



Government Contracts Advisory

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Supreme Court Hears Government Contracts Case on State Secrets Privilege

On Tuesday, the U.S. Supreme Court heard oral argument in the long-running dispute between The Boeing Company and General Dynamics Corp. and the United States over the A-12, the carrier-based stealth aircraft contract terminated by the Navy for default in 1991. At issue before the Court is whether the government can maintain a termination for default where the government's invocation of the state secrets privilege bars presentation of a valid defense to the default.

During argument, various justices on the high court expressed skepticism of both sides' positions on the impact of the invocation of state secrets, labeling the government's position a "pretty convenient rule," because it allowed the government to win no matter what role it played in the dispute, and calling out the contractors for being "greedy," after some discussion of the billions of dollars in payments and interest at stake in this litigation. By the end of the hour-long argument, it seemed clear that the justices would not change much about the state secrets privilege itself. However, it remained unclear how the justices would act with respect to this particular contract dispute and the intersection of the state secrets privilege with government contracts.

Background

The A-12 was an unacknowledged, special access "black" program for the development of a state-of-the-art, stealthy, carrier-based attack aircraft for the Navy. In 1988, the Navy awarded McDonnell Douglas and General Dynamics a fixed-price research and development contract to develop the A-12. At the time the contract was awarded, the government had already conducted flight tests for two other stealthy aircraft - - the B-2 and F-117A. Both the Navy and the contractors expected that the government would share its stealth technology from these two Air Force programs in order to permit the contractors to meet the contract's \$4.8 billion ceiling price and aggressive development schedule.

The program experienced development delays and cost growth from the start, largely because of the government's failure to share its stealth technology, which forced the contractors to embark on a time-consuming and costly effort to reinvent stealth technology from scratch. Unfortunately, for a variety of reasons, the government did not share any of its stealth technology information until it was too late to aid the contractors.

After the contractors failed to deliver the first test aircraft in June 1990, the contractors and the Navy discussed a restructure of the program, with McDonnell Douglas and General Dynamics seeking to have the contract converted to a cost-type arrangement which would

better facilitate the companies' efforts to develop the A-12. The government declined to restructure the contract, and performance continued. During the fall of 1990, the Navy extended the first flight date to December 1991 and after a critical design review, reached a technical resolution on the aircraft design with the contractors. Later in 1990, the contractors filed certified claims in excess of \$1.5 billion, asserting that the delays and cost growth were due to government conduct, including the government's failure to disclose its superior knowledge. All of this transpired at a time when the Pentagon was looking to slash its costs and force structure in order to reap the peace dividend from the end of the Cold War. In early January 1991, the Navy terminated the contract for default, claiming the contractors had failed to meet certain specifications and had failed to make progress towards meeting the first flight date for the first test aircraft.

Following their termination for default, the two contractors challenged their termination for default in the U.S. Claims Court (now the Court of Federal Claims). Among their many claims, McDonnell Douglas and General Dynamics argued that they had been forced by the Navy to "reinvent the wheel" because the government had not shared its superior knowledge about stealth technology, and that government failure was to blame for the program's delays and cost growth.

As part of the proceedings below, the parties commenced discovery into the contractors' allegations that the government possessed, but did not share, its superior knowledge relating to stealth technology. After the government invoked the state secrets privilege, the government urged the court to dismiss the contractors' superior knowledge claim. The contractors argued that they could prove their superior knowledge claim without the information over which the privilege had been asserted. The court found that the contractors had made an "impressive" showing that they could present a *prima facie* case using non-privileged evidence. However, the court ruled that the issue of superior knowledge could not be safely litigated and it removed superior knowledge from the case.

The trial court ultimately rejected the government's allegations that the contractors had failed to meet specifications and had repudiated the contract, and found that, at the time of termination, there was no enforceable schedule in place for the completion of the entire contract effort. Nonetheless, the court sustained the termination on the ground that the contractors were failing to make progress towards meeting the milestone dates for delivery of the first few test aircraft.

