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Federal Contracts Report™

Technical Data

Final Rule on DFARS Data Rights Requirements and Procedures Continues Trend Toward Expanded Government Rights



BY NICOLE J. OWREN-WIEST, SCOTT A. FELDER, AND HEIDI L. BOURGEOIS

Continuing a reversal of earlier policies that encouraged commercial item contracting through a lighter administrative scheme, the Department of Defense (DOD) issued a final rule (76 Fed. Reg. 58,144) on September 20, 2011, amending Defense Federal Acquisition Regulation Supplement (DFARS) provisions involving technical data and computer software relating to commercial items provided to the government. The stated purpose of the revisions was to implement section 802(b) of the Fiscal Year 2007 National Defense Authorization Act (NDAA) (Pub. L. No. 109-364) and section 815 of the FY 2008 NDAA (Pub. L. No. 110-181). These provisions modified the presumption, found in 10 U.S.C. § 2321(f), that commercial items are developed at private expense and changed the allocation of rights in technical data pertaining to such items. These revisions, and those anticipated with the proposed rewrite of DFARS Part 227 (75 Fed. Reg. 59,412), reflect a trend of expanding the government's rights in technical data and computer software and placing greater burdens on commercial item contractors, notwithstanding the fact that the statutorily stated preference for commercial item contracting has not changed. Commercial item contractors must be more vigilant than ever in understanding these heightened demands to ensure that their rights in technical data and computer software enjoy maximum protection.

Nicole Owren-Wiest and Scott Felder are partners and Heidi Bourgeois is an associate at Wiley Rein LLP. They specialize in government contracts and regularly counsel government contractors and subcontractors on all aspects of government contracting, including the unique rules related to intellectual property.

Background of Commercial Item Contracting. The import of these DFARS revisions is best understood in the context of DOD's overall approach to commercial item contracting, which has shifted over time. Prior to the 1994 Federal Acquisition Streamlining Act (FASA), DOD acquisitions primarily involved items tailored to DOD specifications. This had the effect of increasing DOD's costs to acquire items that were available less expensively in the commercial marketplace, while also reducing DOD's access to cutting-edge technology.

The Packard Commission, charged by President Reagan in 1985 with conducting a defense management study, noted as a recurring problem ''government insistence on rigid custom specifications for products, despite the commercial availability of adequate alternative items costing much less.'' President's Blue Ribbon Comm'n on Def. Mgmt., *A Report to the President on Defense Acquisition* 5 (1986). The commission also found that ''[o]ver the years, Congress and DOD have tried to dictate management improvements in the form

 ISSN 0014-9063

of ever more detailed and extensive laws or regulations. As a result, the legal regime for defense acquisition is today impossibly cumbersome.'' *Id.* at 18. In short, the Pentagon was paying too much for too little, as illustrated by stories of $1,000 toilet seats and hammers. Therefore, the commission recommended that DOD ''take steps to assure a major increase in the use of commercial products, as opposed to those made to military specifications.'' *Id.* at 24. The commission also recommended ''the elimination of those legal and regulatory provisions that are at variance with full establishment of commercial competitive practices.'' *Id.* at 26-27.

In 1994, Congress implemented many of the Packard Commission's suggestions relating to commercial item contracting through FASA. The Act defined the term ''commercial item'' in the context of government procurements, 41 U.S.C. § 403(12), and expressed a preference for the acquisition of commercial items, 10 U.S.C. § 2377(a). In order to encourage competition among commercial item suppliers, the Act reduced administrative burdens by, for example, making certain laws inapplicable in procurements of commercial items. 10 U.S.C. § 2375(b). It also established a presumption that commercial items were developed at private expense, which restricted the government's rights in technical data pertaining to commercial items. 10 U.S.C. § 2321(f). Therefore, if the government challenges a use or release restriction asserted by a contractor on technical data provided under a commercial item contract, the burden is on the government to demonstrate that the item was not developed exclusively at private expense. *Id.* As a result, commercial item contractors were not required to maintain records (and incur associated expenses) to demonstrate that a commercial item sold to the government was developed exclusively at private expense.

