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The Clause

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

The President's Column

Dear BCABA Members:

Greetings BCABA Members and friends, and welcome to another edition of *The Clause*. Thanks to Pete McDonald for assembling another fine collection of interesting articles.

In addition, enclosed is the Agenda and Registration Form for our Annual Program that will be held on **October 16, 2013**. We have assembled esteemed judges and leading practitioners to present you with several terrific sessions on such diverse, interesting, and timely subjects as cybersecurity, whistle-blowing, cost effective resolution of issues in controversy at the BCAs, understanding DCAA's role, and the most important and interesting BCA decisions of the year. Recognizing the challenges many organizations have been facing, we have worked hard this year to greatly reduce the costs associated with the program for 2013. Please pass the registration form along to colleagues who may be interested in this program! You can also register online on our revamped website: bcaca.org.

On that note, I would appreciate it if you would please go on over to our new website (bcaba.org), re-register, and check it out while you are there. Re-registering is a one time inconvenience to our members that will allow us to leverage some of the efficiencies of the more modern technological framework.
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President’s Column (cont’d):

If you are interested in becoming more involved in the BCABA, please stick around immediately after the Annual Program for the quarterly BCABA Board of Governors meeting.

See you on **October 16th!**

Best regards,

Donald M. Yenovkian
President
BCABA, Inc.

BCABA ANNUAL PROGRAM

October 16, 2013

Arnold & Porter LLP
555 Twelfth Street, NW

8:30-9:00	**Registration** **Welcoming Remarks: Donald M. Yenovkian II (Fluor), President, BCABA, Inc., and Program Chair** **Hon. Gary E. Shapiro (PSBCA), Vice-President**
9:00 - 10:00	**BCA DECISIONS: YEAR IN REVIEW** Panelists will discuss significant decisions from the Boards of Contract Appeals this year. **Panel Chair/Moderator: David S. Black, Partner, Holland & Knight LLP** **Panelists: Thomas H. Gourlay, Jr., Chief Trial Attorney, U.S. Army Corps of Engineers; Susan Warshaw Ebner, Asmar, Schor & McKenna, PLLC**
10:00 -11:00	**SCARED STRAIGHT: WHY LEGAL PRACTITIONERS SHOULD CARE ABOUT CYBERSECURITY** The panel will discuss the cybersecurity threats facing private practitioners, in-house counsel, and government counsel for their respective organizations. **Panel Chair/Moderator: Elizabeth Ferrell,, Partner, McKenna Long Aldridge LLP** **Panelists: Daniel E. Chudd, Partner, Jenner & Block, Courtney Edwards, SAIC ; Civilian and DoD Agency representatives (invited)**
11:00-11:15	**BREAK**
11:15-12:15	**WHAT YOU SHOULD KNOW ABOUT DCAA's ROLE IN DISPUTE RESOLUTION** Panelists will assist attendees in better understanding DCAA's role in the resolution of contract issues in controversy. **Panel Chair/Moderator: David G. Anderson, Couch White, LLC** **Panelists: Greg Bingham, The Kenrich Group; David L. Cotton, Cotton & Co.., LLC; Judge Diana Dickinson, ASBCA; Joseph Busco, DCAA.**
12:15 - 1:30	**LUNCHEON** **Speaker**: TBD
1:30 - 2:45	**BCA JUDGES PANEL** Board judges will discuss methods for achieving a cost effective resolution of matters before the various Boards. The panel will discuss alternative dispute resolution techniques, as well as other non-ADR practices that can increase efficiency. **Panel Chair/Moderator: Kristen E. Ittig, Partner, Arnold & Porter LLP** **Panelists: Judge Alan Caramella, PSBCA; Judge Elizabeth Grant, ASBCA; Chief Judge Marc Loud, DCCAB; Judge Anthony Palladino, FAA ODRA; Judge Patricia Sheridan, BCABA**
2:45-3:00	**BREAK**

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BCABA ANNUAL PROGRAM

October 16, 2013

Arnold & Porter LLP
555 Twelfth Street, NW

3:00-4:00	**PROTECTING THE WHISTLEBLOWER** The panel will discuss the recently enacted Whistleblower Protection Enhancement Act of 2012 and other whistleblower protection regimes as they affect both government and contractor whistle-blowers. **Panel Chair/Moderator: Judge C. Scott Maravilla, FAA ODRA; Jessica Tillipman, GWU Law School** **Panelists: Kathleen Clark, Washington University Law School; Shirine Moazed, Chief ,Washington Field Office, U.S. Office of Special Counsel**
4:00-4:30	**BCABA, INC., ANNUAL BUSINESS MEETING**

Approval pending for 5 Hours Virginia CLE Credit

BCABA ANNUAL PROGRAM
REGISTRATION FORM

Registration Deadline: October 9, 2013

Name: ______________________________

Title: ______________________________

Company/Agency: ______________________________

Address: ______________________________

City, State, Zip: ______________________________

Telephone: ____________________ **Fax:** ________________

Email Address: ______________________________

Questions?
Contact Don Yenovkian
864-593-3057
Don.Yenovkian@Fluor.com

BCABA Member: __________ **Gold Medal Firm* Member:** __________ **Total Paid: $**________

PAY BY CHECK	PAY BY CREDIT CARD
Mail your check *payable to "BCABA, Inc."* together with this completed form to: **BCABA, Inc.** **c/o Annual Program Registration** **P.O. Box 66612** **Washington, D.C. 20035** **PAY BY PAYPAL** **Follow the links at BCABA.org.**	**- Pay online through our website at: BCABA.org or,** **- Email or mail your completed Credit Card Payment Form together with this completed registration form to:** **Email: thomas.h.gourlay@hq02.usace.army.mil** **Mail:** **BCABA, Inc.** **c/o Annual Program Registration** **P.O. Box 66612** **Washington, D.C. 20035**

2013 Reduced Annual Program Fees

Recognizing the fiscal constraints many organizations are facing in 2013-2014, the BCABA has instituted a one time rate reduction to assist our members and member organizations in securing CLE.

Government Employees, Academics, and Student Members	$50
Gold Medal Firm Members	$75
Other BCABA Members	$100
Non-Members (less expensive to join!)	$150

*A Gold Medal Firm is a law firm or organization in which all of its government contracts lawyers are members of BCABA, Inc. Gold Medal Firms as of 2012-2013 or those signing up all attorneys for the 2013-2014 year are eligible for this discount. We appreciate the support of our Gold Medal Firms.

BCABA ANNUAL PROGRAM
CREDIT CARD PAYMENT FORM

Registration Deadline: October 9, 2013

If you wish to pay for the BCABA Annual Program registration fee(s) and/or membership due(s) by credit card (VISA or Master Card only) *in lieu of check*, please provide the following information:

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4. **Name of your Firm or Agency:** ____
5. **Total Dollar Amount to be charged – breakdown:**
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   b. **For Membership Dues . . . . $ ________**
6. **Credit Card Number:** ____
7. **Credit Card Expiration Date:** ____
8. **CBC (three digit) Code – on reverse of the credit card:** _______________________
9. **USPS Zip Code for the location to which your card is billed:** __________________

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Washington, D.C. 20035

Or email to: thomas.h.gourlay@hq02.usace.army.mil

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

by
Peter A. McDonald
C.P.A., Esq.
(A nice guy . . . basically.)

Leading this issue is a thoughtful piece by two well known practitioners: Steve Gordon and Dick Duvall. Next, Owen Walker discusses the Differing Site Conditions clause, while the article by Kathleen Ellis reminds us of the rules related to Miller Act bonding requirements. Kristina Dahmann then reviews the treatment of OCIs at FAA ODRA. Jim Gallagher and Judy Choi provide a comprehensive analysis of attorney-client issues arising from disclosures related to internal investigations. And if you got that far, you might as well read about cost discipline, a topic of increasing importance in the declining government contracts market.

The Clause will reprint, with permission, previously published articles. We are also receptive to original articles that may be of interest to government contracts practitioners. But listen, everybody: You really shouldn't take all this government contract stuff too seriously. And as usual, we received some articles that were deemed unsuitable for publication, such as: "Cyberinsecurity: Pete's Struggles with a Cell Phone!"; "Pete Cleared of 'Carlos Danger' Suspicions!!"; and (drum roll) "Pete Makes the D-List!!!"

SEX SCANDAL!!!

The heading is just a lure to get you into reading this reminder about the cheap annual dues (it worked, didn't it?). Actually the BCABA has *never* had a sex scandal, which says a lot about public contract attorneys . . . . (ahem). Let's face it: We are mostly insipid, unappealing gnomes with the personality of a brick — and those are our good qualities.

Anyway, the BCABA dues procedures are:

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

Members are reminded that <u>they</u> are responsible for maintaining the accuracy of their information in the BCABA Directory.

It's Time to Rethink the Suspension and Debarment Process

by
Richard O. Duvall
And
*Steven D. Gordon**

[Note: Reprinted with permission from BNA *Federal Contracts Report*, June 17, 2013, The Bureau of National Affairs, Inc. (800-3782-1033). www.bna.com.]

I. Introduction

Federal contractors and grantees face increased risk of being suspended or debarred from federal contracts and programs, or of having to negotiate with the Government in circumstances where such an exclusion might be imposed if the matter is not resolved satisfactorily. This heightened risk results from a number of factors, including new contractor self-reporting requirements imposed by the Federal Acquisition Regulation ("FAR"), amendments of the False Claims Act that permit more whistleblower suits, and the Government's more aggressive use of suspension and debarment. And the stakes of a suspension or debarment are huge. Even a short term exclusion from participation in federal contracts or programs can be devastating; a long term exclusion frequently amounts to the "death penalty" for all or a part of a contractor organization.

This new enforcement climate highlights some deficiencies in the current regime for suspension and debarment of government contractors. These deficiencies, in our view, foster arbitrariness, inconsistency, and unfairness. Suspension and debarment are not supposed to punish contractors or grantees for past misconduct; rather, they are intended to protect the Government from future dealings with contractors or grantees that are unscrupulous, unreliable, or incompetent. It is short-sighted and counterproductive to exclude competent contractors (or grantees) who err but are willing and able to reform. Thus, the process for excluding a contractor must be fair and produce reasonable results. An unfair or arbitrary system will cause needless harm to contractors, and their employees and shareholders. Ultimately, it will harm the public interest and the public fisc, as well, because it will reduce the number of qualified entities who compete for government contracts and grants.

In this article, we re-examine the existing suspension and debarment system and propose changes to it. These proposed reforms would leave intact the Government's ability to exclude irresponsible contractors and grantees, but would increase procedural fairness and make the imposition of suspensions or debarments more uniform and predictable, to the benefit of all parties and the public.

II. The Existing System

Suspension and debarment from federal programs are governed by two separate, but
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It's Time to Rethink (cont'd):

similar, regulatory regimes. Suspension and debarment from federal procurement programs are governed by FAR Subpart 9.4, while exclusion from federal non-procurement (grants and assistance) programs is governed by the OMB Guidance in 2 C.F.R. Part 180 and agency regulations implementing that guidance. An exclusion from federal procurement programs also applies to non-procurement programs, and vice versa. Thus, any suspension or debarment, regardless of its origin, is Government-wide and covers both procurement and non-procurement programs.

Suspension and debarment are prophylactic measures intended to protect the Government, and are discretionary in nature. Even where a cause for suspension or debarment has been established, an agency is not required to exclude the contractor; the seriousness of the contractor's acts or omissions and any remedial measures or mitigating factors are all to be considered. Ultimately, the test is whether the contractor is "presently responsible," with this determination being left to the judgment of the agency. Neither the FAR nor the C.F.R. defines "present responsibility," although they do list factors that should be considered. Mitigating factors include whether the contractor had an effective compliance system in place beforehand, whether the contractor has since instituted adequate remedial measures, and whether the contractor has taken disciplinary action against the individuals responsible for the misconduct.

The decision whether to suspend or debar a contractor (or program participant) has historically been made at the agency level. Each agency has the power to exclude a company or individual from all Government contracting and program participation. The agency decision-maker is the Suspending and Debarring Official ("SDO"). There is a profusion of SDOs among the agencies and within different agencies. For example, the Department of Defense ("DOD") currently has about a dozen different SDOs. Each of the armed services has its own SDO, as does the Defense Logistics Agency. In addition, far smaller entities such as the Defense Threat Reduction Agency and the Missile Defense Agency have their own SDO. Other government departments have even more; as of 2010, the Department of Agriculture had 21 different SDOs. Moreover, there is no uniformity among the SDOs in terms of their position, background, qualifications, or tenure. At DOD, for example, most of the SDOs are attorneys or senior procurement executives. But in two DOD agencies, the SDO is the Agency Head. At the Department of Agriculture, in contrast, most of the SDOs are agency administrators.

The SDO's broad discretion in determining whether a contractor should be excluded is coupled with comparable discretion in deciding the scope of any exclusion that is imposed. A debarment or suspension of a business entity extends to all divisions or other organizational elements of the entity unless it is made more limited in scope by the SDO. Furthermore, an SDO may expand a debarment or suspension to include any "affiliate" of the sanctioned contractor or grantee. Entities are considered affiliates of each other if either one controls or has the power to control the other, directly or indirectly, or a third party controls or has the power to control both. There is no requirement that an affiliate have any complicity in the underlying misconduct; the rationale for excluding the affiliate is to prevent the actual wrongdoer from using the affiliate to circumvent its exclusion.

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Although federal agencies all operate under one of the two common sets of regulations governing suspension and debarment, the procedures and practices for administering the system vary considerably among the agencies. For example, in the Navy and Air Force, the functions of case development (investigation), notice to the contractor of the proposed sanction, and final determination occur within same organizational unit of the agency. In other agencies, such as the Interior Department, the Defense Logistics Agency and Environmental Protection Agency, the case development function is separated from the decision-making process.

The Interagency Suspension and Debarment Committee ("ISDC"), created in 1986, serves as a forum for agencies to share ideas and it assists in coordinating suspension and debarment actions among agencies. It designates a "lead agency" in situations where more than one agency has an interest in the proposed suspension or debarment of a particular contractor. But the ISDC relies on agencies' voluntary participation in its processes and member agencies' limited resources to fulfill its mission. The ISDC does not have any governing regulations and its processes appear to be informal.

Not surprisingly, agencies vary greatly in terms of the vigor with which they pursue suspension and debarment actions and the resources they devote to this issue. A 2011 GAO report found that, over the past five fiscal years, the DOD accounted for about two-thirds of all suspension and debarment cases related to federal procurements. DOD had almost 1,600 cases whereas 70% of the other agencies had fewer than 20. The DOD agencies are virtually certain to consider or pursue debarment if one of their contractors is convicted of fraud or some other criminal offense constituting a ground for debarment. In contrast, a 2010 report by the Inspector General of the Agriculture Department found that, from 2004 to 2007, 42 participants in Rural Development programs had been convicted of crimes involving those programs, but no debarment actions were taken in response to 40 of the 42 convictions.

Agency debarment and suspension decisions are subject to judicial review under the Administrative Procedure Act. In practice, however, courts have been highly deferential to agency decisions. A court might intervene in the rare instance where an agency fails to follow the governing regulations or acts in a patently arbitrary manner. Although the courts can reverse an SDO's decision for abuse of discretion, they almost never second guess a determination that a contractor is not presently responsible, or the length of a debarment that the SDO imposes. In the real world, the SDO's resolution of those issues is effectively unreviewable.