Now, after nearly 20 years of litigation (with five trials, three mandamus actions to the Federal Circuit and three appeals to the Federal Circuit), the Supreme Court is hearing the case on the sole issue of whether the government can terminate a contractor for default and then, by invoking the state secrets privilege, strip the contractors of their superior knowledge defense to that default termination. McDonnell Douglas (now Boeing) and General Dynamics argued that allowing the default termination to proceed in these circumstances was contrary to the Court's precedent in *United States v. Reynolds*, 345 U.S. 1 (1953) and violated due process. In *Reynolds*, in upholding the government's assertion of the state secrets privilege in a tort action, the Court distinguished between a civil plaintiff asserting a monetary claim against the United States and a criminal defendant, stating that in the criminal field, the government can invoke its evidentiary privileges only at the price of letting the defendant go free. However, the *Reynolds* court commented that its rationale has no application in a civil forum where the government is not the moving party, but is a defendant only on terms to which it has consented. The contractors argued that the government is the moving party when it asserts a termination for default claim. In such a case, where the government's invocation of the state secrets

privilege precludes the defending party (the contractors) from proving a valid defense (failure to disclose superior knowledge), the court must enter judgment for the defending party and convert the termination to one for the government's convenience. In its brief, the government challenged the contractors' characterization of the government as the moving party - - arguing that the contractors brought suit under the Contract Disputes Act and hence are the "moving part[ies]" for purposes of the *Reynolds* analysis. Accordingly, the government urged the Court to uphold the government's default termination.

Oral Argument

Carter G. Phillips of Sidley Austin represented Boeing and General Dynamics before the Court. He focused his argument on the fairness question at the heart of the case: whether the government could terminate a contractor for default, reach into the contractor's pocket to take back payments, and then block a challenge to that default termination using the state secrets privilege. Phillips said he did not question the power of the government to invoke the state secrets privilege to protect sensitive information. But when the government invokes the privilege in a case where it is the "moving party," the government should not be able to leverage the privilege for tactical advantage to prevail in the litigation. Phillips argued that, in this case, despite the formal caption of the matter, the government was the moving party because it was seeking to uphold the termination for default, and recoup over \$1.35 billion in unliquidated progress payments (plus interest) from the contractors.

For the government, Acting Solicitor General Neal Katyal argued that that the contractors were the moving party in the case at bar, because they were seeking affirmative relief from the courts, by challenging the government's default termination, and seeking to convert it to a termination for convenience.

In addition, Katyal said the contractors bore the risk of any invocation of state secrets by the government. Citing a pair of state secrets cases, *Totten v. United States*, 92 U. S. 105 (1875), and *Tenet v. Doe*, 544 U. S. 1 (2005), Katyal argued that "at the time [the contractors] signed their contract they were on notice that highly classified information that is the subject of - - of litigation, is something that generally can't be litigated in the federal court," and that any government decision would be therefore be final. Katyal said the companies could have insisted on the insertion of a contract clause requiring the sharing of specific superior knowledge, or a special provision converting a default termination to one for the convenience of the government in the event the government invoked state secrets. By not doing so, Katyal asserted, the companies accepted the risk that they might be terminated for default, with no ability to bring suit because of the sensitive subject matter of the contracts. Katyal later conceded in response to questioning by Chief Justice John Roberts that it was unlikely that the government would ever agree to such a special termination provision, but he argued that the contractors could have demanded "extra money in exchange for greater risk" or agreed on some highly classified alternate dispute resolution mechanism.

Some of the justices clearly appeared more sympathetic to the government than to Boeing and General Dynamics. Justices Ruth Bader Ginsberg and Sonia Sotomayor questioned whether the contractors had a viable "superior knowledge" argument in light of the fact that the contract did not expressly require the government to share all of its stealth technology with Boeing or General Dynamics, and also wondered aloud whether the contractors had raised failure to disclose superior knowledge when performance problems

surfaced. Phillips responded that the “superior knowledge” doctrine was based on long standing government contracts precedent which was known to all parties at the time of their agreement, and did not need to be expressly addressed in the contract, and he pointed out the difficulties of including in a contract “something about information that we don’t know anything about.” He also added that there were “consistent efforts and requests” for the information, and while the government eventually did provide some of its stealth technology, that it was “too little and too late to effectively allow the contract to proceed as -- as planned.”

