The President’s Column

Dear BCABA Members:

Welcome to the December 2012 edition of The Clause. As this is my last message as president of the BCABA, I want to thank Pete McDonald for all of his efforts in assembling and editing The Clause. Pete has provided continual support to our organization, both through his editorship of The Clause and sage counsel as a past president. I am grateful for all of his work during the past year, and hope that you enjoy this issue.

The BCABA enjoyed another successful year of sponsoring various programs to benefit our members. Since my column in September, the BCABA hosted its Annual Program in late October at the Renaissance Washington D.C. Dupont Circle Hotel. Judge Gary Shapiro, Vice President of the BCABA, put together a program of engaging panel discussions that addressed relevant topics for government contract judges and practitioners. We also were fortunate to have Professor Ralph Nash of George Washington University as the program’s luncheon speaker. The Program’s popularity is reflected in its attendance, which increased significantly from last year’s Annual Program. Thanks again to Judge Shapiro and all those who assisted in making the Annual Program a great success.

In November, we sponsored our annual (continued on page 3)
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President’s Column (cont’d):

Executive Policy Forum at the Tysons Corner offices of Smith Pachter. The Policy Forum features an informal discussion of relevant government contracts topics, and this year’s Policy Forum focused on mediations before the boards of contract appeals. Judge Martin Harty acted as moderator, and his panel included Judge Carol Park-Conroy of the ASBCA, Judge Allan Goodman of the CBCA and Alan Caramella, Acting Chief Trial Attorney of the Air Force. Judge Harty and his panelists gave an excellent presentation on various aspects of mediation before the boards, and there was a lively discussion among the attendees. Thank you to Judge Harty and his panelists for all of their efforts. Thanks also to Smith Pachter for hosting the Policy Forum, with special thanks to Katie Muldoon for her hard work in organizing the event.

Finally, I am grateful for the opportunity to have served as president of the BCABA, Inc. This organization strives to provide thoughtful programming to educate and connect members of the public contract bar. The organization’s greatest strength is its membership, particularly those individuals who have offered their sustained support. In addition to Pete and Judge Shapiro, I would like to thank Don Yenovkian, Tom Gourlay, Susan Ebner, Judge Richard Walters and all of the BCABA board members for their help during this past year. Best wishes to Don Yenovkian, who will become the new BCABA president in January 2013, and best wishes to all of our members for a prosperous new year.

Best regards,

Francis “Chip” Purcell
President
BCABA, Inc.
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 an insightful analysis by Andy Shipley of the 5th Circuit’s recent decision in *USMI v. United States*. Scott Maravilla’s article then provides a timely update of the many changes at the FAA’s Office of Dispute Resolution for Acquisition (ODRA). In the next article, the impact of reverse auctions are analyzed by Jacob Ruytenbeek. Finally, Amy Hutchens brings order out of chaos with her discerning discussion of disparate OCI issues.

*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: Don’t take all this government contract stuff too seriously — Get a life. In that regard, we again received some articles that were simply unsuitable for publication, such as: “Pete Makes TSA ‘Cleared to Fly’ List!”; “KISS an Annual Meeting Panel!!”; and “SBA Refuses to Issue a COC!!!”

Reminder of Cheap Annual Dues

This is to remind everyone about the BCABA, Inc., dues procedures:

- 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 they are responsible for maintaining the accuracy of their information in the BCABA Directory.
The USMI Decision: Putting Government Contractor Trade Secrets at Risk

by

Andrew E. Shipley*


The Fifth Circuit's majority panel ruling in United States Marine, Incorporated [USMI] v. United States, if allowed to stand, may severely undermine — at least in the Fifth Circuit — a contractor's ability to protect trade secrets from government misappropriation. In a sua sponte decision, the Fifth Circuit concluded that it lacked subject matter jurisdiction over a claim for which the U.S. District Court for the Eastern District of Louisiana had awarded USMI more than $1 million in damages.

The district court ruled against the United States for misappropriating USMI's proprietary design for special operations boats. The Navy obtained the design through a contract it had with a third party company with which USMI had once collaborated. That company later sold boats incorporating USMI's design to the Navy, but retained USMI's restrictive legends on all design documents and contractually provided the Navy with only "limited rights." The district court noted that the "limited rights" restrictions indicated that the Navy “could not use the designs for future manufacturing or disclose them to other parties without written permission.” Ignoring these restrictions, the Navy distributed the design to USMI's competitors for the design and build of the next generation craft. The Navy even told the companies to track USMI's design except for slight improvements to the craft's ride and handling.

The government conceded during oral argument that the district court had jurisdiction over USMI's claim, but the Fifth Circuit dismissed it — over a stinging dissent. The court reasoned that because the government had received USMI's designs through a prior contract with a third party, USMI's claims necessarily arose out of that contract, subjecting them to the Tucker Act with exclusive jurisdiction residing in the U.S. Court of Federal Claims. The court ignored the fact that USMI held no contract with the Navy and therefore had no basis for bringing a claim for breach of express or implied contract under the Tucker Act.

The Fifth Circuit in reaching its decision cited an inapposite fifty-year old case, United States v. Smith, asserting that in Smith, "we relied on Tucker Act precedent to hold that tort claims brought against the government by six subcontractors sounded in contract even though the subcontractors were not parties to the prime contract between the government and the general contractor."

But the Smith decision had nothing to do with the Tucker Act. Smith involved claims brought by six subcontractors that built swimming pools at an Air Force base under a general

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The *USMI* Decision (cont’d):

contractor that went bankrupt before paying them. The subcontractors sued the Air Force under the Federal Tort Claims Act, arguing that the contracting officer's failure to obtain a performance bond from the general contractor per the Miller Act constituted negligence. The government argued that the Miller Act protected the government, not subcontractors, which meant the government had no duty to the subcontractors. The *Smith* court, however, dismissed the subcontractors' claims under a separate theory. It held that the FTCA waived sovereign immunity for tort claims that could have been brought against a private person. As no private person would have any duties under the Miller Act, a failure to comply with that statute could not support an FTCA claim.

