazardous risks,” or risks that arise in connection with the “direct performance of” the contract where the claim is not paid by insurance or other means. Likewise, state statutes may authorize indemnification by state entities under narrowly defined circumstances.

These limitations on indemnification by public entities, however, do not affect the more common execution of indemnification agreements between private parties, as in the case of sub-contracts under federal government prime contracts.

### **Without Indemnification, What Is the Liability?**

In order to assess risk relating to use of an indemnification clause, one of the first questions should be, “What is the liability if there is no indemnification?” In tort, most states have a right of contribution. That means that one party who is held liable for the torts of another can seek a right of contribution in court against the joint tortfeasor (wrongdoer) to the extent permitted by local law, but this only affects ultimate liability, not defense costs. Again, the general rule in the United States is that parties pay their own attorney fees and bear other expenses of litigation (like discovery costs), which makes a specific reference to the right to recover attorney fees important in a contract. Even in cases where the prospects of ultimate liability may not be very great, the indemnification clause effectively offers some protection against sizeable, unanticipated litigation costs. In our experience, the liability for attorney fees is a significant consideration when settling cases.

Outside of tort, the scope of common law indemnity is less clear. As between a principal and agent, there may be a right of indemnity for acts of an agent that cause liability to the principal. However, the contracting relationship may not be—and often is not—characterized as an agency. Express contract indemnification clauses avoid the need to rely on the existence of often ill-defined common law or implied rights to seek indemnification for liability caused by the acts of a contractor.

Not every contract for the purchase of commercial products includes an express

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## **Negotiating Liability Allocation Terms (cont'd):**

intellectual property indemnification provision. Importantly, the UCC provides a warranty against infringement for off-the-shelf (“in stock”) products that are sold by merchants. In this regard, the UCC states

Unless otherwise agreed, a seller that is a merchant regularly dealing in goods of the kind warrants that the goods shall be delivered free of the rightful claim of any third person by way of infringement or the like, but a buyer that furnishes specifications to the seller must hold the seller harmless against any such claim that arises out of compliance with the specifications.<sup>8</sup>

The UCC warranty against infringement generally gives the seller a right to be held harmless if the buyer furnishes the specifications. The UCC, however, is limited in its application to “merchants” and does not squarely address liability for defense costs; intellectual property infringement provisions should (and commonly do). Even though injunctive relief for patent infringement claims under federal government contracts may be limited when the United States “authorizes and consents” to use of domestic patented inventions—and in many cases, assumes ultimate liability for patent infringement—there can be sizeable litigation costs associated with defense by contractors of intellectual property infringement claims.

In transactions not covered by the UCC, sellers often seek to carve out an exception relating to liability for buyer-provided specifications. Likewise, sellers often attempt to exclude from an indemnity those liabilities that arise after a party purchases the goods and modifies the delivered items, as in an exclusion for liability caused by combination of the item with another item that causes an infringement. Such exclusions are not unreasonable if written properly.

With respect to other statutory liability, the existence of an implied or common law right to indemnification is even less clear and dependent on state or federal law. For example, one court has held that no common law right to indemnification exists from another who has violated the False Claims or Anti-Kickback Acts.<sup>9</sup> The court reasoned that such an implied right only exists through affirmative creation of the right by Congress, either expressly or implicitly, or through judicial creation of a common law right in one of the “few and restricted areas” where courts were expected to fashion such rights. For this reason, subcontracts may provide for indemnification by subcontractors for payment reductions or claims by the customer on the prime contract (for fines or penalties, for example) that are a result of subcontractor acts or omissions.

Without indemnification, companies still can deny liability in court and disavow the actions of subcontractors as not attributable to them. There are no certain outcomes, however, in the judicial process. Juries may see the facts differently, and without some right of indemnification, companies can be saddled with liability awards or penalty assessments arising out the acts of their contractors, as well as defense costs. For this reason, contractual indemnification provisions are commonly used to shift that liability, ostensibly to the party most able to control risk and who should be primarily liable.

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## **Negotiating Liability Allocation Terms (cont'd):**

### **Enforceability and Interpretation of Indemnification Clauses**

The enforceability of indemnification provisions is another issue that requires familiarity with governing state law. Some states' statutes, for example, prescribe formal requirements (such as use of conspicuous language) for indemnification provisions. Other states limit the enforceability of indemnification provisions that apparently shift liability to another for one's own negligence. Some states as a matter of policy may not enforce such an indemnification at all. Other states may enforce the provision only to the extent it does not require the innocent party to indemnify for the other party's sole negligence. Other states permit that kind of shifting of risk, but only if the clause plainly makes one party liable for the other's negligence. In general, most states require that the indemnity clause clearly articulate the coverage of the indemnification.