Justice Antonin Scalia questioned whether “call[ing] the game off” and “leav[ing] the parties where they are” was the correct result since the propriety of the default termination could not be litigated and it was impossible to decide who was in the right. Justice Sotomayor pressed Phillips to give the Court a reasoned way to reach the result Justice Scalia was suggesting, but Phillips continued to advocate for automatic conversion to a termination for convenience with the natural consequences of contractor recovery. In rebuttal, Phillips conceded that there was a way for the Court to achieve a walkaway, by returning to the *status quo ante*, before the contracting officer declared the contractors in default.

Phillips later elicited a rebuke of sorts from Justice Sotomayor, after he said that “maybe, to some extent, you could say [the contractors are] sort of being a little greedy,” as part of a discussion of what amounts Boeing and General Dynamics would be entitled to under a termination for convenience. Sotomayor pounced on Phillips, telling him “You are being greedy. You admitted it,” and pressing Phillips to explain “why it’s unfair, given that you’re two sophisticated contracting parties, to say you entered a contract knowing the government could invoke state secrets...and so you bear the risk of that. [Y]ou always knew the government could do this.”

Justice Stephen Breyer also seemed incredulous at times in response to Phillips’ statements, leaning forward in his seat and asking questions in a sharp tone. Breyer took exception with Phillips’ argument that *Reynolds* should be applied in a contract dispute to preclude default termination by the government. “[I]f we accept as a principle of law what was said in *Reynolds*, a criminal case or whatever, and apply it to government contracting, where sophisticated contractors are perfectly capable of negotiating their own contract, we are not just throwing a monkey wrench into the gears of government contracting; we’re throwing the whole monkey,” Breyer said. To this point, Phillips answered that the parties understood the superior knowledge doctrine to be part of the contract, and that “the basic understanding here is that the government is not entitled to force its contractor down on this course” towards failure.

Other members of the Court seemed equally skeptical of the government’s position. After hearing Katyal’s description of how the state secrets rule would work in the government contracts or claims context – where some private party was always the moving party seeking money from the government in the Court of Federal Claims – Chief Justice Roberts chided Katyal that the doctrine was a “pretty convenient rule” for the government. Justice Elena Kagan also questioned this part of Katyal’s position, saying it amounted to a “tails you win, heads you win” situation for the government if it could never be considered the moving party in a government contracts case.

Justice Scalia also seemed critical of the government’s argument, agreeing with Chief Justice Roberts that the result in this case should be that the whole matter should simply “go away,” with the parties unable to litigate the matter following the government’s invocation of

the state secrets privilege. Katyal responded to Scalia and Roberts that he agreed – but that this outcome should preserve the termination for default and its monetary consequences. Katyal argued that there was no principled way to “cut it even and [the contractors] get to keep the \$1.35 billion and ...[the government doesn't] have to pay the \$1.2 billion” sought by the contractors. Both Scalia and Roberts seemed to disagree with Katyal, with Scalia saying that the government’s position “assumes that the contracting officer’s termination for default was valid. And we don’t know that it was valid, and we don’t want to have to inquire whether it was valid. So to say ‘go away’ means everybody keeps the money he has.”

Following oral argument, it remained unclear how the Court would decide the matter. Some had hoped that the Court (after having declined to hear several recent detainee cases involving state secrets), was taking this case in order to clarify its views on the state secrets doctrine. However, the contractors did not challenge the government’s right to invoke the privilege, did not question whether the privilege had been properly invoked by the Executive in this case, and did not claim that the invocation was overly broad. The issue as presented to the Court was limited to the consequences of the government’s invocation of state secrets in civil litigation where the government is a party. While some justices seemed to signal their views during oral argument, there was no apparent majority position. The Court is expected to issue its opinion in this matter sometime in the next six months, before the end of its current term in June/July 2011.

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