The USMI Decision: Putting Government Contractor Trade Secrets at Risk

By Andrew E. Shipley

The Fifth Circuit's majority panel ruling in *United States Marine Incorporated v. United States (USMI)*,[1] if allowed to stand, may severely undermine—at least in the Fifth Circuit—a contractor's ability to protect trade secrets from government misappropriation. In a sua sponte decision, the Fifth Circuit concluded that it lacked subject matter jurisdiction over a claim for which the U.S. District Court for the Eastern District of Louisiana had awarded USMI more than $1 million in damages.

The district court ruled against the United States for misappropriating USMI's proprietary design for special operations boats. The Navy obtained the design through a contract it had with a third party company with which USMI had once collaborated. That company later sold boats incorporating USMI's design to the Navy, but retained USMI's restrictive legends on all design documents and contractually provided the Navy with only "limited rights." The district court noted that the "limited rights" restrictions indicated that the Navy "could not use the designs for future manufacturing or disclose them to other parties without written permission."[2] Ignoring these restrictions, the Navy distributed the design to USMI's competitors for the design and build of the next generation craft. The Navy even told the companies to track USMI's design except for slight improvements to the craft's ride and handling.

The government conceded during oral argument that the district court had jurisdiction over USMI's claim, but the Fifth Circuit dismissed it—over a stinging dissent. The court reasoned that because the government had received USMI's designs through a prior contract with a third party, USMI's claims necessarily arose out of that contract, subjecting them to the Tucker Act[3] with exclusive jurisdiction residing in the U.S. Court of Federal Claims. The court ignored the fact that USMI held no contract with the Navy and therefore had no basis for bringing a claim for breach of express or implied contract under the Tucker Act.[4]

The Fifth Circuit in reaching its decision cited an inapposite 50-year-old case, *United States v. Smith*,[5] asserting that in *Smith*, "we relied on Tucker Act precedent to hold that tort claims brought against the government by six subcontractors sounded in contract even though the subcontractors were not parties to the prime contract between the government and the general contractor."[6]

But the *Smith* decision had nothing to do with the Tucker Act. *Smith* involved claims brought by six subcontractors that built swimming pools at an Air Force base under a general contractor that went bankrupt before paying them. The subcontractors sued the Air Force under the Federal Tort Claims Act,[7] arguing that the contracting officer's failure to obtain a performance bond from the general contractor per the Miller Act[8] constituted negligence. The government argued that the Miller Act protected the government, not subcontractors, which meant the government had no duty to the subcontractors. The *Smith* court, however, dismissed the subcontractors' claims under a separate theory. It held that the FTCA waived sovereign immunity for tort claims that could have been brought against a private person. As no private person would have any duties under the Miller Act, a failure to comply with that statute could not support an FTCA claim.

The dissent in *USMI* stated, "despite the majority opinion's description, *Smith* did not hold that the subcontractors' claims 'sounded in contract,' and did not even mention, much less rely on, the lack of privity between the plaintiffs and the government. Thus, *Smith* gives no guidance as to how this court should handle the question at issue here."[9] The dissent observed that the majority's decision likely left USMI without a remedy, as the Court of Federal Claims "would likely determine that USMI's lack of a contract with the Navy renders its claim a tort outside [its] jurisdiction."[10]

The dissent did not address whether USMI could have successfully asserted a Fifth Amendment takings claim in the Court of Federal Claims. It is worth noting, however, that in the recent case of *Demodulation, Inc. v. United States,* the government argued that the Court of Federal Claims lacked jurisdiction over a takings claim for misappropriation of trade secrets.[11]

Moreover, and contrary to the *USMI* majority decision, the government argued in *Demodulation* that trade secret misappropriation claims sound in tort, not contract, when they arise outside of a direct contractual relationship. The government originally argued that the non-disclosure agreements at issue had been signed by contractors and not the government; it later acknowledged that the signatures were those of government personnel and tried to argue that they lacked "actual authority" to bind the government. The court rejected the government's arguments, holding that the plaintiff had sufficiently pled privity of contract to bring its claim within the Tucker Act. There was no dispute that absent a contractual relationship with the government, plaintiff's claims would have properly sounded in tort.

The *USMI* decision also runs counter to a long-standing body of law that allows even parties to a government contract to assert tort claims for misconduct that goes beyond their contractual relationship. Under this body of law, the mere fact that contract-related issues may appear in the case does not convert what would otherwise be tort claims into Tucker Act contract claims. The *Megapulse*[12] case is a prime example – the Coast Guard unilaterally decided to remove all restrictions against commercial use of Megapulse's proprietary data after concluding it had not all been developed at private expense. When Megapulse sought injunctive relief in U.S. District Court, the government argued that the court lacked subject matter jurisdiction because the dispute arose out of the parties' contract. The government contended that, pursuant to the Tucker Act, Megapulse could seek relief only in the Court of Federal Claims, which lacked the ability to issue injunctive relief in contract cases other than bid protest actions.