The dissent in *USMI* stated, "despite the majority opinion's description, *Smith* did not hold that the subcontractors' claims 'sounded in contract,' and did not even mention, much less rely on, the lack of privity between the plaintiffs and the government. Thus, *Smith* gives no guidance as to how this court should handle the question at issue here." The dissent observed that the majority's decision likely left USMI without a remedy, as the Court of Federal Claims "would likely determine that USMI's lack of a contract with the Navy renders its claim a tort outside [its] jurisdiction."

The dissent did not address whether USMI could have successfully asserted a Fifth Amendment takings claim in the Court of Federal Claims. It is worth noting, however, that in the recent case of *Demodulation, Inc. v. United States*, the government argued that the Court of Federal Claims lacked jurisdiction over a takings claim for misappropriation of trade secrets. Moreover, and contrary to the USMI majority decision, the government argued in *Demodulation* that trade secret misappropriation claims sound in tort, not contract, when they arise outside of a direct contractual relationship. The government originally argued that the non-disclosure agreements at issue had been signed by contractors, and not the government; it later acknowledged that the signatures were those of government personnel and tried to argue that they lacked “actual authority” to bind the government. The court rejected the government’s arguments, holding that the plaintiff had sufficiently pled privity of contract to bring its claim within the Tucker Act. There was no dispute that absent a contractual relationship with the government, plaintiff’s claims would have properly sounded in tort.

The *USMI* decision also runs counter to a long-standing body of law that allows even parties to a government contract to assert tort claims for misconduct that goes beyond their contractual relationship. Under this body of law, the mere fact that contract-related issues may appear in the case does not convert what would otherwise be tort claims into Tucker Act contract claims. The *Megapulse* case is a prime example – the Coast Guard unilaterally decided to remove all restrictions against commercial use of Megapulse's proprietary data after concluding it had not all been developed at private expense. When Megapulse sought injunctive relief in U.S. District Court, the government argued that the court lacked subject matter jurisdiction because the dispute arose out of the parties’ contract. The government

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The USMI Decision (cont’d):

contended that, pursuant to the Tucker Act, Megapulse could seek relief only in the Court of Federal Claims, which lacked the ability to issue injunctive relief in contract cases other than bid protest actions.

The district court disagreed, stating that Megapulse's "position is ultimately based, not on breach of contract, but on an alleged governmental infringement of property rights and violation of the Trade Secrets Act. It is actually the Government, and not Megapulse, which is relying on the contract, attempting to show that the Coast Guard lawfully came into possession of the property . . . we do not accept the Government's argument that the mere existence of such contract-related issues must convert this action to one based on the contract."

Later, in Love v. United States, the Ninth Circuit analyzed in-depth the difference between tort claims and contract claims asserted against the government. In Love, the government seized and liquidated livestock and farm equipment following the plaintiffs' default on an agricultural loan. Plaintiffs argued that the government's actions violated state statutory notice requirements and constituted conversion and a breach of an implied covenant of good faith and fair dealing. The government countered that the claims arose from the loan agreement and therefore sounded in contract. The Ninth Circuit sided with the plaintiffs and cited a Third Circuit case, Aleutco Corp. v. United States, for the proposition that the "fact that the claimant and the United States were in a contractual relationship does not convert an otherwise tortious claim into one in contract."

As to the conversion claim, the Love court stated the plaintiffs' contract with the government served not to thrust the case within Tucker Act coverage, but instead to establish an element of the tort claim — namely, that the parties had a mortgagor-mortgagee relationship subject to the notice requirements that the government allegedly violated. "Under the FTCA, the federal government assumes liability for wrongs that would be actionable in tort if committed by a private party under analogous circumstances, under the law of the state where the act or omission occurred."

As to the breach of good faith claim, the Ninth Circuit stated that under applicable state law, the claim required wrongful activity beyond the mere existence of a contract breach. Thus, while the duty arose due to the plaintiffs’ contractual relationship with the government, "the duty exists apart from, and in addition to, any terms agreed to by the parties." Thus the claim was not based entirely upon an alleged contractual promise. Under this rationale, the Ninth Circuit held that the claim properly sounded in tort under the FTCA.

The Love court’s holding tracked the long-standing distinction between tort claims that allege a breach of duty outside the contract from claims of tortious breach of contract, such as negligent performance of the contract terms, for which jurisdiction is proper under the Tucker Act. The Fifth Circuit itself recognized the difference more than sixty years ago.

In Kramer v. U.S. Department of the Army, the Second Circuit rejected attempts to

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The *USMI* Decision (cont’d):

dismiss tort claims through re-characterizations that put them outside the district court’s jurisdiction. The plaintiff alleged that after the Army had wrongfully terminated her contract, it disclosed her proprietary information and then awarded the contract to a competitor. Although the plaintiff sued for conversion, the district court recast her claim as one for intentional interference with contract, a claim excluded by the FTCA. The Second Circuit reversed, holding that the plaintiff’s conversion claim was a claim for misappropriation of trade secrets under New York law and hence within the district court’s jurisdiction under the FTCA.

