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Losing Rights to Intellectual Property: The Perils of Contracting with the Federal Government

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No Written Assurance Needed

Last year's National Defense Authorization Act amended 10 U.S.C. section 2320(b) to eliminate the requirement for contractors to furnish written assurance that technical data delivered to the DOD was complete and accurate and satisfied the contract requirements.[2070] This year the DOD issued an interim rule amending the DFARS to implement this legislative change.[2071] The interim rule amends DFARS subpart 227.71, by deleting the references to the prior requirement for written assurances, and removes the Declaration of Technical Data Conformity clause at DFARS section 252.227-7036.[2072] While reducing the amount of paperwork for contractors, the change "does not diminish the contractor's obligation to provide technical data that is complete and adequate, and that complies with contract requirements."[2073]

Out of the FAR and Into the DFARS

Last year's *Year in Review* reported on the FAR Councils' proposed revisions to FAR part 27.[2074] Included among the proposed changes was the deletion of the Patent Rights—Retention by the Contractor (Long Form) clause found at FAR section 52.227-12, because the DOD is the only agency that uses the clause.[2075] Based on this proposed change, the DOD proposed amending the DFARS to include a clause "substantially the same as the clause at FAR section 52.227-12."[2076] As the clause addresses patent rights under contracts awarded to large businesses for experimental, developmental, or research work, the clause will be titled Patent Rights—Ownership by the Contractor (Large Business).[2077] The proposed clause also includes "changes for consistency with current statutory provisions" and the proposed changes to FAR part 27.[2078]

Major Kevin Huyser.

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Ervin and Associates, Inc. v. United States

In a case of first impression, the COFC, in *Ervin and Associates, Inc. v. United States* (*Ervin*),[2079] construed the scope of the "Rights In Data-General" clause at FAR section 52.227-14. The outcome of this case calls for government contractors to have a sophisticated, even nuanced, knowledge of the relevant statutes and regulations governing the procurement of technical data, as well as the underlying intellectual property laws.[2080] Without such knowledge, government contractors risk unknowingly forfeiting their rights to technical data and other intellectual property. Contractors must learn the benefits to using available standard contract clauses to protect valuable intellectual property instead of allowing such clauses to disadvantage the contractors themselves.[2081]

In *Ervin*, the HUD sent out RFPs to procure a computerized system to automate the loan portfolio management of multifamily apartment projects.[2082] Regulations required owners of these loans to submit each year an audited annual financial statement (AFS) to the HUD.[2083] The HUD sought to electronically collect the AFSs and automate the analysis as

[2070] Pub. L. No. 108-136, § 844, 117 Stat. 1392, 1552 (2003).

[2071] Defense Federal Acquisition Regulation Supplement; Written Assurance of Technical Data Conformity, 69 Fed. Reg. 31,911 (June 8, 2004) (to be codified at 48 C.F.R. pts. 227 and 252).

[2072] *Id*.

[2073] *Id*.

[2074] *2003 Year in Review*, *supra* note 29, at 150.

[2075] *Id*. (referencing 68 Fed. Reg. 31,790, 31,811).

[2076] Defense Federal Acquisition Regulation Supplement; Patent Rights—Ownership by the Contractor, 69 Fed. Reg. 58,377 (proposed 30 Sept. 2004) (to be codified at 48 C.F.R. pts. 227 and 252).

[2077] *Id*. at 58,379.

[2078] *Id*. at 58,378.

[2079] 59 Fed. Cl. 267 (2004).

[2080] *Id*. at 270.

[2081] *See* Ralph C. Nash & John Cibinic, *The FAR "Rights in Data—General" Clause: Interpreting Its Provisions*, 18 NASH & CIBINIC REP. 5 ¶ 19, at 70 (2004).

[2082] *Ervin*, 59 Fed. Cl. at 270.

