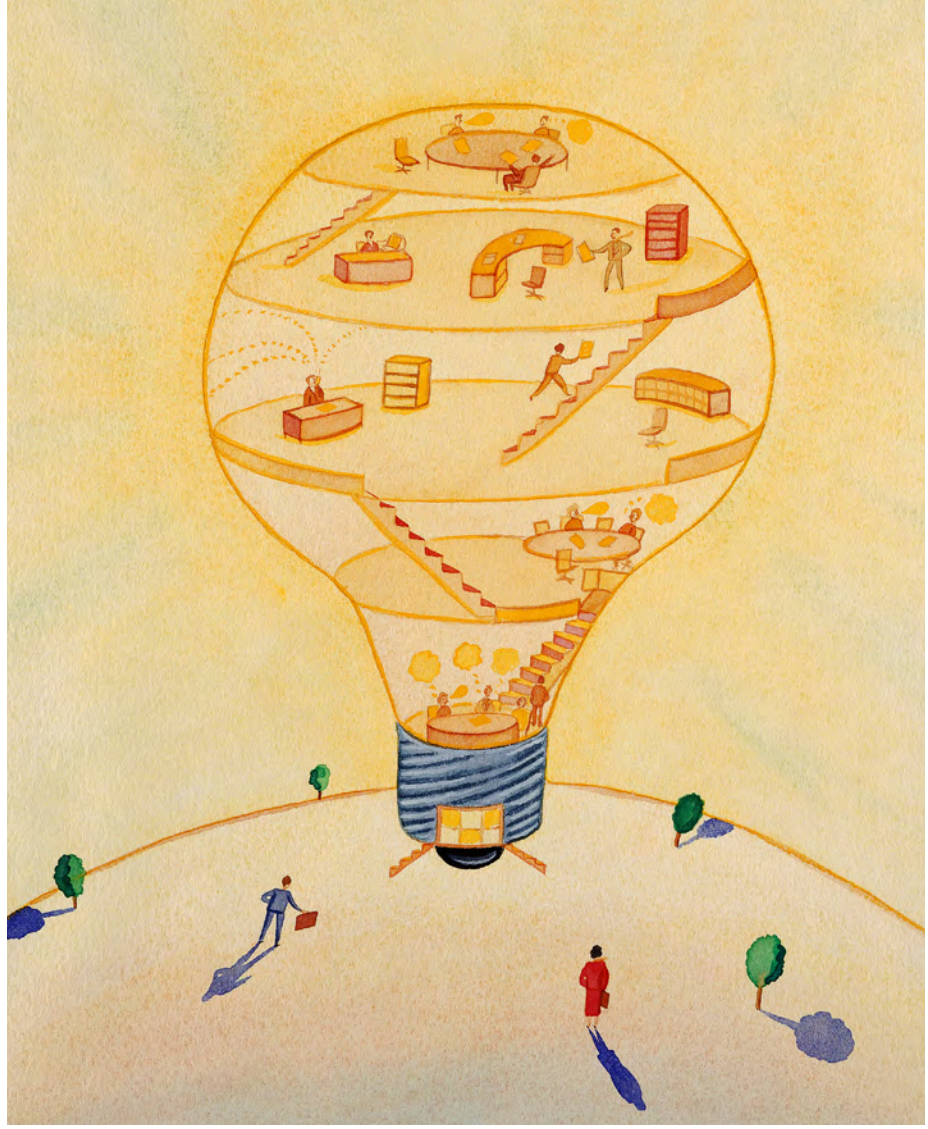
Protecting Subcontractors' Intellectual Property in Government Contracts: Trades Secrets and Proprietary Data



By Taylor M. Norton

Intellectual property may take one of many well-known forms, such as patents, trademarks, and copyrights, but it may also exist in a lesser-known yet highly valuable form of trade secrets and proprietary data. In the context of government contracts, such information may be as valuable to a contractor or subcontractor as the contract itself because of the possibility of follow-on contracts. It naturally follows that there is noteworthy interest in protecting this intellectual property, and one way to protect it is by precluding the dissemination of such information to competitors.

