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818 Connecticut Ave, NW  
Washington, DC 20006  
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Washington, DC 20006-6800

David G. Ehrhart  
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Marilyn Neforas  
321 N Clark St  
Chicago, IL 60610-4714  
(312) 988-5596  
Fax: (312) 988-6033

Suite 1100  
818 Connecticut Avenue, N.W.  
Washington, DC 20006  
Phone: (202) 496-3493  
Fax: (202) 293-6111  
[pwittie@obblaw.com](mailto:pwittie@obblaw.com)

May 10, 2005

**VIA E-MAIL AND FIRST CLASS MAIL**

General Services Administration  
FAR Secretariat  
1800 F Street, N.W., Room 4035  
Washington, DC 20405

Attention: Laurieann Duarte

**RE: Advance Notice of Proposed Rulemaking GSAR ANPR  
2005-N01, 70 Fed. Reg. 19051 (April 12, 2005); GSAR Revision  
Regarding Limitation on Consequential Damages**

Dear Ms. Duarte:

On behalf of the Section of Public Contract Law of the American Bar Association ("the Section"), I am submitting comments on the above-referenced matter. The Section consists of attorneys and associated professionals in private practice, industry and Government service. The Section's governing Council and substantive committees have members representing these three segments, to ensure that all points of view are considered. By presenting their consensus view, the Section seeks to improve the process of public contracting for needed supplies, services, and public works.

The Section is authorized to submit comments on acquisition regulations under special authority granted by the Association's Board of Governors. The views expressed herein have not been approved by the House of Delegates or the Board of Governors of the American Bar Association and, therefore, should not be construed as representing the policy of the American Bar Association.<sup>1</sup>

<sup>1</sup> This letter is available in pdf format at  
<http://www.abanet.org/contract/federal/regscomm/home.html> under the topic "Commercial Items."

The April 12, 2005 Advance Notice of Proposed Rulemaking (“ANPR”) seeks comments on two matters: (1) whether the General Services Administration Acquisition Regulation should be revised to include a waiver of consequential damages for contracts awarded for commercial items under the Federal Acquisition Regulation (“FAR”); and (2) whether “post award” audit provisions should be included in GSA’s Multiple Award Schedules contracts and Government-wide acquisition contracts. This letter offers comments only on the first matter. The Section is submitting a separate letter addressing the second matter.

The Section strongly encourages GSA to move forward with a proposed rule to amend the GSAR to supplement and expand the limited waiver of consequential damages currently provided for in FAR 52.212-4 “Contract Terms and Conditions – Commercial Items”. The Section also recommends that the FAR Council amend FAR 52.212-4 to provide for the same change, thereby making the GSAR amendment unnecessary.

The commercial item clause at FAR 52.212-4 was first issued as a proposed regulatory clause on March 1, 1995, as part of the implementation of the Federal Acquisition Streamlining Act of 1994. When the proposed rule was issued in March 1995, it provided for a broad waiver of a contractor’s liability for consequential damages and had included that waiver as part of the warranty clause as follows:

Warranty. Except as expressly set forth elsewhere in this contract and except for the implied warranty of merchantability, there are no warranties express or implied. In no event will the contractor be liable to the Government for consequential damages resulting from the seller’s breach including (a) 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 (b) injury to person or property proximately resulting from any breach of warranty.

60 Fed. Reg. 11197, March 1, 1995. This approach in the proposed rule was consistent with prior regulatory clauses that existed prior to 1995 in the DOD FAR Supplement and the Federal Information Resources Management Regulation (“FIRMR”) that provided for similar waivers of consequential damages. *See* 48 C.F.R. § 252.270-7001 “Warranty Exclusion and Limitation of Damages”; 41 C.F.R. § 201-39.5202-6 “Warranty Exclusion and Limitation of Damages”.

When the final rule was issued in September 1995, the regulatory clause at FAR 52.212-4 changed the proposed rule with respect to waiver of consequential damages and separated it out from the warranty clause in an apparent attempt to broaden the waiver of consequential damages. 60 Fed. Reg. 48231, Sept. 18, 1995. Nevertheless, the final rule for FAR 52.212-4 provides for a waiver of consequential damages for contractors *only* for defects or deficiencies in accepted items:

(p) Limitation of liability. Except as otherwise provided by an express or implied warranty, the Contractor will not be liable to the Government for consequential damages resulting from any defect or deficiencies in accepted items.

This remains the current language provided for in FAR 52.212-4(p).

The explanatory notes that accompanied the September 1995 final rule explained the change from the proposed rule as follows:

The limitation of contractor liability language, which appeared in the proposed rule in the 'warranty' paragraph of the clause at 52.212-4, has been moved to a separate paragraph to clarify that the limitation does not apply solely to liability relating to any warranty.

