He was deploring the state of the inventor—I believe in an Allen's Alley skit. He said:

> Take the case of Robert Fulton. He suggested the steamboat and everybody thought he was crazy. Take Eli Whitney. Everyone thought he was crazy. Then there was Albert Einstein, who everyone thought was crazy.

Then he said, "Finally, there was Heathburt Thornton, who everyone thought was crazy."

The straight man said, "Say, who was Heathburt Thornton?" Allen retorted, "Oh, he was crazy."

On the other hand, on my wall I have a plaque made from a letter, which I have laminated, from the director of research of a major Government department, which says:

> Dear Dr. Levin: I regret to inform you that while you have demonstrated that your process will make fresh water from sea water, too little is known about the process to warrant further research.

Thank you very much.

Mr. FUQUA. Thank you very much.

I think all of the comments have been very revealing and very interesting, particularly the last comment. I think it demonstrates some of the governmental processes that need improvement.

Mr. Green, you mentioned—and maybe some of the others might want to comment—that the domestic policy review on industrial innovation discussed yesterday by Secretary Krebs before this joint meeting, and also by the President, didn't go far enough but it was a step in the right direction.

What are some of the areas in that innovation report that didn't go far enough? Some of the other panelists may want to elaborate also.

Mr. GREEN. From what I know of what was presented yesterday, it is my impression that there was not enough on tax incentives and things that would help capital formation and regulations on it.

Mr. Lockwood earlier stated very clearly the need for a tiered structure in regulations. In my opinion, it is absolutely essential. From what I had heard—and I wasn't at the presentation yesterday—nothing such as this is in the program.

Mr. FUQUA. I think they did state that they did plan an overall tax program to be submitted later, and they didn't get into that at this time. But they did acknowledge, I think, that it was a very integral step.

Maybe someone else would like to comment on the report yesterday.

Dr. LEVIN. One thing I would like to see included in the legislation or regulation, Mr. Chairman, would be some provision for small businesses to be reimbursed as part of their overhead for in-house research and development.

The hardest thing is to get the money to do some in-house research and development. The large corporations get that from Government agencies. I asked a Government contractor why the difference. The explanation was simple.

DOD, for example, he said, needs the General Electric Co., and it demands tremendous service from GE. Therefore it feels that it is in the Government's interest to pay GE a certain percentage as an

comply with these regulations, how to prepare proposals, and of course also to bypass some of the review procedures, when possible. In examining the methods of the National Science Foundation, let's look at the practice of peer review.

Peer review, for example, is very good if it is a university type academic research project. I am very frequently being used for that kind of review. Obviously the purpose of that is to say: well, what the man wants to work on is good or not good, or other work has been done in this field which he evidently isn't aware of. That is where peer review comes in.

But to ask for peer review for Edison when he invented the light bulb, if you would come out and ask somebody else do you think this will work, well if everybody could comment on it, it would not be an invention.

An invention by definition is something new, that not everybody can see. That is the really important point that distinguishes an inventor from every other human being, that he sees certain things that others don't.

If this wouldn't be the basic criterion here, why would we have patents? Why would we grant somebody some special recognition or special privileges if everybody else would see prior to a demonstration, exactly what the inventor saw.

For example, I was confronted with another invention of mine that I submitted to the Department of Energy. That is an impossible hassle. They sent it out for all kinds of review. I got answers which sounded like large corporation's publicity people speaking, obviously not scientists or engineers that know what it is all about.

Then they hand the whole thing over to the National Bureau of Standards, and those people simply dismiss everything. Everything that you submit to the Bureau of Standards is assumed to be some kind of a crackpot idea, and they reject it.

One review quoted my own 15-year-old publication against it, without saying whose work was being quoted. So I identified myself as the one who published this theory 15 years ago, and that this has absolutely no relevance to the invention at all. Then they immediately passed it.

A week later I got the notice, "Excellent. You have been now promoted to the second level of review." The second level of review now rejected it altogether, saying that, oh, this idea cannot work at all. So I started arguing all over again.

I write technical papers which require much less work than a technical rebuttal to stupid comments. There is nothing worse than trying to explain in a 20-page dissertation that the reviewer doesn't know what he is talking about.

Then he again answers that I am out of my head and that the invention cannot work. If it would be so clear that it can work, who the hell would need Government support? If it were so easy, I could just demonstrate to everybody that it is working and I wouldn't have to get involved in lengthy arguments on the subject.

So, last time this occurred, I went out and I took a machinist who has 4 years of education and can't even read or write and I explained the idea to him. Two weeks later he came back with a model to demonstrate that it worked. So all those engineers could not understand what that machinist could.

I think we will have a problem there. We have a problem where Government is, I guess using the term, I could use is, incest in Government, with contracts from one agency to the next, which is perhaps not the healthiest thing we can do to stimulate the R. & D. market and the free enterprise system.

I don't have any questions on specifics right now, but certainly these five gentlemen brought out in my mind quite vividly that we, as Members of Congress, have an important task in front of us to try to make the small business community a viable community that can deal with Government, and have the cooperation of Government, so we can indeed solve our problems in technology, solve our problems, like Dr. Levin said, in energy, and that type of thing.

I commend you all for coming. Your presentation was most worthwhile to me.

Thank you.

Mr. FUQUA. Mr. Brown.

Mr. BROWN. No questions.

Mr. FUQUA. Mr. Evans.

Mr. EVANS. Thank you, Mr. Chairman.

I, too, would like to echo the thanks for the presentation that has been made. I, too, have heard the horror stories before, but not as graphically. I would like to take this problem one step further and ask a question that has to do with the Government loans to small businesses who have as their inventory the technology that you are talking about.

I have had difficulties or questions raised by businesses trying to get loans where their inventory was technology. They have had no success in getting Government loans. Has this been a problem that any of you experienced on the panel?

Dr. KLEIN. First of all, I must concur with Dr. Levin that Government loans, as far as I understand, are almost unavailable. They were unavailable for many years. The only thing that is available is a Government guarantee on a private loan that one can get from a bank.

That is very difficult to get because banks are not very eager to get involved with the Small Business Administration. So they are only available to those people who have extremely good banking contacts, and then also to a very limited degree.

So without going first to a bank and getting an agreement that they indeed will lend the money, the SBA guarantee just doesn't help anybody.

Dr. LEVIN. If I might add, in our instance we did go to the bank with our first contract and say, "Here is a contract, we would like to borrow money on it." We thought it was the same as borrowing money on a contract to deliver hardware.

The bank said, "No way, this is an R. & D. contract. If you die and we inherit the contract, it isn't going to do us any good." The bank had row upon row of desks of people evaluating mortgages. As I was leaving, I turned to the vice president and said, "Where are the desks that you have for people evaluating high technology?"

Of course, that just missed its mark. The bank had no desire at all to learn anything about high technology, or to participate in the funding of it. That is, to my knowledge, the case today.

our bank recognizes that as a contract similar to all of the rest of our contracts.

Since it doesn't occupy the full amount of our business, we do not find they have any reticence in loaning us money. As a matter of fact, I think with the National Science Foundation, which pays quite promptly, they consider that as good a contract as we have.

So, we should strongly mention a program that does work; that is, the National Science Foundation. I would like to see similar programs instituted with other Government agencies because I do have contracts with other Government agencies that are not research and development.

I do have the problem of slow payment. I do have the problem of trying to get decisions made, all of which delay my work, increase my costs so that my estimates and the firm contracts I have written, profits on them dwindle and disappear.

But we should also consider we do have programs which we are interested in getting—National Science Foundation. The only thing that I stated is that the National Science Foundation funds research. Research is funded. National Science Foundation does not necessarily have a task to carry that research forth and to bring it into the general usage.

What we really need is some other kind of thing to look at bringing that research which has been funded and put into general use. I think that is a secondary problem that does happen, even though their program is a very successful program in developing research.

Mr. EVANS. Thank you.

Thank you, Mr. Chairman.

Mr. LLOYD. Thank you.

Mr. Watkins?

Mr. WATKINS. Thank you, Mr. Chairman.

I appreciate your remarks. I am very interested in industrial innovation. You basically got into the edge of something that applies to my questions. We are evaluating the charter of the National Science Foundation in Chairman Brown's subcommittee.

We are evaluating it from the standpoint of a charter for basic research. A few years ago there was more of a mandate to move in the technology development area, move it closer.

I think the question we have is whether we are getting proper emphasis on that phase of it. Many of us hope that that may be the case. Or do we have within the NSF still primary concern and primary emphasis and primary thought processes of just basic research.

Are we moving with a percentage emphasis, investment of the dollars that come to NSF, that many of us work to try to get there, into putting more of the innovative technology development, into this particular role which I think is basically right now within the charter of NSF.

I see Chairman Brown nod his head. He and I have both been working, evaluating this, and trying to figure which direction to go.

Two questions I guess I would like to ask.

I notice several of you have worked with NSF. Do you think that could be the proper vehicle to go ahead and carry out this technology development? Have you kind of run into the same kind of twist

new in that unless you are talking about photovoltaic. You have to put the pieces together to develop the process to respond to the problem which may be innovative, because it is not being done enough. But we had to overcome that.

How do you recommend that we stimulate them, how do we use the forces of Government processes to bring about what I believe is in the national interest, if we say the Small Business Administration is not the right place, and it seems to me all the other agencies are going to get to the same place, there are so many small businesses so hard to handle, which is a problem we have not overcome?

Mr. KARIOTIS. I think in this case, possibly I know of one other situation which happened in which another agency contracted through NSF, NSF managed the solicitation and proposal. The NSF peer review works quite well in spite of some of the faults we have said. I think it would work much better than in Government review. They have a good track record for knowing how to work with small business. They have an organization which we find as technical people we can talk with, and they understand what we are doing, so very likely there is a good possibility letting them function as a management firm.

I don't know how that fits their charter, but essentially you could utilize what they have done.

Mr. BALDUS. To be able to deal with the numbers, we are talking about small contracts or small people. I think they are used to dealing with rather small numbers and large moneys.

Mr. KARIOTIS. You are right, contract management is always a severe problem. But to hand off contracting management to an organization that isn't used to dealing with small business isn't going to function. They have to begin somewhere. At least we probably should consider beginning with the group that does have a record for contract management with small business.

Mr. BALDUS. Perhaps.

Dr. KLEIN. I agree that the National Science Foundation obviously has a lot of experience in managing contracts and in managing research contracts and, therefore, they probably are the most ideal agency on which you can build another program.

Peer review, of course, that they are using is good to a certain extent. In the case of new technology, new invention, it can only serve as perhaps a guideline, and they would have to institute the different reviews, like, for example, going out to the marketplace and asking around if something like that would be in existence, would you be interested in it, other than asking a scientist do you think this is possible. So peer review coupled with a kind of market review or reviewing the potential marketplace, would be a much better situation.

However, I really have to support the National Science Foundation as being an ideal institution, perhaps with some Small Business Administration infusion, to be a liaison with new technology companies and Government.

Mr. BALDUS. Thank you.

Mr. LLOYD. Thank you.

We are now ready for the next panel consisting of Mr. Gregory and Mr. Davis, who are venture capitalists. We wish to thank the

STATEMENT OF THOMAS J. DAVIS, JR.
TO THE JOINT SENATE AND HOUSE HEARINGS ON
SMALL BUSINESS and SCIENCE AND TECHNOLOGY
WASHINGTON, D. C. - November 1, 1979

My name is Thomas J. Davis, Jr. of 265 Mt. Wood Lane, Woodside, California, in the San Francisco Bay Area of Northern California. After education at Harvard College and Law School and overseas service during World War II, and while working as a vice president of a wealthy California corporation, I became interested in the technology revolution which I noted was taking place around Stanford University and the University of California. I made my first investment of funds to support a start-up technology-based company in 1958 and have made venture capital my business ever since. During my career in venture capital, I have been responsible, with my partners in three partnerships, for investing roughly sixteen million dollars in new or young companies, mostly all with a technology base.

Examples of these investments include: Teledyne and the Watkins-Johnson Electronics Corporation, both start-ups when the investments were made, and both listed in due course on the New York Stock Exchange. The latter has annual sales around $100 million, and the former in excess of a quarter billion. Another is Scientific Data Systems, which, after listing on the New York Stock Exchange, was acquired by Xerox. As an indicator of the values created from small beginnings, Xerox paid over $900 million to acquire this company.

Examples of companies founded quite recently in which my partnership has investments are Tandem Computers, which in its fifth year of life had sales of about $50,000,000, and Dysan, which will probably have sales this year of roughly $33,000,000. Each of these is currently building plants to more than double their capacity. Each is founded upon the most recent advances in innovative technology. Tandem has made several millions of dollars of overseas sales.

Currently, we have investments in 23 companies, for which we paid a total of $8,343,607. These were made over the past five years. When we made these investments, the companies were very young; for the most part they had not yet made any sales, or had only small sales volume. This year, the sales of these 23 companies will aggregate $132,000,000 and their employment will aggregate around 3100. In order to fill out the picture, I should tell you that quite a few companies in which we have invested have not prospered, and some have failed, for venture capital is a very high risk business.

As the foregoing figures and examples would indicate, venture capital plays a vital role in creating employment through financing the most innovative and highly motivated

partnerships, including mine, will terminate and liquidate. For the life of me, I cannot figure what of merit the SEC will accomplish by this additional, unnecessary and ill conceived addition to the regulator burden.

Establishment and growth of innovative, young companies is also sorely handicapped by the rules governing stock options. After the founders grow a company to several millions in sales, an entire second tier of management is needed. Most of the needed managers are working for larger corporations where they have all manner of security blankets. The only chance of getting them to risk all in the young company is to provide them with an ownership stake, so they will have an opportunity to make a significant gain if they are able to cause the company to flourish. But how can this ownership stake be created? These young men in their mid 30's have not been able to put away very much in savings while raising family. So they cannot buy many shares. The obvious mechanism is the stock option, which worked like a charm all through the 60's and until Congress tinkered with it. As a result of this tinkering, its attraction has been severely reduced. As regards stock options, the following two points are particularly difficult to justify to employees:

1. When a Qualified Stock Option is exercised, the spread between the value on day of grant and the value on day of exercise is subject to the minimum tax on preference items, even though the optionee has not sold the underlying stock. If he subsequently sells the stock in less than three years, he pays an ordinary income tax on the stock and does not get credit for the minimum tax already paid. This can result in taxation of 65% (50% personal service income tax plus 15% minimum tax). If the employee sells the stock in the same year that he/she exercises the option, the minimum tax is avoided. Thus the employee is most definitely encouraged to sell the stock in the same year that he exercises the option. Yet the purpose of the stock option is to make the employee really a long term, highly motivated owner!
2. When a Non-Qualified Option is exercised, the spread between value at date the option is granted and value at date of exercise is immediately taxed, even though optionees have realized no cash gain and might like to hold the stock instead of selling it to pay the tax. They haven't gotten anything, so why should the tax collector? They think the government is crazy. They don't necessarily object to paying taxes, but feel it is outrageous to pay taxes when they have not realized any income. Most new employees don't realize what the tax situation is until they have worked

These costs are too heavy for small companies. I do not for a moment suggest abolition of the SEC or the IRS. Their existence is essential, but they constantly invent new regulations, further and further splitting hairs and complicating life and taking time away from building a business.

Rule 144, as the SEC has defined and refined it, is particularly incomprehensible to laymen, and even lawyers are startled quite often by new twists on the regulations that are made in letter rulings with apparently no background or compelling reason. This Rule 144 restricts the sale of stock of young companies over the counter, and it particularly strangles venture capitalists in red tape. I submit that there is no compelling reason in the supposed interest of protecting the public from a stock swindle to place restrictions on the sale of stock over the counter that was originally purchased by a venture firm for investment and held for two years. The companies have registered with the SEC and continue to report to it so the facts about the company are all available and current. Restrictions on sale of assets have always been viewed with great distaste by people active in financial affairs. Removal of this restriction would encourage financing of young companies.

Please note that in my remarks I have not asked the government to spend any money on small businesses or venture capitalists. I am merely asking the government to take some of the rocks out of our saddle bags. The weight of compliance with government regulations can perhaps be pulled in a wagon by a mule, but cannot be carried on the saddle of a Derby winner. I believe few people in government bureaus realize how delicate is the life force of a newly formed company during its first five or ten years.

In my 20 years of work with young, innovative companies, I have not used one dollar of Federal or State money. In one instance, one of the companies I financed got a loan guaranteed by the Small Business Administration. The regulations to which this subjected the company were so onerous that we pitched in more money and paid off the government.

It is simply a matter of national choice. If you really want more jobs to be created and more foreign exchange, and if you want to halt the decline in innovation and productivity, you can create a favorable environment. Other nations are doing so.

If the government wants to take an active step and spend some money, by all means let it put some money into a carefully conceived program of research, in activities not necessarily limited to weapons and space. In the 50's and 60's there was a wave of expenditure by the government to finance research and development. We have been surfing down this wave ever since. But the wave has become attenuated and we need a new one.

by a company backed by a venture group in California, including myself, my partnership, and they have been able to stitch on, as they call it, a human gene that controls the making of insulin in the human being onto a bacterium to produce insulin outside the human body on a commercial scale. Insulin is very scarce, as you know, very expensive.

This will be very good for mankind. I don't know when it will come out. The general notion is it takes 6 years to go through FDA, so I don't know when the world will have it. We are combining with it Ely Lilly so that we can use their distribution and some of their large manufacturing operations, the ideal combination for a large company and small company. I must quickly say that not all of the companies that we have backed by any means have been so prosperous as the ones I have boasted about a moment ago. Venture capital is very risky and a very difficult business.

As to the four areas that I wanted to discuss with you, I might also say that you might say, well, venture capital has raised a lot of money in the last year, it responded beautifully to the action of the Congress down here in turning back partway the capital gains tax which previously had been raised from 25 percent to about 49 percent effective rate, and more than that, in California where you have a capital gains tax also, and this had nearly killed the venture capital business and entrepreneurship business.

I won't talk about the bad effect of the increased tax rate on venture capital business; I am talking about its effect upon young men who leave large corporations and start new businesses and then they work and work and work and 5 or 6 or 7 years later they sell some of their stock in the company if its been very successful and has gone go to the public and then find that Uncle takes over 50 percent away from them. This has caused a lot of them to be very embittered against the Government and a lot of people refused to come out of large companies to start new companies for a period of time.

We will never catch up on the ground we lost for that 5 or 6 or 7 years of that, but right now there is interest and enterpreneurs are coming out and starting new companies and we are raising money. I myself just raised $20 million for my venture capital partnership to support that effort. Nevertheless, despite that fact, there are several very serious matters that I think I should identify in my opinion.

These include the following four areas. One is the stock option, which is a tax problem, obviously. Second, the income tax is too heavy for young companies in their early stages of their life. That is a tax matter, of course. Third, the SEC has suggested that the Investment Advisers Act of 1940 be applied to venture capital partnerships. That is an SEC regulatory problem. Fourth, I want to talk about rule 144 which places a restriction on the sales of shares of young companies that have registered with the SEC and daily reporting over the counter and monthly reporting to the SEC. Last, I want to talk about the cost of registration in going public, which has nearly bankrupt young companies.

To start on those, after a young company has grown to the $10 million sales level, it needs a second tier of management; that is, guys as able as those who started the company. Where you find

hypothetical danger, and nobody has been hurt yet on any of these things we know about. What is the reason for this?

Turning to heavy taxation on young companies, they reach full taxation at $100,000 of profit. Now, this can happen in their second or third year, something like that, at a time when they still need very, very much large infusions of money to meet their rising business. Look at Tandem Computers, they went $7 million, $24 million, $50 million in sales once it got rolling after the first 2 years of setting up an R. & D. program.

Now, it takes a lot of money to run that sort of company. It doesn't make any sense to be paying out the income taxes to Uncle Sam at the same time that you are running to the bank and borrowing at 19 and 20 percent money. This is really counterproductive. What it does, it inhibits the companies from producing more jobs, more innovative products, and all that sort of stuff.

There is a rule called rule 144, which covers quite a few things that I won't go into here. One of the things we run into all the time is it has a restriction on sales of stocks of small companies even if they have registered and have a public offering with the SEC and they are quoted every day on NASDAQ and they report all the time to SEC.

Now, this is a very, very complicated act, ruling, or act—it's an action of the SEC rather than legislation, isn't it, Dan?

Mr. GREGORY. Yes.

Mr. DAVIS. Actually, it was intended to liberalize an earlier thing standing us on all our heads and it made a miasma, a quagmire of rules that we don't understand. They have recently put out another ruling on this in a letter to somebody, and it stood us all on our heads. Now they put out some clarification of it. The odd thing is SEC basically has been going in the right direction. Every once in a while they come out with something like this that is very different.

What we can't understand is why aren't companies registered rather than individual shares of stock numbered 1092 and 1093 and 1094, so that you have 1092 and you can sell it but I have 1093 and I can't sell it.

The company is registered, everyone knows what it's all about, so why are these distinctions between who owns the stock? It really applies to us, venture capital companies who invest for investment purposes, we hold it for 3 years, we didn't do a trading job on it, why should we be treated differently than other people? Well, if you want to inhibit venture capital from going into these things, then you can have regulations like that.

If you want to encourage venture capital to go into the things, then you ought not to have regulations that come out for no real apparent purpose it's very difficult to see what is accomplished by all this thing except cost to us. The cost of registration and reports to the SEC is extremely heavy. It cost us $274,000 to register the public offering of Tandem Computers, when it was a small—that was even a smaller company, only doing about $15 million worth of business. That is not counting the time that was spent by us directors, spent by the employees, all that sort of stuff.

As a director I am a member of the audit committee. Every 3 months we must release our earning statement. We are so afraid,

STATEMENT FOR JOINT SENATE/HOUSE HEARING ON THE STARTUP GROWTH AND SURVIVAL OF SMALL TECHNOLOGY FIRMS

Before the

Select Committee on Small Business
United States Senate

Hon. Gaylord Nelson, Chairman

Committee on Small Business
U. S. House of Representatives

Hon. Neal Smith, Chairman

Committee on Science & Technology
U. S. House of Representatives

Hon. Don Fuqua, Chairman

by

Daniel S. Gregory
Managing Partner, Greylock Investors & Co.
Chairman, Greylock Management Corporation
Boston, Massachusetts

November 1, 1979

hopeful that my comments will shed some additional insight on the nature of our industry.

The venture capital industry provides for channelling of accummulations of capital into promising projects. Any organization can by its own internal decisions, channel capital to its own new projects, which is in itself a type of internal venture capital within the confines of established corporate objectives. We function outside of those channels. As long as people are creative and have some faith in themselves and the future, the able among them will approach an opportunity in their own way, with their own product and service offerings and seek to do so without the constraints of their parent organizations. In a sense, venture capital is an agent of change; it finances change.

Consider the formation of Intel Corporation of California in 1968. Now one of America's major corporations producing, as you know, microprocessors and other advanced computational devices. Intel was a product of the vision of essentially a very small group of men, then at Fairchild Camera. They saw an opportunity--a major revolution in handling information in the form of small, miniscule silicon chips. A corporation was formed to provide a concerted program to develop that product and its use.

Consider a company like Teradyne Corporation Boston, new within the last 20 years, and a result of the recognition of its founders of the need for testing of semiconductors and microprocessors, as well as memory devices. It is an industry which was poorly defined a few years ago and is now reaching the potential which was forseen by its founders.

A second general observation; the venture capital industry cannot and should not be viewed as a ready source for any and all projects. Raising capital has always been, and should continue to be, a tough process. We do not have unlimited funds. We have to expect that our projects will be economically self-supporting fairly early in their life cycle - that is, make money. So, we try to pick only the most promising projects. One of the reasons we have seen some dramatic successes recently is that they have come out of a tough period, the people had to be exceptional. This relates to a third observation. While we deal with early stage projects frequently found in the small business sector, we very much hope they will be bigger business soon. Among our investments we have seven companies each of which, when we made our investment, had less than 30 employees and today have approximately 1,000. Most of these companies have achieved some form of public financial market as well.

A fourth observation is that the venture capital manager must in fact be financially successful. There is no quicker way for venture capital, and those of us in the business who professionally manage venture capital, to fail to finance new companies, then ourselves to fail. Money has to be made by our investors and ourselves in order to produce the gains that can be thereby redeployed in future ventures. Otherwise, there will be no capital for venture capital projects in the future. Finally, there are good projects which do not ever need outside financing. I would not want to leave the impression that we are essential to the economic emergence of every activity, that is simply not the case.

working with those who are advancing the frontiers of knowledge in their particular area and who are determined to pursue their own technological developments and related products as best they can in so long as the commercial market supports them. I think of An Wang, founder of Wang Laboratories in which we had a small investment. Born in Mainland China, he did what he knew how to do best which was to develop a desk top calculator in the 1950's and early 1960's and he has pursued his knowledge to the point where he is a major factor in word and data processing markets - the so-called "office of the future".

Finally, we have to feel that we are sufficiently attracted to people whom we are backing that we are willing to work the long months and years when the numbers are bad, that is when the company fails to reach an economic threshold.

What are appropriate fields of venture capital investment? First of all, the traditional venture capital financing is anywhere from $200,000. to $3,000,000. in equity. Any one participant is probably not likely to finance the entire $3,000,000. but to seek partners. So we are dealing traditionally with smaller amounts of money than say, large scale energy exploration would call for, or smaller amounts of money than that which will be required to produce synthetic fuels.

We are looking at unstructured industries, industries that are demonstrating a high degree of product innovation. We are attracted to new technological areas based on breakthroughs around established methods and procedures and we are attracted to those areas where we think traditional methodology is particularly

projects and indeed as a group, constitute the dynamic force for change and productivity in this country. It is interesting to note that the semiconductor technology upon which all this is based, consumes very little energy and comes at a time when we see the limits of our reserves of fossil fuels. Consider the communications that are made possible with this equipment and the fact that perhaps we can move ideas and information rather than people. You already see it in the optical character recognition, electronic mail and telecommunications which are in early stages of development in venture capital type projects.

As suggested, venture capital in an earlier form played an important role in the industrial revolution, and so it is that venture capital plays an important role in the current technological revolution centering as it does very much on the computer and related fields.

As this period of venture capital emerges a new element is evident. It is the shadow of the U.S. Government and its regulatory agencies asserting active roles. There is a willingness to become acquainted with the venture capital process as evidenced by these and other hearings, for which we are very grateful. Before dealing with the impact of the government on the venture capital business itself, I am obliged to repeat the plea from our companies relating to the substantial drain in money and energy caused by complying with the myriad of Government regulations.

Pertaining to the venture capital industry itself, in 1979 alone, new sets of rules have been proposed by staffs of the SEC and the Department of Labor which, if enacted, would severely

Recent years have seen a substantial number of pertinent reports written to the government. One such report, "Small Business and Innovation," published by the printing office in August 1979, combined the work of three study groups. As Milton Stewart, Esq. pointed out in its introduction, the reports reflected a remarkable concurrence of opinions and recommendations offered by 47 citizen leaders on the problem which we are dicussing here today. As a contributor to the so-called Norris Report, one of the three reports in question, it is gratifying to note that some of our recommendations were heard. We now have graduated corporate income tax rates for smaller companies and greater flexibility under Sub Chapter S regulation. There are seven bills which have been introduced in Congress, of which I am aware, that address themselves to aspects of the problems discussed. I would urge favorable consideration of HR5060 restoring the former tax treatment of stock options. Substantial handicaps were placed upon the difficult job of building a management team when they were removed by Congress in 1964.

Central to the advocacy of small business is the governmental attidude toward capital. We have experienced a period where capital has been consumed, dissipated, and taxed for current programs. We are suffering from declining productivity and inflation as a result. The continuing effort to "carry-over" the original tax basis of appreciated property following the payment of estate taxes based upon current values is double taxation on the same capital; and is evidence of a hostile view toward private capital which must be revised to successfully set the cli-

STATEMENT OF DANIEL S. GREGORY

Mr. GREGORY. I would begin with some humility, Mr. Chairman, because Mr. Davis has said very well a good many of the points that are on my mind. I will be especially brief.

Let me just describe my firm. It is called Greylock, formed in 1965. We are in the business of continuous venture capital investing. Over those years since 1965, we participated in the close to 100 venture capital projects, at one time having more than perhaps 30 investments, the difference being those that have matured and have been distributed out to our partners.

We take a very active role with those companies trying to assist in the development stages and phases of their growth. We think the process of identifying promising new enterprises and developing constructive relationships with those enterprises is one of the more complex and sensitive of all commercial activities, but it is one with a tremendously high yield in the form of job creation, tax revenue, and technological contributions.

I have described in my written remarks certain facts about some of the companies that we have been involved with which was somewhat similar to Mr. Davis' comments on his company's, so I won't go into it, but I would like to comment on a few points I think would be helpful if we are dealing with the environment for venture capital and innovation.

We think that any economy, it is a truism, any economy, communist or capitalist or whatever, requires methods for accumulation and accommodation of capital. The process is absolutely crucial to new jobs and services. It is essential in providing innovation and producing technological breakthroughs. These are the outputs, and we can all agree as to their priority.

However, the input, capital formation, has had a very low national priority. The process of combining these two is little understood. The venture capital industry finds it is squarely in the middle of this process. Because we operate outside the normal corporate channels by which capital is allocated, and because of the high yield from some of our activities, we have a visibility that is out of scale with the money in question. Working with young managements, in most cases, we find ourselves agents of change, we are financing changes, of which we are very proud.

We have experienced a period where capital has been consumed, dissipated, and taxed for current programs, and we have seen productivity decline and inflation intensify. A favorable environment for venture capital, and investment in general, requires a reversal of this attitude.

We place as No. 1 in terms of favorable environment for venture capital, favorable attitude toward capital as reflected in tax policy. Prior to 1978, one of the difficulties in capital and company formation was tax policy which failed to recognize the incentives required to forego current returns for long-term capital growth. A capital gain is itself capital and it tends to be reinvested if it isn't taxed away. The farmer long ago learned not to consume his seed corn, lest he would be without a crop in a future year.

We seek recognition that the investment of venture capital is highly individualistic and diverse and an ever changing process, and we would urge your rejection of laws and regulations that seek

are Harvard University, Rochester University, Yale University, Stanford University, Corning Glass, Hewlett-Packard and a number of wealthy individuals who have become more and more interested in supporting this transfer of capital from them into innovative processes.

Mr. BROWN. When you refer to these universities, this is their endowment funds?

Mr. DAVIS. Yes, they have realized that the prudent man really is not very prudent if he doesn't try to make some capital gain to make up for the erosion of his capital through many means, but also through inflation, and they have found out that it is now believed the prudent man rule doesn't say that you shouldn't make what is a risky investment, it is a question of what percentage of your funds you should put into such a thing.

These are very conservative institutions, of course. They looked into this thing for several years before they became convinced this was the right thing to do.

In a previous partnership, the Ford Foundation has $3 million.

Mr. BROWN. Mr. Davis, you have a tendency to give us more details than we are interested in. Go ahead and answer the second part of the question.

Mr. DAVIS. All right. The arrangement is that we have three general partners who run the business and we have these other limited partners who have put their money into the business.

Mr. BROWN. With regard to the small business that you go into, you take an equity interest?

Mr. DAVIS. Take an equity interest almost entirely. We loan money only now and then when it's absolutely necessary for some very good reason.

Mr. BROWN. And the nature of your partners, then, is not wealthy doctors looking for a tax shelter or something like that?

Mr. DAVIS. Absolutely not.

Mr. BROWN. Let me ask one other question, then.

I think each of you has indicated the value of incentives such as the stock option situation. The problem we have in Congress in enacting general law or regulation is that it may tend to cover more than we want. I think we would be interested in allowing stock options for young executives in the situation that you mentioned. But wouldn't that same device be available to the old corporation that wanted to keep those people that were sought by the new corporation?

Mr. DAVIS. My suggestion is that the stock option that I am talking about should be reinstated the way it used to be, and that it should be available to employees of what is essentially a small business, as already defined in existing legislation. That is where the new employment comes from, that is where you need to entice the people in.

Mr. BROWN. In other words, we should identify clearly high priority public purpose, and limit it to that purpose?

Mr. DAVIS. Exactly, sir.

Mr. BROWN. Would you concur in that, Mr. Gregory?

Mr. GREGORY. I think my answer to the second part of the question you asked Mr. Davis is that I feel that stock options—in 1964 when Congress removed the tax benefit in stock options, they

On the other hand, I would not be for stock options for larger existing ventures.

I happen to have lived through that Cambridge, Mass., explosion, which also went on in Ann Arbor, in Palo Alto, and of course all the classic places. And that is one element of our economy.

But, you know, I represent the area that has the Bethlehem Steel Corp., and we have 20,000 employees there. They have a big task in there on capital formation as well. The pride of the American steel industry, Burns Harbor, was built in 1962, and the Japanese have recently phased out a plant of theirs built in 1962. So the development of capital to provide, to maintain present jobs, and to provide new jobs and the health of our economy does not end up with any sort of cutoff at whether it is high, medium, low, large, or small. I think the marketplace will take care of that factor by adjusting its rates of return accordingly.

I would like to go back for 1 minute.

We all look back to those 1960's and the kind of incentives that were provided. And then we look back at history and we see that those very elements that fed the goose that laid the golden egg were taken away from the goose, and essentially the goose is starving at the present time.

I would just want some comments from you, Mr. Davis, and you, Mr. Gregory, as to why you think the United States, as a society, has moved in this direction. And perhaps if we knew a little bit more about why we went in that direction, we might learn a little bit better how to retain that which was positive.

Mr. Davis.

Mr. DAVIS. Well, it is hard to say. It is a startling thing when the President of the United States says that a capital gains——

Mr. BROWN. Could you speak into the microphone?

Mr. DAVIS. I beg your pardon.

It is a startling thing to me. I was startled when the President of the United States said that the capital gains was a rich man's loophole. People that I am talking about out there are not rich men. They hope to get rich. I think there is nothing wrong with that in a capitalist society. At least I hope not. And——

Mr. BROWN. That seems to be a problem. Investment seems to be a kind of dirty word in the capital.

Mr. DAVIS. But small business is a beautiful word. And these are all small businesses, when they start. And so I am startled that the Congress of the United States did raise that capital gains tax to such a hostile and killing level. I really don't understand the sociology behind why investment has become a dirty word, if it has. I hope it hasn't. And why it is wrong to become wealthy through very, very hard efforts. These fellows work 28 hours a day. These managers are no 9-to-5 jobs.

Mr. BROWN. It is essentially these people who are creating the 8-hour and the 7-hour and the 6-hour jobs of the future by their very productivity in output. I agree with you.

Mr. GREGORY. We saw in the 1960's, after a long rise in the stock market, a culmination of the postwar patterns of high consumption, high orientation to the consumer, to the little investor, the stock-of-the-month plan on the New York Stock Exchange, the mutual funds. But I think there was only slight attention paid to

STATEMENT OF DR. JACK T. SANDERSON
ASSISTANT DIRECTOR FOR ENGINEERING AND APPLIED SCIENCE
NATIONAL SCIENCE FOUNDATION
BEFORE
HOUSE SCIENCE AND TECHNOLOGY COMMITTEE
SENATE SELECT COMMITTEE ON SMALL BUSINESS AND THE
HOUSE COMMITTEE ON SMALL BUSINESS

NOVEMBER 1, 1979

Thank you for the opportunity to participate in your consideration of small business, innovation, and productivity. I would like to discuss the activities of the National Science Foundation designed to increase the number of small business performers capable of conducting innovative research and to stimulate technological innovation and private investment stemming from Federally funded research.

Before discussing our current efforts, let me begin by mentioning the historical background for our small business activities. In 1971, when Research Applied to National Needs (RANN) began, the Foundation initiated awards to small business firms. Since that time there has been a fairly steady increase in both the number of awards and in the dollars awarded to small businesses.

In FY 1976, the Congress established a requirement that 7.5 percent of RANN awards be made to small businesses. This requirement has increased to 10 percent in FY 1977 and 12.5 percent in FY 78 and 79.

Building on the model of these centers, the Canadian government has authorized the establishment of NSF-type innovation centers in two provinces. In addition, several are in the planning stage in other Western European countries.

A second unique small business effort was initiated in FY 1977. The Small Business Innovation Research program was developed specifically to solicit proposals of high quality from small businesses. Its purpose was to increase the number of small business performers capable of conducting research and development for government and industry and of developing innovative products and services for commercialization. This effort has been successful. For example, the program seeks to fund, on a competitive basis, creative, high-risk, potentially high pay-off research ideas. NSF sets the general topics for the research but provides flexibility for creative, innovative research within those basic guidelines.

As you are aware, the solicitation that was developed was unique and has attracted considerable attention. Federally supported applied research was coupled to follow-on venture capital and to private sector market needs. One of the principal objectives of the solicitation was to stimulate technological innovation and commerical application using research on NSF objectives as a base. Small business research in the Directorate for Engineering and Applied Science meets EAS objectives and also may serve as a base for innovative high-risk ideas for the private sector.

This forces consideration of technology transfer to be built in at the research planning stage. Secondly, it provides a coupling of Federally supported research to market needs which is of great interest to venture funding sources. It is a rare third party that is going to commit itself to a six-figure investment for extensive development if there is no market for the potential product, process, or service. The commitment provides the objectivity of a potential third party investor rather than the opinion of reviewers with no risk at stake. Those who risk six-figure amounts are going to look at the potential market, the management, and financial requirements as well as the technology before they commit extensive resources. NSF evaluates the science much better than most investors. Government, however, leaves the evaluation of the market and management -- as well as financial negotiations -- to the private sector. In the process, NSF identifies promising ideas and competent small firms, and obtains research to meet its own objectives in supporting the generation of new scientific knowledge.

NSF's Small Business Innovation program provides a major assist to small science and technology based firms seeking venture capital. It results in larger businesses and venture capital firms approaching the small business awardees. It also provides an incentive for the small firm itself to seek the follow-on capital which is needed for the development phase if the research is successful. NSF provides the small firm with hard-to-obtain front-end dollars and recognizes its technical ability by making an NSF award to those who rank highest in strong competition.

does not pursue commercialization.

The NSF program for encouraging small business innovation is highly competitive and incentive oriented. Only about one of eight proposals is successful in Phase I, and only about half of Phase I winners receive Phase II support. The process, in summary, is that not only must the firm win in Phase I, but the firm must do quality research and demonstrate this quality in the Phase I report. The Phase II proposal then must meet rigorous NSF standards. Should a commitment for follow-on funding be involved, the firm must achieve the technical objectives specified in the commitment in Phase II in order to obtain the Phase III private funding.

The Small Business Innovation Research program has stimulated a great deal of interest, not only from small firms but from large business and venture-capital firms. For example, many large firms see small firms as potential sources of technological innovation and of new technological products and ideas. Both large corporations and venture capital firms see our program as a mechanism to identify highly competent, small technology firms. If the small innovative firm plans to pursue its ideas into manufacturing and marketing itself, it may prefer to secure its Phase III funding from a venture capital firm. On the other hand, some ideas may have more market potential and less risk with large firms already in the field due to their existing production,

and the cover letter of the commitment from the manufacturing firm stated in its first line: "This may be a break-through of national importance in the semi-conductor industry." Thus, while micro-electronics previously had not been considered by this small firm, the lack of market for photoplates led them to this technically-related area, and it is now their major effort.

Since this redirection and Phase II award of $240,000, the firm has been approached by IBM, Varian, and other larger firms for its technology. This firm received a contract from the Office of Naval Research and received two awards for two separate proposals in the second NSF solicitation.

In the productivity area, Advanced Mechanical Technology, Inc., a Massachusetts firm, has developed micro-isotope tipped machine tools. A way has been found to determine automatically when the cutting edge is not sufficiently sharp by implanting a speck of tungsten 1/1000 of an inch in diameter (or one-quarter that of a human hair) in the cutting edge of the tool. A sensor determines when the tool has lost its sharpness and should be replaced in automatic production operations. Ford, Chrysler, General Electric, and Raytheon are all interested in this new technique.

A Pennsylvania firm, Ceramics Finishing Company, in State College, is involved in research to improve the machining of ceramics. This is a field where little research has been done. Although only 6 months into

NSF's Small Business Innovation Research program has received considerable attention from abroad and we have had visitors from many European countries, Japan, Israel, and Brazil. The Swedish and Dutch governments are already arranging to contact winners to secure possible European manufacturing rights; Israel wants to establish some joint R&D efforts between small firms in Israel and the U.S. Sweden is considering the establishment of a program similar to ours and Great Britain, France, Holland, and West Germany are also discussing the possibility of setting up a similar program.

Many states are showing increasing interest in the program as studies affirm the relationships between small businesses, innovation and job creation. Massachusetts, California, Wisconsin, New York, and New Jersey are considering special efforts to inform small firms with research capabilities in their states about the program. While many states had firms which submitted proposals in the first solicitation, awards went to firms in nine states. In the second solicitation, 41 states and the District of Columbia were represented; the number of states receiving awards more than doubled -- 20 states. A third solicitation is now in process which we anticipate will be available to small firms about December 1.

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As I have indicated, the support that NSF provides to small business comes through a variety of channels. Serving as a central coordination point for information is our Office of Small Business Research and Development, whose functions I have described in some detail.

Finally, I want to mention that NSF sponsors two conferences on Federal R&D each year. To date, these conferences have been held in San Francisco, Chicago, Boston, Dallas and Washington, D. C. In the spring, 1980 conferences are scheduled for Atlanta and Los Angeles. In sponsoring these conferences, we have had excellent cooperation from other Federal R&D agencies in our efforts to provide research opportunities for small science and technology based firms.

An important feature in the success of the NSF activities, in my judgement, is the flexibility that we have had to develop programs when and where they seemed most appropriate. The Foundation is very interested in doing what it can to encourage innovative and productive R&D in small businesses. However, I would have serious reservations about mandating a certain percentage set-aside for small business R&D in other agencies.

I would be glad to answer any questions you may have.

In spite of these results, small firms receive only 3 1/2 percent of total Federal R&D obligations and 8 percent of total R&D awards to industry. This contrasts with small business obtaining more than 23 percent of total Federal procurement and its providing approximately 55 percent of all jobs in the private sector. R&D in the U.S., if not technological innovation, is dominated by large firms. Science Indicators indicates that six industries account for 85 percent of total industrial R&D and a paper by Howard Nason states that 31 companies do 60 percent of totaling U.S. industrial R&D. Zerbe in another study concludes that small business does only three percent of U.S. R&D.

Many economists and others have studied the problem both in the U.S. and elsewhere. A number of programs and experiments have taken place. Key concerns have been the need for coupling government research to market needs; government interfacing with the private market process; the inherent risk capital problems of high technology and small business; avoiding government funding simply displacing private capital; and the barriers which inhibit greater small business participation in Federal R&D. Overriding all is the concern for U.S. technological innovation.

The importance of small business is demonstrated through a recent study by Dr. David Birch of MIT for the Department of Commerce entitled "The Job Generating Process." The study found that small business firms with 500 or less employees created 87 percent of all net new jobs in the private sector in the U.S. between 1969 and 1976. Sixty-six percent of all net new jobs came from firms with 20 or fewer employees, and 80 percent of all new jobs were generated in firms 5 or less years old. (The study was based upon 5.6 million businesses or more than the total number of businesses with employees; that is, it covered many firms that have gone in and out of business.)

In contrast, another study showed that between 1970 and 1977 the Fortune 1000 companies increased their employment only 3.9 percent over the entire period or less than one percent per year. During the same period, all other private industrials below the Fortune 1000 level increased their employment 65 percent.

STATEMENT OF DR. JACK SANDERSON, ASSISTANT DIRECTOR FOR ENGINEERING AND APPLIED SCIENCE

Dr. SANDERSON. Thank you, Mr. Brown.

It is a real pleasure to appear again before you to discuss the small business innovation problems and the more general problems of innovation in the country.

I do have a formal statement for the record, which I would like to insert, and see if I can highlight one or two points very quickly.

Mr. BROWN. Without objection.

Dr. SANDERSON. I think we have heard a great deal of testimony this morning about some of the problems, difficulties that have been encountered by small business in making its unique contribution to the innovative needs of our society. The National Science Foundation's program has also been mentioned a number of times as a method of approach. It was one of the program elements highlighted in the President's report on the domestic policy review of innovation, and the Foundation is very pleased to have received recognition.

It is always nice to win one occasionally.

The Foundation began to be involved with small business in 1971, at the time the research applied to national needs, RANN program, was instituted in NSF. In the first year of the RANN program, the Foundation made its first award to small business.

From that time, the participation of small business in NSF's program, particularly in my directorate, which is the engineering and applied science directorate, has grown steadily. In fiscal year 1975, which was the last year before congressional mandates were put on the program, about 5 percent of the research funds went into small business.

In fiscal year 1976 the Congress increased the ante on that by raising the required amount of participation in small business to 7.5 percent of the RANN program. That was increased to 10 percent in 1977 and 12.5 percent for subsequent years.

We have had a couple of activities which I highlight in my testimony. The Innovation Centers program, which is designed more to develop the innovative capability of our young scientists and entrepreneurs by coupling the problems of innovation, of small business formation, to the training that they receive in their undergraduate careers.

The more direct involvement with small business is the Small Business Innovation Research program, which you have heard discussed this morning.

of venture capital, easier to get in touch with larger companies which already have a marketing, manufacturing capability in areas where they want to innovate.

One of the more encouraging things is that a number of large firms, a number of venture capital firms, have standing requests with the National Science Foundation for a list of our winners, and they tend to contact those in their area of interest very quickly in order to make funds available, to get in on a piece of the action.

In my testimony I mention a couple of success stories which have occurred in the two solicitations of this type which we have already run. A third solicitation is currently in the print shop and we hope will be on the streets within a matter of days, so that we can begin the third round of these activities.

There are a number of other activities which the foundation undertakes, which I highlight in my testimony. In particular, Mr. Wirths, who is in the room today, is responsible for the National Science Foundation's Office of Small Business R. & D.

This provides a number of services to small business firms trying to deal with the National Science Foundation. It publishes a small business guide to Federal R. & D. which highlights opportunities in all Federal agencies as well as providing a contact on the average between 1,000 and 2,000 people per year dealing with small firms, trying to relate to the National Science Foundation's activities.

We also sponsor two conferences each year on Federal R. & D. opportunities. We have run those in a number of cities. We have two scheduled for next spring in Atlanta and Los Angeles.

The purpose of this conference, in which a number of Federal agencies participate, is going to go into the field, to sit down on a one-on-one situation and discuss with small companies in the area the research opportunities that exist for Federal support and the needs of the small business or the interests of small business to become involved in Federal R. & D.

With that, Mr. Brown, I think I would stop my statement and would be glad to respond to any questions you have.

Mr. BROWN. Let's proceed with Mr. Evans first, and then we will question both of you.

[The prepared statement of Mr. Evans follows:]

Agency engaged wholly in high technology efforts and, secondly, existence and success has required the application of new technology and has encouraged innovation. Over the twenty-one years of our existence this has been repetitively demonstrated by our Nation's achievements in space.

From the very outset, our space programs have been a national partnership of scientific, technical and managerial participation. There has never been a monopoly--and certainly not a Government monopoly--on ideas and creativity. NASA recognized this from the beginning--and throughout the Agency's twenty-one years the private sector has been a wellspring of innovation in space and aeronautics. Here the contributions of small business have been conspicuous and are reflected in a steady growth in our small business procurement. Today, approximately 82 cents of every dollar in our budget is put to work in some form with the educational, scientific and business community through our procurement process. In similar manner we acquire some 41% of the total manpower we need to conduct or support Agency operations by means of support service contracts. This extensive reliance on the private sector for innovation, technology growth and operational support will continue--and concurrently we fully expect small business participation to grow.

A high technology small business is currently conducting a significant R&D effort in automotive engine technology and increasing small businesses are participating in the solar energy research we perform on behalf of DOE.

Mechanical Technical Inc., Latham, NY, a small business, is NASA's prime contractor at the Lewis Research Center (LeRC) for the development of the Sterling engine for automotive application. MTI's contract is expected to total about $95 million if the development work continues to fruition in 1985.

Small firms are currently involved in about 30 percent of the energy effort at Lewis by contract value. This includes work in wind energy, automotive propulsion systems and fuels, photo-voltaic demonstration and energy storage systems.

At the Jet Propulsion Laboratory (JPL) small firms are also involved in about 30 percent of the energy programs work. This involves them in the low cost silicon solar array, electric hybrid vehicle and small power systems technology.

NASA's Marshall Space Flight Center is working directly with Department of Energy personnel in the development of building energy systems for heating and cooling. In this site demonstration effort small firms have received 35 of the 41 contracts involved, and 18 percent of the total contract value.

A summary of our small and minority business program results are attached hereto as Appendix II.

While we are gratified with the results of our past efforts in this area, our experience also encourages us to move ahead with some deliberate longer term initiatives calculated to involve the small business community more in mainstream of our major programs.

In this respect we are embarking on several concerted, coordinated initiatives. In mid-1978 the Administration established an Industrial Innovation Coordinating Committee under the Secretary of Commerce to address issues and problems bearing on industrial innovation. NASA has been a participant on the committee. NASA also has embarked on a program of Joint Endeavors with US domestic concerns calculated to encourage early usage of space for industrial purposess...initially primarily in the field of materials processing.

On June 25, 1979 NASA issued a Policy Statement of its intent to enter into transactions with US domestic concerns to achieve the objective of national technological superiority through joint action. This notice described the actions/transactions NASA would undertake and set forth the types of incentives NASA would offer in these terms:

concerns to pursue on a totally privately funded basis. Recognizing industry's key role in the successful innovation of any technology for commercial purposes, NASA has initiated a program effort to encourage and stimulate US industry's participation in the development of MPS technology to insure that development activities reflect the needs of industry in the future. We have had numerous discussions with industrial and Government officials and have undertaken a number of studies to determine how best to proceed. These studies and discussions indicated that a cooperative arrangement would best serve the purposes of NASA and industry.

NASA's general policy on the provision of incentives for innovation in the commercial user of space was followed by a NASA statement, "Guidelines Regarding Joint Endeavors with U. S. Domestic Concerns in Materials Processing in Space" carried in the Federal Register and Commerce Daily on August 14 and 28, 1979, respectively, announcing this activity (see Appendix IV). In such a joint endeavor, NASA and a US commercial firm would agree to be responsible for specific portions of a total endeavor. Each party pays for its portion of the work and equitably shares in the risk and return that may accrue. By design, the joint endeavor approach is a developmental activity, therein the institutional relationships needed to establish

on Small Business, NASA participated in the November 1978 Regional Symposium in Los Angeles at which Dr. Frosch, the Administrator of NASA, announced two initiatives by NASA to increase small research business participation in our Supporting Research and Technology Programs.

Simply stated, during each of the fiscal years 1979 and 1980 up to $10 million is being reserved for procurement awards to small business in NASA's supporting research and technology and early development activities. This is viewed as "seed money" to further avail to the Agency the unique qualities and creativity that small R&D firms can contribute in early research phases to broaden the industrial base supporting NASA's future projects and to promote economies through increased competition. The concept is being implemented as follows:

1. At the direction of the Deputy Administrator, the funds are reserved by the NASA Comptroller, and each of the five principal Headquarters Program Office Directors are requested to submit a priority listing of specific work projects susceptible to small business research effort.

2. A funding allocation plan is issued by the Comptroller which prorates the available funds among the Program Offices in the same ratio as their budgeted supporting research and technology funds.

selected areas of technology of specific interest to NASA in support of future flight projects--and secondly, to establish a small business base for the development and production of flight hardware for future NASA missions. If successful this will be a continuing program.

Our second objective--to foster small business participation in major flight programs...we intend to achieve by extending the use of small business subcontracting requirements in our major systems acquisitions wherever we identify specific components or portions of these systems which can be broken out for small business--and we know that small business capability exists. This will be particularly applicable where small firms have participated in our early supporting research and technology efforts. Through these two actions we expect to realize the benefits of an aggressive and growing small business contribution in our major programs.

Let me now Mr. Chairman address the subject of technology transfer and the commercial application of NASA developed innovation.

Under its Congressional mandate to provide the widest practicable and appropriate dissemination of the results of aerospace R&D, NASA operates a variety of dissemination and transfer programs

An example illustrating these efforts was provided recently by the University of Kentucky STAC which was instrumental in assisting a new firm, All-Weather Insulation, Inc. of Springfield, Kentucky, which now manufactures a cellulose insulation product made from shredded newspapers. The Kentucky STAC provided information about the proper chemicals to add to newspaper to meet federal insulation specifications and the proportions to mix the basic materials to yield uniform densities to meet the requirements of nonflammability and obtain an adequate R-factor. All-Weather Insulation is now manufacturing cellulose insulation and is marketing the product in Kentucky, Ohio and Indiana. With an initial investment of $170,000, the company is now generating revenues of $30,000 a month, employs nine workers, and anticipates revenues of over $400,000 by the end of this year. Thus the technical assistance provided by the NASA program at the University of Kentucky has created new job opportunities for Springfield residents, and the transportation of the paper to meet the firm's needs and added even more jobs to the labor base of that region.

The State Technology Applications Center at the University of Florida is broadening its state-wide coverage using the

In another example, the NASA IAC at the University of Pittsburgh held a 3-day conference late last year on microprocessor technology for small and medium-sized industrial firms in the Wilkes-Barre, Pennsylvania region in cooperation with the mayor's Office of Economic Development. The local Chamber of Commerce, Wilkes College, King's College, the Economic Development Council of Northeast Pennsylvania as well as the United Penn Bank of Wilkes-Barre also participated in this effort. Key to the success of this conference were technical survey papers on microprocessor applications by NASA engineers from the Lewis Research Center. Similar opportunities are being explored by other NASA IAC's to involve local government in the transfer of technology to small business in their communities.

The NASA Tech Brief Journal continues to be a popular source of innovative technical ideas for small business concerns, particularly small manufacturing firms who cannot afford major investments in either information or R&D. To some in small companies, having access to the results of somebody else's R&D (such as NASA Tech Briefs provide) is almost the same as having their own in-house R&D program. The popularity of NASA Tech Briefs in filling this need is evident by the number of small business who routinely receive them. Of the 55,000 firms who currently subscribe, approximately

In another case, NASA has recently licensed 36 companies to manufacture and commercialize an energy saving invention called the Power Factor Controller. Of the 36 companies licensed, at least half are small manufacturing firms. Additionally, this device, developed at the NASA Marshall Space Flight Center, has stimulated over 10,000 inquiries from utilities and other industrial firms during the past year. Although the device is relatively simple in design and operation, the Power Factor Controller's significance in potential savings is great because of the large quantity of energy consumed daily by electric motors in home, business and industry nationwide.

To demonstrate such energy savings, the Power Factor Controller was tested by plant engineers on an industrial sewing machine in a South Alabama textile mill. This mill has 3,700 machines, each driven by a 1/2-hp three-phase motor. In a 500-hour test on two identical machines, each performing identical tasks, the machine equipped with the Power Factor Controller consumed 33 percent less energy.

Once commercialized the amount of energy that could be saved on home and industrial appliances could be enormous. We are

F to 1600 F and is applied to hot glass processing machinery, and mechanical seals and rings for pumps, compressors and turbines.

In another example, Streamlight, Incorporated, a small Pennsylvania manufacturing firm, has developed a wide range of high intensity lighting products based on solar simulator technologies developed for environmental test chambers at the NASA Johnson Space Center. One commercial product based on this technology is called Stream Lite-20, a hand-held, rechargeable flashlight that is 4 to 5 times brighter than conventional flashlights. Streamlight has sold over 25,000 units already to homeowners, truckers, campers and police departments nationwide.

These examples illustrate just a few cases where small businesses have benefitted from NASA technology. In months and years to come we trust that small business firms will continue to enjoy the fruits of research and development resulting from NASA's aeronautics and space efforts. Whether small business is directly involved in NASA R&D directly or learns about new advances through NASA's technology transfer programs, there is ample evidence to show that small business enterprises benefit in large measure through aerospace technological innovation.

with the SBA, the Departments of Energy, Defense and Housing and Urban Development, and the National Bureau of Standards sponsored a two and one-half day conference here in Washington on basically the same subject as this hearing. Dr. Frosch, the Administrator of NASA, Mr. Floyd Roberson, Mr. George Deutsch, NASA's Director of Research and Technology, and I all participated in this conference the results of which we hope will indeed open up and improve communications between us. On this occasion, in addition to providing current information on our requirements, the Centers procuring them and our small business procurement programs and procedures, we were able to demonstrate, through the use of remote computer terminals, the actual operation and utility of our Industry Application Centers.

In my judgment the National Aeronautics and Space Act of 1958 has endowed the Agency with the basic authority it needs to innovate in this area. The heritage of this Agency is one of innovation and imaginative approach to a spectrum of challenges. The challenge of capitalizing on small business innovative resources is another. If we can retain the flexibility in our procurement process that we have developed over twenty-one years, I am confident that the small research companies role in our programs will grow.

Thank you Mr. Chairman, I will now be pleased to answer any questions the Committees may wish to ask.

NATIONAL AERONAUTICS AND SPACE ADMINISTRATION

OFFICE OF SMALL AND DISADVANTAGED BUSINESS UTILIZATION

PRIME CONTRACT AWARDS

Fiscal Year	Total Awards to Business	SB Awards	SB % of Total Bus.
1979(goal)	$3,105.0	$291.0	9.4
1978	2,953.8	283.2	9.6
1977	2,838.1	255.0	9.0
1976	2,536.1	218.3	8.6
1975	2,255.0	215.9	9.6
1974	2,118.6	181.2	8.6
1973	2,071.0	162.5	7.8
1972	2,146.5	164.1	7.6
1971	2,279.5	178.1	7.8
1970	2,759.2	161.2	5.8

DOLLARS IN MILLIONS NASA/K

APPENDIX II-1

NASA SUBCONTRACT AWARDS
TO SMALL AND MINORITY FIRMS
FISCAL YEARS 1970-1978

Fiscal Year	Total Subcontract Awards	Subcontract Awards to Small	Small Awards % of Total	Subcontract Awards to Minority	Minority Awards % of Small
78	916,277	274,396	29.9	29,637	10.8
77	988,423	277,683	28.1	27,441	9.9
76	910,171	249,038	27.4	16,010	6.4
75	811,904	207,556	25.6	11,448	5.5
74	602,744	156,770	26.0	7,771	5.0
73	499,629	129,029	25.8	3,208	2.5
72	614,057	154,210	25.1	NA	-
71	558,194	148,097	26.5	NA	-
70	527,191	142,417	27.0	NA	-

NOTE: Includes subcontract awards reported by large firms participating in NASA's Small Business Subcontracting Program, and NASA's contractor operated Jet Propulsion Laboratory. Minority subcontracting was not reported prior to FY-1973.

DOLLARS IN THOUSANDS (K) 10/12/79

As major areas for NASA enhancement of total U.S. capability, including the private sector, may become apparent from time to time, the factors to be considered by NASA prior to providing incentives may include, but not be limited to, some or all of the following considerations: (1) the public or social need for the expected technology development; (2) the contribution to be made to the maintenance of U.S. technological superiority; (3) possible benefits accruing to the public or the U.S. Government from sharing in results; (4) the enhanced economic exploitation of NASA capabilities such as the space transportation system; (5) the desirability of private sector involvement in NASA programs; (6) the merit of the research, development or application proposed; (7) the degree of risk and financial participation by the commercial concern; (8) the amount of proprietary data or background information to be furnished by the concern; (9) the rights in data to be granted the concern in consideration of its contribution; (10) the ability of the concern to project a potential market; (11) the willingness and ability of the concern to market and sell any resulting new or enhanced products on a reasonable basis; (12) the impact of NASA sponsorship on a given industry; (13) provision for a form of exclusivity in special cases when needed to promote innovation; (14) recoupment of the NASA contribution under appropriate circumstances; and (15) support of socio-economic objectives of the Government.

Robert A. Frosch
Administrator

25 June 1979
Date

achieve diversity in the program. The number and/or size of the joint endeavors undertaken will depend upon the nature of the proposals received and resource availability. All joint endeavors will be subject to availability of appropriated funds, as well as NASA procedures regarding flight safety and verification.