The right of exclusion—that is, the right to exclude others—has been coined as "one of the most essential sticks in the bundle of rights that are commonly characterized as property."[1] "With respect to a trade secret, the right to exclude others is central to the very definition of the property interest. Once the data that constitute a trade secret are disclosed to others, or others are allowed to use those data, the holder of the trade secret has lost his property interest in the data."[2]

In the context of Department of Defense (DOD) contracts, rights in the technical data that a subcontractor furnishes to the government are governed by not only the express provisions on the face of the contract documents but also the Defense Federal Acquisition Regulations Supplement (DFARS)—which are incorporated by reference into the contracts. Subcontracts often incorporate by reference the form contract clause, "Rights in Technical Data-Noncommercial Items," as found in the DFARS at 48 C.F.R. § 252.227-7013. Pursuant to that DFARS clause, and as incorporated into a subcontract, the subcontractor grants the government certain rights to the subcontractor's intellectual property. For the unwary subcontractor, the clause may give away more than the subcontractor may desire or can afford to give away.

In order to understand what property stands to be lost, one must first appreciate what intellectual property is granted to the government in the first place.

What Intellectual Property Is Granted to the Government?

In contracts that incorporate by reference DFARS 252.227-7013, the government is granted certain license rights in technical data that is developed at the government's expense and/or delivered to the government under the government contract or data that is developed at private expense yet inadequately protected by the developing contractor or subcontractor. Generally, the government is granted one of three standard licenses that define the license rights: an unlimited rights license, a government purpose license, or a limited rights license. Even though the government's stated policy is to obtain only the minimum necessary rights in technical data,[3] that may not always seem to be the case to the contractors and subcon-

tractors engaged in litigation with the government.

When the government receives *unlimited* rights in a subcontractor's technical data, the government has the right to use, modify, reproduce, perform, display, release, or disclose the technical data in whole or in part in any manner and for whatever purpose whatsoever. In addition, an unlimited rights license gives the government the right to authorize others to do so.

By comparison, when the government receives *government purpose* rights to a subcontractor's technical data, the government may use the technical data in "any activity in which the United States Government is a party." This right may be interpreted to mean that all uses are authorized as long as they are within the parameters of an agency's legally authorized programs.[4]

By further comparison, when the government receives *limited* rights in a subcontractor's technical data, the government has the right to use, modify, reproduce, release, perform, display, or disclose the technical data, in whole or in part, *within the government*. When the government receives only limited rights in the technical data, the government may not, without written permission of the subcontractor, release or disclose the technical data to any party outside of the government, such as to the subcontractor's competitors. (There are narrow exceptions to this right, such as release of disclosure in order to do emergency repairs.)

The inherent risk to a subcontractor's intellectual property is that when a subcontractor provides the government with unlimited rights to proprietary technical data, such data no longer constitute the subcontractor's trade secrets.[5] Consequently, the subcontractor loses its property interest in the data. Losing the right to exclude others from the use of certain proprietary technical data may amount to losing a competitive edge in an industry.

Protecting a Subcontractor's Intellectual Property from the Government

Courts have generally stressed that demonstrative steps taken to protect the proprietary nature of technical information will support the protection of proprietary data. Courts have also recognized that "[t]he DFARS contemplate a way for contractors to protect their trade secrets" and that a contractor needs to take advantage of those protections to avoid losing its trade secrets.[6] An essential element for the protection of the proprietary nature of the subcontractor's data is to maintain secrecy. In other words, a subcontractor needs to take steps to preclude the dissemination of information to others.