[2083] *Id*.

to whether the AFSs complied with HUD regulations and any other data manipulation requested.[2084] The HUD made several amendments to its initial proposal because the projects costs exceeded HUD's funding limitations.[2085] The HUD removed the requirement that the successful contractor develop a "trend analysis" comparing the current year forms with those of the previous two years.[2086] Most importantly, the HUD reduced the number of AFS forms to be reviewed from 100% to 30% of HUD's multifamily portfolio.[2087] Out of all of the offerors, Ervin reduced its price the most and was awarded the contract.[2088] Ervin maintained that it was able to reduce its bid from $39,428,625 to $12,328,000 because the amendments eliminated some of the original HUD requirements.[2089] Because of this scope reduction, Ervin would maintain ownership over any database improvements and consequently was comfortable reducing its performance price significantly.[2090]

Even though the HUD eliminated the contract requirements for the successful contractor to provide a comprehensive computer database, do trend analysis, and review 100% of HUD's portfolio, Ervin decided to do a significant amount of work that was originally requested at no extra charge.[2091] That is to say, Ervin thought the HUD would need a "comprehensive computer database of financial statement data for all of its multifamily loans in the future."[2092] Ervin, thus, agreed to deliver to the HUD "reviews of all information entered into its database for each of HUD's 16,000 properties" as well as engage in trend analysis.[2093] In its best and final offer, Ervin hailed the company's "ability and desire to provide incremental value at no incremental cost."[2094] The resulting contract incorporated by reference Ervin's technical proposal.[2095]

Once performance began, Ervin provided the HUD with almost all of the data and computer programs Ervin had created. Ervin did not mark this data or these programs as proprietary, but declared that the HUD possessed no rights to give or share Ervin's intellectual property to other contractors.[2096] Although some employees agreed that the HUD had no rights to Ervin's intellectual property, other employees made Ervin's technical data and computer software available to competitors.[2097] Because Ervin could not stop the HUD from disseminating its property, Ervin sued the HUD and other complicit contractors; consequently the HUD terminated Ervin for default.[2098] Thereafter, the HUD and Ervin settled their differences, except for the intellectual property disputes.[2099] Ervin filed claims with the Office of the Chief Procurement Officer to seek recourse for HUD's improper disclosure of Ervin's intellectual property to its competitors.[2100] All claims were denied; Ervin filed a second complaint to the COFC.[2101]

Ervin's complaint comprised several claims against the HUD including, *inter alia*, breach of contract, constructive change to the contract, and copyright infringement. The COFC dismissed all counts on summary judgment.[2102] The most critical issue the court addressed was whether the standard FAR "Rights In Data-General Clause" was read into the AFS Contract. Although the AFS Contract referred to this clause, there was no specific language incorporating it by reference, in contrast to other FAR sections expressly included.[2103] In interpreting the contract, the court treated the "Rights In Data-General Clause" as "missing language" necessary to bring meaning to the contract, or in the alternative, the court placed the

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[2084] *Id*. at 271.

[2085] *Id*.

[2086] *Id*.

[2087] *Id*.

[2088] *Id*. at 273.

[2089] *Id*.

[2090] *Id*.

[2091] *Id*. at 272-73.

[2092] *Id*. at 272.

[2093] *Id*.

[2094] *Id*.

[2095] *Id*. at 273-74.

[2096] *Id*. at 277-85.

[2097] *Id*. at 276, 279, 281-82.

[2098] *Id*. at 283.

[2099] *Id*. at 285-86. During settlement, the HUD agreed to convert the termination for default to a termination for convenience.

[2100] *Id*. at 287.

[2101] *Id*. at 288.

[2102] *Id*. at 303-04.

[2103] *Id*. at 294.

burden on Ervin, as an experienced contractor, to take action to bring this patent ambiguity to the Government's attention. Consequently, the court incorporated the clause into the AFS contract. The court concluded that the result of reading the clause into the AFS contract meant that the HUD would have unlimited rights to Ervin's technical data, despite the fact that there are portions of FAR section 27.404 that would not require Ervin to grant the Government unlimited rights.

