

Can the Government Prevail on a Claim That a Contractor Defaulted on a Government Contract Even When the Government Invokes the State Secrets Privilege to Protect Material Needed by the Contractor to Rebut That Claim?

CASE AT A GLANCE

The state secrets privilege is designed to allow the government to protect secret government material from public disclosure in litigation. But the government may not invoke the privilege to withhold material in a criminal prosecution, if the protected material is necessary for the accused's defense. This case asks whether that exception also applies to certain civil cases.

General Dynamics Corp. v. United States and Boeing Company v. United States
Docket Nos. 09-1298 and 09-1302

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From: The Federal Circuit

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INTRODUCTION

Petitioners contracted with the U.S. Navy to design and deliver a state-of-the-art stealth aircraft, the “A-12 Avenger.” The project met with problems and delays from the start. Eventually, the Navy terminated the program and cancelled the contract for default. Petitioners sued, raising a “superior knowledge” argument—that is, an argument that their failure to perform was due to the Navy withholding vital information. In response, the government claimed that the state secrets privilege protected the information necessary for the petitioners’ superior knowledge defense, thus preventing them from establishing that defense. The parties agree that the contractors cannot establish a superior knowledge defense without the protected material, but they disagree about whether the government should therefore prevail on its claim of default.

ISSUE

May the government prevail on a claim that a contractor defaulted on a government contract, even as it asserted the state secrets privilege to prevent certain material from coming into evidence and thus to prevent the contractor from rebutting the government’s claim?

FACTS

The U.S. Navy sought proposals in December 1986 for the full-scale design and production of a state-of-the-art stealth aircraft called the “A-12 Avenger.” Because the project relied on advanced stealth technology already in use by other government programs and because the technology would be costly and time-consuming to reproduce, the government planned to share certain limited information about the stealth technology with winning bidders. The Navy awarded the contract to General Dynamics Corporation and McDonnell Douglas

Corporation (together, the contractors and petitioners) for a fixed price.

The contractors soon ran into problems. In particular, they had trouble meeting Navy performance specifications within the contract’s time and cost constraints. The contract’s blamed some of the problems on the Navy: according to the contractors, the Navy failed to provide them adequate information about the stealth technology, and they lost substantial time and money reproducing it.

Eventually, the Navy cancelled the A-12 program and terminated the contract “for default,” indicating that the contractors were in material breach because they failed to make adequate progress under the contract. The Navy further claimed that the contractors were responsible for reimbursing the government for prior payments under the contract. The Navy thus sought \$1.35 billion, plus interest. (In contrast to a termination “for default,” a termination “for convenience”—a no-fault termination also available to the government here—would have resulted in no charge to the contractors. Under a termination for convenience, the government reimburses a contractor for costs reasonably incurred in performance to date.)

The contractors filed suit in the Claims Court (now the Court of Federal Claims, or CFC), alleging that their performance delays and inability to meet contract requirements were excusable by reason of the government’s failure to disclose information vital to their performance. This is called “superior knowledge” claim. The superior knowledge doctrine says that the government has an obligation to share with its contractors any information vital to contract performance. The contractors asked the CFC to convert the termination for default to a termination for convenience and hold “that the Navy’s

demand for return of unliquidated progress payments is of no force and effect.”

The subsequent route to the Supreme Court was long and complex; indeed, the latest appellate ruling called the case the “American version of *Jarndyce and Jarndyce*.” For our purposes, though, it suffices to say that the government formally invoked the state secrets privilege as to certain information sought by the contractors to establish their superior knowledge claim. The CFC ultimately ruled in favor of the government, concluding that “issues involving superior knowledge cannot be litigated safely.” The court thus excised the contractors’ superior knowledge claim from the case and ruled in favor of the government on the merits. The Appeals Court for the Federal Circuit ultimately affirmed.

General Dynamics and the Boeing Company (the corporate successor to McDonnell Douglas) filed separate petitions for writ of certiorari on April 23, 2010. The Supreme Court consolidated the cases and agreed to hear them.

CASE ANALYSIS

The state secrets privilege is a judge-created privilege that allows the government to protect secret information—information related to national security or military secrets, for example—from disclosure in litigation. Under *United States v. Reynolds*, 345 U.S. 1 (1953), a seminal case on the privilege, the government alone may assert the privilege by lodging a formal claim of the privilege through the head of the department that has control over the matter. The court then determines for itself “whether the circumstances are appropriate for the claim of privilege, and yet do so without forcing a disclosure of the very thing the privilege is designed to protect.” If the court determines that the privilege is appropriate, the court must then determine how, and whether, the case can move forward without the privileged material.

But the *Reynolds* Court recognized that the privilege is always inappropriate in criminal cases, where the government acts as prosecutor. In such cases, the Court ruled, “it is unconscionable to allow [the government] to undertake prosecution and then invoke its governmental privileges to deprive the accused of anything which might be material to his defense.” In these cases, the government can invoke its privilege, but it must then let the accused go free.