Similarly, the DC Circuit in *Jerome Stevens Pharmaceuticals v. Food & Drug Administration* reversed the district court’s dismissal of plaintiff’s trade secret misappropriation claims. The FDA posted on its website confidential trade secrets contained in a New Drug Application filed by Jerome Stevens. Despite Jerome Stevens’ demand that the FDA remove its trade secret information from the website, much of it remained online for up to five months. As a result of this disclosure, Jerome Stevens lost millions of dollars in revenue and had to lay off half its work force. The district court dismissed the trade secret misappropriation claim by, in part, re-casting it as a claim for interference with contract rights arising out of the New Drug Application. The DC Circuit reversed, holding that the claim, reduced to its essence, alleged that the FDA induced plaintiff to disclose its trade secrets in confidence and then disclosed them to others in breach of that confidence. Such a claim, the DC Circuit ruled, sounded in tort.

It is hard to reconcile the majority’s opinion in *USMI* with this backdrop of well-established case law that trade secret misappropriation claims sound in tort when they arise outside of a contractual relationship. Even parties in privity of contract with the government may sue in tort for misappropriation that goes beyond the contours of their contractual relationship. The mere happenstance that the government obtained USMI’s trade secrets through a third party government contract hardly creates a contractual relationship between the government and USMI. USMI’s claim for wrongful disclosure of its confidential information therefore cannot reasonably be viewed as sounding in contract. Quite simply, the *USMI* majority panel got it wrong. USMI’s judgment against the government should have been upheld.

* - Andrew E. Shipley, a partner in the Government Contracts practice at Perkins Coie LLP, has more than 25 years of combined law firm and in-house experience managing and trying significant, high profile cases and counseling clients on contractual and regulatory matters. He has spoken and written extensively on developing successful inside-outside counsel relationships.
The USMI Decision (cont’d):

Endnotes

2. Id. at *1.
3. 28 USC §1491.
4. See 28 USC §1491(a)(1).
5. 324 F.2d 622 (5th Cir. 1963).
7. 28 USC §1346(b).
8. 40 USC §270a.
10. Id. at 4.
11. 103 Fed. Cl. 794 (February 12, 2012). The government argued that as a matter of law the court lacked jurisdiction over the plaintiff’s takings claim. The court disagreed, holding that it had jurisdiction because the “taking” allegedly occurred pursuant to an “authorized act” by a government official.
12. Megapulse, Inc. v. Lewis, 672 F.2d 959 (D.C. Cir. 1982).
13. 915 F.2d 1242 (9th Cir. 1989).
14. 244 F.2d 674 (3rd Cir. 1957).
15. 915 F.2d at 1246, quoting Aleucto, 244 F. 2d at 678.
16. 915 F.2d at 1245.
19. 653 F.2d 726 (2nd Cir. 1980).
20. 402 F.3d 1249 (DC Cir. 2005).
21. Id. at 1256.
Recent Developments
at the
FAA Office of Dispute Resolution for Acquisition
by
C. Scott Maravilla*

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The Office of Dispute Resolution for Acquisition (ODRA), which is the sole administrative forum for the resolution of contract disputes and bid protests under the Federal Aviation Administration’s (FAA) Acquisition Management System (AMS), promulgated a new procedural regulation (rules), effective October 7, 2011. Application under the Equal Access to Justice Act (EAJA) Regulation, codified at 14 C.F.R. Part 14, did not change. The rules retain the ODRA’s well-regarded use of alternate dispute resolution, while updating the adjudication process to reflect changes in standard practices, administrative delegations, and statutory authority. Some of the key changes are summarized below.

Delegation Process

The Administrator has granted authority to the ODRA director to execute and issue final orders on behalf of the administrator for all matters within the ODRA’s jurisdiction valued at not more than $10 million. In furtherance of an efficient FAA acquisition dispute resolution process, the administrator designated the director and dispute resolution officers of the ODRA as administrative judges for all matters within its jurisdiction.

Protests

Multiple additions and revisions have been made to the rules with respect to protests. First, the rules have been amended to codify the standard for filing a request for a suspension or delay of procurement activity or contract performance. In order to gain a suspension or delay, section 17.15(d)(2) provides that the protestor must demonstrate:

- The protestor has alleged a substantial case;
- The lack of a suspension would be likely to cause irreparable injury;
- The relative hardships on the parties favor a suspension; and
- Whether a suspension is in the public interest.

Prior to the rules, the standard was defined in case law. Protestors and their counsel must vigilantly observe the requirement to set forth in the protest the compelling reasons for a suspension, because the new rule allows for “summary rejection” of suspension requests that fail to address the four-part test.

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Recent Developments at the FAA ODRA (cont’d):

Second, the rules now also include updated procedures for initial protest proceedings and reflect ODRA practices that have evolved in the last 10 years. For example, the prior rules required the FAA to submit its response to a request for suspension within two business days of the protest filing, but, in most cases, the ODRA extended this deadline as a matter of procedural necessity. Section 17.17(a) now provides a more practical time period that allows a response to be filed by no later “than the close of business on the date of the initial scheduling conference or on such other date as is established by the ODRA.” Section 17.17 also clarifies initial protest procedures by: (1) eliminating the requirement that parties file joint statements about whether they will attempt alternative dispute resolution (ADR), and instead merely asking the parties to make that decision; (2) emphasizing the idea that ADR may be used concurrently with the adjudication of a protest; and (3) removing time frames associated with the transition of an unresolved matter from ADR to adjudication. These changes create a more efficient process, and provide the ODRA with more discretion and flexibility during the initial proceedings in a protest.

Third, the rules clarify the use of appropriate motions for dismissal or summary decision of protests, and expand the ODRA’s authority to dismiss and issue summary decisions. Section 17.19 emphasizes that separate motions for dismissal or summary decisions are generally “discouraged in ODRA bid protests . . . [and] parties are encouraged to incorporate any such motions in their respective agency responses or comments.” Requiring incorporation encourages parties to be more precise and to more fully develop all motions before filing. Moreover, the ODRA may recommend or order a dismissal or summary decision sua sponte where “appropriate and necessary, after providing an opportunity for briefing on the motion by all affected parties.”