NASA Provided Incentives

NASA incentives for these purposes may include in addition to making available the results of NASA research: (1) providing flight time on the space transportation system on appropriate terms and conditions as determined by the Administrator; (2) providing technical advice, consultation, data, equipment and facilities to participating organizations; and (3) entering into joint research and demonstration programs where each party funds its own participation.

Facts to be Considered in Establishing Endeavors

To qualify for joint sponsorship, the offeror must be engaged in business in the U.S. in such a manner that any promising results from the endeavor will contribute principally to the U.S. technological position; the proposed joint endeavor must comport with one or more of the MPS program objectives as stated above; and the technical uncertainties and risk involved must be significant enough to warrant the government's participation.

The factors to be considered by NASA prior to providing incentives may include, but not be limited to, some or all of the following considerations: (1) the public or social need for the expected technology development; (2) the contribution to be made to the maintenance of U.S. technological superiority; (3) possible benefits accruing to the public or the U.S. Government from sharing in results; (4) the enhanced economic exploitation of NASA capabilities such as the space transportation system; (5) the desirability of private sector involvement in NASA programs; (6) the merit of the research, development or application proposed; (7) the degree of risk and financial participation by the commercial concern; (8) the amount of proprietary data or background information to be furnished by the concern; (9) the rights in data to be granted the concern in consideration of its contribution; (10) the ability of the concern to project a potential market; (11) the willingness and ability of the

EXAMPLES OF HIGH TECHNOLOGY FIRMS
INVOLVEMENT IN NASA SUPPORTING RESEARCH AND TECHNOLOGY

Infrared Detector Development

Alpha Lyra, Inc., is providing the technical expertise required to characterize infrared detectors proposed for use in cryogenically-cooled telescopes such as the Shuttle Infrared Telescope Facility and in airborne infrared telescopes such as the Kuiper Airborne Observatory.

Alpha Lyra, Inc., is performing exceptionally well and has contributed to the basic understanding of the use of the state-of-the-art infrared detectors in astronomical applications. The company is very knowledgeable in cryogenic infrared systems and possesses the analytical capability to complement its experimental expertise in cryogenically-cooled infrared systems.

The experience gained by the contractor will certainly enhance and strengthen its capability to compete for and obtain future R&D contracts in this new and rapidly expanding technology.

Theoretical Characterization of Small Metal Particles

Surface Analytic Research, Inc., is conducting a theoretical investigation of the properties of small metal particles. Specifically the contract calls for the computation of the following: (1) the intensities of electron beams diffracted off crystallographic planes of gold particles, (2) critical sizes and binding energies for particles growing on substrates, and (3) the properties of $CO(Pd)_5$ and $CO(Ir)_5$ clusters obtained from approximate solutions of Schrodinger's equation for the electronic degrees of freedom. This fundamental work assists experimentalists in understanding their measurements of gas-surface interactions and crystal growth which leads to improved materials and processes of interest to NASA. Contractor has obtained two additional related study contracts with NASA, thus demonstrating its ability to perform in this area.

APPENDIX V

innovation. NASA was a participant on subcommittees of that effort.

During that period of time, we embarked on a program of joint endeavors with U.S. domestic concerns that are calculated to encourage early uses of space for industrial purposes, initially in the area of materials processing.

To encourage this form of endeavor, we are prepared to offer a range of incentives, including flight time on the space transportation system on conditions other than full reimbursable terms.

We offer technical consultation, data, equipment, and facilities. This program also includes incentives and preference for small and minority business.

As of today, we have received three proposals as a result of this initiative, two of them small. They are presently under evaluation.

In the same time frame, and working in concert with the Small Business Administration and the White House Conference on Small Business, we participated in a regional symposium in Los Angeles in which our administrator, Dr. Frosch, made a major address.

At that point he announced two other initiatives we were embarking upon, both calculated to increase small research business participation in our supporting research and technology programs.

Simply stated, during each of the fiscal years 1979 and 1980, $10 million of our supporting research and technology funds have been targeted for procurement awards in small businesses, to support our research and technology and development activities.

Although we are still refining this effort within our 10 centers, we are gratified with the results to date. In 11 months of this fiscal year we have awarded 213 contracts to small research firms aggregating some $1.5 million. There are examples of this effort attached to my full statement.

I would also, Mr. Chairman, like to say a few words on technology transfer and commercial application of NASA-developed innovation.

We operate a variety of dissemination and transfer programs designed to encourage the secondary use of our technology in the commercial sector. We have a network of seven industrial application centers and two State technology centers located on university campuses across the country.

Additionally, we are initiating contacts with the Small Business Administration to investigate other possible means whereby our applications center network can beneficially cooperate in the promotion of small business access to national technologies in less developed regions.

The NASA Tech Brief journal continues to be a popular source of innovative technical idea for small business concerns. The popularity of this journal in filling this need is evident to us by the number of small businesses who routinely receive them.

Of the 55,000 firms currently subscribing, approximately 60 percent are small business.

The list of small business firms which have benefited from our space technology is legion. The examples in my full statement are merely illustrative of a few cases where small business has benefited from this type of technology.

only within the United States but by a number of countries, and several foreign countries either are currently setting up or planning to set up similar activities within their own borders.

Mr. WATKINS. I was very enthused by the program that you brought forth about the President, because I think it did indicate a mandate for agencies, NSF, working with NASA, Department of Commerce, other groups which I think some of us have indicated in writing and on paper some joint efforts like that should be worked in with the academic community of enterpreneurship.

I was very enthused about the information, how it was brought together, and I think it gives NSF and also NASA the direction or mandate to move in some directions we have talked about a great deal.

Let me ask you this specific question, Chairman Brown, a couple of quick questions. As you know, we are evaluating the charter of the foundation, and you may have indicated this, but do you feel like NSF is geared or can be geared to take care of our technology development and move out in the direction of innovation?

Dr. SANDERSON. Mr. Watkins, that is a very complex question. Wearing my hat as assistant director for engineering and applied science I think I have an extremely good group of people. I think we have a directorate which has the strong support of the Foundation and that we have identified a number of ways in which we can make important contributions to the innovation problem.

Overall, it's a very complex problem. I think you have heard this morning questions of taxation, questions of regulation, questions of capital formation, which are going to be very important. I don't think NSF can be, should be, viewed as the agency for innovation. I think there are a lot of places in which under the right opportunities the Foundation can make a strong and unique contribution.

Mr. WATKINS. By working together?

Dr. SANDERSON. Working together with. The National Science Foundation has no laboratories, does no research. We are in some ways in the unique position of being able to work with universities, with industry, with other parts of government, in identifying opportunities, moving into them——

Mr. WATKINS. Some——

Dr. SANDERSON [continuing]. Creating an innovative climate and——

Mr. WATKINS. Some of us are hoping this direction can be capitalized on by NSF and move out.

Dr. SANDERSON. As you know, the National Science Board has established a committee to work specifically with your committee in questions of the NSF act, and I think they would be very interested in commenting on this at some later time.

Mr. WATKINS. One other quick question. NASA, I know, work very closely with them on the Space Science Committee, also, just reviewing the budget there, 0.3 percent of NASA's R. & D. budget is utilized in technology utilization. NASA, we have talked in other subcommittees, is supposed to be taking the lead there. Do you think that that is an adequate amount, and appropriate to try to shift over in technology utilization, just 0.3 percent? Do you think maybe some more emphasis should be placed on the dollar budgets?

our total manpower that goes into our programs is in fact private sector manpower.

Mr. WATKINS. Does that include the U factor, phase of it also, do you know?

Mr. ROBERSON. I haven't done an analysis. It's at least half.

Mr. WATKINS. Mr. Chairman, I don't want to belabor this thing. We have a couple other colleagues here.

Mr. BROWN. Mr. Ertel.

Mr. ERTEL. I have no questions, Mr. Chairman.

Mr. BROWN. Gentlemen, I don't want to unduly prolong this but I would like to get at a couple of general areas. I was extremely pleased yesterday when the President's program was released to note the light in which the National Science Foundation was presented and the recognition of the success of these programs and the indication that there would be additional funds forthcoming in some of these areas.

If you were present at the hearing yesterday morning, on the other side of the Hill, I think you will be aware of the fact that the main thrust of the critical comments—there are many commendatory comments—was that we hadn't, the President hadn't given sufficient evidence of the importance of these programs and was not recommending either sufficiently broad or sufficiently enhanced resources for some of them.

Now, in order that we can put that in perspective, Mr. Sanderson, how does the President's proposed increase compare with your present budget?

Dr. SANDERSON. The Foundation currently runs one small business solicitation a year. That small business solicitation including both phase 1 and phase 2 runs about $6 million for an award of approximately 40 to 50 awards in phase 1 and approximately 50 percent success ratio in phase 2. With this $10 million we will certainly be able to run to, double our throughout of some small activities starting next year.

Certainly the scale which he is talking to of going up to something like $150 million a year across government represents orders of magnitude growth over anything that NSF is doing now.

In terms of the other activities that were mentioned in his message, the university-industry coupling program, as you are aware, that is also a relatively new program in the Foundation. This past fiscal year, 1979, we spent about $5.2 million of earmarked funds for university-industry coupling, and the way the program is organized we produced a matching amount out of ordinary program funds so that overall we put about $10 million into the university-industry coupling program.

The proposal of the President is to put $20 million of additional money into the earmark activity and assuming the same sort of ratio of coupling holds, that represents a several-fold increase in the program activity in NSF.

Mr. BROWN. Is there any problem that you foresee within the agency in terms of their capability to move ahead on this scale? In other words, you will be able to effectively utilize the additional resources while maintaining the quality of the program?

Dr. SANDERSON. We see no problem with that. Both of these programs have essentially been resource limited in the past. The

upon the experience that you have had in order to amplify the effects of these programs?

Dr. SANDERSON. I think there are several opportunities in government to diffuse the things that we have learned, and while saying that I think it's also important to realize that other agencies are doing a number of activities along these lines. The Department of Defense, for example, has established a number of centers. Our own materials research centers were transferred to us from the Department of Defense in the early 1970's.

There are a number of questions that have to be answered in making these transfers. NSF has a mission which is defined as a broad support of the Nation's scientific and technological base. A number of other agencies have very specific missions. So I don't think it's possible to generalize without looking at each specific case, seeing what the opportunities are, and seeing where there are opportunities to innovate, maybe not doing the sort of thing we are doing, but building on what we have learned to develop innovations that are suitable for the particular mission and agency involved.

Mr. BROWN. Perhaps I am belaboring this too much. Let me get to NASA for just a moment.

I have been interested, as have other members of the committee—Mr. Watkins just referred to it—to NASA's technology transfer technology utilization program for many years. While we feel it's an important and useful program, I think a general perception is it has not achieved the full potential that we would like to have seen. In other words, there has not been the aggressive utilization of space-generated new developments leading to widespread application or as widespread application in the civilian sector that we would like, and we continue to worry about that, and to see if there are reasons for it.

Let me ask you specifically, is there a problem in the patent area? And I take note of the fact that in the successful NSF program they have been very lenient with regard to patent provision. Is there a problem with NASA in being unduly restrictive with regard to patent rights that might stem from some of these developments, or are there other reasons that you might be able to pinpoint that would have inhibited, we will say, the wider diffusion of space technology than we have had through the small business mechanism?

Mr. ROBERSON. Mr. Brown, I think that the question of is there a problem in the patent area with NASA would possibly be more appropriately addressed to some of the people from outside the agency. I do know that NASA is going through a patent process review at the current time trying to come up with a plan to liberalize our policy. As you know, our policy is very liberal in terms of granting nonexclusive licenses and in those cases where we make a determination it is necessary to move the technology into the private sector. We do grant exclusive licenses.

However, the basic law requires that the patent reside with the Government and that the exception be made by the contractor. But there is serious review going on within NASA now of that policy.

The difficulty I would say in the really broad way is one of simple communication. The perception of most people of NASA R. & D. or NASA technology is that it is very, very high technol-

FDA or the National Institutes of Health for clinical evaluation, things of this nature. So that we in fact have interpreted our mandate liberally enough to do that.

The problem is there are so many problems we can work on at a time, and we run about 90 a year. The thing I think is now encumbent upon us to do is to transfer that process. We have learned what is necessary to make these products and I dispatch the problem, and technology, we have learned what sort of market analysis studies, cost analysis are necessary to do that.

I think it is time for us to try to get that process turned over to the private sector, and that is one of the things that we would like to address and we will do one pilot project where we will have an entire process going through like that addressing a problem for a small business industry that is being impacted by Federal regulations. But when we get to the point where it is time to do the prototype development, we will stop and offer that as a venture package to the private world. If that is successful, I think we will be in a position to have transferred the technique that we have developed.

Mr. BROWN. We mentioned the importance of communication. How well do you communicate with the people over at NSF who are experimenting with ways of solving the problem of new innovation?

Mr. ROBERSON. I think we all suffer the problem that we have enough things to do that we seldom have time, and I think because we do see each other quite often in front of your committees, we do meet at conferences, and we have had several meetings, I have had meetings myself with the Small Business Development Center people and SBA, and I think there is room for improvement in that communications channel.

Mr. BROWN. The message we get from our public witnesses here I think is consistently that the Government agencies sometimes are the worst enemies of the small businessman, because they do not have a concerted strategy, they do not have a uniform set of priorities about their programs of assistance. I think that is regrettable. It is understandable, but it is still regrettable. I think we have to look for ways in which we can improve on that.

Are you sure you don't have any questions, Mr. Ertel?

Mr. ERTEL. Thank you, Mr. Chairman. Very pleasant of you to ask, but I have no questions.

Mr. BROWN. Gentlemen, the bells indicate a very important vote on this fast-track legislation that we have on the floor right now. I think in the interests of keeping you from starving, we will adjourn the hearing at this point. Let me thank you very much for being here with us. I hope that it has been as helpful to you, in sitting through all of the testimony and noting the high importance attached to this subject, as it has been to me and to the other members of the committee.

The committee will be adjourned.

[Whereupon, at 1:30 p.m., the committee adjourned.]

APPENDIX

QUESTIONS AND ANSWERS SUBMITTED FOR THE RECORD

THOMAS J. DAVIS, JR., MAYFIELD II

Question. 1. How do economic incentives influence investor behavior?

Answer. Economic incentives are clearly the outstanding factor in influencing people in charge of wealth to invest. The reduction of the capital gains tax to 28 percent instantly stimulated the allocation of millions and millions of dollars into venture capital investment funds.

Question. 1a. What incentives can be created by federal policy to increase the utilization of innovative small business in the national economy?

Answer. Incentives that can be created by federal policy include (i) raising the amount of profits that are subject to the basic income tax before reaching the surtax level on companies that qualify as Small Businesses; (ii) abolition of the capital gains tax as a further stimulus to young entrepreneurs to take the risk of starting a new business; (iii) restore the restricted (qualified) stock option to the condition it was in during the 1960's with respect to securities of companies that were Small Business when the options are granted; (iv) revise rule 144 of the S.E.C. so as to remove any restrictions on the sale of stock held over two years in a corporation that has had a public underwriting. There is no sense in having two classes of stock (one unrestricted and the other restricted) resulting from the simple fact that the holders did not wish to sell at the time of the public underwriting. It is disclosure of the pertinent facts about the corporation that is important in protecting the public purchasers of stock, not the circumstances of its ownership. Investors abhor restrictions on free alienability of property.

Question. 2. Please describe the relationship between venture capital, job creation and small business.

Answer. At the time of the Steiger-Hansen Bill when reduction of capital gains tax was being debated, the American Association of Electronics manufacturers submitted the results of an extensive survey of the role played by new, young entrepreneurship companies in the creation of jobs.

The facts are startling. I attach a copy and urge you to look at pp. 7, 8, chart and following. As you will see new company formation is vital to the economy.

As I pointed out in my testimony, my own venture capital firm had investments, at the time I testified, in 23 companies totaling over $8 million. These were small, new companies five or six years ago when we made the investments. At the present time the aggregate annual sales of those companies totals over $132 million, and their employment exceeds 3,000 people. Incidentally, in the interim since I testified we have invested an additional $4 million in new or very young companies with a technology base—still further evidence of the effect upon entrepreneurs and venture capitalists of the reduction of the capital gains tax.

The statement of Dr. Edwin Zschau of the American Electronics Association before the Senate Select Committee on Small Business (February 8, 1978) showed dramatically that the growth in employment in the U.S. in the past twenty years has been contributed to overwhelmingly by recently founded companies, especially those with a technology base.

In particular, the contribution of young technical companies was disclosed by the study as spectacular. Seventy-seven companies founded between 1971 and 1975 were studied. For each $100 of equity invested in those companies between 1971 and 1975, there was produced in the year 1976 the following:

$15 in Federal Corporate Income Tax;
$15 in Federal Personal Income Tax;
$5 in State and Local Taxes; and
$70 in Foreign Sales.
$33 spent on Research and Development to produce better products

I hope the foregoing indicates clearly the relationship between venture capital, entrepreneurship, job creation and small business.

Question 3 a & b. Which would you find more desirable:

system—and most of the R&D conducted by small firms is federally funded. Even though the federal government R&D procurement system is very comprehensive, positive changes could be made that would much assist the small firm. Such possible changes have been stated in previous reports and testimony, and I will not repeat them here.

Question 2. Can a comparison be made between the cost/benefits of federally-funded R&D and industry-funded R&D in producing innovative technology? Which is the more effective policy: to encourage industry to invest in R&D in industry through tax and patent policies, or to support R&D in industry with federal funds?

Answer. With regard to a comparison between federally-funded R&D and industry-funded R&D, I will make the following comments. The comparison between federally-funded R&D and industry-funded R&D becomes one of determining where the R&D being performed is done most effectively on a dollar-per-dollar basis, and determining where federally-funded R&D is conducted versus where the industry-funded R&D is conducted. The latter question is straightforward, in that, the industry-funded R&D will be conducted by the industry itself.

For the federally-funded R&D, as you are aware, the bulk of this is also conducted by industry. The answer to the former question is also well known—small firms on a dollar-per-dollar basis are much more effective at producing innovative technology than are large institutions of any kind, including industry.

Therefore, in weighing the benefits of federally-funded R&D versus industry-funded R&D, on a dollar-per-dollar basis, the small amount of federally-funded R&D that goes to small firms produces a disproportionately large amount of innovative technology. Getting more federally-supported R&D into small firms' hands can be done through an increase of the total funding level or through federal government procurement actions which raise the percentage of federal R&D monies going to small firms. I personally prefer the latter, as I strongly support efforts to hold the line on spending and to balance the budget.

I would also like to note that tax incentives will not significantly encourage small firms to conduct additional R&D. They do not have the large profits for which tax incentives will be helpful to allow them to support additional amounts of R&D. What profits a small firm has must be used to finance survival and growth requirements. Tax incentives, therefore, will primarily encourage large companies to invest more of their financial resources in R&D. (Small firms badly need reduced tax rates, however, to provide capital for survival and growth.)

Also, I believe that a change in patent policies will not have any significant effect in encouraging industry to spend more money on R&D. The current patent policies in my opinion do not discourage industry from spending monies for such R&D purposes. A change in patent policies, although not encouraging significant additional amounts of R&D to be spent by small firms, could have a favorable effect on the application of innovative technology which does come from small firms.

DANIEL S. GREGORY, BREYLOCK MANAGEMENT CORPORATION

Question 1. The President's Domestic Policy Review has recommended an expansion of the NSF small business innovation program in fiscal year 1981 by $10 million. They also propose extending similar programs to other mission agencies with a total annual funding of $150 million. Do you expect this level of increased seed capital funding to produce a significant increase in small business innovation activity?

(a) How strong is the relationship between increased funding and increased innovation?

Answer. Federal funding of small business is an unlikely approach. Federal policies would be better directed toward restoring incentives and stimulating private capital formation.

There is a strong relationship between funding and innovation. This relationship is both quantative and qualitative. Funding sources should remain managed by the private sector by professionals experienced in the field of new company formation and innovation, and should look to standards and criteria as required to insure the success of those enterprises.

Question 2. How can the private sector provide more venture capital earlier in the game to innovative businesses?

Answer. Restraints on assembling of more venture capital can be found in the disincentives in the Federal and State tax policies with particular reference to the provisions to tax capital gains even though some progress has been made on this front.

[Attachment 2]

CONTRACTOR REPORTS REQUIRED BY GOVERNMENT

	No. of estimated pages	Comments
I. Securities and Exchange Commission:		
1. Monthly reports, form 8K—Report of certain unusual events of interest to investors. Filed as required.	5 pages (9 copies)	Useful report.
2. Quarterly report, Form 10Q—Financial results for quarter and related management analysis.	12 pages (9 copies)	Useful, but ever increasing requirements make it overly difficult to comply.
3. Annual report, Form 10K—Complete description of business, financial statements, five year financial history, management analysis, and miscellaneous information.	35 pages (9 copies)	Useful, but ever increasing requirements make it overly difficult to comply.
II. Government property:		
1. Annual inventories of property to each agency from which Biospherics has received property.	1–2 pages (3 copies) to 3 different agencies.	Useful.
2. Annual updates to Government property manual for all changes required by government regulations. (Note: NASA sends 3 different auditors to annually audit property utilization, accountability and recordkeeping.	2–3 pages (1 copy)	Obviously drafted for large firms making extensive use of Government property—Nonsense for small firms.
III. Government security:		
1. Semiannual status reports	1 page (1 copy)	Useful.
2. Updates of Biospherics' industrial security manual to comply with changes in Government regulations. (Note: The Industrial Security office conducts semiannual ½ day audits of Biospherics' industrial security.	2–3 pages (1 copy)	Useless for us who have no classified information.
IV. Defense Contract Audit Agency:		
1. Annual Report of costs. (See letter attached requires 40 hrs to prepare).	10–12 pages. 1 copy with additional copies to EPA and NIH.	Basic idea is fine, but agency is asking us to do its work.
V. Contract reporting:		
1. Monthly financial reports	1 page. 3 copies for 8–10 contracts.	Duplicates in different format our invoices, unnecessary.
2. Annual patent reports	1 page. 3 copies for 3–4 contracts.	Useful.
VI. Occupational health and safety report:		
1. Annual report to States of hours worked and accidents by catregory.	2 pages	What good this report does anyone is a mystery.
VII. Group insurance reports:		
1. Annual reports to Department of Labor for health, life, disability and pension plans.	2 pages	Useless.
VIII. Equal employment opportunity:		
1. Affirmative action Plan [1]—Updated annually and including extensive labor area and employment statistics (estimated 80 hrs to prepare).	51 pages	A good idea run amuck.
2. EEO–1—Annual statistical report on minority hiring (estimated 8 hrs to prepare).	2 pages	Useful to insure compliance.
3. Veterans Administration report—Report of number of veterans hired.	1 page	Useful to insure compliance.
IX. Small business and small disadvantaged business subcontracting plan:		
1. Required in contracts with government of $500,000 or more (3–4 days to prepare) requiring the following info:	Estimated 20 pages (4 copies)	Ridiculous requirement.
(a) Small and disadvantaged source lists		
(b) Organizations contacted for small and disadvantaged sources.		

[1] There are conflicts in affirmative action about priorities among black, women, disadvantaged, veterans, etc.

BUSINESS RECORD EXEMPTION OF THE FREEDOM OF INFORMATION ACT

HEARINGS

BEFORE A

SUBCOMMITTEE OF THE COMMITTEE ON GOVERNMENT OPERATIONS HOUSE OF REPRESENTATIVES

NINETY-FIFTH CONGRESS

FIRST SESSION

OCTOBER 3 AND 4, 1977

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APPENDIXES

BUSINESS RECORD EXEMPTION OF THE FREEDOM OF INFORMATION ACT

MONDAY, OCTOBER 3, 1977

HOUSE OF REPRESENTATIVES,
GOVERNMENT INFORMATION
AND INDIVIDUAL RIGHTS SUBCOMMITTEE
OF THE COMMITTEE ON GOVERNMENT OPERATIONS,
Washington, D.C.

The subcommittee met, pursuant to notice at 10 a.m., in room 2203, Rayburn House Office Building, Hon. Richardson Preyer (chairman of the subcommittee) presiding.

Present: Representatives Richardson Preyer, Leo J. Ryan, Ted Weiss, and Paul N. McCloskey, Jr.

Also present: Timothy H. Ingram, staff director; Catherine Sands, minority professional staff, committee on Government Operations; and Robert Gellman, Office of General Counsel, General Accounting Office (on assignment to the subcommittee).

Mr. PREYER. The subcommittee will come to order.

Our hearings today and tomorrow will focus on problems related to the use by businesses and corporations of the Federal disclosure law—the Freedom of Information Act.

We will focus on the fourth exemption of that act, which deals with trade secrets and commercial or financial information obtained from businesses or individuals which is considered privileged or confidential. This "trade secrets" exemption allows Federal agencies the option of withholding from public release documents in their possession which were supplied by private firms and which meet the criteria set out in the exemption.

We will look at the procedural problems associated with sorting out what proprietary data can be released and what should not be released.

During these 2 days of hearings, we also will look at the recent development of so-called reverse Freedom of Information Act lawsuits. These are suits in which a private company will seek a court injunction against the release of material supplied by it to the Government. The difficulty is that the court will place a mandatory bar on the release of data which, under the discretionary exemptions of the Freedom of Information Act, the agency might otherwise be able in its judgment to disclose publicly.

The Federal Government plays an enormous role in the business world as a major purchaser of goods and services and as a regulator of industry. We are all aware of the large quantities of commercial information acquired by the Government. Much of this information involves the functions and operations of Federal agencies and is releasable under the Freedom of Information Act.

However, Congress has always recognized that some information supplied to the Government from private parties should not be released.

The procedural questions may be easier. A number of procedural devices have been adopted by agencies in order to make the decision-making in exemption 4 cases similar and more equitable. We hope to explore some of these procedural alternatives.

These are some of the questions we will be asking:

Should submitters of information receive advance notice of a pending release and an opportunity to object to release at the agency level?

Should confidential information be identified as such and marked when initially submitted to an agency?

Can agencies use rulemaking procedures to establish categories of information that are always releasable or always withholdable?

Should there be some type of formal agency procedure when the submitter objects to release of information?

Which of these procedures can agencies adopt on their own under the Freedom of Information Act or other existing legal authority?

Reverse Freedom of Information Act suits present different problems. As I mentioned at the outset, a "reverse case" arises when the party who supplied the records sues to prevent an agency from releasing material which the party claims is exempt from release under the act.

These cases have been developed by the courts in response to a clear need, but there are no guidelines in the act for the handling of these lawsuits. As a result, different courts have reached different results on some of the procedural aspects of these cases. Legislation may be needed to untangle these.

Most of the "reverse cases" have arisen under exemption 4. Since some of the administrative procedural reforms possible under exemption 4 may have an effect upon the treatment of "reverse cases" by the courts, it is important to deal with this area as a whole.

We will hear from three agencies which have received the majority of business access requests under the disclosure act and from several attorneys familiar with these cases.

Our first witness is Michael A. James, Deputy General Counsel of the Environmental Protection Agency. He is accompanied by James Nelson, also of the Office of General Counsel.

We welcome you both here today. Mr. James, we will ask to to proceed in any way that you prefer.

STATEMENT OF MICHAEL A. JAMES, DEPUTY GENERAL COUNSEL, ENVIRONMENTAL PROTECTION AGENCY; ACCOMPANIED BY JAMES NELSON, OFFICE OF THE GENERAL COUNSEL

Mr. JAMES. Thank you, Mr. Chairman.

It is a pleasure to appear before the subcommittee this morning to relate EPA's experience with exemption 4 of the Freedom of Information Act.

The diverse statutory mandates of EPA require the Agency to handle large quantities of information dealing with internal practices and processes of businesses of all sizes. In handling this information, EPA is faced with the same dilemma that faces most regulatory agencies.

That is, how to insure that the disclosure dictated by the Freedom of Information Act is accomplished, while insuring that the legitimate interests of businesses submitting information will be protected.

mation to evaluate whether specific information is entitled to confidential treatment, the Agency decided to ask the affected business to submit substantiating information. In this way, the Agency has more information upon which to make its decision. The pro forma initial denial gives the Agency time to obtain the substantiation and to use it in making a final confidentiality determination.

At the time the program office issues its initial denial to the requester, the office also sends a letter to the affected business asking the business to substantiate its claim of confidentiality. This substantiation must address several issues, including whether the information is available to the public through legitimate means, how the business protects the information, and whether the business asserts that release of the information would cause it substantial competitive harm.

The business' substantiation goes to the EPA legal office which makes a final confidentiality determination. This determination is the final Agency action under the Freedom of Information Act and is reviewable de novo by the Federal district courts. The final determination is made whether the requester appeals it or not.

The making of the final confidentiality determination is the most difficult part of the process. The EPA legal office receives the substantiation from the affected business and any pertinent information and opinions from the EPA program office. This information may not be enough to guarantee that the legal office can make a fully informed decision.

Under the Freedom of Information Act fourth exemption case law, and in particular *National Parks and Conservation Association* v. *Morton*, two tests have been set out that are crucial to a determination whether information is exempt or not. The tests are that information is exempt from mandatory disclosure if disclosure of the information would be likely: first, to cause substantial harm to the competitive position of the person who supplied the information to the Government; or second, to impair the ability of the Government to obtain necessary information in the future.

The test most often applied is the test of substantial competitive harm. The problem with this test is that it requires the Agency to make a substantive judgment concerning what is competitive harm to a particular business in a particular instance and whether the harm is likely to be substantial. This is a factual determination, as well as a legal one, and it calls on the Agency to make prospective judgments. As I noted above, however, the Agency seldom has much information with which to make this judgment. EPA does receive the substantiation from the affected business in which the business makes its case as to whether there would be substantial competitive harm and what the harm would be. But EPA is at a disadvantage because it cannot test the validity of the business' assertions without specialized knowledge of the business or the particular industry. This is information that EPA seldom has. The result is that, in most cases, EPA must accept the business' contention as to the existence of subtantial competitive harm.

In very few cases does EPA find information not to be confidential based on the lack of substantial competitive harm. EPA is more likely to find information is not confidential because it's already available to the public through some means of disclosure other than EPA.

The second *Morton* test is not used very often at EPA, because EPA has statutory authority to obtain most of the types of information that

determination. The advance determination states that if the business formally submits the information to EPA, EPA will hold some, all, or none of it confidential. This determination is the final determination. If a request were made later for this information, EPA would deny that request in accordance with the advance determination. If the advance determination states that some or all of the information is not confidential, EPA returns the information to the business.

The advance determination is of limited utility. It can only be used in situations where EPA has no statutory authority to compel submission of the information by the business. If EPA has statutory authority to compel submission, EPA will not make an advance determination because the business cannot refuse to supply the information.

The other type of special determination is called a "class determination." In some cases, EPA acquires the same type of information from many different businesses. To simplify the process of dealing with confidentiality claims covering this information, we use class determinations where a particular class of information is identifiable and the issues involved in consideration of whether it is confidential or not will be the same regardless of who submitted it. A class determination may state which information is never entitled to confidential treatment or which information may be entitled to confidential treatment and under what circumstances. We never use a class determination to declare all information of a certain type confidential. Under the Freedom of Information Act case law, we are still obligated to make ad hoc determinations. The class determination is a procedural tool to simplify the work of the legal office in writing individual determinations.

All of the procedures I have discussed above are predicated on our being able to identify confidential business information. One of the most difficult aspects of the fourth exemption is the problem of identification. We have found that the best way to identify confidential business information is to ask the businesses to initially identify it for us.

This is done in one of two ways. When EPA makes a written request for information that EPA believes is likely to be considered confidential by the business, EPA gives the business notice that it may assert a business confidentiality claim covering part or all of the information. The notice states how the business should assert its claim and indicates the regulations that apply if a claim is asserted. The notice also states that if the business fails to assert a claim at the time it submits the information to EPA, EPA may make the information available to the public without further notice to the business.

Of course EPA also possesses information that was not submitted to the Agency in response to a request that contained such a notice. In those cases, the business has not had an opportunity to assert confidentiality. If we believe that the information is of the type that is likely to be considered confidential by the business, we contact the business, usually by telephone, to ask whether the business desires to assert a confidentiality claim. These inquiries are only made if there is a Freedom of Information Act request pending or if we are proposing to disclose the information to the public for some other reason.

By doing this, the initial burden of identifying confidential business information is placed on the affected business. The advantage of this

firms. More agency denials of these requests have been based upon exemption 4 than other exemptions. In calendar year 1976, EPA initially denied 168 out of 4,113 requests received. Of these 168 denials 83 were based in whole or in part on exemption 4. This is almost 50 percent.

I would like to address one other issue that is related to this problem of confidential business information: sharing of information among Federal agencies. EPA has taken the position that it will disclose confidential business information to another Federal agency if EPA receives a written request signed by a duly-authorized official or employee of the other agency and if the request sets out the official purpose for which the information is needed. If EPA supplies information to another Federal agency, EPA notifies the other agency of any unresolved business confidentiality claims covering the information and of any determinations made by the EPA legal office that the information is entitled to confidential treatment. The other agency must agree not to disclose the information unless: first, the other agency has statutory authority both to compel production of the information from the business directly and to make the proposed disclosure; or second, the other agency has obtained the permission of either the EPA legal office or the affected business to disclose the information. EPA maintains a record of these types of disclosure for at least 3 years after disclosure.

No statutes prohibit disclosure of confidential information in EPA possession to other Federal agencies. In the new Toxic Substances Control Act, EPA has authority to disclose information to any Federal employee who has duties under any law for protecting health or the environment.

In addition, the Toxic Substances Control Act authorizes other Federal agencies to furnish information to EPA that EPA needs to administer the act. EPA intends to use this authority, coupled with the authority to furnish information to the other agencies, to promote a general sharing of information among the agencies responsible for protecting health and the environment. We believe this will benefit the public by allowing the agencies involved to coordinate their actions better, and it should benefit business by helping to minimize duplicative requests for information.

Thank you very much, Mr. Chairman. I will be pleased to answer any questions you or the members of the subcommittee may have.

Mr. PREYER. Thank you very much, Mr. James.

I congratulate EPA on making some systematic effort to deal with these problems and setting up a policy on it.

When submitters submit information to you, do they tend to mark everything confidential?

I think you indicated that as they become more familiar with your system, they become more selective.

Do you require, at the outset, for example, that they give reasons for it being marked confidential, or do you just ask them to mark it confidential?

Mr. JAMES. We do not require the reasons initially. We require substantiation only when there's a request for disclosure or we attempt, for our own reasons, to disclose.

Initially the experience of the agency was that confidentiality claims were asserted very broadly by business.

Mr. PREYER. Perhaps he could be given notice at the same time that you give the submitter notice, and the requester may have an opportunity to file a brief or statement as to what policy reasons, for example, might be involved that would argue for its release.

Mr. JAMES. Are you referring to release notwithstanding the fact that it had been determined by us to be confidential business information.

Mr. PREYER. No.

I would think he would be arguing—when I say he, I mean the corporation, the requester of the information—would be arguing the point of whether it's confidential or not.

Of course, the requester would not be in as good a position to argue that as the submitter.

Mr. JAMES. Yes; that's true.

Since the requester gets no look at the information—even a special limited use look at the information—the requester's ability to comment knowledgeably on the information is extremely limited.

I would imagine that we would get arguments based on minimal information—it would have to be based on minimal information—from the requester.

Mr. PREYER. I have gone a little more than 5 minutes.

Mr. Ryan, do you have any questions which you would like to put to this witness at this time?

Mr. RYAN. Mr. Chairman, I am so confident of your leadership in this area that I have left it pretty much to you. This is an area that is extremely important to law, but it is also very narrow. It helps to employ a great many lawyers who, obviously from the testimony of the witness just now, have indicated among other things that in almost every case that comes before them it requires some kind of judgment based upon a knowledge of legal matters.

That, in itself, is of concern to me. But I simply see no place else to go.

I would defer any further questioning to those members on the subcommittee who are more able to help us pick our way through this legislative and legal minefield. I refer to my friend and colleague from San Mateo County, Mr. McCloskey. He is a member of the bar of the State of California.

Mr. PREYER. Thank you, Mr. Ryan.

We'll ask "Minefield" McCloskey if he has any questions for the witness.

Mr. MCCLOSKEY. I was one of the lawyers who played a part in the draftsmanship of this act. I do worry that we have created jobs for too many lawyers, and your testimony is indicative that that may be the case if we have 70 agencies and you're using 2 lawyers full time to process these applications in your single agency. Is that the way I understand your testimony?

Mr. JAMES. Yes. We have two lawyers who are virtually full time, and then there are some, of course, who review above them. So, in fact, it involves more than two individuals in the process.

Mr. MCCLOSKEY. The expertise that your lawyers are gaining in this field probably makes them employable at $100,000 a year by half the corporations in America, so they shouldn't be too unhappy about becoming experts in this field.

spent in these 168 cases, I think it would be helpful to us in trying to appraise whether or not this act is imposing too much paperwork and burden and who is offended by it and who is benefited by this law.

Mr. JAMES. We'll be happy to supply that information.

Mr. MCCLOSKEY. I'd be interested in the breakdown also for 1976 of the man-hours that were put into the administration of the law and the man-hours that were put into legal interpretation by your office of these denials and the man-hours involved in any lawsuits—and perhaps a thumbnail sketch of each lawsuit—who it was brought by and for what purpose.

Mr. JAMES. The figures on hours will have to be approximate.

[See p. 21.]

Mr. MCCLOSKEY. I understand that, and I'm delighted to know that the Government isn't keeping meticulous 10-minute records of each attorney's time in order to bill them at $50 an hour or whatever.

You stated on page 12 of your testimony:

> We are educating our personnel about these procedures and, most importantly, sensitizing them to the problem of confidential business information.

I take it you do that by memos to your staff as to the legal problems involved?

Mr. JAMES. That's the standard approach.

Mr. MCCLOSKEY. Do you have any problem furnishing this committee with those memos by which you sensitize your employees?

There's no Freedom of Information problem there? [Laughter.]

Mr. JAMES. To the extent we can dredge them up we will supply them to you.

[See app. 2.]

Mr. MCCLOSKEY. I am interested in how EPA sensitizes its employees—just as a practical question.

Mr. JAMES. A great deal of this kind of educating and sensitizing is done over the telephone and through meetings, as well as by memos.

Mr. MCCLOSKEY. And, as good lawyers, after those phone calls, you generally follow up with a letter confirming that these things were said over the telephone; do you not?

Mr. JAMES. Probably rather seldom.

Mr. MCCLOSKEY. I'm trying to give Mr. Ryan some idea of how this dubious profession works.

Mr. RYAN. I think I know too much already. [Laughter.]

Mr. JAMES. I rather imagine that there is seldom time to do a follow-up in writing, except where there is some understanding between our office and another office that is really very critical or crucial.

Mr. MCCLOSKEY. There is a built-in conflict in your agency between the enforcement of the antipollution laws and the retaining of confidentiality information that may be helpful to a competitor.

If you have a pollution enforcement case on, say, water pollution and the company involved—let's call it a paper factory in Maine—submits information which indicates that they are polluting the Androscoggin River with a certain degree of chemicals and clearly is information they do not want made public, is there any basis for keeping that information confidential under this business competition rule?

Mr. JAMES. No; there's not. There is a specific statuory override, if you will, in the Federal Water Pollution Control Act.

Mr. RYAN. I appreciate the gentleman's yielding. I don't know that it's quite that simple.

Mr. MCCLOSKEY. I have exceeded my time. I will yield at this point, but I have some followup questions, if I may, Mr. Chairman.

Mr. PREYER. Mr. Weiss?

Mr. WEISS. Thank you, Mr. Chairman.

The information and statistics that you have on page 13 of your statement: do those refer to all of the requests under this statute, or only for confidential business information?

Mr. JAMES. Those are all requests—at least all requests that are sufficiently formal to have been recorded.

Mr. WEISS. Do you have a breakdown as to how many of those were construed to be confidential business information items?

Mr. JAMES. I do not believe we have a breakout approaching it that way.

Mr. WEISS. You indicated that there were 168 items that were denied, and 83 of the denials were based in whole or in part on exemption 4. That's on the top of page 14.

Now it would be helpful for me to know what percentage that 83 is of the total number of exemption 4 considerations or requests—confidential business information. Could you gather that information?

Mr. JAMES. We could try to obtain that information. I'm not sure whether it exists.

Mr. WEISS. Would you be able to surmise this. For example, if that 83 were 83 out of 83, or 83 out of 100, it would be one thing; if it were 83 out of 500, it would be something else. But give us some indication as to how this automatic denial kind of process really works and how much information is due to the confidential nature ultimately.

Mr. JAMES. Mr. Nelson just reminds me that these regulations we're operating under now have only been in effect for about a year; so some of the figures that are 1976 figures here are figures reflecting requests that occurred before these regulations went into effect and established the confidential business information type of review structure quite formally. Before it was less formal and less structured.

Mr. WEISS. Did you, in the course of your statement—perhaps while I was out of the room—have occasion to indicate how many of the reverse suits the Agency has been subjected to?

Mr. JAMES. We have one under the Freedom of Information Act itself. We have 10 other cases under FIFRA right now, which are a source of problem that we've addressed in some testimony on the pending amendments to FIFRA.

Mr. WEISS. I guess those are instances in which the Agency had indicated that, in fact, it would provide the information? Or before you ever got to that position, the company on whom the request was made came in and started an action?

Mr. JAMES. It has actually been a combination of those two approaches.

Mr. WEISS. So, in other words, they don't wait until you've made the determination. Rather than take the chance that you're going to find that the information can be released, they come in and start an action.

Mr. JAMES. A number of them apparently sued on the basis of their fears that we would release, rather than upon the basis of specific information requests that someone had made.

Mr. McCLOSKEY. In your submission of responses following up this hearing, would you give us some data on how the code is defined—including copies of a computer printout that reflects the coding?

That's another matter of interest to this committee as to how, with a computer system this vast in the Government, we protect the privacy of information, as well as that which can be released?

I would like to see, for example, a routine computer printout and pages that reflect some information that must be kept secret and some information that must be released under the FOIA.

Mr. JAMES. We will provide that to you as soon as possible.

Mr. McCLOSKEY. We'll try to submit a followup letter to you defining these questions with particularity, so that you can respond in 10 days with the use of these lawyers dedicated to this purpose. [Laughter.]

Thank you.

Mr. PREYER. Thank you.

[The material follows:]

(4) breakdown of the number of man hours required for (a)the administration, (b) the legal interpretation, and (c) lawsuits involved with the processing of the b(4) exemption of the Freedom of Information Act dealing with trade secrets and commercial or financial information;

(5) as mentioned in your statement,of the 168 denials of information requests under the FOIA, 83 were based in whole or in part on exemption 4. (a) How many of these denials were appealed? (b) How many of those appeals were declined? (c) How many of the declined appeals led to a lawsuit? (d) As a result of the lawsuit, how often was additional, previously "confidential" information released? (e) As a result of the lawsuit how often was all of the previously "confidential" information released? (f) In either (d) or (e) was "confidential" information released prior to the case going to trial but after the initial appeal was denied?

Sincerely,

Paul N. McCloskey, Jr.

Data in NEDS is received from individual states. The states indicate whether data that would fall within the three blocks is confidential. If the state reports the data as confidential, the data is keypunched into NEDS with a confidential designation. This designation triggers a printout such as the attached and can produce a deleted version as discussed above. If the state reports the data as nonconfidential, it is keypunched into the system as nonconfidential.

3. Attachment E includes copies of a few memoranda that have been sent to various program offices within EPA concerning confidential business information. As Mr. James stated in his testimony, most of the work done at EPA to educate and sensitize EPA employees about confidential business information is carried out in meetings and over the telephone. None of these sessions are reduced to writing.

4. It is not possible for me to give you a breakdown of the time spent on specific aspects of exemption four matters. As Mr. James stated in his testimony, we do not keep records of attorney time. Two staff attorneys spend nearly full time on Freedom of Information Act and Privacy Act matters. One attorney works full time and another works about 21 hours per week. In addition, at least three other attorneys are involved in a supervisory capacity, including me. By far the largest portion of the FOIA work relates to confidential business information. Much of the confidentiality related work, however, is not in response to FOIA as such. It involves specific matters arising out of EPA's day-to-day work. Confidentiality, as an issue, arises in many contexts other than FOIA. For these reasons it is not possible to estimate the number of hours required for the various matters in your question.

5. In Mr. James' testimony, he mentioned figures concerning FOIA requests involving exemption four. Those figures were for the period preceding the adoption of EPA's current regulations. As you requested, I have asked EPA's Freedom of Information Office to compile figures for the Agency for the period from September 30, 1976, through September 30, 1977. I will use those figures to answer your fifth question.

During that period, EPA denied 115 requests based upon 5 U.S.C. 552(b)(4). In addition, 4 requests were denied based upon both 5 U.S.C. 552(b)(4) and (b)(5), and 1 request was denied based upon both 5 U.S.C. 552(b)(3) and (b)(4).

(a) Of these 120 denials based in whole or in part on 5 U.S.C. 552(b)(4), 14 were appealed.

Mr. PREYER. I have just two final questions that I would like to ask. One deals with the question of notice.

You've given us considerable testimony on the kind of notice that you give to submitters of information, and I congratulate you for it. It seems to me a part of due process to do it.

The FOI Act does not, of course, require formal notice; but I take it that you feel it is a good idea to give notice to submitters? You would encourage that in the act I would take it.

Mr. JAMES. I think it would be appropriate to have it included in the act; yes.

Mr. PREYER. If it was put into the act, how much extension of the existing time limit for responding to a request would be necessary if we were going to give notice to the submitter? From your experience, would we need to extend that?

Mr. JAMES. I haven't given any thought to it. I'm sure the Agency hasn't come up with any position on it.

Our 10-day period in our regulations, I suppose, could be at least used as a point of departure for discussion as to what would be an appropriate time.

Mr. PREYER. I understood you to say that the submitter of information was given 10 days to respond to a notice of release; is that right?

Mr. JAMES. Yes.

Mr. PREYER. Is that enough time, from your experience, or do you find them requesting extensions?

Mr. JAMES. They usually do come back within that time.

Mr. PREYER. You have given us some figures here that the greatest use of the act is by corporations and law firms. And not too much by individuals and public interest groups. We've been hearing this from many sides.

The FOI Act allows any person to make a request for information, regardless of their purpose for it. Do you think there is any reason why the act should not apply to businesses, as well as to the press or individual citizens?

Mr. JAMES. You mean from a public——

Mr. PREYER. Even though business appears to be perhaps abusing the intent of the act in some cases?

Should we change the law to say that businesses can't use it? That it doesn't apply to businesses as far as making requests for information under it?

Mr. JAMES. There, I suppose, you get into difficult questions such as individual proprietorships versus partnerships versus corporations.

I think at times there are certainly legitimate purposes businesses have in making these requests. Or at least I am willing to assume that for the most part their requests are legitimate need-to-know sorts of requests.

One area in which they, frequently through counsel, use the request is as a means of discovery in connection with lawsuits or potential lawsuits.

It is a means of direct review of Agency action cases—a means of discovery. That is, in those cases that are not recognized by the rules of appellate procedure. However, since there is nothing by way of discovery for appellate litigation, FOIA seems to fill a gap.

tions under several civil law enforcement programs. In addition, there are provisions in some of the statutes administered by the Department which require the submission of such information. Business information comes to us voluntarily, for example, in support of the many crucial statistical studies conducted by the Bureau of Labor Statistics, such as the Consumer Price Index. The Wage and Hour Division, on the other hand, may need to collect business data in order to determine whether a company comes within the definition of a covered enterprise under the Fair Labor Standards Act. The Occupational Safety and Health Administration may have access to trade secrets because of its conduct of safety and health inspections in plants. How and to what extent disclosures are made of this information to the public may be affected by various statutes; but, primarily, disclosure in Federal agencies is governed by the Freedom of Information Act.

The underlying purpose of the Freedom of Information Act is to allow access to Federal records and information so that citizens may know how their Government operates. We support this principle and believe that the act should be construed liberally so as to provide the public with the maximum information possible consistent with the law and the effective functioning of the Government. However, we also realize the potential conflict between a public interest in obtaining information in a particular area and potential harm which might result from releasing information on individuals or businesses. It is the balancing of these conflicting interests which concerns us in responding to requests for business information under the Freedom of Information Act. While the Department has received numerous requests under the act for documents containing trade secrets or business information, the greatest activity has centered around requests for access to affirmative action plans and related documents.

Under Executive Order 11246, the Office of Federal Contract Compliance Programs is responsible for promoting and insuring equal opportunity for all persons without regard to race, color, religion, sex, or national origin, employed by or seeking employment with Government contractors or with contractors performing under federally assisted construction contracts. One method of evaluating compliance with the requirements of the Executive order and of focusing in on problem areas is through the development of written affirmative action programs by contractors.

Large Federal contractors are required to develop a written affirmative action plan and retain the plan for submission to the compliance agency in the event of an audit. An affirmative action plan includes data such as job titles, a breakdown of minorities and women workers, the general rates of pay and a description of job progression for all employees. The development of affirmative action plans and supplemental reports is a vital tool in the implementation of the aims of the Office of Federal Contract Compliance Programs to insure equal employment opportunities for all working men and women. Disclosure of information as to the manner and extent of compliance by contractors assists the Department in meeting its goals and informs the public on a matter which is of interest to all citizens. On the other hand, complete disclosure of internal business practices of individual companies could have a detrimental effect on those businesses in their competitiveness within the business community. In an effort to balance

sought judicial relief by obtaining temporary restraining orders so as to protect the record from disclosure. In addition, companies and requesters have sought review of determinations either to disclose or not to disclose through the district courts. At present, there are approximately 25 cases pending in the district courts or the courts of appeal which were filed by contractors.

Several courts have ruled on the disclosability of the affirmative action plans and related documents. As I understand it, these decisions are in conflict so that this issue is not yet settled. However, the courts are in agreement that each plan must be considered on its own for a determination as to the impact on the contractor's business if disclosure is made. We believe that the procedures adopted by the Department of Labor are in keeping with the decisions of the courts for a case-by-case review.

We recognize that the current practices followed by the agencies and the Department of Labor for notice and appeal are time consuming. This time is extended if the matter is submitted to the courts for a determination. Whether a different type of procedure, such as formal adjudications under the Administrative Procedure Act, would serve to reduce the time required for review is a question which will have to be studied carefully. However, as with all our regulations, we are conducting a continuing review of our regulations in order to develop procedures which will equitably balance the interests of both the companies and the public.

My colleagues and I would be pleased to respond to any questions you may have.

Mr. PREYER. Thank you very much.

Mr. Weiss?

Mr. WEISS. Thank you, Mr. Chairman.

I don't know if you've made it clear in your testimony. Whose regulations govern the request? Is it the Department of Labor's regulations or the compliance agency's regulations?

Mr. ELISBURG. It is the Department of Labor's—the Secretary of Labor's—regulations that the compliance agencies are to follow.

The compliance agency at the first instance is left with the interpretation of whether the request meets the standards of those regulations.

Mr. WEISS. And does the Freedom of Information Act give you authority to direct release policies of other agencies or does the Executive order?

Can you order other agencies to release information?

Mr. ELISBURG. I'd like to defer to Mr. Henry to respond to that.

Mr. HENRY. I'm not sure that that has ever come up as a practical matter.

What we have done is to establish standards which the agencies will follow in making determinations of disclosure.

I guess the real question is whether or not the information is the information of the Department of Labor or of the various agencies.

I think that that information is a part of the contract compliance program. I think that the Department can establish standards for the agencies to follow in determining whether or not that information will be disclosed.

Mr. WEISS. In contract compliance matters, does there have to be a marking of information as confidential by the business in order for

But what about your ordinary 300-page submission? How many pages of that are likely to be alleged to be confidential in the ordinary case?

Mr. HENRY. As a general rule, they will select out certain pages in the affirmative action plan which are confidential—that they consider to be confidential. They would not, as a general rule, stamp the entire document as a confidential document but will list only those kinds of things that they consider to be confidential.

Mr. MCCLOSKEY. You heard the testimony of the EPA. They took a 1-year period where they had over 4,000 requests and they had so many immediate and so many ultimate denials. Can you furnish us that same information?

Mr. ELISBURG. We'll be glad to make that a part of the record.

[The material follows:]

copy of a case file regarding a FOIA request for copies of documents which were in the custody of a compliance agency. This request was for copies of all affirmative action programs and compliance reviews done on the Vistron Corporation, located in Bryan, Ohio. The case file is arranged chronologically.

Item (4): The number of person hours used by OFCCP for the administration of requests filed under exemption b(4) of the FOIA for the period September 30, 1976, through September 30, 1977 was 830. Person hours used for legal interpretation and processing lawsuits was 5,000. No request for information under the Privacy Act was processed during this period.

Item 5(a) - (g) consists of questions which relate to the processing of a FOIA request for information contained in documents in the custody of the Federal Government. Request for release of a company's affirmative action plan (AAP) and related documents are directed to the compliance agency. OFCCP does not normally get involved with these types of requests until such time as an appeal is made to the Director, OFCCP. Under the OFCCP's regulations (41 CFR 60-60.4), the contractor may appeal agency disclosure decisions. Briefly, the procedure for processing such requests are as follows:

1. This process begins once a request for copies of a contractor's AAP and supporting documents is received by the agency.

2. After determining that the documents requested are in its custody, the agency notifies the contractor that it is in receipt of a FOIA request. This notification will also indicate the type of documents requested and the name of the requesting party. The agency further advises the contractor that if he objects to disclosure of any of the documents requested, he must provide the Agency with a written statement within 5 days. This statement must demonstrate specifically why the designated documents should not be disclosed. Additionally,

Mr. McCLOSKEY. When did your regulations go into effect under this Freedom of Information Act?

Mr. ELISBURG. They became effective July of 1974 and have been in effect since 1974.

Mr. McCLOSKEY. You, in essence, have had 3 years of operation under this.

Mr. ELISBURG. Yes.

Mr. McCLOSKEY. Can you tell us how many people are engaged in your department in complying with the Freedom of Information Act requirements under this regulation?

Mr. ELISBURG. Too many, Congressman.

Mr. McCLOSKEY. Well, that doesn't help us much.

We need to know how many people, how many man-hours administratively, how many legal interpretations, how many lawsuits, and so forth are required to comply with the FOIA?

Mr. ELISBURG. We can give a detailed breakdown. Would you like it for the entire department or just for the contract compliance programs?

Mr. McCLOSKEY. I think we'd like them broken out since we have gone into contract compliance here.

I confess my own bias on this. In my area, we have 656 defense contractors serving in the 13 Western States. The paperwork required of them to comply with this law is immense.

There have been six cases of people who complained they were discriminated against; yet in each of those six cases, the person allegedly discriminated against, can't find an employee in your division to whom they may apply to redress their grievance. Everyone is involved processing this paperwork.

I am very anxious to find out how many people are handling paperwork and how many are handling precise complaints or grievances.

We've had employees of the Office of Contract Compliance, in San Mateo County, Calif., come to us and say that this is the worst bureaucracy in Government; that it accomplishes nothing; that when there are valid complaints of discrimnation, they are not followed up; and yet everybody in the agency is involved in paperwork.

So what I'm going to ask you to do is to break down precisely what the paperwork requirements are of processing; what the paperwork requirements are of enforcement; how you proceed with these enforcement cases; and whose time is being taken up with what.

I think rather than do that at this hearing, we'll submit a follow-up letter to you asking for this information. Then I'll try to have my staff come over and sit down with you and work out the precise time that's involved.

Mr. ROUGEAU. We can say, Congressman, that virtually everyone is included in processing some of these—and often to the detriment of——

Mr. McCLOSKEY. That's the point—that I would like your recommendations afterward.

If 6 people of the 656 contracting companies cannot get their grievances redressed—then there are 29 people in that Burlingame office occupied with paperwork. No one has time to do any enforcement.

That makes the title of your Office of Contract Compliance almost meaningless.

One is the exemption regarding confidential commercial and financial information. That's where you get into how many people are they going to hire and whether that's something that creates some kind of a competitive advantage.

Mr. McCLOSKEY. You have nothing in your regulations to say that if there is a potential business secret that the company wants to withhold, they don't file a separate form covering that information?

Mr. ELISBURG. No; what we have in our regulations is that they should advise us of what they are claiming. Our regulations talk about things like pay scales which could also be either commercial or a question about an individual's privacy.

The problem that we have in dealing with——

Mr. McCLOSKEY. That's a policy decision. What is the rule on that? Is a person's pay private or is it public?

Mr. ELISBURG. What our regulations say is that the information which constitutes staffing patterns and pay scales is subject to, as far as we're concerned, disclosure unless you can establish that their release would injure the business or financial position of the contractor.

Mr. McCLOSKEY. If a black man is being paid less than a white man in the same job category, or a woman is being paid less than a man in the same job category, is that or is that not public information?

What's your position on that?

Mr. HENRY. I think that the Department's policy position is sympathetic with the view that you expressed a few minutes ago.

Mr. McCLOSKEY. You mean that it's public information and not private?

Mr. HENRY. We have a policy of disclosure. Our regulations say that you will disclose.

Mr. McCLOSKEY. Pay scales?

Mr. HENRY. Yes; we do disclose pay scales, but we do not disclose those pay scales identified with a specific individual's name.

The range of the pay scales is disclosable.

Mr. McCLOSKEY. Let's take Lockheed. Suppose they hire their first woman vice president, but she's paid $20,000 less than all the male vice presidents. Would they be entitled to privacy in that case, or would the need to show discrimination prevail over the right of that vice president ordinarily to have her salary private?

I thought we were past the stage where salaries could ever be claimed to be private information.

Mr. HENRY. Would we identify the specific individual with the salary?

Mr. McCLOSKEY. In that case, you'd have to know the name of the individual if they only had one woman vice president.

Mr. HENRY. That's right; and that might present a problem for us.

But as a general rule, we do disclose the ranges of the salaries and what have you.

If I may go just——

Mr. McCLOSKEY. I confess that there is enough ambiguity in your own responses here to give me some concern.

Mr. ELISBURG. Congressman, I think we are inclined to want to disclose as much as we can. We, however, feel that we are constrained by the statute itself as to what can be disclosed when it is claimed to fall within an exemption.

Mr. McCLOSKEY. You have 50 enforcement cases.

Your job is enforcement, but you're spending almost 40 percent of your time on FOI problems.

Mr. ROUGEAU. Some of these vary in complexity, but obviously they tie up in some instances considerable staff time in order to process these. That is staff time which is detracting from the enforcement effort.

Mr. McCLOSKEY. Mr. Chairman, I'll defer at this time if I may have leave to submit these written questions and request written answers, and then I think we'll probably meet with you to discuss this further.

Mr. ELISBURG. Sure.

Mr. McCLOSKEY. What I'm anxious to get at is this question of how much administrative time and legal time is required; where in the law you feel we might amend it to reduce the unneeded administrative and legal time. This will put us under the burden of resolving this policy question and not leaving it to the bureaucracy as to what is overriding in the public interest in all cases. It seems to me that it is our obligation to solve these problem areas.

Thank you, Mr. Chairman.

Mr. PREYER. Thank you, Mr. McCloskey.

I think you've asked some very good questions there, and we'll look forward to getting the information on that.

Mr. McCloskey has asked questions about the amount of paper that's required under the Freedom of Information Act and also talked about what has to be released under it.

I'd like to just ask a couple of questions about your procedure on the second point—the releasing of information.

Incidentally, is your experience like that of the EPA in that the overwhelming proportion of requests to release information comes from business, rather than from the press or individuals or public interest groups?

Mr. ELISBURG. I think it is to the contrary. The requests tend to come from public interest groups and legal services groups and individual complainants who are pursuing a remedy separately.

The initiative, of course, in the litigation, in the sense of our being sued to block the release, comes primarily from the business groups.

Mr. PREYER. That's a different situation from EPA's than where it is one business very often trying to get information about another business. Here it is public interest groups and individuals primarily.

Mr. ELISBURG. Yes, sir.

Mr. PREYER. Not businesses seeking trade secrets.

I have found it a little hard, as Mr. McCloskey indicated, to understand why there would be much trade secret or confidential business information involved in a lot of the material that you are getting.

I gather from your answer that it isn't so much that—it is other types of requests.