Ralph C. Nash, professor emeritus at George Washington University's Law School, has pointed out that, from the viewpoint of a contractor, the only policy that ensures that technical data will not be disclosed to competitors or other third parties is a contractual agreement that permits the withholding of proprietary data from the government.[7] However, as Professor Nash has also written, in the context of DOD contracts, the Defense Department found that permitting contractors to withhold proprietary information from delivery to the government was not a viable option, because the DOD needs a substantial amount of proprietary information to carry out its mission. Thus, the DOD adopted the current policy of protecting proprietary rights to technical data by agreeing to accept technical data with limited rights legends. Accordingly, under DFARS 252.227-7013, the foremost element in protecting a subcontractor's proprietary data is to mark the data with protective markings such as restrictive legends or proprietary legends, and recent court rulings have strictly adhered to such provisions. That same DFARS clause requires the subcontractor to identify and list certain data that are to be furnished with restrictions.[8]

A prime example of this principle was illustrated by the U.S. Court of Federal Claims in *Night Vision Corp. v. U.S.* in 2005,[9] in which the court held that the contractor waived any legal protection from disclosure of data rights when it delivered prototypes to the government without marking the prototypes or their packaging with appropriate proprietary data legends. In implementing a strict adherence to the marking requirements, the *Night Vision Corp.* ruling provided an explanation for doing so:

> To read an exception into the regulation … would undermine the entire purpose of restrictive legends. Restrictive legends alert all government officials—even those unfamiliar with the data rights of the contractor—that data is considered proprietary and is inappropriate for dissemination. Creating exceptions to the restrictive rights requirement would place government officials in the difficult position of being unsure which data was subject to restrictions and which was not.[10]

In its ruling, the Court of Federal Claims clearly and unequivocally stated that a failure to use the appropriate legend results in the government's receiving complete and unrestricted use of technical data developed and delivered by contractors. Accordingly, that technical data cannot be protected from disclosure to competitors.

Similarly, in a case heard by the U.S. District Court for the Eastern District of Louisiana in 2008—*L-3 Communications Westwood Corp. v. Robichaux*—the issue was whether the technical data, in the form of source codes, were the subject of efforts to maintain their secrecy—efforts that appeared reasonable under the circumstances. In finding that, "as a matter of law, they were not," the court specifically reasoned that "[g]ranting the government unlimited rights to data without any restrictive legend or markings constitutes a failure to maintain secrecy."[11] Accordingly, the court found that, because the contractor had provided the government with unlimited rights to all of the source codes at issue, they were no longer trade secrets. Thus, "because plaintiff did not use efforts reasonable under the circumstances to maintain the secrecy of the alleged trade secrets in the source code," that intellectual property was no longer protectable by any misappropriation action under the Uniform Trade Secrets Act.[12] *L-3 Communications Westwood Corp.* recognized the principle previously set forth by the Fifth Circuit Court of Appeals

in *Sheets v. Yamaha Motors Corp.*:[13] a "disclosure of a trade secret to others who have no obligation of confidentiality extinguishes the property right in the trade secret."

When a contractor or subcontractor adequately complies with the identification and marking requirements in an effort to maintain the trade secrecy of proprietary technical data, the courts will recognize and afford protection of such intellectual property.

It may have been April Fools' Day, but it was no practical joke when Hon. Carl J. Barbier of the U.S. District Court for the Eastern District of Louisiana rendered the court's findings of facts and conclusions of law on April 1, 2010, in the case of *United States Marine Inc. v. U.S.*[14] The court found that the government had misappropriated the proprietary ship design owned by two contractors by disclosing the design to a competitor shipyard without the consent or permission of either contractor. In *United States Marine Inc.*, the U.S. Navy, through its Special Operations Command (SOCOM), awarded two test craft contracts to one contractor, and each contract incorporated by reference DFARS clause 252.227-7013 concerning rights in technical data. Under each contract, the contractor delivered to SOCOM design drawings and technical data "clearly marked with a 'limited rights legend' as prescribed by DFARS 252.227-7013, which allowed the government or SOCOM only limited rights in the drawings and data." The district court recognized that the designs "constitute proprietary information and trade secrets owned by the plaintiffs," because they "had independent economic value from not being generally known and readily ascertainable by proper means by persons who could obtain value from their disclosure."[15]