Fourth, the rules contain revisions to the adjudicative process of protests. Specifically, the rules detail the authority of the administrative judge to manage the discovery process and specify the type of discovery the ODRA rule contemplates. Accordingly, “the parties may engage in limited, focused discovery with one another and, if justified, with non-parties, so as to obtain information relevant to the allegations of the protest.” The administrative judge has authority to manage the discovery process, including “limiting its length and availability,” and establishing “schedules and deadlines for discovery.” Although the FAA dispute resolution process “does not contemplate extensive discovery,” the administrative judge may direct the parties to exchange relevant, non-privileged documents, and take depositions. Section 17.21 provides the ODRA’s standard of review for protests and the ODRA’s process for development of the administrative record. It further discusses the circumstances under which ex parte communications are permitted in protests.

Finally, protest remedies have been amended in the rules to identify additional factors that the ODRA may consider when determining an appropriate solution. Specifically, when determining an appropriate remedy the ODRA may now consider “the feasibility of any proposed remedy” and “the impact of the recommended remedy.” These additions and revisions to the rules help to streamline and formalize the ODRA protest process.

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Recent Developments at the FAA ODRA (cont’d):

Contract Disputes

The ODRA’s authority over contract disputes has also been simplified and expanded in the rules. Section 17.31 has been revised to clarify the standard for requesting a dismissal or summary decision, as well as the process for responding to and issuing a decision on a request for dismissal or summary decision. The ODRA now has the authority to “recommend or direct” on “its own initiative” that a contract dispute be dismissed. Further, any party may request by motion, or the ODRA “on its own initiative” may direct or recommend, issuance of a summary decision if there is no “material facts in dispute” and the party is “entitled to a summary decision as a matter of law.” These revisions give the ODRA more discretion to streamline the contract dispute process.

Alternative Dispute Resolution

ADR is a major component of the ODRA. The ODRA’s procedures encourage the use of ADR, and as of 2011, 66 percent of all bid protests and 91 percent of all contract disputes were successfully resolved through voluntary ADR. In order to promote and ensure confidence in the ADR process, a confidentiality clause has been added to the rules. Section 17.39 provides that the applicability of the Administrative Dispute Resolution Act of 1996, 5 U.S.C. Sec. 571 §§571–583 (Act), now extends to all ODRA ADR proceedings. Moreover, in consonance with the Act, section 17.39 affirms that “ADR communications are not part of the administrative record.” This addition further encourages parties to engage in ADR.

Nonbinding ADR is the only procedure offered under new subpart G of the rules, which relates to “pre-disputes.” Pre-disputes may involve either solicitations or contracts, but a pre-dispute does not toll the limitations periods for filing protests or contract disputes. In practical terms, this may mean that pre-disputes will be used mostly for contractual matters with a two-year limitation period rather than solicitation issues falling under the much shorter limitation period relating to protests. The party responding to the pre-dispute has the option of voluntarily accepting or declining the offer of ADR. If declined, the ODRA will close its pre-dispute file and take no further action.

Reconsideration

In order to avoid frivolous and untimely filings for reconsideration, the rules now establish a filing deadline and a standard for requesting reconsideration of a final order. Previously, this procedure was supported by ODRA case law. ODRA case law specified that to prevail on a claim for reconsideration, the requesting party must demonstrate: (1) clear errors of fact or law in the underlying finding and recommendation adopted by the final order; or (2) previously unavailable information that would warrant its reversal or modification. Moreover, ODRA case law established that the ODRA would “not entertain [reconsideration] requests as a routine matter,” and would “not consider [reconsideration] ‘requests that demonstrate mere disagreement with a decision or simply restat[e] a previous argument’ raised

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Recent Developments at the FAA ODRA (cont’d):

during the prior protest litigation."35 Consistent with these precedents, section 17.47 now provides that motions for reconsideration must be filed within 10 business days of the date of issuance of the public version of the decision or order.36 In pertinent part, section 17.47 explains the standard for reconsideration:

The ODRA will not entertain requests for reconsideration as a routine matter, or where such requests evidence mere disagreement with a decision or restatements of previous arguments. A party seeking reconsideration must demonstrate either clear errors of fact or law in the underlying decision or previously unavailable evidence that warrants reversal or modification of the decision.37

This addition to the rules formalizes the standard for reconsideration and gives parties clear timelines to reference when filing for reconsideration.

Sanctions and Inappropriate Conduct

The rules now establish guidance for appropriate decorum and professional conduct and provide the ODRA authority to impose sanctions when warranted. In the original rules, ODRA did not have the express authority to sanction misconduct. Revisions to section 17.9 now provide for sanctions if a protective order is violated.38 Such sanctions may include, but are not limited to, “removal of the violator from the protective order and reporting the violator to his or her bar association(s), and the taking of other actions as the ODRA deems appropriate.”39 Moreover, section 17.49 broadly provides for sanctions against parties and counsel who fail to comply with an order or directive of the ODRA. These types of sanctions are not further defined, but allow the ODRA to “enter such orders and take such other actions as it deems necessary and in the interest of justice.” With respect to professional conduct, section 17.51 mandates that legal representatives and counsel “conduct themselves at all times in a professional manner and in accordance with all rules of professional conduct.”40

Conclusion

The updated procedural rules, effective October 7, 2011, simplify and streamline the ODRA’s Procedures for Protest and Contract Dispute. In expanding coverage where guidance was lacking and solidifying processes that have evolved over 10 years of ODRA operations, the updated rules formalize and clarify the processes currently used in all ODRA matters. Accordingly, these rules will serve to assist the parties in achieving a fair and timely resolution of their differences, either through voluntary ADR efforts or by adjudication.