This exception is the sole issue here. The parties dispute whether this exception reaches a civil case such as this one, where the government must support its affirmative decision to cancel the contract for default.

The contractors argue that the exception extends to this case—that when the government invoked the privilege and undercut the contractors’ superior knowledge defense, the contractors should have prevailed. They proffer three principal arguments. (The contractors filed two different merits briefs with the Supreme Court. Because their arguments are substantially the same, they are described together below.)

First, the contractors argue that the reasons behind the exception apply equally to civil cases where the government is the moving party as they do in criminal cases. According to the contractors,

fundamental notions of fairness and due process—principles that are central to the integrity and legitimacy of the judicial system—require courts to reject the government’s assertion of the privilege whenever the government is the moving party, regardless of whether the case is civil or criminal. Under *Reynolds*, they argue, a government civil claim against a private party is more like a criminal prosecution than is a civil claim against the government. Moreover, they argue, the threat of governmental abuse of the privilege is at its height when the government is the moving party, and the courts act as a critical check against that abuse. (Indeed in this case, the contractors argue that the government used the privilege for improper strategic purposes, and not for legitimate national security purposes, in the lower courts.) The contractors further point out that all other federal courts of appeals have applied the exception to civil cases, and the government itself has advocated its application to civil cases, including in the early stages of this very case. (Boeing argues further that judicial treatment of other evidentiary privileges supports a general rule that a claim may not proceed when the government’s invocation of the privilege substantially prejudices a party’s ability to defend against that claim.)

Next, the contractors argue that the government was the moving party in this case, just as it is in a criminal case. The contractors argue that under the government’s own contracting law, a claim for default is a government claim, not a contractor claim. The fact that the contractors had to bring the suit (and are listed as plaintiffs) did not change this: under the Contract Disputes Act (CDA), once a contractor brings a suit, the agency’s decision is effectively vacated; the government carries the burden of proof at trial; and the contractor can defend itself against the government charge of default. All these features of the government-created rules suggest that the government is the moving party. Moreover, the contractors argue, the harsh consequences of a default claim support the notion that the government is the moving party. And they argue that the principles behind the exception and fundamental notions of due process suggest that the government should have been subject to the exception in a case like this, where the government bore the burden of showing that the contractors defaulted. Without it, they argue, they had no means of defending themselves in court against the government’s charge of default.

Finally, the contractors argue that without the privileged material, they are entitled to a judgment in their favor on the government’s claim of default. The contractors argue that the trial court correctly concluded that it could not rule on their superior knowledge claim without the privileged material: none of the court’s many efforts to move the case forward without this material worked. Moreover, they argue, the trial court ruled that they could establish a strong case, a *prima facie* case, based only on nonprivileged evidence. Because they were thus unable to defend against the government’s claim of default by presenting their own strong case, and for the reasons discussed above, they argue that the government’s default termination claim should not have been allowed to proceed. (General Dynamics argues further that it is entitled to have the lower courts’ judgment that the government terminated the contract for default converted to a judgment that the government terminated the contract for convenience. It also argues for reinstatement of an earlier CFC ruling and damage award [both later overturned] that set aside the default termination and awarded \$1.2 billion to the contractors.)

The government argues in response that the exception does not apply—that it should prevail on its default claim even if the contractors cannot establish their superior knowledge because of the government’s invocation of the state secrets privilege. The government proffers four principal arguments. First, the government argues that penalizing it for invoking the privilege (by ruling against it on its default claim) would undermine the privilege’s purpose to protect national security. According to the government, the privilege is deeply rooted in the law of evidence and reflects the president’s constitutional responsibility to protect larger national security interests, such as military and diplomatic secrets. The government argues that national security has long been a compelling government interest. This interest would not be served, claims the government, if the courts entered a judgment against the government each time it invoked the privilege: the government would always face the Hobson’s choice of revealing secret information and risking national security, or losing the case. And as a result opportunistic plaintiffs could successfully “graymail” the government with even the most spurious of suits.

Next, the government argues that it was not the moving party in this case. The government claims that the CDA allows only the contractors, not the government, to file suit; and under *Reynolds*, only a plaintiff who commences a suit and seeks a court ruling in its favor can be a moving party. The fact that the contractors brought the suit in response to an adverse government decision does not change this: almost all suits against the government are in response to adverse government decisions. Moreover, the government points out that the CDA allows only the contractor, not the government, to file claims in the CFC. Segregating the government’s default claim for this purpose is both inappropriate and inconsistent with two leading cases, *Tenet v. Doe*, 544 U.S. 1 (2005), and *Totten v. United States*, 92 U.S. 105 (1876). The Court entirely dismissed those cases because each plaintiff’s breach-of-contract claim against the government would have necessarily relied upon sensitive material that might have endangered national security. (But even if the Court could segregate the claims, the government argues, the Court should treat the contractors as the moving party on their superior knowledge claim.) The government argues that treating it as the moving party for the purpose of the exception would be particularly inappropriate in light of the government’s waiver of sovereign immunity under the CDA: waiver of sovereign immunity should be construed in favor of the government, not the plaintiff, especially on a claim the plaintiff has not proved. Finally, the government argues that it never sought any forfeiture or penalty against the contractors—that the default termination here was not punitive—and therefore it cannot be treated as the moving party under *Reynolds*.