Subsequent to FASA's implementation, the Office of the Under Secretary of Defense for Acquisition, Technology and Logistics noted the ''current movement for DOD to collaborate with industry on more commercially friendly terms, so that the benefits of commercial research and development can be more readily assimilated into defense products.'' Office of the Under Secretary of Def. for Acquisition, Tech. & Logistics, *Intellectual Property: Navigating Through Commercial Waters* 1-4 (2001).

The Final Rule. More recently, however, the pendulum has been swinging back to a regime of less commercially friendly terms and greater license rights for the government. While FASA's statutorily stated preference for commercial item contracting has not changed, some of the burdens lifted by FASA have been shifted back to contractors. For example, the 2007 NDAA eliminated the presumption that a commercial item is developed at private expense in the case of major systems, and subsystems and components of major systems. A ''major system'' is defined, for DOD purposes, as a system for which the total expenditures for research, development, test, and evaluation are estimated to be more than $189.5 million or the eventual total expenditure for the acquisition exceeds $890 million. Federal Acquisition Regulation 2.101. Therefore, under the 2007 NDAA, if the government challenged a use or release restriction asserted with respect to technical data associated with such a major system, subsystem, or component, the government would prevail unless the contractor could demonstrate through appropriate records and other evidence that the item was developed exclusively at private expense—thus, increasing the recordkeeping burden on commercial item contractors seeking to protect their data rights. The 2008 NDAA reduced the impact of this policy shift slightly by restoring the presumption of development at private expense for commercially available off-the-shelf (COTS) items, which are defined as commercial items that are sold in substantial quantities in the commercial marketplace, offered to the government without modification, and in the same form in which they are sold in the commercial marketplace. FAR 2.101.

The September 2011 final rule implements both of these statutory changes by amending the DFARS to state that ''[t]he presumption of development exclusively at private expense does not apply to major systems or subsystems or components thereof, except for commercially available off-the-shelf items.'' DFARS 252.227-7037 (Validation of restrictive markings on technical data).

Furthermore, despite the lack of any statutory basis to do so, DOD extended this policy to noncommercial computer software for major systems, by adding a new provision to the clause at DFARS 252.227-7019 (Validation of asserted restrictions—Computer software). The preamble to the final rule explains that, with respect to computer software, DOD adopted the ''major systems rule'' to apply only to *noncommercial* computer software. Thus, the new procedures for validating that noncommercial computer software was developed entirely at private expense would not be applicable to release or use assertions based on mixed funds and would not restrict the contractor's ability to segregate mixed-funding software development into privately-funded and government-funded portions.

The final rule is also broader than required to implement the changes imposed by the FY 2007 and 2008 NDAAs because it modified the applicability of the DFARS clauses governing technical data rights for noncommercial and commercial items. Under the final rule, if technical data is to be delivered to the government for a commercial item that has been developed *in any part* at government expense, the government's rights in that technical data will be governed by *both* DFARS 252.227-7013 (Rights in technical data—Noncommercial items) and DFARS 252.227-7015 (Technical data—Commercial items). Thus, in those circumstances, DFARS 252.227-7015 will apply to technical data pertaining to those portions of the commercial item developed exclusively at private expense, while DFARS 252.227-7013 will apply to technical data pertaining to those portions of the item developed at government expense. Previously, only the DFARS clause pertaining to rights in technical data for commercial items would have applied.

While such segregation of data rights might sound relatively straightforward, in practice, many commercial item contractors will undoubtedly have difficulty separating components of the item that were developed exclusively at private expense from those where the government paid ''any portion of the development costs.'' In those cases where segregation is impracticable, the government may assert government-purpose rights or unlimited rights in the technical data—thus expanding the government's rights—unless the parties

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agree to a specifically negotiated license pursuant to DFARS 252.227-7013(b)(4).

The final rule also changes the applicability of statutes and DFARS provisions to commercial item subcontractors. Citing ''the best interests of the government,'' the final rule removed 10 U.S.C. §§ 2320 and 2321 from the list of statutes set forth in DFARS 212.504(a), which prohibited their application to subcontracts for commercial items. As a result, subcontracts for commercial items are now subject to the validation requirements of DFARS 252.227-7037. Moreover, the revised commercial item data rights clause at DFARS 252.227-7015 is required to be flowed down to subcontractors and lower-tier suppliers whenever any technical data related to commercial items developed in any part at private expense will be obtained from that subcontractor or supplier for delivery to the government. To the extent that any part of the subcontractor's commercial item was developed at government expense, the technical data related to those portions will be governed by DFARS 252.227-7013, as described above.