* - C. Scott Maravilla is an administrative judge in the Office of Dispute Resolution for Acquisition at the Federal Aviation Administration. Any opinions expressed are those of the author and do not necessarily reflect those of the FAA or the ODRA.
Recent Developments at the FAA ODRA (cont’d):

Endnotes

3. In 2002, the ODRA received the Outstanding Alternative Dispute Resolution Program Award from the Office of Federal Procurement Policy. Similarly in 2008, the American Bar Association’s Section on Public Contract Law recognized the ODRA’s tenth anniversary by publically acknowledging “a decade of excellent service to the public contracting community by advancing the use of alternative dispute resolution as a means to resolve bid protests and contracts disputes.” See, http://tinyurl.com/8rb4bue.
4. This 2010 delegation was issued by the FAA administrator and is included in the 2011 memorandum dated October 12, 2011, available at http://tinyurl.com/c9sw7gy.
5. Id.
7. See, e.g., Protest of Crown Communications, 98-ODRA-00098 (employing a four-part test to determine whether compelling reasons exist to issue a suspension); Protest of Hi-Tec Sys., Inc., 08-ODRA-00459 and 08-ODRA-00461 (consolidated) (stating that the protestor bears the burden of overcoming the AMS presumption against suspension).
9. Id. at §17.17.
10. Id. at §17.17(a).
11. Id. at §17.17(d)-(e).
12. Id. at. §17.19.
13. Id. at §17.19(a).
14. Id.
15. See id. at §17.21(i).
16. Id.
17. Id. at §17.21(i)(1).
18. Id. at §17.21(i).
19. Id. at §17.23 (b).
20. Id.
21. Id. at §17.31 (a)-(c).
22. Id. at §17.31 (a).
23. Id. at §17.31 (b).
25. Confidentiality has been governed by the ODRA ADR agent, which incorporates ADRA & FRE 408.
27. Id. at §17.61(a).
28. Id. at §17.57(c).
29. Compare 14 C.F.R. § 17.27(c) with § 17.15(a) (2012).
30. Id. at §17.59(c).
31. Id.
32. Id. at §17.47.
34. HyperNet Solutions, Inc., 07-ODRA-00416.

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Recent Developments at the FAA ODRA (cont’d):

Endnotes (cont’d)

37. Id. at proposed §17.47.
38. Prior to the rules change, the protective orders themselves provided for sanctions for violations.
39. 14 C.F.R. §17.9(d) (2012).
40. Id. at §17.51.
Leaders in the field of U.S. Government procurement are thrilled that reverse auctions are saving time, increasing participation of small businesses, and generating cost savings. Yet, no government procurement leader should be pleased at the prospect of the expanded use of reverse auctions. The short-term benefits championed by proponents of reverse auctions come at the long-term expense of adversarial supplier relationships and depressed supplier margins. Ultimately, the “win-lose” proposition that reverse auctions present to industry is unsustainable.

“Procurement leadership” means creating sustainable procurement strategies that provide value for both buyers and suppliers. To develop procurement strategies that are sustainable, government procurement leaders must pursue “win-win” strategies that benefit buyers and suppliers, foster collaborative relationships, and promote a healthy industrial base supported by reasonable profits. This is where reverse auctions fail—reverse auctions are not a sustainable way of providing value to buyers and suppliers.

The Rise of Reverse Auctions

In the present era of shrinking federal budgets, it becomes more difficult each day for government buyers to meet mission objectives amid dwindling budgets. In response, the reverse auction has been billed as a best practice in lowering procurement costs to the government.

Reverse auctions, also called “downward price auctions,” rely on direct price competition to reduce procurement costs.1 In 2004, Robert A. Burton, associate administrator for the Office of Federal Procurement Policy (OFPP), stated: “If used correctly, the reverse auction approach can ensure that the government receives competitive prices.”2 In 2010, Dr. Ashton Carter, then under secretary of defense (acquisition, technology, and logistics), reiterated what many government buyers already knew, that “[r]eal competition is the single most powerful tool available to the Department to drive productivity.”3

The use of electronic reverse auctions is widespread and growing. In 2011, Dan Gordon, administrator for OFPP, stated that the Department of Homeland Security runs more than 2,000 reverse auctions every year, typically saving 15–18 percent over historical costs.4 As of late 2011, the Department of the Interior requires contracting officers to consider reverse auctions when buying commercial products and simple services within certain dollar thresholds.5

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Reverse Auctions (cont’d):

On the face of it, one can understand why reverse auctions have become so popular. Reverse auctions are attractive to procurement officials because they rely on the power of direct, head-to-head supplier competition to offer three key benefits to buyers:

- They drive prices down;
- They increase small business participation; and
- They shorten the buying process.6

Reverse auctions are also the safe choice for procurement officials seeking to obtain a fair and reasonable price because Federal Acquisition Regulation 15.305(a)(1) states: “Normally, competition establishes price reasonableness.” So what could be so bad about reverse auctions?

Adversarial Relationships

In 2009, Professor Guhan Subramanian stated that “[r]everse auctions can create the opposite of the collaborative supplier customer partnerships held up as a best practice by many today.”7 Professor Subramanian’s view is hardly unique. In 2000, Professor Sandy Jap wrote about the damaging effects of reverse auctions on business relationships:

As one supplier put it: “[The buyer] talks about the relationship being a partnership, and this [the auction] really takes that away.... What they do is take your existing business that you have worked very hard to achieve and maintain...and they send it out across the board for a competitive bid. I just do not think that is fair.”8

Criticism of reverse auctions is not limited to the academic realm, either. A 2004 survey of aerospace parts suppliers’ reactions to reverse auctions found that “[t]he incumbent suppliers surveyed view online reverse auctions as a divisive purchasing tool that damages relationships with longtime customers.”9 It is not just that reverse auctions make it more difficult to get along. Reverse auctions have the potential to create a chasm between buyer and supplier, making coordination and collaboration all but impossible.10

Professor David C. Wyld, director of the Strategic e-Commerce/e-Government Initiative at Southeastern Louisiana University, recently wrote that “the reverse auction scenario may cause an exploitative relationship between buyers and suppliers, rather than allowing procuring organizations to partner with their suppliers.”11 The exploitative relationship and inherent unfairness of reverse auctions drives home the point of this article: How are reverse auctions supposed to be a sustainable approach to procurement if suppliers are always the ones getting the squeeze? Should the government pursue procurement strategies that have been characterized as exploitative and unfair?