III. The Altered Landscape

In past years, shortcomings in the system of suspension and debarment were of little concern to contractors and program participants because the reality was that exclusion was the administrative "tail on the dog" to a criminal prosecution. In 1995, for example, the

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It's Time to Rethink (cont'd):

Administrative Conference of the United States ("ACUS") reported that 96% of suspensions and debarments initiated by the Air Force during the previous year were based on criminal indictments and convictions. Thus, the existence of cause for exclusion had already been established through the judicial system, with its panoply of rights and protections afforded to a criminal defendant. A debarment did not require the agency to make any factual determinations about contractor misconduct.

The landscape has now changed significantly because of recent developments that have magnified the potentially prejudicial impact of deficiencies in the existing system of suspension and debarment. These developments include the following.

A. The Rise of "Fact-Based" Suspensions and Debarments

There has been a dramatic increase in the use of "fact-based" suspension or debarment actions, where the agency adjudicates the facts and decides whether the contractor engaged in misconduct that warrants exclusion. In previous years, agencies almost never undertook such actions. For example, in 1995 ACUS reported that, during the previous five years, none of the armed services nor the Defense Logistics Agency had conducted a fact-based hearing in any case to determine whether a cause for debarment or suspension existed. In contrast, a recent survey of federal Inspectors General showed that 27% of suspension referrals and 24% of debarment referrals in 2010 were fact-based. That same year 62% of Air Force suspension/ debarment actions were fact-based, *i.e.* actions in which the Air Force alleged that the contractor had engaged in misconduct that warranted exclusion from government contracting and where it decided that issue for itself.

Furthermore, many of these fact-based actions were instituted pursuant to the catch-all FAR provision that covers "any other cause of so serious or compelling a nature that it affects the present responsibility of the contractor," rather than commission of a criminal offense or some other defined misconduct. This means that the range of contractor conduct or derelictions that may trigger a debarment has expanded considerably. In addition, the burden of proof for these "fact-based" exclusions is only a "preponderance of the evidence" rather than the proof "beyond a reasonable doubt" that is required to obtain a criminal conviction.

The number of fact-based suspensions and debarments is likely to keep growing. Both Congress and the Office of Management and Budget are encouraging agencies to become more aggressive about suspending and debarring contractors. And a 2011 report by the Council of Inspectors General on Integrity and Efficiency urged that there are many occasions when protecting the government's interest warrants pursuit of fact-based suspension or debarment actions, which do not rely on a judicial finding. Thus, other agencies are likely to follow the Air Force in aggressively pursuing more fact-based actions.

B. Growth in False Claims Act Litigation

The increasing number of actions brought under the civil False Claims Act ("FCA") also
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has changed the suspension/debarment landscape. Since the FCA was revised in 1986, the number of FCA actions has increased each year, sometimes exponentially. Furthermore, recent amendments to the FCA have further expanded its reach and eliminated or reduced barriers to certain suits brought by whistleblowers. The likely result of these amendments will be a significant increase in the number of whistleblower suits that proceed to trial. In addition, because the FCA is a civil remedy, liability only needs to be proved by a preponderance of the evidence.

A finding of liability under the FCA constitutes a cause for debarment and so can result in the exclusion of a contractor unless the SDO makes the discretionary judgment that it is outweighed by other factors in the contractor's favor. Any DOD contractor that is found liable under the FCA is virtually certain to be contacted by an SDO and at least asked to explain itself, if not confronted with a notice of proposed debarment. Thus, an increase in FCA actions probably will result in an increase in related suspension or debarment actions whose outcome will be determined by an exercise of discretion by the SDO.

C. The Increase in Contractor Self-disclosures

The new regime of mandatory disclosure imposed on contractors by the FAR has created a "sea change" in the relationship between the government and its contractors, and has further increased the risk of suspension or debarment in federal procurement programs. Contractors are now required to disclose to the government any credible evidence that, in obtaining or performing a contract, there was a violation of federal criminal law or the FCA, or a significant overpayment on the contract. Obviously, a violation of federal criminal law or the FCA would be a potential cause for debarment, and the circumstances surrounding a significant overpayment might provide cause for debarment. Furthermore, a contractor's failure to timely disclose such events to the government has now been made a cause for suspension or debarment.

These self-disclosures will increase the number of situations in which an SDO makes a discretionary judgment about the present responsibility of a contractor. Some number of self-disclosures will result in the institution of a formal suspension or debarment action. Beyond that, some contractors who make a self-disclosure will initiate a dialog with the SDO about their present responsibility in order to forestall any suspension or debarment action. Regardless of whether the dialog between the contractor and the SDO precedes or follows the commencement of a formal action, the SDO will ultimately have to assess the contractor's responsibility under the same set of regulatory standards and with the same considerable latitude afforded to him or her under those standards.

Moreover, in a recent case the Air Force suspended an entire office of a prominent contractor that had made a voluntary disclosure (not required by the FAR) about its receipt of inappropriate procurement-related information. The Air Force SDO took the position that the

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the contractor's internal investigation and corrective actions had been inadequate and that its disclosure was flawed, as well. Thus, deficiencies in a contractor's investigative and disclosure process can themselves lead or contribute to suspension or debarment problems.

D. Increasing Use of Administrative Agreements

The use of administrative agreements as a method for resolving proposed debarment actions is increasing. A 2012 GAO report found that the DOD used administrative agreements in 30 cases over the three-year period from fiscal year 2009 - fiscal year 2011. In many instances, it is in the best interests of both the contractor and the agency to rehabilitate the contractor through remedial administrative measures rather than disqualify the contractor. As noted in a 2005 article in the *Army Lawyer*: "Administrative compliance agreements offer a viable alternative to the perceived draconian suspension and debarment process. In addition to restoring the government's confidence in the company's present responsibility, these agreements provide the government an unprecedented opportunity to assess and influence a company's corporate ethical climate."

But the increasing use of administrative agreements also creates cause for concern because this process is almost completely unregulated. There is a single provision in the Department of Defense FAR Supplement (209.406-1) which simply authorizes a SDO who decides that debarment is not necessary to require the contractor to enter into a written agreement to establish and maintain standards of conduct and internal control systems and other requirements the SDO considers appropriate. The FAR itself says nothing about the substance of administrative agreements or the criteria for entering into them. In 2010, a provision was added to the FAR that merely provides for collecting and disclosing information about administrative agreements. Likewise, 2 C.F.R. Part 180 contains several brief references to administrative agreements but nothing of substance.

Because administrative agreements are essentially unregulated, they amplify the discretion and the authority of the SDO. The SDO has unbridled discretion about whether to enter into an administrative agreement and on what terms. The SDO, if he or she chooses to do so, can scrutinize virtually all of a contractor's internal controls and its compliance program and demand any changes that are deemed appropriate or desirable. Likewise, the SDO can insist upon the removal of officers or employees whom the SDO deems responsible for the misconduct that is the focus of the proposed debarment. The contractor is in no position to complain or resist.

IV. The Need for Reform

The altered landscape of suspension and debarment highlights shortcomings in the current process and changes the calculus of what process should be "due" to affected

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It's Time to Rethink (cont'd):

contractors or grantees. The fairness and adequacy of agency suspension/debarment procedures become far more important where the agency defines the offense, lodges the charge, and acts as prosecutor and adjudicator, rather than simply following up on a criminal conviction or civil judgment that already has been adjudicated by a court.

Furthermore, this new landscape underscores the enormous range of discretion that is given to the SDO in resolving suspension and debarment actions. Assuming that a "cause" for suspension or debarment exists, it is almost entirely up to the SDO, based on his or her assessment of the relevant circumstances, to determine whether or not to apply the sanction. In comparison, we do not grant federal judges the authority -- and discretion -- to decide whether to put out of business a company that has been convicted of a criminal offense. Likewise, the Department of Justice was roundly criticized for effectively putting Arthur Andersen out of business by pursuing a criminal prosecution of the company. And commentators have cast a wary eye on the Department's recent practice of using deferred prosecution agreements and similar arrangements to secure the adoption of sweeping internal corporate reforms in order to avoid criminal prosecution. They correctly note that this practice raises questions about the reach of federal executive branch power.

This is not to suggest that the determination of a contractor's present responsibility is or can be anything other than a judgment call, nor is it to suggest that the exercise of discretion in making that call can or should be channeled through detailed guidelines. (The Sentencing Guidelines provide a cautionary lesson in that regard). But the question arises whether such a momentous and discretionary decision should be delegated to a single individual without any truly effective avenue of review. Giving a government official so much unbridled power creates a risk of overreaching that is at odds with the ideal that we are "a nation of laws, not of men."

Finally, this new landscape amplifies the impact of inconsistent enforcement practices among the different agencies and between SDO's in the same or related agencies. Contractor missteps that would be ignored by one agency can trigger an exclusion by another agency. Congress is rightfully concerned about lax enforcement by certain agencies while contractors and grantees are concerned about overly aggressive enforcement actions by other agencies. The overall system operates too inconsistently.

V. What Reforms Are Needed

What steps can and should be taken to address these concerns? We propose the following reforms.

A. Separation of Adjudication and Investigation/Prosecution Functions

There should be a clear separation between the functions of prosecution and
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It's Time to Rethink (cont'd):

adjudication. Lodging the prosecution and adjudicative functions within the same organizational unit of an agency carries a serious potential for arbitrariness and abuse, and violates basic notions of due process. The investigative function and the prosecution function could remain with the various agencies while, as discussed below, the adjudication function is shifted to a central authority. Alternatively, if both the prosecution function and adjudication function are shifted to a central authority, there must be a complete separation between them.

B. Centralized Adjudications

Because the effect of a suspension or debarment is government-wide, there is a strong argument for centralizing the adjudication function rather than have decisions depend on the vagaries of each federal agency or a particular SDO within the agency. Such centralization would promote consistency and high quality not only in decisions about whether a party should be suspended or debarred, but also in the negotiation of appropriate administrative agreements to settle suspension or debarment actions.

The potential advantages of centralizing the system of suspension and debarment already have drawn the attention of Congress. In February 2013, the chairman of the House Oversight and Government Reform Committee issued a discussion draft of legislation that would create a single Board of Civilian Suspension and Debarment, under the General Services Administration, to manage all suspension and debarment activities of the 41 civilian executive agencies and eliminate the suspension and debarment function in those agencies. This legislation would also consolidate the current non-procurement and procurement suspension and debarment regulatory schemes into one generally applicable regulation.

Such centralization of the suspension and debarment process, whether limited to the civilian agencies or extended to include the military agencies as well (either jointly with the civilian agencies or through a separate central authority), would be a dramatic change and doubtless would engender considerable resistance from the affected agencies. But the current system that allows each agency to take its own approach will continue to produce disjointed and inconsistent results that will dismay Congress on one hand and contractors/grantees on the other hand.

C. Panel Decision-making for Companies or Organizations

As discussed above, the determination of a contractor's or grantee's present responsibility is a judgment call, and we do not believe that the exercise of discretion in making this judgment can be effectively channeled through guidelines. But because this judgment is so momentous and is so highly discretionary, we submit that it should not be made by a single individual. Instead, we propose that this decision be made by a panel of three persons, each of whom has equal stature, operating through majority rule if there is a division among them. Three-judge panels have long been used in our judicial system and their track record is admirable. They are far less likely than a single judge to overlook salient issues or render a

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It’s Time to Rethink (cont’d):

flawed decision. The collective wisdom and judgment of three qualified persons generally will result in a sound decision.

If there are disputed issues of material fact relating to a proposed exclusion, they would be referred to a single Administrative Law Judge for resolution through an evidentiary hearing. Once the facts are determined, however, the ultimate decision whether to exclude the contractor would be made by a three-person panel. The panel would also decide the length and scope of the debarment if it is imposed. Likewise, if a company is attempting to negotiate an administrative agreement to resolve a proposed exclusion, it might deal with a single point person at the debarring authority. But, again, the ultimate decision on whether the terms of the agreement are acceptable would be made by the three-person panel, not a single individual. Because the panel is the decision-maker, the contractor would have the right to appear before the panel to submit information and argument in opposition to the proposed debarment.

For practical reasons, however, we would limit the use of such panels to cases involving the proposed exclusion of an organization, not an individual. The number of individuals who are considered for debarment is relatively large and the cost of employing a three-person panel for each of them could be substantial. Moreover, in cases involving an individual respondent, it is far less likely that mitigating circumstances or corrective actions may outweigh the existence of cause for debarment -- because it is difficult for an individual to demonstrate his present responsibility notwithstanding proof that he personally engaged in misconduct.

D. Expanded Right to an Evidentiary Hearing

In many or most debarment cases involving a company or organization, there will not be a dispute about whether the cited "cause" for debarment occurred. Rather, the critical issue will be whether the contractor or grantee can demonstrate sufficient mitigation and/or remediation to establish its present responsibility. Given the importance of mitigating factors, a respondent should be entitled to an evidentiary hearing if there is a dispute about the existence of a particular factor. Moreover, any prospect for meaningful judicial review of an adverse decision requires that the factual record be fully developed.

E. Limiting Exclusions of Affiliates

Under current regulations, a blameless "affiliate" of a wrongdoer may be suspended or debarred to prevent the wrongdoer from using the affiliate to circumvent its exclusion. In order to exclude an affiliate on this basis, the Government should be required to establish that it is likely that the wrongdoer will use the affiliate for this purpose. And, if there are disputed material facts relating to this issue, the respondent should be entitled to an evidentiary hearing.

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It’s Time to Rethink (cont’d):

VI. Conclusion

These reforms, we submit, would provide greater assurance that contractors and program participants are treated fairly when their future ability to deal with the federal government is at stake. They would make the imposition of suspensions or debarments more uniform and predictable, to the benefit of all parties and the public.

Legislation or rule making would be required to implement many of these recommended changes, and the prospects for such reform are unclear. But we believe that the time has come to commence the discussion and to address candidly what changes are needed, not simply what changes may be possible.