You mentioned that when an agency grants release of information to a requester, the submitter of that information then has the opportunity to present their arguments to the OFCC.

What sort of hearings do you have before the OFCC? Does the requester, the submitter, and the agency each have a right to be heard at that hearing, or is it just one or two of them?

Mr. PREYER. What do you think might be the shortest feasible time?

Mr. HENRY. I couldn't speak to all of the resources which would be required, but obviously you would have to have a hearing officer. You'd have to have a transcript that would be reported back in some fashion. You'd have to have an opportunity to review all of the various submissions and what have you.

I would hate to hazard a guess. But I would say, I guess, 90 days or something.

Mr. ELISBURG. I'd like to point out that our concern with this whole business is that, however we recognize the significance of the disclosure needs, we are concerned about this whole process being used as a way to avoid compliance with the law that we have to enforce.

It is, in effect, a way to block the compliance and enforcement process. To the extent that you get tied up for 1 month, 2 months or 3 years in an FOIA issue, that takes away not only the resources that we could be using for compliance activities but in fact keeps the Government from getting at the underlying case that is involved that we are dealing with.

That poses very severe problems to us in the way that we're trying to carry out these statutes. It is not just the contract compliance program. We have the same problem under the Fair Labor Standards Act and a number of other law enforcement programs that we have in the Department.

Mr. PREYER. We could ask a number of questions on your procedures there, but we have one other witness this morning. I would like to say, since we will be following up with you on some of the other questions that Mr. McCloskey mentioned, that we would like to submit some additional questions that perhaps you could answer in writing.

Mr. ELISBURG. We'd be delighted.

[See app. 3.]

Mr. MCCLOSKEY. Mr. Chairman, in fairness to the witness I would like to read to you the basis for what I said earlier. This is a letter from nine employees of the Burlingame office. I would just read you one paragraph:

> We also believe there is a deliberate attempt by management to overwhelm the program with so much senseless paperwork and harassment so as to make the affirmative action program completely inert and, consequently, impossible to be effective.

Now that comes from nine of your own employees.

> We believe there is a deliberate attempt by management to overwhelm the program with much senseless paperwork and harassment so as to make the program ineffective.

That's what I want to get the answers to when you comply with these requests.

Mr. ELISBURG. I would just make clear that those employees are employees of the Department of Defense who are assigned to the program. They are not employees of the Department of Labor.

We do have a separate——

Mr. MCCLOSKEY. That's one of the problems that I have. They are carrying out Department of Labor directives. And, apparently, they seem to believe that the paperwork imposed on them by the Department of Labor is calculated to make the whole program inoperable.

I point, for example, to those provisions governing time periods which have been discussed this morning already.

It is virtually impossible to think of a procedure whereby everyone's views could be obtained and an agency determination reached within 10 days. I think the result of the time periods, although I applaud them and I am glad they are there, has been that other agencies like EPA make initial determinations of denial without having time to think through what their position should really be.

Or they simply violate the time provisions because that is all they can do to keep up with the problems which are presented.

I also agree with what has been said about many of the paperwork problems here. What I think has happened, because of the availability of reverse FOIA suits, has been that agencies have found it more difficult to make determinations. They have been afraid of restraint by the courts or unable to cope with these problems easily.

Submitters, as was suggested by Congressman McCloskey, have overwhelmed the agencies with paperwork because that does make it more difficult to decipher what is really confidential from what is not.

Requesters have also, when making their initial request, found it necessary not simply to send a letter but to attach a brief in support of their position.

All of this has contributed to a confusion in making these determinations—both by the agencies and by the courts in reviewing them.

Because of this, I think that Congress should establish a procedure whereby all of the interests of all of the parties can be presented to the agency for a determination prior to disclosure.

Now the procedure I envision is an informal one. It would not require, as I thought was suggested by the Department of Labor, a hearing officer, a lengthy transcript, and the like.

Rather, when the agency received a request for information, the first place it might turn would be to its own regulations. And here I would urge agencies to issue substantive regulations detailing certain things that generally would or would not be releasable. For example, affirmative action plans or EEO–1's. Agencies might make general determinations, and these would act as an initial guideline for the release of information.

Also, the agency should, when it receives a request, give notice to the submitter of the request. I think that submitters do have important interests at stake here and should be heard in the process.

At that time, the agency would also notify the requester that it had notified the submitter, so that both of these parties could submit, by means of written documents, their views on, one, whether the information is exempt and, two, even though exempt whether it should be released in the public interest.

Again, I envision this as an informal proceeding. There would be written documents. They would have to be submitted within a relatively short time period. And the agency would reach its determination based on these documents, rather than any oral proceeding.

I don't think this is terribly far beyond what most agencies are doing today. Unfortunately, however, they seem to be getting the views only of the submitters in these instances.

If a standardized procedure were established with fixed time limits, there would be a record for the agency to consult and, of course, on

There you see in the middle of the page that I have said that:

Suppose a requester has asked an agency for information and is waiting for the time periods to expire. The problem is that the submitter is worried that the agency is going to divulge the material. So the submitter will file a reverse FOIA case in a forum which may be thousands of miles away from the requester's forum and, in many instances, will be able to secure a temporary restraining order against disclosure before the requester has even exhausted his or her administrative remedies.

Now under the procedure that I envision, both parties would have to exhaust their administrative remedies before going to court.

By exhaustion, I mean as the act currently provides: either go through the process or wait until the time periods expire.

In any event, this would insure that neither party would get the jump on the other party in going to court.

Now you still have the problem of possibly two separate suits in two separate forums.

I have had some difficulty in trying to come up with a procedure that would alleviate that problem. What I am now leaning toward in my suggestions, I think, is that the preference which the FOIA currently has for the rights of requesters, I believe, should be maintained. I think that Congress primary purpose in the statute was disclosure of information and that that should be maintained while still giving submitters rights of access, including court review, to present their arguments on these matters.

Therefore, what I would suggest at this point would be a procedure whereby—let's suppose a situation where the determination is adverse to the requester. In that situation, the requester, of course, would be the one who would want to appeal to the courts.

I would suggest that that party then be able to file an appeal under the venue provisions of the current act, and that the submitter should be given by legislation an opportunity to intervene, as of right, in that lawsuit.

One might think that this could be accomplished under the general Federal rules, but there have been problems in this in the cases.

Therefore, I would suggest that it be specifically provided that the submitter in that instance be permitted to intervene as of right in that lawsuit; and that his or her remedies in court perhaps be limited to intervention in that suit. Then you would have litigation in one forum, it would be the requester's choice of forum. Yet the submitter would have the opportunity to come into the lawsuit and make arguments on behalf of or with the agency about why the information should not be disclosed.

Where the decision is conversely adverse to the submitter, then again to maintain the preference for the requester, I would suggest that the submitter be permitted to file suit again, but that the requester be either given intervention as of right in the suit of the submitter, or that the requester be permitted to file suit in his or her own choice of forum under the act. Then, upon motions for consolidation, which I'm sure would come at least from the agency—since they do not want to litigate in separate forums—at that point the requester's forum would be preferred.

In a couple of other areas I go into in my testimony, particularly the relationship of section 1905— the Trade Secrets Act—to exemption 3, I prefer not to go into those here but draw your attention to those now.

Lastly, I think, in terms of the procedures that I am suggesting here, some alteration should be made in the attorney's fee provision of the act.

Now the act pretty clearly provides for, at the court's discretion, the award of such fees to requesters in standard FOIA suits.

I think what Congress needs to address here is whether submitters should ever be entitled to attorney's fees in reverse FOIA cases, and possibly whether the Government should always be the defendant to pay these fees.

For example, I give you the situation where the Government decides the material should be disclosed; the requester wants it to be disclosed; and the submitter files a reverse action.

Suppose, in that situation, that the requester and the Government's position is upheld by the courts. In that situation, if the requester is to be granted attorney's fees, who should pay? Should the Government have to pay when the Government has taken the same position as the requester, or should perhaps the submitter in that situation have to pay, or should there be no attorney's fees?

This area, I think, is particularly difficult and I raise some questions about it in my testimony. But I do not feel firmly that I have any very good suggestions for the answers to these questions. I just think that they need to be addressed.

I thank you for this opportunity.

I am now in the process of preparing a fairly lengthy article on this topic; and, of course, will be happy to make it available to the subcommittee when it's completed.

Mr. PREYER. I want to thank you, Ms. Campbell, for a very interesting group of suggestions. We certainly will look forward to your article.

I think you made some very good points here, and it will be extremely helpful. We'd like to keep in touch with you on it.

I regret that I am going to have to leave at this time, but I see from the bells that we may all have to leave.

I would ask Mr. McCloskey and Mr. Weiss if they have any questions that they would like to address to you right now.

Mr. MCCLOSKEY. I have one or two.

Ms. Campbell, my problem with your suggestion is that we're not familiar with what has happened in the courts. When you suggest the formality of setting up a submitters' separate bill of rights, I haven't had called to my attention a single example of where a submitter was denied his rights. Is there any indication that submitters have been abused in this process?

We felt the Government agencies, given the choice, would always keep information secret. We put attorney fees on the other side to put a little edge on the administrator that if he got hit with too many administrative fees or legal fees, it might indicate he wasn't making the proper determinations.

We felt that it was weighed entirely on the side of secrecy—of Government's attitudes.

Mr. McCLOSKEY. Well, do you feel we should require the submitter of information to have to meet the venue needs of the requester of information? We could tighten up the law in that respect to say that the submitter of information would have to file in the District of Columbia. That seems a little difficult.

Ms. CAMPBELL. I am a little concerned about picking one forum where all the FOIA law would be made for some years to come, even though the District of Columbia is probably the most convenient forum for the Federal Government.

I do think that some preference should be given to the forum of the requester under the act.

Mr. McCLOSKEY. Ms. Campbell, my problem with your testimony—and it is just incredibly valuable to us to have a thoughtful law professor submit testimony on this—but I can't tell whether it is theoretical or practical. I can't tell whether there are precise cases that have occurred that cause you to feel these fears, or if theoretically these things could have happened.

The consumer case that you mentioned, is that one of a kind or is it something that submitters of information may use to frustrate the law?

Ms. CAMPBELL. I think there are several cases like that.

In my article in draft, which is now 85 pages long, it goes in much greater depth through all of the cases and the problems that have been raised.

So I think I can document my conclusions.

Mr. McCLOSKEY. Would you submit that to us for examination, and then maybe we'll get back to you.

I guess the problem I have is that every time we enact a law to cure a problem, we create 50 more.

Ms. CAMPBELL. I understand.

Mr. McCLOSKEY. I'm concerned about putting such a paperwork burden on all agencies because of a few abuses of the process. Do we then create a vehicle for lawsuits?

Ms. CAMPBELL. I guess my judgment would be simply that the paperwork problems are there now, and that this is a way of simplifying those.

Mr. McCLOSKEY. Thank you very much.

Mr. WEISS [presiding]. Ms. Campbell, thank you very much for your testimony. We do look forward to your followup article.

The subcommittee will now stand adjourned until 9:30 a.m. tomorrow.

[Ms. Campbell's prepared statement follows:]

where it involves trade secrets or other data whose release might injure their competitive position.

Reverse-FOIA cases are of relatively recent vintage, the first case having been decided in 1974. Consequently, at the time of original enactment of the FOIA in 1966, and again at the time of the 1974 amendments, Congress did not confront the issues raised by them. Although there is an oblique reference to one such suit in the legislative history of the 1976 amendment to the FOIA, the only legislative action at that time was in response to difficulties incurred in conventional FOIA suits. As a result, although the courts have tried to discern Congressional intent in this area, they have been operating with very little guidance. Moreover, because of the complexity of the issues involved, the judicial solutions have not been wholly satisfactory to the interests of either submitters or requesters and have indeed, in some instances, resulted in the frustration of the rights of requesters under the current Act. These problems are also not capable of resolution by administrative regulation, as they involve a balancing of the rights of requesters and submitters which cannot fairly be accomplished without legislative changes in the FOIA itself. For all these reasons, Congressional attention to these issues, at this time, is necessary.

Areas Where No Congressional Action is Necessary

Before addressing the areas in which I believe Congressional action is needed, I would like to discuss briefly those issues that the courts have dealt with adequately and which do not

be clearly in the public interest. While Congressional affirmation of this interpretation might be helpful in the form of legislative history, specific statutory change does not seem essential at the present time.

Third, in the agency's exercise of its discretion to disclose exempt material, the considerations both for and against must be identified, and balanced accordingly. The courts have identified several factors which may be taken into account in this balancing in reverse-FOIA situations, including the FOIA's general purpose to promote disclosure, the interests intended to be protected by the Act's exemptions (such as privacy and confidentiality), the nature of the particular interests of the requester and the submitter, and the nature of any representations made by the government to the submitter that the material would not be disclosed. While issue can be taken with the particular application of these factors in some of the cases, in general the courts have correctly identified the different considerations which should affect the agency's determination. Thus while some guidance might be given in legislative history as to the particular emphasis Congress would like to see given the various factors, for the most part it seems wise to let the agencies identify and balance the considerations which are logically relevant to their exercise of discretion, limited of course by judicial review to assure that that discretion is not abused in any particular instance.

that de novo review (on a new record, without deference to the agency's determination) should be afforded the first question, while the agency's judgment should be upset on the second question only if it is arbitrary, capricious, or an abuse of discretion. In holding that de novo review is appropriate for at least the first question, the courts have simply employed the standard of review set forth in the Act for such questions in FOIA cases. I believe, however, that the standard of review for both questions in reverse-FOIA cases should be narrower than that employed in FOIA cases.

First, Congress' primary concern in passing the FOIA was to promote the disclosure of information. This overriding concern with disclosure was a reaction to the extreme reluctance of administrative agencies to make virtually any information available to the public. Indeed, this was the reason that de novo review of nondisclosure decisions was considered essential. In reverse-FOIA situations, however, agencies are asked not to disclose information. There is no reason to believe that agencies are likely to "overdisclose information in this situation. The special protection afforded by the de novo standard is therefore not needed. Rather, these agency determinations should be treated like all other informal agency actions under the APA, and judicial review of both questions in reverse-FOIA actions limited to whether the agency has abused its discretion.

There are also practical reasons why de novo review should not be employed in reverse cases. De novo review dictates that courts consider the questions before them as if they were the

of matters to be withheld." The relationship between §1905 and the FOIA is not wholly clear. Unanswered questions relevant to the inquiry here include 1) whether material which is within §1905 is to be considered exempt from disclosure because it is also within exemption (3); 2) whether material which is within §1905 and some other of the FOIA's exemptions, usually exemption (4), may, at the agency's discretion, nonetheless be disclosed; and 3) whether material within §1905, even if not within any of the Act's exemptions, may be disclosed. The caselaw dealing with these issues is conflicting, and the Congressional amendment of exemption (3) in 1976, because of confusion in the legislative history, is not particularly helpful. Congressional clarification would therefore be extremely helpful in resolving two questions.

First, Congress should make clear that §1905 is not a statute within the amended exemption (3). The purpose of the 1976 amendment, as its language and legislative history suggest, was to restrict exemption (3)'s applicability to statutes specifically describing the types of matters to be withheld, or statutes providing that material be withheld in a manner which leaves no discretion on the matter to the agency involved. Section 1905 is not such a statute, as it does not describe material within it in sufficient detail. It also permits disclosure "authorized by law," which could include, at the agency's discretion, material whose release is permitted under valid regulations.

Second, even where material is found to be within some other of the Act's exemptions--most probably exemption (4)--Congress should make clear that §1905 does not operate to absolutely prohibit the dis-

Thus, presumably if material is found exempt under some FOIA exemption other than exemption (3), its disclosure might nonetheless be prohibited under one of these other statutes. These statutes, even if not within exemption (3), may therefore still be relied upon as a basis for nondisclosure so long as the information in question is also within some other exemption to the FOIA.

I do not believe that Congress can fairly be expected to address the relevancy of all such statutes either to exemption (3), or generally to the reverse-FOIA situation. With the exception of §1905, this job must be left to the courts. Developments in the law in this area should, however, be carefully monitored with a view towards possible later congressional action.

5. Procedures

A major question that has begun to be raised in reverse-FOIA cases involves the procedures that must be followed by an agency before it releases information. In order to best accommodate all of the competing interests at stake, I have concluded that a procedure whereby both submitters and requesters can present their views to the agency, prior to any disclosure determination, should be established by Congress.

The benefits of citizen participation in the administrative process are well documented. Where one member of the public seeks information provided to the government by another member, both parties have real interests in, and contributions to make to, the agency's decisionmaking on this issue. A few agencies have in fact begun to incorporate into their FOIA regulations provisions for notice to submitters of requests for information. However,

all of the reverse-FOIA cases to date, however, the agency has failed to comply with these time periods. Neither the courts nor the agencies, for the most part, have addressed or attempted to rectify this situation. Nor could they easily do so, for it is virtually impossible to construct a procedure whereby a meaningful exchange between the requester, the agency, and the submitter can transpire, and a decision by the agency be made, within ten days. The Act's time periods should therefore be extended to accommodate the procedure suggested above permitting both submitters and requesters to present written arguments in support of their respective positions to the agency prior to the disclosure of information. In order to assure that this procedure does not unduly delay the release of information, however, only a slight extension of the time periods should be made, and then only in situations where the information requested has been supplied by someone outside the government who objects to its disclosure. Although this will mean that agencies will be permitted more time to decide whether to disclose their records in these cases, their decision should be a more fully informed one as a result of their having obtained both the submitter's and the requester's views on the question. The hope is thus that time spent at this stage of the proceedings is time saved later, whether in the form of fewer administrative appeals, or fewer cases in the courts for review of agency determinations, or both.

7. Indexing of Documents

In the procedure suggested, as well as in the current reverse-FOIA cases, both the submitter and the agency have knowledge of the particulars of the information, while the requester does not. Consequently, even if the requester is given an opportunity to present his or her views on disclosure to the agency prior to its determination, he or she will be at a

convenient to the requester. An example of this is the situation in Consumers Union v. Consumer Products Safety Commission, 400 F. Supp. 848 (D.D.C. 1975), ___F. 2d __, No. 75-2059 (D.C. Cir. July 5, 1977), in which seven separate suits were filed by seven submitters in the District of Delaware, five separate suits by five submitters in the Southern District of New York, the Northern District of New York, and the Western District of Pennsylvania, and one suit by the two requesters in the District of Columbia.

To protect his or her interest the requester must as a result intervene in a lawsuit in which he or she is a defendant, not a plaintiff, with all the implications attendant to that posture, in a forum which may be 3000 or more miles away. Alternatively, the requester may file his or her own suit, in a forum prescribed by the venue provisions of the FOIA. In such case, however, some courts have ruled that the requester may be barred from "relitigating" the issues presented in the submitter's original suit, if the government is seen as having "represented" the requester's interests in that suit. Efforts to join the submitter in the requester's suit may also fail, for lack of jurisdiction over that party. Or the two suits may be consolidated in the submitter's forum, despite the requester's attempt to litigate the issues in his or her own choice of forum. Thus, the requester will either lose the benefit of the venue provisions of the FOIA, or the litigation will continue in two or more jurisdictions, with the resultant possibility of inconsistent adjudications and wasted time and effort.

How should this problem be solved? First, following the administrative procedure suggested above in which both the supplier and the requester present their views on the question of disclosure to the agency, the agency must of course render a decision. If that decision is adverse to either the submitter or the requester, that individual should be afforded an administrative appeal in which all parties would again be permitted to participate. If

an adjudication of his or her rights. In each of these situations notice would be required to be given by the plaintiff to the other party (the requester or the submitter) of any suits filed against the agency. The broad venue provisions of the FOIA would govern the choice of forum for only the requester, with the submitter limited to the more narrow provisions of 28 U.S.C. §1391; or the venue provisions of the FOIA would govern the forum choices for both parties.

Alternatively, Congress could remain neutral, by affording no preference in the choice of forums to the requester. Rather both requester and submitter would be permitted to choose among the forums provided in the current FOIA, but in the case of their filing separate suits consolidation of those suits would be accomplished by the use of conventional notions of convenience to the parties, including reference to multi-district litigation panels to resolve these problems where necessary.

In short, by affording both a cause of action and jurisdiction to both requesters and submitters to sue not only the agency involved but also to join each other in their respective suits, and where separate suits are filed without such joinder, by employing one of these two procedures for appeal to the courts, many of the problems currently being incurred in reverse-FOIA litigation could be resolved.

9. Attorney Fees

In 1974 Congress amended the FOIA to provide that the courts "may assess against the United States reasonable attorney fees and other litigation costs reasonably incurred in any case under this section in which the complainant has substantially prevailed." This provision needs clarification in the context of reverse-FOIA suits. First, may a requester who intervenes or is joined in a reverse-FOIA case be awarded attorney fees under the Act? Second, should fees and costs ever be assessed against parties other than the government, for example the unsuccessful requester or submitter in a

Conclusion

Thank you again for the opportunity to appear before you today. I will be happy to provide any further information to the Subcommittee which might be helpful, including of course a copy of my article on this subject as soon as it is completed.

Respectfully submitted,

Nancy Duff Campbell

BUSINESS RECORD EXEMPTION OF THE FREEDOM OF INFORMATION ACT

TUESDAY, OCTOBER 4, 1977

HOUSE OF REPRESENTATIVES,
GOVERNMENT INFORMATION
AND INDIVIDUAL RIGHTS SUBCOMMITTEE
OF THE COMMITTEE ON GOVERNMENT OPERATIONS,
Washington, D.C.

The subcommittee met, pursuant to notice, at 9:40 a.m., in room 2203, Rayburn House Office Building, Hon. Richardson Preyer (chairman of the subcommittee) presiding.

Present: Representatives Richardson Preyer and Paul N. McCloskey, Jr.

Also present: Timothy H. Ingram, staff director; Catherine Sands, minority professional staff, Commitee on Government Operations; and Robert Gellman, Office of General Counsel, General Accounting Office (on assignment to subcommittee).

Mr. PREYER. The subcommittee will come to order.

Today we continue our hearings on problems related to the use by businesses and corporations of the Federal Freedom of Information Act. We are examining the handling by agencies of the fourth exemption of the act—the so-called trade secrets exemption—and the procedural problems associated with sorting out what proprietary data submitted to the Government should be publicly released, or withheld.

Yesterday we heard testimony from the Environmental Protection Agency and the Department of Labor, and from a law professor familiar with these issues.

Our first witness this morning is the Honorable Donald Kennedy, Commissioner of the Food and Drug Administration. I understand that Mr. Kennedy is accompanied by Stuart Pape of the Office of General Counsel at FDA. We are certainly delighted to have you with us this morning.

We will ask you to proceed in any manner you see fit.

STATEMENT OF DR. DONALD KENNEDY, COMMISSIONER, FOOD AND DRUG ADMINISTRATION; ACCOMPANIED BY STUART PAPE, OFFICE OF GENERAL COUNSEL

Dr. KENNEDY. Mr. Chairman, thank you very much. We welcome the opportunity to share with your subcommittee some thoughts about the trade secrets provision of the Freedom of Information Act. We have submitted a statement for the record. I think, if that procedure suits you, I would like to hop and skip through some of the high spots and not read it all.

This was a major undertaking, but we think it was a wise investment. Our own regulations and extensive preamble discussion that accompanies them describe for our own employees and for the public what the status of each kind of record is under FOI.

For that reason, we try to make our disclosure decisions both more uniform and more prompt than they would otherwise be. That is not to say that we are quick as others would like us to be or would like to be ourselves in all cases. But we are certainly quicker than we would be if we had to make an ad hoc decision in every case without a set of guidelines published as part of agency regulations.

We still have to expend a lot of scarce professional resources to determine whether particular records contain exempt information. That kind of material is often intertwined very closely with disclosable material.

I would want to emphasize to you very strongly that the call-upon resources that that task constitutes is not simply clerk time. There are a great many decisions that can only be made by persons who are familiar with the nature of scientific data, with its applicability to particular problems or issues—in other words, persons with substantial professional training. As a consequence, it is not only a time-consuming but expensive task for my agency.

Let me briefly touch on a couple of other apects of our regulations that relate to the handling of records potentially covered by exemption 4.

One area has to do with the so-called notice provision in our regulations that relate to the circumstances under which we will consult with the submitter of allegedly confidential information about a contemplated disclosure. Unlike some agencies, we have adopted a restrictive notice procedure. We only consult with the submitter about the status of requested records when the confidentiality of the records is "uncertain," and then only to enable the submitter to provide additional information to FDA to permit us to make the disclosure decision. We do not regard the providing of notice as an opportunity for an argument. We simply ask for information that is going to enable us to make the call according to our own criteria and regulations.

As you might expect, we have been challenged in court on that procedure by the PMA. Fortunately for us, that challenge did not succeed. We think that our entire FOI operation would have been in great jeopardy had it succeeded because what is now a staggering investment would have become simply out of bounds had we had to adopt the most liberal of notice procedures that we have been advised to adopt.

Let me digress briefly and return to a point I intended to make earlier. Our concern about the very extensive use of professional time that already exists at FDA in connection with FOI and that would exist in an even greater amount had that lawsuit succeeded has to do with the fact that about 80 percent of the Freedom of Information requests we receive are from business entities, private attorneys, and FOI service companies who are requesting records on behalf of corporate clients.

FDA does not argue that corporate clients should be deprived of some rights to access of information that they may have under the law. On the other hand, as you well know, there is a brisk cottage

On the other hand, Mr. Chairman, FDA believes that scientific data, including safety and efficacy data now considered trade secret, ought to be made public. We are formally requesting legislation to accomplish that this year. We believe that any negative impact it might have on innovation in drug research should be addressed by adjusting statutes that properly regulate market entry and not by continuing to use public health regulatory statutes as devices to adjust the height of barriers to entry. I think that is an inappropriate use of the law.

But it is clear that this is a dilemma that FDA cannot solve by itself even if we were legally able to. I think it is a public policy issue that deserves public resolution through full congressional scrutiny. I hope very much, Mr. Chairman, that you and your colleagues will be inclined as part of your activity to give that particular issue your scrutiny as well as the other matters that are before you.

Thank you very much.

Mr. PREYER. Thank you, Commissioner Kennedy. You and your office have obviously given this a lot of serious thought and study. I think the major undertaking that you mentioned of defining trade secrets for your records is an admirable example of trying to make your disclosure decisions more uniform and more prompt as you say.

You concluded on page 8 by talking about scientific data which includes the safety and efficacy data which is now considered trade secrets and you think it should be made public.

We in the full Commerce Committee, tomorrow, will be taking up the Recombinant DNA Act. That raises some points about this. We are having some difficulty with what sort of rule to put in about disclosure of scientific research.

I would like to ask you this. Would you include in your recommendation for public release proposals for scientific research before a Federal contract or grant has been awarded?

Scientists tell us that if we do that, then there is no good way to guard against one scientist stealing another scientist's ideas. Would the FDA's scheme of public disclosure have a chilling effect on scientific research by allowing one scientist to steal the ideas of another? I wonder what your views are in that area.

Dr. KENNEDY. Mr. Chairman, you are asking me to put on a hat that I used to wear. I worked on the administration bill on recombinant DNA research as the consultant to the Office of Science and Technology Policy last fall. As you may know, I fed at the generous publicly provided trough of research support and before that as an academic.

I have complicated feelings about the release of grant proposals before they are approved for Federal funding. I think in the best of all possible worlds those proposals ought to be made public too because I think the scientific community works best when their work is open.

I am afraid all of us are aware, who have done bench science, that there are conditions under which the competitiveness of a certain field makes the scientists in it fear, and sometimes legitimately fear, that their ideas will be subject to theft if their research plans are announced before they have an opportunity to begin to execute them.

So, I guess that with respect to the particular provision of non-

Dr. KENNEDY. Only to the extent that we are asking the Congress to give us authority to release them. We have already made some more moves by regulation. For example, there are some data relating to standards of purity, of solubility, and bioavailability regarding drugs that have not been considered releasable for which we have proposed, by regulation, to release. A comment period on that preliminary regulation ended in the middle of this month, and we have 20 or so comments, all from private manufacturers and all saying that we should not release the data. We will consider and promulgate a final order there.

Mr. Pape might add something.

Mr. PAPE. We do now release detailed summaries of the safety and effectiveness data concerning new drugs after the drugs have been approved by the agency. This is something we did not do until the early part of 1975.

Mr. PREYER. You talked in your statement, Mr. Kennedy, about adjusting other statutes that regulate market entry. What sort of statutory adjustments do you propose on this?

Dr. KENNEDY. One that comes to mind directly and which is obviously a complicated one to propose because it involves several jurisdictions in the Congress has to do with patent protection. One of the things that pharmaceutical manufacturers are concerned about is that the life of a patent dates from the time of the innovation and not the time of its market approval.

I think I personally would favor—and I know that this is under discussion in the Department—provisions that would start the patent clock ticking at the time FDA approves the drug for marketing instead of at the time when the patent is applied for.

I think that that would provide some additional protection for innovators that might be a good trade for the surrogate protections provided by the requirement to repeat experiments that somebody else has already done or summarized which are not available to public scrutiny.

Mr. PREYER. That does seem to make a lot of common sense.

If you have anywhere in the agency a "wish list" of statutes you would like to see adjusted in this respect, we would be interested in getting hold of that list so that we might be able to disseminate that a little better.

Dr. KENNEDY. We would be very happy to have your help in that matter, Mr. Chairman.

Mr. PREYER. We do not guarantee instant results, however. It would be interesting to get it into discussion.

Do you feel the release of scientific data will reduce this burden of Freedom of Information Act requests that you are receiving now?

Dr. KENNEDY. Yes; I think it will. I do not think that it will reduce it by a remarkable extent, but I think it will help with one of the toughest pieces of the task which is this untangling or disaggregation task of separating out the disclosable from the nondisclosable information.

We now have an investment of about 67 person-years annually in Freedom of Information, and $1.8 million per year. That investment is growing at the rate of about 15 percent per year which I can assure you is faster than our appropriation is growing.

Mr. PREYER. The Attorney General, to shift to another area, on May 5 of this year wrote all of the agency heads announcing a new policy on behalf of the Justice Department in which he said:

> The Justice Department will defend Freedom of Information Act suits only when the disclosure is demonstrably harmful to legitimate public or private interests, even if the documents technically fall within the exemptions of the Act.

Has this new standard requiring a showing of actual harm if access to the requested records were granted, resulted in the release by FDA of a larger number of documents?

Dr. KENNEDY. My own experience with that is pretty short and I do not have a very good baseline since I came after the order.

Mr. Pape?

Mr. PAPE. To a certain extent it has. As part of HEW we work with our colleagues in the Department on this. Appeals of requests of ours that we have denied go to the Department level where I think it is fair to say that they interpret the Attorney General's instruction a bit more literally than we do. So, we have no doubt had some instances in which we have denied access to records, the requester has appealed that denial to the Department level, and we have been overruled. The primary basis of the Attorney General's instruction in this case and the anticipation that if the Department upheld the denial that there would be a substantial likelihood that the Department of Justice would decline to pursue the case if it got to that stage.

Mr. PREYER. So most of the interpretation and memorandum writing of the Attorney General's new policy has been at the departmental level?

Mr. PAPE. No. We think we have adopted a very liberal disclosure policy in the first instance. If one reads through the preamble, you will see that we try to exercise our discretion to give out most information except in situations in which we think there would be harm.

The difficulty we have with the Attorney General's instruction is that it is very difficult in some cases to make a showing of demonstrable harm, although you know that ultimately some harm may occur. The best example of that I think would be some types of internal agency communications, advice from agency lawyers to the Commissioner, for example.

If someone asks for one of those, it might be very difficult in the particular context of that request to demonstrate harm that would occur if that memo were released. But if one adopted a practice of routinely releasing memorandums from agency lawyers to the Commissioner or other agency personnel to each other, then over a relatively short period of time I think you would find an awful lot of communication taking place on the phone and in person and people being less willing to reduce thoughts, ideas and legal advice to writing.

Certainly I think the private bar would find it uncomfortable if their advice to their clients were subject to requests on the part of agencies, like a reverse freedom of information system. I think we would find it uncomfortable also.

It is difficult to show harm in a particular case. All you can do is make the general case of harm.

Mr. PREYER. Is that your major difference in interpretation with HEW of the Attorney General's policies, that is, the difficulty of showing actual harm?

act. As far as Freedom of Information is concerned and as far as I know—Mr. Pape may want to amend this a little—there is enough freedom to attack the categorization problem by regulation. We may not need much more by statute.

Mr. Pape?

Mr. PAPE. I think that is correct. If you mean "binding" in the sense that it is not subject to judicial review, then I think it would not be appropriate. Certainly someone who disagrees with the agency's categorization or interpretation of the act, an act which applies governmentwide, ought to have access to the courts. But in our judgment, as we reflect in our regulations and in the Commissioner's statement, we think that the kinds of challenges to agencies on FOI are best taken in the context of challenges to specific provisions in the regulations. That is a much better way for agencies to go about litigating the propriety of their FOI disclosure policies rather than what you now have: a series of ad hoc kinds of cases with the agency not in a position to have its reasons and basis for its policies well articulated.

I think most agencies do have authority now to issue regulations that would bind themselves and put the public on notice as to their disclosure policies.

In some agencies, it may not be a useful investment of time. If they do not get many requests, they may be perfectly able to handle it on an ad hoc basis.

We are going to get something on the order of 25,000 this year, and it would be an absolute disaster if we did not have the regulations.

Mr. PREYER. It is disturbing to learn that the requests are not plateauing but they continue to increase each year.

Mr. PAPE. Part of the reason for that is that the requests feed on each other. You have the FOI service companies. They service corporate clients. Corporation "A" will ask the FOI service company to seek some information concerning corporation "B." We maintain a log of all of our requests.

The FOI service company may also represent corporation "B" with instructions that "whenever someone asks for information about us we want to get it for us also."

So the same FOI service company asks on behalf of corporation "A" for information about "B" and then turns around and says, "Oh, somebody asked about information on corporation "B" and I have to get it to give to corporation "A." It feeds on itself.

Dr. KENNEDY. The metaphor is "Who wakes the bugler?" There are a lot of people out there being assigned the job of waking buglers.

Mr. PAPE. We just became aware of another little industry developing. It is called GMP Trends Inc.

What they do is this. They get from us a form we call form 483 which is a list of observations that our inspectors make after completing an inspection of a pharmaceutical firm, for example. They put them together listing the observations and they will ask for these forms and delete the company's name and put together a 24-a-year newsletter which pharmaceutical executives can purchase and keep abreast of the kind of observations that inspectors are making at these facilities.

These forms are all available and the companies could write in and ask for them if they were so inclined. But here is an enterprising per-

Mr. PREYER. Let me ask Ms. Sands if she has any further questions along that particular line of questioning.

Ms. SANDS. I have a number of questions that I know were of interest to Congressman McCloskey yesterday and I see he has just arrived.

Mr. PREYER. While he is regrouping I will ask you this: Are there any innovations in your filing or records systems which you are examining which might more easily facilitate FOI requests through the ready filing and locating of frequently requested documents?

Mr. PAPE. We have established an office within the agency known as the Public Records and Documents Center. They are the focal point for our FOI activity. They maintain the files. They maintain a copy of all the records that we disclose in response to a request. Not infrequently we will get numerous requests for the same or similar information which we are able to respond to rather promptly because it is already on file and we can identify it and so forth.

But there is another problem and that is filing within the agency at large. When you get a request that asks for everything the agency has on saccharin, then you really cannot send the memorandum to all 7,000 FDA employees asking them to meet in the parking lot at noon with their shopping carts to compare information. It is a difficult task.

Nevertheless, all that information is not filed in one place. We do not have a room that says, "saccharin" over the door filled with paper. I wish we could come up with a system that would keep all the information on one topic available. You will never get to a perfect system of that sort. The requests are too wide ranging and too dissimilar to enable you to do that.

Mr. PREYER. Let me go into one other area.

Your regulations provide for consultation with the submitter of information when the confidentiality of data is uncertain. Who makes the decision to consult? In the 22,000 cases that you had last year, what percentage required a consultation with a company or researcher who supplied the data?

Mr. PAPE. I do not have any precise figures on that. I doubt that we could come up with that.

In addition to the public records and documents center which is the central point for this, we have a freedom of information officer in each of the agency's components. When a request comes in, it will be routed to the appropriate freedom of information officer who then may further route it to a member of the component who has custody of the records or knowledge about the contents of the records. Ordinarily we leave it to the discretion of those freedom of information officers to determine when they have a problem situation that requires consultation.

Sometimes they may consult with those of us in the Office of General Counsel or the people in the public records or documents center about it, but they are free, if something is troubling them, or they think they are missing something, or there is a fact they would like to get to help them make their determination, to find the contact person in the company involved and give that person a call and ask for some information. Of course, regulations of the agency require that they make a memorandum of that conversation so that we know what information was passed on.

NINETY-FIFTH CONGRESS
Congress of the United States
House of Representatives
COMMITTEE ON GOVERNMENT OPERATIONS
2157 Rayburn House Office Building
Washington, D.C. 20515

October 6, 1977

Mr. Donald Kennedy, Commissioner
Food and Drug Administration
5600 Fishers Lane
Rockville, Maryland 20857

Dear Don:

It was great to see you Tuesday, and I'm sorry the Cargo Preference fight has kept me from putting in the time on the very important points your testimony addressed.

As we discussed in the hearing, we need the following requested information. Using the twelve month period ending September 30, 1977, please provide:

(1) a copy of your regulations on the FOI and the Privacy Acts;

(2) a full set of notices and other documents exchanged in an actual typical case where an FOIA request was submitted, an initial denial issued, the company which had submitted the information notified, an ultimate denial issued and litigation commenced. Attach copies of the initial submission of information with that portion claimed to be confidentially marked. Indicate the process by which the information was computerized and coded for confidentiality, and provide copies of computer print outs reflecting which information is confidential and which is not, and how each category is designated;

(3) copies of all memoranda or instructions to employees on how to determine what information should be considered "confidential business information";

DEPARTMENT OF HEALTH, EDUCATION, AND WELFARE
PUBLIC HEALTH SERVICE
FOOD AND DRUG ADMINISTRATION
ROCKVILLE, MARYLAND 20857

NOV 10 1977

Honorable Paul N. McCloskey, Jr.
Ranking Minority, Subcommittee on
Government Information and Individual Rights
Committee on Government Operations
House of Representatives
Washington, D.C. 20515

Dear Mr. McCloskey:

This is in reply to your letter of October 6 requesting additional information for the record of the hearing by the House Subcommittee on Government Information and Individual Rights on October 4, 1977. I was very pleased to have the opportunity to see you again, and to participate in the excellent hearing conducted by the Subcommittee.

Following are answers to your specific questions or requests:

Item #1

A copy of your regulations on the FOI and the Privacy Acts.

Response #1

Copies of the regulations are enclosed under Tab A.

Item #2

A full set of notices and other documents exchanged in an actual typical case where an FOIA request was submitted, an initial denial issued, the company which had submitted the information notified, an ultimate denial issued and litigation commenced. Attach copies of the initial submission of information with that portion claimed to be confidentially marked. Indicate the process by which the information was computerized and coded for confidentiality, and provide copies of computer print outs reflecting which information is confidential and which is not, and how each category is designated.

Response #2

The case we have selected is the Freedom of Information (FOI) request by Ms. Anita Johnson of the Health Research Group of Public Citizen for data submitted by Upjohn Company in support of the new drug application for Depo-Provera. The key documents involved in this case are enclosed under

Item #5(c)

How many of those appeals were declined?

Response #5(c)

Eighteen in full and four in part.

Item #5(d)

How many of the declined appeals led to a lawsuit?

Response #5(d)

None to our knowledge in 1976.

Item #5(e)

As a result of the lawsuit, how often was additional, previously "confidential," information released?

Response #5(e)

Not applicable.

Item #5(f)

As a result of the lawsuit, how often was all of the previously "confidential" information released?

Response #5(f)

Not applicable.

Item #5(g)

In either (e) or (f), was "confidential" information released prior to the case going to trial but after the initial appeal was denied?

Response #5(g)

Not applicable.

We are enclosing under Tab E copies of memoranda supplied to the Department containing statistics to be included in the Department's annual report to Congress on the FOI Act.

Mr. McCLOSKEY. As I read the concluding pages in your written statement, you need a clarification of the law as to precisely what your responsibilities are.

Dr. KENNEDY. Not exactly. We think that we need to amend our own law—the Food, Drug, and Cosmetic Act—in order to allow us to disclose and thereby to uncover and not have to sort a very important category of information, namely the safety and efficacy data brought by drug manufacturers in connection with IND's and NDA's. But at this time I do not feel prepared to propose changes in FOI itself. It seems to me that we can accomplish categorization and systematization as we have already tried to do under our act by regulation. We do not think that at this time we need additional statutory tools.

Mr. McCLOSKEY. The reason I asked is that last year in 1976 we amended the FOI Act specifically to overrule the *Robertson* case which had held that, in cases where discretion existed on the part of an administrative agency whether to release information or not, the agency could withhold it without violating the FOI Act.

The purpose of our amendment, as I recall it, was to specify that only in cases where the law directed that the information be held secret would it not come within the mandate of that act.

Do I understand that your 1938 statute requires that the method of process which includes a trade secret is entitled to protection covers animal and human testing data?

Dr. KENNEDY. No. That is an interpretation of that act. It is an interpretation the agency has given for 40 years. It is one that has been consistently upheld.

I will give you a bit of history. As you know, 18 U.S.C. 1905 carries some pretty heavy penalties for Federal employees who disclose trade secrets. That was a strong incentive for the agency to define trade secrets in such a way that its employees would not involuntarily wander into the zone of criminal penalty.

We are on record for such a long time and so consistently as regarding safety and efficacy data as being in that zone and the industry has come to rely on it. There is such a long list of precedents that we really think we need statutory help with changing that.

I think we would have great difficulty doing it by regulation.

Mr. McCLOSKEY. That was pointed out to us yesterday by witnesses from other agencies and a law professor here in Washington. They pointed out that section 1905 and the Freedom of Information Act as amended last year leave an ambiguity which the courts will have to determine if we don't do it statutorily.

Appreciating that any recommendations for statutory change have to be cleared by OMB and go through a lengthy process, have you initiated any work as to what the statutory change might be?

Dr. KENNEDY. Yes; with respect to our own statute, we will be requesting legislation to amend our own act to allow safety and efficacy data to be released.

At this time we are not recommending any changes in the FOI Act. We think we can address the problem in our own yard. But as I told the chairman just before you arrived, in response to some questions about whether or not we could seek other statutory avenues to guarantee the innovation incentives, what we were doing is to possibly remove some of the secrecy of safety and efficacy data that requires

Mr. McCLOSKEY. I see.

The bulk of the application does deal with safety and efficacy?

Dr. KENNEDY. Yes.

Mr. McCLOSKEY. You treat it routinely as nonreleasable?

Dr. KENNEDY. Yes.

Mr. McCLOSKEY. Mr. Chairman, I think that we should invite some of these drug companies to provide their thoughts on how they want to be protected.

Dr. KENNEDY. If I might suggest it, Congressman McCloskey, we have held hearings on the recommendations of the Secretary's panel on new drug evaluation which was recently produced by a panel chaired by Norman Dorsen. We held hearings last week. At those hearings, the PMA and several other witnesses examined explicitly that point. There was a recommendation of the Dorsen panel that safety and effectiveness data become public. There are extended comments. Some of them are very interesting. They are exactly on that subject and we will be glad to supply those for the record.

Mr. McCLOSKEY. My concern is that in trying to write an act that applies to some 70 agencies to what extent can we draw a law that applies to your agency as well as to the other 69 and make a simple criteria that reduces the amount of paperwork. It might be in your opinion that in your specific case we should not attempt that. But it is not unlike OSHA and not unlike the Environmental Protection Agency.

Thank you very much, Mr. Chairman.

Mr. PREYER. Thank you. That is a good suggestion.

Gentlemen, we thank you very much for coming. It is very helpful and we wish you good luck in the "fourth hardest job in Washington."

[Additional questions were submitted to FDA. See app. 4.]

Dr. KENNEDY. It has been a pleasure to appear.

I would like to say one thing for the record and that is that it was a special pleasure after 17 tries to finally get to testify before my own Congressman. [Laughter.]

[Dr. Kennedy's prepared statement follows:]

and commercial or financial information obtained from a person and privileged or confidential"--does not explicitly define the kinds of records that Congress intended to exempt. Neither does the legislative history of the Act provide detailed guidance about the scope of the exemption. To solve this problem, we turned to the definition of trade secret in section 757 of the Restatement of Torts.

The Restatement definition, which the Supreme Court has characterized as "widely relied - upon," is a useful basic guideline for application of the fourth exemption. Trade secrets are defined generally in the Restatement, and in our public information regulations as:

> ...any formula, pattern, device, or compilation of information which is used in one's business and which gives him an opportunity to obtain an advantage over competitors who do not know or use it.

Both the definition, and the leading judicial decision interpreting the exemption (National Parks and Conservation Association v. Morton, 498 F. 2d 765 (D.C. Cir. 1974)) place primary emphasis upon the notion of competitive advantage. Determining what information provides a "competitive advantage" is one of the more difficult tasks we face in implementing the Act.

The definitions of a "trade secret" and "confidential commercial or financial information" in our regulations are, we believe, reasonably explicit. It would be extremely difficult, however, to make correct and consistent disclosure decisions involving potentially valuable business information without relating the definitions to the categories

Because of the complexity and variety of information in our files, and the possibility that the significance of certain information would escape the attention of a nonprofessional employee, we must frequently use physicians, scientists and other professionals to perform these tasks. Obviously, the time required to review records for material exempt under the fourth exemption is obviously time that is not spent on the substantive work of the Agency.

We would not be nearly so concerned about this use of professional time were it not for the fact that 80 percent of the FOI requests we receive are from business entities, private attorneys, and FOI service companies requesting records on behalf of corporate clients. The use of professional time to seek and review records for companies regulated by FDA rather than actually engaging in the business of regulating them is not, we believe, the best use of our energies.

NOTICE AND PRESUBMISSION REVIEW

Several other aspects of our regulations relate to the handling of records potentially covered by exemption 4 that may be of interest to the Subcommittee. Let me briefly describe them.

The first provision--the so-called "notice provision" (21 CFR section 20.45)--relates to the circumstances in which FDA will consult with the submitter of information about a contemplated disclosure. Unlike some agencies,

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with an interest in confidentiality, an opportunity to negotiate each disclosure decision. Detailed regulations, like ours, with notice in limited situations where the disclosure decision is a close one are preferable.

FDA's public information regulations also provide for a special procedure known as "presubmission review." This procedure enables persons who may wish to submit information voluntarily to learn in advance the FOI status of their records before doing so. The presubmission review is not limited to voluntarily submitted records; it extends to records with uncertain status under the Act. Because our regulations comprehensively treat the status of FDA's records under the FOI Act, presubmission review is not a widely used procedure.

REVERSE FOI LAWSUITS

We have been fortunate in that only one reverse FOI suit has been brought against FDA--I say fortunate because reverse FOI suits require heavy call upon the resources of our General Counsel's office and of other Agency personnel. However, we welcome court challenges to specific provisions in our regulations to clarify substantive issues of dispute and to minimize future litigation.

Decisions to disclose records that may appear to contain proprietary information are difficult to justify because most agencies are ill-equipped to conduct a sophisticated analysis of the value of the

protection" in section 301 (j) as encompassing animal and human testing data. Later, however, the Agency adopted a policy of releasing a summary of such data when a drug was approved for marketing.

In our opinion, legal constraints have largely dictated FDA's policies and practices with respect to release of safety and efficacy data. Agency representatives have on numerous occasions since the early 1960's indicated in public statements that current statutory prohibitions prevent disclosure of useful information contained in the Agency's files, and particularly, data relating to the safety and effectiveness of drugs. FDA has repeatedly stated that it cannot unilaterally change its longstanding interpretation of the law, on which the industry has relied for almost 40 years.

FDA believes that scientific data, including safety and efficacy data now considered trade secrets, should be made public. Any negative impact this might have on innovation in drug research would have to be addressed by adjusting other statutes that regulate market entry. This dilemma is probably not one that FDA should solve by itself, even if it legally could. It is an important public policy issue that deserves public resolution through full Congressional scrutiny.

Mr. Chairman, that concludes my formal statement. I will be happy to answer any questions you or members of the Subcommittee may have.

policies were. It was not designed to change the traditional rules of business secrecy.

The courts initially interpreted the act consistent with this approach. The courts held that where confidential information was at issue in a disclosure situation, if that information was found to have been customarily treated in a confidential manner by the business or if it was shown that disclosure of the information would harm a legitimate commercial interest, then the information would be held to be nondisclosable. In addition, the courts held that once information was found to fall within the fourth exemption, Federal agencies would not be allowed to disclose it.

In 1974, the U.S. Court of Appeals for the District of Columbia Circuit issued a decision in a case called *National Parks and Conservation* v. *Morton*. In that case, it articulated a very new and different standard for interpreting exemption 4: It said that information would henceforth be considered confidential only if the business could show that its disclosure would cause substantial competitive injury.

I say this is a new standard because it now required a fairly concrete showing of substantial competitive injury whereas, under previous interpretations of the exemption, a company was not required to show that it would necessarily be competitively injured and was not required to meet that stringent burden of proof.

In addition, at this time the courts took a new approach as to what discretion Federal agencies had in this area. Whereas Federal agencies previously would not disclose information which they initially found to fall within the fourth exemption, the courts now said that even where information was found to fall within the fourth exemption, Federal agencies could choose to disregard that and nevertheless could choose to disclose that information to the public.

Courts have gone both ways and, in fact, even the District of Columbia Circuit, which issued the *National Parks* decision, has since that time fallen back a bit. In another case, it has seemed to embrace the previous standard. The point is that there is great controversy over what the appropriate standard under exemption 4 is, over what the proper burden of proof should be, and over what information should and should not fall within the exemption.

In addition, there is still great controversy over whether a Federal agency should have discretion to disclose information that is found to fall within the exemption.

Both of these questions have been presented to the Supreme Court on at least two occasions, but unfortunately the Supreme Court has declined to decide these issues. So, we keep having these issues arise in reverse FOI case after reverse FOI case. I fear that the end is not in sight unless there is some congressional guidance on the point.

I believe there is a solution here to this problem and that Congress, either in the form of an amendment to the act or in terms of guidance through the legislative history, can provide the answer. That answer seems to me to be that there is a distinction in the way private documents should be treated under the act and in the way Government documents should be treated.

As I said, my view and that of many others of the legislative history shows that the act was intended to end Government secrecy about

I think this is a prime example of what the failure to provide for mandatory notice and the failure to provide for adequate time to object will do to a company's rights in the documents that they believe and profess to be confidential. I think that the act should be amended to require agencies to provide notice in every instance that a submitter's documents are to be disclosed and also to require that sufficient time be afforded to the submitter, perhaps 30 days, in order to submit his arguments to that agency.

In addition, I think the agency needs more time to make a decision. In the statements submitted to the subcommittee, I believe most of the witnesses have indicated that their agencies really do not have the expertise necessary to make the kinds of complex business decisions necessary in determining whether information is confidential or not. While they suffer from a lack of expertise, at least they need the time to analyze those documents and to analyze the comments that are received from the businesses. Under the 10-day—extendable to 20-day—period that the act provides to them, there simply is not enough time for the agency, let alone the submitter, to participate in any kind of a proceeding which will result in a reasoned and educated decision on disclosure.

The same problem arises with appeal provisions. Many of the implementing regulations under the act allow a requester to take an appeal from an initial decision which refuses to disclose documents, but virtually no set of Federal agency regulations provides a right for a submitter to take an administrative appeal. Even where some regulations do provide that right, in most cases the agency will not await the outcome of that appeal to disclose the documents. Here is an example of what I think is another case of agency abuse.

The Office of Federal Contract Compliance Programs and the Federal agencies that serve as contract compliance agencies operate under a regulation which does at least indirectly contemplate an appeal by a submitter of documents. However, many of the contract compliance agencies have issued memorandums to their regional offices indicating that, because the 10- or 20-day period under the Freedom of Information Act would pass before the appeal is decided, disclosure of the documents will not be withheld. So, consequently, the documents would be disclosed, the case would be mooted and the appeal right would be illusory.

I am aware that, in the chairman's letter, there have been several contemplated proposals mentioned which have been discussed here. I think some of these have merit. I think others would create intolerable burdens.

The first that I have heard mentioned is a "mark it or lose it policy." Should a submitter of documents be required to mark each and every document, perhaps each and every page of the documents that he submits, "confidential" if he believes them to be confidential in order to preserve his rights to notice in any further disclosure procedure?

I think this would be extremely burdensome. As the chairman knows, many corporations submit thousands upon thousands of pages of documents to the Government every year.

Although I think it would be quite burdensome, I think that this is a burden that many companies would be willing to bear. I do not think they would like to bear it. But if that is the cost of at least securing

that goes into these documents, by and large, is never available through any other source to the public. It is compiled solely from the internal records of the company and it is given to a compliance agency solely for the purpose of demonstrating compliance with Government regulations.

The information provides, in my experience, the greatest detail concerning the layout, the staffing and the manning of the facility that can be obtained from any source.

In my experience and also from discussions with economists, the information is valuable. It is valuable in a commercial sense. It is valuable in a competitive sense. It is used in cost analysis. It is used in the raiding of key employees. It is used in predicting the development of new processes and techniques.

That is not just my opinion. It happens to be the opinion of a number of courts which have held, after trials on the merits, that the disclosure of this kind of information indeed would result in substantial competitive injury. Though I do not agree with the use of the substantial competitive injury test, I do concur with the courts' findings that disclosure of the documents would in fact result in that kind of injury.

So, I felt it was necessary to state at least my view on the record that there indeed can be quite a bit of confidential information in those documents and that they ought to be protected, just as should a great deal of other business information.

Thank you.

Mr. PREYER. Thank you very much. We appreciate your comments on that subject, on which I, for one, was speaking pretty much off the top of my head but I am sure Mr. McCloskey was speaking in a more informed way, but you have given us some very interesting ideas. We will read your full statement with interest.

I will ask counsel if they have questions.

We do have several more witnesses so I will pass up questioning at this time.

Mr. GELLMAN. You suggest that FOI should be used to permit the release of information relating to an agency's actions, plans, and policies but not the actions, plans, and policies of private persons. Since the Government's activities as a purchaser of goods and services and as a regulator of industry necessarily involve the collection and accumulation of business information, doesn't this collected data also relate directly to the Government's actions, plans, and policies?

Mr. BRAVERMAN. The information, I think, would relate indirectly. I think there is a major distinction. Many agencies compile their own reports, their own summaries of what they are doing in their various fields of responsibility. It seems to me that if the interest of the public is in learning what the agency is doing, then there are alternative sources of information that could be disclosed which would not jeopardize the privacy of the regulated companies. I believe that the availability of alternative sources of information, such as reports prepared by the agency personnel themselves and their studies of the efficiency of the operation of the agency, will give the public an extremely incisive view of what the agency is doing.

For example, the EEOC is an agency which is the subject of quite a bit of public clamor concerning its efficiency, the degree of efficiency with which it has enforced the civil rights laws. That agency has

Mr. BRAVERMAN. That thought occurred to me in the context that many of these requests were not related to any examination of how the Government was functioning. I think that where a showing has been made by a submitter that the information is confidential—and I do not mean necessarily under the *National Parks* standard—I think that he has sought that information and how he intends to use that in terms of analyzing what the Government is doing.

For example, if the requester then says, "Well, the real reason I am seeking the information is that I would like to know how they have staffed their facility, I would like to know what their process is in that section of their manufacturing plant, I would like to know what they have done on this because I am contemplating suit against them," then that would not serve Congress' purpose of opening Government processes to private scrutiny. All that would accomplish would be to open private matters to private scrutiny—a goal which Congress may perhaps want to entertain at some point in the future but which Congress was not contemplating at the time of the act.

So, I think that some demonstration and some explanation would be necessary from the requester to show that, first, this relates to a Government-related activity and that, second, there is no other way they can get that information from the agency without jeopardizing the confidentiality.

Mr. GELLMAN. You would require the requester to show that there are no alternative types of Government documents that would reflect the Government's performance without breaching the privacy of information submitted by corporations?

Mr. BRAVERMAN. I think it would be threefold. After notification I think that the submitter should be entitled to make a showing that the information is confidential. I think the second step of the process would be that the requester would then be at least required to show that what he is seeking is information about how the Government operates and how the Government functions, not simply a private bit of information. Then perhaps, if he has satisfied that burden, I think the third step would be that the Government should be required to come in and at least demonstrate that there are no existing Government reports or aggregate information that they can disclose which would satisfy the requester's need without jeopardizing the confidentiality and the privacy of the individual's documents.

Mr. GELLMAN. Let me go on to another topic. With regard to an advantage that FOI may or may not afford businesses, does the act allow companies to acquire corporate documents of their competitors indirectly through Federal agencies which they could not acquire directly because of the antitrust laws?

Mr. BRAVERMAN. Absolutely, yes. Quite frankly, my experience here has been in representing companies more often in the context of reverse FOI cases, but also in cases where we have sought documents from the Government. In those cases, however, without exception, my clients have been seeking documents that relate to the agency's practices and procedures.

Companies, of course, are subject to great restrictions under the antitrust laws as to when they can meet, what they can discuss and what they can exchange. Believe me, they are quite concerned about this.

PREPARED STATEMENT OF BURT A. BRAVERMAN, ATTORNEY, COLE, ZYLSTRA & RAYWIN

I am Burt A. Braverman, an attorney and member of the firm Cole, Zylstra & Raywid. I am appearing before the Subcommittee in response to its invitation to testify concerning Exemption 4 of the Freedom of Information Act ("FOIA"), 5 U.S.C. §552(b)(4), and "reverse FOIA" law suits.

I. PRELIMINARY REMARKS

My testimony today will deal with what I perceive to be the principal problems under Exemption 4 and the principal causes for the rapidly increasing number of reverse FOIA law suits. My testimony is based on the experience and knowledge which I have gained in representing businesses in a number of reverse FOIA actions which they have commenced in order to enjoin federal government agencies from publicly disclosing private documents which are confidential and commercial in nature. While the views which I will present today coincide with some of the positions which I have asserted on behalf of my clients in those cases, this testimony reflects my personal opinions and experience.

When enacted by Congress, Exemption 4 of the FOIA was intended to serve a definite protective purpose with

fair agency treatment and to adequate judicial review. The Act should be revised to delineate minimum types of procedures which must be adhered to by agencies before private documents may be publicly disclosed and to formalize the right of access to the courts of an aggrieved submitter of private documents. However, it must be emphasized that unless the fundamental dispute over the meaning of the term "confidential", as used in Exemption 4, is eliminated, and unless courts are directed to adhere anew to the meaning of Exemption 4 which Congress originally intended, no amount of reform in FOIA procedures will stem the growing tide of reverse FOIA litigation.

In dealing with these substantive and procedural questions, it is my intention both to review past developments under Exemption 4 and in reverse FOIA cases, and to propose certain changes which would protect important private interests while continuing to effectuate the Act's underlying purpose of opening government processes to public scrutiny.

II. A VAST ARRAY OF PRIVATE INFORMATION IS AT STAKE

As our nation has grown during the past century, so has the size of our government and the amount of business regulation. Today, there are literally thousands of federal departments, commissions, boards, task forces, etc., which administer a complex network of federal statutes and regulations cutting across all industries.

businesses and, quite understandably, has not been disclosed either to competitors or to the public. Now, however, the tables of business privacy have turned as a result of the novel use to which the FOIA has been put.

Today, the FOIA is being utilized by an extremely diverse group as a means of obtaining this private data. The Act has been employed by competitors, analysts, investors, disgruntled employees, potential and existing adverse litigants, self-styled "public interest" groups, foreign businesses and governments and a wide variety of others to obtain information concerning private businesses which, but for the FOIA, would not be available to them. Yet now, for the price of a postage stamp, such persons can generally obtain such data from federal agencies. The use of the FOIA for such surveillance of private affairs was not intended by Congress and needs to be remedied.