Depressed Supplier Margins

One Fortune 10 technology executive described reverse auctions as a tool designed

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Reverse Auctions (cont’d):

to transfer margins from the supplier to the buyer.\textsuperscript{12} In this light, reverse auctions are a pure value-claiming tool. Reverse auctions are designed to take from the supplier and give to the buyer. With each successive bid in a reverse auction, bidders lose and buyers win. In short, the supplier’s loss is the buyer’s gain.

\begin{figure}[h]
\centering
\includegraphics[width=\textwidth]{fig1.png}
\caption{Number of Sellers Bidding Compared to the Number of Sellers Notified (Department of State, Fiscal Years 2007–2010)}
\end{figure}

In fact, the competitive pressure can be so great that it sometimes leads to suppliers bidding below cost. In 2001, the Section of Public Contract Law of the American Bar Association alleged that “many contractors routinely reduce their margins or bid at a loss for sound business reasons.”\textsuperscript{13} John Conroy, president of Xcelcom, a specialty contracting and technology integration firm, noted that in all of the reverse auctions that Xcelcom’s member company has participated in, the final price has been below the company’s or any reasonable competitor’s cost.\textsuperscript{14}

It certainly appears that reverse auctions achieve Pyrrhic victories—turning winners into losers. While suppliers are free to bid as they wish, how long will they continue to participate in reverse auctions where a win necessitates a loss? As Ernest Gabbard, director of Corporate Strategic Sourcing for Allegheny Technologies, Inc., put it: “Supplier prices can only be compressed so far before suppliers may no longer find your business desirable.”\textsuperscript{15} Are suppliers beginning to get the message? The data suggests that they are.

\textbf{An Unsustainable Strategy}

A case study of reverse auctions at the Department of State during fiscal years 2007 through 2010 suggests that suppliers may be choosing to avoid reverse auctions in growing numbers.\textsuperscript{16} The data shows that the average number of bidders participating in any one reverse auction...
Reverse Auctions (cont’d):

Auction dropped by 30 percent from 2007 through 2010, while the average number of suppliers notified grew by 227 percent (see Figure 1). Furthermore, the supplier participation rate in reverse auctions where bidders were notified dropped by 70 percent over the same period (see Figure 2). These trends suggest that suppliers, once tempted by the glossy marketing of reverse auction providers like FedBid, are taking notice of the threat that reverse auctions represent to their business.

**Figure 2**

**Seller Participation Rate in Reverse Auctions**
*(Department of State, Fiscal Years 2007–2010)*

Leadership

As noted previously, procurement leadership is about sustainability, which separates procurement leadership from a series of haphazard procurement strategies. Balancing competing priorities is inextricably linked to the question of sustainability. Reverse auctions tip the scale out of balance. They create poor working relationships, win-lose results, and erode the ability of suppliers to earn a reasonable profit. In this light, the rise of the reverse auction as a best practice is shortsighted and unsustainable. In sum, reverse auctions are a failure of procurement leadership.

Suppliers understand that reverse auctions are bad for business and are beginning to take steps to avoid them. A procurement strategy that is built around reverse auctions is unsustainable and is therefore bound to fail. The success of any sustainable procurement strategy cannot rest on the buyer’s outcomes alone, but instead must rest on the outcomes of both parties. If government procurement leaders are going to rebalance the scale, they must work with suppliers, not against them. This means abandoning reverse auctions as a

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Reverse Auctions (cont’d):

procurement strategy and pursuing win-win strategies that provide mutual benefit to buyer and supplier.

Government procurement leaders could learn a lesson from a greatly successful business leader—Wayne Huizenga. He personally built the Blockbuster, AutoNation, and Waste Management empires over the course of hundreds of acquisitions, both large and small. In the context of discussing repeated business dealings, he stated:

You have to treat the other person fairly and honestly, just as you would want to be treated. It has to be a win-win situation for both sides. The other players in the deal can’t feel they’ve lost. This is especially critical if the two parties are going to continue to work together.17

At the heart of Huizenga’s wisdom lies the “Golden Rule”: to treat others as you would like others to treat you. The idea of fairness inherent in the Golden Rule is also an ethical trait that we value in leaders, yet reverse auctions violate the Golden Rule by exploiting suppliers to create win-lose outcomes that only benefit the buyer.

It is not too late for government procurement leaders to demonstrate real leadership and abandon reverse auctions as a procurement strategy. True procurement leadership should not be measured by the savings captured at the expense of industry, but by the ability to sustainably create value for government and industry alike. There is still time to change course and to create win-win solutions that will provide meaningful, long-term value to all parties involved. Government procurement leaders just need to know where to look. I’d say that the Golden Rule is a good place to start.

* - Jacob Ruytenbeek is a contract specialist with the U.S. Air Force Space and Missile Systems Center in Los Angeles, California. He is a Distinguished Graduate of NCMA’s 2012 Contract Management Leadership Development Program.

