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Legal Innovators

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The Courts Sharpen FOIA's Double-Edged Sword

In recent years, there have been significant changes in the disclosure protections afforded to government contractors' confidential pricing. Two recent court decisions have refined the rules governing the disclosure of contract pricing, and serve to highlight the pitfalls and opportunities facing government contractors. As competition in the government marketplace becomes more fierce, a government contractor must understand its rights, and the risks, surrounding the submission of pricing to the government.

Under the Freedom of Information Act (FOIA), the government must, upon request, disclose any information in its possession unless that information falls within one of FOIA's nine "exemptions." Traditionally, government contract pricing has been protected from disclosure by FOIA Exemption 4, which protects "trade secrets and commercial or financial information." In *McDonnell Douglas I*, the U.S. Court of Appeals for the D.C. Circuit expanded the protections afforded to government contractors under FOIA Exemption 4.¹ The court held that a contractor's line-item or unit prices,

including option-year prices, are protected under Exemption 4 if disclosure would: (1) likely harm the government's ability to obtain pricing information in the future ("government harm"); or, (2) substantially harm the contractor's competitive position ("contractor competitive harm"). Under *McDonnell Douglas I*, a contractor's recent line-item or unit prices and contemporaneous option-year pricing would almost certainly be protected from disclosure.

In August 2002, the U.S. District Court for the District of Columbia eroded the broad protections afforded to contractors' pricing under *McDonnell Douglas I*. In *McDonnell Douglas II*, the Air Force awarded McDonnell Douglas a services contract with one base-year and eight one-year options.² Approximately two years after the award, the Air Force decided to release McDonnell Douglas's option-year prices in response to a FOIA request. McDonnell Douglas filed a "reverse FOIA" appeal to block the planned release of its pricing. The district court found that McDonnell Douglas's option-year prices were subject to disclosure. While *McDonnell*

Douglas II may ultimately be reversed or modified on appeal, it currently represents a significant erosion of a contractor's right to protect its pricing information.

“Government Harm” Under *McDonnell Douglas II*

Under *McDonnell Douglas I*, FOIA Exemption 4 bars the disclosure of contract pricing if disclosure will likely harm the government's ability to obtain pricing information in the future. In the years between *McDonnell Douglas I* and *McDonnell Douglas II*, the government consistently took the position that the disclosure of contractor pricing does not harm its ability to obtain future pricing information, because contractors will always seek work in the government market, despite the risk of pricing disclosure. In fact, many in the government believe that contractor pricing disclosure benefits the government by allowing competitors to underbid incumbent contractors.

In *McDonnell Douglas II*, the district court held that a contractor may not assert government harm to protect its pricing from disclosure, because the “managerial decision about how to best protect the government's interests in gathering information simply does not lend itself easily to judicial review.” In a not-so-subtle swipe at the plaintiff, the court also noted that *McDonnell Douglas* itself continues to seek government work even though its pricing might be disclosed. The court's holding effectively guts the “government harm” prong of *McDonnell Douglas I* by

placing the issue of government harm squarely within the discretion of government officers. Under *McDonnell Douglas II*, once the government decides to release contract pricing, a contractor may no longer rely on the “government harm” prong of *McDonnell Douglas I*.

“Contractor Competitive Harm” Under *McDonnell Douglas II*

The *McDonnell Douglas II* court turned next to *McDonnell Douglas I*'s “contractor competitive harm” prong, and further weakened the protections afforded to contract pricing. The court found that economic uncertainty about the government's future purchasing needs, coupled with “all of the variables that are not in the contract that one would need in order to deduce sensitive information,” made it unlikely as a factual matter that disclosure of *McDonnell Douglas*'s contemporaneous option-year prices would cause it competitive harm. Given the broad language of *McDonnell Douglas II*, it appears that a contractor must now show substantial, actual harm in a *specific competitive circumstance* to protect its pricing from disclosure.

The holding in *McDonnell Douglas II* is illuminated by a second recent FOIA-related decision, *R&W Flammann GmbH v. United States*, No. 02-800C (Fed. Cl. Aug. 28, 2002), a bid protest case before the U.S. Court of Federal Claims. In early 2001, the Army awarded Flammann a services contract with one base-year and four one-year options. Less than a year

after award, the Army notified Flammann that it would not exercise the first option year and would instead re-solicit the contract work. The Army made clear that its decision was not based on the quality of Flammann's work, and that Flammann could compete in the re-solicitation. During the re-solicitation process, a competitor submitted a FOIA request for Flammann's option pricing under the terminated contract, to which Flammann “warmly objected.” The Army nonetheless released Flammann's option prices, and proceeded with the re-solicitation.

After an unsuccessful competition for a government contract, a contractor should consider filing a FOIA request to obtain the terms and prices of the successful offeror.

Flammann filed a pre-award protest arguing that the re-solicitation was “tainted” by the Army's unlawful release of its pricing. The court agreed, finding that while Flammann's option-year prices were “generally subject to release under FOIA,” the “peculiar factual circumstances” of the case created an appearance of impropriety, warranting cancellation of the re-solicitation. As a remedy, the court ordered the Army to “level the playing field” by disclosing Flammann's option-year prices to all bidders in the re-solicitation,

and by disclosing to Flammann the prices of all of the other bidders in the re-solicitation.