A key interpretation issue is whether the indemnification obligation (and defense) is triggered by claims, or whether indemnification goes only to the ultimate liability as determined judicially or by a competent administrative authority.<sup>10</sup> As a practical matter, most indemnification provisions encountered in commercial contracts tend to be the broadest form, requiring a defense, and consequently, are triggered by third-party claims. This prompts indemnitors to want to have notice of claims and the right to control the defense in intellectual property infringement indemnification provisions. Failure to comply with these provisions also provides a potential first line of defense for the indemnitor.

There may be distinctions in some jurisdictions between use of indemnity versus "hold harmless" language, as in whether they embrace attorney fees and other litigation costs. In our experience, there have been no practical distinctions in negotiations between use of indemnity and "hold harmless." Divorcing the underlying liability from litigation costs and even attorney fees, however, can be a way of negotiating through an impasse, and distinguishing between hold harmless and indemnity language can be one way of accomplishing the distinction.

Because of varying state statutory and common law limits on indemnification provisions, there is general motivation to retain some kind of equity in these provisions, as in not making another liable for a company's own negligence. More importantly, one needs to be precise about the scope of the coverage of indemnification provisions. Further, as has already been suggested, indemnification obligations must be considered in the context of other contract provisions excluding damages and otherwise limiting liability. For these reasons, we recommend you work closely with counsel when negotiating contract indemnification clauses.

### **Balancing the Considerations and Risks During Negotiation**

A contract negotiation relating to indemnification, damages exclusions, and other limitations on liability eventually involves one party acceding to negotiated liability allocation provisions. Faced with such a negotiation, a party tries to assess the effect of the liability allocation provisions in terms of the risks: breach of contract and the likelihood and magnitude of other potential liability and litigation costs.

The potential legal risks, however, often are not the only business considerations. Other  
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## **Negotiating Liability Allocation Terms (cont'd):**

considerations include industry standards and perceptions among customers. Although there is economic benefit for a company in limiting its liability to the least amount possible, industry trends and competition might force a company to take on a greater amount of liability. Also, standing firm on a particular liability cap during negotiations might be seen as playing hardball and unreasonable, turning away valuable customers.

When faced with requests to limit contract breach damages—as is the case in most damages exclusions and liability caps—caution is advised. Generally, parties should retain some ability to recover unexpectedly higher prices for performance (the buyer) or actual costs of performance (the seller) arising out of breach of contract by the other party. Damages exclusions and liability caps may operate to frustrate those objectives.

For both buyers and sellers, risk from intellectual property infringement claims arises from potential claims by third parties that one (or both) have violated intellectual property rights. The buyer, though, also faces the risk that the contract performance may not be completed because the buyer cannot use the deliverables that infringe. In some cases, a buyer may determine that stopping use of infringing products may be an acceptable remedy in the unlikely event of an infringement claim, with substitute performance available from other vendors. On the other hand, if those products are central to a larger integrated system, replacement may be impracticable or prohibitively expensive. There may be a need, then, to mitigate risk using indemnification, paying special attention to other liability limits in the contracts.

The UCC provides only limited protection against infringement, and then, generally only with respect to claims of patent infringement. With less mature, emerging technologies and products, there may be more risk from intellectual property infringement claims because of the sharing of ideas and the untested nature of the product. The UCC does not cover the liability arising in the context of copyright infringement and misappropriation of trade secrets. It is quite common, therefore, for buyers to insist on—and seller's to provide—intellectual property infringement indemnity in sales involving complex systems and supplies. Ensure, however, that other liability limitations in the contract do not frustrate the contract objectives.

Ultimately, the responsible person in the organization makes a decision about the likelihood of events occurring, the potential impact from the potential events, and other business risks and benefits attending the negotiation. This decision likely factors in the business needs that go with the transaction. From our experience, organizations differ in terms of who makes that ultimate call. While legal counsel often has a central role, the factual underpinnings for assessing the likelihood for events occurring, the intangible considerations such as customer relations, and knowledge about the organization's appetite for risk may reside elsewhere in the organization than in the legal department. This means that program personnel and other company management typically have the responsibility for making the final decision that includes tradeoffs between various liability risks and other considerations.

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