III. EXEMPTION 4 HAS BEEN CONSTRUED BY THE COURTS IN A MANNER INCONSISTENT WITH CONGRESSIONAL INTENT

The Freedom of Information Act was intended to better inform the electorate by opening the processes of government to public scrutiny; thereby, government would be made more accountable to the public.[1/] However, Congress sought to balance the Act's disclosure philosophy with the

1/ S.Rep.No. 813, 89th Cong., 1st Sess. 3 (1965)(hereinafter "S.Rep.No. 813"); H.Rep.No. 1497, 89th Cong., 2d Sess. 12 (1966)(hereinafter "H.Rep.No. 1497"). See Bristol-Myers Co. v. FTC, 424 F.2d 935, 938 (D.C.Cir.), cert. denied, 400 U.S. 824 (1970).

Congress thus contemplated that the Exemption would "assure confidentiality" of "quite broad"[1] categories of information. And, consistent with this intent, courts -- including the U.S. Court of Appeals for the District of Columbia Circuit -- repeatedly sustained this congressional interpretation of the Exemption by refusing to order release of information on Exemption 4 grounds of confidentiality where the "information [is] of the type which would not customarily be released to the public by the person from whom it was obtained";[2] or where such disclosure might be harmful to the private interests of the party who supplied the information to the Government.[3]

Exemption 4 was consistently construed in this fashion during nearly the first seven years of the FOIA's existence. However, in a series of cases culminating in its

1/ 110 Cong. Rec. 19667 (1964).

2/ Sterling Drug, Inc. v. F.T.C., 450 F.2d 698, 709 (D.C.Cir. 1971)(emphasis added). See also Grumman Aircraft Engineering Corp. v. Renegotiation Board, 425 F.2d 578 (D.C.Cir. 1970), rev'd on other grds, 421 U.S. 168 (1975); Porter County Chapter of the Isaak Walton League of America, Inc. v. United States Atomic Energy Commission, 380 F.Supp. 630, 634 (N.D.Ind. 1974) (disclosure denied where information had previously been treated as confidential "in accordance with normal company procedures having a rational basis, and [where] information involved is in fact customarily held in confidence and is not customarily made available to the public"); M.A. Shapiro & Co. v. S.E.C., 339 F.Supp. 467, 471 (D.D.C. 1972)("a court should determine, on an objective basis, that this is not the type of information one would reveal to its public"); Ditlow v. Shultz, 379 F.Supp. 326 (D.D.C. 1974); Rural Housing Alliance v. U.S. Dept. of Agriculture, 498 F.2d 73, 79 (D.C.Cir. 1974).

3/ Ditlow v. Shultz, supra; Grumman Aircraft Engineering Corp. v. Renegotiation Board, supra.

mately treated as confidential only if it can be concretely shown that disclosure of such information would cause substantial competitive injury; indeed, proof of competitive injury as a test of confidentiality was simply not considered in the legislative deliberations on Exemption 4.[1/] Instead, the legislative history of the FOIA reveals that Congress intended that information which customarily and rationally has been treated as confidential[2/] by the party who submits it to the Government, or which would adversely affect a business' interests if disclosed, should be exempt from the disclosure provisions of the FOIA regardless of whether disclosure would result in competitive injury.[3/]

The National Parks test of confidentiality is undesirable in several respects. First, it establishes a standard for exemption which is far more rigorous than Congress prescribed or intended, and under which important private interests will be lost. For, the National Parks test imposes a nearly impossible burden of proof on the party seeking to bar disclosure by requiring it to make a concrete showing, within a period of ten days, that substantial

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1/ See Patten and Weinstein, supra, 29 Ad.L.Rev. at 198.

2/ Black's Law Dictionary 370 (4th ed. 1968) defines "confidential" as: "Entrusted with the confidence of another or with his secret affairs or purposes; intended to be held in confidence or kept in secret."

3/ See Patten and Weinstein, supra, 29 Ad.L.Rev. at 197: "It seems clear that Congress intended Exemption 4 to maintain the status quo: business information which industry customarily held in confidence would continue to be exempt from mandatory disclosure under the FOIA."

pressed to concretely demonstrate under National Parks that disclosure will cause substantial competitive injury even though they know that the likelihood of such harm at a future date is sufficiently great to justify the standard business practice of not disclosing the information.

Second, the National Parks test imposes upon agencies and courts the undesirable responsibility of making speculative judgments as to whether, if such information were to be disclosed and if such information were to be used by a competitor, disclosure would cause substantial competitive injury. Such a decision obviously involves a substantial element of crystal-ball gazing and represents a questionable means, at best, for determining if information is confidential.

Finally, the National Parks test focuses only on competitive injury but ignores other kinds of injury which disclosure of confidential commercial information might cause such as employee unrest, damage to goodwill, exposure to vexatious litigation, etc. These too are equally real, immediate and compelling forms of commercial injury which warrant, and were intended by Congress to result in, the treatment of information as confidential under Exemption 4.[1/]

What have been the consequences of this judicial revision of Exemption 4? Whereas confidential private informa-

1/ "[T]he reach of the exemption ... is not necessarily coextensive with the existence of competition in any form." Washington Research Project, Inc. v. HEW, 504 F.2d 238, 244 (D.C.Cir. 1974), cert. denied, 421 U.S. 963 (1975). See also Ditlow v. Shultz, supra, 379 F.Supp. at 329 (recognizing likelihood of harm to "legitimate private interests" as a foundation of confidentiality); and see Patten and Weinstein, supra, 29 Ad.L.Rev. at 197.

Moreover, the National Parks test has forced courts, agencies, submitters and requesters alike to engage in complex, cumbersome and costly economic analyses of documents which, at best, lead only to speculative conclusions regarding injury and, at worst, burden the courts, agencies, parties and the public. Indeed, the National Parks standard has in fact made the protection of Exemption 4 available only, if at all, to the very largest businesses. For, due to the extreme burden of proof imposed by National Parks and the resulting need to undertake extensive economic analysis and to employ expert witnesses, as well as the necessity of commencing litigation in the first place, reverse FOIA lawsuits simply are not feasible for most companies even though faced with the threatened disclosure of confidential private data.[1/] Surely, Congress could not have intended to trigger such an inquiry each time a request was made for business records under the FOIA. And, that would not be the case if Exemption 4 were construed and applied by agencies (and by courts) in the manner which Congress originally intended.

Is this was Congress intended? Does this better inform the electorate about its government? Does this make the Government, as opposed to private businesses, more accountable? Was the FOIA intended to reverse traditional legitimate notions of business privacy? The answer to each of these questions is an emphatic NO!

1/ See Patten and Weinstein, supra, 29 Ad.L.Rev. at 194.

held that agencies cannot choose to disclose information which falls within the protective terms of Exemption 4. 1/

Those courts which have held that agencies may not choose to disclose information which is found to fall within Exemption 4 have placed considerable weight on the Senate Judiciary Committee Hearings, where it was said:

> "[N]ot only as a matter of fairness, but as a matter of right, and as a matter basic to our free enterprise system, private business information should be afforded appropriate protection, at least from competitors." 2/

On the basis of this language, the U.S. Court of Appeals for the Fourth Circuit, in Westinghouse Electric Corp. v. Schlesinger, observed that

> "the Act was intended, to use the language of the Senate report, to set 'up workable standards for what records should and should not be open to the public for inspection.'" 3/

Thus, where information is shown to fall within the protective terms of Exemption 4, the Government should not be permitted to disclose such documents in utter disregard of the Exemption's terms and of the harm which disclosure might precipitate; for, such an approach

1/ Westinghouse Electric Corp. v. Schlesinger, 392 F.Supp. 1246 (E.D.Va. 1974), United States Steel Corp. v. Schlesinger, 8 FEP Cases 923 (E.D.Va. 1974), both aff'd sub nom Westinghouse Electric Corp. v. Schlesinger, supra; McCoy v. Weinberger, 386 F.Supp. 504 (W.D.Ky. 1974); Neal-Cooper Grain Co. v. Kissinger, 385 F.Supp. 769 (D.D.C. 1974).

2/ Hearings on S. 1666 Before the Subcomm. on Admin. Practice and Procedure of the Senate Comm. on the Judiciary, 88th Cong., 1st Sess. 199 (1964)(hereinafter "Hearings on S. 1666") (emphasis added).

3/ 542 F.2d at 1210-11 (footnote omitted).

what those individuals or corporations are doing, or about what their activities and policies are ***;" rather, "[t]he purpose of the ... Act was to protect the people's right to obtain information about their government, to know what their government is doing, and to obtain information about government activities and policies."[1/]

Most of the documents whose threatened disclosure has given rise to reverse FOIA actions have concerned the actions, plans and policies of private parties, and not those of the government. The FOIA was not intended to serve as a vehicle for the "envious competitor or the curious busybody ... [to obtain] access to that private information ..."[2/] and, therefore, a claim of exemption for private information should be given a much more hospitable reception than a claim of exemption for a government document.

Indeed, recognizing that the underlying purpose of the FOIA was to enable the electorate to inform itself on the manner in which its government was functioning, it is questionable whether members of the public should be entitled to obtain private documents at all. While federal statutes

1/ Westinghouse Electric Corp. v. Schlesinger, supra, 542 F.2d at 1210 n. 64 (emphasis added), quoting Note, supra, 9 Akron L.Rev. at 694.

2/ Westinghouse Electric Corp. v. Schlesinger, supra, 542 F.2d at 1213. See also Hearings on S. 1666, supra, at 174 ("We can see no reason for changing the ground rules of American business so that any person can force the Government to reveal information which relates to the business activities of his competitor.")

which would adequately reflect the Government's performance without breaching the privacy of persons or companies who have submitted information to the agency.[1/]

In this latter regard, some federal agencies such as the Department of the Census and the Department of Labor's Bureau of Labor Statistics routinely collect private information from businesses across the nation. These agencies guarantee that the confidentiality of those data will be maintained and that disclosure will not occur unless the data is aggregated with data from other companies in a form in which the submitter cannot be identified.[2/] If in fact there is a public need to know more about the nature of private activities in order to determine whether the Government is properly administering its responsibilities, such data should be disclosed only on an aggregate basis in which data cannot be identified by company. This approach has been applied on an ad hoc basis by some courts[3/] and is even contemplated, although not frequently utilized, by some agencies' disclosure regulations.[4/]

1/ See Sterling Drug, Inc. v. FTC, supra, 450 F.2d at 709, where the court of appeals acknowledged "the private citizen's right to be secure in his personal affairs which have no bearing or effect on the general public."

2/ See, e.g., 13 U.S.C. §8(b).

3/ See Grumman Aircraft Eng'r. Corp. v. Renegotiation Bd., supra; Pennzoil Corp. v. F.P.C., 534 F.2d 627, 632 (5th Cir. 1976); GTE Sylvania, Inc. v. Consumer Prod. Safety Comm'n., 404 F.Supp. 352, 374 (D.Del. 1975).

4/ See, e.g., 21 C.F.R. §20.111(c)(3)(V), and 40 C.F.R. §2.202(f).

A. Lack of Formal Notice Requirement

The Freedom of Information Act contains no requirement that the submitter be notified by the agency that its documents are to be disclosed. Nor do virtually any agency regulations contain such a requirement,[1] although some agencies gratuitously provide such notice to submitters.[2] Those agency regulations which do provide for notification to the submitter of a request for disclosure make such notification discretionary, conditioning the giving of such notice on an agency's own preliminary views regarding the disclosability of the document. For example, the EPA provides notice of an FOIA request only if it believes that the information is of the type likely to be considered confidential by the business.[3] Yet, the fallacy of this procedure is that agency personnel are often unaware of the significance of information whose disclosure has been requested and, consequently, may not notify the affected business that its documents are to be disclosed.

1/ At least one court has held that no such notice is required. Pharmaceutical Mfrs. Ass'n. v. Weinberger, 411 F.Supp. 576 (D.D.C. 1976).

2/ Would Macy's Tell Gimbel's, supra, 6 Loyola L.J. at 610.

3/ 40 C.F.R. §§2.203 and 2.204(d)(1)(i) (Environmental Protection Agency); see also, e.g., 32 C.F.R. §.285.7(b)(7) (Defense Supply Agency); 43 C.F.R. §2.13(h) (Department of the Interior); 21 C.F.R. §4.45 (Food and Drug Administration).

given and that confidential information may be unknowingly disclosed becomes even more imminent.

B. Inadequate Time to Comment

Where notice is provided, the submitter is generally afforded not more than five days, and in some cases as few as one day, to submit written objections to disclose. For example, in Armco Steel Corp. v. Marshall,[1] where a number of companies have sued to enjoin the release of assertedly confidential, private information, the government agencies gave only five days to some of the companies to object to disclosure; as little as one day to one of the companies; and, in fact, did not notify another of the companies until the prescribed time for objection to disclosure had already passed.

Since disclosure is often a complex matter requiring analysis of copious documents and possible testimony by an expert witness, allowance of only five or fewer days for submission of comments is, in effect, a denial of a right to object at all. Indeed, some more enlightened agencies have openly admitted that the statutorily mandated ten days time is simply not enough time for the agency to evaluate the issues in an Exemption 4 situation, let alone for the submitter to analyze the documents, obtain expert economic assistance and plead its case to the agency.[2]

1/ No. 77-121 (E.D.Ky., filed August 2, 1977).

2/ EPA Statement, supra, at 5. See Clement, The Rights of Submitters to Prevent Agency Disclosure of Confidential Business Information: The Reverse Freedom of Information Act Lawsuit, 55 Tex.L.Rev. 587, 635 (1977)(hereinafter "Clement").

Moreover, the agency appellate bodies to which such appeals can be taken often suffer from the same pro-disclosure bias which characterizes many agency staffs. Consequently, such appeals, even where afforded, are generally little more than a rubber stamp process and the submitter has little hope of overturning an adverse initial decision.

Even where a right of appeal is allowed, some agencies refuse to delay disclosure pending completion of the administrative appeal. Since, once disclosure occurs, the disclosability of the documents becomes a moot question,[1] the refusal to delay disclosure ultimately has the effects of denying the submitter his right to an administrative appeal and of insulating the agency's disclosure decision from judicial scrutiny.

Some agencies have sought to cure these defects by establishing a presubmission review procedure whereby a submitter may, at the time it submits its documents to an agency, claim that the documents are confidential and secure a ruling by the agency on that claim. Yet, such agencies have not always adhered to those procedures and have in fact denied submitters an opportunity for a presubmission determination of confidentiality. For example, the Department of Labor's Office of Federal Contract Compliance Programs ("OFCCP") has promulgated a rule which allows a government contractor (1) to claim, at the time it initially furnishes its documents

1/ Sears, Roebuck and Co. v. GSA, 384 F.Supp. 996, 1001 n. 7 (D.D.C.), stay dissolved, 509 F.2d 527 (D.C.Cir. 1974).

pending a submitter's §60-60.4(d) appeal of the agency's disclosure decision.[1/] And, since disclosure would moot the appeal, any appeal granted at that point would be meaningless.

Thus, some agencies such as the Defense Supply Agency have in effect suspended presubmission review procedures such as §60-60.4(d) by not allowing submitters to (1) assert confidentiality at the time of submission or (2) appeal from an adverse decision on the contractor's claim of confidentiality prior to disclosure. While this conduct underscores the arbitrary manner in which many federal agencies have treated submitters' claims of confidentiality, mere elimination of those unsavory practices would not solve the problem. For, as treated later in this testimony, the presubmission review concept suffers from other inherent defects and is not the panacea which some agencies believe.

E. Inadequate Opportunity To Seek Judicial Review

In response to an agency decision to disclose, a business may choose to vindicate its rights by commencing a reverse FOIA action. Yet, despite the fact that disclosure of the contested documents might moot the case, many if not most agencies refuse to delay disclosure pending the completion or even the commencement of judicial review. In contrast, government agencies never disclose their own documents pending a requester's suit to compel disclosure.[2/]

1/ Defense Supply Agency Memorandum DSAH-G, 1820-75, AIC 7817, dated 18 Feb. 1975, to Counsel, concerning "Release of Compliance Data under Freedom of Information Act Amendments."

2/ Patten and Weinstein, supra, 29 Ad.L.Rev. at 204.

a submitter initially shows that there is at least a reasonable possibility that the documents which the agency proposes to disclose contain confidential commercial information.

(d) Agencies should be required to issue a written decision reciting specifically in nonconclusory fashion the grounds upon which they have concluded that information is not exempt from disclosure.

(e) Where agencies choose to afford submitters the right to an administrative appeal from an adverse disclosure decision, the agencies should be required to delay disclosure pending completion of the appeal process.

(f) The Act should require that, in the event of an adverse final agency decision regarding disclosure, the submitter should have at least five days in which to notify the agency whether it intends to seek judicial review of the agency's disclosure decision. If the submitter expresses that intent, he should then be entitled to twenty days from the date of notification of the agency's decision to prepare and file its reverse Freedom of Information Act lawsuit. The giving of notice within five days should operate to stay disclosure for the duration of the period in which the action is allowed to be commenced. Thereafter, should the action be commenced in a timely fashion, the filing of that action should operate to stay disclosure until such time as the district court rules on the merits of the reverse FOIA action.

would impose an extreme burden on companies to review and mark each and every document which they submit to the federal government each and every year since, particularly in the case of larger firms, this may require the review and marking of tens of thousands of pages of complex commercial and financial reports on an annual basis. The desirability of channeling significant amounts of business resources into such analysis, when the large majority of such documents will never be the subject of an FOIA request, is highly suspect.

2. Should submitters claiming that documents which they submit to the Government are confidential be required to obtain from the agency a presubmission determination of confidentiality? This suggestion too poses extreme burdens from the standpoint of not only the submitter but the agency as well. Under such a procedure, a business would be required to assert a claim of confidentiality each and every time it submitted a document which it believed was entitled to confidential treatment. Many companies simply could not afford the expense of asserting multiple claims before the agency -- particularly where it was unknown whether disclosure of the documents would ever be sought -- and might consequently be denied their right to protection from disclosure. Those companies which could afford to press their claims of confidentiality before the agency would be required to do so in potentially scores, or even hundreds, of instances; and, since under the prevailing standard detailed economic proof of competitive

3. Should agencies consider promulgation of regulations governing availability of categories or classes of documents? This proposal has great facial appeal, particularly in the case of private information which is submitted to the Government in the form of standardized report forms. Yet, although the disclosure of information in a particular standardized report form might not be injurious to companies within one industry, disclosure of the same type of information might be harmful to companies in another industry. Similarly, it is conceivable that there could be a different impact on disclosure of identical information relating to different companies within the same industry.[1/] And, classes of information previously determined not to be confidential may, through changes within a company or industry, take on added competitive significance with the passage of time. These possibilities have been acknowledged even by those who support the concept of category determinations.[2/] Accordingly, regulations governing disclosure of categories of documents should not be considered unless there is a fair and realistic waiver procedure which would allow a submitter to demonstrate that, despite an agency's general determination that a class or category of documents is not confidential, disclosure of documents within that

1/ It is noteworthy that courts have, in reverse FOIA actions, reached conflicting conclusions regarding the confidentiality of the same types of documents. Compare, e.g., Westinghouse Electric Corp. v. Schlesinger, supra, with Hughes Aircraft Corp. v. Schlesinger, 384 F.Supp. 292 (C.D.Cal. 1974), appeal pending.

2/ See Clement, supra, 55 Tex.L.Rev. at 639.

cases.[1] However, because the courts have occasionally disagreed as to the basis of that jurisdiction, and because federal agencies and document requesters persist in their contention that the federal courts do not have jurisdiction over reverse FOIA cases, legislative clarification is desirable.

The FOIA expressly grants federal district courts jurisdiction in cases brought to compel disclosure of documents under the Act.[2] Is not the submitter of such documents -- whose documents are at stake and who asserts that disclosure would violate the Act -- equally entitled to his day in court to seek review of an adverse disclosure decision? All courts have agreed that, indeed, the submitter has such a right and that the courts possess adequate jurisdiction to protect that right.

Congress can and should put this issue to rest by expressly providing by amendment that the district courts, on complaint, shall have jurisdiction over reverse FOIA cases.

B. De Novo Review In Reverse FOIA Cases

In addition to challenging courts' jurisdiction over reverse FOIA actions, federal agencies and requesters have uniformly asserted that, in a reverse FOIA action, the district court may engage only in a limited review of an agency decision to disclose to determine whether the agency has abused its discretion or acted in an arbitrary or capricious manner.

1/ See, e.g., Westinghouse Electric Corp. v. Schlesinger, supra, 542 F.2d at 1203-10; Sears II, supra.

2/ 5 U.S.C. §552(a)(3).

While most courts have held that a reverse-FOIA plaintiff is entitled to de novo judicial review, legislative action expressly establishing this right is nonetheless necessary because the issue continues as a source of litigation and conflicting judicial opinions.

Legislative recognition of a submitter's right to de novo judicial review is also desirable in light of the nature of the administrative decision-making process in which the submitter's rights are initially determined. While the agency employees who pass upon disclosure requests are skilled at performing their primary functions, they are not properly qualified to assess the serious impact which disclosure of assertedly confidential commercial information will have on the submitter. Thus, most government employees who pass upon FOIA requests and claims of exemption are primarily trained to perform wholly distinct job responsibilities; they are not, however, either expert economists or judges, and have no adequate training or experience either to independently analyze the impact of threatened disclosure or to assess competing claims and expert testimony as to what effect disclosure will have. Indeed, some government agencies have admitted as much, stating before this Subcommittee that they do not have the capability to independently evaluate the competitive nature and value of much

> as has already been observed, [1/] in most instances, sufficient knowledge to assert properly the private party's right to confidentiality. And it must not be forgotten that the protection of a competitive position is both a valuable and often complex matter, dependent upon full proof, and one 'basic to our free enterprise system.' Should not the person who is threatened with harm through a disclosure, which the Congress has indicated clearly is against the public policy as expressed in the FOIA itself, be the proper one to assert that right to protection from disclosure assured him under Exemption 4, in an equity action in which he can have a de novo trial? The envious competitor or the curious busybody demanding access to that private information has the right to such a de novo trial. The Act gives it to him. But is not the same right to be implied, when the supplier, with a right that Congress gave him 'not only as a matter of fairness but as a matter of right', seeks what may be regarded as correlative relief?" 2/

Similarly, it must also be recalled that many agencies are now characterized by an institutional bias in favor of disclosure which may render these agencies insensitive to businesses' claims of confidentiality and may well impair the agency's ability to develop a fair and adequate record of the administrative action.

Just as Congress recognized that de novo review of an agency decision not to disclose was necessary to "prevent

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1/ The Fourth Circuit, quoting several commentators, observed that "'the agencies cannot always be relied upon to protect adequately the confidentiality of that information. *** Counsel for the agency ... has little or no incentive to protect the secrets of the business community. *** It may be bad for appearances in a period of "openness" and "honesty" for an agency to refuse disclosure from its files.'" In contrast, "the individual is more aware than the agency of the potential competitive harm he will suffer should information be released." 542 F.2d at 1212. See O'Reilly, supra, 30 Bus. Lawyer at 1134; Reverse FOIA Suits, supra, 70 Northwestern U.L.Rev. at 998-9.

2/ 542 F.2d at 1213.

nished pursuant to requirement; for even though the Government possesses the power to collect the information, cooperation by the submitter may improve both the quality and quantity of information which is supplied.[1/] These governmental functions would be severely inhibited, and the success of the programs gravely imperiled, if private documents, including competitively damaging or embarrassing information, were to be publicly disclosed. Disclosure would directly discourage compliance and would disperse a crucial source of industry information to the Government if the sense of integrity with which it was given was not respected.

A number of agencies have formally recognized this proposition, though their adherence to it in practice has been less than complete. For example, the Department of Labor has recognized that "[d]isclosure of information obtained [in] confidentiality would hamper operating programs by reducing the quantity and reliability of the information which we received ..."[2/] Similarly, in FAA Administrator v. Robertson,[3/] where the Supreme Court held that information provided to the agency by commercial air carriers was not disclosable, the

1/ Id. at 604.

2/ Hearings on S. 1335 Before The Senate Committee on the Judiciary, 89th Cong., 1st Sess., 436-437 (1965); see also Government Operations Committee Hearings, supra, at 1619.

3/ 422 U.S. 255 (1975).

In fashioning any amendments to, or guidance under, Exemption 4, Congress should consider the effect which disclosure of confidential business information must necessarily have on the future submission of such information to government agencies. Absent such an accommodation, the certain effect of disclosure will be the impairment of the Government's ability to obtain information necessary for the effective implementation of important regulatory programs.

CONCLUSION

The Freedom of Information Act was conceived as a means of remedying rampant government secrecy regarding matters which Congress believed should be subject to public scrutiny. The Act was designed to bring these matters within public reach, view and criticism, and thereby to make government more responsive to the citizenry. The goal of the Act was laudible; and, while not without problems, the Act has during its first decade achieved that goal to a remarkable degree.

The Freedom of Information Act was not, however, intended to affect long standing and well founded practices of business secrecy. The legislative history and the exemptions themselves reflect that Congress did not intend, in increasing public access to information concerning how the Government operates, to invade the privacy of businesses which submit information to the Government showing how they operate.

Mr. PREYER. Now we will hear from Diane Cohn, an attorney on the staff of the Freedom of Information Clearinghouse. The clearinghouse is a project of Ralph Nader's Center for the Study of Responsive Law and is involved in a broad range of FOIA litigation.

Thank you very much for joining us today. We will ask you to proceed in any way you see fit.

STATEMENT OF DIANE B. COHN, FREEDOM OF INFORMATION CLEARINGHOUSE

Ms. COHN. Thank you, Mr. Chairman.

I very much appreciate your invitation to appear before the subcommittee today to address what we now all recognize to be the many problems presented by the trade secrets exemption of the Freedom of Information Act and the so-called reverse litigation which has resulted from it. We are very pleased that the subcommittee is undertaking this oversight hearing with a view toward exploring what legislative changes might be appropriate for resolving the myriad problems and uncertainties which exist under the present state of the law.

There is now an ever growing list of conflicting judicial opinions which have attempted to delineate the rights of submitters of information to enjoin the disclosure of information which is claimed to be confidential and commercial within the meaning of exemption 4. Many of these actions have arisen in response to requests by public interest groups for access to information such as civil rights compliance reports and affirmative action plans.

In one such case, the U.S. Court of Appeals for the Fourth Circuit found that these reports constituted confidential commercial information, disclosure of which was absolutely barred by 18 U.S.C. 1905, a broad criminal statute which applies only to disclosure, not authorized by law.

I am referring to *Westinghouse Electric Corporation* v. *Schlesinger*, 542 F. 2d 1190 (4th Cir. 1976), cert. denied, 431 U.S. 924 (1977).

As Mr. Braverman indicated, despite conflicts between this decision and other opinions rendered in the District of Columbia circuit, the Supreme Court refused the opportunity to resolve these questions of law.

Just last week, however, the third circuit correctly concluded, we think, that the FOIA exemptions are merely permissive in nature, and, therefore, allow the Department of Labor to promulgate regulations authorizing disclosure of civil rights compliance information—notwithstanding the applicability of an exemption—when the public interest would be furthered thereby. *Chrysler Corporation* v. *Schlesinger*, Nos. 76–1970 and 76–2238 (3d Cir., Sept. 26, 1977). In addition, that court held that if this civil rights information is properly released pursuant to such a valid agency regulation, it is an authorized disclosure for purposes of 18 U.S.C. 1905. Authough the Supreme Court will once again have an opportunity to attempt to reconcile these conflicting interpretations, the fact will remain that the process of applying the prevailing *National Parks* competitive harm test may continue to require expensive and time-consuming trials—see *Sears, Roebuck & Company* v. *GSA*, 553 F. 2d. 1378 (D.C. Cir. 1977)—a re-

competitive harm, but instead out of fear of possible title II suits or adverse public reaction to an unsafe product. Surely, these types of harms are not protectable under the FOIA's exemptions from disclosure.

While we are not suggesting at this time that Congress need clarify its intent by amending the language of exemption 4, we would suggest that this subcommittee ask every agency to submit a list of the categories of documents for which requests relating to the fourth exemption have been received.

After having a true picture of the parameters of the problem, it may be simpler for Congress to enact legislation which establishes that certain types of information are specifically not exempt from disclosure and must therefore be disclosed. In fact, Congress has already utilized this very method of enacting such statutes, which might be called "reverse (b) (3) statutes." The IRS statute requiring the disclosure of revenue rulings and related documents is just one case in point. See section 6110 of the Internal Revenue Code, as added by the Tax Reform Act of 1976.

I think that this is the type of statute which Commissioner Kennedy is suggesting that Congress enact to mandate the release of safety and efficacy data, although, under our reading of the current law, we feel that FDA has ample authority to release this type of information.

While our first concern is thus that too much information is being withheld under the guise of exemption 4, the second proposition which we find equally compelling is that each submitter has the right to be given an opportunity to make its interests known. In this regard, we believe that a number of procedural changes may be appropriate with respect to the treatment of documents submitted in the future.

We would therefore make the following recommendations which are designed to help protect the interests of all concerned parties, without undermining the FOIA's policy of the fullest responsible disclosure. We believe that such procedures would at the same time relieve some of the burdens and delay which are now an inherent part of the processing of requests for records which are claimed to be protected under exemption 4.

Identification should be required upon submission of exemption 4 material. In order to expedite the processing of a request for material that may be exempt, the submitter should be required to specify at the time of submission what portions of the information are claimed to be trade secrets or confidential commercial information. Each claim should include a brief statement of the basis upon which the company asserts that exemption 4 applies, as well as an indication of whether the necessity for confidentiality will be altered in any way by time or future event. Finally, the submitter should identify the individuals who are prepared to come forward and explain in greater detail the need for confidentiality at the time the request for information may be received.

While these procedural rules may impose a greater burden on the submitters of information who will in each instance be required to make a fairly particularized showing, we anticipate that such procedures will ultimately stimulate what the District of Columbia circuit has recognized would be "the simplest and most effective solution,"

Information: The Reverse Freedom of Information Lawsuit," 5 Texas Law Review 587 (March 1977) at 598–600, 619–624.

In this context, Congress should also clarify that 18 U.S.C. 1905, which is a criminal prohibition against disclosure that is "not authorized by law," is clearly inapplicable to situations where disclosure is made pursuant to a validily promulgated regulation. Even in the absence of such regulations, however, we believe that section 1905 has not been construed in accordance with the legislative history of that provision, and a clarification of the scope of this broad criminal statute would go far toward eliminating much of the time-consuming litigation now underway. For an excellent discussion of the legislative history and judicial interpretation of 18 U.S.C. 1905, see *Clement*, *supra*, at 607–619.

We do not, however, believe that agencies should necessarily be encouraged to designate by rule categories of information that are deemed to be exempt under exemption 4. Such a determination is essentially a legal one, which would not be binding in the sense of depriving a requester or submitter of his or her right to challenge that legal conclusion in court.

Fourth, the requesters of information should be joined in reverse suits. To guarantee that requesters of information also have a full opportunity to be heard, we would suggest that Congress legislate changes which would eliminate the present forum shopping problems which reverse suits have created. As already indicated above, the choice of an inconvenient forum by the submitter who files a reverse suit may effectively bar participation by the requester of the information and, as courts have recognized, the Government may not always adequately represent the prodisclosure interest. See *Consumers Union* v. *CPSC*, *supra*.

At the same time, under present law, agencies may be required to defend several suits in different forums involving the very same documents, and ultimately be subjected to conflicting judgments. See id.; *Robertson* v. *Department of Defense*, 402 F.Supp. 1342 (D.D.C. 1975).

In order to alleviate these problems and to preserve the requester's right to a liberal choice of forum in enforcing the provisions of the FOIA, we would suggest that whenever a request for information has been made, the submitter who files a reverse suit be required to join the requester as a party defendant, and the requester should then be given the right to transfer the action to any other district court where the requester could have filed suit under the FOIA; for example, where the requester resides or has his or her principal place of business, where the documents are located, or in the District of Columbia. We would note that the procedure we have suggested might require a legislative modification of the general venue statute applicable in all civil litigation, 28 U.S.C. 1404(a), which provides that a case may be transferred to any district in which the case may originally have been brought. It may be possible that a requester could not have obtained original jurisdiction over a company in one of various forums designated in the FOIA, since that company may neither be incorporated nor have its principal place of business in one of those districts.

Another recognized barrier to enforcement of the FOIA by average citizens is the high cost of legal fees associated with exercising one's right to obtain judicial review of agency withholding. To assure that

We thank you very much for your testimony.

We will be in touch with you.

Our final witness today is Charles Derr, senior vice president of the Machinery & Allied Products Institute which has been involved in monitoring Freedom of Information activity.

We welcome you, Mr. Derr. Do you have a statement?

Without objection, it will be made a part of the record, and we will ask that you proceed in any way you wish.

STATEMENT OF CHARLES I. DERR, SENIOR VICE PRESIDENT, MACHINERY & ALLIED PRODUCTS INSTITUTE; ACCOMPANIED BY PAUL J. SEIDMAN, STAFF ATTORNEY

Mr. DERR. I am Charles Derr, senior vice president of Machinery & Allied Products Institute. My associate is Mr. Paul Seidman who is a staff attorney with the institute.

Since I am running the anchor lap in this relay I will make it just as painless as possible, Mr. Chairman.

I should explain that Machinery & Allied Products Institute (MAPI) is a national association of capital goods and allied equipment manufacturers. Because those companies depend for their livelihood and their progress upon high technology, they are perhaps more sensitive than other business groups might be to the danger of losing business secrets by reason of the FOIA or for any other cause.

We think that certain recent developments have made it especially timely for the subcommittee's hearing and we commend the subcommittee for its action.

You specified, Mr. Chairman, three special areas in which you would like to have witnesses' comments. Because our full statement is in the record I will first summarize very briefly our general conclusions and discuss briefly those matters on which you have requested special commentary.

Our recommendations in general are as follows: first, that Congress should reexamine, with a view toward correction, the immense and growing burden on both Government and industry created by FOIA bearing in mind that any solution must protect private rights. Second, we believe the act must be amended to require advance notice to a private source of information in Government hands of the possible disclosure of such information so that the source of the information may undertake to demonstrate its confidential character and if need be file suit to prevent its disclosure.

Third, we believe that Congress should recognize in its report of these hearings and by appropriate amendment of the act the distinction between public documents created by Government action, and private source documents in the Government's possession.

Mr. Braverman has already commented on that at some length and I agree with what he has to say.

Fourth, by amendment of the act and/or unmistakable language in the legislative history Congress should strike down the substantial competitive harm test of confidentiality and simultaneously make exemption 4 to the act mandatory as it applies to information which

In addition, 18 U.S.C. 1905 makes it a criminal offense for a Federal employee to make disclosures not authorized by law of certain confidential business information, knowledge of which was obtained in the course of his employment.

Finally, exemption 4 to FOIA makes possible the protection from disclosure of information in Government's hands which constitutes trade secrets and commercial or financial information obtained from a person which is privileged or confidential.

We recite these obvious facts because the interrelationships of these three propositions raise two questions which we believe call for legislative direction.

First, is 18 U.S.C. 1905 an exemption 3 statute? If this criminal statute is one of those statutes contemplated by exemption 3, then information within its purview could not be disclosed, first, because the exemption is mandatory on the agency; and, second, by providing a clear statutory basis for a reverse FOIA injunction.

We believe that 18 U.S.C. 1905 should be an exemption 3 statute and that Congress should make this clear by appropriate action.

Second, is the application of exemption 4 permissive or mandatory? We have already recommended that exemption 4 to FOIA should, as a matter of policy, be made mandatory in its application by appropriate legislative action. We think our contention is made more persuasive by the fact that some courts have held that this exemption is coextensive with 18 U.S.C. 1905 and thus in effect is mandatory rather than discretionary.

We believe Congress should clarify this issue and, thus, we recommend that exemption 4 be made mandatory in this application by amendment of the act.

Now as to some other issues in the chairman's letter—first, the scope of review of FOIA cases.

In discussing the jurisdictional basis for reverse FOIA suits we have already touched upon the question of the character of judicial review. It can be de novo or a review limited to the record of agency proceedings.

The issue deserves legislative direction because it is freighted with constitutional due process considerations. Whereas there now is an absence of agency procedural safeguards such as those described in the Administrative Procedure Act provisions relating to agency adjudication, we believe due process requires a de novo judicial review of an agency decision to disclose under FOIA.

Moreover, elementary fairness would seem to require it since information requesters having no interest beyond mere curiosity are entitled to a de novo review of an agency decision to withhold information requested.

On the other hand, where the formal agency adjudicatory procedures compatible with the Administrative Procedure Act are available, it would probably be unnecessary to have de novo review.

The chairman's letter refers to certain procedural alternatives in handling exemption 4 requests. One has to do with the advance determinations of confidentiality. I take it from listening to the testimony this morning that what you have in mind here is a procedure for inducing the voluntary submission of information by making a confidentiality determination in advance of the submission. Is that correct, counsel?

Mr. PREYER. Thank you very much, Mr. Derr. You have outlined your comments very succinctly and very much to the point.

I appreciate them very much.

Your statement would get us into a philosophical discussion of the whole issue on the basis of your statement.

Mr. DERR. I wish we could.

Mr. PREYER. I am afraid that with the bells having just rung that this is not a very good time to launch that debate. Perhaps we can do it again on some other occasion.

Your statement certainly will be very helpful to us.

Counsel, do either of you have any key questions?

If not, then we will thank Mr. Derr and congratulate Mr. Derr on putting this in a nutshell. It is a difficult subject to keep in a nutshell. I think you have done a good job in summarizing your recommendations.

At this time the Chair will ask that the record remain open for 30 days to allow for the submission of additional comments. I have been asked by several people for the opportunity to comment further on these hearings. So, we will keep the record open for 30 days for that purpose.

Any other wisdom you want to give us in the next 30 days we will be glad to hear.

[See apps. 7–20.]

Mr. PREYER. At this time the subcommittee stands adjourned.

[Mr. Derr's prepared statement follows:]

> grounds to object, either because of personal privacy or business secrecy considerations. But the stringent time requirements under the Freedom of Information Act, as amended, as well as the heavy financial and manpower burden that the Commission would be obliged to sustain if it were to attempt to examine each individual record for these purposes, will generally prevent the Commission from refusing to make disclosure on these bases. (Underscoring supplied.)/1

When the administrative burden imposed by a law requires those who administer it to jettison rights the protection of which was supposedly guaranteed by the Act and its legislative history then we think it is high time for a reexamination. Accordingly, we commend the Subcommittee for this oversight hearing.

The Justice Department position.--Let us underline and extend the point just made by reference to the attitude of that government department responsible for interpretation of FOIA. In his letter of May 5, 1977 to the heads of all federal departments and agencies, the Attorney General said:

> Freedom of Information Act litigation has increased in recent years to the point where there are over 600 cases now pending in federal courts. The actual cases represent only the "tip of the iceberg" and reflect a much larger volume of administrative disputes over access to documents. I am convinced that we should jointly seek to reduce these disputes through concerted action to impress upon all levels of government the requirements, and the spirit, of the Freedom of Information Act. The government should not withhold documents unless it is important to the public interest to do so, even if there is some arguable legal basis for the withholding. In order to implement this view, the Justice Department will defend Freedom of Information Act suits only when disclosure is demonstrably harmful, even if the documents technically fall within the exemptions in the Act. (Underscoring supplied.)

One hopes it is an inadvertent exaggeration but the Attorney General's statement may be read to mean that "the public interest" is the sole criterion by which disclosure vs. withholding is to be decided; private rights presumably are to be ignored. Is this the same government whose House of Representatives said, ". . . where the Government has obligated itself in good faith not to disclose documents or information which it receives, it should be able to honor such obligations?"/2

1/ SEC Release No. 33-5571, 40 Federal Register, 8797, 8799 (March 3, 1975).
2/ H. Rept. No. 1497, 89th Cong., 2d Sess., p. 10 (1966).

Are confidential private documents converted into "Federal documents" merely by the fact of government possession and which, incidentally, may have resulted from a government requirement imposed upon the supplier of information? We believe that a private document remains a private one even though information taken therefrom may be used confidentially by government for its purposes or combined with similar information from other private documents to constitute a wholly new "Federal document."

Chairman Preyer's letter of September 21 indicates that the central purpose of these hearings is ". . . to identify any problems presented by the existing trade secrets provisions of the law and to explore possible alternatives." We suggest that the initial failure to distinguish clearly between documents wholly of government origin and private documents given to government in confidence may be one of the more important--albeit one of the less obvious--problems which these hearings seek to identify.

With one exception--Exemption 3/1--so-called "exemptions" to FOIA are permissive, not mandatory. In short, they are exemptions which do not exempt save in those cases where fact and circumstance combine to persuade a civil servant to withhold information sought by a requester. Exemption 4 to FOIA is said to protect from disclosure ". . . trade secrets and commercial or financial information obtained from a person and privileged or confidential."/2 Manifestly, it applies largely if not wholly to documents of private origin. Because of our conviction that such documents are different in kind from those of government origin, we believe that Exemption 4 should be mandatory without question and not permissive in character. We recommend that the Act be so amended.

Congressional Intent vs. Judge Made Law

Of all the ". . . problems presented by the existing trade secrets provisions of [FOIA]," perhaps the most serious is the judicially-devised test for determining whether or not private information in government hands is "confidential." Both House and Senate reports on the Freedom of Information Act make clear that Exemption 4 was intended to cover information that ". . . would not customarily be made public by the person from whom it was obtained by the Government."/3 Both reports list examples of information

1/ Exemption 3 to FOIA, as amended in 1974, applies to matters "specifically exempted from disclosure by statute (other than section 552b of this title), provided that such statute (A) requires that the matters be withheld from the public in such a manner as to leave no discretion on the issue, or (B) establishes particular criteria for withholding or refers to particular types of matters to be withheld."

2/ 5 U.S.C. § 552(b)(4).

3/ The language quoted is from H. Rept. No. 1497, 89th Cong., 2d Sess., p. 10 (1966).

-- A burden of proof test which defies definition, much less satisfaction, is made even more onerous by the brief period of time--ten days--within which the agency generally must respond to a request and the submitter must present proof of competitive harm.

-- All litigation is expensive. A "reverse FOIA" suit intended to satisfy the extraordinary burden of proof imposed by the "substantial competitive harm" test--and which may approach in complexity antitrust litigation--can be crushingly expensive.

-- Rather than protecting private rights confided to government, the judicially-amended Exemption 4 empowers a civil servant--because the exemption is discretionary rather than mandatory--to dispose of such rights if he judges that proof of "competitive harm" submitted by the source is insufficient to satisfy National Parks.

-- Once trade secrets which Exemption 4 was intended to protect have been handed over there is literally no means of adequate recourse or recoupment. The value of a trade secret lies in the fact it is secret; disclosure destroys that value forever.

-- As noted above, the House Committee report on the Freedom of Information Act says, ". . . where the government has obligated itself in good faith not to disclose documents or information which it receives, it should be able to honor such obligations."/1 The "competitive harm" test has been applied in such a way that government may not be able to keep its word given in good faith. We think that this is neither the intent of Congress nor responsible government.

Let us sum up briefly. Recognizing the well-nigh impossible burden of proof inherent in its initial formulation of the "substantial competitive harm" test, the court in National Parks II has reduced somewhat the rigor of that test. We think the test was--and is--wrong under either National Parks I or National Parks II. Therefore, we recommend that Congress amend the Act to reaffirm its original intent by making Exemption 4 mandatory in its application to information that ". . . would not customarily be made public by the person from whom it was obtained by the Government."

1/ H. Rept. No. 1497, 89th Cong., 2d Sess., May 9, 1966, p. 10.

of this character have been numerous, the courts have been unable to agree on the proper jurisdictional basis for granting reverse FOIA relief. The importance of the issue lies in the fact that its resolution may determine whether judicial review of an agency decision to disclose is limited to the administrative record or is to be undertaken de novo.

Without taking the time to review the leading cases, it should be noted that case law concerning the proper jurisdictional basis for reverse FOIA relief and the resulting scope of judicial review is far from clear. We believe Congress should settle the matter by providing through amendment a statutory basis for judicial review de novo of an agency decision to disclose.

The substantive basis for reverse FOIA relief.--As the Subcommittee knows, Exemption 3 to FOIA--as amended by the Sunshine Act--protects from voluntary agency disclosure information "specifically exempted from disclosure by statute (other than section 552b of this title), provided that such statute (A) requires that the matters be withheld from the public in such a manner as to leave no discretion on the issue, or (B) establishes particular criteria for withholding or refers to particular types of matters to be withheld." In addition, 18 U.S.C. § 1905 makes it a criminal offense for a federal employee to make disclosures "not authorized by law" of certain confidential business information knowledge of which was obtained during the course of his employment. Finally, Exemption 4 to FOIA makes possible the protection from disclosure of information in government's hands which constitutes ". . . trade secrets and commercial or financial information obtained from a person and privileged or confidential." The relationships of these three facts raise at least two questions which call for "legislative direction." Each is discussed below.

(1) Is 18 U.S.C. § 1905 an Exemption 3 statute?--If this criminal statute is one of those statutes contemplated by Exemption 3, then information within its purview could not be disclosed--first, because the exemption is mandatory on the agency and second, by providing a clear statutory basis for a "reverse FOIA" injunction.

We believe that 18 U.S.C. § 1905 should be an Exemption 3 statute and that Congress should make this clear by appropriate action.

(2) Is the application of Exemption 4 permissive or mandatory?--We have already recommended that Exemption 4 to FOIA should as a matter of policy be made mandatory in its application by appropriate legislative action. We think our contention is made more persuasive by the fact that some courts have held that this exemption is coextensive with 18 U.S.C. § 1905 and thus in effect is mandatory rather than discretionary in effect. We believe Congress should clarify this issue and we renew our recommendation that Exemption 4 be made mandatory in its application by amendment of the Act.

Scope of review of reverse FOIA cases.--In discussing the jurisdictional basis for reverse FOIA suits we have already touched upon

On the other hand, if we are discussing an advance determination procedure by which an agency--e.g., EPA/1--seeks to induce the voluntary submission of confidential private information, then obviously a different set of considerations would apply. The virtue of such a procedure lies in the fact that the submitter of information knows before submitting it that information confided to government will be secure. Or does he? A possible drawback is the fact that information in the agency's hands for the purpose of making an advance determination would be subject to disclosure by FOIA request during that period of time. If this possibility can be overcome, it would seem to us that advance determinations in this second situation we have hypothesized might be a very useful device.

(2) Class determinations through rulemaking.--We have three comments on this suggestion. First, resort to class determinations of confidentiality would require abolition of the National Parks "substantial competitive harm" test of confidentiality under which nothing is confidential per se. We have, or course, already strongly recommended that test's repeal.

Second, adoption of our earlier suggestion that Exemption 4 be made mandatory as to information the submitter would not customarily release would represent a most significant and a very proper class determination--and one wholly in accord with the original congressional intent. Accordingly, we repeat the recommendation.

Third, if class determination is not to be accomplished by making the application of Exemption 4 mandatory, we think this approach could be used to establish "guidelines" in advance but with the necessity remaining for an ad hoc decision consistent with those guidelines in the individual case. We understand that EPA currently employs such a system and is convinced that it is simplifying administration./2 We believe this approach deserves further study.

(3) Advance notice.--We have already--and repeatedly--urged that the Act be amended to require advance notice to a source of information that such information may be disclosed under FOIA.

(4) Formal agency proceedings.--In discussing "scope of review of reverse FOIA cases" above we have already suggested that steps should be taken to correct the imbalance of rights now existing as between information suppliers and information requesters. A requirement for formal agency proceedings in the handling of requests under Exemption 4 and reverse FOIA cases as well would substantially redress the present inequity.

We have no procedural or substantive reforms to suggest beyond those discussed above. In conclusion, let me express again our appreciation for the privilege of testifying in this important hearing on the administration of the Freedom of Information Act.

1/ See pertinent EPA regulations at 40 C.F.R. § 2.206.
2/ 40 C.F.R. § 2.207.

APPENDIXES

APPENDIX 1.—LETTER FROM MICHAEL A. JAMES, DEPUTY GENERAL COUNSEL OF ENVIRONMENTAL PROTECTION AGENCY, DATED DECEMBER 1, 1977

UNITED STATES ENVIRONMENTAL PROTECTION AGENCY
WASHINGTON, D.C. 20460
December 1, 1977

OFFICE OF
GENERAL COUNSEL

Honorable Richardson Preyer
House of Representatives
Washington, D.C. 20515

DEC 5 1977

Dear Mr. Preyer:

I am pleased to furnish the following additional information for the record of the Government Information and Individual Rights Subcommittee hearing about the trade secret exemption of the Freedom of Information Act (FOIA) as requested in your letter of October 25, 1977.

1) In cases involving Freedom of Information Act requests for possible confidential business information, we understand EPA may issue an initial pro forma denial to the requester to allow time to contact the submitter of the data.

a) Where pro forma denials are used, how frequently are appeals decided within the twenty-day statutory time limit?

Answer: In approximately half of the cases where an appeal is made from an initial denial on the grounds of 5 U.S.C. 552(b)(4) EPA is able to render the appeal decision within the twenty-day statutory time limit. In those cases where the appeal decision is not made within the twenty-day time limit, the delay is most often caused by the large numbers of affected businesses and large amount of information involved. In cases where a single affected business is involved, we usually have little problem meeting the statutory time limit.

b) Do you ever use pro forma denials when the material involved is covered by a Freedom of Information exemption other than the (b)(4) exemption?

Answer: When more than one exemption is applicable to information, the EPA program office responding to the request may cite one or all of the applicable exemptions. In cases where the information may be confidential and the program office cites 5 U.S.C. 552(b)(4) as the

20-466 O - 78 - 12

Answer: When a request is made under FOIA for information within a class covered by a class determination, EPA issues a pro forma initial denial if the information is claimed as confidential, and requires the affected business to substantiate the claim. Upon receipt of the substantiation, we evaluate the substantiation in light of the criteria set forth in the class determination and decide whether the specific information in question is confidential. The class determination helps us by cutting down on paperwork and allows us to narrow the issues addressed by the business in its substantiation.

d) Can a submitter, or requester, or other interested party, challenge a class determination?

Answer: Any person could challenge a class determination in general. However, it is more likely that a requester or an affected business would challenge a class determination when it is applied to a specific request for information. In that case, the class determination is really a part of the specific determination in the particular case and could be challenged as such.

e) Should the FOIA be amended to permit EPA to issue binding class determinations? If so, how?

Answer: By "binding class determinations" I assume you mean determinations that classes of information are confidential. In these cases the determination would be binding for all information within the class and would eliminate the need for individual determinations in response to specific requests. Such an approach would be useful in some situations. Inevitably, however, it would result in confidential treatment for some information that could not meet the independent requirements necessary in an ad hoc determination. Such an amendment would mean that agencies would be able to deny requests for some information that would not be confidential under current law. Adoption of such an approach would indicate a philosophical change in direction for the FOIA against disclosure. EPA is not ready to take a position on this matter.

f) Are there other categories of information for which class determinations could be made?

Answer: We have several categories of information under consideration for class determinations at the present time: information in contract proposals, information in the National Emissions Data System, and information received under section 8(b) of the Toxic Substances Control Act relating to the inventory of chemical substances.

of the Clean Air Act, 42 U.S.C. 7417(c), 7542(b), and 7607(a); section 13(b) of the Noise Control Act of 1972, 42 U.S.C. 4912(b); section 1445(d) of the Safe Drinking Water Act, 42 U.S.C. 300j-4(d); and sections 308(b) and 509(a) of the Federal Water Pollution Control Act Amendments, 33 U.S.C. 1318(b) and 1369(a).] Also 5 U.S.C. 301 authorizes the head of an agency to prescribe regulations for the government of the agency, the performance of its business, and the preservations of its records, papers, and property. Under these various authorities EPA has determined that it must have that information identified at the time of submission so that EPA can meet its obligations under its substantive statutes. It is clearly within the Agency's discretion to promulgate rules to carry out its statutory mandates.

c) Do you follow the same practice if the information requested is exemption 3 material?

Answer: EPA has no statutory authority that bars release of certain information under 5 U.S.C. 552(b)(3)(A). The specific statutes cited in the answer above, however, may be statutes within 5 U.S.C. 552(b)(3)(B) in that they either establish particular criteria for withholding or refer to particular types of matters to be withheld. We follow the same process for identifying information submitted under any of our statutes, even those that might be under 5 U.S.C. 552(b)(3)(B), because EPA is not in the best position to identify information that is confidential. The business submitting the information is in the best position to identify information that may be confidential under a specific statute.

4) Your regulations provide for determinations of the confidentiality of information before formal submission

a) How do you treat a FOIA request for information received before a determination of confidentiality has been made?

Answer: I believe your reference here is to EPA's "advance confidentiality determinations." If EPA receives a request under FOIA for information that is under consideration for an advance confidentiality determination, one of two situations would occur. If the information in question was not in the possession of EPA it would not be an Agency record and therefore not subject to FOIA. If the information were in the possession of the EPA legal office for the limited purpose of review for an advance confidentiality determination when the FOIA request was received, EPA would deny the request on the grounds that the information had been submitted

Answer: Section 14(a) of the Toxic Substances Control Act (TSCA) states that EPA may not disclose any information obtained under TSCA that is exempt from disclosure under 5 U.S.C. 552(b)(4). This specifically eliminates Agency discretion to disclose such information. There are specific exceptions to this in section 14. EPA may disclose information that otherwise would be confidential (a) to officers or employees of the United States with duties under any law for protection of health or the environment or for law enforcement purposes, (b) to contractors of the United States performing contract work under TSCA, (c) when necessary to protect health or the environment against an unreasonable risk to injury, and (d) when relevant to a proceeding under TSCA if the disclosure is made in a way that preserves confidentiality to the extent practicable without impairing the proceeding. In addition section 14(b) states that EPA may not deny requests for data from health and safety studies for any chemical substance or mixture distributed in commerce or subject to certain TSCA requirements on the grounds of 5 U.S.C. 552(b)(4), except to the extent the data would disclose processes used in manufacturing or processing of a chemical substance or mixture or the portion of a mixture comprised by any of the chemical substances in it. Section 14 requires that EPA give 30 days advance notice before public disclosure of information that has been claimed as confidential (except in the case of the four types of disclosure discussed above).

6) In a rulemaking proceeding, what is your policy if a company asks for a confidential treatment of its comments?

Answer: EPA has no agency-wide policy on this issue. Some offices will accept confidential comments and others will not. We are currently reviewing this issue with a view to establishing an agency-wide policy.

a) How could anyone challenge a rule which was based on secret comments?

Answer: If EPA treated certain comments as confidential in certain types of rulemaking and EPA relied on those comments in part or in whole in making its decision, EPA would acknowledge that reliance in the public record and, to the extent possible, would disclose the substance of those comments while protecting the part that is confidential. If someone challenged a rule that was based on confidential information, EPA would ask the reviewing court to place a protective order on the information allowing the challenging party to review the information and challenge it in the court but not allowing the party to disclose it outside of the court proceedings. In this way the party could participate fully and have access to all of the information that was the basis of the rule; yet the legitimate confidentiality interests would be protected as far as public disclosure.

APPENDIX 2.—MEMORANDUMS OF THE ENVIRONMENTAL PROTECTION AGENCY WHICH DISCUSS THE PROBLEMS INVOLVED IN HANDLING CONFIDENTIAL BUSINESS INFORMATION

UNITED STATES ENVIRONMENTAL PROTECTION AGENCY
WASHINGTON, D.C. 20460

JUN 27 197

MEMORANDUM

OFFICE OF GENERAL COUNSEL

SUBJECT: Furnishing Confidential Business Information to EPA Contractors and Using Contractors to Gather Information

FROM: G. William Frick
General Counsel (A-130)

TO: Assistant Administrators &
Deputy Assistant Administrators

EPA's regulations concerning the confidentiality of business information in 40 CFR Part 2 Subpart B (41 Federal Register 36906, September 1, 1976) specify the circumstances under which EPA may make otherwise confidential business information available to EPA contractors for performing work under a contract. Under such circumstances, the regulations require that a specific procedure be followed before information is made available to a contractor.

The specific procedure appears in 40 CFR 2.301(h), attached. Before information gathered under one of the acts may be given to a contractor, the EPA program office for which the contract work is being done must make a written determination that a disclosure of confidential information is necessary in order for the contractor to carry out its work. The information cannot be disclosed to the contractor unless there is a clause in the contract that follows the requirements of 2.301(h)(2)(ii).

Attached to this memorandum is a copy of a contract clause entitled "Treatment of Confidential Business Information." This clause meets the requirements of 2.301(h). The clause was written by my staff in consultation with the Contracts Management Division. This clause will be made an optional clause to be included in contracts as needed.

It has come to my attention that there may be contracts entered into after the October 1, 1976, effective date of the business confidentiality regulations that involve EPA furnishing confidential information to a contractor but which do not contain this clause or a similar one. In addition, there are contracts entered into before October 1, 1976, that are still in force with work being performed under them at the present time. Some of these are level of effort type contracts and others are long-term contracts. If these contracts involve EPA

The clause has two purposes. The first is to have the contractor identify all of the sources of information used in writing the report. The contractor would supply this information at the time the first draft is submitted to EPA. In this way, the program office may identify business information early in the process of clearing a report for publication. This lead time would allow a confidentiality determination to be made while the report is being completed. This would shorten the process of clearing the information for publication.

The second purpose of the clause is to have the contractor give the notice required in 40 CFR 2.203, attached. This notice to a business or business representative allows the business to assert a confidentiality claim for any information it supplies. Failure to assert a claim constitutes a waiver of any claim. At the time the first draft is supplied to EPA, the contractor would report on all claims that were made or waived. In this way, the program office will be able to identify all of the confidentiality claims early enough to clear the information for publication.

This clause may be especially useful in cases where a contractor will be gathering information as an authorized representative of EPA directly from a business. But it is also useful in cases where the contractor probably will not gather any information directly from businesses because it helps to document the source of information that on its face looks like confidential business information.

This clause may be appropriate for inclusion in new contracts to be performed for a particular office. If so, the Contracting Officer should be requested to include it in the contract. Note that the clause "Treatment of Confidential Business Information" must appear in any contract in which the cluase "Screening Business Information for Claims of Confidentiality" appears.

If you have any questions concerning the use of these clauses or any problems including them in a contract, contact Dick Boehlert at X50774 or Jim Nelson at X50794.

Attachments

to compete with any business to which the confidential information relates.

(b) The Contractor agrees to obtain the written consent of the Contracting Officer, after a written determination by the appropriate program office, prior to entering into any subcontract that will involve the disclosure of confidential business information by the Contractor to the subcontractor. The Contractor agrees to include this clause, including this paragraph (b), in all subcontracts awarded pursuant to this contract that require the furnishing of confidential business information to the subcontractor.

(B) If no such claim is made at the time this information is received by [the Contractor], it may be made available to the public by the Environmental Protection Agency without further notice to you.

(ii) Upon receiving the information, the Contractor shall make a written notation that the notice set out above was given to the source, by whom, in what form, and on what date.

(iii) At the time the Contractor initially submits the information to the appropriate program office, the Contractor shall submit a list of these sources, identify the information according to source, and indicate whether the source made any confidentiality claim and the nature and extent of the claim.

(b) The Contractor shall keep all information collected from nonpublic sources confidential in accordance with the clause in this contract entitled "Treatment of Confidential Business Information" as if it had been furnished to the Contractor by EPA.

(c) The Contractor agrees to obtain the written consent of the Contracting Officer, after a written determination by the appropriate program office, prior to entering into any subcontract that will require the subcontractor to collect information. The Contractor agrees to include this clause, including this paragraph (c), and the clause entitled "Treatment of Confidential Business Information" in all subcontracts awarded pursuant to this contract that require the subcontractor to collect information.