Endnotes


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Reverse Auctions (cont’d):

Endnotes (cont’d)

9. See Emiliani and Stec, note 1, at 150.
11. Wyld, see note 6, at 22.
16. See Wyld, note 6, at 6.
Herding Cats: Managing Conflicts of Interest in Federal Contracting

by

Amy E. Hutchens*

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As federal budgets tighten and regulatory oversight increases, there are now more federal contractors competing for less money. Whether a company is an industry titan or a three-person shop, those that depend on federal contracting cannot afford to lose millions of dollars — or their federal contracting privileges — because of preventable conflict of interest (COI) violations.

By involving themselves in federal contracting, companies explicitly agree to more rules and regulations governing things such as executive compensation, internal controls, business systems, purchasing, and document retention. The sheer number of these factors increases the chances for compliance violations from the outset. Additionally, in federal contracting there are sometimes as few as two companies vying for a contract in a narrow or specialized market, which heightens scrutiny of potential COIs, so it is important to understand and monitor all of the complexities of the different types of COI.

An inadvertent COI in fields like healthcare can be embarrassing and costly, but in federal contracting it can be devastating to the wellbeing of a company because of the suspension and debarment rules. To avoid suspension or debarment, the Federal Acquisition Regulation (FAR) requires a company to “timely” disclose any “violation of federal criminal law involving fraud, conflict of interest, bribery, or gratuity violations.” In order to disclose, a company must first be able to identify when a COI arises.

What makes COIs unique among other violations, with an arguable exception for gratuities, is that a COI is not patently recognizable as a “crime.” Violations are situational; that is, a relationship or knowledge may not be unlawful to have, it just may be unlawful to use to one’s advantage.

Because COI violations can be latent, it is a challenge to identify them without establishing a process for monitoring compliance. As with any compliance area, you don’t know what you don’t know, yet this excuse will not suffice in the government contracting context. The FAR rules expect companies to know, and in fact FAR 52.203-13 requires a compliance and ethics program be designed specifically so that a company will either know or have no excuse why they were not aware of these types of violations. Despite widespread media coverage of recent COI scandals in various industries, and efforts of the Federal Acquisition Regulatory Council to define what constitutes a COI, many federal contractors have only an informal understanding of what does and does not create a COI.

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The renowned author Thomas Mann once wrote, “Order and simplification are the first steps toward mastery of a subject; the real enemy is the unknown.” To enhance compliance, some federal contractors are turning to online COI management systems to assist them in identifying conflicts and to simplify and organize tracking and reporting. While this is a step in the right direction, these electronic systems must be complemented by robust policies and processes for avoiding COIs, beginning with a code of conduct that is easy to understand and is an integral part of employee education and management. Ultimately, one of the best ways for federal contractors to demonstrate they are good stewards of federal dollars is to create a culture of compliance and ethics that permeates the entire organization.

**Avoid the Unknown: Defining the Categories of Conflicts**

The FAR defines a COI in general terms:

[A] conflict of interest arises 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.\(^2\)

There are two distinct types of COI in federal contracting: “personal conflicts of interest” (PCIs) and “organizational conflicts of interest” (OCIs). The rules pertaining to both types of COI are found in FAR Subpart 9.5.

PCI violations typically involve things such as:

- Undisclosed financial holdings;
- Improper gifts;
- Entertainment or travel;
- Other employment relationships such as seeking or negotiating employment; and
- Spouse’s or other close relative’s relationship with the contracting agency, prime contractor, or subcontractor.

Another common PCI violation may occur when a federal contractor employee takes advantage of nonpublic information received through involvement in the acquisition process or the performance of another contract. A PCI can also arise due to lateral moves of government employees into contractors’ workforces.

OCI violations are more likely to occur at companies that do consulting, management support, system engineering, or technical evaluations. There are three general types of OCI.

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The first is unequal access to information such as occurs when a company has access to non-public information as part of its performance of a government contract and that information may provide the company a competitive advantage in a later competition for a government contract. The second type of OCI concerns biased ground rules, such as when a company, as part of its performance of a government contract, has in a way set the ground rules for another government contract by, for example, writing the statement of work or the specifications. In these biased ground rules cases, the primary concern is that the company could skew the competition, whether intentionally or not, in favor of itself. These situations may also involve a concern that the company, by virtue of its special knowledge of the agency’s future requirements, would have an unfair advantage in the competition for those requirements (e.g., a contractor that is providing a technical review of a project cannot later bid on supplying components for that job). The third type of OCI is impaired objectivity, such as when a company’s work under one government contract could entail it evaluating itself, either through an assessment of performance under another contract or through an evaluation of proposals. In these impaired objectivity cases, the concern is that the company’s ability to render impartial advice to the government could appear to be undermined by its relationship with the entity whose work product is being evaluated.

Compounding the multiple types of COIs with the fact that COIs are not obviously criminal in the manner that fraud and bribery are, and it can make total compliance appear unattainable. This is where a compliance and ethics program, combined with intelligently leveraged technology, brings a competitive edge.

**Internal Vigilance and Competitiveness Aided by Technology**

Since a single undetected COI violation can result in a costly bid protest or catastrophic suspension or debarment, it is imperative for federal contractors to establish comprehensive policies and processes for managing COI compliance and to educate all employees on how to identify and avoid conflicts. Even the most robust internal training program will not succeed without an effective system for identifying, managing, auditing, and documenting COI compliance workflow.

For these reasons, many federal contractors are switching from paper-based systems to software solutions. Gathering COI disclosure data by paper questionnaires (or even emailed PDFs) is a costly, inefficient process, often requiring a company to dedicate one or more full-time employees to that task alone. Paper-based disclosure systems make sharing information across the organization difficult, if not impossible, because documents are usually reviewed, filed, and stored locally. Disclosure review and follow-up are manual, and analysis of information contained in disclosures is exceedingly time-consuming. Further, searching paper-based disclosures for certain relationships or financial interests is nearly impossible.

