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DOD Guide on Intellectual Property Practices

The Department of Defense (DoD) is developing an intellectual property (IP) guide for contracting personnel which stresses flexibility in the use of IP provisions in order to encourage commercial industry to participate more fully in federal procurement. DoD recognizes that it is not, as it once was, the main source of research and development (R&D) funding in the U.S. economy and that it would benefit from more active participation of private industry to help it develop technologically advanced solutions for weapons and management systems. The reality that DoD faces is that companies unaccustomed to federal contracting often reject doing business with the government largely because of the perception of unfairness and inflexibility in the negotiation of IP rights.

Patents, technical data, computer software, and copyright issues, in fact, are often obstacles in the negotiation of federal contracts. For any given federal procurement, the standard FAR and DFARS clauses often are inappropriate in some respect and, from a commercial perspective, must be negotiated. Contracting officers, however, often are unfamiliar with IP matters and are unwilling to alter the use of standard clauses, particularly without the involvement of agency counsel. The new guide, which is under development by Under Secretary of Defense for Acquisition, Technology, and Logistics USD (AT&L) and still in draft, is intended to educate DoD contracting personnel on IP issues of concern to industry and to encourage DoD to be flexible in negotiations. The guide notes several typical negotiation problems and proposes solutions:

One problem is that the government often includes FAR Patent Rights clauses in solicitations for contracts that are not for R&D. These clauses give the government a license, and in some situations the right to receive title, in inventions made by the contractor in performing the contract. The guide notes that these clauses belong only in research, experimental, and development contracts. The guide in this regard instructs DoD personnel that if the contract is, for example, for services to modify a commercial item, the contract need not include a Patent Rights clause if the modification is minor or the kind customarily performed in the market.

A common concern of contractors is the protection of IP that was developed prior to or outside the government contract at issue and is considered by a company to be its trade secret. For example, DoD may take a broader view of the data or software in which DoD has unlimited rights than will the contractor. In this regard, under the Rights in Technical Data - Noncommercial Items clause, DoD acquires unlimited rights in a broadly defined body of data relating to items developed exclusively with government funds. Under the Rights in Noncommercial Computer Software clause, DoD acquires unlimited rights in computer software developed exclusively with government funds. To avoid dispute over the extent of the data in which DoD receives unlimited rights, the guide provides the same advice we often offer to our clients: the parties should ensure that the scope of work and data deliverable requirements are clearly and narrowly defined. The parties should further ensure that, to the extent that any trade secrets must be delivered, they are identified as such during the negotiation process and

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contain the appropriate FAR and DFARS legends to limit their disclosure.

A similar risk flows from the Patent Rights clauses. The government acquires rights in inventions first reduced to practice under the contract, even if the contractor first conceived of the invention prior to or outside the contract. This rule can lead to particularly unfair results if the bulk of the cost and risk is born by the contractor in conceiving of the invention, then DoD makes a small financial contribution to demonstrate its workability. Again the guide's advice in this regard is apropos to both parties: draft the statement of work narrowly to preclude previously-conceived inventions from being first reduced to practice under the contract.

The FAR Patent Rights clause generally permits the contractor to retain rights in inventions, provided the contractor complies with certain deadlines, including a one year patent application filing deadline. A problem for contractors is that often the inventions are also trade secrets or may involve background trade secrets and that, by filing a patent application, which is a public document, the contractor must reveal these trade secrets. Thus, the one year filing deadline is often too short for the contractor. The guide recognizes this problem and suggests that the contracting officer consider extending the one year deadline, even at the time of contracting, or agreeing that the government forebear from filing for a patent.

Prime contractors also generally are required to flow down the Patent Rights clause to subcontractors, such that subcontractors may retain title to their inventions, even where the prime contractor is co-funding the subcontractor's developmental efforts. The guide suggests that the agency could issue an exceptional circumstance determination or a FAR waiver or deviation to this rule.

DoD obtains government purpose rights (GPR) in data and software that is created with mixed DoD and private funding. GPR limits the disclosure of data and software to government officials and others for U.S. Government purposes. It is sometimes a concern that the Rights in Technical Data - Noncommercial Items and Rights in Noncommercial Computer Software clauses state that, after five years, GPR expire and become unlimited rights. Another industry concern is that there is no restriction on the disclosure of the information between agencies. The guide suggests that the five year period could be extended and that restrictions on the flow of the information also could be negotiated.

The guide also points out that the government is having little success in attracting commercial businesses, under FAR Part 12, Acquisition of Commercial Items, to research Government problems. The likely cause is that the business model of most R&D oriented businesses, particularly nontraditional government contractors, is built on retaining the potential IP value generated by the work of company scientists and engineers, and is ordinarily too great to forego for a simple fee. The guide suggests as a solution that DoD acquire rights only in the application of the technology in which DoD is interested, with the contractor receiving IP rights to all other applications of the technology.

The guide's discussion of these and other IP issues suggests that DoD is seeking to encourage companies to participate in federal contracting and in R&D activities in particular. The IP clauses still in the FAR and DFARS reflect a world in which the government once had superior bargaining power, such as in 1960, when DoD contributed more than half (53%) of the total R&D dollars spent in the nation. Today, however, DoD contributes only 16% of R&D funding and increasingly needs the technological innovation that much of the non-federal sector has to offer. Most of the suggestions in the draft guide are potentially useful solutions to significant problems, but the question remains how quickly federal procurement practices actually will change.