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Differing Site Condition Claims: What is Below the Surface of Exculpatory Clauses Or Other Disclaimers?

by
*Owen S. Walker**

It is a well-settled proposition that the purpose of a Differing Site Conditions clause is to shift the risk of unknown physical conditions to the owner of the site by allowing a contractor to seek an equitable adjustment in the contract price when the contractor encounters unanticipated conditions.[1] Ideally, the corollary benefit to the owner is that a contractor does not inflate its bid price to accommodate for the possibility of encountering unanticipated conditions. Thus, a Differing Site Conditions clause serves to prevent "turning a construction contract into a gambling transaction."[2]

Typically, subsurface data such as boring logs or a geotechnical report are made available with solicitations to facilitate accurate bidding. Nevertheless, even when a Differing Site Conditions clause is incorporated into a contract, the government owner may still attempt to reduce its own liability for any such unanticipated conditions by inserting broad exculpatory language or other disclaimers in or about the subsurface data provided to a contractor. This occurred recently in *Drennon Construction & Consulting, Inc.*, decided by the Civilian Board of Contract Appeals (CBCA).[3]

In *Drennon,* the Department of Interior contended, *inter alia*, that certain disclaimers contained in the geotechnical report precluded a contractor from forming a reasonable reliance as to certain physical conditions of the site expressed in the report. The contractor, Drennon Construction & Consulting, Inc., argued that defective specifications and inaccurate information about the site conditions were the fundamental problems on the project. The CBCA agreed with Drennon on both points and awarded Drennon its damages flowing from those issues.[4] Using the decision in Drennon as the backdrop, this article will address the effect of broad exculpatory clauses and other disclaimers on the Differing Site Conditions clause.[5]

Types of Differing Site Conditions Claims Generally

Differing site conditions claims can take one of two forms, or "types." A Type I claim exists where the actual site conditions differ from the conditions indicated in the contract documents.[6] Importantly, under a Type I claim, "it is not necessary that the 'indications' in the contract be explicit or specific; all that is required is that there be enough of an indication on the face of the contract documents for a bidder reasonably not to expect subsurface or latent physical conditions at the site differing materially from those indicated in [the] contract."[7]

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Differing Site Condition Claims (cont'd):

Admittedly, whether a contract includes "indications" of anticipated latent subsurface conditions depends upon the particular facts of each case. Further, to prevail on a Type I claim requires the contractor to prove four elements: (i) that a reasonable contractor reading the contract documents as a whole would interpret them as making a representation as to the site conditions; (ii) the actual site conditions were not reasonably foreseeable to the contractor, with the information available to the particular contractor outside the contract documents, i.e., that the contractor "reasonably relied" on the representations; (iii) that the particular contractor in fact relied on the contract representation; and (iv) the conditions differed materially from those represented and that the contractor suffered damages as a result.[8]

In contrast, a Type II claim exists where the actual site conditions differ from those reasonably anticipated based on the nature of the work and locale.[9] Prevailing on a Type II claim generally requires satisfying three conditions. Specifically, "the unknown physical condition must be one that could not be reasonably anticipated by the contractor from his study of the contract documents, his inspection of the site, and his general experience [,] if any, as a contractor in the area."[10] Establishing a Type II claim does not require proving that a reasonable contractor would interpret the contract documents as making a representation of the site conditions. Therefore, exculpatory clauses and disclaimers of site conditions generally do not have any bearing on establishing a Type II claim.

In *Drennon*, the CBCA acknowledged the existence of a Type I claim based on the fact that the site conditions were materially different from what was described in the geotechnical report included in the solicitation. The Department of Interior's Bureau of Land Management (BLM) wanted to have a road, which accessed the Tangle Lakes Campground located in central Alaska, widened from one lane to two and to have a blind curve in the road eliminated. In August 2009, BLM awarded a $127,688.23 contract to the engineering firm USKH, Inc. (USKH) to design the project. At the outset, the limited amount of available funds for the project required BLM to "keep modifying the scope of work to fit within that budget constraint."[11]

During the design phase, USKH determined that the digital terrain model used to design the road contained inaccurate control points. USKH's request for an additional $25,000 to perform a survey from which an accurate design could be made was denied by BLM, as BLM contended that the digital terrain model was sufficiently accurate.[12] In an attempt to avoid potential additional costs resulting from inaccuracies in the design, a USKH engineer proposed adding "weasel words" (his phrase) to warn potential bidders of the possible inaccuracies in the model.[13]

USKH was also tasked with performing a geotechnical investigation of the site. USKH contracted with Shannon & Wilson, Inc. (S&W) to perform subsurface investigations including making soil borings, geotechnical analysis, and the preparation of geotechnical design and construction report.[14] S&W's report contained information about eight soil borings taken under the existing road, generally described the soil conditions of the existing area, and addressed

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Differing Site Condition Claims (cont'd):

some preferred construction techniques.[15] S&W's report, including the soil borings and geotechnical analysis was included as part of the solicitation. The solicitation and contract also incorporated Federal Acquisition Regulation (FAR) clause 52.236-2 (Differing Site Conditions) (Apr. 1984), among various other standard government contract clauses.

Shortly after Drennon commenced excavation into the hillside adjacent to the road, it became apparent that the soils were "at or near [its] angle of repose, so every scoopful that is excavated from the slope causes a landslide of material from above."[16] Drennon concluded that the hill was not going to stabilize and would continue to unravel. Thereafter, the contracting officer issued a stop work order. Ultimately, BLM decided to scale back the project, limited only to the installation of a gabion wall along the existing one lane road.

The Effect of Disclaimers on Type I Claims

The CBCA concluded that the S&W report clearly made representations as to the anticipated site conditions.[17] Specifically, the report contained information about the soil borings that depicted the soil as containing "5.1 and 10.7% fines" and described the hillside as containing similar soils.[18] The results of soil test borings are often considered the most reliable reflection of subsurface conditions.[19] However, the report also included a reference to "esker soils" on the hillside (the area that Drennon was required to excavate to widen the road) as "non-cohesive" and "[a]lthough temporary excavation slopes may initially stand steep they may slough and cave if they … are subjected to equipment vibrations."[20]

BLM's expert witness asserted that Drennon's reliance on the soil borings was misplaced as the esker soils are "flower rock material, which has no cohesion" and Drennon was on notice of that fact by virtue of the disclaimer in S&W's report.[21] The CBCA, however, was persuaded by Drennon's expert witness's explanation that while a geotechnical engineer should know the term "esker," it would be unreasonable to expect the same of a construction contractor.[22]

Although Drennon prevailed in its claim, not all contractors have been as fortunate. Certain disclaimers have been found to prevent a contractor from establishing the first element of a Type I claim. For example, in *Metcalf Construction Co., Inc. v. United States*, a contractor undertook a design-build housing project for the Navy.[23] During construction, the contactor encountered "expansive soils," which required a substantial amount of additional excavation.[24] The contractor sought an equitable adjustment for its additional costs and relied upon a soil report provided by the Navy as evidencing conditions materially different from those actually encountered. The court, however, found that the contractor failed to establish the first element for a Type I claim, because the contract required the contractor to "perform post-award site design and engineering work, including the retention of a geotechnical engineering firm to conduct soil investigations to ensure that the contractor's design addressed relevant geotechnical issues."[25] As such, the court determined that the contractor could not reasonably rely on the soil report that was expressly labeled "information only."[26]

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Differing Site Condition Claims (cont'd):

Instructions to Review Available Data Can Operate as a Form of Disclaimer

When a solicitation or contract includes instructions to review available subsurface data and a contractor fails to undertake a review of the available subsurface data, it becomes increasingly difficult for such contractor to establish reasonable reliance on subsurface data set forth in the contract documents.

In *Stuyvesant Dredging Co. v. United States*, the Corps of Engineers let a contract to perform maintenance dredging of the Corpus Christi Entrance Channel. Stuyvesant Dredging Company, the dredging contractor, anticipated removing material of a certain density, but the actual material had a significantly higher density and was, therefore, more difficult to remove.[27] Stuyvesant filed a Type I claim based on a representation of the material in the contract documents. However, the contract contained a provision stating, "[b]idders are expected to examine the site of the work and the records of previous dredging, which are available … and after investigation decide for themselves the character of the materials."[28] Stuyvesant had recently performed two other projects on the Texas Gulf Coast and decided that a pre-bid investigation was unnecessary. Further, Stuyvesant failed to visit the site to take its own readings of the dredge material's density and did not review the records of previous dredges. The court found that the subsurface information provided in the contract on which Stuyvesant relied were to serve as "'guides only[,]' and did not 'reach the level of estimates and [were] clearly not facts upon which [the contractor] could rely.'"[29] Hence, the contractor could not establish a Type I differing site conditions claim.

In *Randa/Madison Joint Venture III v. Dahlberg*, the Army Corps of Engineers (Corps) let a contract for work that included the construction of a sewage pumping station.[30] The Corps contracted the design out to a separate firm, but the Corps performed the geotechnical investigation. The pump house foundation was to extend forty feet below the surface, so it was necessary to determine whether any subsurface water would have to be removed. The Corps entered into a contract with Randa/Madison Joint Venture III to perform the required dewatering work.

However, prior to submitting its bid, Randa reviewed the boring logs but failed to inspect certain other subsurface test results made available by the Corps. Randa's contract included the Site Investigation clause (FAR 52.236–3), among other standard government contract clauses. After Randa experienced difficulty dewatering the site, it filed a claim for a Type I differing site condition, relying upon the information contained in the boring logs. The court held that the Site Investigation clause placed on the contractor the risk of not inspecting "exploratory work" performed by the Corps.[31] Finding that the contactor had a duty to review the available subsurface data, whether in the contract documents or not, the court upheld the denial of the contractor's differing site conditions claim.[32]

The Differing Site Conditions Clause Prevails

The predominant view as expressed in *Drennon* is that broad exculpatory clauses cannot

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Differing Site Condition Claims (cont'd):

be given any effect, as they would render the Differing Site Conditions clause meaningless as to Type I claims. In *Drennon*, the CBCA stated, "broad exculpatory language does not relieve the agency, which provided the report to prospective bidders with the expectation that they would rely on it, from liability resulting from conditions which are materially different from those described specifically."[33]

As to the three other elements of a Type I claim, in *Drennon* the CBCA found that the actual conditions were not reasonably foreseeable as the only available information was the S&W report. Drennon could not access the site to see firsthand the conditions as the area was covered with snow and inaccessible to bidders during the period of time that bids were accepted. In light of the absence of any other available subsurface information, Drennon was able to establish reliance on the subsurface data in the S&W report. Lastly, with the aid of expert testimony, Drennon established that the actual site conditions differed materially from those represented.

In *Travelers Casualty & Surety Co. of America v. United States*, the Army Corp of Engineers entered into a contract with Red Samm to improve a small boat harbor in King Cove, Alaska, part of the Aleutian Island chain.[34] The contract required the performance of work in two stages.

The initial phase consisted of the construction of a breakwater followed by dredging of the harbor behind the breakwater. Red Samm encountered copious amounts of "cobbles" (rounded or ragged stone between three and twelve inches in diameter) during the performance of the second phase of the contract. Red Samm planned on employing a hydraulic dredge, based on its interpretation of the site conditions represented in the contract documents. The presence of the cobbles, however, forced Red Samm to employ more costly and time-consuming means to complete its dredging work. The court held that the contractor's "differing site conditions claim turns primarily on determination of the contract's representations."[35]

The government, relying on FAR 52.236–3, contended that the contractor was at fault based on its incorrect interpretation of the subsurface data contained in the contract. The court strongly disagreed and found that based on the government's argument, "FAR § 52.236–3 would in essence vitiate Section 02222, the contractual provision describing the conditions at the site."[36] Further, "if the government is permitted to disavow through exculpatory language any responsibility for its representations, a showing of a differing site condition becomes impossible and therefore superfluous."[37] Thus, the court concluded that in order to "effectuate the underlying policy of a differing site condition clause as laid out in *Foster*, the Court will not interpret the exculpatory language of the Site Investigation Clause [FAR 52.236–3] excessively broadly."[38]

In *Whiting-Turner/a.l. Johnson Joint Venture*, the General Services Administration

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Differing Site Condition Claims (cont'd):

(GSA) awarded a contract for the construction of a building at the Centers for Disease Control in Atlanta, GA. The GSA was responsible for providing "[c]omplete Geotechnical and Soils information."[39] However, accompanying the bid package for the foundation work was the following disclaimer,

> A geotechnical report has been prepared for this Project and is available for information only. The report is not part of the Contract Documents. Opinions expressed in this report are those of the geotechnical engineer and represent interpretations of subsoil conditions, tests, and results of analyses conducted by the geotechnical engineer. Government will not be responsible for interpretations or conclusions drawn from this data by Contractor.[40]

The contractor performing the foundation work encountered unanticipated groundwater and a Type I differing site conditions claim was made against the government. The contractor's claim was premised on certain representations in the contract documents, including soil boring logs, regarding the anticipated subsurface conditions for the project. The government argued that the subsurface information contained in the bid was labeled for "information only" and the bid package expressly stated the information was "not part of the Contract Documents."[41] Further, the government argued that the contract instructed bidders to make their own borings. The board disagreed, stating that the disclaimers in the bid were not controlling. The board also held that "the Government cannot provide borings, so that bids can be based on them, and at the same time disclaim the validity of those logs."[42] Thus, the board found that such disclaimers are not effective because they would render the differing site conditions clause meaningless as to Type I claims.[43]

Conclusion

Based on established legal precedent, it is likely that courts and boards will continue to prevent broad exculpatory clauses or other disclaimers from eroding contractors' rights to pursue Type I differing site condition claims. However, in order to preserve the right to seek recovery for a Type I claim prudent contractors, prior to submitting a bid, will review all available subsurface data. As *Randa* instructs, it is imperative to review not only the documents that form the contract, but also any subsurface reports referenced in the contract and made readily available for inspection.

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Differing Site Condition Claims (cont'd):

Endnotes

1. *See*, e.g., *HSG Technischer Serv. GmbH*, 2009-2 BCA ¶34,177 (June 16, 2013) ("[a] well established purpose of the Differing Site Conditions clause is to eliminate inclusion of contingencies to cover the possibility of encountering conditions more adverse than the indicated and usual.")
2. *J.F. Shea Co., Inc. v. United States*, 4 Cl. Ct. 46, 50 (1983) citing *Peter Kiewit Sons' Co. v. United States*, 109 Ct. Cl. 517, 522–23, 74 F. Supp. 165, 168 (1947).
3. *Drennon Constr. & Consulting, Inc*., 13-1 BCA ¶35,213 (Jan. 4, 2013).
4. *Id.* at 13-14.
5. *See* FAR 52.236-2, Differing Site Conditions clause (April 1984).
6. *See id*. at (a)(1).
7. *Foster Constr. C. A. & Williams Bros. Co. v. United States*, 435 F.2d 873, 875 (Ct. Cl. 1970). *See also J.F. Shea Co., Inc., supra*, at 51 (Bidding schedules can have legal significance as contract "indications" in the absence of express contract provisions disclaiming their significance.); *Cont'l Drilling Co*., ENGBCA No. 3455, 75-2 BCA ¶11,541 (Sept. 9, 1975) (ruling that bidding schedule estimates served as "indications" of subsurface conditions.).
8. *Metcalf Constr. Co., Inc. v. United States*, 102 Fed. Cl. 334, 354 (Fed. Cl. 2011) quoting *Int'l Tech. Corp. v. Winter*, 523 F.3d 1341 (Fed. Cir. 2008) (the term "representation" referenced in the first element of Type I claim is consistent with *Foster*'s use of the term "indication").
9. *See* FAR 52.236–2 (a)(2).
10. *Randa/Madison Joint Venture III v. Dahlberg*, 239 F.3d 1264, 1276 (Fed. Cir. 2001) quoting *Perini Corp. v. United States*, 180 Ct. Cl. 768, 381 F.2d 403, 410 (1967).
11. *Id.* at 2.
12. *Id.*
13. *Id.*
14. *Id*. at 3.
15. *Id.*
16. *Id*. at 6.
17. *Id*. at 10-11.
18. *Id*. at 10.
19. *Whiting-Turner/a.l. Johnson Joint Venture*, 02-1 BCA ¶31,708 (Dec. 5, 2001).
20. *Id.* at 11 (finding that the "[t]he value of this last disclaimer was made dubious, however, by the recommendation that the contractor use equipment which creates a significant amount of vibration.").
21. *Id*. at 4.
22. *Id*. *See also Shank-Artukovich v. United States*, 13 Cl. Ct. 346, 354 (1987) aff'd, 848 F.2d 1245 (Fed. Cir. 1988)("While it is true that a contractor has a duty to consider all of the specifications, he has no duty to conduct his own investigation, and is not bound to know that which only an expert could derive from the contract.").
23. *Metcalf Constr. Co*., *supra*.
24. *Id.* at 352.
25. *Id.* at 349.
26. *Id.* at 354.
27. *Stuyvesant Dredging Co. v. United States*, 834 F.2d 1576 (Fed. Cir. 1987).
28. *Id.* at 1579.
29. *Id.* at 1581 (Fed. Cir. 1987) citing *Stuyvesant Dredging Co. v. United States*, 11 Cl. Ct. 853, 858 (1987).
30. *Randa/Madison Joint Venture III*, *supra*.
31. *Id.* at 1268.
32. *Id.* at 1267 ("The actual contract documents included the boring logs, but not the gradation curves or other test results. The gradation curves and other test results, as well as the soil samples themselves, were made available for inspection at a Corps office.").