In FAR section 27.404 (b), a contractor has a right to withhold limited rights and restricted software data from the Government, except when an agency has a need to obtain delivery of such data and software. When this is necessary, the "Rights In Data-General" clause may be used with its Alternates II[2104] or III[2105] that put the burden on the contracting officer to selectively request the delivery of limited rights data and restricted software.[2106] As part of the negotiations between the Government and the contractor, the contract may specify what data and restricted software the contractor will deliver and, if delivered, the Government will obtain limited rights.[2107]

In *Ervin*, however, the contracting officer did not make such a request and Ervin did not specifically identify data or restricted software. The court found that all data and software delivered fell under the "Rights In Data-General" clause without reference to whether the contracting officer should have added Alternates II and III to the clause.[2108] The court places the burden on the contractor to have affixed the appropriate notice and clauses to the data and software. Without such, delivery defaulted to granting unlimited rights to the HUD.[2109] Even if the data and software were developed at private expense, because the contractor did not withhold delivery, the Government acquired unlimited rights.[2110]

This holding should alert contractors that they are responsible for having the appropriate contract clauses in the contract. If the contracting officer does not add Alternates II[2111] or III[2112] to the contract, the default rule is that the Government obtains unlimited rights to data and restricted software, thus forcing the contractor to lose rights to its intellectual property inadvertently. This requires the contractor to have a sophisticated knowledge of how to appropriately contract with the Government and take action to correct errors the contracting officer makes.[2113]

The COFC also found that the AFS contract required "Ervin to provide HUD with data from the AFS forms by downloading it in a manner that can be utilized in HUD's automated systems."[2114] In making this determination, the court looked at the text of the contract but also noted that HUD did not provide Ervin with the required software that could incorporate the data for delivery. According to the court, the HUD did not breach its contract with Ervin.[2115]

In addition, the court said there was no constructive change to the AFS contract. TheHUD maintained that it had made no changes of an extra-contractual nature and, regardless, that Ervin failed to properly inform the HUD of any such changes. Apparently, Ervin made the mistake of not directly talking with the contracting officer and informing the contracting officer that the data downloads were not a contract requirement. Ervin merely spoke to those HUD employees who had access to the contracting officer and could have conveyed such information to the contracting officer. According to the court, because Ervin is an experienced contractor, Ervin knew or should have known of the requirement to inform the contracting officer directly of any issues regarding the contract.[2116] Therefore, the court found no constructive change in the contract.

In order to discontinue HUD's ability to freely give away Ervin's data to its competitors, Ervin applied for and received a copyright on certain aspects of the data.[2117] The court rejected each and every copyright infringement claim.

[2104] *See* FAR, *supra* note 20, at 27.404 (d)-(e) and 52.227-14 (g)(1)-(g)(2).

[2105] *See id*. at 27.404 (d)-(e) and 52.227-14 (g)(3).

[2106] *Id*. at 27.404 (b).

[2107] *Id*. at 27.404 (d)-(e).

[2108] *Ervin*, 59 Fed. Cl. at 297.

[2109] *Id*.

[2110] *Id*.

[2111] *See* FAR, *supra* note 20, at 27.404 (d)-(e) and 52.227-14 (g)(1)-(g)(2).

[2112] *Id*. at 27.404 (d)-(e) and 52.227-14 (g)(3).

[2113] *See* Nash & Cibinic, *supra* note 2081, at 67.

[2114] *Ervin*, 59 Fed. Cl. at 292.

[2115] *Id*.

[2116] *Id*. at 293.

[2117] *See id*. at 298.