UNITED STATES ENVIRONMENTAL PROTECTION AGENCY
WASHINGTON, D.C. 20460

27 SEP 1977

OFFICE OF
GENERAL COUNSEL

MEMORANDUM

SUBJECT: Use and Disclosure of Confidential Pesticide Production Data from Section 7 of FIFRA

FROM: James C. Nelson, Attorney
Contracts and General Administration Branch (A-134)

THRU: Richard Denney, Associate General Counsel
Pesticides, Toxic Substances & Radiation Division (A-132)

TO: Edwin L. Johnson, Deputy Assistant Administrator
Office of Pesticide Programs (WH-566)

You requested a written opinion concerning use and disclosure in the RPAR process of pesticide production data collected under section 7 of FIFRA. The short answer to your question is that there is nothing unique about the RPAR process that would allow the disclosure of otherwise confidential production information to the public. This does not necessarily restrict disclosure of the information to the U. S. Department of Agriculture or to congressional committees.

Section 7 of FIFRA requires producers of pesticides to report production information to EPA. Subsection (d) of section 7 states that "[a]ny information submitted to the Administrator pursuant to subsection (c) shall be considered confidential and shall be subject to the provisions of section 10." We have interpreted this language to mean that there is a presumption that production information is confidential and that it should be treated as such unless a contrary determination has been made under section 10.

Not all production information is confidential. Section 10 gives the Administrator the responsibility of determining whether the particular information in question is confidential. Under EPA's Freedom of Information regulations in 40 CFR Part 2 (41 Federal Register 36902, September 1, 1976), a required procedure is set out whereby determinations are made whether information is in fact confidential. These regulations also set out the standards by which confidentiality is judged and special rules that apply under EPA's specific statutes such as FIFRA (see 40 CFR 2.307 for FIFRA special rules).

The Contracting Officer has determined that during performance of this contract the Contractor may be required to collect information to perform the work required under this contract. Some of the information may consist of trade secrets or commercial or financial information that would be considered as proprietary or confidential by the business that has the right to the information. The following clause is included in this contract to enable EPA to resolve any claims of confidentiality concerning the information that the Contractor will furnish under this contract. The clause entitled "Treatment of Confidential Business Information" is also included in this contract.

SCREENING BUSINESS INFORMATION FOR CLAIMS OF CONFIDENTIALITY

(a) Whenever collecting information under this contract, the Contractor agrees to comply with the following requirements:

(1) If the Contractor collects information from public sources, such as books, reports, journals, periodicals, public records, or other sources that are available to the public without restriction, the Contractor shall submit a list of these sources to the appropriate program office at the time the information is initially submitted to EPA. The Contractor shall identify the information according to source.

(2) If the Contractor collects information from a State or local government or from a Federal agency, the Contractor shall submit a list of these sources to the appropriate program office at the time the information is initially submitted to EPA. The Contractor shall identify the information according to source.

(3) If the Contractor collects information directly from a business or from a source that represents a business or businesses, such as a trade association:

(i) Before asking for the information, the Contractor shall identify itself, explain that it is performing contractual work for the U.S. Environmental Protection Agency, identify the information that it is seeking to collect, explain what will be done with the information, and give the following notice:

(A) You may, if you desire, assert a business confidentiality claim covering part or all of the information. If you do assert a claim, the information will be disclosed by EPA only to the extent, and by means of the procedures, set forth in 40 CFR Part 2, Subpart B, 41 Federal Register 36906, September 1, 1976.

The Contracting Officer has determined that during the performance of this contract EPA may furnish confidential business information to the Contractor that EPA obtained under the Clean Air Act (42 U.S.C. 1857 et seq.), the Federal Water Pollution Control Act (33 U.S.C. 1251 et seq.), the Safe Drinking Water Act (42 U.S.C. 300f et seq.), the Federal Insecticide, Fungicide and Rodenticide Act (7 U.S.C. 136 et seq.), the Federal Food, Drug, and Cosmetic Act (21 U.S.C. 301 et seq.), the Resource Conservation and Recovery Act (42 U.S.C. 6901 et seq.), or the Toxic Substances Control Act (15 U.S.C. 2601 et seq.). EPA regulations on confidentiality of business information in 40 CFR Part 2 Subpart B require that the Contractor agree to the clause entitled "Treatment of Confidential Business Information" before any confidential business information may be furnished to the Contractor.

TREATMENT OF CONFIDENTIAL BUSINESS INFORMATION

(a) The Contracting Officer, after a written determination by the appropriate program office, may disclose confidential business information to the Contractor necessary to carry out the work required under this contract. The Contractor agrees to use the confidential information only under the following conditions:

(1) The Contractor and Contractor's Employees shall: (i) use the confidential information only for the purposes of carrying out the work required by the contract; (ii) not disclose the information to anyone other than EPA employees without the prior written approval of the Deputy Associate General Counsel for Contracts and General Administration; and (iii) return to the Contracting Officer all copies of the information, and any abstracts or excerpts therefrom, upon request by the Contracting Officer, whenever the information is no longer required by the Contractor for the performance of the work required by the contract, or upon completion of the contract.

(2) The Contractor shall obtain a written agreement to honor the above limitations from each of the Contractor's Employees who will have access to the information, before the employee is allowed access.

(3) The Contractor agrees that these contract conditions concerning the use and disclosure of confidential information are included for the benefit of, and shall be enforceable by, both EPA and any affected business having a proprietary interest in the information.

(4) The Contractor shall not use any confidential information supplied by EPA or obtained during performance hereunder

furnishing confidential business information to the contractor after October 1, 1976, these contracts must also contain this clause.

Each office should review the contracts that are currently in force for the office. If the review reveals contracts where the contractor is being furnished or has been furnished confidential information after October 1, 1976, steps should be taken to amend the contracts to include this clause. In addition, written findings of necessity in accordance with the regulations should be made for any information that has been or will be furnished to a contractor.

In some contracts EPA does not furnish confidential information directly to the contractor but rather makes the contractor an "authorized reprsentative" under one of the acts and arranges for the contractor to collect potentially confidential business information directly from a particular business. Since EPA is the authority by which the contractor is given access to the confidential information, it is considered to have been supplied to the contractor by EPA. In this case, the clause should also be included in the contract.

In some contracts the contractor is required to do research or gather data for EPA. In the course of its work, the contractor may acquire confidential business information. Sometimes this information is acquired directly from an affected business, but at other times it is acquired through a representative such as a trade association. Sometimes a contractor gathers information that on its face appears to be confidential business information, but the contractor, in fact, obtained the information from a public source or from another Government agency. This contract work usually results in a written report to EPA from the contractor. Frequently EPA wants to publish the report. However, if the report contains potentially confidential business information, EPA cannot publish it until the information has been formally determined not to be confidential or until the confidential information has been excised.

Once the final report has been received from a contractor, it may be difficult for the EPA program office to identify the sources of the information in the report. This in turn makes it difficult to identify confidential business information. If the information came from a public source it is not entitled to confidential treatment. If the information came directly from a business or a business representative it may be entitled to confidential treatment. The source of the information may be crucial to the ultimate decision as to confidentiality.

To deal with this problem my staff, in consultation with the Contracts Management Division, has written the attached clause entitled "Screening Business Information for Claims of Confidentiality." This clause will be made an optional clause to be included as needed.

b) Doesn't this practice result in the making of secret law?

Answer: This would not result in the making of secret law. The Agency rule that results from the rulemaking process is public and subject to judicial review.

c) Is the practice consistent with the Administrative Procedure Act?

Answer: The Administrative Procedure Act (APA) does not address the issue of whether an agency can consider confidential information in the course of rulemaking. We do not feel that consideration of confidential comments in certain types of rulemaking is inconsistent with the APA. The APA sets forth a general procedural framework within which an agency has a certain discretion. In certain types of proceedings it may be necessary to consider confidential information. In such a situation, EPA would make the information part of the record and therefore subject to judicial review. In some cases a statute clearly contemplates the use of confidential information in a proceeding. For example, section 14(a)(4) of TSCA states that EPA may disclose confidential information if it is relevant to a proceeding. The disclosure, however, must be made in a manner that preserves confidentiality to the extent practicable without impairing the proceeding. This indicates that in some cases EPA may use confidential information in a TSCA proceeding but not disclose it.

I hope these answers have addressed all of the Committee's concerns.

Sincerely yours,

Michael A. James

Michael A. James
Deputy General Counsel

to EPA for the limited purpose of advance review and was exempt from disclosure under 5 U.S.C. 552(b)(4). We would rely on the second test in National Parks and Conservation Association v. Morton, 498 F.2d 765 (D.C. Cir. 1974), that disclosure of the information would impair EPA's ability to obtain necessary information in the future, i.e., voluntarily submitted information that EPA would have no statutory authority to compel. At the same time we would work to issue a final confidentiality determination concerning the specific information in question and might find that the information also was exempt under the first Morton test of substantial competitive harm.

b) Is there any authority in the FOIA which would permit you to categorically deny requests for this "pre-submission" data?

Answer: Our authority for a denial would be grounded in the FOIA case law under Morton as discussed above.

c) Can a determination of confidentiality be made in advance of an actual request for the information? Shouldn't the determination be made at the time of the request, since information may lose its confidential character over time or the public interest may dictate a different release policy at the time the data is requested?

Answer: Facts may change and with them the confidential nature of information. All of our confidentiality determinations make clear that the determination may be subject to later review and revision if circumstances change. Consequently, even information that has been determined to be confidential under an advance confidentiality determination may later cease to be confidential. If in response to a subsequent FOIA request either the EPA program office or the EPA legal office believes there might be a change in circumstances, that office would be free to reopen the question of confidentiality for a new determination. This would not be done every time a new FOIA request was received; only when some new information came to light. This has no impact on the question of release in the public interest because EPA has adopted an explicit policy that information that is exempt from disclosure under 5 U.S.C. 552(b)(4) will not be disclosed as a matter of Agency discretion, except under specific statutory authorization. Such authorizations occur in the statutes cited in the answer to question 3.b above.

5) The Toxic Substances Control Act has a special disclosure provision with its own time limits and requirements. How do the disclosure provisions of that Act differ from those of the FOIA?

g) Please estimate what percentage of information maintained by EPA is covered by a class determination of confidentiality or nonconfidentiality.

Answer: Less than 1% of information maintained by EPA is covered by any form of class determination.

3) EPA regulations provide that when information is initially requested by the agency, businesses must assert a claim of confidentiality at the time the material is provided; otherwise, the data may subsequently be made available under the FOIA without notifying the submitting companies.

a) Is it your practice to give notice before public release anyway? Under what circumstances?

Answer: The purpose of requiring confidentiality claims to be asserted at the time the information is submitted to EPA is to eliminate the need to go back to businesses that have not asserted confidentiality when EPA is faced with a subsequent FOIA request. If a business had actual notice of the requirement to claim confidentiality at the time of submission of the information and fails to assert confidentiality, EPA does not give that business any further notice prior to release. At the present time, however, much of the information in EPA's possession came to EPA without the requirement to assert confidentiality claims at the time of submission. Consequently, EPA gives those businesses actual notice of their right to claim confidentiality at the time FOIA requests are received.

b) What authority is there for you to issue such a regulation? The FOIA does not appear to require the marking of (b)(4) material.

Answer: Section 14(c)(1) of the Toxic Substances Control Act (15 U.S.C. 2613(c)(1)) and section 10(a) of the Federal Insecticide, Fungicide, and Rodenticide Act (7 U.S.C. 136h(a)) allow this approach. Other specific statutes administered by EPA contain the following or similar language: Any records, reports, or information obtained from any person under this section shall be available to the public, except upon a showing satisfactory to the Administrator by any person that records, reports, or information, or particular part thereof, to which the Administrator has access under this section, if made public, would divulge methods or processes entitled to protection as trade secrets of such person, the Administrator shall consider such record, report, or information or particular portion thereof confidential in accordance with the purposes of section 1905 of title 18 of the United States Code. [Section 3007(b) of the Solid Waste Disposal Act, 42 U.S.C. 6927(b); sections 114(c), 208(b), and 307(a)

primary ground for denial, such a denial would trigger EPA's process for an automatic final determination. Such a denial would be pro forma. In cases where the primary ground for denial is other than 5 U.S.C. 552(b)(4), the automatic final determination is not triggered. Instead, the requester would have to appeal the denial. In dealing with the appeal, EPA would consider whether the information was confidential as well as whether other exemptions applied.

2) EPA regulations provide that the agency may make a determination that classes of information are or are not confidential.

a) What types of information have been covered by a class determination?

Answer: The following class determinations have been issued:

1-77 Confidentiality of Business Information Contained in Bi-monthly Summary Report on Fuel Gas Desulfurization Systems

2-77 Confidentiality of Business Information Submitted in Applications for Light Duty Motor Vehicle Certifications Through Model Year 1978

4-77 Confidentiality of Business Information Submitted in Applications for Light Duty Motor Vehicle Certifications Model Year 1979

b) What authority is there for this regulation?

Answer: Our authority for using class determinations is the same as that for making individual determinations in response to FOIA requests under 5 U.S.C. 552(b)(4). EPA does not use class determinations to declare information confidential as a class. Rather, the class determination is a procedural tool to streamline the process of making ad hoc determinations concerning confidentiality. In the class determination we set forth the criteria that we will apply in making determinations in the class. We still make the individual determinations. The class determination notifies affected businesses of our general approach to the specific class of information, and in the case of information that would never be confidential because statute requires disclosure, we would define that information. The class determination is not a determination that specific information is confidential.

c) How do you handle requests for information covered by a class determination of confidentiality or non-confidentiality? Does the issuance of a class determination make it easier to deal with FOIA requests for information covered by the determination?

[Whereupon, at 11:50 a.m., the subcommittee adjourned, to reconvene subject to the call of the Chair.]

the question of the character of judicial review--de novo or a review limited to the record of agency proceedings. The issue deserves further mention and "legislative direction" because it is freighted with constitutional due process considerations.

Where, as now, there is an absence of agency procedural safeguards such as those described in the Administrative Procedure Act provisions relating to agency adjudication/1, we believe due process requires a de novo judicial review of an agency decision to disclose under FOIA. Moreover, elementary fairness would seem to require it since information requesters having no interest beyond mere curiosity are entitled to a de novo review of an agency decision to withhold information requested./2

On the other hand, if formal agency adjudicatory proceedings, compatible with APA, were available, then it seems unnecessary to have de novo judicial review.

Value of Procedural Alternatives in Handling Exemption 4 Requests

The Chairman's letter of invitation asks that we discuss certain procedural alternatives in dealing with Exemption 4 requests. Our comments on each of the several possibilities suggested follow.

(1) Advance determinations of confidentiality.--This suggestion reminds one of the almost endless skein of interrelated problems presented by the administration of FOIA. However, first we must be sure of what we are talking about. Are we discussing determinations of the confidential status of information in government's hands in advance of any FOIA request? Or are we discussing a procedure for inducing voluntary submission of information by making a confidentiality determination in advance of the submission? If the former, it is a kind of "good news-bad news" story.

The good news is that advance determination would presumably require notification to the submitter of information, an opportunity to be heard and sufficient time in which to make a proper determination. The bad news is that such a procedure would add to an already intolerable administrative burden.

1/ APA § 5 et seq, 5 U.S.C. § 554 et seq. Broadly speaking, APA adjudicatory hearings require, among other things, notice to information suppliers, adequate time to prepare the case, an opportunity to be heard and an agency decision on the record.

2/ We concur with the judicial declaration that ". . . (t)he supplier, if his claim to protection is as Morton declared a 'matter of right,' is entitled to a fair and adequate hearing, on proper evidence, in the courts, a hearing that is no less broad and adequate than that given the merely curious who may seek disclosure." Westinghouse Electric Corp. v. Schlesinger, 542 F. 2d, 1190, 1215 (4th Cir., 1976).

The Subcommittee's Questions

Let us turn now to a discussion of those issues raised in the Chairman's September 21 letter of invitation.

The Need for Legislative Direction in Reverse FOIA Cases

We have already discussed those issues raised by the Freedom of Information Act which we consider most important. Everyone of those issues involves the need for legislative direction. Without rearguing those several cases, we recommend that:

-- Congress reexamine with a view to correction the immense and growing burden on both government and industry created by FOIA bearing in mind that any solution must protect private rights.

-- The Act be amended to require advance notice to a private source of information in government hands of the possible disclosure of such information so that the source of the information may undertake to demonstrate its confidential character and, if need be, bring suit to prevent its disclosure.

-- Congress recognize, in its report of this hearing or by amendment of the Act, the distinction between public documents created by government action and private-source documents in the government's possession.

-- By amendment of the Act and unmistakable language in the legislative history Congress strike down the "substantial competitive harm" test of confidentiality and simultaneously make Exemption 4 to the Act mandatory as it applies to information which would not customarily be released to the public by the source of the information.

-- The Act be amended to extend the time of agency response to a FOIA request to at least 30 days with power in agency discretion to extend this response time where circumstances require more time to decide the issue of disclosure vs. withholding.

Beyond these larger issues there are a number of technical questions which need legislative attention. Each is discussed below.

The jurisdictional basis for reverse FOIA relief.--One by-product of FOIA and the problems already discussed herein is the "reverse FOIA" suit in which the source of confidential private information in government's hands seeks by judicial process to prevent its disclosure. Although suits

qualifying for the exemption. Both reports clearly contemplated exemption per se of broad categories of information (e.g., "business sales statistics, inventories, customers' lists and manufacturing processes").1/

The clear legislative intent of Exemption 4 as outlined above appears to have been adopted initially by the courts.2/ Subsequently, however, the very court which had originally accepted the "customary release" test rejected it and engrafted on the exemption a wholly new test. In brief, the court held in this later case that, ". . . commercial or financial matter is 'confidential' for purposes of the exemption if disclosure of the information is likely to have either of the following effects: (1) to impair the government's ability to obtain necessary information in the future3; or (2) to cause substantial harm to the competitive position of the person from whom the information was obtained."/4

In devising this new test the D.C. Circuit Court of Appeals remanded the case to the district court ". . . for the purpose of determining whether public disclosure of the information in question poses the likelihood of substantial harm to the competitive positions of the parties from whom it was obtained." Among the consequences of adoption of this "substantial competitive harm" test--which has been approved by several other appellate courts--are the following:

-- An exemption clearly intended by Congress as a shield to protect private documents passed to government in confidence has been converted by judicial interpretation into a most uncertain and untrustworthy weapon of defense.

-- The "substantial competitive harm" test subjects the source of the private information in question to a very nearly impossible burden of proof. Indeed, this has now been acknowledged by the very court which first fashioned this unworkable--and, we think, improper--test of confidentiality./5

1/ S. Rept. No. 813, 89th Cong., 1st Sess., p. 9 (1965).
2/ Sterling Drug, Inc. v. FTC, 450 F. 2d 698 (D.C. Cir. 1971).
3/ Footnote omitted.
4/ National Parks and Conservation Association v. Morton, 498 F. 2d 765, 770 (D.C. Cir. 1974).
5/ In a second appellate review of National Parks [i.e., National Parks and Conservation Association v. Kleppe, 547 F. 2d 673 (D.C. Cir., 1976) and now known as National Parks II], the court, although insisting on the correctness of its initial opinion, held that, "No actual adverse effect on competition need be shown, nor could it be, for the requested documents have not been released. The court need only exercise its judgment in view of the nature of the material sought and the competitive circumstances in which the concessioners do business, relying at least in part on relevant and credible opinion testimony."

Further, the Attorney General's basic premise seems to be that the FOIA workload at Justice is the critical consideration.

A Statutory Gap--No Requirement for Notice

Where privately-developed information is submitted to government with the understanding that it is to be held in confidence, there is no statutory requirement that the source be notified that such information may be disclosed in response to a request under the FOIA. Most agencies apparently follow the administrative practice of giving notice to a person whose information may be disclosed. Only a handful of departments and agencies have embodied such a requirement in pertinent regulations. The Attorney General has suggested that, ". . . there may be instances when agencies will find it appropriate to consult with the person who provided the information before deciding whether the exemption applies."/1 Although helpful, this suggestion is neither directive in character nor general in application. The plain fact of the matter is that in most cases the person who submitted information in confidence to government must rely wholly on the sufferance of civil servants for the protection of his rights in that information.

The disclosure by government of valuable, privately-developed information without giving the source notice of possible release and the opportunity to contest such action seems to us to be something very close to an unconstitutional taking of property without due process. We believe the law should be amended to require such notice. If this is not feasible, then the legislative record should make clear that such action is desired by Congress.

Public Documents vs. Private Documents

In the course of House debate on the measure which became the Freedom of Information Act, Congressman Moss--the floor manager of the bill--said, "The bill lists nine categories of Federal documents which may be withheld to protect the national security or permit effective operation of the Government but the burden of proof to justify withholding is put upon the Federal agencies."/2

One is reminded of the Attorney General's letter of May 5, 1977, noted above. Subject to the agency involved sustaining the burden of proof, information sought by a requester may be withheld, according to Congressman Moss: (1) to protect the national security or (2) to ". . . permit effective operation of government." One searches in vain for any reference to protection of private rights. Once again, this may be an inadvertence of expression but it is of a piece with Attorney General Bell's assertion that the only touchstone for deciding whether to disclose or to withhold is the public interest.

1/ Attorney General's Memorandum on the Public Information Section of the Administrative Procedure Act, June 1967, p. 34.
2/ 112 Congressional Record 13008, June 20, 1966.

PREPARED STATEMENT OF CHARLES I. DERR, SENIOR VICE PRESIDENT, MACHINERY AND ALLIED PRODUCTS INSTITUTE

The Machinery and Allied Products Institute greatly appreciates the invitation of the Subcommittee to testify in these hearings.

As you may know, the Machinery and Allied Products Institute (MAPI) is the national spokesman of the capital goods and allied equipment manufacturers. From the time of adoption of the Freedom of Information Act (FOIA), the Institute has followed closely the administration and judicial interpretation of this legislation, conducted studies on the subject and has sought to keep its membership informed of significant developments in this increasingly important field of law. In the decade and more which has passed since enactment of the FOIA, we have seen a reemphasis--by the 1974 amendments--on the Act's mandate of disclosure and a clarification of the Act's application through a very considerable body of case law. Against this background it is altogether timely--as indicated in your letter of invitation--to undertake by these hearings ". . . to identify any problems presented by the existing trade secrets provisions of the law, and to explore possible alternatives."

Beyond this general objective of the present hearings we have been asked to focus particularly on certain specific questions set out in the Chairman's letter of September 21. In due course we shall discuss those questions but first we want to review briefly some questions of policy which deserve the Committee's attention.

An Administrative Monster?--Time for Reexamination

Ten years of experience under FOIA has created an intolerable burden on many government departments and agencies. This burden coupled with the Act's mandate for disclosure of information in government's hands has brought about a visible temptation on the part of government to reduce the burden of administering the law by deciding all the "close ones" in favor of disclosure. The result is an increasing danger of violating private rights in information subject to FOIA requests.

We can think of nothing which illustrates better the present situation under FOIA than this statement of the Securities and Exchange Commission in changing its FOIA regulations:

> The Commission regrets that in many cases the Commission will disclose records although persons who cooperated in its investigation would have reasonable

Mr. GELLMAN. Yes.

Mr. DERR. There are really two possibilities. One possibility is an advance determination of information already in the agency's hands before FOIA request. The second is an advance determination for the purpose of inducing voluntary submission.

If it is a case of asking for a determination of information already in Government's hands, then it is a good news-bad news story as our principal statement says. The good news is that the submitter obviously would receive notice and he would have time to do a reasonable job of evaluation.

The bad news is that you would add to an already intolerable administrative burden in Government.

As to the second possibility, I understand EPA is now attempting to induce voluntary submission. This raises one question. Is the information submitted for the purpose of determining whether or not it is confidential subject to an FOIA request during that interval?

If you can overcome that hurdle, then it may have some benefit, as we see it.

You have also referred to class determinations through rulemaking. We have three comments on this suggestion.

First, resort to class determinations of confidentiality would, in our judgment, require abolition of the *National Parks* substantial competitive harm test under which nothing is confidential per se. We have, of course, already strongly recommended that test's repeal.

Second, adoption of the suggestion made in our principal statement that exemption 4 be made mandatory as to information the submitter would not customarily release would represent a most significant and a proper class determination and one wholly in accord with the original congressional intent.

Third, if class determination is not to be accomplished by making the application of exemption 4 mandatory, then we think this approach could be used to establish guidelines in advance but with the necessity remaining for an ad hoc decision consistent with those guidelines in the individual case.

We understand that EPA currently employs such a system and is convinced that it is simplifying administration. We believe the approach deserves further study.

As for advance notice, we have already and repeatedly urged that the act be amended to require advance notice to a source of particular information in Government's hands that such information may be disclosed under FOIA.

As for formal agency proceedings, in discussing the scope of review with the reverse FOIA cases, we have already suggested that steps should be taken to correct the imbalance of rights as between information suppliers and information requesters.

A requirement for formal agency proceedings and the handling of requests under exemption 4 in reverse FOIA cases as well would substantially redress the present inequity.

We have no further procedural or substantive reforms to suggest and we would be very pleased to try to answer any questions you may have.

would not customarily be released to the public by the source of information.

If I may pause there to interject one observation, Mr. Chairman, you will recognize that that last bit of language about information which would not customarily be released to the public by a source of information is taken from House and Senate reports which accompanied that bill which ultimately became the Freedom of Information Act.

It is our contention that the courts, through the *National Parks* case and its substantial competitive harm test, have simply taken the test established by Congress and turned it on its head and made it a matter virtually impossible of proof.

Finally, the act should be amended to extend the time of agency response to a FOIA request to at least 30 days with power in the agency's discretion to extend this response time where circumstances require more time to decide the issue of disclosure versus withholding.

These are our principal recommendations concerning the legislative direction of philosophy, content and administration of FOIA.

Against that background let us turn to some of the more technical questions that the chairman's letter has raised.

First he speaks of the need for legislative direction in reverse FOIA cases. We think there are at least three technical questions raised by reverse FOIA cases which deserve legislative direction. Permit us to offer some suggestions on each.

First, there is the jurisdictional basis for reverse FOIA release. Obviously one significant byproduct of FOIA has been the reverse FOIA suit instituted by the submitter of information to prevent its disclosure.

Although suits of this character have been numerous, the courts have been unable to agree on the proper jurisdictional basis for granting reverse FOIA relief. The importance of this issue, of course, depends on the fact that its resolution may determine whether judicial review of an agency decision to disclose is limited to an examination of the administrative record or is to be undertaken de novo.

Without taking the time to review the leading cases, I repeat that case law concerning the proper jurisdictional basis for reverse FOIA relief and the resulting scope of judicial review is far from clear. We believe that Congress should settle the matter by providing through amendment a stautory basis for judicial review de novo of an agency decision to disclose. As the subcommittee is aware the act has always provided for de novo review of a decision to withhold.

The second technical question is the substantive basis for reverse FOIA relief. Two general questions are raised by any discussion of this matter. Before discussing them, however, it becomes necessary to recite certain preliminaries.

As you know, exemption 3 to FOIA as amended by the Sunshine Act, which was discussed a few moments ago by Congressman McCloskey, protects from voluntary agency disclosure information specifically exempted from disclosure by statute, provided that such statute requires that matters be withheld from the public in such a manner as to leave no discretion on the issue: or establishes particular criteria for withholding or refers to particular types of matters to be withheld.

requesters can seek enforcement of their rights under the FOIA, Congress has authorized courts to order the United States to pay the attorneys' fees of a plaintiff which has prevailed in a FOIA suit.

Where it is the submitter of the information which is advancing the claim that information should be withheld, however, it is unclear whether the current FOIA provision would permit the assessment of attorneys' fees on behalf of an intervening requester. Some provision for award of attorneys' fees to a requester who is forced to pursue his or her claim for information in the face of a reverse suit would further the original purposes of the existing FOIA fees provision.

Fifth, it is essential to eliminate delay. While we strongly believe that every person should be permitted one opportunity to have his or her case heard by a Federal district judge, we also believe that parties seeking to enjoin disclosure should not be permitted to indefinitely delay the final resolution of such cases by seeking interminable stays of judgment should the submitter not prevail on the first go-around. In keeping with Congress' direction that all FOIA cases be given expedited consideration, 5 U.S.C. § 552(a)(4)(D), we would suggest that some of the delay associated with reverse cases could be eliminated if Congress directed that stays of judgments ordering disclosure be permitted only in extraordinary circumstances. This would require that as to FOIA cases, Congress reverse the very liberal presumption favoring the entry of stays which was recently articulated in *Washington Metropolitan Area Transit Commission* v. *Holiday Tours*, No. 77–1379 (D.C. Cir., July 5, 1977). Congress should place a greater burden on the party seeking to prevent disclosure to demonstrate that the likelihood of its being successful on appeal is "probable."

These are merely a few suggested approaches for addressing the many problems which the upsurge of reverse litigation has created. Our experience in attempting to work out legislation in just one narrow area of concern involving the disclosure of IRS letter rulings indicates that it may require extraordinary efforts and bargaining skills to negotiate acceptable solutions. In that one instance, however, the IRS, the American Bar Association, numerous accountants, and various public interest representatives working in conjunction with the Joint Economic Committee, were able to agree on effective and workable legislation.

I would again like to express my appreciation for the opportunity to voice our particular concerns and to identify some initial areas in which we would hope to work with the subcommittee in reaching appropriate legislative solutions.

I would be happy to answer any questions that the subcommittee may have.

Mr. PREYER. Thank you very much, Ms. Cohn, for a helpful statement.

I regret that I am going to have to leave a little before noon. I wonder if we might submit some questions to you which I think your statement would suggest to us. We would do that in writing rather than go into detail now inasmuch as we have another witness.

If either counsel has a key question that you have to ask right now, we will entertain that now. If you don't then we will proceed in that manner.

namely, the voluntary disclosure of more information and the creation of internal procedures that will assure that disclosable information can easily be separated from that which is exempt. See *Vaughn* v. *Rosen*, 484 F. 2d 820, 828 (D.C. Cir. 1973), cert. denied, 415 U.S. 977 (1974).

Indeed, EPA recently testified in oversight hearings in the Senate that such procedures, combined with the fact that businesses are aware that they will be called upon to substantiate their confidentiality claims, have tended to limit the scope of information claimed to be exempt. See statement of Michael A. James, Deputy General Counsel, EPA, before the Subcommittee on Administrative Practice and Procedure of the Senate Committee on the Judiciary, September 15, 1977.

Second, there is the problem of notice to submitters of information. Whenever a request is received that pertains to material for which no exemption 4 claim was asserted at the time of submission, that information should be immediately disclosed. If, however, a claim has been asserted in the manner indicated above, the agency should immediately notify the submitter by telephone or certified mail and request that the submitter provide whatever additional information is deemed relevant to the exemption 4 claim. In cases where the present 10-day time limit for an initial response does not permit the agency to reach a decision, or permit the submitter to adequately make its case before the agency, we believe that some modification of the time deadlines may be in order.

But we believe such an exception should only be permitted in the case of a request for material submitted to the Government by private parties where there is a reasonable basis for believing that trade secrets or confidential commercial information are involved. In that event, agencies should be permitted to combine the present 10 working day time limit for initial requests and 20 working day time limit for appeals into a single period of 30 working days during which time the agency will render a final decision as to whether the information is deemed to be exempt and whether the agency will nonetheless exercise its discretion to disclose.

Third, agency rulemaking should be undertaken. We believe that much of the litigation which exists today could be eliminated if Congress were to reaffirm the fact that agencies possess the discretion to release categories of exempt information pursuant to validly promulgated rules. In formulating such disclosure regulations, the notice and comment provisions of the APA would permit both information providers and requesters to make their views known to the agency.

Some courts, however, have interpreted Congress intent as prohibiting agencies from exercising any discretion to release exempt information. Under that view, if an exemption applies, agencies are absolutely foreclosed from balancing the important public and private interests involved. See, for example, *Westinghouse Electric Corp.* v. *Schlesinger*, *supra*. Such cases, however, have ignored the legislative history of the FOIA, which clearly indicates that the exemptions were intended to be permissive only, thereby leaving room for agencies to establish guidelines for determining when disclosure would benefit the public interest. See *Chrysler Corp.* v. *Schlesinger*, *supra;* Clement, "The Rights of Submitters to Prevent Agency Disclosure of Confidential Business

sult which has virtually obscured two of the FOIA's most fundamental precepts: (1) that disclosure should be promptly made and, (2) that the average citizen should have an available judicial remedy for challenging agency withholding.

Aside from grappling with the question of whether the particular documents in each case are confidential and commercial, the courts have also had to face difficult procedural problems in reverse suits. Of particular concern in this area is the fact that a requester of information may suddenly find that a submitter has obtained an injunction in a far away court, a situation which may as a practical matter deprive the requester of the opportunity to participate in the very proceedings which will determine his or her right of access to the documents.

In the one judicial opinion thus far which has addressed these issues, the District of Columbia circuit recently recognized for the first time that requesters are necessary parties to such reverse suits, and if they are not joined or do not intervene in the forum in which the reverse suit is filed, requesters are not deprived of their right to obtain a judicial determination in a forum of their own choice which is specifically authorized under the FOIA. See *Consumers Union* v. *Consumer Product Safety Commission*, 561 F. 2d 349 (D.C. Cir. 1977), pet. for rehearing denied, No. 75-2059 (Aug. 25, 1977) (per curiam). Of course, in this particular case, the resolution of just this preliminary issue consumed more than 3 years' time.

We recognize that there are many complex problems in this area and that there are no simple answers. But our experience points to two basic propositions which we believe need to be addressed as an initial matter in attempting to resolve these problems. The first proposition stems from the fact that while Congress did intend to protect the interest of submitters in the confidentiality of business proprietary information, we believe that the *National Parks* test has been interpreted far too broadly by submitters, by several agencies, and by some courts. As a result, information is being withheld which we believe Congress never intended would be encompassed within exemption 4.

While Mr. Braverman seems to imply that most of the reverse litigation involves the purely private policies, private plans, and private actions of the submitting companies, in fact, if we look at the context in which most of this reverse litigation has arisen, it is clear that this is not the case. Much of the reverse litigation has involved access to equal employment opportunity information which is essential in evaluating how companies are conforming to the important national policies which are inherent in the whole civil rights compliance program.

As another example, in the *Consumers Union* case, manufacturers are seeking to withhold safety information about television accidents and instances in which consumers of televisions have been hurt or had their health jeopardized by the use of the product.

And in the one case that Commissioner Kennedy referred to in his testimony this morning in which FDA has been sued in a reverse context, a company was seeking to enjoin the release of summaries of safety and efficacy data related to a drug whose approval for marketing had been revoked on the grounds that the company's report of its test results contained material misstatements of fact.

In such cases, we are truly concerned that many of the exemption 4 claims raised are primarily motivated not out of fear of substantial

Yet, as reviewed in this testimony, this is precisely what has happened in recent years as a result of the insensitive reception which courts and agencies have given to legitimate business concern over the disclosure of confidential commercial information. The FOIA has become a bonanza for competitors, special interest groups, and indeed for anyone who desires to inspect private business files which he would otherwise have no right or opportunity to examine. This development does not comport with the purposes of the Act and, in my opinion, represents one of the low points in the ten year history of the FOIA.

I urge the Subcommittee to consider amendment of the FOIA in order to make clear that the Act should not be available as a means of acquiring private, as opposed to government, documents. In particular, Exemption 4 should be amended to make clear that the National Parks construction of the Exemption is not consistent with congressional intent and to provide comprehensive protection of private business documents from public disclosure. Finally, I urge this Committee to confirm the rights of submitters to the fair agency procedures suggested above and to de novo judicial review of adverse agency disclosure decisions.

These recommendations, I believe, will serve to protect the important private interests which Congress sought to safeguard through Exemption 4 without impairing or obscuring the basic purpose of the Freedom of Information Act to open government processes to greater public scrutiny.

Court adopted the agency's argument that, even though 14 C.F.R. §121.681 et seq. required that the information be submitted to the agency and provided sanctions for noncooperation, agency disclosure "would surely undercut the Federal Aviation Administration's ability to properly fulfill its investigative duties ... [since] ... frank and full voluntary disclosure" was essential. The agency argued, and the Court recognized, that disclosure would adversely affect airline cooperation and, as a result, the program would be "seriously impaired."[1/] And, just recently, the Environmental Protection Agency has stated in Senate FOIA oversight hearings that disclosure of information submitted voluntarily by government contractors would impair the agency's ability to obtain such information from the contractors in the future.[2/]

Despite statements such as the foregoing, many federal agencies assert that disclosure of private information will not disrupt the flow of data to them. Apart from the basic conflict of such a contention with common sense, the fact is that a number of courts have found that disclosure of documents will in fact impair the agencies' ability to collect data from the public.[3/]

1/ See the FAA's Supreme Court Brief on the Merits, at 26, in FAA Administrator v. Robertson, supra.

2/ EPA Statement, supra, at 9.

3/ E.g., United States Steel Corp. v. Schlesinger, supra; Dickerson v. United States Steel Corp., 12 E.P.D. §11095 (E.D.Pa. July 16, 1976); Porter County Chap. v. U.S. Atom. Energy Commission, supra, 380 F.Supp. at 634; Sanday v. Carnegie-Mellon University, 12 FEP Cases 101 (W.D.Pa. 1975).

[judicial review] from becoming meaningless judicial sanctioning of agency discretion",[1] de novo review of a decision to disclose must likewise be ensured. Accordingly, the Freedom of Information Act should be amended in order to provide for a right to de novo judicial review of an agency decision to disclose.

X. DISCLOSURE OF PRIVATE INFORMATION WILL HAVE AN ADVERSE EFFECT ON SUBMISSION OF INFORMATION TO THE GOVERNMENT

By offering protection under Exemption 4 to confidential commercial information, Congress hoped to encourage individuals and businesses to provide this type of information to the Government.[2] Unless federal agencies are held to a strict standard of conduct in passing upon disclosure requests, businesses are bound to decrease their free flow information to the Government. In losing that important source of information, government regulatory programs would suffer.[3]

Most regulatory programs administered by government agencies rely heavily upon cooperation of the regulated companies in reporting as well as in compliance. Cooperation is significant not only where information is submitted on a wholly voluntary basis, but also where information is fur-

1/ S.Rep.No. 813, supra, at 8; see 5 U.S.C. §552(a)(3).

2/ Soucie v. David, 449 F.2d 1067, 1078 (D.C.Cir. 1971).

3/ Would Macy's Tell Gimbel's, supra, 6 Loyola L.J. at 603-5.

of the private, commercial data which is furnished to government agencies.[1/]

Moreover, the inadequacy of the agency process generally results in the agency's failure to develop an adequate "record" of the agency's action. Absent an adequate agency record, judicial review must be provided on a de novo basis since there is otherwise no basis for determining whether the documents ought to be disclosed.

The U.S. Court of Appeals for the Fourth Circuit has focused on this very matter. Recognizing that "the protection of a competitive position is both a valuable and often complex matter ...",[2/] the Court has reasoned that it is essential that a submitter who is confronted with an agency decision to disclose be afforded access to the courts for de novo review of his claim of exemption from disclosure:

> "There is always the real risk that the agency itself will be delinquent in asserting the rights of the private party. After all, it could not care less about protecting the competitive position of a supplier of information. That is no part of its responsibility. Neither does it have,

1/ Hearings on the Administration and Operation of the Freedom of Information Act Before A Subcomm. of the House Comm. on Government Operations, 92d., 2d Sess. 1619, 2114 (1972) (hereinafter "Government Operations Committee Hearings"). See also FTC Statement, supra, at 3.

2/ Westinghouse Electric Corp. v. Schlesinger, supra, 542 F.2d at 1213.

Most courts, in contrast, have held that the submitter is entitled to de novo review of its claim of nondisclosability, particularly where Exemption 4 is at issue. 1/

For example, in Westinghouse Electric Corp. v. Schlesinger, supra, the U.S. Court of Appeals for the Fourth Circuit affirmed the district court's holding that a reverse FOIA plaintiff is entitled to de novo review of intended agency disclosure of its documents. 2/ In reaching that conclusion, the Fourth Circuit gave great weight to the decision of the D.C. Circuit Court of Appeals in Charles River Park "A", Inc. v. HUD where the court of appeals had instructed the district court to

> "hold a hearing to determine whether the information involved here would have been exempt just as it would if a suit had been brought under the FOIA to compel disclosure. *** In holding this hearing, the district court is not reviewing agency action; it is making a threshold determination whether the plaintiff has any cause of action at all ..." 3/

An identical result was reached, although on somewhat differently articulated grounds, in the recent decision of the D.C. Circuit in Sears II.

1/ But see Chrysler Corp. v. Schlesinger, ___F.2d___ (3d Cir.), decision filed Sept. 26, 1977.

2/ 542 F.2d at 1208, 1214-15.

3/ 519 F.2d at 940-1 n. 4. "[S]ince the only or principal dispute relates to the meaning of the statutory term, the controversy must ultimately be resolved, not on the basis of matters within the special competence of the Secretary, but by judicial application of canons of statutory construction. See Texas Gas Transmission Corp. v. Shell Oil Co., 363 U.S. 263, 268-270." Barlow v. Collins, 397 U.S. 159, 166 (1970).

category relating to a particular company would in the company's individual circumstances be harmful.[1/]

Each of these procedures thus suffers from potential pitfalls. While the "mark it or lose it" and "class determination" proposals could conceivably be utilized to streamline the agency decision making process without materially jeopardizing the rights of submitters, the "presubmission review" procedure entails such intolerable burdens upon submitter and agency alike that it should be rejected.

IX. THE FOIA SHOULD BE AMENDED TO EXPRESSLY PROVIDE FOR DE NOVO JUDICIAL REVIEW IN REVERSE FOIA ACTIONS

A company seeking relief from an agency decision to disclose private business records generally encounters two principal challenges to its right to judicial review: first, that the federal district courts do not have jurisdiction to entertain a reverse FOIA action; and second, that only limited, as opposed to de novo, judicial review of the agency decision can be obtained. While courts have largely rejected both of these assertions, the FOIA nevertheless should be amended to ensure that submitters of private business documents will have full access to the courts for review of assertedly unsound agency disclosure decisions.

A. Jurisdiction of the Federal District Courts

There is no disagreement among the courts that federal district courts have jurisdiction over reverse FOIA

1/ See EPA Statement, supra, at 10; and see 40 C.F.R. §2.204(a).

injury is required, the costs and burdens of repeatedly pressing those claims as to diverse documents before a number of different federal agencies would be staggering. Similarly, the agencies would be subjected to the same burdens since they would be required to rule upon each claim of confidentiality. All of this might prove to be largely a waste of time and resources on the part of both the submitters and the agencies since, as to most of the documents, there might ultimately be no request for disclosure and, therefore, no need for a determination of confidentiality.

This in fact is the experience of some federal agencies. As noted previously, despite the existence of a presubmission review procedure in the rules of the Office of Federal Contract Compliance Programs, to which rules the Defense Supply Agency was subject, DSA declined to follow that procedure because of its view that it would be too administratively burdensome to allow a contractor to assert a claim of confidentiality and to appeal from an adverse determination at a time when it was not certain that a request for disclosure of those documents would ever be received.

Consequently, even if this Subcommittee believed that a "mark it or lose it" policy was warranted, it would be highly inadvisable to propose that agencies be required to engage in a presubmission review procedure on a document by document basis.

To ensure that disclosure is not unduly delayed, a parallel provision should be added to the Act requiring the court to give precedence on the docket to reverse FOIA actions.

VIII. COMMENTS REGARDING POSSIBLE AGENCY PROCEDURES UNDER EXEMPTION 4

The foregoing suggestions would assure that submitters of confidential commercial information are afforded at least minimal procedural rights before the agencies. In addition, there have been proposed a number of alternative procedures for streamlining the administrative process. Some of these have merit whereas others, while facially attractive, do not withstand scrutiny. The foremost of these proposed procedures are considered below.

1. Should agencies institute a "mark it or lose it" policy whereunder submitters of private documents to an agency would be required to mark those documents at the time of submission in such a way as to identify assertedly confidential portions? This procedure poses a number of problems. First, and perhaps most easily resolved, is the need to prescribe the appropriate manner in which documents would be marked. Should they be marked page by page? Could the documents be accompanied by an index of confidential portions, with specific page references? Or would it be sufficient for a company simply to place a covering page with a blanket claim of confidentiality on an entire document? Such a mark it or lose it policy might encourage businesses to identify considerably broader sections of their documents as confidential merely out of an abundance of caution. Most significantly, such a policy

F. Recommendations

In each of these respects the disclosure regulations of virtually all federal agencies are weighted heavily against the submitters of information and deprive them of necessary and minimal procedural safeguards. Congress should amend the FOIA to provide for the following minimum standards:

(a) Agencies should be required to notify the submitter of private documents whenever disclosure of those documents is proposed; notice cannot depend upon the generosity of agencies alone.[1/]

(b) The submitter should be afforded adequate time (at least 30 days)[2/] to prepare and submit its views regarding disclosure, including the presentation of expert testimony if necessary. In addition, the agencies should be given sufficent time to make their disclosure decision in order to assure that they are able to meaningfully consider the submitter's case against disclosure.[3/]

(c) Agencies should be required to afford a full hearing, including the presentation of testimony and argument before a competent administrative officer or law judge, where

1/ See Clement, supra, 55 Tex.L.Rev. at 635.

2/ See, e.g., 15 U.S.C. §2055(b)(1) where Congress has provided for 30 days advance notice to a submitter prior to disclosure of certain information by the Consumer Product Safety Commission.

3/ See Clement, supra, 55 Tex.L.Rev. at 635.

to a government contract compliance agency, that such information is exempt from disclosure and (2) to appeal to the Director of OFCCP from the compliance agency's determination that the contractor's data is not exempt. Yet some of the contract compliance agencies subject to that rule have refused to comply with it and have not made the presubmission review procedure set out in 41 C.F.R. §60-60.4(d) available to submitters of confidential information. Thus, by memorandum to all regional offices, the Defense Supply Agency directed that government contractors would not be allowed to exercise the rights provided to them by §60-60.4(d) at the time their documents are initially furnished to the Government, as contemplated by the regulation; the agency explained its action by stating that it would be too administratively burdensome to allow a contractor to assert a claim of confidentiality and to appeal from an adverse determination at the time the contractor's documents were initially submitted to the agency. Rather, such rights would be available only at the time a request for disclosure of the documents was received by DSA. 1/

However, at that later time, submitters were practically foreclosed from exercising the appeal provision of §60-60.4(d). For, by memorandum to all regional offices, the Defense Supply Agency directed that it would not delay disclosure

1/ Defense Supply Agency Memorandum DSAH-G, dated 17 December 1974, to Commander, Defense Contract Administration Services Region, concerning "Release of Contract Compliance Data Under The Freedom of Information Act."

C. Inadequate Hearing

Nor do agency regulations provide for right to a hearing. While many regulations allow a company which has been notified of intended disclosure to comment upon disclosure, that opportunity is largely meaningless because (1) the submitter is given only five days or less to analyze often complex documents, to obtain the assistance of an expert witness (if necessary) and to prepare and present comments to the agency; (2) the right to comment is discretionary only, since the agency may choose not to notify the submitter at all;[1] and (3) no opportunity is afforded to the submitter of the information to challenge the rationale or foundation of the agency's initial decision[2] to disclose since that is not made known to the submitter.

D. Inadequate Agency Appeal

Similarly, while many agency regulations provide for an administrative appeal from an initial agency decision refusing to disclose documents, virtually no agency has established appeal procedures for a decision to disclose information.[3] Those few agencies which do provide such a right allow only a brief period of time in which the submitter may file, and the agency must rule on, such an appeal; and, further, the appeal is generally based on an inadequate agency record.

1/ See supra, p. 21 n. 3 and accompanying text.

2/ See Sears, Roebuck and Co. v. GSA, 553 F.2d 1378 (D.C. Cir. 1977), petition for cert. filed, No. 76-1642 (May 23, 1977) (hereinafter "Sears II").

3/ Reverse FOIA Suits, supra, 70 Northwestern U.L.Rev. at 999.

As both courts,[1] commentators[2] and even agencies themselves[3] have observed, agencies seldom have the special knowledge of the business or the particular industry to determine whether disclosure would be harmful; and since the disclosure of even mere fragments of information can often have significant consequences, competitive and otherwise, to the affected business,[4] an agency may simply be unaware of the presence of valuable information in a document which it proposes to release. Compounding these problems is the fact that many, although not all agencies, have no incentive to protect the confidentiality of private information[5] and are, in fact, predisposed towards disclosure;[6] thus, the possibility that notice may not be

1/ See, e.g., Westinghouse Electric Corp. v. Schlesinger, supra, 542 F.2d at 1212-13.

2/ See, e.g., O'Reilly, supra, 30 Bus. Lawyer at 1134; Note, Reverse-Freedom of Information Act Suits: Confidential Information in Search of Protection, 70 Northwestern L.Rev. 995, 998-9 (1976) (hereinafter "Reverse FOIA Suits").

3/ See, e.g., Statement of Michael James, Deputy General Counsel, Environmental Protection Agency, Before the Subcommittee on Administrative Practice and Procedure of the Senate Committee on the Judiciary, September 15, 1977, at 7-8 (hereinafter "EPA Statement"); and FTC Statement, supra, at 3.

4/ Westinghouse Electric Corp. v. Schlesinger, supra, 542 F.2d at 1213; Note, supra, 9 Akron L.Rev. at 683-4.

5/ Westinghouse Electric Corp. v. Schlesinger, supra, 542 F.2d at 1212; O'Reilly, supra, 30 Bus. Lawyer at 1134.

6/ Patten and Weinstein, supra, 29 Ad.L.Rev. at 204.

The key to resolving the controversy over the substantive meaning of Exemption 4 thus lies in returning to the pre-National Parks interpretation of the Exemption, and in recognizing the important distinction between private and government documents. Absent legislative action which accomplishes both of these goals, the debate over Exemption 4 can be expected to continue.

VI. EXISTING AGENCY PROCEDURES INADEQUATELY PROTECT THE RIGHTS OF SUBMITTERS OF CONFIDENTIAL INFORMATION

Problems also abound in the procedures which are employed by federal agencies in ruling upon claims of confidentiality and in processing requests for disclosure of confidential information.

Release of the confidential, private documents would often injure, and possibly destroy, a submitter's property rights in the commercial information contained in those documents. While the formality and procedural requisites may vary, it is nevertheless well settled that the Fifth Amendment requires that notice must be given and some form of hearing must be held before an order depriving a person of property may become effective.[1/] Unfortunately, neither the FOIA nor virtually any agency disclosure regulations satisfy these requirements.

1/ Mathews v. Eldridge, 47 L.Ed.2d 18, 41 (1976); Opp Cotton Mills v. Administrator of Wage and Hour Division of the Department of Labor, 312 U.S. 126 (1941).

defining "government records" are quite broad, confidential private documents and information do not lose their basic private character merely by virtue of the fact that those documents have been submitted to an agency either pursuant to a mandatory filing requirement or voluntarily in an effort to comply with a regulatory program. 1/ As one commentator has stated, there is a

> "philosophical distinction between exemption (4) and Government information generally; the general public has no claim to a business' secret or a financial ledger, as it might to a Government-generated highway map or agency interpretative bulletin ... [T]here is a significant policy justification for not 'giving away for free' what private industry, not Government, has paid for. Government's duty to reveal its inner workings provides no similar justification for the disclosure of private parties' operations." 2/

At a minimum, requestors who seek to obtain private commercial documents which are shown by the submitter to be confidential in the traditional sense of the term should have the burden of demonstrating that they seek those documents for the purpose of learning how the Government is functioning, that the documents will in fact directly serve that purpose, that disclosure will not injure the submitter or expose him to possible injury in any meaningful sense, and that there are no alternative types of government documents

1/ See Note, Would Macy's Tell Gimbel's: Government Controlled Business Information and the Freedom of Information Act, Forwards & Backwards, 6 Loyola L.J. 594, 611 (1975)(hereinafter "Would Macy's Tell Gimbel's").

2/ O'Reilly, Government Disclosure of Private Secrets Under the Freedom of Information Act, 30 Bus. Lawyer 1125, 1134 (1975)(hereinafter "O'Reilly").

"makes the statutory exemption meaningless and flies in the face of the protective purpose of the exemption as enunciated in the Senate and House Reports ..." 1/

V. A PROPOSED SOLUTION TO THE CONTROVERSY OVER THE SUBSTANTIVE MEANING OF EXEMPTION 4

The continuing debate over the permissive vs. mandatory nature of Exemption 4, and over the National Parks test, could be quelled by legislatively recognizing the important distinction between government records on the one hand and private documents on the other.

While the FOIA was intended to foster full disclosure of government information to the public, the exemptions to the Act were specifically designed to create categories of information which Congress intended would not be disclosed. Consequently, while the FOIA exemptions should be narrowly construed concerning disclosure of information relating to a government "agency's actions, plans, and policies", the exemptions should be given a considerably greater breadth with respect to disclosure of information concerning the "'actions, plans and policies' of private parties." 2/ This is because the FOIA "was not enacted for the purpose of enabling the public to obtain information about individuals and corporations, about

1/ Westinghouse Electric Co. v. Schlesinger, supra, 392 F.Supp. at 1250.

2/ Westinghouse Electric Corp. v. Schlesinger, supra, 542 F.2d at 1197 n. 10 (emphasis added), quoting with approval Levin, In Camera Inspection Under the Freedom of Information Act, 41 U.Chi.L.Rev. 557 n. 9 and n. 10 (1974).

Exemption 4 should be amended to make clear that substantial competitive injury is not the test of confidentiality under Exemption 4. Where documents whose release is sought are private in nature, where they do not directly reflect government conduct, and where the documents contain the type of information which objectively a company would not disclose, they should not be subject to disclosure under the FOIA regardless of whether disclosure can be shown to cause "substantial competitive" injury or any kind of injury. In those limited situations where private commercial documents do directly reflect upon government actions, they should be subject to disclosure only if (1) there is no alternative source of information which can be disclosed without identifying the submitter, and (2) disclosure would not be likely to harm the company in some commercial sense (as opposed to only substantial competitive injury).

IV. EXEMPTION 4, WHEN APPLIED TO PRIVATE INFORMATION, IS NOT MERELY "PERMISSIVE" IN NATURE

Considerable debate also has been waged over whether Exemption 4 is "permissive" or "mandatory" in nature. While some courts [1/] have held that the exemption is only permissive -- and that agencies may, despite the applicability of the exemption, disclose confidential information -- other courts have

1/ See, e.g., Charles River Park "A", Inc. v. H.U.D., 519 F.2d 934 (D.C.Cir. 1975).

tion was originally intended by Congress to be protected from disclosure, such information now is available to anyone who wants to peer into the private affairs of companies which are regulated by or do business with the Government. The requesters include competitors, suppliers, customers, analysts, potential and existing adverse litigants, union organizers, and even mere "crackpots" with a grudge against a particular company. While none of these would otherwise be entitled to or have a means of securing much of the private information which businesses submit to the federal government, the Freedom of Information Act, as construed in National Parks, gives such persons carte blanche to rummage through these private records.

A particularly sorry example of the undesirable effects in which the courts' narrow interpretation of Exemption 4 has resulted is the use of the FOIA to circumvent the carefully drawn Federal Rules of Civil Procedure and the "discovery" rules of various agencies. The Act increasingly has been used by both existing and potential litigants to obtain discovery against their adversaries which may not be allowed by judicial and administrative discovery rules. The use of the Act for that purpose, particularly when discovery is sought against private parties for private documents, is impossible to reconcile with the indisputable purpose of the FOIA of better informing the electorate how its government operates. 1/

1/ See, e.g., Title Guarantee Co. v. NLRB, 534 F.2d 484 (2d Cir.), cert. denied, 429 U.S. 834 (1976); and see Statement of Gerald P. Norton, Deputy General Counsel, Federal Trade Commission, Before the Subcommittee on Administrative Practice and Procedure of the Committee on the Judiciary, September 15, 1977, at 6 (hereinafter "FTC Statement").

injury will result when the submitter may not know whether the information will be used by a competitor or, if so, how.[1/]

In this regard, it cannot always be demonstrated prospectively that information whose disclosure is sought will, if disclosed, competitively injure the submitter. As commentators and courts have acknowledged in the context of reverse FOIA actions, disclosure of a mere fragment of information, which alone might not cause competitive injury, may ultimately cause substantial competitive injury if combined with other data which the competitor has been able to secure from other sources.[2/] Consequently, businesses which are unaware of the other data which their competitors have collected may be hard

1/ Id. at 199. To make matters worse, some agencies, such as EPA, have imposed an even more stringent standard of confidentiality than that prescribed in National Parks. See Note, The EPA's Proposed Rule for Freedom of Information Act Disclosures: A Model for Orderly Agency Determinations, 1975 Utah L.Rev. 943, 956.

2/ In Westinghouse Electric Corp. v. Schlesinger, 542 F.2d (4th Cir. 1976), the U.S. Court of Appeals for the Fourth Circuit, in acknowledging the complexity of determining what information will, if disclosed, injure the competitive well being of a business, quoted the following passage from Note, A Review of the Fourth Exemption of the Freedom of Information Act, 9 Akron L.Rev. 673, 683-4 (1976)(hereinafter "Note"):

> "[T]he industrial sector is still highly competitive. Corporations have varying numbers of market and financial specialists who continually search out fragments of information about competitors and markets from any available source; published government statistics and information, various legislative documents, analyses and surveys performed by corporate specialists, information continually obtained and reported by sales personnel, or disclosures by government agencies. Since government-derived information is often submitted according to statutory or regulatory requirement, it is usually more credible than information from other sources; the latter usually depends on what a company decides, for its own carefully considered reasons, to make available. An additional reliable 'fragment' of information may be enough to bring the whole picture into much clearer focus and could conceivably mean the difference between success or failure in certain contract bidding situations." (Emphasis added).

1974 opinion in National Parks and Conservation Assn. v. Morton,[1] the U.S. Court of Appeals for the D.C. Circuit articulated a new and considerably different interpretation of Exemption 4 which would have the effect of emasculating the Exemption and eviscerating the protection for business records which the Act was intended to afford. In National Parks, supposedly in an effort to replace the more "subjective" approach of earlier cases with a more "objective" standard, the court of appeals formulated a new test for determining whether information is confidential within the meaning of Exemption 4:

> "commercial or financial matter is 'confidential' for purposes of the exemption if disclosure of the information is likely to have either of the following effects: (1) to impair the Government's ability to obtain necessary information in the future; or (2) to cause substantial harm to the competitive position of the person from whom the information was obtained."[2]

The standard adopted by the National Parks case does not find its source in the legislative history of the FOIA and is in fact contrary to both the express terms and the legislative history of the Exemption.[3] Nothing in the FOIA or the Act's legislative history reflects any intent by Congress that Exemption 4 should apply to information which is inherently confidential in nature and which has been reasonably and legiti-

1/ 498 F.2d 765 (D.C.Cir. 1974).

2/ 498 F.2d at 770 (footnote omitted).

3/ See Patten and Weinstein, Disclosure of Business Secrets Under the Freedom of Information Act: Suggested Limitations, 29 Ad.L.Rev. 193, 195-202 (1977)(hereinafter "Patten and Weinstein).

"equally important rights of privacy with respect to certain information in government files."[1] While each of the exemptions to the Act reflects this concern over rights of privacy to a varying degree, it was of particular significance to Congress in fashioning Exemption 4.

Exemption 4 was specifically designed to protect the confidentiality of information which is obtained by the Government through questionnaires, reports or other inquiries, but which would "customarily not be released to the public by the person from whom it was obtained."[2] The congressional intent concerning the scope of Exemption 4 was clearly defined by the House Report dealing with the Exemption:

> "This exemption would assure the confidentiality of information obtained by the Government through questionnaires or through material submitted and disclosures made in procedures such as the mediation of labor-management controversies. It exempts such material if it would not customarily be made public be the person from whom it was obtained by the Government ... It would also include the information which is given to an agency in confidence, since a citizen must be able to confide in his government. Moreover, where the Government has obligated itself in good faith not to disclose documents or information which it receives, it should be able to honor such obligations." 3/

Cited by the Senate Report as types of information which "customarily would not be released to the public" were "business sales statistics, inventories, customers' lists, and manufacturing processes."[4]

1/ S.Rep.No. 813, supra, at 3.

2/ Id. at 9 (emphasis added).

3/ H.R.Rep.No. 1497, supra, at 10 (footnote omitted)(emphasis added).

4/ S.Rep.No. 813, supra, at 9.