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Differing Site Condition Claims (cont'd):

Endnotes (cont'd)

33. *Drennon Constr. & Consulting, Inc.*, supra.
34. *Travelers Cas. & Sur. Co. of Am. v. United States*, 75 Fed. Cl. 696 (Fed. Cl. 2007).
35. *Id.* at 712.
36. *Id.* at 714.
37. *Id.*
38. *Id.*
39. *Whiting-Turner/a.l. Johnson Joint Venture*, *supra*, at 156,607.
40. *Id.* at 156,610.
41. *Id.*
42. *Id.* at 156,618.
43. *Id.*

Understanding Bonding Requirements For Federal Construction Contracts

by
*Kathleen A. Ellis**

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Construction contracting for the U.S. federal government brings about challenges that are not often met during the acquisition of goods and/or services. As a result, the federal government often requires that contractors who offer construction services provide various types of bonding and/or payment protections, depending on the overall cost of the project.[1] Bonds act as insurance to the government that the contractor will complete the requirements of the contract satisfactorily.[2] Further, since there are few common exceptions to bonding requirements, such as a waiver for contracts completed in foreign countries, contracting officers and supporting contract specialists need to understand when bonding and/or payment protection requirements are applicable.[3]

A contract may require payment bonds, performance bonds, and/or bid guarantees depending on the value of the construction contract. The Federal Acquisition Regulation[4] and the Miller Act[5] regulate which type(s) of bonding and/or payment protections the contracting officer must include in a solicitation for a construction project, and ultimately in the construction contract. Occasionally, a contracting officer might determine that it is in the government's best interest to request bonding or payment protection beyond what is required by law—the Miller Act authorizes contracting officers to request additional performance and/or payment protections as long as he or she remains in compliance with 40 U.S.C. §3131(b).[6]

For contracts over $30,000, but less than or equal to $150,000, the Miller Act requires payment protections, but does not mandate that these payment protections are payment bonds.[7] A list of acceptable payment protections includes:

- A payment bond,
- An irrevocable letter of credit,
- A tripartite escrow agreement,
- Certificates of deposit,
- A deposit of U.S. bonds or notes, and
- Certified or cashier's checks, bank drafts, money orders, or currency in the amount equal to the sum of the bond required.[8]

In the solicitation payment protection provision,[9] the contracting officer must notify the potential contractors which payment protections will be deemed "acceptable" for the requirement. Contracting officers are encouraged to use irrevocable letters of credit as one of

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Understanding Bonding Requirements (cont'd):

the payment protection options; however, any of these payment protections are acceptable for the contracting officer to utilize.[10] Ultimately, the payment protection offered by the contractor must be at least equal to the value of the contract. It is important to note that performance bonds are not automatically required for construction contracts within this threshold.

Further, payment and performance bonds are required for construction contracts exceeding $150,000.[11] A payment bond provides for "the protection of all persons supplying labor and material in carrying out the work provided for in the contract."[12] While the payment bond relationship is only between the prime contractor and the government, subcontractors are protected by these bonds as well.

> [The payment bond] shall equal the total amount payable by the terms of the contract unless the officer awarding the contract determines, in a writing supported by specific findings, that a payment bond in that amount is impractical, in which case the contracting officer shall set the amount of the payment bond.[13]

However, "the amount of the payment bond shall not be less than the amount of the performance bond."[14] In contrast, a performance bond protects the government against partial or otherwise inadequate completion of a construction project by a contractor.[15] If the contractor uses a corporate surety for either of these bonds, the contracting officer must verify that the corporate surety is acceptable to the Department of the Treasury.[16] This can be completed easily using the Department of the Treasury's website at www.fms.treas.gov/c570/ or by submitting a written request for a hardcopy of the Department of the Treasury Circular 570.[17]

Finally, "bid guarantees shall be required whenever a performance bond or a performance and payment bond is required."[18] Contracting officers are not permitted to require bid guarantees beyond this threshold; "a contracting officer shall not require a bid guarantee unless a performance bond or a performance and payment bond is also required."[19] Because contracts that require performance bonds also require payment bonds, bid bonds are required if a performance bond is required unless the contract meets one of the exceptions for bid guarantees under Federal Acquisition Regulation 28.101-1(c).[20] Therefore, bid guarantees are required for contracts that exceed $150,000 because these contracts require performance bonds.[21] Typically, the penal sum of a bid bond is either 20 percent of the bid price or $3 million, whichever is less. This amount can be altered within the bid guarantee clause of the solicitation if the specific characteristics of the procurement require different thresholds due to complexity, risk, or other justifiable factors[22] (see Figure 1 on next page).

Ultimately, the contractor is required to submit bid guarantees with its quote, proposal, or bid by the due date in the solicitation. A contractor can submit all required bonds and payment protections at any time prior to the due date per the solicitation and/or the contract;

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however, the contracting officer cannot issue the notice to proceed or allow the contractor to begin work until acceptable bonds and/or payment protections are received, reviewed, and accepted.[23] The process of requesting and reviewing bonds is a critical part of the award of and the commencement of a construction contract. Requiring contractors to provide bonds insures the government against significant loss when a contractor fails to perform as required.

Figure 1
What Bonds Are Required?

Contract Value	Bid Guarantee	Payment Bond	Performance Bond
< $30,000			
≥ $30,000 but ≤ the Simplified Acquisition Threshold ($150,000)		X (for Alternative Payment Protection per FAR 28.102-1(b)(1)	
> $150,000	X	X	X

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The views expressed in this article are those of the author and do not reflect the policy or position of the U.S. Department of Veterans Affairs or the U.S. government.

Endnotes

1. Prior to awarding a contract for more than $150,000 "for the construction, alteration, or repair of any public building or public work of the federal government, a person must furnish to the government…bonds, which become binding when the contract is awarded." (40 U.S.C. §3131.) These bonds are known as "bid guarantees" or "bid bonds."
2. According to Federal Acquisition Regulation (FAR) 28.001, a bond is defined as: "a written instrument executed by a bidder or contractor (the 'principal'), and a second party (the 'surety' or 'sureties')…to assure fulfillment of the principal's obligations to a third party (the 'obligee' or 'government'), identified in the bond. If the principal's obligations are not met, the bond assures payment, to the extent stipulated, of any loss sustained by the obligee."
3. 40 U.S.C. §3131(d).
4. *See* 41 U.S.C. §101-8707.
5. *See* 40 U.S.C. §3131 (Only applicable to contracts above the simplified acquisition threshold).
6. 40 U.S.C. §3131(e).
7. 40 U.S.C. §3132. *See also* FAR 28.102-1(b)(1).

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Understanding Bonding Requirements (cont'd):

Endnotes (cont'd)

8. FAR 28.102-1(b)(1).
9. FAR 52.228-13.
10. FAR 28.102-1(b)(1).
11. *See* 40 U.S.C. §3131-32 *and* FAR 28.120(a). Note: The simplified acquisition threshold has been increased from $100,000 to $150,000.
12. 40 U.S.C. §3131(b)(2).
13. *Ibid*.
14. *Ibid*.
15. 40 U.S.C. §3131(b)(1).
16. FAR 28.202.
17. *Ibid*.
18. FAR 28.101-1(a).
19. *Ibid.*
20. "The chief of the contracting office may waive the requirement to obtain a bid guarantee when a performance bond or a performance and payment bond is required if it is determined that a bid guarantee is not in the best interest of the government for a specific acquisition (e.g., overseas construction, emergency acquisitions, sole-source contracts). Class waivers may be authorized by the agency head or designee." (FAR 28.101-1(c).)
21. For the purposes of this article, the term "bid" is used interchangeably with the terms "proposal," "offer," and "quote." Government construction contract bonding requirements apply to projects that are solicited via any of these methods.
22. FAR 52.228.
23. "The contractor shall furnish all bonds or alternative payment protection, including any necessary reinsurance agreements, before receiving a notice to proceed with the work or being allowed to start work." (*Ibid*.)

OCIs as Addressed in the AMS and the FAR and Reviewed by the FAA ODRA and GAO

by
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This article addresses Organizational Conflicts of Interests ("OCI") and the administrative review of alleged OCIs. Specifically, comparing and contrasting two regulations governing the creation of government contracts, and the subsequent bid protest and contract dispute resolution processes with respect to OCIs. These two regulatory systems, the Federal Aviation Administration ("FAA") Acquisition Management System ("AMS") and the Federal Acquisition Regulation ("FAR") both address OCIs, and the FAA Office of Dispute Resolution for Acquisition ("ODRA") and the Government Accountability Office ("GAO") respectively review alleged OCIs. In addition to this comparison, this article starts with an illustrative case of a Washington, D.C.-based organization's difficulty with acquisition-based conflicts of interest. This article also includes background information on the basis for a separate FAA acquisition system. Finally, this article concludes with a summary of other governing laws and looks to the future of FAR.

This article provides: (1) a framework of regulatory acquisition OCI provisions; (2) shows how the FAR's OCI provisions are greatly supplemented by GAO decisions; and (3) demonstrates how proposed changes to FAR OCI provisions mirror many of the concepts addressed and included in the AMS.[1]

Acquisition Scandal: The Metropolitan Washington Airport Authority

The Metropolitan Washington Airport Authority ("MWAA") is a congressionally created non-governmental organization that oversees the Washington, D.C. area airports.[2] In early November of 2012, *The Washington Post* reported MWAA's board of directors and senior staff members had flouted governance requirements pertaining to award and management of contracts as highlighted in a federal investigation report in May 2012.[3] "From 2009 to 2011, the MWAA awarded two-thirds of its contracts with less than full and open competition. Those included $6 million in sole-source contracts in which board approval was required but not secured – a violation of its lease agreement with the federal government."[4]

A Department of Transportation Inspector General Audit Report found that overwhelming number of MWAA's contracts violated the federal practice to encourage competition. The existence of an OCI can hinder this practice. For example,

> MWAA's Board of Directors awarded a $150,000 contract to help prepare a solicitation for a study to assess MWAA's organizational structure. Forty days later, MWAA decided not to compete the contract. Instead, MWAA—without the Procurement and Contracts Department's involvement—

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> awarded an $885,000 organizational study sole source contract to the contractor hired to develop the solicitation. Contracting without a solicitation not only limits competition but can lead to potential misunderstandings about the requirements or scope of the contract. In addition, under Federal procurement rules, if a contractor assists in preparing a work statement to be used in competitively acquiring a service, that contractor generally may not supply that service, except in limited situations. These rules are designed to ensure that the Government receives unbiased advice and avoids allegations of favoritism.[5]

The Report references an example of organizational conflict of interest ("OCI") explicitly prohibited in the FAR and addressed in AMS Guidance. If a company creates the statement of work for a contract, the company may have an unfair advantage when submitting a bid for the contract. FAR section 9.505-2 states, "If a contractor prepares and furnishes complete specifications ..., to be used in a competitive acquisition, that contractor shall not be allowed to furnish these items … for a reasonable period of time."[6] This OCI example demonstrates the importance of strong ethical rules regarding government acquisitions.[7]

This example demonstrates that even small entities struggle to follow adequate acquisition related ethic rules. The effect of this scandal is exacerbated by Washington's reliance on government contracts and the joint responsibility between Maryland, Virginia, and the District of Columbia for MWAA's actions. OCI scandals may not be as easily caught-up in the media because OCIs do not involve individuals; however, OCIs are a growing concern in government procurements and thus worthy of close attention.

I. A Basic Definition

A conflict of interest is defined as "a conflict between one's obligation to the public, and that of a public officeholder, and one's self-interest."[8] Black's Law Dictionary defines OCI as "a situation that can undermine a person due to self interest and public interest" or "a situation when parties discharge responsibility to a third party."[9] An OCI rarely involves an individual conflict of interest, but rather because of an organization's action or participation, the organization has unfair advantage over another organization. As described in one case, "[a]n OCI centers upon the conflict of interest of the *contractor*."[10] The ODRA further explains the question is: "whether a contractor is in a position to grant itself an unfair advantage based on its performance on an existing contract, or the contractor is unable to provide the agency with objective evaluations over itself, another division, subsidiary, or entity in which it has a significant financial interest."[11]

GAO ruled that when an agency identifies contractor activities that could arise to an OCI and the agency does not consider the OCIs potential impact, the GAO ruled that the agency must assess the contractor's activities, and prepare a plan to combat possible OCIs or simply

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terminate the existing contract.[12] By way of another example, significant organizational conflict of interest exists where through the performance of a contract the contractor could create additional commercial work for the offeror.[13] There are three types of organizational conflicts of interest, which will be discussed further: (1) unequal access to information; (2) biased ground rules; and (3) impaired objectivity.[14]

The Acquisition Management System and the Federal Acquisition Regulation

This section explains why the federal acquisition systems exist and lays out how each system addresses OCIs.