Contract Bundling – Limits on Agency Discretion

Federal contract "bundling" affects both large and small businesses and remains under great scrutiny as agencies continue to consolidate contract requirements under larger contract vehicles. This trend is demonstrated by the Air Force's recent $7.4 billion Flexible Acquisition and Sustainment Tool (FAST) contract program, which was the subject of a bid protest decision last month by the General Accounting Office (GAO), *Phoenix Scientific Corporation*, B-286817 (Feb. 22, 2001), discussed below.

Bundling has been occurring for decades, but has become a significant issue in procurement policy in recent years, particularly for small businesses, following the rising popularity of large government-wide acquisition contracts (GWAC) and passage of the Federal Acquisition Streamlining Act of 1995 (FASA). Streamlining initiatives have altered the competitive playing field and generally made it more difficult for small businesses to win prime contracts. A September 2000 Small Business Administration (SBA) report concluded that the "increasingly common practice of contract bundling is accelerating the concentration of larger and fewer federal contracts into the hands of fewer and larger companies." *See* The Impact of Contract Bundling on Small Business FY 1992-FY 1999.

Laws restrict an agency's authority to bundle its requirements. Large and small businesses alike may challenge bundling decisions as violative of the Competition in Contracting Act of 1984 (CICA), on the basis that bundling tends to diminish competition. CICA requires that solicitations include specifications that permit full and open competition and include restrictive provisions or conditions only to the extent necessary to satisfy the needs of the executive agency or as authorized by law. GAO has sustained many protests over the years where the procuring agency cannot show a reasonable basis for the bundling decision. An oft-cited case is *National Customer Engineering*, 72 Comp. Gen. 132 (1993), which held that "bundling . . . is permissible only if [the agency] demonstrates that the bundling is necessary to meet the agency's minimum needs."

For example, in *Better Services*, B-266751.2, 96-1 CPD 90 (1996), GAO held that the General Services Administration improperly required firms to offer photocopier sales in connection with maintenance and repair service where "GSA has presented no evidence showing that any expected additional contracts would involve significant additional cost to the government." Similarly, GAO has held that an agency may not bundle requirements merely for administrative convenience, as in *Pacific Sky Supply, Inc.*, B-2280849, 87-2 CPD 504 (1987), where GAO ruled that the Air Force had improperly bundled aircraft engine spare parts into a single contract award for administrative convenience.

More recently, in *Pemco Aeroplex, Inc.*, B-280397, 98-2 CPD 79 (1998), GAO objected to the Air Force's bundling of several depot workload requirements into a single solicitation. GAO stated that "while our office will show deference to agency claims that requirements of military readiness supports a combination of workload requirements, such claims must be properly documented and reasonably related to the workload combination."

In addition to GAO's scrutiny of bundling decisions under CICA, bundling decisions are now also subject to review under the Small Business Act. This statute, as amended by the Small Business Reauthorization Act of 1997, expressly states that "each federal agency, to the maximum extent practicable, shall avoid unnecessary and unjustified bundling of contract requirements that precludes small business participation in procurements as prime contractors." 15 U.S.C. § 631(j)(3). "Bundling" is defined as "consolidating two or more procurement requirements . . . previously provided or

performed under smaller contracts into . . . a single contract unsuitable for award to a small business."

The Small Business Act's prohibition on bundling, however, is not absolute. Bundling is permissible when "necessary and justified," *i.e.,* when there are "measurably substantial benefits." SBA regulations define "measurably substantial benefits" as 10% of the contract value where the contract value is $75 million or less, or 5% of the contract value or $7.5 million, whichever is greater, where the contract value exceeds $75 million. 13 C.F.R. § 125.2(d).

There have been few small businesses to date that have formally challenged bundling decisions under the Small Business Act. One of the few decisions is the recent case of *Phoenix Scientific*, referenced above, involving the Air Force's FAST program, which covers all unplanned maintenance requirements for all Air Force weapons systems. GAO concluded that this $7.4 billion program did not involve "bundling" as that term is defined by the Small Business Act. The protester complained that the contracts would be too big for most small businesses to perform. GAO agreed, but found that "larger" small business could perform the work and that, on that basis, the contracts were not "unsuitable for award to a small business." GAO noted that several firms that qualified as "small businesses" under the procurement's 1500 employee size standard actually had expressed interest in submitting offers. The Air Force also was intending to award two of six contracts to "small businesses" (as defined by the 1500 employee size standard).

This decision, though a reasonable interpretation of the statute, raises a fair question of whether such results were intended when Congress passed its anti-bundling legislation. This decision also apparently prompted a letter from Sens. Christopher Bond (R-Mo) and John Kerry (D-Ma), Chairman and Ranking Member, respectively, of the Senate Small Business Committee, to the Air Force expressing "deep concern with whether the Air Force will be able to ensure small business participation" in the FAST program.

The FAST procurement also offers an example of other types of bundling challenges. SBA is authorized to appeal bundling decisions affecting small business to the procuring agencies. SBA initially invoked these rights in the FAST procurement by challenging the bundling decision and appealing it directly to the Air Force, albeit unsuccessfully. In addition, Phoenix Scientific separately appealed the Air Force's designation of the small business size standard of 1500 employees for the procurement. If this size appeal, which was filed with the SBA Office of Hearings and Appeals, had been successful, a lower size standard would have been applicable to the procurement. In that event, only much smaller firms would have qualified as "small businesses" for the procurement, and therefore it would have been more difficult for the Air Force to contend that the procurement was still suitable for "small businesses" as defined by the smaller size standard.

In summary, there are several means by which businesses, both large and small, as well as SBA itself, can challenge the bundling decisions of the agencies when those decisions appear unreasonable. Although procuring agencies enjoy substantial discretion in this area, protesting concerns historically have had some success in challenging these decisions. Congress, furthermore, will undoubtedly continue to express interest in agency bundling decisions.

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