In obtaining a copyright, Ervin sought to protect against the unauthorized use of its standardized methods and approaches. In other words, Ervin wanted to safeguard the way in which Ervin processed individual AFSs. The court, citing *Atari Games Corp. v. Nintendo of America, Inc.*,[2118] held that such subject matter is not copyrightable. "To protect processes or methods of operation, a creator must look to patent law."[2119] That is to say, to accomplish its goal, Ervin should have sought patent protection instead of copyright protection. Further, Ervin complained that the HUD reverse-engineered Ervin's system without permission. Again, the court stressed that Ervin should have received patent protection to prevent reverse engineering. Under the "Fair Use Doctrine," reverse engineering is permitted and is not a copyright infringement.[2120]

Every other concern Ervin had regarding how its computer programs and teaching materials were being used was not prohibited by copyright.[2121] Either the Government had unlimited rights because of the contract scope, or what was developed was not at private expense.[2122] The "Rights-In- Data General" clause governed the court's opinion.[2123]

Lastly, the court stated that Ervin's databases were not copyright eligible under *Feist Publications v. Rural Telephone Service*.[2124] In that case, the Supreme Court held that white pages to a telephone book, because they contain only raw facts, are not eligible for copyright protection. In *Ervin*, the COFC interpreted *Feist* as requiring a minimal degree of creativity in order for databases to be copyrightable. According to the court, because Ervin had not proffered any evidence of such creativity and the databases merely compile the intrinsic logic of the AFS forms and information the HUD specified, the databases are not copyrightable. Even if such databases were copyrightable, the court said Ervin had the duty to withhold a database in order to seek "limited rights" protection, unless delivery is required under the contract. If delivery were required, Ervin should have affixed the mandatory "Limited Rights Notice" at time of delivery, which Ervin did not do.[2125]

In summary, contractors should never voluntarily provide material not expressly requested in the contract.[2126] Any proprietary materials should be appropriately marked as proprietary. Contractors should ensure the contracting officer includes only the appropriate clauses in the contract and be able to document which material was created at private expense. The *Ervin* court did not take into account the reduced cost of the contract in exchange for Ervin keeping its intellectual property rights in material delivered. Thus, courts may not recognize such a bargained for exchange without appropriate legends affixed and clauses expressly included in the agreement.

Finally, when contracting with the Government, contractors must become more sophisticated in obtaining the appropriate intellectual property for what they are trying to protect.[2127] Knowledge of what copyright protection does versus patent protection was critical in this case.

Data Enterprises of the Northwest v. General Services Administration

In *Data Enterprises of the Northwest v. General Services Administration*,[2128] the GSBCA demonstrated its inability to adequately compensate a contractor where the Government blatantly breached its contract and distributed proprietary software to others without permission. Because the Government's breach was a copyright infringement, a cause of action over which the GSBCA has no jurisdiction,[2129] the GSBCA sought an equitable division in trying to compensate for the contractor's loss. Although the GSBCA held the Government liable,[2130] the lack of creativity in calculating damages left the contractor less than fully compensated.

[2118] 975 F.2d 832, 842 (Fed. Cir. 1992).

[2119] *Ervin*, 59 Fed. Cl. at 298 (quoting Atari Games Corp. v. Nintendo of Am., Inc. 975 F.2d 832, 842 (Fed. Cir. 1992)).

[2120] *Id*. at 299 (citing Feist Publications v. Rural Tel. Serv. Co., 499 U.S. 340, 347-48 (1991)).

[2121] *Id*. at 300.

[2122] *Id*. at 301.

[2123] *Id*. at 300-01.

[2124] 499 U.S. 340 (1991).

[2125] *Ervin*, 59 Fed. Cl. at 301.

[2126] *See* Nash & Cibinic, *supra* note 2081, at 70.

[2127] *See id*.

[2128] GSBCA No. 15607, 04-1 BCA ¶ 32,539.

[2129] *Id*. at 160,949.

[2130] *Id*. at 160,960-61.