These federal agencies secure a constant flow of information from the private sector. Such information comes both in response to statutory and regulatory filing requirements and also in response to informal, but no less compelling, agency requests for information from regulated as well as unregulated businesses. Thus, although much of the private information which finds its way into government possession is required to be filed with federal agencies, a substantial amount of information is voluntarily submitted to the Government in a spirit of cooperation.

The information submitted by the private sector is staggering both in amount and in diversity. Major corporations each submit thousands of reports and documents every year to the federal government; and even small businesses supply the Government with a surprisingly large number of reports and other documents. These reports contain information concerning sales, manufacturing costs, technical designs, salaries and identities of key personnel, financial forecasts, descriptions of manufacturing processes, employment practices, etc. Because such reports are often submitted on a recurring basis, annually and even monthly, they provide extremely current and accurate data concerning these varied aspects of the reporting companies' operations.

The business value of such privately generated information depends upon its continued secrecy. Consequently, such information traditionally has been carefully guarded by

respect to private documents and information. Initially, the Exemption was construed by the courts consistent with this legislative intent. However, in recent years, many courts have deviated from the original congressional intent and have substantially restricted the protection which Exemption 4 offers to persons or businesses who submit private, confidential commercial information to federal government agencies. These federal agencies, in turn, have followed and contributed to the distortion of Exemption 4.

Paralleling and perhaps in part responsible for this development, there has been a profound change in the purposes for which FOIA requests are being made. While initially intended to serve as a means for the public to learn more about its government, the Act has increasingly become a vehicle for surveillance, at public expense, of the private affairs of commercial enterprises by their adversaries.

Exemption 4, as now construed by the courts and federal agencies, bears little resemblance to the exemption which was enacted by Congress in 1966. Assuming that the purpose of the Act still is to better inform the public of the manner in which its government operates, but not to facilitate the looting of private business records, Exemption 4 sorely needs to be amended to clarify its purpose and to restore the Exemption to its original character.

Amendment of the Act is also needed in order to confirm the rights of submitters of private information to

But there is a fair amount of information which they would not want to be caught passing among each other that they could, in fact, obtain simply by third-party requests to agencies. This information might relate to pricing. This information might relate to market shares. I think that there is a possibility that there could be an exchange of information under the act that might not be permissible otherwise.

Mr. GELLMAN. That is all I have, Mr. Chairman.

Mr. PREYER. Ms. Sands, do you have any questions.

Ms. SANDS. No, sir. Thank you.

Mr. PREYER. We thank you very much for your testimony. We appreciate your helpful testimony. You have given us some interesting suggestions.

[Mr. Braverman's prepared statement follows:]

been the subject of reports and reviews by the Office of Management and Budget. It has been subject to internal reviews and it has been the subject of congressional reviews which provide a wealth of information concerning that agency.

Similar investigations and examinations of other agencies and the manner in which they are accomplishing their statutory and regulatory obligations could be made available to the public.

It seems to me that in those few instances where you have a situation where that kind of information does not exist or where that kind of information could not be readily compiled at a reasonable effort, then there is still another alternative that could be pursued.

Certain agencies, such as the Bureau of Labor Statistics and the Department of the Census assemble and compile a great deal of information which they obtain from private companies. They disclose that information to the public, but they do so only in a form which guarantees the confidentiality of the submitter of that information.

It seems to me that, in situations where a member of the public does want to find out how the Government is dealing with companies that it regulates, there is no need to find out information about the one particular company, but that more comprehensive data could be provided in an aggregate form concerning a group of regulated companies. In doing that you would avoid the possibility of disclosing information relating to a particular company that would jeopardize that company's competitive standing.

Mr. GELLMAN. Where someone is interested in learning how an agency is operating and functioning overall, what you suggest might be sufficient. But where a requester of information is interested in how well the agency is regulating one particular company, I do not think that it is satisfactory.

Mr. BRAVERMAN. I think in many cases, though, you begin to wander astray from what the intention of the act was. The intention of the act was to look into the Government to see how it was operating. I think you will find that, if you review the broad number of requests that are made for individual company data, the relation of the request and the interest of the requester runs very far afield from an examination of what the Government is doing.

Quite often the information is sought by someone who is contemplating suit against the individual company and not in connection with an examination of Government policies. Quite often the information is sought, as we have heard this morning, by a competitor who is not concerned about how the Government is regulating that company but is concerned about how that company is operating its own private internal affairs.

I think that the basic problem here is that the act has now become a vehicle, a tool for many people to obtain information about private activities that are not related to Government regulation which they could not otherwise obtain.

Mr. GELLMAN. You suggested that a requester seeking private commercial documents should have the burden of demonstrating that he seeks the documents for the purpose of learning how the Government is functioning. What kind of proof would you require the requester to make as to his intent?

notice and securing the other rights that I have talked about, then I think they might be willing to accept that.

There has also been discussion here of a class or category-wide system of determinations regarding documents. The testimony of the witnesses from the EPA and the FDA have pointed out a conflict among the agencies as to how they utilize these category determinations.

I believe that the EPA, on the one hand, stated that it would make a category determination that it would use as a rule of thumb, but that in every disclosure case there would be an ad hoc determination to make sure that that category determination did apply to those documents.

On the other hand, I believe this morning we have heard that the FDA utilizes a category determination without any further ad hoc determinations. It seems to me that if category determinations are to be utilized, then there must be a provision that there either be an ad hoc determination or some form of waiver procedure whereby a company could demonstrate to the agency that the general conclusion that it has reached concerning the disclosability of the category of documents may not apply to either the industry in which that company operates or that this company may, for some reason, be in a different posture than its competitors would in the same industry.

The last proposal that I have heard is the presubmission review proposal. That is one that I think would create intolerable burdens.

The presubmission review proposal contemplates that the company would be required to obtain a decision from the agency and to demonstrate to the agency, at the time that it submits the document, that the information is confidential. This would require the company to demonstrate this on the basis of economic proof at the time it submits each and every document that it contends is confidential. This would create a situation for certain companies of being required to make scores and perhaps even hundreds of presubmission confidentiality showings when, at that time, it is not even certain that any of these documents would ever be subject to disclosure.

The same burden would fall upon the agency. The agency would be required to consider claims of disclosability or confidentiality for hundreds and perhaps thousands of documents when in fact a very few of these documents would ever become subject to an FOIA request. It seems to me that that is a commitment of resources both from the private sector and from the Government that would bear little fruit.

That really completes the testimony that I had planned, but there was one additional aspect that I wanted to bring up.

Yesterday, Mr. Chairman, you and Congressman McCloskey made several statements concerning your skepticism as to how the document called "An Affirmative Action Program" could ever be confidential or could ever contain confidential information.

As you may know, there has been quite a bit of litigation in the reverse FOIA field concerning affirmative action programs. So I thought that I would address just a few remarks about those kinds of documents.

AAP's are generally quite comprehensive documents, 200 pages in length quite often. These documents portray a great deal of information concerning a manufacturing or sales facility. The information

how the Government was operating. It was designed to increase the access of citizens to Government documents that would show what those Federal agencies' policies were, what their actions were, and why they took them.

It was not the intention of the act to increase public access to private business documents which are within the possession of the Government due to regulatory requirements, but that are not, by definition, Government documents. They retain their private character, in my view. They are proprietary in nature. They have been prepared at private expense and for private purposes.

If the Congress were to recognize that the fourth exemption had two potential applications, one with respect to private documents and another with respect to Government documents—indeed, I think that distinction could run through all of the FOIA exemptions—then it would seem possible to me to accommodate the competing but yet compatible aims of the Freedom of Information Act. On the one hand, you would open access to Government documents through the act's disclosure provisions. But on the other hand, you would respect and preserve the privacy of business documents.

I know that the subcommittee has asked all of the witnesses to address the procedural problems under exemption 4. I will proceed to do that. But I would like to state that I do not think that any procedural changes are going to stem the problem under the fourth exemption unless Congress does tackle this substantive question.

In my view there are a number of procedural defects both in the Freedom of Information Act itself and in the implementing regulations.

Starting with the very inception of an FOI case—the Freedom of Information Act, and I believe virtually all Federal regulations—fail to have any provisions for notice to the submitter of a document.

Yesterday, Congressman McCloskey asked for some examples of abuses that the witnesses believe existed in terms of the procedures under the act. With respect to the notice requirement and also with respect to the time which a submitter is afforded to oppose or object to disclosure, an example of what I consider an abuse came to mind.

Recently a case was commenced in the eastern district of Kentucky by nine companies to enjoin certain Federal agencies from disclosing documents which they had submitted to those agencies. When the agencies received the request for disclosure under the act and decided to disclose the documents, the agencies gave 5 days notice to some of the companies in order to allow them to object to the disclosure of the information.

The agencies gave only 1 day notice to other of the companies in order to object. In fact, notice was not given to another of the companies until several days after the disclosure decision became final and the release date had passed.

I would argue that even 5 days notice is absolutely not enough time for a company to review the documents, to prepare its case, to obtain economic advice and assistance, and to submit its case to the agency. One day's notice certainly is not enough and I do not believe I have to say anything about a notice that is received after disclosure.

Mr. PREYER. Our next witness is Burt Braverman, an attorney with the law firm of Cole, Zylstra & Raywind.

Mr. Braverman has been involved in several important FOI cases on behalf of corporations. We welcome you here today and your statement will be made a part of the record.

STATEMENT OF BURT A. BRAVERMAN, ATTORNEY, COLE, ZYLSTRA & RAYWID

Mr. BRAVERMAN. With your permission I will dispense with reading the statement. It is a little bit too long to burden the record.

As you stated, my role in this area has been in representing businesses that have been confronted with threatened disclosure of confidential information which they had submitted to various Federal agencies under varying circumstances. Uniformly, however, the information at stake was considered by the businesses themselves to be highly confidential and significant in a commercial sense.

These businesses, like many others, submit a staggering amount of information to the Government every year. They do so in response to mandatory filing requirements; they also do so under voluntary circumstances, sometimes in a spirit of cooperation and sometimes in a spirit of self-interest. But the short end is that a great amount of business information that is compiled at private expense and private effort is furnished to Federal Government agencies.

In the past, much if not most of this information was treated confidentially by Federal agencies. The company statements and claims of confidentiality were respected. Much of that has changed since the Freedom of Information Act was promulgated, particularly in the past several years.

As a witness for the EPA said yesterday, whereas 90 percent of the business information submitted to EPA in previous years was formerly held nondisclosable, today 90 percent of that information is now held disclosable.

Something happened to create that overnight change in circumstances. I would like to talk about what that something was.

As I see it, the Freedom of Information Act had a distinct purpose. The purpose was to open the processes of government to public scrutiny. The aim was that if you could better inform the public, the electorate, what the Government was doing and why it was doing it, the Government would become more responsive to the public. The act was passed with that end in mind, and it was passed to correct what was seen by the Congress to be a period of time in which Federal agencies had closed up as tight as a clam and had not been willing to provide this kind of information to the public.

I do not think that the act, however, was designed to be a private disclosure act. I do not think that the act was designed to make private businesses more accountable. Those statements are not found in the legislative history of the act in the 1960's.

The aim was distinct. The aim was to correct secrecy of Federal Government agencies concerning how the Federal Government agencies were acting, how they were reaching their decisions, and what their

information within the statutory ten-day deadline. On the other hand, corporations whose information is at issue have a ready supply of experts willing to testify about the value of the contested information.

I do not think that the answer to this problem lies in providing for a hearing, even an informal one, before deciding to disclose potentially valuable business information. Such a requirement would wreak havoc with the ten-day deadline established by Congress--a beneficial statutory provision designed to prevent unnecessary delays in the release of information to the public.

In our view, the answer lies in the use of rulemaking to make generic determinations about the disclosure of categories of information. Our experience to date with our public information regulations would tend to confirm the advantages of this approach.

SAFETY AND EFFICACY DATA

In the recent reverse FOI case brought against the Agency, the principal issue involves the release of what the Agency considers to be summaries of safety and efficacy data pertaining to a new drug. Drug manufacturers have always claimed trade secret status for the data generated from preclinical and clinical trials, on the theory that these data provide an important competitive advantage over those who do not have access to it.

The Agency has generally agreed with this position since enactment of the Federal Food, Drug, and Cosmetic Act in 1938, by interpreting the term "method or process which as a trade secret is entitled to

we have adopted a very restrictive notice procedure. We will only consult with the submitter about the status of requested records when the confidentiality of the records is "uncertain," and then only to enable the submitter to provide additional information to FDA to permit us to make the disclosure decision. The providing of notice is not an opportunity for the submitter to argue or attempt to persuade us to deny access to the requested records.

Our restrictive policy on notice was the subject of an early challenge by the Pharmaceutical Manufacturers Association (PMA) in Pharmaceutical Manufacturers Association v. Mathews, 401 F. Supp. 444 (D.D.C. 1975), subsequent opinion, 411 F. Supp. 576 (D.D.C. 1976). PMA asserted that notice and an opportunity to consult with FDA about the disclosure decision should be given in every instance in which material was requested that had been submitted by or related to one of PMA's member companies.

Fortunately, the court ruled in our favor. Although, some agencies may find it possible to provide notice of a contemplated disclosure in every instance, in our judgment, our entire FOI operation would have been seriously threatened had PMA succeeded in court. Nor do we feel that providing notice in advance of every disclosure would provide benefits justifying the time and expense involved. If the public is to have prompt access to Agency records, the disclosure process cannot be encumbered with elaborate procedures that give private persons,

of records (and information in those records) routinely found in FDA's possession.

We have canvassed our files, identified the different types of records we possess, and applied the "trade secrets" and "confidential commercial or financial information" definitions to those records. In our regulations, we have stated precisely, for the majority of records we have, whether they are disclosable or exempt under the fourth exemption (or the other statutory exemptions).

Obviously, this was a major undertaking on our part, but we think the time and resources were well spent. Our regulations, and the extensive preamble discussion that accompanies them, describe for Agency employees and the public what the status of those records is under the FOI Act. Our disclosure decisions are thus more uniform and prompt, and less subject to dispute or challenge than would be the case if each disclosure decision was an ad hoc one. Moreover, it is clear that we would not be able to fulfill our obligations under the Act without detailed regulations.

This is not to say that we have no difficulties in implementing the trade secrets provision of the Act. We still must expend scarce professional resources to determine if records contain exempt information, because such material is often intertwined with disclosable material and the Act requires that, where possible, we segregate the two. Court decisions interpreting this provision of the FOI Act require a line-by-line analysis of each document in pursuit of the disclosable.

Prepared Statement of Dr. Donald Kennedy, Commissioner, Food and Drug Administration

Mr. Chairman:

I welcome this opportunity to share with the Subcommittee our thoughts concerning the trade secrets provision of the Freedom of Information (FOI) Act and reverse FOI suits.

Broadly considered, the FOI Act and the Food and Drug Administration's (FDA) implementing regulations have resulted in substantial public benefits, although they have also produced some disappointing local effects. Contrary to some fears expressed at the time our regulations were first published, our policy of disclosure has neither hindered communications with anyone outside the Federal Government nor has it impeded internal Agency deliberations. It has, on the other hand, properly encouraged closer public scrutiny of our actions, and thereby has enhanced public accountability of the Agency.

The trade secrets provision of the Act is a troublesome one with which FDA and other Federal agencies have had to struggle continuously. The records we maintain are often laden with trade secret or confidential commercial information and, as the recipient of an enormous number of FOI requests--we expect some 25,000 this year--we are called upon daily to make disclosure decisions that involve potentially valuable business information.

DEFINITIONAL PROBLEMS

A basic problem that has plagued agencies in implementing the trade secret provisions of the FOI Act has been defining the coverage of exemption 4. The language of the exemption itself--"trade secrets

successor firms to provide new data to bring a competing drug into the same status as the first entrance drug.

That is what your friend and mine, Professor William Baxter, calls "barnyard equity." It essentially uses a regulatory statute as a barrier to entry instead of addressing entry problems through statutes designed to address entry problems. So I told the chairman that I thought that we might be found at some time urging that the patent laws be altered. For example, drug companies could start the patent clock ticking at the time of new drug approval rather than at the time the patent was granted.

Mr. McCLOSKEY. I wonder if we could submit a letter to you and ask for some supplemental information. I would like to see, for example, how your regulations work. They do not require the submitter of information to designate the specific part of the application which is to be held in confidence according to the submitter's criteria. Is that correct?

Dr. KENNEDY. That is correct.

Mr. McCLOSKEY. So you are faced with the position that if anybody requests a submitter's facts then you have to go through the entire 1,000 pages or 50 pages of that submitter's information to determine what should be released and what should be retained in confidence; is that right?

Dr. KENNEDY. Not with respect to safety and efficacy data. In those cases we have, by regulation, established the practice of releasing summaries. That is a summary of the full thing.

Incidentally, you may be distressed to learn that 1,000 pages would be our short form.

Those data are not releasable, indeed none are releasable except the summary.

So we would not have a sorting problem there, as I understand it.

Mr. McCLOSKEY. What is the average length of one of your applications for a new drug?

Dr. KENNEDY. There is a great variance, but it would be many many volumes of material.

Mr. McCLOSKEY. From the submitting company's viewpoint, how much of this information would they consider to be privileged?

Dr. KENNEDY. Not all of the material included in that stack of paper would be privileged information. Much of it is already published because it is reprints and things of that sort. But from the point of view of FDA's releasability it forms a unit that we have treated as nonreleasable.

Mr. McCLOSKEY. That's by custom?

Mr. PAPE. The entire safety and effectiveness data. There are portions of a new drug application file that are released after the drug is approved. Ordinarily the protocols, the summary, any adverse reaction data that we have reported to us and so on. The big chunk of it is the safety and effectiveness data and that is not given out.

Mr. McCLOSKEY. You don't have a problem with that big chunk of it; but the competitive proprietary information that the company might not want released from the competitive standpoint—how do you break that out from the rest of the volumes?

Dr. KENNEDY. In that particular case, we do not have to because we treat it all as nondisclosable except for the summary and except for the parts of the NDA that do not deal with safety and effectiveness.

Regarding the last unnumbered question in your letter: as I stated in testimony, we believe that Congress should explicitly authorize FDA to release all safety and effectiveness data on new drugs. Such a policy would, we think, enhance public confidence in the new drug approval process. It would also reduce the amount of professional time that we now spend on reviewing records related to new drugs to delete confidential data and information.

Furthermore, we believe that Congress should clarify the status of the general Federal confidentiality statute, 18 U.S.C. section 1905 to the Freedom of Information Act. In our judgment, that statute should not be a so-called "exemption three" statute.

If I can provide additional information, please let me know.

Sincerely yours,

Donald Kennedy
Commissioner of Food and Drugs

Enclosures

[Subcommittee note: Enclosures not included; available in subcommittee files.]

Tab B. We have not included copies of all of the animal data that we disclosed after Upjohn waived its right to confidentiality because these data are very voluminous. If, however, the Subcommittee wishes to have copies of these data, we can supply them. Because we do not utilize a computerized system for retrieving FOI data, there are no computer printouts to submit.

Item #3

Copies of all memoranda or instructions to employees on how to determine what information should be considered "confidential business information".

Response #3

These are enclosed under Tab C.

Item #4

Breakdown of the number of man hours required for (a) the administration, (b) the legal interpretation, and (c) the lawsuits involved with the processing of the b(4) exemption of the Freedom of Information Act, dealing with trade secrets and commercial or financial information;

Response #4

As I indicated during the hearing, although we keep a variety of FOI statistics, we do not have breakdowns by occupational discipline. We keep workload statistics by GS grade level within our major organizational components. Such figures for calendar year 1976 are enclosed under Tab D.

Item #5(a)

How many requests for information under the Freedom of Information Act have been denied by the FDA?

Response #5(a)

During 1976, out of a total of 21,778 requests, 309 requests were denied.

Item #5(b)

How many of those denials were appealed?

Response #5(b)

Twenty-four.

(4) breakdown of the number of man hours required for (a) the administration, (b) the legal interpretation, and (c) the lawsuits involved with the processing of the b(4) exemption of the Freedom of Information Act, dealing with trade secrets and commercial or financial information;

(5) (a) How many requests for information under the Freedom of Information Act have been denied by the FDA? (b) How many of those denials were appealed? (c) How many of those appeals were declined? (d) How many of the declined appeals led to a lawsuit? (e) As a result of the lawsuit, how often was additional, previously "confidential," information released? (f) As a result of the lawsuit, how often was all of the previously "confidential" information released? (g) In either (e) of (f), was "confidential" information released prior to the case going to trial but after the initial appeal was denied?

What specific statutory sections of FOIA and other Acts, such as 18 U.S.C. 1905, may require review and possible revision, in your counsel's judgment, if we are to minimize the paperwork and procedural problems of the FOIA?

Many thanks. In retrospect I think you may have one of the three toughest jobs in Washington.

Sincerely,

Paul N. McCloskey, Jr.
Ranking Minority Member
Subcommittee on Government
Information and Individual
Rights

Mr. PREYER. It has been suggested by some of our other witnesses that companies should identify confidential data at the time of submission.

Does this really differ from your practice?

Dr. KENNEDY. We offer them prior consultation about what our regulations are likely to require us to do with the information they submit to us. I would not want us to get into a position where we accepted the validity of a corporate label as to disclosability a priori. We have more responsibility in this situation than that.

Mr. PREYER. You do not require that they indicate which data they think is confidential and why?

Mr. PAPE. No; we do not. With the narrow exception that the Commissioner was speaking about, we don't. With respect to voluntarily submitted information, information the agency does not have authority to require that it be submitted, then we permit someone to get an advance reading on our view of the status of those records under the FOI Act.

If that person does not like the answer we give them, they can withdraw the records. But for the majority of records, those that are discussed in our regulations certainly, I suppose we tell the submitter what the status of the records is, and we do not really need the submitter to mark the records confidential or to submit justification.

That may be a perfectly appropriate system to be employed by an agency which does not have a heavy docket. It may make sense to put the onus on the submitter to explain and justify confidentiality, assuming the agency reviews it and makes its own call.

We do not think that would be helpful in our instance.

Mr. PREYER. Mr. McCloskey?

Mr. MCCLOSKEY. Mr. Kennedy, I want to congratulate you on undertaking what must be one of the top four toughest jobs in Washington. [Laughter.]

Do you have the ability without further straining your professional staff to give us a breakdown over a 1-year period of the number of manhours required for administration of the Freedom of Information Act and the interpretation as to what is confidential under the trade secret exemption?

Dr. KENNEDY. The number of person years in fiscal 1976 that we invested in freedom of information searches that can be directly allocated was 67-person years. The cost was somewhere between $1.6 and $1.8 million. That is a serious underestimate because, as you realize, the amount of time we spend worrying about appendages of the problem like FOI hearings, lawsuits and so forth is not included in that number.

Mr. MCCLOSKEY. Do you have any way to break that down between professional interpretation by scientists and legal interpretation by lawyers?

Dr. KENNEDY. We have it broken down by components and GS grades. That is for 1976. I can supply it for the record. I can also decode it for you. It's in our acronyms for bureaus, but we can clean that up for you.

[The material follows:]

son who is going to do the dirty work and put them together. This person accounts for about 5 percent of the requests that we now receive.

Mr. PREYER. Is this exchange of information good for the economy or bad for it?

Dr. KENNEDY. Tracing the audit trail, Mr. Chairman, is a little difficult to do. It certainly is good for the economy of those information-generating institutions out there. Otherwise, they would not be incorporating at a rapid rate.

I think it probably leaves the pharmaceutical and the food industry at a standoff. My suspicion is that getting all of that information out there may lead to a certain homogenization of practices but that it is doubtful that it is going to, for example, affect industry's overall compliance rate with our good manufacturing practices regulations. If I thought it would, I might consider it a reasonable price to pay. But I do not really think it is likely to. We have not seen any suggestions as it is.

Mr. PREYER. Do you have any thoughts about what we ought to do about it, Mr. Kennedy?

Dr. KENNEDY. No. My instinct, Mr. Chairman, is to suspect that this is just a side effect of what is basically a socially useful kind of law that one probably cannot avoid and that it is simply part of the cost of doing open business.

I doubt seriously whether an attempt to address this little problem of parasitism here would produce more benefits than costs to the general fabric of that statute.

If I knew a way to amend it to get rid of only the sort of nonuseful faction of corporate information exchanging, then I suppose I would do it. But I do not know a way to do that without robbing the act of some of its legitimate purposes.

So, I guess the way we want to go at it is to try by changing our own act and bringing more of our information out into public view or at least to eliminate distinctions and save work that way. Then GMP Trends and other corporations who are part of this cottage industry are changed essentially from freedom of information organizations to abstracting services. If the corporations want to continue to buy an abstracting service, they can do it but these folks will then have to compete with other abstracting services that are working with information that is out there in libraries and stuff.

Mr. PREYER. You drew on your scientific background to come up with some good metaphors there. You have "side effects," "parasitism" and the like. [Laughter.]

As for the cottage industry thing, are there any other specific categories of requests such as the GMP Trends that you just mentioned?

Mr. PAPE. There is a cottage industry in FOI Services Inc., it is called, which accounts for about 25 to 30 percent of our requests.

Dr. KENNEDY. That is more than a cottage then.

Mr. PAPE. It is a "summer home." [Laughter.]

Their requests will run the gamut. They will be interested in establishment inspection reports that our inspectors prepare, minutes of meetings, memorandums of telephone conversations, minutes of advisory committee meetings. They really run across the line. We have a number of FDA manuals that are publicly available that are best-sellers. [Laughter.]

Mr. PAPE. I think that is probably the one that is at the forefront now. Over the years, no doubt, we have had some disagreements in particular situations where we thought something was appropriately withheld or a provision in our regulations was appropriate and lawful and the Department has disagreed. But I do not want to make it seem as if we are constantly having fisticuffs with our colleagues down at the Department. That is not the case.

Mr. PREYER. You have mentioned that your regulations provide for the availability of specific categories of information and that that makes it easier for you to handle Freedom of Information requests.

I would like to ask you this. How does that work? Do your regulations allow you to release or withhold documents without a page-by-page review?

Dr. KENNEDY. That really depends on the document. I think sometimes the existence of our categories makes it possible to do a sorting by whole documents. I do not know. I must confess that I don't know what percentage of the time that is. But there are certainly frequent occasions in which we are asked for a file, for a set of correspondence, or a document in which we simply have to go through it on a page-by-page basis and make those separations, despite the existence of clear-cut criteria. All it does is make the task a little less difficult.

Mr. PREYER. So, these categories can be overruled at the time of a specific Freedom of Information request?

Dr. KENNEDY. It is not so much overruling, Mr. Chairman, as it is that different information, even in a single document, can belong to different categories where one is releasable and one is not.

Mr. PAPE. Our regulations provide that correspondence between the agency and persons outside the agency ordinarily are available but correspondence will sometimes contain a trade secret. If a Director of the Bureau of Drugs is corresponding with a pharmaceutical firm about a new drug, then it may be that the formula or some manufacturing method or something like that is discussed in that correspondence. You start from the premise that the correspondence is available but you nevertheless must review it to see that there are no trade secrets, for example, that you would have to delete before disclosing the letter.

Mr. PREYER. Do you think we ought to change the Freedom of Information Act to permit explicitly that agencies would have the right to grant binding rules covering the availability of categories of documents?

Dr. KENNEDY. Let me take a shot at that and then let me ask Mr. Pape to give his views.

It seems to me that creating categorical statements in regulation about kinds of releasable information and kinds of nonreleasable information is sort of a way of testing the intent of the present law and working that out. Presumably if we create a category of releasable data by regulation, as, for example, we could attempt to do conceivably in the case of safety and efficacy data, we would then be challenged in court. There would ultimately be a judicial judgment about the intent of Congress in that matter. That is one way to go. The other way to go is to change it.

I think that the category that I am most concerned about, which is the safety and efficacy data, are better addressed by amending our own

I cannot estimate exactly how much we would diminish that by if we were to have our way on safety and efficacy data.

Mr. Pape, can you help me out?

Mr. PAPE. There might be a reallocation of time. We now need professional time to review and sort out that which is disclosable from that which is not, in the records. If we broaden the category of disclosable information by including safety and effectiveness data there, then you would not require the professional time. You might require clerical time because the day the change becomes effective or shortly thereafter, the agency no doubt will be inundated with requests from people who for 40 years have been waiting to get their hands on that kind of information.

An NDA can run several yards in length. All of that information would have to be copied and made available.

Mr. PREYER. From the figures we had, you had received in 1976 almost 22,000 requests and you made only 309 denials. Would that indicate that in most cases the decision to release information was not time consuming or very difficult?

Mr. PAPE. In most cases the decision is not difficult because we have already made the difficult decision in the regulations and we know the answer. What is sometimes difficult and time consuming is identifying the documents that the requester is interested in and locating these documents. It is not at all uncommon to get a request that runs five or six pages or a request that says, "Let me have everything that you have on saccharin."

As you might imagine there are quite a few pieces of paper running around on saccharin at FDA. It is time consuming to locate all of those and to look through them.

There are some difficult decisions that nevertheless have to be made. But I think your impression is correct.

Mr. PREYER. Can you give us a rough ball park estimate on how many of the 22,000 requests would have been granted even if they were not under FOI? I'm not asking you for a scientific count on that.

Mr. PAPE. It is almost an impossible question to give you a guess on. You can go back historically to see the way we treated requests for information before the FOI Act came around. It was almost as if we had a rubber stamp that said "No." I think we would readily concede that the passing of the act was a great impetus at our agency in changing our policies.

We went from a situation in which about 10 percent of our records were disclosed before the act to a situation now where we estimate about 90 percent of the categories of records we have are disclosed. That is about the best I can give you on that question.

Dr. KENNEDY. I would like to interpose one thought, Mr. Chairman. There is another question you could ask which is: "How many of those requests would you have gotten?" There I think the thing that needs to be emphasized is that the Freedom of Information Act, among many other things, constitutes a kind of self-fulfilling prophecy. As I tried to mention in my statement, it has spawned an active freedom of information industry. It has generated its own activity so that much of what we are being asked is as a direct consequence of the existence of a system. We would not have been asked those things had the system not existed.

disclosure before approval for funding that I probably would stick with the present system if I were making the decision.

On the other hand, I see no excuse for keeping the results of already completed studies from public scrutiny under any circumstances. I think the challenge for policymakers in the Congress is to find a way of making sure that plans for research are made public at a time when it is still opportune for public commentary to be made and to effect those plans—but not so early that it robs the research planner of the advantage of thinking it up first.

I think such a point is likely to be discoverable although not without the kind of discussion that I am sure it will get in the Commerce Committee.

Mr. PREYER. Because of the alleged risk in DNA research, would you tilt that rule in the direction of more disclosure?

Dr. KENNEDY. I think that where the public safety is affected my tendency would be to tilt it in the direction of public disclosure because I think people who are going to be affected by a practice ought to know as much as they can about it.

Mr. PREYER. I had wanted to ask this. Would you make any exceptions to your broad policy of public release? I think you have indicated one area.

Is there any other data that you would withhold?

Dr. KENNEDY. I think there are certain kinds of process data having to do with manufacturing methods, production methods, isolation methods, or extraction methods which are properly the product of private innovation which deserves protection. But I would make a sharp distinction between those data that have to do with process, manufacture, and method, and those data that have to do with proof of efficacy or safety because data of the latter kind clearly are matters which are in the public interest to disclose.

I think innovation incentives can adequately be preserved, Mr. Chairman, by guaranteeing that the protections provided to legitimate trade secret information, like process information, are made firmer or of adequate duration so that the rights of innovators are well protected through the kinds of statutory provisions that are meant to address those rights.

Mr. PREYER. Would your proposal for public release of safety and efficacy data include information on toxic substances?

Dr. KENNEDY. Yes. Yes; it would.

I cannot think of a single datum about a toxic substance that would not be releasable under the kinds of provisions I am talking about unless one characterizes certain drugs that have rather high risks of adverse side effects but are nevertheless useful in the treating of especially serious conditions as toxic substances which they are not usually defined as. There again, I would favor the release of safety and efficacy data but not necessarily process data relating to manufacture.

All other toxic substances that I know of that are treated under our act are treated as food additives, either direct or indirect food additives. The scientific data regarding the safety of food additives are already open to public scrutiny. So there is no problem with those data.

Mr. PREYER. Have you started to implement your new policy in any way, the policy of public release of safety and efficacy data?

industry of freedom of information organizations whose primary business it is to extract from the Government agencies information that they think may be useful or at least salable to corporate clients.

In the fulfilling of this kind of almost mechanized request, we find that a substantial amount of our resources are going. It is for those reasons that we have attempted to be fairly tough about aspects of our procedures, including those involving notices which would embroil us even more deeply in these obligations.

FDA's public information regulations also provide for a special procedure which we call "presubmission review." This procedure enables persons who may wish to submit information voluntarily to learn in advance the FOI status of their records before doing so. This presubmission review is not limited to voluntarily submitted records; it extends to records with uncertain status under the act. It allows anybody who is giving information to the agency to know what we are likely to do with it under these regulations.

FDA has been fortunate in that only one reverse FOI suit has been brought against it. I say "fortunate" because such suits, as you surely realize Mr. Chairman, require a heavy call on the resources of our Office of General Counsel and other agency personnel. We do welcome court challenges to specific provisions in our regulations because they may clarify substantial issues of dispute and minimize future litigation.

We devoutly wish for any minimization of litigation that our agency can bring about.

Now let me turn to an issue that interests me really more than any other single one on your agenda, Mr. Chairman. It has to do with a particular category of information, the release of which the agency has consistently interpreted to be prohibited even under FOI. I refer to the safety and efficacy data brought to the agency in connection with submissions of IND's or NDA's as a part of our premarket approval process for new drugs.

Drug manufacturers have always claimed trade secret status for the data generated from preclinical and clinical trials on the theory that these data provide important competitive advantages over those who do not have access to it.

In general, our agency has, as a matter of historic fact, agreed with that interpretation. We have interpreted, since, 1938, the term "method of process which as a trade secret is entitled to protection" under section 301(j) of our law as encompassing animal and human testing data.

I should point out that throughout most of our history that kind of interpretation has virtually been a necessity. I'm talking about before FOI now. That kind of interpretation has been a virtual necessity because of the very stiff penalties provided under 18 U.S.C. 1905 for Federal employees who release such trade secret data. It was almost a matter of protecting agency personnel.

In our opinion, legal constraints have thus largely dictated our policies and practices with respect to release of safety and efficiency data. We have repeatedly stated that we cannot unilaterally change a longstanding interpretation of the law on which the agency has relied for almost 40 years.

Mr. PREYER. Without objection, the entire statement will be made a part of the record.

Dr. KENNEDY. We think that, broadly considered, the FOI Act and our implementing regulations have resulted in substantial public benefits, although they have also produced some disappointing local effects.

Contrary to some fears expressed at the time our regulations were first published, we think that the policy of disclosure has not hindered communication with the people outside the Federal Government nor has it impeded internal agency deliberations.

On the other hand, we think it has properly encouraged closer public scrutiny of our actions and thereby has enhanced the public accountability of the agency. But, like other agencies, we have had to wrestle with some problems and prominent among those are the trade secret provisions of the act.

The records we maintain are often laden with trade secret or confidential commercial information and, as the recipient of enormous numbers of FOI requests—we expect some 25,000 this year—we are called upon daily to make disclosure decisions that involve potentially valuable business information. Those problems, Mr. Chairman, will highlight my testimony today.

One of the problems that we have had—and I am sure these too we share with others—involve our interpretation of exemption 4. As you realize the language of that exemption does not explicitly define the kinds of records that Congress intended to exempt. Neither does the legislative history of the act provide detailed guidance in this area. Like others, we have turned to the definition of trade secrets in section 757 of the Restatement of Torts. We use the definition which the Supreme Court has also characterized as "widely relied upon." That defines trade secrets as "any formula, pattern, device, or compilation of information which is used in one's business and which gives him an opportunity to obtain an advantage over competitors who do not know or use it."

Both the definition and the leading judicial decision interpreting the exemption place primary emphasis on the competitive advantage. Our job then is to determine what information provides a "competitive advantage." It is one of the more difficult tasks we face in implementing the act.

We think that the definition of trade secrets and confidential commercial or financial information in our own regulations are reasonably explicit. It would be very difficult, however, to make correct and consistent disclosure decisions involving potentially valuable business information without relating the definitions to the categories of records that are routinely found in FDA's possession.

As a result, after we went through our rulemaking exercise, we did another kind of exercise. We searched our own files and tried to categorize the kinds of information that were contained therein and attempted to draw up a set of fairly explicit definitions and exclusions with regard to trade secrets and confidential commercial information so that in examining our own records in response to Freedom of Information requests, we would have a set of guidelines for our people that were consistent and that were understood by the public.

[Whereupon, at 12:10 p.m., the subcommittee adjourned, to reconvene at 9:30 a.m., Tuesday, October 4, 1977.]

reverse-FOIA case? Third, is the submitter ever entitled to fees or costs if he or she "substantially prevails" in either a reverse-FOIA case or an FOIA action where he or she has been joined or has intervened? Fourth, may the agency that "substantially prevails" ever recover its fees and costs?

The answers to these questions are not simple. If Congress' primary intent in the FOIA was to provide fees to individuals simply to encourage them to assert their legislative rights, submitters who substantially prevail, it would seem, should be entitled to the recovery of fees and costs on an equal basis with requesters. If, however, Congress' primary concern in the FOIA was to award such fees to parties who might not otherwise be able to afford to litigate to defend their rights, as it seems to have been from the legislative history, at least submitters who represent substantial commercial interests should perhaps not be awarded fees. In either case, however, requesters who are successful in reverse-FOIA cases should be able to recover their costs and fees on the same basis as they now are able to do in FOIA cases.

Similarly, if Congress' primary purpose in the attorney fee provision was compensation to the victor, the government should not necessarily be the only party ever required to pay, nor should it be prevented from recovering its own expenses. If the purpose was, however, as seems more likely, one of compensating those who might not otherwise assert their rights, the government will surely always assert its rights, and therefore should probably not be allowed to recover its expenses. Moreover, insofar as Congress' purpose was the financing of litigation for the purposes of compensating those unable to pay, it could be argued that such financing should be public and not private such that the government should also always be the sole party responsible for payment of costs and fees to those prevailing parties who are in need of such assistance.

the initial agency decision is partially adverse to both the submitter and the requester, their appeals should be consolidated for decision. Any administrative appeal should be determined by the agency within a fixed number of days, not to exceed the current twenty-day period in the FOIA. Neither the submitter nor the requester should be permitted an appeal to the courts until the completion of this administrative process, or the completion of the time period in which it is to occur, whichever comes sooner--i.e., no cause of action should be afforded either party until and unless administrative remedies are exhausted.

Thereafter, either or both, in the case of agency decisions partially adverse to both, the requester and the submitter should be permitted to appeal to the federal district court. Congress, in furtherance of "the primary purpose of the FOIA" to promote the disclosure of information, may wish to continue its preference for the rights of the requester by permitting that party's choice of forum, under the broad venue provisions of the FOIA, to control the location of the litigation. This could be accomplished in the cases where the agency's determination is adverse to the requester by limiting the submitter to intervention as of right in the requester's suit as a means of adjudicating his or her rights. Where the agency determination is adverse to the submitter, the requester would then be permitted to intervene as of right in the submitter's suit or file a separate suit in a forum which, upon a motion for consolidation, would be preferred over that chosen by the submitter. Where the agency determination is adverse to both the requester and the submitter, the requester would be afforded a certain number of days within which to file an appeal. If no such suit is filed within the requisite time period, the submitter could file in his or her choice of forum and the requester would be limited to intervention in that suit in that forum for

distinct disadvantage in trying to argue in favor of disclosure. To remedy this, Congress should provide as part of its new procedure that the agency supply the requester with a detailed analysis of the withheld information or, where it would not unduly compromise, sample documents. This would assure a more equal opportunity to the requester to advance his or her position. The information provided the requester would also be a helpful part of the record in any court review of the agency's determination.

8. Judicial Review

Under current law, an individual who is denied information under the FOIA may file suit in the United States district court in the district "in which the complainant resides, or has his principal place of business, or in which the agency records are situated, or in the District of Columbia." Such suits are generally to take precedence on the court calendar and to be "expedited in every way." These protections may also be frustrated by the reverse-FOIA action. Suppose a requester has asked an agency for information, and is awaiting the expiration of the initial ten-day period for agency response, or the twenty-day appeal period. Until he or she receives a response from the agency, or the time periods expire, whichever comes sooner, the requester may not file suit in district court. The submitter, however, may file suit at any time after he or she learns of the request. There is no administrative or other procedure for the submitter to exhaust; indeed, it is not even clear that the submitter has to attempt to obtain from the agency a determination of the agency's intentions with respect to disclosure. The result is that the submitter can file suit in the forum of his or her choice and possibly obtain at least a temporary restraining order without the requester's ever having the opportunity to contest the proceedings. Where the material has been obtained by the agency from several submitters, several of them may file suit in several different forums, none of them

they have done so in many instances at the expense of requesters' rights under the FOIA. For example, the Food and Drug Administration has provided that in cases where the agency is uncertain as to the confidentiality of information submitted to it, the agency will consult with the submitter before determining whether to release the material. No parallel provision for notice to the requester of the position of the submitter, or any opportunity to respond to the submitter's arguments, is, however, given. The first time the requester may in fact even learn of any objections of the submitter to disclosure is when the requester is notified by the agency that it cannot release the information because it has been enjoined in a reverse-FOIA lawsuit.

Congress should require agencies to establish procedures whereby notice may initially be given to a submitter of information whenever a request for that information is made. The submitter should then be afforded an opportunity to present to the agency any objections which he or she has to disclosure. This should be accomplished by written submissions rather than a time-consuming oral hearing. The requester should correspondingly be notified of any objections the submitter raises, and be given an opportunity, again by way of written submissions, to respond to those objections. The entire process should be accomplished within a fixed, relatively short, time period so that a prompt determination by the agency whether to disclose the information can be made.

6. Time Periods

This proposed procedure will cause several problems that Congress will also have to address. For example, currently the FOIA provides that an agency must respond to a request for information within ten days, and to an appeal from a denial of information within twenty days. In virtually

closure of exempt information. Rather an agency should be free to disclose such information limited simply by the abuse of discretion strictures discussed above, included within which would be consideration of whether the general policies sought to be addressed by §1905 might require in any particular case that the information not be disclosed. This is a solution which would strike the appropriate balance between the concerns of the FOIA and the concerns of §1905, as it would involve a case-by-case examination of the equities of each particular case rather than an absolute determination either that the material should be released or that it should not.

4. Relation to Other Federal Statutes

In addition to 18 U.S.C. §1905, several other statutes have been relied upon to prohibit the disclosure of information in reverse-FOIA cases in conjunction with exemption (3). While these are too numerous to discuss here, it is noteworthy that the legislative history of the amended exemption (3) makes specific reference to only two of these statutes, the statute at issue in Administrator, FAA v. Robertson, section 11 of the Federal Aviation Act of 1958, 49 U.S.C. 1504, and section 1106 of the Social Security Act, 42 U.S.C. §1306. Although analogies can be drawn between the statutes specifically mentioned in the legislative history and other statutes which have been relied upon in the cases, for the most part development of the relationship between these statutes and exemption (3) will have to be accomplished on a case-by-case basis. Moreover, as with §1905, the question of the relationship between any particular provision and exemption (3) is only the beginning of the analysis.

agency faced with deciding the case in the first instance. This increases the amount of court time beyond that which is necessary simply to determine from the agency's own record whether there has been an abuse of discretion. The granting of relief to either party in the case is also thus delayed, as is the decision of other perhaps equally if not more important cases on the court's docket. While these consequences may be justified in FOIA cases where Congress has, for substantial reasons, provided for de novo review, to engender such consequences in reverse-FOIA cases seems both unwarranted and unwise.

3. 18 U.S.C. §1905

In some cases, submitters of information have argued that provisions of federal law other than the FOIA should be invoked to restrain agency disclosure of exempt information. The statute most relied upon as the basis for such arguments is the Trade Secrets Act, 18 U.S.C. §1905, which makes it illegal for a government employee to disclose "to any extent not authorized by law any information coming to him in the course of his employment... which information concerns or relates to... the amount of any income, profits, losses, or expenditures of any person."

Exemption (3) of the FOIA provides for the exclusion from mandatory disclosure of matters "specifically exempted from disclosure by statute... provided that such statute (A) requires that the matters be withheld from the public in such a manner as to leave no discretion on the issue, or (B) establishes particular criteris for withholding or refers to particular types

Issues Requiring Congressional Action

1. Express Cause of Action

The FOIA only grants a right to bring suit to persons whose requests for information have been denied by the government. The Act is silent regarding the right of providers of information to sue to protect the confidentiality of that information. The courts, however, have generally held that submitters have such a right of action, not under the FOIA, but under the Administrative Procedure Act, 5 U.S.C. §702 (1970).

While I have no quarrel with the result achieved--the right of the submitter of information to litigate the issue of whether the information should be disclosed--recognition of the cause of action as one under the APA has led to some confusion in the cases, for example confusion about the appropriate scope of judicial review. For this reason I believe that Congress should explicity provide submitters with a cause of action under the FOIA, and should set forth in that legislation an appropriate standard for judicial review.

2. Scope of Review

The question of the scope of judicial review to which agency determinations should be subjected involves the degree of deference which the courts should give to those determinations. In reverse-FOIA cases two questions are presented to the court on review: 1) whether the information is exempt, and 2) assuming that it is exempt, whether it should nonetheless be disclosed. For the most part, the courts in reverse-FOIA cases have determined

therefore appear to require Congressional action at this time. First, in each reverse-FOIA case the individual seeking to prevent disclosure must initially show that the information is within one of the Act's exemptions. The exemptions primarily relied upon by such individuals have been those whose basis is found in the protection of confidential information or other privacy interests--exemptions (3), (4), and (6). There has been no more controversy in the reverse-FOIA context, however, about the meaning of each of these exemptions than one would expect to find in the standard FOIA suit. No substantive Congressional amendment of any of the Act's exemptions seems therefore warranted, at least not because of problems encountered here, with one possible exception discussed below.

Second, assuming that the material requested is within one of the Act's exemptions, the next issue raised by the reverse-FOIA action is whether the agency nonetheless has the authority to disclose it, i.e. whether the Act's exemptions are permissive or mandatory. Although in the early reverse-FOIA cases the courts were divided in their response to this question, in the more recent cases the view that the exemptions are merely permissive, and therefore that the agency has discretion to disclose exempt material, seems to be the prevailing one. I believe that this latter conclusion finds strong support in the statutory language and legislative history of the Act, particularly the 1974 amendments. It also seems sound as a matter of policy to permit, at the discretion of the agency, the release of even exempt material where that disclosure would

PREPARED STATEMENT OF NANCY DUFF CAMPBELL, VISITING ASSOCIATE PROFESSOR OF LAW, GEORGETOWN UNIVERSITY LAW CENTER

Mr. Chairman, Ladies and Gentlemen of the Subcommittee, I thank you for the opportunity to appear before you today. My name is Nancy Duff Campbell. I am a Visiting Associate Professor at Georgetown University Law Center, where I am currently finishing an article on the issues raised by reverse-Freedom of Information Act lawsuits. I will attempt today to summarize briefly the conclusions of my research.

As this Subcommittee is aware, the reverse-FOIA lawsuit is one in which a private party seeking to prevent the disclosure of information by the government under the Freedom of Information Act sues in federal court to restrain that disclosure. Any such suit clearly affects the rights of individuals seeking to obtain information under the Act, as well as the rights of individuals who have supplied the information to the government in the first instance. Both parties have significant interests at stake--the requesters in learning about the activities of their government and the submitters in protecting the privacy and confidentiality of information they have provided the government, particularly

Do you have any record of cases where the submitters of information were denied due process, or their rights were abused?

Ms. CAMPBELL. I certainly didn't mean to indicate in my testimony that I thought submitters' rights were being denied. I think just the opposite.

Mr. MCCLOSKEY. But the whole thrust of your testimony is that we should establish some way that a submitter is entitled to due process and intervention in this procedure. I'd be willing to consider it if I had any indication that submitters had been hurt in any way. But so far no one has come to this Congress with that suggestion.

Ms. CAMPBELL. Again, I didn't mean my testimony to suggest that.

I think that agencies are providing rights to submitters. I am worried that in that process they are denying rights to requesters—the individuals that Congress intended to protect primarily under the act.

For example, by not permitting requesters to state their views—or even in some instances telling requesters that they are getting the views of submitters—I believe the requesters' interests are being hurt.

Mr. MCCLOSKEY. We could do that, I suppose, merely by asking that agencies include that provision in their regulations.

Ms. CAMPBELL. That's right; but I think they will have difficulty with the time period provisions of the act for one.

They are now, in my judgment, in all the cases that I have read, violating the time provisions of the act.

I think it's almost impossible to comply with those periods under this kind of process where you're getting the views of others.

Second, I think the scope of review issue is an important one where the courts have leaned too far toward the rights of submitters by providing de novo review rather than abuse of discretion review.

So I am primarily concerned with the rights of requesters in reverse FOIA suits. I only meant to mention by my——

Mr. MCCLOSKEY. There, again, we have asked these requesters to tell this committee if they feel they are denied their rights—in most cases, they have indicated they've been successful, either in their requests or ultimately in their lawsuits.

I haven't heard of any flood of people who, as requesters, felt that they weren't receiving proper attention under the act.

I grant you that the time restraints are difficult to comply with, and we knew that when we set the 10-day and the 20-day period. But we also felt that, given the ordinary bureaucratic desire to postpone, we would much prefer to have a statute with which it may have been difficult for the Government to comply, rather than give them time limits which might be too permissive.

I say this as an ex-lawyer, having dealt with Federal attorneys. They will use every weapon at their hands to delay.

But do you have any factual cases that we could consider where a requester has been hurt by the present lay-out of the law?

Ms. CAMPBELL. I think that I have several.

My judgment is that in most of the reverse FOIA cases, there has been some damage to the requester's rights.

I cite in my testimony the Consumer's Union example where submitters filed suits in several different forums. The requester then tried to file his own suit in the District of Columbia——

Again, because I think that in general in these suits the submitters have greater opportunity to litigate and greater ability to litigate in different forums than requesters do—particularly where requesters are members of the public.

And, second, because if we are wanting to continue the notion of pushing disclosure over other interests in the act, I think there is justification for the requester's choice of forum to govern in these instances.

In situations where the decisions are adverse to both parties, then I believe that the requester could be given a certain number of days to file suit—say 20 days—in his or her own forum. If the requester did not do that, then the submitter could file and the requester would be limited to intervention in the submitter's suit if he or she wanted to adjudicate rights.

That's really an alternative which suggests some preference to rights of requesters.

Alternatively, it seems to me that Congress could provide simply for a cause of action and jurisdiction for both parties and could allow both parties to file suits in their respective choices of forum. Then the ordinary rules of consolidation, including possible reference to multidistrict litigation panels under the Federal rules, could be used to get these suits together in one forum.

As to what the court should look to in reviewing the agency's determination, I believe that the scope of review should be narrower than that now provided for requesters' suits in the FOIA.

In other words, I would make a distinction in scope of review between the situation where the requester is trying to get information and the situation where the submitter is trying to keep the requester from getting information.

The courts, I believe, have not made this distinction. They have provided de novo review—a review where the court proceeds to analyze the materials from the very beginning of the process of an issue, without any deference to the agency's determination.

I believe that under the procedure I have set out, there will be an agency record which the court can review. And that the rights of submitters will not be injured if the scope of review is limited to that generally provided for in informal agency actions under the APA. That is, whether the determination was arbitrary, capricious, or an abuse of discretion.

I believe that this scope of review will be sufficient because there will be a record and because, insofar as Congress was attempting in the original act to promote disclosure, Congress believed that this could only be done where the courts were able to give an independent judgment to the agency's determination—that is, de novo review.

The legislative history of that provision suggests that the reason for that was that Congress was concerned that agencies were simply not disclosing information and wanted the court to be able to look at that determination anew.

In this instance, however, the problem will be that the agency wants to disclose information and someone is trying to keep it from being disclosed.

I think that the courts need not take a fresh look at that determination and can look to the agency record.

The policy interests are simply not the same in terms of the purposes of the act.

court review there would also be a record for the court to review—which I'll come back to in a few moments.

Now in order to accommodate this, I believe that the time periods of the act would have to be extended. By this I mean the initial 10-day time period for responding to agency requests.

The 20-day agency appeal period I'm not sure would need to be extended.

But I would envision some extension of time.

Now where I've had difficulty is in figuring out exactly how much extension of time is necessary.

I would hope it would not be as long as 90 days, as suggested by the Department of Labor. On the other hand, I'm not sure that many agencies can do as EPA says it is doing, which is respond within 10 days or make a determination within 10 days.

So I would hope that somewhere between the 10-day period now present in the act and possibly 30 days could be given for this process to be accomplished.

Again, I can't make a judgment on that, because I would myself like to hear from other agencies as to what they think the feasibility of such a procedure would be.

After an initial determination is made by the agency, there would be a provision for administrative appeal, assuming that the agency now has a procedure for administrative appeal.

Again, all parties would be represented. I see no reason why that could not be accomplished within the current 20-day period. In fact, that period might even be shortened since there would be a record already compiled as to the arguments of the various parties.

I think that the problem at that point then will be when a determination is made by the agency which is adverse to one of the parties or, as in some instances, adverse to both parties. Sometimes, for example, the agency would say: We will disclose some information but not other. That I would characterize as a decision adverse to both parties.

I think at that point, the act should provide specifically for a cause of action by submitters, as well as requesters, for court review.

The courts seem to be permitting such actions now under the Administrative Procedure Act. I think that it would be neater, if you will, if such a provision were contained in the FOIA.

It would also give the Congress an opportunity to establish the scope of review, rather than the approach which the courts have taken which has been very confusing, I believe. They have tried to decide whether, since the cause of action is based on the APA, there should be APA type review or whether it should be FOIA type review. And that has resulted in some confusion.

I'll get back to that in a moment.

In any event, I think that a cause of action and jurisdiction should be established in the Federal courts for review of agency determinations by both submitters and requesters.

The problem in the current case law is really something that occurs when you have a suit by one party.

I would direct you at this point to page 13 of my testimony, which is an effort to go through the kind of complicated scenario that can result.

Mr. ROUGEAU. To the extent that that may exist, following analysis by the staff and by those of us who are new, we will do everything we can to eliminate that so that compliance with the requirements of the Executive order will be foremost in our minds.

Mr. MCCLOSKEY. That's the beauty of our system—that new people come in every 4 years. And, hopefully, a new broom sweeps clean.

We will be coming over to observe that process. Thank you.

Mr. PREYER. Thank you very much. We appreciate your being here today. It has been very helpful to us, and we will look forward to working further with you.

Our final witness today is Ms. Nancy Duff Campbell, visiting associate professor of law at Georgetown University Law Center.

Professor Campbell is an expert in administrative law and has been examining various aspects of the Freedom of Information Act.

Welcome, Professor Campbell. We appreciate your being with us today.

STATEMENT OF NANCY DUFF CAMPBELL, VISITING ASSOCIATE PROFESSOR OF LAW, GEORGETOWN UNIVERSITY LAW CENTER

Ms. CAMPBELL. Thank you, Mr. Chairman.

What I would like to do—largely in the interest of time—is rather than read my prepared statement to just give you informally the kinds of things that I think need to be done in this area.

I would emphasize, of course, that I am an academic and do not represent a constituency, so my views should be tempered with that knowledge.

Also, as a law professor, I always tend to see both sides of the question, so that has made it difficult for me to approach this problem in some instances.

It is my very firm belief, however, that Congress does need to act and to pass legislation to deal with many of the problems presented by reverse FOIA suits.

My reasons for saying that are several really. One, as you stated in your opening statement, these problems were simply not contemplated by the Congress when the original legislation was passed or even at the time of subsequent amendments.

Second, I believe that the courts—in addition to their difficulty in discerning congressional intent, because these areas were not contemplated by Congress—have also been wrong in many instances in their judgments about how to deal with these problems. They have been wrong both from a legal standpoint and a policy standpoint in interpreting the purposes of the FOIA.

Third, I think that while the agencies are trying in this area by promulgating regulations to deal with some of the procedures, I believe that their regulations have not gone far enough in representing the views of the requesters in this area.

They have attempted, in the instances presented this morning, to draw the submitter more into the process but I believe that requesters should, as well, be brought into the process of the agency's determination of whether to disclose the documents.

I also believe that agencies can't fully deal with these problems because certain parts of the FOIA would need to be amended to adequately address the issues here.

Mr. HENRY. Mr. Chairman, in one instance, there was a situation in which the requester requested that they be able to present their views with respect to the confidentiality of the information. I think in that instance we granted that request, but that has not come up as a practical matter in too many situations.

What generally happens is that the supplier or the submitter of the information will submit its objections, and the OFCCP will make a determination on the basis of the written record.

I might add that, as you can see from the number of reverse Freedom of Information Act cases we have against us, the OFCCP has been deciding that there is nothing confidential about these affirmative action plans.

Mr. PREYER. Are those hearings written or oral, or are they both?

Mr. HENRY. They're decided on the basis of the written record for the most part.

It is conceivable that in some instances it could be possible to have an informal type of hearing, but for the most part it is a determination based on written submissions.

Mr. PREYER. Do you have a fixed timetable for submission of briefs and rebuttals?

Mr. HENRY. The contractors are generally notified and told that they have 5 days in which to get their objections in.

Now the regulations do accommodate a process by which, at the time that they submit the affirmative action program, they can make whatever arguments they wish to make at that time.

But they are notified before the materials are released, and they can submit additional information at that time.

Mr. PREYER. Does the OFC consult independent experts during this process, or do you rely solely on the arguments made by the parties on the record.

Mr. HENRY. Depending upon the complexity of the matters involved, we have consulted experts. But for the most part, these experts have been in-house and other bureaus in the Department or special employees.

Mr. PREYER. When you do have an expert, do you allow any opportunity to respond to their views from the parties? Or is that just put in as part of the record?

Mr. HENRY. It is put in as part of the record.

Mr. ELISBURG. I might add that, again, we're dealing with primarily hiring, employment, and payroll kinds of information. We don't get into the question of what one would call scientific data or patents or that kind of thing that typically comes up under trade secrets or commercial information.

Mr. PREYER. I can understand that point.

You apparently run on a pretty tight timetable on this.

Would it be possible to compile an adequate record for the court, including participation from all the parties, in say 30 days?

In your experience, would that be too short a time or would that work?

Mr. HENRY. It would be extremely difficult. You're talking about monumental documents that you have to go through. As Mr. Elisburg indicated, we are dealing with employment-related data. I think that would be extremely difficult to accomplish within that period of time.

Mr. McCLOSKEY. What part of the statute; what language of the statute; and how are you restained?

Mr. ELISBURG. Sofia, maybe you can respond.

Ms. PETTERS. In terms of the question with regard to the salary of an individual, the courts generally have held that a salary of an individual in private industry—not a public servant—is nondisclosable information. How much a person makes is a very personal matter.

Many people object to having people know what salary they do receive.

Obviously, if someone—such as a woman vice president—is willing to sue on the subject of her not being paid as much as a man in a comparable position, that changes the circumstances. But basically, it is our posture to protect that kind of personal, private information.

Mr. McCLOSKEY. That's a different answer than I just received from the other witnesses.

Ms. PETTERS. I'm talking basically——

Mr. McCLOSKEY. You're saying your policy is to protect a person's salary as a private matter.

Ms. PETTERS. Yes.

Now it does not prevent us from making a disclosure if there are overriding reasons, which are in the public interest.

Mr. McCLOSKEY. Now are those overriding reasons set forth in any policy memorandum or in your regulations?

Ms. PETTERS. The regulations under FOIA, in general—not the OFCC regulations, but the Department's FOIA regulations which were published following the 1974 amendments—provide for us to use discretion where we find that there is a public interest even though there may be an exemption applying to certain material. We will use discretion if there is an overriding public interest and there is no harm to an individual.

Mr. McCLOSKEY. That leaves it open season for an administrative determination; that requires time for an administrative determination and for the legal interpretation; does it not?