In 1995, Congress directed the FAA to develop a revised acquisition management system to "address ... the unique needs of the agency and, at a minimum, provide ... for more timely and cost-effective acquisitions of equipment and materials."[15] The FAA believed that given the majority of its agency acquisitions are technologically complex, time sensitive, and very large, the use of a new, tailored procurement system would facilitate a more smooth acquisition process.[16] Furthermore, the GAO designated FAA's Air Traffic Control Modernization as "high-risk" in 1995, fueling acquisition reform.[17]

a. The Federal Acquisition Regulation

This section describes the FAR subpart devoted solely to OCI rules, provides examples, and highlights additional parts of the FAR that reference OCIs. The FAR governs federal agency acquisitions, i.e. the creation of contracts between the government and outside parties. The FAR, however, solely regulates the actions of government actors. Therefore, in terms of OCIs, FAR subpart 9.5 "Organizational and Consultant Conflicts of Interest" "prescribes responsibilities, general rules, and procedures for identifying, evaluating and resolving organizational conflicts of interest" for government acquisition personnel.[18]

The FAR provides that an OCI exists "because of other activities or relationships with other persons, a person is unable or potentially unable to render impartial assistance or advice to the Government, or the person's objectivity in performing the contract work is or might be otherwise impaired, or a person has an unfair competitive advantage."[19] In the definition, it is important to note that person likely refers to companies or other organizations in order to fulfill the "organization" component of the term.[20] "Because of other activities or relationships with other persons" most likely "refer[s] to the organization's financial interests that are at stake in carrying out the organization's responsibilities to a third party."[21] The GAO provides context, "An organizational conflict of interest exists where, because of other activities or relationships with other persons, a person is unable or potentially unable to render impartial assistance or advice to the Government, or the person's objectivity in performing the contract work is or might be otherwise impaired, or a person has an unfair competitive advantage."[22]

The FAR identifies three groups of organizational conflicts of interest: (1) unequal

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access to information; (2) biased ground rules; and (3) impaired objectivity.[23] The first type of OCI addressed in the FAR is "unequal access to information."[24] The FAR identifies three means to gain unequal access to information by obtaining: (1) "proprietary information from others to perform a Government contract"[25]; (2) "proprietary information of other companies in performing advisory and assistance services for the Government"[26]; and (3) proprietary and source selection information by acquiring the services of marketing consultants."[27] In general, this OCI is forward looking such that the information affects a contractor's future acquisitions.[28] Thus, "'[u]nequal access to information' arises where a company has access to nonpublic information (typically through performance of a contract) that gives it an unfair to competition for a later contract."[29] The GAO sustained a protest alleging the awardee's prior contract performance "gave it access to competitively useful, non-public information and thus created an unequal access to information," and the GAO ruled "there is no reasonable basis in which to conclude that all competitively useful information obtained by the [awardee] was disclosed to the other offerors."[30]

The second type of OCI addressed in the FAR is "biased ground rules."[31] The two at risk contractors identified under this type of OCI are contractors that provide systems engineering and technical direction and contractors that prepare specification or work statements.[32] Contractors that provide systems engineering and technical direction for a system "shall not (1) be awarded a contract to supply the system or any of its major components or (2) be a subcontractor or consultant to a supplier of the system or any of its major components."[33] Contractors that prepare specification or work statements are assumed prohibited from competition from an award unless the contractor or solicitation meets certain criteria.[34] The FAR explains, "Agencies should normally prepare their own work statements. When contractor assistance is necessary, the contractor might often be in a position to favor its own products or capabilities."[35] "If a contractor prepares and furnishes complete specifications covering *nondevelopmental* items, to be used in a competitive acquisition, that contractor shall not be allowed to furnish these items, for a reasonable period of time."[36] And alternatively, "If a single contractor drafts complete specifications for *nondevelopmental* equipment, it should be eliminated for a reasonable time from competition for production based on the specifications."[37] The FAR specifies the restriction to nondevelopmental items because an unavoidable competitive advantage exists in developmental work because "it is normal to select firms that have done the most advanced work in the field."[38] However, "[i]f a contractor prepares, or assists in preparing, a work statement to be used in competitively acquiring a system or services…that contractor may not supply the system, major components of the system, or the services."[39] The FAR goes as far as to limit a contractor that "provides material leading directly, predictably, and without delay to such a work statement."[40] This prohibition is lifted if the contractor is the sole source, the contractor "participated in the development and design work," or "more than one contractor has been involved in preparing the work statement."[41] When reviewing alleged "biased ground rules" cases, the GAO "look[s] to see whether a firm was in a position to affect competition, intentionally or not, in favor of itself."[42] The final type of OCI, impaired objectivity, prohibits the award of "contracts for the evaluation of offers for products or services" "to a contractor that will evaluate its own offers for products and services,

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or those of a competitor."[43] For example, this OCI can "occur[] when a company is asked to perform tasks that require objectivity, but another role that the company lays cases doubts on the company's ability to be truly objective."[44] An agency can mitigate this OCI by "using proper safeguards to ensure objectivity to protect the Government's interests."[45] In order for the GAO to sustain an "impaired objectivity" protest, the protestor must demonstrate prejudice to the protestor.[46] For example, when members of an evaluation team were "relatively critical of [their company's] proposal, there [wa]s no reasonable basis on th[e] record to conclude that they were biased in favor" of their company.[47] The GAO ruled lack of prejudice and denied the allegations that the company had an impaired objectivity organizational conflict of interest.[48]

GAO provides some freedom to contracting officers because "the regulatory guidance cannot anticipate all situations which pose potential conflicts of interests."[49] Thus, "contracting officers must exercise common sense, good judgment, and sound discretion in assessing the existence of significant potential conflicts of interest, and in developing appropriate means to resolve them."[50] And the contracting officers must act unless the benefit to a contractor is speculative and too remote for a procurement to establish organizational conflict of interest.[51] However, the FAR explicitly requires solicitation provisions when an organizational conflict of interest can reasonably be expected with the solicited contract.[52] The solicitation "shall contain a provision that: (a) Invites offerors' attention to this subpart; (b) States the nature of the potential conflict as seen by the contracting officer; (c) States the nature of the proposed restraint upon future contractor activities; and (d) Depending on the nature of the acquisition, states whether or not the terms of any proposed clause and the application of this subpart to the contract are subject to negotiation."[53] And "[i]f, as a condition of award, the contractor's eligibility for future prime or subcontract awards will be restricted…[a clause shall be included] in the contract."[54] For example, if an OCI clause will likely be included in a contract the "solicitation shall contain a proposed clause that specifies both the nature and the duration of the proposed [contract] restraint."[55] Finally, the FAR explicitly mandates a hierarchy procedural review process when a potential or actual OCI is identified.[56] See below for more discussion addressing the FAR hierarchy review process.[57]

OCIs are addressed in other parts of the FAR as well.[58] For example, when a potential contractor contacts an agency for unsolicited work, the agency must provide information identified in subpart 9.5.[59] The FAR highlights the importance of adequately reviewing possible OCIs when an agency solicits management and operating contracts because these contracts "usually involve high levels of expertise and continuity of operations and personnel."[60] Interestingly, the FAR mandates that Federally Funded Research and Development Centers (FFRDCs) "be free from organizational conflicts of interest" because FFRDCs meet agency "long-term research and development need[s]" and must enter into a "special relationship with the Government."[61] The FAR is includes specific types of OCIs that must be resolved, neutralized, or minimized through appropriate administrative procedures.[62]

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OCIs as Addressed in the AMS (cont'd):

b. The Acquisition Management System

This section reviews the FAA Acquisition Management System ("AMS") organizational conflict of interest provisions. The FAA Acquisition System Toolset ("FAST") is the official record of the AMS.[63] And the AMS, "the collective body of information within FAST," was originally published in 1996. See supra for more information as to why the AMS was created.[64] The AMS structure seeks to provide agency-wide policy and guidance for the acquisition management lifecycle.[65] The AMS provides a holistic approach to procurement planning including mandatory policy provisions, as well as advisory guidance.[66]

AMS policy is the agency-wide, mandatory requirements of the AMS and is applicable "to all activities associated with the analysis of agency needs," "determination of requirements," "allocation and expenditure of resources," among others, but most applicable, "procurement" and "deployment of products and services."[67] The AMS Policy is supplemented by the AMS Guidance, which provides a thorough review of proper FAA practice involving potential, perceived or actual conflicts of interest.

II. Analysis

AMS Guidance is "a set of agency-endorsed guidelines, processes, instructions, templates, databases, handbooks, checklists, and other information that supplements, expands, illustrates or implements acquisition management policy."[68] AMS Guidance is designed to guide and support FAA employees plan and execute AMS Policy.[69] In practice, AMS Policy is mandatory and there is an expectation to comply AMS Guidance unless "a rational basis exists for alternative action."[70] Any deviations must be recorded and approved by "appropriate officials."[71]

AMS Policy provides three short provisions regulating OCIs. "The policy of the FAA is to avoid awarding contracts to contractors who have unacceptable organizational conflicts of interest. The FAA will resolve organizational conflict of interest issues on a case-by-case basis; and when necessary to further the interests of the agency, will waive or mitigate the conflict at its discretion."[72] AMS Policy provides a clause list of appropriate provisions to include in Solicitations and contracts when a potential or actual organization of conflict of interest either has determined to exist or could exist in the resulting contract or in Solicitations, contracts, and Broad Agency Announcements for research and development.[73]

AMS Guidance specifically addresses OCIs, related responsibilities, required disclosure by participating offerors and contractors, the remedies for nondisclosure, and administrative procedures.[74] The AMS Guidance addresses contractor participation in preparing specifications or statements of work in a separate sub-section.[75] The focus of AMS Guidance is to avoid unacceptable OCIs. "It is not the intention of the FAA to foreclose a vendor from a competitive acquisition due to a perceived OCI."[76] The AMS Guidance points to a Contracting Officer's

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OCIs as Addressed in the AMS (cont'd):

business judgment and sound discretion, and thus, "[t]he final determination of such action may be negotiated between the impaired vendor and the Contracting Officer."[77] The AMS Guidance defines an OCI as follows: "because of existing or planned activities, an offeror or contractor is unable or potentially unable to render impartial assistance to the agency, or has an unfair competitive advantage, or the offeror or contractor's objectivity is or might be impaired." *Id.* The AMS Guidance states, "The term 'person' includes any legal entity including a partnership, corporation, or association."[78] The AMS Guidance instructs CO to identify and evaluate potential OCI's early and "avoid, neutralize, or mitigate potential conflicts before contract award."[79]

The AMS Guidance lists three types of OCI's: "unequal access to information," "biased ground rules," and "impaired objectivity."[80] The AMS Guidance describes each type and issues instruction as to who may provide input on a plan to mitigate the OCI.[81] "Unequal access to information" involves access to 'non public information,' which may "provide a contractor a competitive advantage in a later competition for another FAA contract."[82] In this example, all vendors should have opportunity to submit and negotiate a mitigation plan.[83] "Biased ground rules" occurs when a contractor establishes some important "'ground rules' for another FAA contract, where the same contractor may be a competitor."[84] The concern is that this contractor "could slant key aspects of a procurement in its own favor, to the unfair disadvantage of competing vendors."[85] In this case the contractor is responsible for submitting and negotiating its own acceptable mitigation plan.[86] Finally, "impaired objectivity" may become an issue when a contractor is in the course of performing an FAA contract and "placed in a situation of providing assessment and evaluation findings over itself."[87] The FAA's concern is that the "contractor's ability to render impartial advice to the FAA could appear to be undermined by the contractor's financial or other business relationship whose work produce is being assessed or evaluated."[88] For this example, the "affected contractor should provide a mitigation plan that includes recusal by the vendor from the affected contract work."[89]

The AMS Guidance lists key FAA personnel to advise the Contracting Officer including legal counsel, evaluation team members, and appropriate technical specialists.[90] The AMS Guidance takes an expansive view of what should be disclosed to determine possible OCIs, including "past, present or currently planned interests (financial, contractual, organizational, or otherwise)."[91] And the AMS Guidance provides a list of five possible remedial actions if an offeror or contractor refuses to disclose or misrepresents information.[92] The possible remedial actions include: disqualification of contractor for award, disqualification of offeror for award, termination of contract if discovered later, disqualification from subsequent contracts, and otherwise permitted and provided by law or in the resulting contract.[93] The administrative procedure component of the AMS Guidance provides detailed steps depending on when an OCI has been identified.[94]

Finally, the AMS Guidance separately addresses occasions when a contractor support is used to prepare specifications or statements of work.[95] As a rule, the AMS Guidance states, "If

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a contractor prepares and furnishes complete specifications covering nondevelopmental items, to be used in a competitive acquisition … should be excluded from competition for that acquisition."[96] The section provides two circumstances in which an OCI may not exist: (1) the contractor prepared the specifications at the government request regarding a product the contractor provides; and (2) when contractors act on behalf of an industry to "help Government agencies prepare, refine, or coordinate specifications."[97] The second rule provided in this section is identical to the language used in the FAR and states that when a contractor assistance is necessary in preparing statements of work, the contractor might be in a position to favor its own products or capabilities."[98] Exceptions to this second rule are if the contractor is the single source, it participated in the development and design work, or more than one contractor has been involved in preparing the work statement.[99] Finally, the section addresses development work and concludes, "While the development contractor has competitive advantage, it is an unavoidable one that is not considered unfair, therefore no OCI mitigation would be necessary."[100]

AMS Guidance provisions addressing OCIs are also contained in the following sections: "Competing Requirements Among Vendors on a Qualified Vendors List (QVL)" requiring procurements to allow incumbent contractors on the QVL to compete "unless otherwise precluded from competing under follow-on competition by a specific Organizational Conflict of Interest provision"[101]; "Unsolicited Proposals (UP)," in which UPs are required to submit statements about organizational conflicts of interests[102]; "Novations and Change-of-Name Agreements," requiring contract officers (COs) to consider the proposed novation request "with emphasis on the successor's ability to perform" including OCIs and if an conflict of interest (COI) exists and cannot be resolved, "but the novation[103] is in the best interest of the FAA, the CO may initiate action to wave or mitigate the COI"[104]; and in the "Source Selection Guide: Getting Started," stating if "non-governmental advisors are part of the" Source Evaluation Team than the advisors "must not have any organizational conflicts of interest."[105]

IV. Comparison between FAR and AMS

This section compares the Federal Acquisition Regulation ("FAR") and the Acquisition Management System ("AMS") as regulatory frameworks and also analyzes the administrative bodies that review bid protests or contract disputes that allege organizational conflicts of interest.

a. Regulatory Frameworks

As detailed above, both the AMS and FAR contain provisions that govern agency action pertaining to potential or actual organizational conflicts of interests ("OCIs"). The most notable comparison is the binding provisions compared with the non-binding provision. The AMS binding OCI provisions are short and leave Contracting Officers ("COs") wide discretion to

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identify, avoid, and waive or mitigate a conflict. The AMS Guidance overwhelmingly mirrors the FAR mandatory provisions, but the AMS Guidance has several, small but distinctive difference. Both the AMS Guidance and the FAR identify the same types of OCIs, contain procedures to govern agency actions, provide examples, and require clear notice of potential OCI contract clauses.[106] Despite the similarity of these provisions, the FAR binds agencies to the regulation and the AMS Guidance is "a set of agency-endorsed guidelines."[107] In tandem with this point is the specificity of the regulations requirements. While the AMS requires the FAA "to avoid awarding contracts to contractors" and to "resolve unacceptable organizational conflicts of interest," the FAR governs agency response in three types of OCIs, and lists five key "contracting officer responsibilities."[108] The AMS Guidance maintains the flexibility of the AMS Policy and expands up it and, unlike the FAR, addresses perceived OCIs.[109] The second most notable difference is the administrative procedural steps to resolve, neutralize, minimize, or wave an OCI. AMS Policy and AMS Guidance allow the CO to award a contract notwithstanding an OCI.[110] The FAR procedures mandate a chain-of-command approach after a "contracting officer decides that a particular acquisition involves a significant potential organizational conflict of interest."[111] The CO must "submit for approval to the chief of the contracting office."[112] The AMS Policy is silent regarding procedure and the AMS Guidance only instructs the CO to "consult[] with legal counsel and team members."113 And then once "the Contracting Officer determines that it is in the best interest of the FAA to award the contract," the AMS Guidance addresses the steps the CO must take to properly proceed with the procurement.[114]

The AMS Guidance emphasizes the importance of documentation. While the FAR references the CO needs to prepare a written analysis to the approving official (who also must respond in writing), the AMS Guidance specifically asks for documentation.[115] Furthermore, the AMS Guidance recommends, "The Contracting Officer [] retain all organizational conflict of interest information in the contract file."[116]