The contractor's software is a tool for inventory management.[2131] The contract at issue was a Federal Supply Schedule, Multiple Award Schedule contract.[2132] The contract comprised acquiring licenses to use existing commercial software that was not developed at Government expense.[2133] The dispute arose because of the differing views on the Government's right to use the contractor's proprietary information.[2134] The Government had disclosed the contractor's proprietary information to a third party to develop competing software. The Government maintained it had acquired unlimited rights to such information. Conversely, the contractor maintained the Government breached the licensing agreement by disclosing the information to develop competing software to a third-party developer.[2135]

The GSBCA agreed with the contractor. Because the contractor's information was developed at private expense, it was considered restricted software.[2136] As such, the contractor negotiated specific rights with the Government that were expressly set forth in the "Utilization Limitations" clause.[2137] The "Utilization Limitations" clearly did not grant the Government unlimited rights to the software and related proprietary information.[2138] In fact, the Government promised not to disclose or copy contractor's software and proprietary information consistent with contractor's commercial license.[2139] When the Government allowed a third party access, the Government breached the agreement.[2140]

In determining what damages to award the contractor for the Government's breach, the GSBCA stated that the non-breaching party was entitled to be restored to an economic position in which it would have been had the various breaches of contract not occurred.[2141] Because calculating damages based on a reasonable royalty is a remedy for copyright infringement, and the GSBCA has no jurisdiction over copyright infringement, the GSBCA refused to award these damages.[2142] Instead, the GSBCA awarded lost profits on the contract sales the contractor would have made had there been no breach.[2143] To keep these damages solely contract related, the GSBCA insisted it could not award lost profits on transactions not directly related to the breached contract.[2144]

The GSBCA noted that giving the third party access to the contractor's information "played a critical role" in developing the competing software.[2145] The third party saved money, time, and effort in developing competing software because the Government had improperly given access to the contractor's software and proprietary information.[2146] The GSBCA took these advantages into account in calculating damages by measuring the time the Government would have had to continue licensing from contractor because the competing software was not yet available.[2147] The GSBCA stated that it was clear from the evidence that the Government was able to replace contractor's system more quickly through using its proprietary information in developing the competing software.[2148] Accordingly, the GSBCA determined that it would have taken another ten months for the Government to develop the software had it not breached. Thus, the board calculated lost profits over another ten months to compensate the contractor.[2149]

[2131] *Id*. at 160,950.

[2132] *Id*.

[2133] *Id*. at 160,953.

[2134] *Id*. at 160,952.

[2135] *Id*. at 160,952-53.

[2136] *Id*. at 160,956.

[2137] *Id*. at 160,955.

[2138] *Id* at 160,955-56.

[2139] *Id*. at 160,958.

[2140] *Id*. at 160,961.

[2141] *Id*. at 160,963.

[2142] *Id*. at 160,964. This damage characterization sounds like reliance damages, but the GSBCA actually attempts to award expectation damages. For a discussion on contract remedies, see E. ALLAN FARNSWORTH, CONTRACTS §§ 12.1-12.3 (4th ed. 2004).

[2143] *Id*.

[2144] *Id*.

[2145] *Id*. at 160,963.

[2146] *Id*. at 160,965.

[2147] *Id*.

[2148] *Id*.

[2149] *Id*. at 160,967.

Unfortunately, the contractor was limited to contract damages and did not receive damages for copyright infringement, which would have significantly increased the compensation level. Indeed, the GSBCA could have been more creative in calculating damages. For example, restitution is a contract remedy.[2150] The GSBCA could have calculated how much the Government was unjustly enriched by the breach. Such unjust enrichment could have been calculated from the record, which showed that for the Government to have received permission to disclose the software to a third party the contractor would have required an "up front" $1,000,000 fee plus a royalty on all sales of the resulting competing software licenses.[2151] Although expectation damages are the general measure of damages in breach of contract cases, the board could make an exception here to more adequately compensate the contractor for the Government's breach.

Major Katherine White.