Ms. PETTERS. Yes, Mr. McCloskey.

Mr. McCLOSKEY. May we have a breakdown of the time that has been spent in the 3 years under these regulations of how much administrative time and how much legal time has gone into this kind of administrative determination?

What we're seeking is information to determine whether to amend the law to cut down on the administrative time and the legal interpretation and particularly to cut down on the time that the courts are spending with this subject.

I think our job, as lawmakers, is to give them a clear law which makes it clear whether the right of privacy or the right of an individual to keep his salary secret is overridden.

The point you're making is the very one I think we have to resolve legislatively.

Ms. PETTERS. Right.

Mr. McCLOSKEY. I can't tell from your testimony how much time you're spending—whether it is too much or too little.

Mr. ROUGEAU. I will tell you that at the present time we have 40 FOIA appeals, as opposed to 50 enforcement cases, which have been brought to us by the compliance agencies.

Mr. ELISBURG. I'd like to point out, Congressman, two separate things we are trying to deal with in this paperwork business of contract compliance.

The larger one is the whole problem of affirmative action plans, and how much paper needs to be generated to accomplish the purpose of an affirmative action plan.

You can generate rooms and rooms of it without any problem.

We came into office very concerned about the volume that is generated just by itself.

The second thing that we're dealing with, with respect to the Freedom of Information Act, is that once you have all of this, what portion of it may not be subject to disclosure and what portion can be.

That, by itself, has generated a separate area of litigation—defensive litigation—and tremendous tieup of resources.

Mr. MCCLOSKEY. I agree.

Whenever there is Federal court litigation and you have appellate courts differing on the interpretation of a statute, the best way to resolve that is by a clear definition of congressional intent. That means a change in the law, and that's why I wanted to get back to your testimony here.

When you say there have been differing court decisions by Federal appellate courts, has your legal office reached any conclusion as to what, if any, change should be made in the law to remedy this difference in interpretation by the courts?

Mr. ROUGEAU. We presently have staff working on this problem.

It could very well be that one thing we would want to do would be to set standards for disclosability. That certain sections of an AAP would be disclosable, and we would let everyone know exactly what that is.

Mr. MCCLOSKEY. Let me hear your argument why any portion of an affirmative action plan is something that ought to be retained in confidence and that doesn't apply to a future decision by a company to market a different kind of product.

I can't conceive of an affirmative action plan being confidential under the Freedom of Information Act as a business secret.

Mr. ROUGEAU. I would probably have to agree with you that most portions of AAP's should not be withheld.

I think that in the main there is really nothing there that could harm business practices.

Mr. MCCLOSKEY. Your testimony isn't very helpful to us today, because it does not define with precision those areas of the act that are causing administrative and legal interpretation problems.

If we knew where you were having to spend your time and where the courts were having to spend their time, we could make a decision in this committee whether or not to amend the law to relieve you of that problem.

I think we need a breakdown. If the companies are making these arguments, what success have they had in the courts with them, what is the validity as to that argument, and what do we do to modify the law to remove this ambiguity?

Mr. ELISBURG. We have, Congressman, two separate areas that I think are the primary problem.

within 5 calendar days of receipt of a FOIA request, the agency submits copies of the requested documents to OFCCP and thereafter allows OFCCP 5 working days to comment.

3. Upon completion of its analysis of the contractor's objections, a determination letter containing the agency's disclosure decision is sent to the requester and concurrently, to the contractor. This takes approximately 8-10 days from receipt of the request. The contractor may appeal that ruling to the Director of OFCCP within 10 days. The Director of OFCCP must make a final determination within 10 days of the filing of the appeal. (Note: It is at this point OFCCP becomes involved in the Agency FOIA process).

The OFCCP appeal process usually begins 20 days after the disclosure decision letter is sent to the contractor and the requester. The time period for processing a request under FOIA at the agency level including an appeal of the agency's disclosure decision by the contractor, is 30 days. Should the appeal result in a law suit, the time period for processing is at least 90 days.

From September 30, 1976 through September 30, 1977, OFCCP received 49 appeals from Government contractors. Most of these appeals were based on exemption b(4) of the FOIA and were denied by OFCCP. Five of the appeals which were denied, subsequently, led to law suits.

If we can be of any further service, please contact us.

Sincerely,

Donald Elisburg
Assistant Secretary

Enclosure

[Subcommittee note: Enclosures not included; available in subcommittee files.]

U.S. DEPARTMENT OF LABOR
OFFICE OF THE ASSISTANT SECRETARY FOR EMPLOYMENT STANDARDS
WASHINGTON, D.C. 20210

DEC 2 1977

Honorable Paul N. McCloskey, Jr.
House of Representatives
Washington, D. C. 20515

DEC 5 1977

Dear Congressman McCloskey:

This is in response to your letter dated October 3, 1977, requesting copies of certain documents and information regarding the Office of Federal Contract Compliance Programs (OFCCP) implementation of the Freedom of Information and Privacy Acts. We regret the delay in our response.

Items (1) and (3) of your letter deal with the rules and regulations promulgated by OFCCP for both acts and request copies of memoranda which instruct employees on how to determine what information should be considered "confidential business information". We have enclosed copies of the following:

a) OFCCP regulations Part 60-40, "Examination and Copying of OFCCP Documents" 41 CFR 60-40 and Part 60-60, Subpart C- "Disclosure and Review of Contractor Data" (41 CFR 60-60);

b) Staff Memorandum No. 11 entitled "Implementation of the Provisions of the Freedom of Information Act of 1967, as amended", and the Addendum to Staff Memorandum No. 11 entitled "Instructions for Processing Requests Received Under the Freedom of Information Act (FOIA) and Privacy Act".

c) ESA Notice, 75-61 - "Implementation of the Freedom of Information Act and Privacy Act".

Regarding Item (2): "A request for a full set of notices and other documents exchanged in an actual typical case where a FOIA request was submitted and an initial denial issued ....". For your information, we have enclosed a

it to be held confidential, or how does that work? Will it be released automatically otherwise?

Mr. HENRY. In order to facilitate the processing of requests and in order to know what objections the companies may have, there is a provision in the regulations which asks them at the time of submission of the AAP's, that they delineate those portions of the affirmative action program which they believe to be nondisclosable.

The purpose of that is to have some idea, before you get to the stage of releasing, what the company's position is on that.

Mr. WEISS. Thank you, Mr. Chairman.

Mr. PREYER. Mr. McCloskey?

Mr. MCCLOSKEY. Thank you, Mr. Chairman.

Mr. Elisburg, when a defense contractor submits the information on how many people are employed in how many categories, what possible contention is there that any of that information would be confidential under any act?

Mr. ELISBURG. The argument that is posed to us from time to time is that the numbers of employees that are going to be hired, the ways in which employees are assigned to various component parts of the company—that type of thing—could give a——

Mr. MCCLOSKEY. Is that a business secret?

Mr. ELISBURG [continuing]. Could give a competitive advantage to other employers if they know how many people are going to be hired for a particular division under one of the affirmative action plans. It is argued that it could give some——

Mr. MCCLOSKEY. Is there any court decision that upholds that contention?

Mr. HENRY. What the regulations say is that it is not mandatory to disclose.

We list one item here: those portions of affirmative action plans, such as goals and timetables, which would be confidential, commercial, or financial information because they indicate—and only to the extent that they indicate—that a contractor plans major shifts or changes in his personnel requirements; and he has not made this information generally available to the public.

That is the——

Mr. MCCLOSKEY. Let's take a typical submission to you.

I've had complaints from defense contractors in my district that they're asked to produce an inordinate amount of paperwork in order to comply with your requirements.

Varian, for example, came to me and said that they had 400 different categories of employees. It is my recollection that there were 13 kinds of people and minorities for each of those 400 jobs that they had to list.

Now let's assume that they were going to create a new division in their company to proceed with solar heating, and they didn't want their competitor to know about that.

Presumably, they would then set up a special part of this 300-page document that they submit to you to list the potential employees in their solar heating division. And they would mark that confidential. And, presumably, you would treat it as such.

these two interests, the Office of Federal Contract Compliance Programs (OFCCP) has established procedures for the processing of Freedom of Information Act requests for copies of the affirmative action plans and related documents.

Before discussing these procedures in detail, it should be noted that all Federal agencies must include provisions in their nonexempt contracts for the assurance of equal employment opportunities for minorities and women and contractors agree to these provisions as part of the contract. In accordance with Executive Order 11246, the Secretary of Labor has promulgated regulations with regard to implementation of the order and has assigned 11 Federal compliance agencies, on an industry-by-industry basis, the responsibility for conducting compliance reviews.

When a compliance review is conducted, an affirmative action plan is submitted to the agency by the contractor whose company is being reviewed. In some cases, the company will indicate at the time of submission what information it considers to be confidential. While affirmative action plans are submitted to the Government only upon request, all nonexempt contractors are required to submit a completed EEO–1 form annually to the Joint Reporting Committee. The EEO–1 form contains statistical information indicating the number of minorities and women employed by the company in broad occupational categories. The Equal Employment Opportunity Commission and the Department of Labor receive copies of EEO–1 forms. This form has been in existence and filed by contractors for well over 13 or 14 years now.

The Department of Labor regulations governing disclosure of EEO–1 forms provide that an EEO–1 will be disclosed to the public. Therefore, copies are released without prior notice to the contractor. Requests for release of affirmative action plans under the Freedom of Information Act are directed to the compliance agency. It is the practice of the agencies receiving such requests to notify the company involved of the receipt of the request in order to give the company an opportunity to present its views on the information it would consider confidential and to state its reason in support of confidentiality. The statement from the company is taken into consideration by the agency in responding to the Freedom of Information Act request.

The initial determination as to whether information may be withheld under the Freedom of Information Act is made by the agency under the criteria established by the regulations issued by the Office of Federal Contract Compliance Programs. The regulations include such considerations as the nature and type of information involved, the potential competitive harm to the company if the information is disclosed, and the public interest to be served by disclosure. A decision by the agency to disclose the requested documents may be appealed by the company to the Director of the Office of Federal Contract Compliance Programs who will issue a final determination.

This two-step process is designed to provide an independent review of the material, the company's reasons for asserting confidentiality, the interest of the requester and the agency decision. Since July 1974, when the regulations went into effect, approximately 100 appeals have been filed with the Director. It is our estimate that the average time for a review and decision by the Director is between 4 and 5 weeks.

During the pendency of these proceedings, many companies have

Now this gap could presumably be addressed more directly. And perhaps that's something that may be under consideration; I don't know.

Mr. PREYER. I would think that generally circulation of information that results from an FOIA request is a valuable asset to the economy, generally speaking, permitting the spread of useful information.

It would seem to me that we ought to be able to deal with the abuses by some procedural changes and procedural safeguards. And I hope that is the line down which we can go.

I'm glad you aren't advocating that we should just cut off requests from businesses, because they can be abused. But I think that we can make some changes to try to deal with the abuses.

I want to thank you and Mr. Nelson for your testimony here today. It's been very helpful.

We probably have some more detailed questions about your procedures which we would like to submit to you for your answers in writing, because I think you have a very interesting approach to it. And we might want to know something more about it.

If there are no further key questions that you need to ask right at this time, as long as we can submit the other questions in writing, we will excuse Mr. Nelson and Mr. James at this time.

Thank you very much.

[See app. 1.]

Mr. PREYER. Our next witness is Donald Elisburg, Assistant Secretary of Labor for Employment Standards. He is accompanied by Weldon Rougeau, Director of the Labor Department's Office of Federal Contract Compliance.

We will ask you to proceed in any way that you choose.

STATEMENT OF DONALD ELISBURG, ASSISTANT SECRETARY FOR EMPLOYMENT STANDARDS ADMINISTRATION, DEPARTMENT OF LABOR; ACCOMPANIED BY WELDON J. ROUGEAU, DIRECTOR, OFFICE OF FEDERAL CONTRACT COMPLIANCE PROGRAMS; JAMES HENRY, ASSOCIATE SOLICITOR FOR LABOR RELATIONS AND CIVIL RIGHTS; AND SOFIA PETTERS, COUNSEL FOR ADMINISTRATIVE LEGAL SERVICES

Mr. ELISBURG. Good morning, Mr. Chairman, and members of the subcommittee. We appreciate this opportunity to discuss with you issues related to exemption 4 of the Freedom of Information Act which deals with trade secrets and commercial and financial information. Accompanying me today on my left is Mr. Weldon Rougeau, Director of the Office of Federal Contract Compliance Programs. On my far right is Mr. Jim Henry, Associate Solicitor for Labor Relations and Civil Rights. To my immediate right is Miss Sofia Petters, Counsel for Administrative Legal Services.

The Department of Labor collects and maintains a considerable amount of business information in the course of administering its many and varied programs. Business information is obtained in a variety of ways. In some cases, it is submitted voluntarily by businesses in response to requests from the Department. At other times, it is collected by Department of Labor employees incidental to investiga-

(b) Of those 14 appealed, 3 were denied in full, 8 were denied in part, 2 are still pending, and in one case the affected business withdrew its confidentiality claim.

(c) None of these led to a lawsuit.

(d) Not applicable

(e) Not applicable

(f) Not applicable

I hope this information will be of assistance.

Sincerely yours,

Joan Z. Bernstein

Joan Z. Bernstein
General Counsel

Enclosure

[Subcommittee note: Enclosures not included; available in subcommittee files.]

DEC 8 1977

UNITED STATES ENVIRONMENTAL PROTECTION AGENCY
WASHINGTON, D.C. 20460

5 DEC 1977

OFFICE OF
GENERAL COUNSEL

Honorable Paul N. McCloskey, Jr.
House of Representatives
Washington, D.C. 20515

Dear Mr. McCloskey:

We are pleased to furnish the enclosed materials and specific answers to the questions in your letter of October 3, 1977.

1. Attachment A is a copy of EPA's Freedom of Information Act regulations that were published September 1, 1976. Attachment B is a copy of EPA's Privacy Act regulations appearing in 40 CFR Part 16, first published November 19, 1975.

2. As Mr. James stated in his testimony before the Subcommittee on Government Information and Individual Rights, EPA has had only one lawsuit under exemption four of the Freedom of Information Act (FOIA) since the promulgation of the new regulations. This case is a "reverse" Freedom of Information case and is still pending. I have enclosed under Attachment C a copy of the original information claimed as confidential, the correspondence between EPA and the FOIA requester, the correspondence between EPA and the affected business, and the papers filed to date in the court action. Please note that this matter is still under litigation and that the information in question is being treated as confidential pending the outcome of the litigation. This information is furnished to you as a member of the Committee in connection with the request stated at the hearing and should be kept confidential.

This particular case did not involve confidential information in a computer system. Because of your expressed interest in how EPA treats confidential information in a computer, I have enclosed under Attachment D a copy of a printout from EPA's National Emissions Data System (NEDS). The version of the printout enclosed is produced for internal EPA use. It includes the legend at the bottom. "These data are proprietary and must not be released outside of EPA." Three blocks of data on the printout are treated as confidential: "Hand-Calculated Emission Estimates," "Emission Estimation Methods," and "Operating Rates" (indicated in red). The computer can also produce a nonconfidential version of this printout on which these three blocks are deleted. That version of the printout could be disclosed outside of EPA.

NINETY-FIFTH CONGRESS

Congress of the United States

House of Representatives

COMMITTEE ON GOVERNMENT OPERATIONS
2157 Rayburn House Office Building
Washington, D.C. 20515

October 3, 1977

Mr. Michael A. James
Deputy General Counsel
Environmental Protection Agency
401 M Street, S.W.
Washington, D.C. 20460

Dear Mr. James:

Thank you for appearing before the Subcommittee on Government Information and Individual Rights this morning. Your testimony was very informative.

As we discussed in the hearing, your cooperation in providing the following information will be appreciated.

Inasmuch as your new regulations were not effective until October 1, 1976, please use the twelve month period from September 30, 1976 through September 30, 1977, when the regulations were in effect, where applicable.

Please provide:

(1) a copy of your regulations on FOI and Privacy Act implementation;

(2) a full set of notices and other documents exchanged in an actual typical case where an FOIA Request was submitted, an initial denial issued, the company which had submitted the information notified, an ultimate denial issued and litigation commenced. Attach copies of the initial submission of information with that portion claimed to be confidentially marked. Indicate the process by which the information was computerized and coded for confidentiality, and provide copies of computer print outs reflecting which information is confidential and which is not, and how each category is designated;

(3) copies of all memoranda or instructions to program, contract or administrative offices used to "sensitize" them to confidential business information;

Mr. WEISS. Thank you.

Thank you, Mr. Chairman.

Mr. PREYER. Thank you, Mr. Weiss. Mr. McCloskey?

Mr. MCCLOSKEY. Thank you, Mr. Chairman.

Mr. James, let me pose another hypothetical question of an industry that I'm acquainted with. It's not in my district, but the people that operate it reside in my district.

They have, in effect, a small chemical company that competes with Dow and the major chemical companies. They take extraordinary measures to preserve the makeup of their chemical compounds—using safes with one employee who has the only key. It is something like launching a missile where you have to have two people combined to ever get the ingredients together.

When they make an application to you for the registration of a new toxic chemical, of course, they have to lay out the makeup of that product in their application. Let's assume that the application is 100 pages, and only the makeup of the compound itself would be treated as confidential. How do you administratively handle a 100-page application with 1 page of confidential information? Do you stamp the whole document "confidential" or just the makeup of the chemical compound?

Mr. JAMES. We ask them to specify which portions they consider to be confidential.

Mr. MCCLOSKEY. Out of excessive caution though they are going to specify nearly everything they can as confidential.

Mr. JAMES. As I indicated to the chairman in some earlier questions, the trend seems to be the other direction—toward their going with us on specifying. Whereas earlier, particularly before these regulations were in effect—our current regulations—the tendency was to make across-the-board identifications.

Mr. MCCLOSKEY. How do you handle it? Do you stamp on the page "Confidential"? What is the mechanism by which you indicate on your written application files the information you feel is confidential?

Mr. JAMES. We ask them to mark it. They provide the marking, and all of them seem to possess a confidential or trade secret stamp. Then we respond to that. We treat it in accordance with the way they marked it.

Mr. MCCLOSKEY. Are your key words then: "Confidential; Trade Secret"? Is that the word of art that goes onto this application form?

Mr. JAMES. "Confidential Business Information" is the generic term we use.

Mr. MCCLOSKEY. Now do you then put that into a computer system of any kind?

Mr. JAMES. Some of the information we receive does go on computer runs.

Mr. MCCLOSKEY. What step do you take when inserting the information into an EPA computer to preserve the fact that it is a confidential business item in that computer?

Mr. JAMES. My recollection of this is vague, but as I recall, they do use a code that identifies somewhere in the printout that the information is identified by the submitter as confidential. So it is highlighted.

Whether that information was submitted voluntarily or not, if it's information that we could obtain under the Water Act, in this case section 308 of that act, then there's a provision in that section that says: Effluent data must be publicly available.

Mr. RYAN. Would the gentleman yield on that point?

Mr. MCCLOSKEY. Certainly, I'd be glad to yield.

Mr. RYAN. Having spent a year at Bates College in Lewiston, Maine, the Androscoggin River is very familiar to me.

Let's take that same paper company on the Androscoggin River. Suppose the company's plant there is 60 years old, and the order has been given to cease and desist, and so on, and the usual procedure is being followed. That company knows that in order to comply with the request, it will probably be cheaper to simply close down the plant and move south—as happens so often—and open a new plant someplace else with nonunion employees, and so on.

That then becomes an extremely important matter in the corporate structure, I suppose, of competition—especially in the area—as it relates to labor relations and other matters. So the decision of whether or not that papermill is to go out of business become political, economic, and so on. Once that knowledge gets out, especially if that order has been given and especially if the information has been withheld up to the point which Mr. McCloskey is talking about, I think we're talking about an extremely important area here.

I doubt if that hypothetical situation is as hypothetical as it might appear to be. I think it probably has either happened or will happen.

I can think of some cases in an urban city in San Mateo County in California where the orders of a similar kind have had some significant impact in an economic sense.

Now what kinds of guidelines do you have, if I may pursue the question, Mr. McCloskey, that give you a chance to determine—or do you have any?

Mr. JAMES. Our regulations are Freedom of Information Act regulations. They specifically recognize that there is information submitted from a pollution source, to use a general term. That is, information that could be used to tell the public what it is that company or facility is doing to the environment. That's the kind of information I was responding to when I responded to Mr. McCloskey.

Mr. RYAN. If I am a competitor and Mr. McCloskey owns a factory on the Androscoggin River and I can get information from you that indicates the nature and the depth of the problem which he has, it may be possible for me to help him go out of business by perhaps lowering prices or doing whatever is necessary in order to drive him out and thereby reduce the competition—just by asking effectively what his business condition is there.

Mr. JAMES. The business condition itself would not be revealed by us if the proper claims of confidential business information had been made by the company, which presumably they would be.

Again, differentiating between general information about the economic status of that source, on the one hand, and what it is emitting to the environment, on the other hand.

I can see a connection being made. The degree of this source's violation of whatever environmental standards apply to it is certainly a relevant factor in anybody's determination as to whether or not that facility is going to remain in business there.

Like most law firms, do you keep track of the time of each attorney spent in these matters?

Mr. JAMES. We have never adopted in any of our legal advice areas the logging of time—largely because we don't bill it out on an hourly basis. We just react to the demands of the agency upon us.

So the simple answer is: No.

Mr. MCCLOSKEY. Let me take calendar year 1976 in your testimony on page 14.

Out of 4,113 requests, you initially denied only 168 of those. Is that correct?

Mr. JAMES. Yes.

Mr. MCCLOSKEY. So somebody other than a lawyer was able to make a determination on the spot, presumably within 10 days, that there was no possible way this information could be confidential.

Is that correct?

Mr. JAMES. That's correct.

Mr. MCCLOSKEY. Now of those 168 initial denials, 83 were based in whole or in part on this exemption 4 for competitive information. What was the ultimate result of those 168 denials?

These were initial denials based on the possibility that they could be confidential. What was the final result?

Mr. JAMES. I'm not sure that we have that information with us today. In fact, I'm confident that we do not.

Mr. MCCLOSKEY. I think we need that information. I think we need to know if this was an administrative decision by somebody other than a lawyer in a program or contract office.

What is 168 out of 4,113? That would be about 5 percent. It is not a very high percentage.

Mr. JAMES. Many of these requests are very routine and become Freedom of Information Act requests because of the existence of the act. They would ordinarily, prior to the existence of the act, have been just requests for information that would have been handled in the most routine fashion under no statutory deadline.

Mr. MCCLOSKEY. This is what I would like to find out. And I would like to ask if you could submit this information by letter in response to these questions; 168 cases a year, to then be reviewed by counsel, would not seem to be too many cases for lawyers to handle in a given year. That's about one every 2 days, or one every working day perhaps.

Do you have any idea how many of these cases went to litigation?

Mr. JAMES. We have only one reverse Freedom of Information Act case going right now; aside from, I believe, 10 cases involving claimed trade secret information under FIFRA.

So we have not seen a great deal of reverse Freedom of Information Act exemption 4 type litigation resulting from our determinations.

Mr. MCCLOSKEY. Mr. James, let me see if I can phrase these questions properly and see if we can get a followup on this information.

Let's take the year 1976. Of the 168 denials at the initial stage, 83 were based in whole or in part on exemption 4. If you could follow that up with a tracking of how many of those 168 denials ultimately were considered to be proper denials by your legal staff, the time that was taken to resolve these matters, which were litigated ultimately and by whom, and how the breakdown of your attorneys' time was

I believe the trend now, especially under our new regulations, is in the other direction—as my testimony has indicated—as businesses are becoming more familiar with our practice.

Mr. PREYER. Do you think it would be valuable to require submitters to give reasons for marking information confidential in the first place rather than just marking it confidential?

Mr. JAMES. It would slow the acquisition of data.

It is difficult enough to get the information in, let's say, for a major regulatory action. Requiring the substantiation initially, would in all likelihood slow things down. It would, almost undoubtedly, have the effect of further lessening the number of items of information claimed as confidential, so there would be some advantage to it.

Mr. PREYER. Do you know whether there are many other agencies who have adopted the same practice that you follow in your agency?

Mr. JAMES. There are apparently variations on our approach, but I don't believe that we have exactly patterned ours on any other agency or they on ours.

Mr. PREYER. One thing that's a little troublesome about your approach is where you make it a practice to make a pro forma denial of the request for information that may be confidential. Then you automatically reconsider the denial when the submitter has responded.

One wonders if this automatic pro forma denial is really consistent with the intention of the act, which is to make more information available.

Mr. JAMES. I think that's largely a consequence of the deadlines in the act. That is, an answer has to be made within the specified deadline. Some response has to be made.

Our system is designed to go ahead and follow through completely and do so expeditiously. And I think our practice does get the process taken care of expeditiously.

Mr. PREYER. One wonders if an automatic denial would qualify as a determination within the meaning of the act.

Mr. JAMES. Here again, I think we have this competing interest between rapid and full disclosure, on the one hand, and protection of information that various statutes specify must be protected, on the other hand.

Those competing interests are always there, and they have an inherent delaying factor built into them.

Mr. PREYER. When you make your agency determination—your final agency determination—the next step would then be appeal to the district court.

At the time of making your final agency determination, you hear from the submitter of the documents; but shouldn't you also at that stage allow the requester of the information to be heard too and argue for the release of the information? He doesn't get another crack at it until district court, I take it?

Mr. JAMES. That's correct.

The basic question of whether the information is a trade secret or not is difficult enough for us to address. Let's assume it's a competitor, or someone else—possessed of any information that would enable him to make any showing to us that would assist us—in addition, of course, to the fact that that does prolong the proceeding before you ultimately get to the point of a final determination by a court.

approach is that much information that might otherwise be exemption 4 information is eliminated from consideration because the businesses do not claim it as confidential. There could be disadvantages to the Agency if businesses asserted very broad claims, but our experience has been that once businesses are made aware of the procedure EPA follows and the fact that they may later have to substantiate their claims, they tend to make claims that are limited in scope to information that is most likely to be entitled to confidential treatment.

Once the business identifies which information is claimed as confidential, it is treated as if it were entitled to confidential treatment until the need arises for EPA to make an actual confidentiality determination. This need arises in one of two situations, either where we receive a Freedom of Information request for the information or where we propose to make a public disclosure of the information. Either of these events would trigger the procedure I have outlined above.

Our regulations and procedures have been in effect for 1 year. They allow us to deal with confidentiality in a systematic way. Some EPA program offices, such as the contracts office and the pesticides office, bear a disproportionate share of the burden of requests for confidential business information. In addition, the Office of General Counsel spends a lot of time on business confidentiality issues. Two staff attorneys in my office spend almost full time on Freedom of Information matters, much of that on confidentiality. In general, however, we feel that the burden is not overwhelming, and we accept it as the price for implementing the Freedom of Information Act.

Because of the large volume of information in EPA's possession that is or may be confidential business information, we are educating our personnel about these procedures and, most importantly, sensitizing them to the problem of confidential business information. This is especially important in light of information EPA will be acquiring under the Toxic Substances Control Act. Industry has made it very clear that some of the information submitted under the Toxic Substances Control Act is very confidential. Therefore, we are reexamining our internal security procedures to make sure that confidential business information is not inadvertently released.

I have some specific statistics about Freedom of Information requests handled by EPA. For fiscal year 1976 (excluding the transition quarter) EPA received 3,352 requests in Washington and each regional office. Of these 1,817 were from corporations, 398 were from law firms, 473 were from individuals, 253 were from State and local governments, 200 were from public interest groups and unions, 132 were from universities, 48 were from the media, and 31 were from congressional committees and Federal agencies. I asked our Freedom of Information Office to update these figures for July 1, 1976, to June 30, 1977. These figures are for EPA's headquarters only; they do not include figures for our regional offices. From July 1, 1976, through June 30, 1977, EPA headquarters received 917 requests from corporations, 202 from law firms, 124 from individuals, 77 from public interest groups, 55 from State and local governments, 48 from universities, 36 from the media, and 10 from Congress and Federal agencies.

It is clear from these figures that the greatest use of the Freedom of Information Act by requesters at EPA is by corporations and law

it acquires. Businesses could not refuse to furnish information without subjecting themselves to legal liability. However, there are cases where information is supplied to EPA by a business when the business has no legal obligation to do so. In making a final confidentiality determination that involves this voluntarily submitted information, we consider whether disclosure of the information would be likely to impair our ability to obtain necessary information in the future. In applying this test, we look to the Agency's interest—not the affected business' interest. We apply this test most frequently in our procurement activities. Information that is submitted to EPA by offerers competing for EPA contracts is voluntarily submitted; and in many cases, we have determined that disclosure of that information by EPA would be likely to impair our ability to obtain necessary procurement information in the future.

Having made a determination that information is covered by the fourth exemption, the final problem is whether the Agency may release the information anyway. Under seven of EPA's substantive statutes, there are provisions that provide that if EPA determines that information constitutes confidential business information, EPA may not disclose that information.

About 90 percent of the information in EPA's possession is controlled by these statutes. For this reason, the EPA policy, expressed in our Freedom of Information Act regulations, is that once EPA determines that information is exempt from mandatory disclosure as confidential business information, EPA will not release that information. In this way, EPA has eliminated the possibility of discretionary release of exempt information, unless release is specifically provided for under one of the substantive statutes. Here I should emphasize that some of these statutes do require disclosure of specific information, such as information identifying the rates or amounts of emissions or effluents under the Toxic Substances Act. Data on health and safety studies is mandatorily disclosable.

If EPA determines that information that has been claimed as confidential is not entitled to confidential treatment, our regulations require us to give notice to the affected business at least 10 business days before disclosure of the information will take place. During this notice period, the affected business may attempt to block the disclosure by going to a Federal court.

Two other types of special determinations are authorized under EPA's regulations to deal with specific problems. The first is called an advance determination. An advance determination will be made in a situation where an EPA program office needs to obtain information from a business which the business considers to be confidential and which the business refuses to furnish to EPA without a pledge of confidentiality.

In this case, the program office asks the business to submit the information to the EPA General Counsel for the limited purpose of making an advance determination. The business, if it agrees, furnishes the information to the General Counsel along with substantiating comments similar to those required for other confidentiality determinations. The General Counsel examines the information, the substantiating material, and any comments from the program office. The General Counsel then makes an advance confidentiality

The chairman's letter of September 9, 1977, posed several questions concerning how EPA handles some of the continuing problems that arise under the fourth exemption. I will deal with each of those in turn.

First, how does EPA handle Freedom of Information requests involving possibly confidential information? EPA promulgated new regulations to deal with the problem of confidentiality about 1 year ago. In those regulations, we set out a detailed procedure. These regulations, cover any information in EPA's possession that may be confidential under the fourth exemption.

The fourth exemption speaks of "trade secrets and commercial or financial information." We have adopted the term "confidential business information" as a generic term to encompass the concept expressed by exemption 4, and I shall use that term to refer to the type of information that falls under exemption 4. Our use of this generic term does not in any way expand or contract the coverage of exemption 4.

When EPA receives a request for information, an EPA program office is assigned responsibility for initially responding to the request. The program office is usually the office where the bulk of the records will be found. The program office determines whether the information covered by the request has been claimed as confidential. I will discuss the method of asserting claims of confidentiality later. If the information has been claimed as confidential, the program office makes an initial determination. This initial determination is either that the information is clearly not entitled to confidential treatment, in which case the office sends a notice to the affected business at least 10 days prior to disclosure, or that the information may be entitled to confidential treatment. In the case of the latter determination, the program office issues an initial denial to the requester. This denial letter states the initial denial is based on a claim of business confidentiality and that the EPA legal office will make a final confidentiality determination.

The EPA program office is given little discretion when dealing with a request for confidential business information. The program office must issue a denial of the request based upon the claim of confidentiality, unless the information is clearly not entitled to confidential treatment. We chose this approach for several reasons.

First, because of the difficult legal issues that arise in these cases and the threat of reverse Freedom of Information Act cases, the Agency decided that the decisionmaking should be centered in the legal office. Second, because the Freedom of Information Act requires an initial response within 10 days, the Agency decided that there was no time to evaluate the issues involved in a particular situation except in those cases where information is clearly not entitled to confidential treatment. Therefore, whenever there is any doubt, the program office must issue an initial denial. Third, because the initial denial is based on a determination that the affected business has asserted a confidentiality claim and because the denial is issued unless the information clearly is not entitled to confidential treatment, the Agency decided that a final determination should be made automatically by the EPA legal office, whether or not the requester appealed the initial denial. The Agency decided that this would give the requester a decision based on the facts of the specific situation, rather than the pro forma denial standing alone. Fourth, because the Agency does not usually have enough infor-

This is to protect the rights of those who submit the information and to insure the necessary flow of data to the Government.

This is the policy behind exemption 4. It is an attempt to distinguish between business information that can and should be released and that which should be protected. This is not an easy task, and all of those involved in the process have encountered serious problems.

Submitters of information are concerned that confidential information will be released to competitors, and that they will not be notified of the pending release in time to present arguments in favor of the confidential treatment of the documents. On the other hand, requesters of information complain that too much is being withheld without adequate justification, and that the timeliness of release required by the Freedom of Information Act is being ignored.

In these hearings, we hope to focus more on the procedural aspects of exemption 4 and less on the substantive problems of what information should be treated as confidential. The substantive problems are important, but they may need more consideration by the courts before they become ripe for legislative examination. However, we may be able to suggest some changes in the procedures that would make things easier for everybody.

The courts have become more sophisticated in the last few years in distinguishing between business information which is truly confidential and which is properly releasable. In cases arising under exemption 4, the courts have passed through several stages.

The initial cases were decided upon a "promise of confidentiality" test. If agencies had promised confidentiality to submitters or if the submitters had a reasonable expectation of confidentiality, then the courts said the information could be withheld under exemption 4. The courts have wisely abandoned this test. It stimulated active bartering over promises of confidentiality and closed much public access needlessly.

The most widely used standard today is based on the *National Parks and Conservation Association* v. *Morton* case decided by the District of Columbia Court of Appeals, 498 F. 2d 765. The court held that commercial or financial information is withholdable under exemption 4 if disclosure would either:

First, impair the Government's ability to obtain necessary information in the future; or

Second, cause substantial harm to the competitive position of the submitter.

This interpretation of exemption 4 means that agencies are confronted with the difficult task of deciding whether the release of information could cause substantial competitive harm. Such a determination is certainly difficult to make and one that many agencies have had little experience in making. Yet the widespread adoption of this complex test suggests that it will not be easy to find a simpler method of identifying information that should be protected from release.

The narrower, but related, concept of "trade secrets" is much more familiar to the courts. While we may more easily talk about trade secrets in the abstract, it generally requires a difficult factual determination in each case in order to decide whether information actually qualifies as a trade secret.

The experience to date with the broader concept of "commercial or financial information" in exemption 4 cases suggests similar difficulties with such factual determinations.

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	No. of estimated pages	Comments
(c) Records supporting all subcontract solicitations over $10K.		
(d) Records to support other outreach efforts.		
(e) Records to support internal activities to guide and encourage employees (workshops, training programs, etc.).		
(f) Records to support award data		
(g) Total dollar planned subcontracting to small business, small disadvantaged business and large business.		
(h) A description of principal product and service areas to be subcontracted.		
(i) Method used in developing proposed subcontracting goals for small business and small disadvantaged business.		
(j) Method used in delivering the proportionate share of indirect and overhead costs incurred with small business and small disadvantaged business.		
Total: 130 different reports per year, exclusive of all tax reports.		

GEORGE S. LOCKWOOD, MONTEREY ABALONE FARMS

Question 1. How should the formulation of an innovation and technology policy be coordinated within the government?

Answer. Innovation (or lack of) is impacted upon by the activities of many federal agencies, and is frequently ignored because it is not a sufficient priority to require forced interaction between these agencies. I would suggest the formation of an inter-agency committee to consist of active membership by at least Treasury, Commerce, National Science Foundation, Small Business Administration, Security Exchange Commission, and the Regulatory Council. Officials in the executive branch as well as in Congress often perceive that their largest impact upon innovation is through the expenditure of funds from their budget to "support" innovative technologies. I would urge that a high priority of this inter-agency committee be to identify and eliminate *the impediments* to innovation in the private sector. I believe that a renaissance in innovation would exist without any government support whatever if these constraints were eliminated. The elimination of constraints should be a higher priority than new direct support.

Question 2. What input should the small business community have in this process?

Answer. The recent White House Conference on Small Business formulated sixty recommendations. Although fifteen of these were determined as top priorities, I would urge that *all sixty* be included in all future considerations of small business policy. Furthermore, the five recommendations concerning innovation should receive very careful consideration in the formation of any innovation and technology policy. Again, I would emphasize, that any policy formation process make as its first priority the release of the enormous private sector innovation capability without direct government support through the elimination of the multitude of presently existing tax, legal, and regulatory constraints.

Question 3. How should the small business community be organized in order to furnish input into Federal policy decisions affecting innovation?

Answer. The Office of Advocacy of the Small Business Administration, and its Chief Counsel, Milton Stewart, have done an unbelievable job as a voice for the small innovative business community inside of government. Furthermore, the White House Conference on Small Business articulated many of the legitimate concerns of this community. I would urge the continued strong support of the Office of Advocacy by the Congress, and I would urge Congress to seek the immediate implementation of all sixty recommendations. Furthermore, the several existing associations in the private sector representing small businesses be relied upon for further input.

○

In addition, the Investment Advisors Act of 1940, the Investment Company Act of 1940 and ERISA of 1974 all constitute obstacles to the allocation of capital to innovative activities.

Question 3. Does present legislation as embodied in the Investment Advisory Act of 1940; the Investment Company Act of 1940; or the ERISA of 1974 generally help small business? How should this legislation be modified?

(a) How far should the ERISA prudent man rule be modified?

Answer. These Acts were intended to protect the small investor and pension fund participant. They were not concerned with the problems of innovative small business and that of the assembly of capital necessary for financing them. They have not been helpful to the small business sector.

Modifications should include:

exemptions from the Advisors Act for professional organizations devoted to venture capital; and

encouragement by the Department of Labor to channel a small portion (4 percent) of pension funds into venture capital.

GILBERT V. LEVIN, BIOSPHERICS INCORPORATED

Question 1. To what extent does compliance with federal regulations divert resources away from activities that lead to technological innovation?

Answer. Regulatory reporting is a major problem eating into our time and money. In one contract alone, we have calculated that the routine regulatory reporting costs our company approximately $16,000 per year. Much of this stems from new regulations governing subcontracting. We are trying to recover these costs and have notified the Agency that we will bill the contract directly for them. It would not be fair to spread those costs as overhead. Moreover, if we were to do that, the impact on our overhead rate would jeopardize our competitive position.

Congressional Acts, of course, require that the responsibility to administer the new law be given to an Agency. It, therefore, seems perfectly reasonable that the Bill contain language such as, "the Agency shall issue whatever regulations it deems appropriate to administer the Act" or words to that affect. This *seems* reasonable language, but, when interpreted by unreasonable bureaucrats, it is construed out of all intent of the Congress. To illustrate this matter, I have had a list prepared of the reporting that our small firm, grossing just $5 million in revenues per year, must submit in the course of a year (Attachment 2). I suspected the reporting problem was getting worse, because, increasingly, when I needed accounting information, I found it had to be delayed because our people were preparing Agency required reports to meet deadlines. But, even I was surprised to learn that, in the course of last year, our company prepared 130 such reports totalling 315 pages. One of the most difficult is the "Small Business and Small Disadvantaged Business Contracting Plan Report." This extensive report requires we obtain information on matters not within our corporate purview. Responding to these requirements has become very costly and interferes with the close day-to-day attention management must give to a small business. I ask that you carefully consider this problem whenever you are tempted to insert words such as "the Agency shall make appropriate regulations. . . ." and that, instead you indicate precisely what reporting is required—and keep it reasonable.

I think that the Bills under consideration, hopefully with the changes suggested above, would have a major, positive impact upon small innovative businesses and, in fairly short order, would become an important factor in returning technological leadership to the United States. With other appropriate actions by the Congress, this all-important objective can be achieved in time to prevent the progessive decline of our quality of life to the point of no return.

a. Would you favor a "two-tier" regulatory structure that would separately consider the inherent characteristics of small business in order to allocate an appropriate regulatory burden? Could this goal be achieved without sacrificing important social objectives?

I would favor an easing of the regulatory burden for all businesses, as a last resort, a "two-tier" regulatory structure may be practical.

b. Would technological innovation be stimulated to an extent that would justify this special treatment?

Any easing of the regulatory burden, which I favor for all businesses, would allow key personnel to devote more time to innovation and production.

a. "piece-meal" legislative reform of tax provisions that retard capital formation by innovative small business; or

b. no "piece-meal" action but wait for a major tax reform package to be introduced?

Answer. I urge enactment of pieces that are needed, as suggested here and in my testimony because the situation in our country is so desperate with respect to employment, investment in capital goods, and productivity. It is disgraceful for this nation to lag behind other industrial nations in providing new plants to replace ours, which are twice as old as the Japanese production equipment. We have mainly caused this condition by such high taxes on investment and low depreciation allowances on corporations.

Question 4. What are tax reform priorities of small business capital formation?

Answer. (1) Reduce tax rate on first million of profits in companies that qulaify as Small Business;

(2) Reinstate the qualified stock option of the 1960's.

Question 5. Why is it becoming difficult for small, growing firms to attract second-tier management talent from large corporations?

Answer. (i) need effective stock options;

(ii) with runaway inflation, the 2d tier managers become more dependent upon the high salaries and fringe benefits that the larger corporations can pay and the young company with restricted financial resources cannot afford to pay; (iii) I have referred above to the stock option; (iv) stock ownership plans in small business should receive special tax concessions;

I note an inclination on the part of state and federal bodies to want to throw money into some form of kitty from which it would be dispensed to young companies. That is a perfect prescription for losing vast sums of the taxpayers money while accomplishing nothing but confusion. At the moment, there is adequate money available, at least for technology based companies.[1] Perhaps a billion dollars or more has been raised by venture capital firms since the passage of the Steiger-Hansen Bill to reduce capital gains taxes. All that is needed in order to stimulate the continuation of this money is to: (i) abolish capital gains taxes on securities acquired while the company was a Small Business; (ii) reinstate the stock option of the 1960's; (iii) reduce the tax rate on the first million dollars of profit in a Small Business; (iv) remove the restrictions on the sale of securities held of excess in two years in companies that are registered with the SEC; (v) prohibit the issuance of any new regulations by the SEC, IRS, OSHA, and ERISSA without clearance through the Bureau of the Budget based on a clear showing that a clear and present need exists for the regulation to curb existing and serious abuses.

We could all write a book, but the evidence is so overwhelming on the importance of new companies and the response of capital so dramatic to the first recognition of the necessity of decreased taxes on capital, that I wonder how any legislation could ask for more before enacting desperately needed reform of taxes antipathetic to capital investment.

SIDNEY J. GREEN, TERRA TEK, INC.

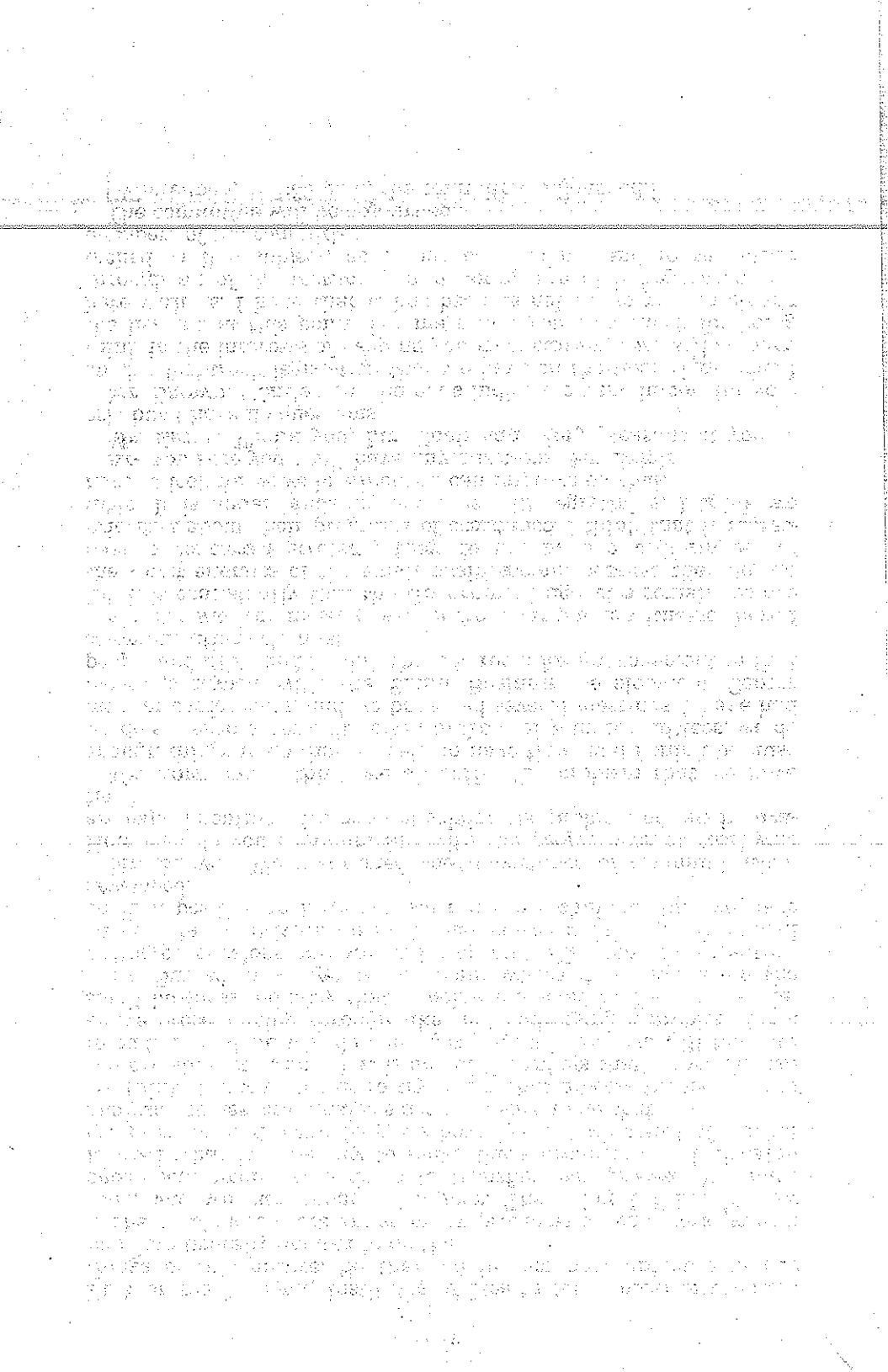
Question 1. What effect does inflation have upon the performance of R&D in small firms?

Answer. First, small firms in general are not able to perform very much R&D except to the extent that it might be financed via government contracts, or as a direct (and I mean very direct) route to the commercialization of some product or service. Small firms simply do not have the financial resources to commit to conduct very much R&D on their own.

With respect to a small firm that is conducting R&D on a government contract basis or as a direct route to commercilization of a product or a service, I believe the largest effect of inflation is on planning and projecting ahead. Small firms do not generally have the sophistication to compete with big insitutions regarding pricing, bidding, negotiating, collecting payment, securing loans, and the like. Hence, the small firm has great difficulty in handling inflation—the big institutions (whom the small firm continually deals with) are able to "win" in most interactions. Therefore the small firm does not have the ability to "pass-through" the higher costs, and inflation raises the cost of doing business and reduces the future options for the small firm.

The difficulty of the small firm interacting with big institutions is particularly true when the small firm interacts with the federal government. R&D procurement

[1]For inventions and very far out projects, better and more liberal procedures in DOE & NSF may be needed, but these projects are outside the scope of venture capital and it is doubtful whether additional sums from the government would be productive.



ogy, very advanced, and the likelihood that someone who builds a home appliance device to think to go ask or to look through the NASA patent portfolio for a piece of technology that might be very, very useful to him, is a problem we continually wrestle with. We do have an active program of dissemination as we try to promote it, and we have instituted some activities to try to communicate with particularly small business industries through their industry associations to try to promote more of this activity.

I am planning to try in the next year a small pilot project to actually go and actively do a patent development activity so that we make a concerted effort or that we have a contractor make a concerted effort to go through and look for opportunities within the patent portfolio and look for liens, having them move into the private venture capital and do business, new business activities that way.

Mr. BROWN. I think one of the things that impressed all of us as a result of this emphasis, that these two days of hearings have given to the innovation process is that the complexity of the process, the fact that it does involve a long chain of operations from the initial ideas, final commercialization, many difficult steps along the way, many things that inhibit and a few things that encourage, and I would like to ask you if you feel that NASA in its own operations—I am not trying to suggest anything adverse here—do you think you have a mandate and has the practice of the agency been sufficiently broad in its scope to encompass the whole chain of problems here, so that, for example, you would not only send out extensive information about new technological developments but that you might be able to provide follow-on services that might extend through or further along, at least, the chain of development, so as to assist this transfer process?

Do you feel you have the mandate to do that and have you been doing it, is what I am trying to get at, or do we need to give as an additional encouragement a broader direction to the agency here?

Mr. ROBERSON. I think that there is not a specific mandate that is worded very well that directs us to do that, but we have interpreted what mandate we have fairly aggressively and we do precisely what you have described in a limited number of projects. We run about 90 projects at anyone time, and in these particular projects we have looked to other Federal mission agencies, biomedical community or the public safety community, largely in those areas that have large social return for problems in which we think some technology may apply. We take that problem statement then and look for a technology match anywhere within the agency we can find it, and we take, essentially we go through the entire process of a new business development.

We do the market analysis to determine whether or not we are working on a product that would compete with one already available. If in fact there is a market product already there, we will do the initial design and cost estimates and try to determine what it will cost to put a product in the marketplace and then we advertise and bring a private-sector partner in and fund them during the high-risk R. & D. phase through the development of prototype, and we do the brokerage with them to bring in organizations that have to do with approval to get the product in the marketplace, such as

small business solicitation is a solicitation in which the Foundation has defined fairly broad but nonetheless limiting areas of interest in which we would receive proposals.

This gives us the opportunity not only to support a larger fraction of proposals in the areas we have been supporting but to expand research into other areas of direct interest to the U.S. economy.

The present success ratio, we fund one in eight proposals. That is about 12 percent of the small business proposals that come to the small business solicitation.

In the other program identified, the university-industry coupling, we had proposed to put an increase this year into that activity. We were very much fund-limited last year, and even in fiscal year 1980 we are going to try and move some additional funds into that area. The interest, the proposal pressure, the opportunities to support good research built up much faster than we had anticipated, so I don't see any difficulty in either of those programs.

Mr. BROWN. What we are talking about are additional programs, similar—if I am not correct, correct me—similar to the MIT Palmer Laboratory or——

Dr. SANDERSON. No, the university-industry cooperative research program is individual grants for research projects that will run typically $100,000, $200,000.

Mr. BROWN. In other words, specific research, not the fund——

Dr. SANDERSON. It is funding specific research projects in which the industry and the university research team come together for the duration of the project and then any future is uncertain rather than the funding of a concentrated effort for a generic technology center.

In the proposal of the President were four generic technology centers of which—we will have one, three will be with the Department of Commerce. That would be more like the MIT Palmer Center.

Mr. BROWN. Does that seem to you to be a reasonable expansion from our present base, or do you feel that that can proceed at a faster pace?

Dr. SANDERSON. I have a number of areas where there is real interest and excitement in moving out in the area, in generic technology centers. As you are aware, there have been a number of hearings held here looking specifically at the problem of Robotics' mechanical design. On the other hand, I think it is important to realize that the National Science Foundation funded a number of these efforts about 5 or 6 years ago, and for several years there has been no additional centers of this type started, so at least I think we are moving in the right direction.

Mr. BROWN. The thrust of at least some of what I saw in the President's proposal was that there would be a transfer of these successful mechanisms from, for example, the NSF to other Federal agencies, which spend large amounts of R. & D. funds. Now, I am not precisely sure what we are talking about here, but is there any reason why a Department of Energy or NASA or some of the other large Government agencies with extensive R. & D. budgets couldn't be engaged in somewhat similar or parallel operations building

Mr. EVANS. I believe we would like to place more emphasis there than resources permit us to. I come back and say before I ask Mr. Roberson to comment further because it's his areas, communications are quite a problem to us. Disseminating what we have learned, disseminating our technology, placing it in the hands of small firms who are operating in that field, is always a challenge. Again, I feel that is our major problem. I think Mr. Roberson may be able to elaborate in terms of the extent of our efforts there in what we may perceive to do further in that area.

Mr. WATKINS. We welcome you here.

Mr. ROBERSON. Thank you, Mr. Watkins. That is a question of course, as a bureaucrat it's difficult for me to say no, I wouldn't like to have more money. We are putting all of it on that we can effectively but in effect I think we are providing funds for this activity at the level that we can reasonably do and we are increasing the funds at a rather cautious rate.

As you know, our experience over the past several years, and our successes have grown out of operating our technology utilization program in somewhat of an experimental mode. In other words, those parts of it that are successful we have determined are successful by trying different techniques and as far as the effect that we have, the calculation of the percentage of total R. & D. dollars for the agency is a very difficult one to do in terms of what effect we have with what we do and with what that portion of the Space Act requires us to do in technology transfer in relation to our mainline R. & D. mission.

With particular regard to what impact we can have on small business, I think there are things we can do within that amount of resources. As you know, we are investigating new ideas for trying to do that. I think we also have to proceed with caution because if you look at some of the testimony this morning, there is an element of concern about whether or not we should be putting money into this or facilitating moneys for the technology to be used and supported by the private sector and venture capital, and in fact that form of capital formation is one of the effective growth mechanisms in this country. So it is a debate that I am sure we will continue for some time.

Mr. WATKINS. You don't have any question, though, those who receive some service contracts, they probably understand the working relationship and partnership with government, private sector and nonprofit ratio. I see NASA doing like getting about an 8-to-1 benefit-cost ratio. As a businessman, I like to think that that is the direction to go. You made a statement in your testimony, on page 2 it says we acquire some 41 percent of our total manpower we need, conduct support agency operation by means of support service contracts.

Is that within that .3 percent or is that outside that, that you are able to go and get the support service contracts? Am I misinterpreting? Would this be the area where you are awarding contracts for particular projects or proposals?

Mr. ROBERSON. That particular item I think is a broader agency position. It does not deal within that technology utilization program. That is a support service contract for the NASA field centers. In other words, I think the statement was that about half of

I should like to make one final observation, Mr. Chairman.

One of our main challenges in communicating our discrete research needs in a timely way to specific small firms possessing the capability we need and to respond in a meaningful manner.

Finding these firms has been more of a challenge to us than capitalizing on their capabilities once known.

I feel and feel quite strongly that any means of improving communications such as a symposium we held last week and sponsored jointly with several other agencies and the Small Business Administration, hearings of this nature, and an association with small business research associations all are of benefit, not only to the small business communities, but to ourselves and the Nation as a whole.

Thank you very much for this opportunity.

Mr. BROWN. Thank you very much, Mr. Evans.

Mr. Watkins, do you have any questions?

Mr. WATKINS. Let me say, as the fourth group from NSF and NASA—no, I have been deeply concerned and have been very much involved and one great interest is trying to move forward into industrial innovation, and I have been trying to work out with both of your agencies in the hope that we can set a model example of some technology and all. Dr. Sanderson, you mentioned in your testimony the research and development incentive program innovation centers which I have discussed with you all. What division is this under in NSF?

Dr. SANDERSON. Mr. Watkins, I have with me today Mr. Bill Wetmore, who is the division director of our Division of Intergovernmental Science and Public Technology. This is the division responsible for the innovation centers activity. With me also is Mr. Rolland Tibbets, who is the person directly responsible for our very successful small business innovation program.

Mr. WATKINS. I was kind of making that assumption, it probably was under that area, and I have read a great deal and studied a great deal about some of the actions and some activities, all of you I think know of my interest in those areas. They seem to be working pretty good.

Do you think this is an area, the thrust NSF is going to take in trying to assist in this technology development that is kind of mandated under the charter that some of us have kind of observed and kind of wondered where we should go and should the thrust continue to be made there? Do you think that is the area that can handle this phase of it?

Dr. SANDERSON. I think that the National Science Foundation has been very successful in a number of innovative activities. We have proven in some ways we have some unique ability to deal in these areas. There is still an evolution of the implementation of the President's domestic policy review which came out yesterday. I believe it is highly significant that one of the areas that he emphasied was a joint effort by the NSF and Department of Commerce to work with business schools, with universities, with engineering schools, to try and develop a climate for innovation, for innovative curricula.

That is particularly the areas we have concentrated in, and certainly its innovation centers experiment has been reviewed not

Laser Velocimeter and Buried Hot Wire Test and Analysis

Contractor, Complere, Inc., is conducting wind tunnel tests of the flow about bodies at angle of attack and airfoils. For the most part, these tests involve using laser velocimeters to measure the flow velocities in vortices or viscous layers. Contractor has gained considerable experience in probing complex aerodynamic flows with laser velocimeters as well as analyzing and reporting the results. Potential for future growth is excellent.

Preparation and Operation of Dynamic Measurements Instrumentation

Raman Aeronautics, Inc., is providing instrumentation and support for wind tunnel test of electro-optics investigations. Contractor is performing at a high level of competence and providing a steady flow of valuable data to the NASA engineering staff. Potential for future growth is excellent.

STATEMENT OF STUART J. EVANS, DIRECTOR OF PROCUREMENT

Mr. EVANS. Thank you, Mr. Chairman.

We appreciate this opportunity to be here today, and also the opportunity to hear the comments of the three foregoing panels. We found them to be both stimulating and rather thought-provoking.

At the outset, there are two points I would like to make as background to NASA.

First, we are a research and demonstration agency and, as agencies go, relatively young, 21 years old.

Second, with respect to the space program, from the beginning it was in essence a partnership of Government, the scientific and educational community, and the industrial sector.

Thus, we started with heavy reliance on the private sector for both innovation and technology.

I think one result of that approach is illustrated in the fact that this year, as in several previous years, approximately 82 cents of every dollar that Congress appropriates to us flows to the private sector through procurement processes.

In a slightly different vein, approximately one-half the equivalent manpower we need to operate our programs and run the agency comes from the private sector, again through our procurement process. So we have from our outset been heavily oriented in that direction.

Within the context of this hearing, there are two activities which we have undertaken in the past year that I would like to speak to very briefly.

In mid-1978 the administration established an Industrial Innovation Coordinating Committee under the Secretary of Commerce basically to address the issues and problems bearing on industrial

concern to market and sell any resulting new or enhanced products on a reasonable basis; (12) the impact of NASA sponsorship on a given industry; (13) provision for a form of process exclusivity in special cases when needed to promote innovation; (14) recoupment of the NASA contribution under appropriate circumstances; and, (15) support of socioeconomic objectives of the Government.

Administration

The Associate Administrator, Space and Terrestrial Applications, is delegated the authority to enter into negotiations and to approve MPS joint endeavors on behalf of the Agency. Before proceeding into comprehensive evaluation of a joint endeavor, a preliminary assessment will be made of the merits of the offer. (Joint endeavor offers which are too sketchy or ill-defined to establish that the basic idea contained in the offer has merit, is in accord with MPS program objectives, or that the organization is willing to make significant contribution to the endeavor, will not be evaluated in depth and will be handled as correspondence or advertising.) This preliminary assessment will be reviewed by the Associate Administrator, Space and Terrestrial Applications, or his designee, to determine if the proposed endeavor warrants further consideration from NASA's standpoint. If this determination is positive, further evaluation will be made. After such evaluation and discussions with the offeror, if the parties mutually agree to proceed with a joint endeavor, designated representatives of NASA will enter into detailed discussions and negotiations with the offeror regarding the technical and business aspects of the offer in an effort to consummate a mutually satisfactory joint endeavor agreement. Management of the MPS joint endeavor program will be carried out by the Division of Materials Processing in Space of the Office of Space and Terrestrial Applications.