The district court disagreed, stating that Megapulse's "position is ultimately based, not on breach of contract, but on an

alleged governmental infringement of property rights and violation of the Trade Secrets Act. It is actually the Government, and not Megapulse, which is relying on the contract, attempting to show that the Coast Guard lawfully came into possession of the property … we do not accept the Government's argument that the mere existence of such contract-related issues must convert this action to one based on the contract."

Later, in *Love v. United States*,[13] the Ninth Circuit analyzed in-depth the difference between tort claims and contract claims asserted against the government. In *Love*, the government seized and liquidated livestock and farm equipment following the plaintiffs' default on an agricultural loan. Plaintiffs argued that the government's actions violated state statutory notice requirements and constituted conversion and a breach of an implied covenant of good faith and fair dealing. The government countered that the claims arose from the loan agreement and therefore sounded in contract. The Ninth Circuit sided with the plaintiffs and cited a Third Circuit case, *Aleutco Corp. v. United States*,[14] for the proposition that the "fact that the claimant and the United States were in a contractual relationship does not convert an otherwise tortious claim into one in contract."[15]

As to the conversion claim, the *Love* court stated the plaintiffs' contract with the government served *not* to thrust the case within Tucker Act coverage, but instead to establish an element of the tort claim—namely, that the parties had a mortgagor-mortgagee relationship subject to the notice requirements that the government allegedly violated. "Under the FTCA, the federal government assumes liability for wrongs that would be actionable in tort if committed by a private party under analogous circumstances, under the law of the state where the act or omission occurred."[16]

As to the breach of good faith claim, the Ninth Circuit stated that under applicable state law, the claim required wrongful activity beyond the mere existence of a contract breach. Thus, while the duty arose due to the plaintiffs' contractual relationship with the government, "the duty exists apart from, and in addition to, any terms agreed to by the parties."[17] Thus the claim was not based entirely upon an alleged contractual promise. Under this rationale, the Ninth Circuit held that the claim properly sounded in tort under the FTCA.

The *Love* court's holding tracked the long-standing distinction between tort claims that allege a breach of duty outside the contract from claims of tortious breach of contract, such as negligent performance of the contract terms, for which jurisdiction is proper under the Tucker Act. The Fifth Circuit itself recognized the difference more than sixty years ago.[18]

In *Kramer v. U.S. Department of the Army*,[19] the Second Circuit rejected attempts to dismiss tort claims through recharacterizations that put them outside the district court's jurisdiction. The plaintiff alleged that after the Army had wrongfully terminated her contract, it disclosed her proprietary information and then awarded the contract to a competitor. Although the plaintiff sued for conversion, the district court recast her claim as one for intentional interference with contract, a claim excluded by the FTCA. The Second Circuit reversed, holding that the plaintiff's conversion claim was a claim for misappropriation of trade secrets under New York law and hence within the district court's jurisdiction under the FTCA.

Similarly, the DC Circuit in *Jerome Stevens Pharmaceuticals v. Food & Drug Administration* reversed the district court's dismissal of plaintiff's trade secret misappropriation claims.[20] The FDA posted on its website confidential trade secrets contained in a new drug application filed by Jerome Stevens. Despite Jerome Stevens' demand that the FDA remove its trade secret information from the website, much of it remained online for up to five months. As a result of this disclosure, Jerome Stevens lost millions of dollars in revenue and had to lay off half its work force. The district court dismissed the trade secret misappropriation claim by, in part, re-casting it as a claim for interference with contract rights arising out of the new drug application. The D.C. Circuit reversed, holding that the claim, reduced to its essence, alleged that the FDA induced plaintiff to disclose its trade secrets in confidence and then disclosed them to others in breach of that confidence. Such a claim, the D.C. Circuit ruled, sounded in tort.[21]

It is hard to reconcile the majority's opinion in *USMI* with this backdrop of well-established case law that trade secret misappropriation claims sound in tort when they arise outside of a contractual relationship. Even parties in

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[33]*Id.* at 8-9 (noting annual appropriations ranging from $91 million to $125 million).

[34]*Cherokee*, 543 U.S. at 636-37.

[35]*Ramah*, slip op. 7.

[36]*Id.* at 7. *See also id.* at 16 ("it is not reasonable to expect [each] contractor to know how much of [a lump sum] appropriation remain[s] available for it at any given time.") (quoting 2 GAO, Principles of Federal Appropriations Law, p. 6–18 (2d ed. 1992)). Dissenting Chief Justice Roberts, joined by Justices Ginsburg, Beyer, and Alito, agreed with the basic principles but read the ISDA as conferring upon the secretary special authority to allocate an insufficient appropriation among tribes. Dissenting op. at 3-4. The majority found this reading of the ISDA "improbable," *Ramah*, slip op. at 12, adding "We are not persuaded that § 450j-1(b) was intended to enact that radical departure from ordinary government contracting principles." *Id.* at 12-13, n.6.