Proposed DFARS 227 Rewrite. This trend toward an expansion of the government's rights in technical data and computer software and away from less burdensome commercial practices also is reflected in DOD's proposed rewrite of DFARS Part 227. On September 27, 2010, a proposed rule was issued to amend DFARS Part 227 relating to Patents, Data, and Copyrights, as well as the associated clauses in DFARS Part 252 and certain commercial item provisions in DFARS Part 212. 75 Fed. Reg. 59412. With respect to commercial items, the proposed rewrite would seek to impose a number of new requirements, including requirements related to commercial software, that are inconsistent with FASA and its policy to treat the government, when in the commercial marketplace, like any other commercial actor. For example, under the proposed revision of DFARS 252-227.7015, which would apply to both commercial item technical data and, for the first time, commercial computer software, while the government would obtain the same license rights that are customarily provided to the public, any portions of the contractor's standard commercial license that are ''inconsistent with federal procurement law'' will automatically be considered stricken from the license. 75 Fed. Reg. 59412, 59454 (Proposed DFARS 252.227-7015(b)(1)). The clause does not identify terms that would be considered ''inconsistent with federal procurement law.''

Additionally, for the first time, contractors would be required to identify *and mark* all commercial technical data and commercial computer software delivered to the government with prescribed restrictive legends (Proposed DFARS 252.227-7015(d)), notwithstanding the fact that, in practice, most commercial computer software is restricted according to the terms of the commercial license regardless of any particular markings. Consistent with the current requirements, under the proposed rule, any technical data or computer software that are not marked would be presumed to be delivered with unlimited rights. Moreover, the proposed revised clause includes a release of government liability for any release of commercial technical data or computer software that are not properly marked as restricted. Proposed DFARS 252.227-7015(e). Consequently, if the revised clause is issued as proposed it will be critical for commercial contractors to have systems in place to ensure that technical data and computer software are properly marked before they are delivered to the government or incorporated into a contract deliverable, or they run the risk of giving up valuable rights.

Maximizing Data Rights and Software Protections. The changes implemented by the September 2011 final rule underscore the importance of, among other things, the ''doctrine of segregability'' and maintaining adequate accounting and other records to substantiate any claims of development at private expense. Under the doctrine of segregability, the determination of the source of development funds is made at the lowest practical sub-item or sub-component level or segregable portion of a process. DFARS 227.7103-4(b). Thus, contractors may assert limited rights in any segregable sub-item, sub-component, or portion of a process that was developed exclusively at private expense. *Id.*

Contractors who provide customized solutions for their customers using commercially-developed items, components, and processes need to be especially wary of the changes implemented by the final rule. To ensure maximum protection of their intellectual property, these contractors will need to find ways to differentiate the privately-funded platform from the government-funded customization, both technically and financially.

Moreover, where the customized component is destined for a major system or subsystem, some contractors may find themselves in the unenviable position of reconstructing the accounting records necessary to substantiate that the underlying item was developed exclusively at private expense. The difficulty, of course, is that such records were first created in an environment where the contractor was entitled to a presumption of development at private expense, and thus may not be sufficient to carry the burden required under the final rule.

These complications may be most acutely felt by contractors and subcontractors who do only minimal business with the government, and who are thus less familiar with the FAR and DFARS rights allocation schemes. Indeed, the burden of developing the internal controls necessary to create sufficient records, and the prospect of losing valuable intellectual property rights to the government if those controls fail, may well prevent some companies from doing business with the government in the first place. This, in turn, reduces competition and increases the government's costs. By imposing the types of burdens that FASA sought to alleviate for commercial item contractors, the government has potentially subjected itself to the types of consequences that FASA was intended to avoid.

Conclusion. As the trend toward greater government rights in technical data and computer software and away from less burdensome commercial practices continues, commercial item contractors will need to be more vigilant than ever in understanding the government's heightened demands and the steps that can be taken to ensure that their rights in technical data and computer software enjoy maximum protection.