COI management software can help federal contractors significantly improve reporting

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workflow and timeliness and can offer an easy-to-use platform for monitoring, searching, and documenting compliance efforts companywide. This capability can prove invaluable by providing a competitive edge when considering bidding on a released solicitation with a shorter timeline. COIs can be identified quickly and planning for mitigation can begin early in the solicitation process before the investment in a proposal is made. For example, if a company is considering bidding on a solicitation for a product for a government agency, a few clicks of the mouse can produce a report detailing the following:

- Who has a family member working at the agency;
- Who has previously worked on contracts with the agency;
- Who used to be employed by the agency; and
- Other information critical to identifying a potential conflict before the Investment in the proposal.

If a conflict is identified, a few more clicks of the mouse manage the process for review of the conflict and the development of a mitigation plan—including template language that can be selected and customized to make the process seamless and immediate.

Consider the real-life example of a federal contractor being awarded a procurement and a competitor filing a bid protest claiming that the winning contractor had a COI.⁶ During the bid protest process, the awardee must be able to produce ample evidence that any COIs were identified, analyzed, disclosed, and mitigated. Producing required documentation from paper records would be time consuming and difficult, possibly taking weeks to pull the information together — time that a contractor does not have in the bid protest process. Such information, however, can be readily accessed in an online COI disclosure management system.

Avoiding Penalties Under Increased Scrutiny: Best Practices in COI Monitoring

In August 2011, the Government Accountability Office (GAO) released a report⁷ that criticized federal agencies for failing to sufficiently use suspensions and debarments to protect public funds. The report reflected that only 16 percent of government-wide exclusions were arising from suspension and debarment proceedings. The remaining 84 percent were exclusions based on violations of statutes or other regulations, including healthcare fraud or illegal exports.

As with any GAO report, in the years following there tend to be policy shifts and increased focus on the areas identified by GAO. So, we can reasonably expect to see an increase in the use of suspension and debarment, including for reasons such as undisclosed COIs.

When a private individual runs afoul of the law, the justice system provides degrees of leniency if a person can provide mitigating or extenuating circumstances, including evidence of

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good character. In other words, evidence that points toward less culpability. With federal contracting compliance and ethics issues such as a COI, a company cannot offer character references, of course, but it can provide evidence that good-faith efforts were made to establish a robust compliance and ethics program. That is often enough to reduce or avoid punishment, based on Chapter 8 of the U.S. Federal Sentencing Guidelines. It also goes a long way to show that a contractor is “presently responsible” so as to avoid suspension or debarment under the FAR.

By documenting compliance efforts promptly and thoroughly, a contractor can greatly reduce the risk of federal penalties. To take maximum advantage of this, COI management must be a part of an overall compliance and ethics program to be most effective. The following best practices are recommended for ensuring a high level of organizational COI compliance.

**Find a C-suite–Level Executive to be Your COI Compliance Champion**

Employees take compliance seriously when they know it is a priority among senior leaders. Select one executive (such as the chief ethics and compliance officer or general counsel, if the company has one) to be the point person for putting together an internal COI identification and mitigation program and finding technological tools to make it easier to manage and document COI compliance as part of an overall compliance and ethics program.

**Establish an Easy-to-Understand Code of Conduct and Communicate it to All Employees**

Many federal contractors have a code of conduct written in “legalese” such as, “It is the policy of the company to comply with all laws and regulations applicable to its operations, as such laws and regulations are authoritatively interpreted and administered.” While that may seem plain enough to those who understand what constitutes “authoritatively interpreted,” it is likely to baffle many employees. Ensure your code of conduct is written in plain English and is easy to understand. It is also helpful to have a code of conduct FAQ section within the code or on your company website for easy reference. Use FAQs to explain the most common employee scenarios where a conflict may be present.

**Take a “Compliance 101” Approach With All Employees**

Never assume your employees know the intricacies or complexities of COI compliance. This is especially true due to the otherwise lawful appearance of COIs. Many employees do not fully understand what kinds of relationships can cause a COI, or how they may or may not use nonpublic information. In addition, because federal contractors and government employees often work closely together, friendly mistakes can occur with the sharing of non-public information during normal workplace conversations. Training is key, but the training must be relevant and assist employees on an elemental level to identify COIs.

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Explore Software Solutions to Replace Paper-Based Tracking

In today’s environment, federal contractors cannot afford even a single slip-up in compliance reporting. Electronic systems are more precise and allow for compliance efforts to be instantly documented. Compared with paper processes, an electronic solution can greatly accelerate and simplify COI mitigation data gathering, monitoring, and reporting. It doesn’t have to take a lot of paper to show that a compliance and ethics program is more than a “paper tiger.”

The best way to deal with COIs and compliance (and ethics generally) in federal contracting is to prevent issues from arising at the outset. This requires a program directed at compliance and ethics and managed with no less attention than would be devoted to a scope of work. Savvy companies are leveraging technology to recapture time otherwise spent on compliance activities. They can then spend that extra time serving their clients and bidding on more work. Comprehensive compliance is an excellent way to demonstrate your company is indeed a good steward of federal dollars and to keep the competitive edge companies need to survive.

* - Amy E. Huntchens is general counsel and vice president of compliance and ethics services for Watermark Risk Management International, LLC, based in Fairfax, Virginia. After graduating from Johns Hopkins University and Vanderbilt University School of Law, she served as a special assistant U.S. attorney and an Air Force Judge Advocate for 11 years, attaining the rank of major. She then began her civilian career as in-house counsel to a large and diverse federal contractor. She assists companies with compliance and ethics program infrastructure. She can be contacted at amy.hutchens@wrmi-llc.com.

Endnotes

1. FAR 52.203-13(b)(3)(i).
2. FAR 9.501.
5. See FAR 9.505-3.
7. GAO 11-739.