In *United States Marine Inc.,* the court found that "[b]oth the contractual provisions and limited rights legends were sufficient notification to the government that disclosure of the [proprietary] Mk V design would violate a duty to its owners."[16] The court acknowledged that, in addition to including limited rights legends or references within the proprietary drawings and contracts, the two contractors had also restricted access to their proprietary designs and data in various ways, including limiting access to certain employees and requiring employees to sign nondisclosure agreements. The court concluded that the companies "always treated the … design data as proprietary trade secrets, using various procedures to protect critical information from public disclosure," and accordingly, the court afforded protection to the contractors by way of the viable action they took against the government for misappropriation of their trade secrets. It is worth noting that it was clear to the court that, even though this case did not involve a breach of contract, the government contract, which incorporated by reference DFARS clause 252.227-7013, would "play a role in this case" to demonstrate how the government came to possess the proprietary design data and "to provide the underpinnings" of the state law trade secret argument."[17]

These recent cases demonstrate that subcontractors should make every effort to strictly adhere to the marking and identifying requirements set forth in the DFARS clause that is incorporated by reference into the subcontract in order to protect the subcontractor's proprietary technology. Otherwise, failure to comply with such requirements may grant the government unlimited rights to subcontractor's technical data, resulting in a loss of valuable property belonging to the subcontractor. Similarly, the subcontractor should also be fully aware of the rights being granted to the prime contractor by the delivery of subcontractor's technical data under a subcontract that incorporates DFARS 252.227-7013 and therefore should identify and mark proprietary data and pay attention to the flow-down provisions.

Protecting a Subcontractor's Intellectual Property from the Prime Contractor

Subcontractors are afforded certain protections under DFARS clause 252.227-7013 against over-reaching contractors.[18] For instance, contractors are precluded from using their power to grant contracts as economic leverage when negotiating and obtaining rights to subcontractors' technology when awarding subcontracts. In addition, when a prime contractor calls upon a subcontractor to deliver proprietary technical data (that is, limited rights data) in fulfillment of an obligation under the prime contract, the subcontractor may deliver that data directly to the government, thereby bypassing the prime contractor. Bypassing delivery to the prime contractor would be an affirmative step toward protecting the secrecy of a subcontractor's technical data, but this practice may prove impractical in light of a prime contractor's likely need to ascertain and integrate such data with other subcontractor-provided data as part of the prime contractor's overall work product. A more practical method of protecting the proprietary nature of the subcontractor's technical data—allowing protected delivery to the prime contractor—is to enter into a separate confidentiality agreement with the prime contractor that restricts the prime contractor from further use or disclosure of the subcontractor's technical data.

When a subcontractor fails to implement the protections afforded under DFARS 252.227-7013 and fails to maintain the elements of secrecy, the subcontractor will not be entitled to protection for alleged trade secret technology when it is delivered and disclosed to the prime contractor.

This was the case in *Plainville Electrical Products Co. v. Bechtel Bettis Inc.*, which was heard by the U.S. District Court for the District of Connecticut in 2009. In this case, the subcontract incorporated by reference the standard DFARS terms of 252.227-7013, including the provision that the prime contractor was to have "unlimited rights in technical data that are … developed exclusively with government funds." In addition, the subcontract's technical specifications expressly provided that "[a]ll drawings and other documentation shall become the property of [prime contractor] and can be used by [prime contractor] as deemed necessary."[19] Interpreting these provisions, the district court determined that the prime contractor had unlimited rights to the technical data that had been developed and delivered by the subcontractor.