60 Fed. Reg. at 48234, Sept. 18, 1995. As the explanatory note indicates, the change apparently was an attempt to broaden the application of the waiver of consequential damages beyond breach of warranty, but the final rule does not do so because it still limits the waiver to defects or deficiencies in accepted items.

The legislative acquisition reforms set forth in the Federal Acquisition Streamlining Act and the Clinger-Cohen Act addressing the Government's acquisition of commercial items require, among other things, that the Federal Government, to the maximum extent practicable, "revise the executive agency's procurement policies, practices and procedures not required by law to reduce any impediments in those policies, practices, and procedures to the acquisition of commercial items." 41 U.S.C. § 264b(b)(5). FAR 52.212-4(p) represents such an impediment because it fails to provide protection to a commercial contractor from all consequential damages, as is customary in the commercial marketplace. As recognized in the commentary to the ANPR, although FAR 12.302 permits

contracting parties to tailor the terms of FAR 52.212-4(p), some contracting officers are unwilling to do so. FAR 52.212-4(p) should, at a minimum, be revised to state clearly that a commercial contractor will not be liable for *any* consequential damages, not just consequential damages resulting from a defect or deficiency in accepted items.

The Section urges GSA and the FAR Council to take action now to further broaden the waiver of consequential damages provided for in FAR 52.212-4(p) to make it clear that commercial companies doing business with the Government will be protected from exposure to open-ended and unlimited liability of consequential damages that may arise from the performance of commercial services or delivery of commercial items. Such potential open-ended, unlimited liability poses a significant barrier to commercial companies desiring to do business with the Government. This is especially true given that statutory and regulatory requirements have been strengthened in recent years to impose increased corporate responsibility and accountability to their stockholders and other constituents. As a result, many companies feel that they can no longer assume the risk of open-ended, unlimited potential liability. The Section understands that it is an accepted and common practice in the commercial marketplace for vendors to disclaim not only any liability for consequential damages arising from the performance of services or delivery of items, but also to include limitations on direct damages.

Furthermore, it may reasonably be assumed that contractors include a risk premium when contracting with the Government to account for the risk of consequential damages. Especially for those procurements where consequential damages could amount to a “bet the company” proposition, the risk premium amount (sometimes referred to as a “contingency”) included in contractor pricing may be substantial. The natural tendency for contractors to price this risk, as well as the potential for reduced competition resulting from the specter of consequential damages, could lead to increased Government costs. The Government could avoid such increased costs if the contract terms completely protected contractors from consequential damages. Moreover, a complete waiver would be consistent with the Government’s general policy to “self insure” against contract-related risks.

The ANPR also implicates an important fairness issue. It has long been recognized and held that, absent statutory authority, the Federal Government itself may not be bound to similar open-ended, unlimited liability because this would constitute a violation of both the Anti-Deficiency Act, 31 U.S.C. § 1341 and the Adequacy of Appropriations Act, 41 U.S.C. § 11. *See GAO Principles of Federal Appropriation Law*, 2<sup>nd</sup> Ed., Chapter 6, at pages 6-30 through 6-42. It is the Section’s view that it is inappropriate for the Federal Government to impose, by contract, this same type of open-ended, unlimited liability on its commercial-item

contracting partners when the Government itself may not agree to corresponding, mutual liability. Indeed, assignment of such differing levels of risk to the contracting partners is inconsistent with the American Bar Association's Principles of Allocating Risk in the Formation of Public Procurements.

At the public meeting conducted by GSA on April 14, 2005, concerning this ANPR, the GSA officials requested specific input on the impact of expanding the waiver of consequential damages in performance-based contracts. Performance-based contracts are intended to ensure that the required performance quality levels are achieved and that total payment to the contractor is related to the degree that services performed meet contract standards. *See* FAR 37.601. Also, performance-based contracts are required, to the maximum extent practicable, to include performance incentives, either positive or negative, to encourage contractors to increase efficiency and maximize performance. *See* FAR 37.602-4; FAR 16.402-2. There is no reason to anticipate that expanding the existing waiver of consequential damages currently provided for in FAR 52.212-4(p) would impair the Government's ability to structure adequate performance incentives for inclusion in performance-based contracts in order to encourage contractor efficiency and maximum performance. Moreover, the Section is unaware of any indication that the existing waiver of consequential damages in FAR 52.212-4(p) has had any negative effect on the Government's ability to successfully utilize performance-based contracts.

The Section appreciates the opportunity to provide these comments and is available to provide additional information or assistance as you may require.

Sincerely,

A handwritten signature in black ink that reads "Patricia H. Wittie". The signature is written in a cursive style with a large, looped initial "P".

Patricia H. Wittie  
Chair, Section of Public Contract Law

cc: Robert L. Schaefer  
Michael A. Hordell  
Patricia A. Meagher  
Carol N. Park-Conroy  
Hubert J. Bell, Jr.

General Services Administration  
May 10, 2005  
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Mary Ellen Coster Williams  
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