Third, the government argues that even if it were the moving party, it can still invoke the privilege without losing its claim. The government argues that *Reynolds* and other cases draw a sharp and principled distinction between application of the privilege in criminal and civil cases and that the distinction makes sense: the sanction in a typical criminal case is loss of liberty, but the possible sanctions in a typical civil case are far less severe. This difference makes the *Reynolds* exception for criminal cases inappropriate in a civil context. Moreover, the government argues, no court in a civil case has ever entered judgment against the government in response to its proper invocation of the privilege. Finally, the government argues that cases cited by Boeing supporting its argument that due process principles guarantee

a civil defendant an opportunity to present a defense all involve other privileges and reasoning that is inapplicable here.

Fourth, the government argues that the contractors’ policy reasons do not support a judgment against the government. It argues that affirming the Federal Circuit’s judgment that the contract was terminated for default will not lead to abuse of the privilege. The contractors have not shown that abuse has been a problem, and Court-created processes and the government’s own protections ensure against abuse. (In contrast, the government argues, the contractors’ position could lead to manipulation by private parties, which might, for example, lodge spurious superior knowledge defenses in order to force the government to invoke the privilege and thus win the case.) Moreover, the government argues, the Federal Circuit’s judgment will not undermine defense contracting. The contractors here provided no evidence that the judgment deterred defense contractors, and in any event future contractors can still request contractual provisions to protect themselves—by requiring the government to disclose specific information, for example, or by assigning the risk of an invocation of the privilege to the government. (Boeing itself contracted with the government for a significant project after the government invoked the privilege in this case.)

The government argues that if the Court reverses the Federal Circuit, it should remand for consideration of the government’s other defenses to the contractor’s superior knowledge claim before reinstating the CFC’s 1998 damage award, as requested by General Dynamics.

SIGNIFICANCE

This case comes at a time of some uncertainty for the state secrets privilege. On the one hand, some (including amici in this case) have noted that the government has pushed for a dramatically expansive state secrets privilege over the last decade, principally in cases arising out of its programs in the war on terror. The government has urged that the state secrets privilege is more than just a common-law evidentiary privilege; it is a constitutionally compelled privilege that belongs to the president alone by virtue of the executive authority in Article II of the Constitution. This approach has potentially dramatic effects on the separation of powers and access to the judiciary: if the privilege is rooted in the Constitution, as the government has sometimes argued, it severely curtails the courts’ ability to second-guess its invocation. It also curtails Congress’s ability to restrict it through legislation. The net result is that the president alone could (and has) unilaterally shut down lawsuits by invoking a *constitutional* state secrets privilege with little or no check by the other branches.

On the other hand, there is a strong tide against an expansive state secrets privilege. Legislation is now pending in Congress that would curtail the government’s use of an expansive state secrets privilege, and the Obama administration itself has moved to reform the government’s use of the privilege.

But this case seems a poor vehicle for deciding the scope of the privilege—and whether it is rooted in the Constitution (and is therefore very broad) or merely in common law (and is therefore likely narrower). Resolution of the case does not require it; the government did not aggressively pursue it (although it did preserve it in passing in its briefing); and two of three amici in the case, the Constitution Project and the Al-Haramain Islamic Foundation, Inc., both urged

the Court to avoid it. (The third amicus did not argue this point.) Moreover, there is another case, *Mohamed v. Jeppesen Dataplan, Inc.*, 614 F.3d 1070 (9th Cir. 2010), that much more squarely presents this question. (Petitioners in that case asked for Supreme Court review on December 7.) While this larger debate looms in the background of the case, it seems unlikely that the Court will issue a sweeping ruling on the scope of the privilege here.

Instead, the Court is more likely to address the precise question in the case: whether the government can invoke the privilege in a civil case such as this without giving up its claim. This is an important question—and a question left open by *Reynolds*—but it is also a very narrow question. It is significant for three reasons. Most immediately, it is significant for the parties themselves just because of the sheer amount of money involved. A ruling either way will cost one party or the other well over \$1 billion. Next, it is significant for its impact on government contracting. The contractors here, and amicus the Chamber of Commerce, argue that a ruling for the government would create commercial uncertainty in defense contracting, ultimately adversely impacting the provision of goods and services in this critical area. (The government counters that the contractors have provided no evidence of this.)

Finally, even a narrow ruling here will have some impact on the larger debate over the scope of the state secrets privilege. A ruling for the government may represent just one more step in the direction of an expansive state secrets privilege. Moreover, such a ruling may give the government additional fodder in other civil cases to expand the privilege yet further. And if the Supreme Court says anything determinate about a constitutional basis of the privilege—even if it need not, and even only in passing—the ruling could go a long way to strengthen and expand the privilege and to insulate it from congressional or judicial attempts to rein it back in.

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PREVIEW of United States Supreme Court Cases, pages 152–155.
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