In dismissing the subcontractor's breach of contract

claim, the court indicated that no data restrictions had been identified by the subcontractor and that there was no agreement that any of the technical data could retain restrictive markings.[20] The court emphasized that the parties "chose not to exercise the opt-out right" in the DFARS provision in 252.227-7013(e)(2), which permits the parties to choose specific items that may retain their proprietary/restrictive markings. In ruling against the subcontractor's claim for misappropriation of trade secrets, the court also emphasized that the DFARS provisions at 252.227-7013(e)(2)-(3) provide a mechanism for protecting trade secrets and that the parties had chosen not to use it. Because the subcontract gave the prime contractor the unlimited right to use, distribute, or disclose the data, there can be no "misappropriation" of the subcontractor's data, and therefore there were no trade secrets to claim.[21] To the extent that the subcontractor had provided its trade secrets to the prime contractor without restricting the prime contractor's use of those data, the subcontractor was "precluded from arguing that it took the necessary steps to preserve the secrecy of that data as a matter of law."[22]

Plainville Electrical Products Co. demonstrates that a subcontractor's trade secrets are not protected ipso facto by the mere existence of DFARS 252.227-7013; rather, this DFARS clause provides a mechanism under which subcontractors may take active steps toward protecting their proprietary trade secret data. Those steps include marking the data with restrictive legends and identifying in an attachment what data is to be furnished subject to such restrictions.

Flow-Down of DFARS Clauses

For those interested in protecting a subcontractor's proprietary technical data, one possible way to properly flow down DFARS clauses applicable to a subcontractor's proprietary technical data is to expressly provide in the subcontract that, for purposes of this subcontract, the terms "government" and "contracting officer" in the DFARS clauses shall mean "prime contractor" and the term "contractor" shall mean "subcontractor," "*except for purposes of the rights to the subcontractor's intellectual property and proprietary/trade secret data*." Inserting such an exception implements and reinforces the crux of protection afforded by the DFARS clause for the subcontractor's rights to proprietary technical data—that is, the license rights granted by a subcontractor in the clause are granted to the government and not to the prime contractor. Section (k)(2) of DFARS 252.227-7013 explicitly provides that "[n]o other clause shall be used to enlarge or diminish the government's, the [c]ontractor's, or a higher-tier subcontractor's or supplier's rights in a subcontractor's or supplier's technical data." This section also provides that a "Contractor … shall not use their power to award contracts as economic leverage to obtain rights in technical data from their subcontractors or suppliers."

Negotiating Ownership Rights with the Prime Contractor

A prime contractor may not be allowed to assume unlimited rights to a subcontractor's technical data simply by virtue of subcontracting with the subcontractor, but the parties may negotiate for *ownership rights* and reduce their agreement to a written contract.[23] This is what happened in *KDH Electronic Systems Inc. v. Curtis Technology Ltd.*, which the U.S. District Court for the Eastern District of Pennsylvania heard in 2009. The court found that a teaming agreement itself defined the rights of the parties and that the existence of the DFARS clause 252.227-7013 did not alter the terms of that contract. The court found that the prime contractor had received the rights to the subcontractor's technical data by negotiating with the subcontractor for ownership rights and not simply by virtue of subcontracting with the subcontractor. The court specifically stated that the prime contractor "has not used any contractual language, or the absence of language, to impermissibly expand its rights to the … [technical data] in violation of 48 CFR 252.227-7013(k) or 48 CFR 252.227-7014(k)."

The district court also concluded that there was no

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Endnotes

[1]U.S. Government Accountability Office, *Allegations That Certain Audits at Three Locations Did Not Meet Professional Standards were Substantiated*, GAO-08-857 (July 22, 2008).

[2]Defense Contract Audit Agency, Memorandum for Regional Directors, 08-PAS-042 (R), along with an instruction letter, DCAA Instruction No. 7640.17 (Dec. 19, 2008).

[3]Defense Contract Audit Agency, Memorandum for Regional Directors, 09-PAS-004 (R) (March 13, 2009).

[4]Pub. L. No 111-21, 123 Stat. 1617 (codified at 31 U.S.C.).

[5]31 U.S.C.A. § 3729(a) (1)(b).

[6]Robert Brodsky, *Watchdog Asked to Study Contractor Salaries, Benefits*," www.governmentexecutive.com (April 1, 2010).