McDonnell Douglas II and *Flammann* make clear that the determination to disclose a contractor's prices is a highly factual analysis that may turn on subtle factual differences. The critical factual difference between *McDonnell Douglas II* and *Flammann* is that in *Flammann*, the government disclosed the contractor's prices while the parties were in the process of re-soliciting the very same work for which the prices had been disclosed. As a practical matter, however, the same level of competitive harm can occur even if prices are disclosed months or years before a particular competition.

As a result, contractors must remain wary of the pitfalls created by FOIA. Under the FOIA

regulations, before a government agency may disclose a contractor's proprietary information, it must provide the contractor notice, and an opportunity to object to the disclosure. See, e.g., 32 C.F.R. § 286.23(h). Any contractor receiving such a notice must promptly and carefully review the information that the agency is planning to disclose. If release of that information is likely to cause competitive harm, the contractor must timely object in writing to the agency, and may ultimately choose to file a "reverse FOIA" appeal to block disclosure.

FOIA also presents contractors with an opportunity to gain a competitive advantage. After an unsuccessful competition for a government contract, a contractor should consider filing a FOIA request to obtain the terms and prices of the successful offeror. A well-timed FOIA request will

often provide a relatively inexpensive view into a competitor's strategies.

¹ *McDonnell Douglas Corp. v. NASA*, 180 F.3d 303 (D.C. Cir. 1999) (*McDonnell Douglas I*) is discussed in detail in *The Advisor*, Vol. 1, Issue 4 (Nov. 1999). That issue, and other back issues of *The Advisor*, may be obtained by sending an e-mail request to MoraM@dsmo.com or by contacting Merle DeLancey at (202) 828-2282.

² *McDonnell Douglas Corp. v. U.S. Dep't of the Air Force*, C.A. No. 00-1693 (RWR) (D.D.C. Aug. 27, 2002) (*McDonnell Douglas II*).

Department of Labor/Office of Federal Contract Compliance Programs (OFCCP) Alert:

Different administrations, same practice – next month, the U.S. Department of Labor is scheduled to issue the second wave of the controversial "Equal Opportunity Surveys" to randomly selected federal contractors. The first wave was sent to 49,000 contractors in January 2001, at the end of the Clinton administration. These surveys require contractors to provide information, including race and gender, regarding employee compensation. The Director of the OFCCP, Charles James, has said that the first wave was "too small" to generate dependable results, so a second survey is needed. The OFCCP reports that the purpose of the survey is to help the agency best target its resources to where they can be used most effectively to eliminate discrimination.

If a survey arrives in your company's mailbox, don't panic. Call or e-mail Deborah Kelly at (202) 775-4772; KellyD@dsmo.com.

Avoiding Holiday Gift-Giving Pitfalls: A Guide For Government Contractors

by Tina D. Reynolds

As the holiday season approaches, companies consider giving tokens of appreciation to their government customers. Then, they reconsider. Regulations make holiday gift-giving a dicey proposition. As a general rule, federal government employees may not solicit or accept a gift, or any other thing of value, that is from a prohibited source (i.e., a person or company seeking official action by, doing or seeking to do business with, or otherwise regulated or affected by, the employee's agency) or that is given because of the employee's official position. *See generally*, 5 C.F.R. pt. 2635, "Standards of Ethical Conduct for Employees of the Executive Branch." But exceptions to this rule do exist. Below is a road map to giving gifts of which even Uncle Sam approves:

❖ **Gifts of \$20 or less:** Federal regulations permit government employees to accept non-cash gifts on any one occasion worth \$20 or less in value. However, the total value of gifts given to a government employee from any single source cannot exceed \$50 per calendar year. Companies and organizations are considered a single source – gifts from company employees are aggregated. Thus, if you, or anyone else from your company, has twice paid \$20 lunch tabs for a government customer in 2002, your holiday spending limit is \$10.

❖ **Gifts based on personal relationships:** Gifts based on family relationships and personal friendships are exempt from federal gift-giving prohibitions. The fact that you and your co-workers have developed a friendly relationship with a government customer does not convert a gift from your company into one based on friendship. If the cost is properly characterized as a business expense, it is not a gift based on a personal relationship. As a good

rule of thumb, if your relationship with a government employee predated your business-related contacts, gifts will be subject to less scrutiny than if the friendship arose by virtue of your business dealings. If the latter is the case, it is probably best not to give gifts based on personal relationships. In addition, if you claim or seek reimbursement for the gift as a business expense, the gift is not based on a personal relationship.

❖ **"Widely attended gatherings:"** Provided that other customers are invited free of charge, you also may invite government customers to your company's annual holiday party. Each agency, however, will have to determine whether its employees' attendance – at what may be characterized a "widely attended gathering" – is in the agency's interest. This exception is typically reserved for educational seminars and similar events, not social gatherings.

Keep in mind that notwithstanding these exceptions, some government employees take the position that it is never appropriate to accept gifts from contractors. In such cases, or where a regulation has been violated (for example, the value of the gift exceeds \$20), a gift may be returned or the recipient may pay the donor market value for the item. If the gift is perishable (i.e., food, flowers) the item may, at the discretion of the recipient's supervisor or an agency ethics official, be donated to charity, shared within the recipient's office, or be destroyed.

If you have any concerns regarding giving gifts or entertaining customers during this holiday season, you should seek guidance from your in-house or outside counsel, who also may want to consider consulting with the applicable agency ethics official.



The Government Contracts Practice of the Technology Group of Dickstein Shapiro Morin & Oshinsky LLP assists clients in obtaining and maintaining a competitive edge in government procurements.

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