[37]*Id.* at 9, n.4; Brief for Arctic Slope Native Assoc. as Amicus Curiae Supporting Respondents at 3-7, *Salazar v. Ramah Navajo Chapter*, 567 U.S. __, 132 S. Ct. 2181 (2012) (No. 11-551) (detailing agency payment scenarios).

[38]*Ramah*, slip op. 9 (discussing *Lincoln v. Vigil*, 508 U. S. 182, 193 (1993) and *Int'l Union, United Auto., Aerospace & Agricultural Implement Workers of Am. v. Donovan*, 746 F. 2d 855, 861 (D.C. Cir. 1984) (Scalia, J.)).

[39]*Id.*

[40]*Ramah*, slip op. 14, quoting *Dougherty v. United States*, 18 Ct. Cl. 496, 503 (1883). *But see id.* at n.7 ("We have some doubt whether a Government employee would violate the Anti-Deficiency Act by obeying an express statutory command to enter a contract, as was the case here. But we need not decide the question, for this case concerns only the contractual rights of tribal contractors, not the consequences of entering into such contracts for agency employees.")

[41]*Id.* at 8 (quoting Brief for Federal Parties in *Cherokee Nation v. Leavitt*, O. T. 2004, No. 02–1472 et al., p. 24).

[42]Brief for U.S. Chamber of Commerce, et al. as Amici Curiae Supporting Respondents at 2, Salazar v. Ramah Navajo Chapter, 567 U.S. __, 132 S. Ct. 2181 (2012) (No. 11-551).

[43]Chamber Br. at 7. The chamber explained existing contractors may have no recourse when told appropriated funds were spent elsewhere, adding that future contractors, if willing to contract at all, would need to insist on binding contractual language or demand risk premiums "assuming the government would even accept such language under its new view." The government's "ability to contract in advance of appropriations" will be threatened and the pricing discounts it currently enjoys due to its "reliable billpayer" reputation will be undermined. *Id.* at 23-24 (citation omitted).

[44]*Ramah*, slip op. 8 (citation omitted).

[45]Transcript of Oral Argument at 62, *Ramah*, 567 U.S. ___, 132 S. Ct. 2181 (No. 11-551) ("JUSTICE KAGAN: This is a very—this is a very strange kind of contractual right. The—the contracting tribe has a right to have the Secretary to use discretion to decide how much the contracting tribe gets. What kind of contract is that? (Laughter.)")

[46]*Federal Crop Ins. Corp. v. Merrill*, 332 U.S. 380, 387-88 (1947) (Jackson, J., dissenting) ("It is very well to say that those who deal with the Government should turn square corners. But there is no reason why the square corners should constitute a one-way street.")

[47]*See generally* II Keppler, Indian Laws and Treaties (GPO 1904). The first treaty with an Indian tribe was the Treaty with the Delawares, 7 Stat. 13 (1778).

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privity of contract with the government may sue in tort for misappropriation that goes beyond the contours of their contractual relationship. The mere happenstance that the government obtained USMI's trade secrets through a third party government contract hardly creates a contractual relationship between the government and USMI. USMI's claim for wrongful disclosure of its confidential information therefore cannot reasonably be viewed as sounding in contract. Quite simply, the *USMI* majority panel got it wrong. USMI's judgment against the government should have been upheld. **TFL**

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Endnotes

[1]2012 WL 2052953 (5th Cir. May 11, 2012).

[2]*Id.* at *1.

[3]28 U.S.C. §1491.

[4]*See* 28 U.S.C. § 1491(a)(1).

[5]324 F.2d 622 (5th Cir. 1963).

[6]2012 WL 2052953, at *3.

[7]28 U.S.C. §1346(b).

[8]40 U.S.C. §270a.

[9]2012 WL 2052953, at *4.

[10]*Id.* at *4.

[11]103 Fed. Cl. 794 (Feb. 12, 2012). The government argued that as a matter of law the court lacked jurisdiction over the plaintiff's takings claim. The court disagreed, holding that it had jurisdiction because the "taking" allegedly occurred pursuant to an "authorized act" by a government official.

[12]*Megapulse Inc. v. Lewis*, 672 F.2d 959 (D.C. Cir. 1982).

[13]915 F.2d 1242 (9th Cir. 1989).

[14]244 F.2d 674 (3d Cir. 1957).

[15]915 F.2d at 1246, quoting *Aleucto*, 244 F.2d at 678.

[16]915 F.2d at 1245.

[17]915 F.2d at 1247 (quoting *Gates v. Life of Montana Ins. Co.*, 668 P.2d 213, 214-215 (Mont. 1984)).

[18]*United States v. Huff*, 165 F.2d 720 (5th Cir. 1948).

[19]653 F.2d 726 (2d Cir. 1980).

[20]402 F.3d 1249 (D.C. Cir. 2005).

[21]*Id.* at 1256.