Major Systems Acquisition

The Defense Acquisition Guidebook

As discussed in last year's *Year in Review*, the DOD issued its revised and streamlined 5000 series regulations on 12 May 2003 to remove restrictions and give program managers greater flexibility.[2152] In addition to implementing a new directive[2153] and instruction,[2154] the DOD replaced the prior regulation,[2155] a 193-page document, with an *Interim Defense Acquisition Guidebook* (*Interim Guidebook*).

On 8 October 2004, the DOD replaced the *Interim Guidebook* with an "electronic" *Defense Acquisition Guidebook* (*Guidebook*).[2156] The memo introducing the *Guidebook* states that while last year's issuance of a new directive and instruction "explain 'what' acquisition managers are required to do, the [*Guidebook*] complements those documents by explaining 'how.'"[2157] The *Guidebook* provides "non-mandatory staff expectations" for meeting the requirements in the instruction.[2158] And as the *Guidebook* advertises, it is much more than a "book;"[2159] it is an interactive resource with different viewing settings,[2160] internal links, as well as links to statutes, regulations and lessons learned.

DFARS Part 242 Gets Even Slimmer

As part of the DFARS Transformation initiative, the DOD proposed making part 234, Major System Acquisition, slimmer by deleting or moving language to other DFARS parts.[2161] For example, the proposed rule deletes the definitions of "systems" and "systems acquisition" from the definitions at DFARS section 234.001 because the terms are not used elsewhere in part 234.[2162] The proposed changes also move the text on "earned value management systems (EVMS)" from

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[2150] *See* RESTATEMENT (SECOND) OF CONTRACTS, § 371 (1981); *see also* FARNSWORTH, *supra* note 2142, § 12.3.

[2151] GSBCA No. 15607, 04-1 BCA ¶ 32,539, at 160,964.

[2152] *2003 Year in Review*, *supra* note 29, at 144-46.

[2153] U.S. DEP'T OF DEFENSE, DIR. 5000.1, THE DEFENSE ACQUISITION SYSTEM (12 May 2003), *available at* http://dod5000.dau.mil/DOCS/DoD%20Directive%205000.1-signed%20(May%2012,%202003).doc.

[2154] U.S. DEP'T OF DEFENSE, INSTR. 5000.2, OPERATION OF THE DEFENSE ACQUISITION SYSTEM (12 May 2003), *available at* http://dod5000.dau.mil/DOCS/DoDI%20h5000.2-signed%20(May%2012,%202003).doc.

[2155] U.S. DEP'T OF DEFENSE, REG. 5000.2-R, MANDATORY PROCEDURES FOR MAJOR DEFENSE ACQUISITION PROGRAMS (MDAPS) AND MAJOR AUTOMATED INFORMATION SYSTEM (MAIS) ACQUISITION PROGRAMS (5 Apr. 2002).

[2156] Memorandum, Under Secretary of Defense (Acquisition, Technology, and Logistics), to Secretaries of the Military Departments *et al*., subject: The Defense Acquisition Guidebook (9 Oct. 2004), *available at* http://akss.dau.mil/docs/GBMemo.Wynne.pdf [hereinafter Acquisition Guide Memo]. The *Defense Acquisition Guidebook* is available at http://akss.dau.mil/dag.

[2157] Acquisition Guide Memo, *supra* note 2156.

[2158] *Defense Acquisition Guidebook*, Document View, foreword *available at* http://akss.dau.mil/dag.

[2159] *Id*.

[2160] *Id*. There are three ways to view and navigate through the Guidebook's information: (1) the Document View allows review of information page-by-page, (2) the Lifecycle Framework view permits review of statutory and regulatory requirements and related best practices for each milestone and acquisition phase, and (3) the Functional/Topic View provides comprehensive discussions of key acquisition topics. *Id*.

[2161] Defense Federal Acquisition Regulation Supplement; Major Systems Acquisitions, 69 Fed. Reg. 8155 (proposed Feb. 23, 2004) (to be codified at 48 C.F.R. pts. 134, 242, and 252).

[2162] *Id*. at 8156.