Due to resource limitations and necessity for diversity in the program, normally only one offer will be accepted to apply a particular materials process in a given technical area. If substantially similar offers are received within any 45-day period, they will be evaluated/negotiated together. The one which provides the best total consideration for the Government will be accepted. Special consideration shall be given to small and minority businesses, as appropriate.

August 3, 1979.

Robert A. Frosch,

Administrator.

[FR Doc. 79-24898 Filed 8-13-79; 8:45 am]

BILLING CODE 7510-01-M

NATIONAL AERONAUTICS AND SPACE ADMINISTRATION

[Notice No. 79-70]

Guidelines Regarding Joint Endeavors With U.S. Domestic Concerns in Materials Processing in Space

Background

NASA, by virtue of the National Aeronautics and Space Act of 1958, is directed to conduct its activities so as to contribute to the preservation of the role of the United States as a leader in aeronautical and space science and technology, and their applications. In furtherance of these objectives, the Administrator of NASA on June 25, 1979, promulgated a statement of *NASA Guidelines Regarding Early Usage of Space for Industrial Purposes*. These guidelines recognized that "since substantial portions of the U.S. technological base and motivation reside in the U.S. private sector, NASA will enter into transactions and take necessary and proper actions to achieve the objective of national technological superiority through joint action with United States domestic concerns."

Materials processing in Space (MPS) is an emerging technology which can potentially provide public benefits through applications in the private sector. However, in the foreseeable future, normal market incentives appear to be inadequate to bring about technological innovation in the private sector based on this technology. Therefore, in accordance with the above referenced Guidelines, NASA contemplates entering into joint endeavors with U.S. industrial concerns. Through these joint endeavors, NASA seeks, within the context of the MPS program objectives, to broaden the base of understanding of MPS technology, particularly with regard to its usefulness in the private sector where economic benefits may result. Present MPS program objective are: a) to understand the pervasive role of gravity in materials processing; b) to develop and demonstrate enhanced control of materials processes in weightless environment; c) to explore the unique nature of space vacuum for materials processing; and, d) to foster commercial applications of MPS technology.

Nature of the Joint Endeavor

Joint endeavors in MPS will generally be for the purpose of: 1) engaging in research programs directed to the development and/or enhancement of U.S. commercial leadership in the field of materials processing in space, and 2) encouraging commercial applications of MPS technology. Joint endeavors may cover ground-based research to create a sound scientific basis for investigations in space; the investigation of materials properties or phenomena and process technology in the unique environment of space; the making in space of exemplary materials to serve as a point of reference for ground-based materials and processes; and the application investigations and feasibility demonstrations of space-made or space-derived materials and processes.

In joint endeavors, NASA and the industrial concern share in the cost and risks of the endeavor. Terms and conditions, including the business arrangements, are negotiable within the limits of prevailing statutes and regulations and will be commensurate with the risks, involvement and investment of all the parties. NASA's intent is to offer as much latitude as practical in joint endeavor arrangements. Due to the experimental nature of the program, both technically and institutionally, each endeavor will be negotiated on a case-by-case basis. Endeavors are expected to vary in size, complexity, and arrangements to

NASA GUIDELINES REGARDING EARLY USAGE OF SPACE FOR INDUSTRIAL PURPOSES

NASA, by virtue of the National Aeronautics and Space Act of 1958, is directed to conduct its activities so as to contribute to the preservation of the role of the United States as a leader in aeronautical and space science and technology and their applications.

Since substantial portions of the U.S. technological base and motivation reside in the U.S. private sector, NASA will enter into transactions and take necessary and proper actions to achieve the objective of national technological superiority through joint action with United States domestic concerns. These transactions and actions will be undertaken in the context of stated NASA program objectives and after a determination by the Administrator. They may include, but are not limited to: (1) engaging in joint arrangements with U.S. domestic concerns in research programs directed to the development of enhancement of U.S. commercial leadership utilizing the space environment; (2) conducting research programs having as an end objective the enhancement of U.S. capability by developing space-related high-risk or long-lead-time technology; and (3) by entering into transactions with U.S. concerns designed to encourage the commercial availability of products of NASA space flight systems.

NASA incentives for these purposes may include in addition to making available the results of NASA research: (1) providing flight time on the space transportation system on appropriate terms and conditions as determined by the Administrator; (2) providing technical advice, consultation, data, equipment and facilities to participating organizations; and (3) entering into joint research and demonstration programs where each party funds its own participation.

In making the necessary determination to proceed under this policy, the Administrator will consider the need for NASA funded support to commercial endeavors and the relative benefits to be obtained from such endeavors.

NATIONAL AERONAUTICS AND SPACE ADMINISTRATION

OFFICE OF SMALL AND DISADVANTAGED BUSINESS UTILIZATION

MINORITY BUSINESS PROCUREMENT AWARDS

Fiscal Year	Section 8(a) Contracts	Direct Awards	Reported Subcontracts	Total Minority Awards
1979 (goal)	$42.0	$15.0	$43.0	$100
1978	32.2	14.1	29.6	75.9
1977	27.1	4.8	27.5	59.4
1976	20.4	2.8	16.0	39.2
1975	13.9	2.3	11.4	27.6
1974	12.9	1.2	7.8	21.9
1973	7.2	2.1	3.2	12.5
1972	3.2	-	-	3.2
1971	1.4	-	-	1.4
1970	.07	-	-	.07

This chart reports NASA's total awards to minority business firms through direct contracts, Section 8(a) awards and subcontracting.

DOLLARS IN MILLIONS NASA/K

APPENDIX II-2

SUBJECT: Report of Minority Subcontracting on Space Shuttle Construction, Kennedy Space Center, January 1975 - September 1979

	Value
Total Prime Awards	$160,473,281 (36 contracts)
Large Business Prime Awards	134,494,683
Small Business Prime Awards	25,978,598
Small Business Prime Awards % of Total Prime	+16.2%
Total Subcontracts	$110,979,081
Small Business Subcontract Awards	64,683,682
Small Business % of Prime	40.3%
Small Business % of Subs	58.3%
Minority Business Subcontract Awards	$ 26,342,020
Minority Business % of Prime	16.4%
Minority Business % of Subs	23.7%
Small Business Prime and Subcontract Awards	$ 91,025,702
Small Business Prime and Subcontract Awards % of Total Prime Awards	56.7%

This table reports the current status of the minority business subcontracting effort at KSC with the contractually established 20 percent minority subcontracting goal.

(K) 10/11/79

APPENDIX 1

Finally, Mr. Chairman, I think some observations on our experience with the small business R&D community might be appropriate within the context of this hearing. We do not lack statistics in a macro sense of federal R&D funds and their placement in the private sector; nor the proportion of those funds which go to small research firms. When it comes to innovation however, we find that this takes place generally in the study and research of solutions or approaches to problems more than it does in the engineering effort applied to actual hardware development or construction. This is why we have focused our initial attention primarily in the areas of our research programs than in the development and production of hardware.

One of our main challenges is in communicating our discrete research needs in a timely way to specific small firms possessing the capability to respond in a meaningful manner. Finding those firms has been much more of a challenge than is capitalizing on their capabilities once known. I believe that any means of improving this communication process whether it be the refinement and expansion of the SBA Procurement Automated Source System, coordination with small business research associations or hearings of this nature is a benefit to both the Government and the small research company. Just a week ago NASA , along

gratified that so many industrial firms, including small manufacturers, have expressed their intent of making this device commercially available.

Another NASA invention, stimulated by a technology transfer applications project, has been licensed to a small manufacturer in Williamsburg, Virginia. The development known as a "Stack Plume Visualization System", has been commercialized under the name Visiplume. The system visualizes sulfur dioxide smoke-stack emission plumes by observing the absorption of ultra-violet radiation by sulfur dioxide against a normal sky back-ground. The marketed NASA invention is intended to monitor coal and oil-fired power plants and facilities that manufacture sulfurice acid.

Availability of this remote monitoring technique developed by NASA is expected to aid in establishing environmental controls for sulfurous smog prevalent in many US industrial communities.

The list of small business firms who have benefitted from new aerospace technology goes on and on. For example, the Hohman Plating and Manufacturing Company in Ohio has developed an improved high temperature, self-lubricating plasma sprayed coating based on NASA developed technology. Hohman's product, known as Surf-Kote 800 withstands temperature ranges from -200

60% are small business under 500 employees. In addition, technical inquiries received this year by NASA from small companies which are prompted by NASA Tech Briefs will number close to 100,000 or 54% of the total received by NASA.

In our efforts to trace aerospace technologies and their secondary use in industry, we often learn of small manufacturers who have spun off commercial products and processes based on work originally done for NASA. In one such example, Odetics, Incorporated, a small electronics firm in Anaheim, California, developed advanced stitch bonding and parallel gap welding processes for spacecraft electronic packaging applications, including Space Shuttle, Spacelab and several unmanned satellites. Called Multi-Link, Odetics space-originated electronic welding concepts have found their way into a number of commercial applications, including a micro-film storage and retrieval system producted by Odetics. Commercial demand for these processes resulted in the establishment of separate manufacturing group in the Company. The new Odetics Multi-Link Division now provides automated electronic packaging services for Odetics' own commercial products and for such other customers as Dalmo Victor and Sperry Sun, and Xerox.

state-wide university system and is cooperating at the local level with Small Business Development Centers sponsored by the Small Business Administration.

Additionally, NASA is initiating contacts with the Small Business Administration to investigate other possible mechanisms whereby the NASA Industrial Applications Center network can beneficially cooperate in the promotion of small business access to NASA technologies in less developed regions. While seeking additional approaches in serving small business communities, we are continuing a joint program with SBA initiated three years ago as a means of creating an awareness of the value of aerospace technology to commercial enterprises in small business firms. Three (3) of NASA's applications centers in Connecticut, Oklahoma and California, have been jointly funded by NASA and SBA to provide one-time problem-oriented retrospective searches of the NASA data bank to small business firms. The NASA Center at the University of Southern California, for example, has serviced nearly 1000 small companies with search services in their areas of interest and specialty. A number of companies served have reported economic benefits and cost savings received through this service, and have invested in continuation of these services with the IAC in their region.

designed to encourage the secondary use of its technology in the commercial sector. Among these transfer mechanisms is a network of applications centers to provide information retrieval services and technical assistance to industrial and government clients. The network consists of seven Industrial Applications Centers (IAC) and two State Technology Applications Centers (STAC) located at university campuses across the country. The centers are backed by off-site representatives in many major cities and by technology coordinators at NASA field centers; the latter seek to match ongoing NASA research and engineering with client interests.

The STACs facilitate technology transfer to state and local governments, as well as to private industry, by working with existing state mechanisms for providing technical assistance. The STACs perform services similar to those of the IACs, but where the IAC operates on a regional basis, the STAC works within an individual state.

The two experimental STAC programs in Florida and Kentucky have been achieving success in their programs to assist state and local government as well as local industry in those States, and are having a particularly beneficial impact on the small business community.

3. Each Program Office issues a call to the field installations for work project proposals in support of the small business initiative.

4. The Program Office reviews and prioritizes the field proposals for further submission to the Deputy Administrator for project approval and release of funds.

5. Funds may be reallocated between Program Offices for proposed project work which best meets the requirements of the small business initiative.

6. On receipt of project approval and funding authorization, the field installation carries out its small business procurement actions at a time and manner most appropriate for the work involved.

Although we commenced this specific effort about a year ago and are still refining its details with our ten Centers, we are gratified with the results to date. Through eleven months of Fiscal Year 1979 we have awarded 213 contracts to small research firms for some $12.5M in such efforts as set forth in Appendix V.

In initiating this form of effort, we have two objectives--to foster the development of small business capabilities in

effective industry participation and interaction in NASA's space technology efforts can be developed and refined.

In connection with these activities, NASA has received joint offers from three different private firms, two of which are small. These are now being considered according to the above guidelines. In general terms, these offers propose that the firms be responsible for ground-based experimentation and development of experiments for flight investigations and technology demonstrations, and NASA be responsible for STS services and general purpose support equipment. In consideration of their investment, the firms would expect to retain commercial patent and data rights commensurate with their level of involvement. For its work, NASA would receive scientific and engineering data required to understand and characterize the role of gravity in material processes.

As industry becomes aware of the potentials of MPS technology, we are confident that additional joint endeavor offers will be forthcoming.

A second initiative NASA has embarked upon in the same time frame relates directly to enhancing small business involvement in our basic research efforts. Working in concert with the Small Business Administration and the White House Conference

"NASA incentives for these purposes may include in addition to making available the results of NASA research: (1) providing flight time on the space transportation system on appropriate terms and conditions as determined by the Administrator; (2) providing technical advice, consultation, data, equipment and facilities to participating organizations; and (3) entering into joint research and demonstration programs where each party funds its own participation."

This notice concluded by setting forth fifteen factors NASA would consider in providing incentives including "support of socio-economic objectives of the Government." A copy of this Policy Statement is also attached as Appendix III. One of the first areas that promises considerable payoff is space industrialization and, specifically, materials processing. Materials Processing in Space (MPS) is emerging as a new technological capability for materials research and for materials processes not possible on earth. The application of this technology must occur in the industrial community to satisfy the needs of an ever-expanding market for new and improved goods and services.

At this time, however, the nascent state of MPS technology places it in a long-term, high-cost, high-risk category which is generally beyond the interest and capacity of commercial

Within the last decade NASA has also focused considerable energy and imagination in the development of minority business opportunities throughout the Agency. Our return on this investment has been excellent, and for the third consecutive year, minority prime and subcontract participation has increased substantially. Here again, we are constantly seeking, and finding, new reservoirs of minority capability to tap within our programs and mission--and I expect to see continued growth in our minority source base and resulting procurements.

For example, within the last six weeks we have awarded a $5.8M, eighteen month contract with a high technology 8(a) firm for major R&D support in advanced computer technology. If performance meets anticipation, this effort may continue for as long as five years at essentially that level.

Concurrently, working in partnership with the Small Business Administration, we are exploring with another high technology 8(a) firm for the development of Space Shuttle compatible solar backscatter ultraviolet calabration instrument. This is a highly complex, technically demanding effort and, to our knowledge, would be the first minority enterprise built instrument to fly in space.

Our relationship with the Nation's small business community is a prime example of growth, learning and innovation. From the beginning we have attempted to capitalize upon the initiative, imagination and productivity of small business in both space and aeronautical programs. The results have been gratifying, and we look back with pride to the involvement of thousands of small businesses in our Apollo and other manned space programs of the 1960's.

Today there are some seven thousand small businesses working to make the Space Shuttle a reality. To prepare for its operation at Cape Canaveral we are in the middle of construction of major assembly, launch, recovery and overhaul facilities--in large measure by small business. I refer here to Appendix I which reports that small construction firms received 16 percent ($25.98 million) of the total value of prime contract awards ($160.5 million), and 58 percent ($64.7 million) of the total value of subcontract awards ($110.98 million). Thus small firms received a total of $91 million in prime and subcontracts, or 57 percent of the value of the Shuttle construction contract awards accrued to small firms. It should also be noted that small minority firms received 24 percent ($26.3 million) of the subcontract awards, largely as the result of the 20 percent minority subcontracting goal which was set for the Shuttle construction effort.

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PRESENTED BY WITNESS

STATEMENT OF
STUART J. EVANS
DIRECTOR OF PROCUREMENT
NATIONAL AERONAUTICS AND SPACE ADMINISTRATION
BEFORE THE
COMMITTEE ON SCIENCE AND TECHNOLOGY AND
SMALL BUSINESS, US HOUSE OF REPRESENTATIVES
AND THE SELECT SMALL BUSINESS
COMMITTEE, US SENATE

NOVEMBER 1, 1979

Mr. Chairman and Members of the Committees:

NASA appreciates the opportunity to appear before these committees today to address the Agency's policies, actions and views on opportunities for small technology firms in our aeronautics and space programs. We shall also discuss initiatives we have taken to encourage small technology firms in developing commercial uses for space processes and commercial applications of NASA developed innovations.

Appearing with me today are Mr. Floyd Roberson, Director of NASA's Technology Transfer Division, and Mr. Kenneth J. Kier, NASA's Director of Small and Disadvantaged Business Utilization Office.

To set our activities in perspective, Mr. Chairman, I wish to stress two points. First, NASA is a research and demonstration

We founded that with the idea both of increasing the number of small business performers who were capable of conducting research and development for Government and industry, and with the intent of coupling Government research to the needs for innovative products and services in the commercial sector.

In this program, we set the general topics for research within the broad mandates of the National Science Foundation but provide a great deal of flexibility for the creative and innovative idea that did come out of small companies within those basic guidelines.

Specifically, we emphasize the coupling of Federal support to the follow-on venture capital and to the private sector market needs.

Successful firms which compete for a very small award, a phase one award, of only $25,000 are allowed to submit a proposal for the actual research effort which usually runs substantially more, typically 24 months, at about $200,000.

When they submit the proposal for this phase two research, they are requested to submit a commitment, usually a contingency commitment, from a venture capital firm that if the research meets certain criteria, the venture capital fund will provide the follow-on support for commercialization and development of a product or service.

This has a number of important features. Some of them were mentioned earlier today.

First, it provides some direct coupling between the research we support and the ability of the firm to take it to the market because the funds committed generally are available if the research is successful.

Second, it gives the foundation an opportunity to benefit from the market evaluation and from the management evaluation of this third source of support, the venture capital firm.

NSF, through the use of its peer review system, and through the skills of its program officers, has a great deal of capability in evaluating the science and technology. By obtaining this commitment of the venture capital firm, we get the evaluation of the market, the management, as well as a great deal of the financial arrangement to the private sector.

Through this program, we have successfully provided the front end, the highest risk money, to a number of firms, and are beginning to see some of the payoffs that are coming out of this activity.

One of the most important aspects of this program is that we make the patent rights available to the small firms. At the time the small firm has obtained enough support from the venture capital source, or from third party commitments, to equal or exceed the investment of the U.S. Government in the research effort, we transfer or we give all rights subject to Government use to the company.

We believe that this is quite important because a small company facing all the difficulties you have heard this monitoring needs the protection which the control of a patent can give it in trying to penetrate a market.

This program has had a number of effects which we are pleased with, one of which is that it has provided a means of identifying and heightening the visibility of some of our best small high technology firms, so that they find it easier to get in touch with sources

- And, although the mature firms had 27 times the total employment of the firms less than 20 years old as a group, the younger smaller firms created an average of 89 new jobs per company in 1976 versus an average of only 69 new jobs per mature company.

If we look at a similar cross industry study of leading firms in each of three classifications: young technology companies (Data General, National Semi conductor, Compugraphic, Digital Equipment and Marion Laboratories); larger innovative companies (Polaroid, 3M, IBM, Texas Instruments and Xerox); and the mature industry leaders (Bethlehem Steel, Dupont, GE, Proctor and Gamble, General Foods and International Paper), a 1975 MIT Development Foundation Study found:

- The five young technology companies with ending sales only 2 percent of the sales of the six mature firms actually hired 34 percent more people during the 1969-1974 five year period.
- The larger innovative companies with ending sales only 52 percent of the mature leaders created four times as many new jobs during the same period.
- In addition, these same larger innovative companies provided 52 percent more income tax revenue or a ratio of nearly 3 to 1 in tax revenue to sales compared to the mature companies during the period.

Another important reference is from NSF's Science Indicators 1976 which stated that in a large study of major innovations between 1953-1973:

- Small firms produced about 24 times as many major innovations as large firms and nearly four times as many as medium-sized firms per R&D dollar expended.
- Small firms also had a ratio of innovations to R&D employment four times greater than large firms.
- The total number of major innovations by small firms was greater than by large or medium-sized firms.

Finally, the Office of Federal Procurement Policy's report on Small Firms and Federal R&D adds the following element:

- The total cost per scientist and engineer was almost twice greater in firms of over 1000 employees as it is in firms of less than 1000 employees.

APPENDIX

The Real Leverage of High Technology and Small Firms

The leverage of high technology and small innovative firms in creating jobs, improved productivity, business expansion, and in meeting inflation and trade deficits can be enormous. Research is critical to high technology and to most technological innovation.

Four recent studies point up what the Charpie Report of 1967, a major study by the Department of Commerce, and most economists have known for years. A 1977 study by Data Resources, Inc. for General Electric found that in a comparison of high technology with low technology firms over the 25 year period 1950-1974:

- Employment in high technology firms grew nine times as fast.
- Productivity grew at three times the rate.
- Output expanded twice as fast.
- Prices went up only one-sixth as rapidly.
- And our trade balance increased to a $25 billion surplus in 1974 while the balance for low technology products declined from break-even to a $16 billion deficit.

When we compare job creation differences between older and younger firms, The American Electronics Association Survey in 1977 for the 1969-1974 period showed:

- Firms 10 to 20 years old had an employment growth rate 20 to 40 times the rate of firms more than 20 years old.
- Firms between 5 and 10 years old had a rate 55 times of the mature firms.
- Firms less than 5 years old average 115 times the employment growth rate of the mature firms.

In addition to these small business and innovation activities, NSF established an Office of Small Business Research and Development in 1978 to focus on assisting small research and development companies, and other small firms, by providing information about NSF programs, and opportunities at NSF for grants and contracts. The office advises small companies concerning NSF policies and procedures and how best to submit proposals to NSF. The Office collects and periodically publishes information on program awards by NSF to small business. It advises NSF management officials concerning policies and procedures that affect how NSF draws upon the capabilities available in the small business community. The Director of the Office of Small Business R&D works closely with the Assistant Director for Engineering & Applied Science on the small business activities of that Directorate.

The Office of Small Business Research and Development provides information sheets, a specially prepared Small Business Guide to Federal R&D, and other NSF publications to the small business community. Staff of the OSB work on an individual case basis as appropriate to make contact between prospective applicants for NSF support and NSF program specialists. No precise statistics are kept, but we estimate there are between 1,000 and 2,000 individual contacts per year with representatives of small firms. This does not include companies reached by mass distribution of NSF publications and the NSF Small Business Guide to Federal R&D at meetings and conferences.

the program, it has discovered an important new factor after analyzing stress distribution, yield zone shapes, and depth of crack propagation. It has also proven that blunt diamonds are more effective in machining ceramics than sharp diamonds. New proposals have already gone to the Office of Naval Research, as a result of the NSF work. Applications are in ceramic bearings and in gas turbines for aircraft, power plants, and automobiles through such companies as Ford, Airesearch Division of Garrett Corporation, General Motors, Detroit Diesel and the Allison Division of GM.

Collaborative Research of Waltham, Massachusetts undertook a project that seeks to prove that mammalian cells can be taught to produce insulin. The gene could then produce insulin inside or outside the body. Outside of the body, the gene would be able to produce vast quantities of insulin through tissue culture using a synthetic approach in an ingenious manner. Furthermore, this research may also lead to the rejuvenation of malfunctioning cells and this may result in other exciting breakthroughs.

A number of the ideas of the small firms originated with research in universities, but the application ideas came from the small firm. It takes both to have innovation, and the program is producing considerable collaboration of university scientists and small firms to blend strong research capabilities with technical expertise. There are many more examples.

marketing, and financial capabilities. In this case, the small firm benefits from the available experience and expertise, and receives the development funding and a royalty arrangement in return. The latter approach may be the most capital-efficient approach for many ideas because it couples the small innovative firm to the existing production and marketing resources of the larger firm.

Although the program is relatively new, some awardees have already had major benefits from the program.

Ionomet, initially a one-man company in Massachusetts, received an award under the first solicitation for research to increase the sensitivity and reliability of photoplates for mass spectrometers. The Phase I performance was excellent, but Ionomet indicated that they could not obtain venture capital for the limited mass spectrometer photoplate market. We encouraged them to think about other possible applications for the same research which had as its purpose production of half-micron silver halide lines. Ionomet approached the Massachusetts Institute of Technology to explore potential microelectronics applications. MIT was highly encouraging, and Ionomet went to an electronics firm to seek funds. Ionomet required $250,000 in venture capital; it was immediately offered to them. After determining their patent position, Ionomet sought venture capital from a large manufacturer of equipment in order to produce semi-conductor chips for the computer industry. This firm, too, offered a commitment,

This, coupled with Phase III private funding, provides a financial path, not only to phase out Government support, but to connect research to commerical use.

Another objective of this program is to fund some of the high-risk science or technology-based ideas which usually are too risky to obtain private investment at the research stage. Successful NSF sponsored research lowers the risk for follow-on investors and provides a greater incentive for them to invest in the idea as well as in the smaller firm. Let me emphasize that the commitment by NSF is contingent on certain mutually agreed upon objectives between the small firm and the investor. If that research does not meet those objectives, the private venture capitalists' commitment is void.

Another aspect of the program is that it makes patent rights available to the small firm. These rights are contingent upon follow-on investment actually taking place in an amount at least equal to NSF Phase II funding. This provides an incentive for the small business to obtain the development funding to pursue commercialization if the firm is to receive the patent rights. If it does not pursue commercialization or if there is no follow-on investment, the firm does not receive the patent rights. As you know, however, providing a means to obtain the protection of patent rights is often essential for a new idea and a small firm if it is to attract private investment. These rights continue to be reserved, though, for Government use for its own purposes, and Government retains "march-in" rights if the firm still

Successful firms in Phase I of this program become eligible to submit Phase II proposals to carry out the principal research effort for up to 24 months. Funding in the second phase of the program depends upon the quality of the proposal and the firm's ability to obtain follow-on private funding from a third party to pursue development toward commercial use. In short, federal funding pays for research in selected topic areas in Phases I and II, and private funding pays for subsequent work toward commercial use. Phase III is the development phase in which commercial objectives are pursued from the same research base but with private capital.

Our request to the small business that it prove the commercial potential of its idea by obtaining a commitment for Phase III funding from a private third party is essential to the success of the innovative process. This commitment may come from a venture captial firm or it may come from a large manufacturer already in the same field. But while the commitment is requested, it is not required. It should accompany the Phase II proposal and becomes an extra point of merit in the evaluation process for a Phase II award. Proposals which not only meet government objectives but also have commercial potential receive preference in the award process.

Let me say why the commitment is important. It does a number of things. First, it forces the small firm to consider possible commercial applications of the research at the beginning of the process, not after the R&D has been completed or after a product has been produced.

This past year, more than 100 awards were made totalling over 8 million dollars. In total, during the nine year history of this effort at NSF, the applied science programs have made 475 awards of more than forty million dollars to numerous small business firms.

During this period, NSF has developed specific programs directed at innovation and small business. In 1973, the Research and Development Incentives program, which subsequently became a part of RANN, began an Innovation Centers program. These Centers focus on small businesses and promote new business start up. They are located on university campuses and draw on the resources of the industry and academia. They experiment with new ideas to work and train young technologically-oriented entrepreneurs. These centers have spurred widespread interest in this concept both in this country and abroad. One example of the types of innovation being developed in these Innovation Centers comes from the Center at the University of Utah. A new infinitely variable automatic transmission, originally developed for bicycles but now being adapted for other applications such as power tools, motorcycles, snowmobiles and lawn mowers, was developed with assistance from the Center. The essence of this belt-driven transmission is a continuous automatic adjustment feature which gives the effect of an infinite range of gear ratios.

the impairment of the capital formation process during that long postwar period. The consumer, the small investor vote, capital does not vote.

The laws that we would like to put in balance relate to the advocacy for the creative side of the economy calling for capital formation and investment. Investment Company Act of 1940 which was from a different period, protecting the little investor from abuse, and speculation, for good reasons. But to apply those to the formative, creative side, is a grave mistake.

Somebody mentioned photovoltaic cells. I have been watching that field very closely. There is nobody anywhere that I know, except maybe in heaven, who call tell you exactly where the breakthrough is going to come. And I do not think you can write policy directions to lead researchers in little lofts in Cambridge or Palo Alto to that breakthrough. But I think it is going to come. And it is going to come from a lot of people doing what they can do well in advancing their particular field of knowledge.

I have been exposed to a very brilliant person at CalTech who has what is called a concentrator. When applied to a photovoltaic cell it will concentrate and enhance the electrical generation from the Sun very substantially. And there he is. He wasn't even under contract. He knew about what was happening at JPL, which is working with the photovoltaic cells. But he was in optics, in refraction physics. I don't want to overdo that one. But my point is that from very surprising quarters can come breakthroughs. And we and others like us are out there with our antenna going around all the time.

Mr. BROWN. Would you give a quick comment on the role of the Congress in this last 15-year period, where we have seen these kinds of really legislative bases for these declines?

Mr. GREGORY. I think that is beyond my—I would stand by my statement. I think it has been terribly oriented toward protection and avoidance of risk. And I don't think we can afford that. I think you have to put risk and the productive side back in the equation. And I think you are. I think this is evidenced by these hearings and other hearings that I have been exposed to, the SEC I think have imaginatively conducted hearings around the country to hear out comments that we all had on how they could streamline the process. So I think it is turning to be honest.

Mr. BROWN. I hope you are right.

Mr. LLOYD. Thank you very much.

At this time we will shift to panel 4. My colleague, Mr. Brown will be chairing. Dr. Sanderson, Mr. Wetmore, Mr. Tibbetts, Mr. Evans, Mr. Kier, and Mr. Roberson will be the panelists.

Mr. BROWN. Gentlemen, we welcome you here this afternoon. We trust that we can dispose of the panel adequately without running too long this afternoon and let you get some lunch.

We are going to start with Dr. Sanderson.

[The prepared statement of Dr. Sanderson follows:]

made it very costly for a person, when the time came, for him to take down those options. It became taxed as income. I would be for removing that and allow a person to take down the option in the form of capital in that company. I think the competition between the big company he is leaving and the new company he is going to is more in terms of the value that is likely to be generated by the company in question.

Our people like to identify themselves with companies that are truly building new values. And I recited in my written comments something about Intel, something about Environmental Research and Technology, now part of Comsat, and something with Teradyne, all of whom were born in the last 15 years—people were attracted to sharing in the value growth in those enterprises, and where there was a grandfather clause in effect, in the case of Teradyne, there were still options that could be released that had the old values to them. So I think the competition between the company you are leaving and the new company is in terms of the value likely to be generated.

Mr. BROWN. Well, I have to emphasize that this is the sort of thing that Congress has to be concerned with. We are not in the business of making regulations just so people can make more money. There has to be a clearly identified public purpose which I think most of the public and most of the Congress would have to agree is important to the national welfare. And it has to be of course equitable in its application.

Thank you, gentlemen.

Mr. DAVIS. Would it be possible for me to mention just briefly, on this contribution to the public welfare, that a study was made of companies that were founded between 1970 and 1975 in the high technology area. And then it was looked at, 1976, to see what results came for every $100 of equity investment in companies founded between 1970 and 1975. And they found that there was $15 created in Federal corporate income tax, $15 in personal income tax, $5 in State and local taxes, something like $70 in overseas credits, and $33 in R. & D. I can't imagine a more beautiful payoff for the U.S. Government or any government than that. Plus, of course, the jobs that were created. They are the net creators of jobs, these high-technology small businesses, not United States Steel, not General Motors.

Mr. BROWN. I think we are beginning to recognize their importance.

Mr. FUQUA. Thank you. Mr. Ritter.

Mr. RITTER. Thank you, Mr. Chairman.

I would just like to take off where Mr. Brown left off and put in a plug that says that profitability and making money is perhaps one of those creative incentives that drives this whole country forward. I believe, as Mr. Gregory does, that the incentive for that young manager or entrepreneur to leave the big company by taking stock option in a small company is based on the rate of return that he would expect from that small company that in no way a stock option from an industrial giant could achieve. And the market would take care of itself in bringing those people back into the high-technology industries, or the new innovative industries by itself.

to define and confine the process. It is risky enough just dealing with the marketplace, as we have to do, and it would be an unnecessary complication to try to live within definitions that rapidly become absolete at the leading edge of technology.

It is equally important to have rejection of controls on formation of capital for this purpose and contractual arrangements between venture capital managers and their investors. Our industry has had an enviable record and responsibility and adherence to both legal and ethical standards and there are ample laws on the books to protect inventors, consumers, and the general public from those whom might use venture capital for improper purposes.

We resist, like Mr. Davis, the application of laws written for other problems in other periods to the business of venture capital. We have reference to the contemplated application of the Investment Company Act of 1940 and the Investment Advisers Act of 1940, to what we are doing in venture capital. We do not seek protection, we do not seek to be underwritten by the Government, we would instead rather be left alone to deal with the very high risk business of building new enterprise.

I won't repeat my third point because it has been so well said by others this morning, about Government regulation and bureaucracy. Given a climate which reflects a favorable attitude toward capital, its free allocation, and a climate which includes recognition of the difficulty in defining venture capital, dealing as it does with the frontier of technology, and with some relief from the oppressive Federal regulation, I think the role of venture capital could be even more productive than it has been so far in identifying and supporting financially in a business way pioneer entrepreneurs.

I want to thank you very much for giving me this chance I will be happy to.

Mr. LLOYD. Mr. Brown.

Mr. BROWN. Gentlemen, let me comment very briefly that your contribution is of particular value to us because of the problem which Government has in general in its own philosophical orientation toward the importance of stimulating innovative high technology businesses. The Government is not in the business, normally speaking, of helping the entrepreneurial process. In many ways, as you have both commented, it has inhibited that process.

It is important, I think, that we in the Congress and those in the executive branch dealing with research and technology—and we fund a huge proportion of the national research and technology—understand the length and complexity of the chain that is involved before that becomes a socially useful product. So I compliment you on your presentation.

Let me just ask a couple of quick questions, because I am not familiar with your business. Where do you get your capital? In other words, where do your limited partnerships that you referred to come from and, second, what is the nature of your equity, your investment in the small firms? Is it an equity participation? How does the mechanism operate?

Mr. DAVIS. Which one of us do you want to address that to?

Mr. BROWN. Possibly you, Mr. Davis.

Mr. DAVIS. All right, in my particular case, I just raised $20 million, so this is a good time to talk about it. The backers of this

mate right. We have abused our capital through excessive consumption and expenditures at the expense of the future. The farmer long ago learned not to consume his seed corn, lest he would be without any crop at all in the future year.

We are not looking for any protection whatsoever. We do not look for our losses to be underwritten by the government or by anyone else. We value our right and freedom to make our own decisions and our own determinations in the investment marketplace. We accept that risk. We want the free market-place to determine our success and our failures. At the same time, we want the opportunity to benefit from gains involved in a successful project. We think that capital formation by definition suggests that capital gains should not be taxed away, but instead, be in a position to be reinvested by the current owner of the capital or by the future owners of that capital.

We seek to preserve the opportunity to strike a partnership relationship with an entrepreneur and hopefully help magnify his skills. We want the opportunity to channel private capital freely into deserving projects which will breathe life into those projects and ideas. And we seek some alleviations from the weight of government regulations under which we and our company must operate.

The venture capital industry intends to combine people and money and provide a new result of which either one alone, would not be capable. What we do is a very exciting human activity dealing with new skills and new contributions and I thank you for your interest.

cripple the venture capital industry as we know it. The SEC proposal, following as it did their constructive work on Rule 144, came as a disappointment. Those of my colleagues who have included pension funds as part of their capital are equally concerned about the proposed venture capital rules under ERISA.

Using the framework in previous legislation like the Investment Advisers Act of 1940, Investment Company Act of 1940, or the ERISA of 1974, there have been attempts to control the field of venture capital. We do not see the justification or the evidence of abuse to be so limited. Nor do we feel these acts contemplated venture capital when they were first enacted.

These Acts were from the period when protection of the investor, the consumer, was the major issue and the intent; when less attention was paid to the creative and productive side of the equation; or to the attitudes and policies needed for capital formation.

We are encouraged by the reduction of the rate on capital gains tax. Through 1977 one of the prime reasons for the difficulties in company and capital formation was a tax policy which failed to recognize the incentives required to forego current returns on capital for long term economic growth and job creating activities. A capital gain is itself capital and tends to be reinvested to the extent it isn't taxed away. In addition to contracting available capital, a tax on gains significantly impacts our risk/reward calculations and therefore, the number of eligible projects. Lower return projects, and therefore more projects, may be considered where there is little or no tax on capital gain. Only premium return projects receive funding when the government takes a high portion of the return.

vulnerable. Certainly medical technology and the life sciences have been important areas for us. We have been associated with a number of companies who have made distinct product contributions, including array processors as applied to CAT scanners, micro filtration, diagnostic techniques, kidney dialysis and blood phoresis.

A major focus of venture capital interest these days centers around the computer revolution. It is considered by some thoughtful people to be perhaps more important than the industrial revolution a century ago. During the industrial revolution, we had tremendous growth in productivity and our standard of living caused by using a combination of the energy found in fossil fuels and engineering to leverage our muscles. At the present time the average invested capital per production worker in this country is something like $25,000. In contrast, the investment in equipment used by the office worker totals approximately $2,500. As the production workers productivity has risen, more and more of the labor force has in fact shifted to office work to handle the rapid increase in total output. Today over 50% of the U.S. work force operates in offices rather than in factories suggesting limits of our productivity unless we can find some way to leverage the use of the human mind and to process and communicate information. This is what the computer revolution has now just begun to do.

With this trend, a myriad of companies have come to the forefront. Semiconductors, microcomputers, minicomputers, microprocessors, software, small business systems, the vision of the office of the future, telecommunications, the number-crunching capability of array processors are all venture capital type

The actual decision making process, how we select a project, is a very complex and a very subjective matter. I know you will agree when we say that the character, integrity and creativity of the entrepreneur and those he selects as part of his team are of paramount importance. We all look to these qualities in identifying ourselves with an entrepreneur and his program, but it should also be said that we intend to conduct ourselves in a way that the entrepreneur will see in us the same characteristics when we enter into a project together. Out of mutual respect can develop the working partnership relationship which should contribute to the success of the venture.

We look for an intense, real-world, thorough knowledge of an industry, of the products in that industry and of the products which the entrepreneur hopes to improve upon or replace. We look for a thorough knowledge of each competitor in the marketplace and the weaknesses of each competitor's products as well as the attributes of those products.

Where a new market is without definition, we have to understand and be satisfied that the person envisioning it has the credentials and the experience to intelligently base his program. We are very cautious in determining whether or not capital is in fact the real need. Frequently, the absence of capital is perceived as the root of the problem, when in fact, that may not be the case. We give considerable attention to the individual motivational factors at work in a project. We are wary of projects where economic return appears as the singular motivational aspect. We find a great deal more logic and a lot more satisfaction in

Consider Environmental Research and Technology, Lexington, Massachusetts, a corporation formed 11 years ago with a vision that an important industry in the U.S. would be environmental monitoring and testing. That corporation now is part of the Comsat Corporation here in Washington.

These three companies were all a function of a new view of the future and all sought out venture capital as part of their development effort. So we feel venture capital, is an agent of change, freely flowing where it can be well treated but not without risk, and where it acts in partnership with promising new opportunities to commercialize technological developments.

Let me make a few observations about this process. First, there is absolutely nothing new about venture capital in the fundamental sense. During the industrialization of this country, the courageous commitment of funds by those attracted to new ventures was a major activity. In Boston, for example, capital that had been developed in the China Trade found application in the origins of several ventures which were to become major U.S. industrial corporations. The early partners of Lee Higginson & Co. played instrumental roles in the formation of what were to become Atchison, Topeka & Santa Fe, Calumet and Hecla Copper Mine, American Telephone & Telegraph, Union Pacific, General Electric and General Motors. This was a period of great building, of combining men and money to do what appeared quite impossible. It was repeated elsewhere, wherever capital had been accummulated and wherever there was the vision of the new industrialization in mind. So, venture capital is not new.

To the Honorable Gaylord Nelson, Chairman
Select Committee on Small Business
United States Senate

To the Honorable Neal Smith, Chairman
Committee on Small Business
U.S. House of Representatives

To the Honorable Don Fuqua, Chairman
Committee on Science & Technology
U.S. House of Representatives

My name is Daniel S. Gregory, I am Managing Partner of Greylock Investors & Co., a Boston-based venture capital limited partnership. I am also Chairman of Greylock Management Corporation and I have been associated with Greylock since its inception in 1965. I also serve as a Director of the NVCA (National Venture Capital Association), a primary purpose of which is to foster broader understanding of the importance of venture capital to the vitality of the U.S. economy. The NVCA is comprised of approximately 80 members across the U.S. which, while acting independently and competitively, invest approximately two to three hundred million dollars per year to launch new businesses and to finance the growth of young businesses in their formative years.

I believe the process of identifying promising new companies and working with them to be among the more complex, and sensitive of all marketplaces, but one with a tremendously high yield in the form of job creation, new tax revenues and technological contributions. I sincerely appreciate the interest shown by your committees in reviewing the process of venture capital and I am

we want to do it exactly right. We have an audit committee, I am scared to death I am not doing it right because I can't know all these regulations. We have to meet with professional auditors, outside auditors, with our own internal auditors, we have to pay for, and we have to meet with our lawyers to make sure we do it exactly right, and that we have dotted every "i" and crossed every "t" and all the rest.

As a matter of fact, we have to have two sets of lawyers. We have to have Internal Revenue Service experts, and we have to have the SEC experts, because not even a lawyer, trained lawyer, has enough brainpower to keep all the regulations of both of those agencies in his head.

So what the dickens am I to do there as a director to know whether I am complying with all the things I should do. I get two sheaves of paper every month furnished by the lawyers and I have to read both of them and sign and say that I have read all of these, I understand it, subject to the penalty of perjury.

The question was asked here about the brain drain. Really that happened to us in other ways than just having students come here and go away. The Japanese financed one of our major new developments in computers, the Amdol Computer Corp. He is the man that invented the major line of IBM computers, but he couldn't get venture capital here when the high tax rate was going on, they got their money in Japan. Japan owns a large part of the company. Similarly, you couldn't get money up for several companies in the area where I live during that period so the Germans, Bosch and other people, and the French came over, they bought a lot of technology. They take that home. We are going to have a hard time keeping up with those people.

The other thing I would like to say is that really it seems to me that from where I sit, to be honest with you, that the country is not in the control of the Congress and it is not in the control of the administration. It is in the control of the agencies and commissions, because there seems to be no effective control by which Congress can determine that the agencies are properly issuing these regulations which are the real laws that we deal with, not the laws that you pass, it is the regulations that we deal with.

There is no effective way of seeing whether they really need this regulation, this new regulation, whether they need half of the million regulations that already are out. These are only examples I have given of overregulation and overtaxation—I really believe that many of the things that we have been talking about here this morning would be taken care of by favorable tax treatment and cutting down on the overkill of these regulations.

Thank you very much for letting me speak to you.

Mr. LLOYD. Mr. Gregory.

[The prepared statement of Mr. Gregory follows:]

them of course is in the larger companies. But there are all manner of security blankets in those companies and it is very difficult to entice them to leave them and take the risk in the young company which may go bankrupt. So, the way to attract them, the thing that worked so beautifully for over a decade in the 1950's and 1960's was the stock option. However, after awhile the stock option was tinkered with by the Government to the extent that it has lost most of its value. For instance, in certain cases the stock option must be held for several years after exercise.

Well, the typical young 35- to 38-year-old fellow who is going to exercise this option has no money, he has been busy raising his family, getting their teeth straightened, now he is working for a young company where they don't have the security programs, so he hasn't the money to exercise this option, as he can't pay for—if he can't sell some of it to pay for the other, he just can't exercise the option, it's just not available to him. He thought it was going to be and now he sees it isn't.

In other cases they must pay 65 percent of the gain out in taxes. In still others they have to pay a tax the minute that they exercise the option, even though they haven't sold the stock, they don't have it, any money, they haven't gotten any money from selling anything, but Uncle has to have some money and they have to dig down in to get the money. That is a tax on something that has given them no gain so far. It is pretty upsetting to these fellows when they do this.

Turning to the Investment Advisers Act. This was an act that regulates people who are investment advisers, and all the investment advisers I have ever known in my life have been the people who have a bunch of clients and they treat each one separately and individually and try to get an investment program that makes sense for him and his family and all that.

Venture capital partnerships are exactly the opposite. I never advised anyone in my whole life about an investment. The general partners, I and my other two general partners, make investments of our money, and money of the limited partners who put it with us, we don't counsel them at all; we tell them about each investment when we have done it. They can't even withdraw in the 7-year period term of my partnership, if they don't like what I am doing, so they are stuck and they are treated exactly the same. We are not advisers to those individual partners.

The provisions of the act are not applicable since it was built for such completely different things, a perfectly good act, I assume, but applying it to our situation would absolutely hamstring us. I don't have the time to go into all these points but there are all kinds of restrictions. This doesn't fit us and would absolutely ruin our capability to act. In fact, I believe I will turn my money back if this happens to us and I know a number of other venture capital partners who feel the same way.

The point is, what purpose is being served by this extension of jurisdiction except to please bureaucrats who want to extend their jurisdiction. It is human nature. If I were in a bureau, an agency, I would want to extend the jurisdiction, I would want to do something I think is good. But there is an overkill here because of some

In conclusion, apart from the specific steps recommended earlier in my statement, let me urge that new regulations be permitted only after a clear demonstration that each one is truly needed for an important, non-trivial purpose, and that each one in the existing maze of regulations be subjected to a searching scrutiny to determine whether anything seriously deleterious would occur if it were removed. Then, if the qualified stock option were restored, the exemption from surtax on young companies increased, and the capital gains tax further reduced, you would be agreeably surprised at the renewed energy in the field of innovative productivity!

STATEMENT OF THOMAS J. DAVIS

Mr. DAVIS. Yes, I want to express my appreciation to the Senators and Congressmen for a chance to participate in your deliberations on something that is very important to the Nation and very close to my life.

I have filed a statement. I would just like to hit the highlights of it. I have been told I have 5 minutes and I doubt that I can say very much that is very elucidating in 5 minutes but I will do my best.

My plan is to spend 1 minute describing my background so you will have some notion of where I come from, another minute perhaps in just naming four areas that I think are of concern to all of us, that need action on your part, then I will turn back the next 3 or 4 minutes and try to say some few things about each one of those points that I mentioned.

As to background, for over 20 years I have been solely devoted to making equity investments to back new and young technology-based companies, companies based on advanced technology. I have been instrumental in placing $16 million in such investments. I cannot remember exactly how many of the total investments they were.

However, we currently have investments in 23 companies for which we paid over $8 million. Those 23 companies were all very tiny, either brand new or had almost no sales when we made these investments. That was some 5 or 6 years ago. And at the present time, on the average, at the present time, this year, the aggregate sales of all of those companies will be $132 million, and their employment will exceed 3,000 people.

Examples of a few of those that we have invested in, to give you some idea of what can happen, is Teledyne, which now has sales of, over $2 billion; Watkins Johnson, which has been on the New York Stock Exchange for a long time and has over $100 million worth of sales; and Scientific Data Systems, which went on the New York Stock Exchange, then was acquired by Xerox for $900 million. Current examples of things that we are interested in are Tandem Computers, which is 5 years old and did about $50 million in this last fiscal year, on its way to 75 or 100, with activities here and Germany and England and so forth, a totally new kind of computer, really innovative.

Another one is Genentech, which is engaged in genetic engineering, and there is an article about it in the Wall Street Journal of yesterday, under the heading "Ely Lilly May Soon Test Its New Insulin on Human Subjects." It is a new insulin totally developed

> themselves to the bone in growing a company over a five or ten year span, and then they find out that the government is out to get much of the potential reward. At that point, there is utter dismay. The coterie of young companies that have done so much for employment and productivity have been sadly handicapped by the warped version of the stock option imposed upon them in the last decade.

Fortunately, a bill to repair this strange and damaging legislation has been introduced in the House as the Jones/Frenzel Bill (H.R. 5060).

Another factor handicapping the growth of young, innovative companies is the smallness of the exclusion from federal surtax. Well managed companies reach profitability, and therefore taxability, rather early, while they are still growing explosively and requiring very large sums of annual additions to their operating funds. It is counter-productive in the economy to require them to pay money out to the government in income taxes only to have to borrow at 13 to 19% to finance their business growth. Such a tax policy simply means fewer new jobs, less foreign exchange, and actually smaller tax receipts over the long run because growth is restricted.

Still another handicap to young companies is the cost of registering a public offering with the SEC, and then the continuing costs of reporting pursuant to SEC regulations. For example, Tandem Computers expended $274,000 on its public offering, not including commissions, and not including the cost of time spent by its own employees.

With respect to continuing costs of being a public company subject to SEC jurisdiction, every quarter we feel we have to have a meeting of our Audit Committee of the Board of Directors to review audited earnings figures with members of the professional auditing firm and with our lawyers to make certain every penny is accounted for and described in exactly the manner prescribed in the regulations. And every month I receive two forms, each consisting of many, many pages which I have to swear I have carefully read, even though they relate only to sale of shares, which I have not done.

Most chief financial officers of small firms cannot afford to spend the time necessary to become expert on the reams of SEC and IRS regulations. So we have to consult our auditors and lawyers constantly. If fact, we often have to consult one set of lawyers and auditors regarding SEC matters and another set regarding tax matters because the two sets of regulations appear to be too abstruse for any one head to hold! Big companies, of course, have large staffs maintained solely to deal with governmental regulations of a complexity never dreamed of by the legislators who enacted the basic laws.

of our technically trained managers. It should be noted that these venture funds are mostly private (as in the case with Mayfield, my partnership) tho' some have SBA loans in addition. At the moment, it would appear that the future is bright for both venture capitalists and the entrepreneurs they back. In reality, however, both are beset on all sides by threatening forces. These forces are mostly arms of our governments, federal and local.

After the burgeoning of new companies based on innovative technology in the 1960's, the Congress raised the capital gains tax to an effective rate of 49% (and higher including state taxes). Public markets for securities of young, growth companies disappeared, and private funds became scarce, particularly for the start-ups that would employ the newest innovative technology. Proposals for financing made to my firm dropped from several a week to just a few per month. Few entrepreneurs were willing to leave secure jobs in giant companies to risk their futures, only to have more than half of the gains they created taxed away from them. Venture capital firms looked to other types of investments. Some of our already started young companies of great importance to our nation - such as Amdahl Computer - had to get their growth money from Japan in return for substantial portions of the ownership of the technology. The Germans acquired major portions of American advanced technology companies that needed money, which our tax beset Americans would not risk.

Our economy will never catch up the ground we lost in the creation of new jobs, foreign exchange and equipment that promotes productivity. We suffered a loss, every one of us in this nation, and not just the entrepreneurs and venture capitalists, from a counter-productive tax policy that truly was an example of killing the goose that lays the golden egg.

As a result of the reduction last year of the capital gains tax, new, private venture capital funds have been raised, perhaps in excess of $200,000,000. My partners and I have recently raised a fund of $20,000,000. However, these very funds are threatened by the desire of the SEC to require venture capital partnerships to register under and be subject to the requirements of the Investment Advisors Act. This is palpably absurd with respect to my partnership and those with whom I collaborate. I have never advised anyone on investments. I do not treat my limited partners individually as an advisor most certainly must. My two fellow general partners and I invest our money, and along side it, the money of our limited partners. They have no voice in the selection of investments. They cannot ever withdraw for the 7 year duration of the partnership. If the SEC prevails in this, it is probable that many venture

panel which has just concluded. It was most interesting and we look forward to working with you again.

Mr. Gregory and Mr. Davis, proceed.

Mr. DAVIS. You want me to start? My name is Thomas J. Davis.

Mr. LLOYD. Sure, if you wish to paraphrase or whatever you like, we will accept your testimony for the record.

Mr. DAVIS. Thank you.

Mr. LLOYD. Without objection.

[The prepared statement of Mr. Davis follows:]

we have, looking at some of the emphasis placed more on the basic research and not enough on the technology development that must be carried out?

If you have any suggestions or comments on how we might improve the situation, because this is an evaluation taking place basically within the Congress right now. Several of you I know have participated in the NSF. You may have some constructive criticism and constructive comments.

I think we are trying to find a way we can get NSF to work to a greater degree, maybe closer with NASA, some of the other agencies, maybe working with this combination that we think has to be there if we are going to have industrial innovation in this country.

Mr. LLOYD. I would remind everyone that we do have some other panels and some other questions. If you would like to respond, Mr. Green, please be brief.

Mr. GREEN. I think it is worth noting that this final program we are talking about, the NSF small business innovation research program, would not have happened if it had not been for Congress. At least, that is my impression. The Senate and the House of Representatives can make things happen, and it's true to say that sometimes things don't happen unless Congress does something.

Mr. LLOYD. Mr. Baldus.

Representative BALDUS. Thank you, Mr. Chairman.

In the last session of Congress, when I was chairing a small business subcommittee, we ran into a difficulty. There was a bill introduced that had to do with solar energy, and really the alternate energy sources, which is very much in the national interest. We asked the Department of Energy to come over and testify on a bill, and they were in opposition to it, but one of the questions we asked them is, How many people do you have who deal with small business? And the answer, after a little bit of shuffling, was one which later we found out was not a full person, they had other scientists. When we asked the Small Business Administration, How do you deal with these alternate energy things, which is again the national interest, they said—well, let me add first the Department of Energy says there are so many of them and we really don't know how to handle them, we just have a category or place, it's easy for them to deal with the large major firms, who always come in with the right kind of contracts and all that, small businessmen have a lot of loose ends and things just aren't nice and neat.

When we asked the Small Business Administration, they said, "Well, you know, a lot of these ideas we don't know how to evaluate them, if they are nutty or kooky or out of the bin, so we don't do anything." What it amounted to, neither agency was addressing the problem. We knocked the heads together a bit and finally passed the bill.

Incidentally, Mr. Evans isn't here any more. We ran into the same problems, incidentally, when we were passing a bill that had to do with some loans and perhaps some grants, and different kinds of loans, the track record of profitability, that usually is a threshold, is something that we had to deal with. I have got a guy with a new subcorporation, he might have a track record of profit built in some other company, now he is into something new that he is trying to develop. We are talking about solar. There isn't too much

As a matter of fact, when our wastewater treatment process became successful, Union Carbide paid us about $500,000 as an initial payment. The first thing our bank did, instead of congratulating us, was to ask us to pay some of that money in to them to reduce the secured loan that we had.

Mr. EVANS. Well, recognizing the unique nature of your type of business, do you think that any legislation that we consider should include a Government consideration of technology as a collateral?

Dr. LEVIN. I don't know how you can force a bank to say——

Mr. EVANS. I am not talking about a bank. I am talking about the governmental agencies. I am talking about SBA and other governmental agencies which are set up to help especially in this time of high interest rates, to help small business.

Dr. LEVIN. I would agree with Mr. Morse in the first panel. If the Government agencies would stop being so afraid that these innovative companies were going to cheat them out of a little bit of money they could guarantee loans and make loans, and lose far less money than they spend at the present time with the one-on-one system by which they watch us whenever we work for them.

Mr. EVANS. We might have a system of powdering coal that would replace some of our petroleum needs now if we had had this kind of policy in the past. Would you agree?

Dr. LEVIN. Yes.

Mr. GREEN. Mr. Evans, it is probably interesting to note that in the recommendations that have come from the number of studies that have gone on last year, I cannot recall a single one—there may be, but I cannot recall a single recommendation—that the Small Business Administration should do anything.

Maybe there are some, but I cannot recall a single recommendation that recommends that the SBA get involved in any way. When you talk of Government loans, which might or might not come through the SBA, in my opinion—and as I understand—that certainly did not surface as a priority recommendation.

What did surface had to do with tax incentives, things that would affect capital formation, patents, Government procurements. But nowhere in any of the committees I was involved with recommended that the SBA should get involved more and do something, as I recall.

Mr. EVANS. Are you saying that the SBA should not get involved or legislation should not be formulated which would provide for assistance?

Mr. GREEN. I think it was interesting to note that these experts who convened and met did not recommend further actions by the SBA.

Mr. EVANS. I am asking about you, though.

Mr. GREEN. I concur with these recommendations that I helped make.

Mr. EVANS. Yes, sir.

Mr. KARIOTIS. In all of our comments we have made, we have not discussed one program which is quite successful; that is, the National Science Foundation work with small business.

Our work with the National Science Foundation is only a small part of our typical offering of engineering services. We find that

This is the kind of problem we are working ourselves into. Obviously, the comments we heard from the first panel relate to this kind of attitude.

Nobody needs this kind of headache if there were a way around it. I would never consider applying for Government funds if some funds were available any other way. But venture funding dried up 10 or 12 years ago.

Money is not available today, so I don't see any alternative. I really want to urge Congress to rapidly generate some sort of legislation to help, not only small businesses, but anybody that can create new technology, because without it, we will sink.

Mr. FUQUA. Thank you.

Mr. Lloyd.

Mr. LLOYD. Mr. Chairman, these appear to be a series of horror stories once again describing our governmental processes. I would remind you gentlemen by way of comment, the problem that we face on the political side is that when we go forward with some studies which may or may not be productive, we instantaneously are attacked by the press for wasting the public's money.

Unfortunately we do not couch our studies in the right language. Of course, we try to solve these problems, and may end up with legislation which is more stifling.

Somebody has an idea on how he is going to save energy. I don't know whether it will work or not, but if you send it over to the Department of Energy or any of the agencies, they instantaneously tell you what is wrong with it.

The same way in the military. If a military weapons system doesn't take 10 years to develop and cost about $5 billion, it is not worth looking at by our Department of Defense.

We have a little outfit called WWMCCS which we have been working on for several years. I believe we are into about the $15 billion range. Not one person over there will admit they may be on the wrong track.

I am just delighted with the representation we have here on this panel because it is your stories that need to be told. I just hope that we on this side are able to synthesize all of this and take appropriate action because if we don't do it, we have indeed wasted even more of your precious time.

Thank you very much for joining us today. It has been not only interesting but most revealing.

Mr. FUQUA. Mr. Carney.

Mr. CARNEY. Thank you, Mr. Chairman.

We indeed do have a unique panel here because they have managed to be successful in that environment. From listening to the members of the panel, I guess one of the things that you have to do when you deal in that environment is you have to maintain a sense of humor.

I think that all of you have, and all of you have been able to be successful.

I can only say that I am concerned about several of the statements, in particular the statement that Dr. Levin had mentioned about when he has to compete with Government, and Government is coming and taking away his inventions.

overhead payment so that it can do in-house R. & D. which subsequently may benefit them.

"As a small company, you have nothing to offer us, and therefore we don't allow in-house R. & D."

Mr. FUQUA. Dr. Levin, you mentioned the regulation, and you first thought that the purpose of the Small Business Administration was to hinder you, not to help you.

One of the recommendations of the committee was that we have a review of regulations and that they try to be simplified and streamlined so that many of the problems I assume that you were referring to could be eliminated or less burdensome.

Does anyone want to elaborate on that? Apparently that is one of the big problems that face not only small business but all business, and probably most all Americans that are in some type of enterprise.

Mr. GREEN. Mr. Chairman, I would argue that we don't need a review. We need some relief from them. There have been a number of reviews. I think we simply need some relief from these regulations.

Dr. LEVIN. An example, Mr. Chairman, might be what happened to us in our second year, when we were fortunate enough to get two contracts at the same time. The Small Business Administration called us up. I thought, gee, we are going to get some help.

Not so. They told us that they had seen the dual award, they had concluded we couldn't fund two contracts at once, and were recommending we drop one. They don't understand small business. We would rather die than drop a contract.

They imposed upon us an arduous burden of completing literally a 1-inch thick sheath of documents to demonstrate that we had the financial capacity. We had to prepare a 5-year cash flow, which we have never done since, but we were able to do it after 10 days, night and day.

But I would submit that is a bad kind of exercise to put a small company through.

Dr. KLEIN. Indeed it is extremely difficult for small companies to satisfy the Government regulations. I see that the Government agencies——

Mr. FUQUA. You mean in the area of ability to perform?

Dr. KLEIN. To perform, and in general, the complexity of reporting requirements as well as in the complexity of the proposals needed to satisfy the whole bureaucracy, which is really set up to deal with large corporations. It is not productive to require the same kind of performance from a small organization, that often would rather drop a contract if they can rather than supply all this data, which really could bankrupt a company.

We were on the verge of really dropping the whole idea of getting Government support, simply because so much was required. This was the National Science Foundation, which indeed want to support small businesses.

But the bureaucracy is not set up to cater to small business. I really——

Mr. FUQUA. The National Science Foundation?

Dr. KLEIN. Yes. I would really like to urge the Government to institute in addition to financial help also assistance in how to