As stated *supra*, the majority of provisions included in the FAR subpart regarding OCIs are similar in the AMS Guidance. However, the AMS Guidance contains provisions addressing disclosure and remedies for nondisclosure of OCI related information, which are not included as part of the FAR OCI subpart.[117] The AMS Guidance includes an extensive view of elements required to be disclosed, addressed supra, and provides sanctions that include disqualification for award and subsequent FAA contracts, termination of the contract, and any "other remedial action as may be permitted providing by law or in the resulting contract."[118]

Finally, the overall focus of the AMS Policy and AMS Guidance compared with the FAR differ; the FAR seeks to resolve, neutralize, and minimize, and the AMS seeks to avoid unacceptable OCIs.[119] This point further demonstrates the business-minded focus of the AMS. The AMS Policy governing CO action toward OCIs shows the AMS's focuses on the FAA as a business.[120] For example, a section of the AMS Guidance that requires OCI disclosure in the novation and change of agreement processes and emphasizes a successor's "ability to perform" the existing contract.[121] And the section forwards the CO to the AMS Guidance addressing

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OCI, and then if the CO determines the novation with an OCI is in the best interest of the FAA, the FAA may waive the OCI.[122]

In conclusion, both the FAR and AMS thoroughly address the issue of "the potential OCI" because the bottom line is when the government seeks to contract with an outside party maintaining conflict free relations is vitally important.[123] The effect of an OCI on an agency's outward image can be amplified by high dollar amounts, safety concerns, and politically charged matters. While the government's integrity is vital, the AMS and FAR demonstrate two frameworks for addressing OCIs. The AMS places the responsibility on the CO, while the FAR provides for a chain of command before approving resolutions of any "significant potential" OCIs.[124] And while both frameworks provide detailed guidance, the FAR mandates agency action depending on specific conditions such as the offeror's possible affiliates or subcontractor or the procurement's status.[125] The administrative review of alleged instances of OCIs sheds further light on these issues.

b. Administrative Review

Contracting agencies may attempt to resolve an OCI related conflict outside of the Government Accountability Office ("GAO") or the Office of Dispute Resolution for Acquisition ("ODRA"). However, if an interested party seeks review of FAA action then the ODRA provides a forum for the protest or dispute.[126] While the ODRA adjudicates on behalf of the FAA Administrator with Findings & Recommendations, interested parties in other agency actions may seek review from the GAO or from the Court of Federal Claims. This article covers only the administrative review of this issue and thus focuses on the GAO and ODRA case law. Daniel I. Gordon in "Organizational Conflicts of Interest: A Growing Integrity Challenge" provides an excellent overview of the basis cases alleging OCI:

> [A] protester may allege either that an OCI has tainted the procurement process or that a competitor should be excluded from the competition (in part or entirely) because of the firm's performance of the contract would create an OCI. In either of these contexts, there is a dispute about whether an OCI exists (or may arise). … Additionally, a protestor might contend that while the contracting agency recognized an actual or potential OCI, the agency's steps to address it were legally inadequate, or in the case of a party excluded from competition, that the agency improperly determined that the protester has an OCI that cannot be mitigated.[127]

After conducting numerous searches, it became evident that there is a clear difference between the number of ODRA decisions and number GAO decisions that address the issue of conflicts of interests. There is significantly more GAO case law than ODRA case law concerning OCIs. The GAO has been reviewing the "legality and adequacy of government expenditures since before World War II."[128] The ODRA and the AMS have a much later inception date.[129] Even though the ODRA began reviewing alleged AMS violations in 1996,

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the amount of GAO OCI case law still overwhelmingly outnumbers the amount of ODRA OCI case law between the years 1996 and 2012.

The ODRA standard of review guarantees the FAA decisions have a "rational basis, were supported by substantial evidence and were neither arbitrary, capricious, nor an abuse of discretion."[130] The ODRA often defers to FAA decisions as long as the decisions are rationally based and the complaining party's viewpoint amounts to "mere disagreement."[131] In terms of OCI related claims, the ODRA often defers to the CO's decision at the time of acquisition because both CO analysis and ODRA review is on a case-by-case basis.[132] Therefore, as long as the FAA has a rational basis for its determination in a given case then the ODRA will defer judgment.[133] The ODRA even recognizes that, "AMS policy gives considerable leeway to the contracting officer regarding the most effective manner to address OCI situations."[134]

GAO ensures that agencies recognize the significant of organizational conflicts of interest and take reasonable steps to avoid or mitigate them.[135] Further, the record must adequately support an agency's OCI assessment.[136] GAO Bid Protest Regulation criteria "include the seriousness of the procurement deficiency, the degree of prejudice to the Interested party and to the integrity of the competitive procurement system, the good faith of the parties, cost to the government, urgency of the procurement, and the impact of the recommendation on the contracting activity's mission.[137]

The ODRA's recognition of the AMS's deference to CO judgment highlights one of the keep differences between the FAR and AMS.[138] In addition, the ODRA's emphasis on alternative dispute resolution and the high proportion of cases that are mediated outside of the adjudication process, or at the very least, the OCI issues may be resolved prior to adjudication, may also help explain the little case law on the matter.[139]

The prior discussion highlights the fact that AMS Guidance provides detailed guidance for COs. While the FAR provides some detailed rules, the GAO supplements the FAR through its high volume of decisions. For example, the GAO ruled when an affiliate of an offeror's major subcontractor evaluates the proposals for a procuring agency a significant organizational conflict of interest exists because "there is no basis to distinguish between a firm and its affiliates, at least where concerns about potentially biased ground rues and impaired objectivity are at issue."[140] This ruling clarifies how an agency should assess affiliate relationships in the context of OCIs. Since this rule was issued in a decision, an interested party, including the agency, can use the rule and review the case facts of the decision to determine under what circumstances the ruling was made.[141] Interestingly, the ODRA views GAO decisions to be persuasive authority where consistent with AMS Policy.[142]

III. Additional Statutory Provisions

Several other federal laws govern federal procurement practice. Brief mention of these

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laws is necessary to understand the legal considerations made when the government enters into a contract. These laws are as follows: Procurement Integrity Act, 41 U.S.C. §423, implemented at FAR §3.104; 49 U.S.C. §40122(g)(3), implemented at AMS Guidance T.3.1.8; Bribery and Conflict of Interest Laws, 18 U.S.C. §201; and Standards for Employees of the Executive Branch, 5 C.F.R. §2635.

IV. Proposed changes to Federal Acquisition Regulation Organizational Conflict of Interest Rules

In 2011, the Civilian Agency Acquisition Council and Defense Agency Regulations Council (FAR Council) along with the Department of Defense, General Services Administration, National Aeronautics and Space Administration proposed changes to FAR provisions governing OCIs.[143] These proposed changes have come under close scrutiny by private law firms demonstrated by webpage articles from the major Washington, D.C. government contract firms.[144] The changes aim is to protect the integrity of the competitive acquisition process and government business interest.[145] The changes seek to provide COs increased discretion, including the ability to accept performance risk on behalf of the government.[146] The proposal also addresses CO role to review offerors and their affiliates with leniency, as long as the parent company is adequately separated from the affiliate. See Analysis Section, *supra*. This proposed change responds to changing business dynamics, "the consolidation within the industrial sectors selling to the Government, mergers and acquisitions leading to the presence of multifaceted corporations selling a wide range of goods and services to the Government, the reliance of umbrella contracts, and public/private competitors."[147]

V. Conclusion

Whether these changes, or a portion of these changes are adopted remains to be seen, however the proposed changes mirror many of the AMS concepts addressed in this article, such as CO discretion and the important of making decisions based on a business model. These changes would transform future government procurement due to the expansive application of the FAR and the binding nature of FAR provisions.[148]

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Endnotes

1. The views expressed in this article are my own and do not necessarily represent the viewpoints of any agency or its components.
2. Pub. L. 99-591, see also VIRGINIA. CODE ANN. §5.1-153, *et seq.* (2001).

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Endnotes (cont'd)

3. Lori Aratani, *Report Rebukes Airports Authority*, WASHINGTON POST, Nov. 2, 2012, A1, A12.
4. *Id.* at A12.
5. U.S. DEP'T OF TRANSPORTATION, OFFICE OF THE INSPECTOR GENERAL, AV-2013-006, "*MWAA'S WEAK POLICIES AND PROCEDURES HAVE LED TO QUESTIONABLE PROCUREMENT PRACTICES, MISMANAGEMENT AND A LACK OF OVERALL ACCOUNTABILITY,*" citing FAR §9.505-2.
6. FAR §9.505-2.
7. The MWAA's practices are riddled with ethical violations and Washington media continues to highlight the organization's missteps. *See* Cheryl W. Thompson, "Relatives of officials, employees have often joined MWAA payroll," WASHINGTON POST, Dec. 9, 2012, A1, A10.
8. WEBSTER'S NEW WORLD DICTIONARY 140 (4th Ed. 2003).
9. BLACK'S LAW DICTIONARY (2nd online ed.), available at http://thelawdictionary.org.
10. *Protest of Carahsoft Techs. Corp. and Avue Techs.*, 08-TSA-034 (emphasis in original). All citations to GAO and ODRA decisions follow the ODRA's standardized citation guide for government contract decisions used in writing ODRA decisions.
11. *Id.,* citing AMS Guidance T3.1.7 (Apr. 2004).
12. *Science Application Int'l Corp.*, B–293601, 2004 CPD ¶96 at 5 (2004).
13. *See* Radiation Safety Servs., Inc. B-237138, CPD ¶56 at 2-4 (1990), *cited in* J&E Assocs., Inc., B-278771, 98-1 CPD ¶77 at 3 (1998).
14. *See generally* FAR §9.505.
15. Department Of Transportation and Related Agencies Appropriations Act, Pub. L. No. 104-50, §§347, 348, 109 Stat. 436 (1996); *see also* Air Traffic Management System Performance Improvement Act of 1995, S. 1239, §201, 104th Cong. (1996) (identifying additional improvements to the FAA, including providing an acquisition framework that addresses FAA's unique needs).
16. *FAA Acquisition Management System*, Research and Innovative Technology Administration, Bureau of Transportation Statistics, National Transportation Library, 1.8 "Key Features", available at ntl.bts.gov/data/letter_am/ams0697.pdf.
17. U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-11-278, "*HIGH-RISK SERIES: AN UPDATE*," App. 1 (2011); GAO identifies government programs with "serious weaknesses in areas that involve substantial resources and provide critical services to the public." U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-11-278, "*HIGH-RISK SERIES: AN UPDATE,"* App. 1 (2011). Aided by the installation of a revised federal acquisition management system, GAO removed the FAA's Air Traffic Control Modernization in 2009. *Id*.
18. FAR §9.500(a).
19. FAR §2.101.
20. *Id.*
21. *Id.* Daniel J. Gordon, *Organizational Conflicts of Interest: A Growing Integrity Challenge*, 35 PUB. CONT. L.J. 25, 31 (2005).
22. *Matter of J&E Assocs., Inc.,* B-278771, 98-1 CPD ¶77 at 2 (1998) citing FAR §9.501; *Aetna Gov't Health Plans Inc.; Found. Health Fed. Servs., Inc.,* B-254397 *et al.* CPD ¶129 at 12 (1995).
23. *See generally* FAR §9.505.
24. FAR §9.505-4.
25. FAR §9.505-4(a).
26. FAR §9.505-4(b).
27. FAR §9.505-4(b).
28. *See generally* FAR §9.505.
29. Gordon, *Organizational Conflicts of Interest*, 35 PUB. CONT. L.J. at 32.
30. *L-3 Servs., Inc.* B-400134.11, B-400134.12, 2009 CPD ¶171 at 8 (2009).
31. FAR §§9.505-1, 9.505-2.
32. FAR §9-505-1.

(*continued on next page*)

OCIs as Addressed in the AMS (cont'd):

Endnotes (cont'd)

33. FAR §9.505-1(a). The FAR provides examples of systems engineering activities as "determining specifications, identifying and resolving interface problems, developing test requirements, evaluating test data, and supervising design" and technical direction activities as "developing work statements, determining parameters, directing other contractors' operations, and resolving technical controversies." FAR §9.505-1(b).
34. FAR §9.505(a).
35. FAR §9.505-2(b)(2).
36. FAR §9.505-2(a)(1) (emphasis added).
37. FAR §9.505-2(a)(2) (emphasis added).
38. FAR §9.505-2(a)(3).
39. FAR §9.505-2(b)(1).
40. *Id.*
41. *Id.*
42. *Matter of B.L. Harbert-Brasfield & Gorrie, JV*, B-402229, 2010 CPD ¶69 at 5 (2010) (sustaining a protest in which an awarded contractor was familiar with details of the procurement in question because of the recent merger by the awardee of the design contractor that provided procurement development services to the agency).
43. FAR §9.505-3.
44. Gordon, *Organizational Conflicts of Interest*, 35 PUB. CONT. L.J. at 32.
45. FAR §9.505-3.
46. *McCarthy/Hunt, JV*, B-402229.2, 2010 CPD ¶68 at 8 (2010).
47. *McCarthy/Hunt, JV*, B-402229.2, 2010 CPD ¶68 at 10 (2010).
48. *Id.*
49. *Matter of J&E Assoc., Inc.* B-278771, 98-1 CPD ¶77 at 2 (1998).
50. *Id.*
51. *Am. Mgmt. Systems., Inc.,* B-285645, 2000 CPD ¶163 at 5 (2000).
52. FAR §9.507-1.
53. FAR §9.507-1.
54. FAR §9.507-2(a).
55. *Id.*
56. FAR §9.506.
57. *Id.*
58. *See* FAR §15.604; FAR §15.605; FAR §17.605; FAR §35.017; FAR §35.017-2; FAR §42.1204.
59. FAR §15.604.
60. FAR §17.605.
61. The FAR explains, "FFRDC's enable agencies to use private sector resources to accomplish tasks that are integral to the mission and operation of the sponsoring agency." FAR §35.017.
62. FAR §§9.505-1 – 9.505-4.
63. "FAST Home," fast.faa.gov.
64. "AMS Information: AMS Policy vs Guidance" available at fast.faa.gov.
65. *See* Appendix A, "FAA Lifecycle Management Process."; "AMS Policy vs Guidance".
66. *Id.*
67. "AMS Policy vs Guidance".
68. "AMS Policy vs Guidance".
69. *Id.*
70. *Id.*
71. *Id.*
72. *AMS Policy* 3.1.7, *AMS Policy* 4.2.3.14.3.
73. *See* Appendix B.
74. *AMS Guidance* T3.1.7.A.1-4, 6 (Apr. 2006).
75. *AMS Guidance* T3.1.7.A.5 (Apr. 2006).
76. *AMS Guidance* T3.1.7.A.1 (Apr. 2006) (emphasis added).