[7]Robert Brodsky, *High Road Contracting Policy Comes into Focus*, www.Nextgov.com (April 2, 2010).

TRADES SECRETS *continued from page 41*

showing that the prime contractor had used its economic position or position as a government contractor as leverage to take property rights away from the subcontractor. In support of this finding, the court reasoned that, in fact, the prime contractor had come to the subcontractor to design and develop a technology about which the prime contractor knew relatively little. As a result of this knowledge gap, the subcontractor was the party that had the stronger position in the negotiations over the terms of the teaming agreement, which defined the ownership rights to the technical data.

Conclusion

The Defense Federal Acquisition Regulation Supplements "are key to understanding what rights the government acquires pursuant to one of its defense contracts."[24] In contracting with the government, the DFARS contemplate a way for subcontractors to protect their proprietary data and trade secrets. A subcontractor needs to take advantage of those protections in order to avoid losing valuable trade secret technology. Accordingly, the DFARS clauses relating to intellectual property should be of particular concern to subcontractors interested in maintaining their competitive edge. **TFL**

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Endnotes

[1]*Kaiser Aetna v. United States*, 444 U.S. 164, 176 (1979).

[2]*Ruckelshaus v. Monsanto Co.*, 467 U.S. 986, 1012 (1984).

[3]Office of the Under Secretary of Defense for Acquisition, Technology And Logistics, *Intellectual Property: Navigating Through Commercial Water* (Version 1.1 2001), available at www.acq.osd.mil/dpap/Docs/intelprop2.pdf (last visited Sept. 30, 2010).

[4]Matthew S. Simchak, *Protecting Rights in Technical Data and Computer Software: Applying The Ten Practical Rules and Their Corollaries*, 33 Pub. Cont. L.J. 139, 143 (2003).

[5]*L-3 Communications Westwood Corp. v. Robichaux,* No. 06-279, 2008 WL 577560, *7 (E.D. La. Feb. 29, 2008).

[6]*Id.* at *8.

[7]Ralph C. Nash and Leonard Rawicz, Intellectual Property in Government Contracts (6th ed., 2008) Aspen Publishers Wolters Kluwer.

[8]48 C.F.R. § 252.227-7013(e)(2).

[9]*Night Vision Corp. v. U.S.*, 68 Fed. Cl. 368 (Fed. Cl. 2005).

[10]*Id.*

[11]*L-3 Communications Westwood Corp. v. Robichaux,* No. 06-279, 2008 WL 577560, *8 (E.D. La. Feb. 29, 2008).

[12]*Id.* at *5.

[13]*Sheets v. Yamaha Motors Corp.*, 849 F.2d 179, 183–184 (5th Cir. 1988).

[14]*United States Marine Inc. v. U.S.*, 2010 WL 1403958, *6, No. 08-2571 (Case 2:08-cv-02571-CJB-DEK, Document 130, Filed 04/01/10) (E.D. La. April 1, 2010), *recon. denied*, 2010 WL 2008887 (E.D. La. May 18, 2010).

[15]*Id.* at 5 (quoting *MicroStragety Inc. v. Li*, 268 Va. 249, 263 (Va. 2004)).

[16]*Id.* at 6.

[17]*See United States Marine Inc. v. U.S.*, 2008 WL 4443054, 3 (E.D. La. 2008).

[18]*See* DFARS clause 252.227-7013(k).

[19]*Plainville Electrical Products Co. v. Bechtel Bettis, Inc.*, No. 3:06cv920 (SRU), 2009 WL 801639, *6 (D. Conn. March 26, 2009).

[20]*Id.* at *8.

[21]*Id.* at *7.

[22]*Id.*

[23]*KDH Electronic Systems Inc. v. Curtis Technology Ltd.*, No. 08-2201, 2009 WL 564417, *2 (E.D. Pa. March 4, 2009).

[24]*L-3 Communications, supra*, note 5 at *6.