(*continued on next page*)

OCIs as Addressed in the AMS (cont'd):

Endnotes (cont'd)

77. *Id.*
78. *Id.*
79. *AMS Guidance* T3.1.7.A.2 (Apr. 2006).
80. *AMS Guidance* T3.1.7.A.1 (Apr. 2006).
81. The Procurement Guidance includes a disclaimer regarding Mitigation Plans, "The FAA reserves the right to audit any or all proposed mitigation plans, and to reject a plan, if in the opinion of the Contracting Officer such a plan is not in the best interests of FAA." *AMS Guidance* T3.1.7.A.1 (Apr 2006).
82. *AMS Guidance* T3.1.7.A.2 (Apr. 2006).
83. *Id.*
84. *AMS Guidance* T3.1.7.A.2 (Apr. 2006).
85. *Id.*
86. *Id.*
87. *AMS Guidance* T3.1.7.A.2 (Apr 2006).
88. *Id.*
89. *Id.*
90. *AMS Guidance* T3.1.7.A.2 (Apr. 2006).
91. *AMS Guidance* T3.1.7.A.3 (Apr. 2006).
92. *AMS Guidance T3.1.7.A.4 (Apr. 2006).*
93. *Id.*
94. *See AMS Guidance* T3.1.7.6 (Apr. 2006).
95. *AMS Guidance* T3.1.7.A.5 (Apr. 2006).
96. *Id.*
97. *Id.*
98. *Id., see also* FAR §9.505-2(b)(2).
99. *Id.*
100. *AMS Guidance* T3.1.7.A.5 (Apr. 2006).
101. *AMS Guidance* T3.2.2.3.A.6 (Oct. 2012).
102. *AMS Guidance* T3.2.2.6.A.2, see also FAR §15.605.
103. "Novation is a legal instrument executed by the contractor (transferor), the successor in interest (transferee) and the Government by which, among other things, the transferor guarantees performance of the contract, the transferee assumes all obligations under the contract, and the Government recognizes the transfer of the contract and related assets. Novations typically occur when the assets of the transferor are purchased by another company but may also be considered when a contractor is unable to perform and another viable contractor is willing to assume the original contractor's rights and duties under the contract." *AMS Guidance* T3.10.1.A8(a)(1), *see also* FAR §2.101.
104. *AMS Guidance* T3.10.1.A.8 (Apr. 2008), *see also* FAR §42.1204.
105. *AMS Guidance*, Appendix D (Oct. 2010).
106. *See AMS Guidance* T3.1.7.A.1, 2, 5-7 (Apr 2006); FAR §9.501; FAR §9.505; FAR §9.505-1, 2, 3, 4; FAR §9.506; FAR §9.507-1, 2; FAR §9.508.
107. "AMS Information: AMS Policy vs Guidance" available at fast.faa.gov.
108. *Compare* AMS Policy 3.1.7 *with* FAR §9.504.
109. *See* AMS Guidance T3.1.7.A.1 (Apr. 2006).
110. *AMS Guidance* T3.1.7.A.4 (Apr. 2006).
111. FAR §9.506(b).
112. *Id.*
113. *AMS Guidance* T3.1.7.A.6 (Apr. 2006).
114. *Id.*

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OCIs as Addressed in the AMS (cont'd):

Endnotes (cont'd)

115. *Compare* FAR 9.506(b), (c) *with* AMS Guidance T3.1.7.A.2 (stating "the rational basis supporting the Contracting Officer's decision on an OCI issue should be documented in the contract file"); AMS Guidance T3.1.7.A.2 (providing "the contracting officer should document" the determination that it is in the best interest to waive an OCI).
116. *AMS Guidance* T3.1.7.A.2 **(**Apr. 2006).
117. *AMS Guidance* T3.1.7.A.4 (Apr. 2006).
118. *AMS Guidance* T3.1.7.4 (Apr. 2006).
119. FAR §9.506(b); *AMS Guidance* T3.1.7.A.4 (Apr. 2006).
120. *AMS Policy* 1.1.1.
121. *AMS Guidance* T3.10.1.A.8 (Apr. 2008).
122. *Id.*
123. *See* Metropolitan Washington Airports Association discussion, *supra*.
124. FAR §9.506.
125. FAR §9.500, *et al.*
126. Department Of Transportation and Related Agencies Appropriations Act, Pub. L. No. 104-50, §§347, 348, 109 Stat. 436 (1996).
127. 35 PUB. CONT. L.J. at 31.
128. "The History of GAO – The Early Years," available at http://www.gao.gov/about/history/earlyyears.html.
129. *Id.*
130. *Protest of MAXIMUS, Inc*. 04-TSA-009 (holding the agency prepared an adequate mitigation plan for a potential OCI that was supported by substantial evidence).
131. *Protest of PCS*, 01-ODRA-00184.
132. *AMS Policy* 3.1.7.
133. *See Protest of Sentel Corp*., 09-ODRA-00512.
134. *Protest of Sentel Corp*., 09-ODRA-00512.
135. *Aetna Government Health Plans, Inc.; Foundational Health Federal Services*, B-25497, B-254397, B-254397.16, B-2.54397.17, B-254397.18, B-254397.19, 95-2 CPD ¶129, at 13 (1995).
136. *Alion Sci. & Tech. Corp*., B-297022.3 2006 CPD ¶ 2 at 8 (2006).
137. *Aetna Gov. Health Plans, Inc.; Found. Health Fed. Servs*., B-25497, B-254397, B-254397.16, B-2.54397.17, B-254397.18, B-254397.19, 95-2 CPD ¶129, at 14 (1995)(citing 4 C.F.R. §21.6(b)).
138. *AMS Guidance* T3.1.7.A.2 (Apr. 2006). The ODRA's review process considers the AMS Policy as controlling and AMS Guidance as persuasive.
139. *See* 14 C.F.R. §17.17 (2012).
140. *Matter of Aetna Gov. Health Plans, Inc.; Found. Health Fed. Servs.*, B-25497, B-254397, B-254397.16, B-2.54397.17, B-254397.18, B-254397.19, 95-2 CPD ¶ 129, at 9 (1995).
141. *Id.*
142. *Protest of Carahsoft Techs. Corp. and Avue Techs.*, 08-TSA-034 (stating "it is well established that the ODRA will treat GAO decisions as persuasive authority to the extent such decisions are on point and when the ODRA finds that they are consistent with the AMS").
143. *See* 76 Fed. Reg. 23236 (Apr. 26, 2011).
144. *E.g.,* Kara M. Sacilotto and Daniel P. Graham, Wiley Rein, *FAR Councils Release Rewrite of OCI Rules*, April 11, 2011, available at http://www.wileyrein.com/publications.cfm?sp=articles&id=7029; Perkins Coie, *Proposed FAR Changes Identify New Framework To Address OCI and Unequal Access to Information Issues,* available at http://www.perkinscoie.com/proposed-far-changes-identify-new-framework-to-address-oci-and-unequal-access-to-information-issues-05-10-2011/, Alison L. Doyle, McKenna Long & Aldridge, "FAR Organizational Conflict of Interest Proposal—A Major Departure," April 28, 2011, available at http://www.mckennalong.com/publications-advisories-2500.html, see also Keith Szeliga and Anne Perry, *Proposed FAR Rule: A New Regulatory Framework For Organizational Conflicts of Interest and Unequal Access to Nonpublic*

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OCIs as Addressed in the AMS (cont'd):

Endnotes (cont'd)

Information, GOVERNMENT CONTRACTS, INVESTIGATIONS & INTERNATIONAL TRADE BLOG (May 12, 2011), http://www.governmentcontractslawblog.com.
145. *See* 76 Fed. Reg. 23236 (Apr. 26, 2011).
146. *Id.*
147. Gordon, *Organizational Conflicts of Interest*, 35 PUB. CONT. L.J. at 41.
148. In order for a proposal to be enacted a majority of the FAR Council agencies must approve the changes. For a complete list see: http://www.acquisition.gov/comp/caac/index.html.

Disclosure of Attorney-Client and Work Product Protected Information During Internal Investigations

by
*James J. Gallagher and Judy Choi**

I. Introduction

In the modern era of Government Contract law, there is an ever-increasing need for contractors to conduct internal investigations. A typical example is the possibility that the contractor has violated the Truth In Negotiations Act, 10 U.S.C. §2306a, which could give rise to a claim by the Government either under the contract or under the Civil False Claims Act, 31 U.S.C. §3729 *et seq*. An immediate issue that must be addressed when undertaking such an investigation is whether the effort should be done under some form of protection. The first possibility that frequently comes to mind in that regard is the attorney-client privilege.[1] However, there are circumstances in which the work product doctrine may provide greater protection for contractors. That is especially true when the product of an investigation may have to be disclosed to the contractor's public accounting firm to enable them to satisfy their professional obligations. A thorough understanding of the circumstances in which the attorney-client privilege or work product apply, what constitutes a waiver of each and if there is a waiver, precisely what the scope of that waiver is, are important factors in protecting the client's interest.

II. Attorney-Client Privilege

a. What is it?

The attorney-client privilege protects confidential communications between the client and attorney made for the purpose of obtaining or providing legal advice. The purpose of the attorney-client privilege is to "encourage clients to make full disclosure to their attorneys. As a practical matter, if the client knows that damaging information could more readily be obtained from the attorney following disclosure than from himself in the absence of disclosure, the client would be reluctant to confide in his lawyer and it would be difficult to obtain fully informed legal advice." *Fisher v. United States*, 425 U.S. 391, 403 (1976).

b. Application of the Attorney-Client Privilege

The attorney-client privilege applies when: (1) legal advice of any kind is sought, (2) from a professional legal advisor in his or her capacity as such, (3) the communications relating to that purpose, (4) made in confidence, (5) by the client, (6) are, at the client's instance, permanently protected, (7) from disclosure by the client or by the legal advisor, and (8) unless the protection is waived. *United States v. Martin*, 278 F.3d 988, 999 (9th Cir. 2002), citing *Wigmore*, Evidence §2292 at 554 (McNaughton rev. 1961).

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Disclosure of Protected Information (cont'd):

The attorney-client privilege also applies to employee interviews in the course of an internal investigation. In the landmark case, *Upjohn Co. v. United States*, the Supreme Court found that the privilege existed where "the communications at issue were made by Upjohn employees to counsel for Upjohn acting as such, at the direction of corporate supervisors in order to secure legal advice from counsel," concerning matters within the scope of the employees' corporate duties. 449 U.S. 383, 394 (1981).

c. Waiver

Generally, the disclosure of attorney-client communications to a third-party waives the privilege, although there are some exceptions for disclosures made to accountants, financial consultants, or advisors, where the third party's communication is to "improve the comprehension of the communications between the attorney and the client." *U.S. v. Ackert*, 169 F.3d 136, 139 (2d Cir. 1999).

III. Work Product Doctrine

a. What is it?

The work product doctrine is "intended to preserve a zone of privacy in which a lawyer can prepare and develop legal theories and strategy 'with an eye toward litigation,' free from unnecessary intrusions by his adversaries." *United States v. Adlman (*"*Adlman*"*)*, 134 F.3d 1194, 1196 (2d Cir. 1998); *see Hickman v. Taylor*, 329 U.S. 495, 510-11 (1947). It differs from the attorney-client privilege in that the work product doctrine provides a qualified protection from discovery; it does not render attorney work product completely outside the scope of discovery.[2] Furthermore, the scope of the work product doctrine is fundamentally different from the attorney-client privilege. While the attorney-client privilege protects the attorney-client relationship by safeguarding confidential communications, the work product doctrine "promotes the adversary process by insulating an attorney's litigation preparation from discovery." *U.S. v. Deloitte LLP* ("*Deloitte*"), 610 F.3d 129, 139-40 (D.C. Cir. 2010). The work product doctrine protects the integrity of an attorney's work and his or her own efforts and keeps this work out of the hands of opponents.

b. Application of the Work Product Doctrine

The work product doctrine was established by the Supreme Court in *Hickman v. Taylor*, 329 U.S. 495 (1947) and codified in Federal Rules of Civil Procedure Rule 26. In *Hickman*, the Supreme Court held that an attorney's notes memorializing interviews with witnesses to the accident that prompted the lawsuit were protected from discovery. The Court held that an attorney must "assemble information, sift what he considers to be the relevant from the

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Disclosure of Protected Information (cont'd):

irrelevant facts, prepare his legal theories and plan his strategy without undue and needless interference." 329 U.S. at 511. The attorney's preparation is reflected "in interviews, statements, memoranda, correspondence, briefs, mental impressions, personal beliefs, and countless other tangible and intangible ways." *Id.* Consequently, the Court held that an attorney's work product is protected from discovery unless the litigant can "establish adequate reasons to justify production through a subpoena or court order." *Id.* at 512.

The principles laid out in *Hickman* were partially codified in the Federal Rule of Civil Procedure 26(b)(3), which allows a court to order disclosure when the requesting party shows "substantial need" for the material and an inability to procure equivalent information "without undue hardship." Fed. R. Civ. Proc. 26(b)(3)(A)(ii). However, even when a court allows disclosure, it provides special protection "against disclosure of the mental impressions, conclusions, opinions, or legal theories of a party's attorney or other representative concerning the litigation." Fed. R. Civ. Proc. 26(b)(3)(B).

c. Waiver

Work product protection, therefore, applies to both tangible and non-tangible work product that is prepared in anticipation of litigation or for trial.[3] Unlike the attorney-client privilege, in which disclosure to a third party generally waives the privilege, disclosure to a third party does not automatically waive work product protection. *See Cellco P'ship v. Nextel Comm., Inc.*, No. M8-85 (RO), Civ. A 03-725-KAJ, 2004 WL 1542259, at *1 (S.D.N.Y. July 9, 2004). Instead, work product protection is not considered to be waived unless "the disclosure is inconsistent with maintaining secrecy from possible adversaries." *Merrill Lynch & Co., Inc. v. Allegheny Energy, Inc.* ("*Merrill Lynch*"), 229 F.R.D. 441, 445 (S.D.N.Y. 2004) (internal quotation marks and citation omitted). Under this standard, discussed further below, the disclosure of attorney work product to an adversary or a conduit to an adversary waives work product protection for that material.

IV. Disclosure to Third Parties / Application in Internal Investigations

a. Attorney-Client Privilege

Generally, disclosure of attorney-client communications to a third party waives the privilege. *See United States v. Rockwell Int'l.*, 897 F.2d 1255, 1265 (3rd Cir. 1990). The scope of that waiver, however, depends on the context of the waiver. Under the so-called fairness doctrine,[4] "implied waiver may be found where the privilege holder asserts a claim that *in fairness* requires examination of protected communications." *In re Grand Jury Proceedings,* 219 F.3d 175, 182 (2nd Cir. 2000) (internal quotes and citation omitted). Therefore, a privilege holder cannot use the privilege as both a shield and a sword.

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<u>Disclosure of Protected Information (cont'd):</u>

In *In re von Bulow*, litigation which was filed after Claus von Bulow's acquittal for the attempted murder of his wife, an issue arose regarding four conversations between von Bulow and his criminal defense attorney which were disclosed by the attorney in his book, *Reversal of Fortune*. Following the acquittal, von Bulow's wife sued von Bulow for assault and fraud and argued that the totality of the four conversations, not just the parts used in the book, should be discoverable. The court denied this request and explained: "Applying the fairness doctrine, we hold therefore that the extrajudicial disclosure of an attorney-client communication—one not subsequently used by the client in a judicial proceeding to his adversary's prejudice—does not waive the privilege as to the undisclosed portion of the communication." 828 F.2d at 102. The court distinguished from cases that involved disclosures made in judicial proceedings because those cases "have no application to disclosures in a book made outside the litigation context." *Id.* Even when disclosure is made in a judicial setting, however, the question of fairness determines whether there is a waiver of attorney-client privilege. *See In re Grand Jury Proceedings*, 219 F.3d at 183 ("Where a defendant neither reveals substantive information, nor prejudices the government's case, nor misleads a court by relying on an incomplete disclosure, fairness and consistency do not require the inference of waiver."). Thus, the context in which the waiver takes place has a substantial impact on the scope of the waiver.

Likewise, in *Chevron Corp. v. Pennzoil Co.*, 974 F.2d 1156 (9th Cir. 1992), Pennzoil disclosed to its auditors two legal memos that involved subsidiary tax issues. Chevron argued that all documents that touched on the tax deferral question should be disclosed because of the disclosure of the two legal memos. The court held that the disclosure of information resulting in the waiver of the attorney-client privilege constituted waiver "only as to the communications about the matter actually disclosed." 974 F.2d at 1162 (internal citation omitted). The court held that Pennzoil was not required, as a result of its limited disclosure, to provide Chevron with every document or communication that touched on the more general tax deferral question. *Id.*

b. Work-Product Protection

Under the attorney-client privilege, any voluntary disclosure to a third party is likely to waive the privilege. This includes disclosure of materials stemming from an internal investigation—memoranda, investigation reports, and so forth. However, these same investigation materials, disclosed to a third party auditor, may still be protected from discovery under the work product doctrine, so long as the materials are: (1) prepared in anticipation of litigation; and (2) not disclosed to an adversary.

1. Prepared In Anticipation of Litigation

Eligible work product must be prepared "in anticipation of litigation." Fed. R. Civ. Proc. §26(b)(3). Most courts have interpreted this broadly to cover documents prepared with an eye to litigation, which may also be used for non-litigation purposes. *See Deloitte*, 610 F.3d at

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<u>Disclosure of Protected Information (cont'd):</u>

138. In *Deloitte*, Dow Chemical Company ("Dow") challenged the IRS tax adjustments to the tax returns of two partnerships owned by Dow. 610 F.3d 129. The IRS subpoenaed documents from Deloitte & Touche's ("Deloitte") audit of Dow's reserves, established in case the IRS imposed tax disallowances. Deloitte was Dow's independent auditor. One of the documents that Deloitte refused to produce was a memorandum prepared by Deloitte that discussed a meeting between Deloitte employees, Dow employees, and Dow's outside counsel regarding the possibility of litigation over the tax treatment. The government argued that this memorandum was not protected by the work product doctrine because it was not prepared in anticipation of litigation, but as part of the routine audit process. 610 F.3d at 137.

Applying the "because of" test, the court held that the "material generated in anticipation of litigation may also be used for ordinary business purposes without losing its protected status." *Id.* at 138; *see Adlman*, 134 F.3d at 1195. Therefore, while the memorandum in question was created as part of a routine audit, "material developed in anticipation of litigation can be incorporated into a document produced during an audit without ceasing to be work product." 610 F.3d at 138. Thus, under the standard articulated in *Deloitte*, the attorney work product doctrine encompasses materials prepared "because of the prospect of litigation," even if the material serves ordinary business purposes as well. ("a document can contain protected work product material even though it serves multiple purposes, so long as the protected material was prepared because of the prospect of litigation.") *Id.*

In contrast, the First Circuit applied a much more stringent test to determine whether material has been prepared "in anticipation of litigation." In *U.S. v. Textron, Inc.*, the First Circuit held that a corporation's tax accrual workpapers were not prepared in anticipation of litigation because the papers were "tax documents and not case preparation materials" and were "prepared in the ordinary course of business." 577 F.3d 21, 28, 30 (1st Cir. 2009). The court found that the work papers were created to comply with audit requirements and not for impending litigation, so the work product doctrine did not apply. However, rather than apply the usual "because of " standard, the court noted that the work papers at issue were not created "for use" in litigation, implying a stricter test than the "because of" test. 577 F.3d at 27. *See also U.S. v. El Paso Co*., 682 F.2d 530, 543 (5th Cir. 1982) (company's tax accrual workpapers not protected by the work product doctrine because the "primary purpose" of the workpapers was to assure compliance with GAAP).

Most circuit courts still apply the "because of" test to determine when materials are prepared in anticipation of litigation. *See e.g.*, *Sandra T.E. v. S. Berwyn Sch. Dist. 100*, 600 F.3d 612, 622 (7th Cir. 010); *In re Prof'ls Direct Ins. Co.*, 578 F.3d 432, 439 (6th Cir. 2009); *In re Grand Jury Subpoena*, 357 F.3d 900, 907 (9th Cir. 2004); *PepsiCo, Inc. v. Baird, Kurtz & Dobson LLP,* 305 F.3d 813, 817 (8th Cir. 2002); *Maine v. U.S. Dept' of Interior*, 298 F.3d 60, 68 (1st Cir. 2002); *Montgomery County v. Microvote Corp.*, 175 F.3d 296, 305 (3d Cir. 1999); *United States v. Adlman*, 134 F.3d 1194, 1195 (2d Cir. 1998); *Nat'l Union Fire Ins. Co. v. Murray Sheet Metal Co.*, 967 F.2d 980, 984 (4th Cir. 1992).

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<u>Disclosure of Protected Information (cont'd):</u>

2. Disclosure to Adversaries

"[D]isclosure simply to another person who has an interest in the information but who is not reasonably viewed as a conduit to a potential adversary will not be deemed a waiver of the protection of the rule." *Browne of N.Y. City, Inc. v. AmBase Corp.*, 150 F.R.D. 466, 479 (S.D.N.Y. 1993). Generally, there is no waiver of work product where the third party and the disclosing party share a common interest. *See Merrill Lynch*, 229 F.R.D. at 446. In *Merrill Lynch*, after it was notified that it was the subject of a criminal investigation, Merrill disclosed to Deloitte two reports prepared by counsel regarding theft by one of its traders. Merrill conceded that the disclosure to Deloitte waived attorney-client privilege, but argued that the two documents were still protected by work-product. The court agreed, finding that Merrill and Deloitte shared a common interest, that Deloitte was neither a likely litigation adversary nor, in its role as accountant, an adversary inconsistent with privacy protection that underlies the work product doctrine, and that Deloitte had an ethical and professional obligation to keep the information in the report confidential unless disclosure was required by law or accounting standards. However, the court noted that there was a split among courts as to whether disclosure to a corporation's auditors waives work product privilege. "More precisely, courts differ in their conceptualization of two critical points that are often implicitly intertwined in their analysis: whether the 'adversary' contemplated by the work product privilege is necessarily a litigation adversary and whether a corporation's auditor is such an adversary, to whom disclosure will waive the privilege." 229 F.R.D. at 446.

This question of whether disclosing work product to an independent auditor constitutes waiver is one that has only recently reached the circuit courts, although it has been the subject of many district court opinions. *See Deloitte,* 610 F.3d at 139. In *Deloitte*, the D.C. Circuit noted that "while voluntary disclosure waives the attorney-client privilege, it does not necessary waive the work product protection." *Id.* The court found that "as an independent auditor, Deloitte cannot be Dow's adversary," then added that "the possibility of a future dispute between Deloitte and Dow does not render Deloitte a potential adversary for the present purpose." *Id.* at 140. Consequently, the court found that disclosure of documents prepared in anticipation of a dispute with the IRS, not Deloitte, remained protected by the work product protection. In doing so, the court distinguished from *U.S. v. Massachusetts Institute of Technology* ("*MIT*"), in which MIT, in its capacity as a defense contractor under IRS investigation, claimed that the work product doctrine applied to expense reports it had disclosed to the Defense Contract Audit Agency ("DCAA"). 129 F.3d 681 (1st Cir. 1997). The First Circuit in *MIT* found that MIT had waived the work product protection when it disclosed its expense reports to DCAA, a potential adversary. *Id.* at 687. The D.C. Circuit distinguished *Deloitte* from *MIT* on the grounds that MIT "disclosed its work product not to an independent auditor, but to an auditor affiliated with a potential adversary." *Deloitte*, 610 F.3d 141. *See also Medinal, Ltd. v. Boston Scientific Corp.*, 214 F.R.D. 113, 116 (S.D.N.Y. 2002) ("in order for auditors to properly do their job, they *must* not share common interests with the company they audit").

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Disclosure of Protected Information (cont'd):

Consequently, attorneys should be aware that if a company shares its work product with auditors, that work product may or may not be protected by the work product doctrine depending on whether the auditor should be considered truly "independent." However, the D.C. Circuit and many district courts have agreed that disclosure of work product to an independent auditor does not constitute waiver. *See Deloitte*, 610 F.3d at 139.

V. Conclusion

Important points to remember when addressing these attorney-client and work product issues include:

1. If attorney-client materials are disclosed resulting in a waiver, was the disclosure made in the context of litigation or outside of that context? The answer has a substantial bearing on the scope of the waiver.
2. Were the materials that are subject to the attorney-client privilege prepared in anticipation of litigation? If so, even though their disclosure may constitute a waiver of the attorney-client privilege, the materials may be subject to work product protection if the disclosure was not made to an adversary or a potential adversary.

While the attorney-client privilege provides attorneys with a strong shield to protect materials stemming from an internal investigation, companies may be required to disclose some attorney-client materials to third parties in the course of an audit. In those cases particularly, attorneys should look to the work product doctrine, which may provide additional protections for materials which, if disclosed to a contractor's outside auditors constitute an attorney-client privilege waiver, but which still may be protectable as work product.

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Endnotes

1. In order for attorney-client privilege to protect an internal investigation, however, attorneys must first be involved in the investigation in a meaningful way. Recently, in *United States v. ISS Marine*, the District Court for the District of Columbia ruled that "[f]or the results of an internal investigation to enjoy the attorney-client privilege, the company must clearly structure the investigation as one seeking legal advice and must ensure that attorneys themselves conduct or supervise the inquiries, and, at the very least, the company must make clear to the communicating employees that the information they provide will be transmitted to attorneys for the purpose of obtaining legal advice." 905 F. Supp. 2d 121, 131 (D.D.C. 2012).

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Disclosure of Protected Information (cont'd):

Endnotes (cont'd)

2. Fed. R. Civ. Proc. 26(b)(3) provides qualified protection from discovery when materials are: (1) documents and tangible things otherwise discoverable; (2) prepared in anticipation of litigation or for trial; and (3) by or for another party or for that other party's representative. However, the party seeking discovery can overcome qualified protection if they make showing of: (1) a substantial need for the materials; and (2) an inability to obtain the substantial equivalent of the information without undue hardship. *See* Fed. R. Civ. Proc. 26(b)(3).
3. The majority of courts have adopted the "because of" test, which asks whether a document was "prepared or obtained *because of* the prospect of litigation." *Adlman*, 134 F.3d at 1202; *see United States v. Roxworthy*, 457 F.3d 590, 593 (6th Cir. 2006).
4. The fairness doctrine comes into play when a party attempts to employ the attorney-client privilege as both a shield and a sword, disclosing only selected portions of an attorney-client communication. *Clark v. United States*, 289 U.S. 1, 15; *In re von Bulow*, 828 F.2d 94, 103 (2nd Cir. 1987).

Cost Discipline ([*Smack*!])

by
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As a consequence of budget retrenchments, the government contract market has grown increasingly competitive in all industries. Many government contractors have learned that mere technical excellence is no longer sufficient to achieve "best value," as agencies tout the mantra of doing more with less. In an environment where businesses compete for a diminishing number of opportunities, small differences in proposals assume greater significance. (Sit up straight.)

One distinguishing characteristic between a good government contractor and a better one is cost discipline.

What is Cost Discipline?

The term, cost discipline, generally refers to those measures set forth in an organization's policies and procedures that are intended to maintain its budget. Cost discipline is interrelated with the concept of cost efficiency, wherein assigned tasks in the work breakdown structure (WBS) are performed consistent with the cost and time estimates. ([*Smack*!] I told you to sit up.) The opposite of cost discipline is a climate of lax oversight and managerial apathy or incompetence.

As discussed in greater detail below, cost discipline may be established through the application of performance ratios and formulas at different junctures of a contractor's organization.

How is Cost Discipline Created?

It is axiomatic that cost management is an integral part of project management. Let me repeat that for emphasis: Cost management is an integral part of project management. ([*Smack*!] Pay attention.) It doesn't matter how experienced a project manager you may be, or even how educated or well-connected a project manager you are. A project manager that performs contracts over budget will have a very short career because no one will be able to afford his "expertise."

So, how is cost discipline created? There is no one way to do it. Instead, the best project managers all develop a methodology that enables them to maintain active control over emerging cost issues, while at the same time addressing the daily technical and performance-related concerns. These cost controls are created at strategic performance intersections within

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Cost Discipline (cont'd):

the different departments and organizations. Generally speaking, the more cost controls management establishes the greater the cost discipline. Each of these cost controls can quickly create its own high and low norms, which some financial analysts colloquially refer to as "windows." In fact, what the high and low amounts should be can usually be calculated in advance of performance. As performance proceeds, cost controls which are within their "windows" (i.e., normative levels) require little or no management involvement.

On the other hand, cost controls that generate unusually high or low figures warrant management intervention. In this manner, contract performance is carefully and constantly monitored to achieve success. (Are you chewing gum?! Spit it out! [*Smack*!]) On the other hand, contractors wanting in cost discipline typically beat a path to a board or court with explanations about how surprised they were to discover that they had exceeded their contract's budget.

How Can Cost Discipline be Measured?

Financial analysts use a variety of tools to evaluate corporate performance, and most people are familiar with the widely used measurements used in the stock market, i.e., price/ earnings (P/E) ratio, return on investment (ROI), current ratio, and so on. Not widely known among government contractors, however, is the fact that there are dozens and dozens of other ratios or formulas available to financial analysts. Not surprisingly, the analyst's tools vary depending on the contractor's type of business. For example, an important function for a supply contractor would normally be to manage an inventory of products, either its own or those made by others. Accordingly, financial ratios related to the operational facets of inventory management could reveal significant trends for a supply contractor. ([*Smack*!] Wake up!)

To illustrate, the percent of obsolete inventory for a particular accounting period is the value of inventory over 90 days (or other suitable period) over the total value of the inventory. Obviously, maintaining obsolete items is wasteful and inefficient, so regularly using this ratio enables a contractor to impose cost discipline in its inventory management. Trend analyses enable even more efficient performance. Another yardstick measures on-time deliveries by subcontractors or suppliers, who typically play important roles in production. This isn't a mathematical ratio, but simply the difference between the actual delivery date and the requested delivery date. This measurement doesn't take into consideration the quality of the components or their cost – only their delivery. Ideally the number should be zero, which is to say that all the items were delivered when requested or earlier. However, tracking performance of subcontractors or suppliers in this manner is another aspect of cost discipline.

These same performance ratios would be meaningless for a services contractor. For that reason, a completely different set of performance measurement tools are used. In like manner, there are dozens of ratios and formulas applicable only to construction contractors. The point

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here is that the principles of cost discipline are similar from one company to the next, but they are all different as well. ([*Smack*!] Quit biting your nails!)

How much or how little cost discipline there is depends on the extent management decides to measure performance. Of course, it is inadvisable to go too far as the cost of gathering data should not outweigh its usefulness. Keep in mind that the goal is to employ a judicious balance of performance ratios which are interstitially woven into an effective and vigilant pattern of program assessments. Again, cost management is an integral part of project management (Did you get that?).

Conclusion

As competition for contract awards gets keener, costs of performance will become even more important. In a down market, those organizations with greater cost discipline will more frequently win and profitably complete contracts than those that do not. (I don't like your attitude. [*Smack*!].)

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