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Phone: +1 646 783 7100 | Fax: +1 646 783 7161 | customerservice@law360.com

False Claims Act Trends: Technical Data, Software And IP

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W. Jay DeVecchio

Government contracting has never been easy. But occasionally it is exciting, at least at the outset: Figuring out how to prepare the most competitive proposal and landing a significant contract are memorable achievements (assuming one survives the bid protest). The work also can be satisfying: Getting the customer what it needs, when it needs it, and doing this well can make a difference in peoples' lives. Indeed, it may save lives, whether one is delivering health care services or military equipment. Patriotism is an underappreciated and real motivator for many contractors, often more so than profits, which — unbeknownst to the general public — are slim enough under the weight of this regulated industry. Now, though, they are taking all fun out of contracting.

Barely a week goes by without a report of another False Claims Act allegation based on an aggressive "implied certification" theory — an issue that will be addressed soon by theU.S. Supreme Court in Escobar — or a novel allegation turning what should be a contract disagreement into a fraud case. Plaintiffs attorneys and some in the U.S. Department of Justice hold the view that essentially perfect performance is the measure for contractors, with any imperfection being reckless. And recklessness is, after all, a standard for fraud under the FCA. This disregards, of course, the broad swaths of uncertainty involved in many government contracts and in all the complex ones. Navigating the thicket of Medicare rules, regulations, and guidance to the single "right" answer is virtually impossible. So is agreeing on the "only" correct interpretation of performance specifications for a major weapons or computer system, particularly after a run of constructive changes.

These FCA difficulties are compounded when the contractual area in dispute is at once complicated, counterintuitive and thoroughly misunderstood. That describes precisely the "data rights" regulations, those collections of clauses that determine the allocation between the government and its contractors of intellectual property rights in technical data and computer software. There is substantial room (even inevitability) in this field for a lack of perfection by contractors and corresponding misguided zeal by plaintiffs and their counsel. Consequently, "data rights" FCA cases seem to be on the rise, as are their cousins, trade secret misappropriation litigation between prime and subcontractors under government contracts. We see this in FCA decisions, such as United States v. Honeywell Intl., Inc., No. 12-02214 (C.D. Cal. 2014), and misappropriation opinions such as memorandum Opinion and Order, GlobeRanger Corporation v. Software AG, et. al, No. 3:11-CV-0403 (N.D. Tex. 2015), where the courts are struggling with the correct interpretation and application of the data rights provisions. We also hear it in discussions with our clients and colleagues.

To diminish these risks, contractors should be more attuned to a few simple, practical aspects of the data rights regulations; and everyone needs to understand better a few fundamental principles that are commonly misunderstood and consequently lead to misplaced suspicions and flawed allegations. Let us start with some background on data rights and then consider what contractors should do early in the procurement sequence to avoid allegations of false data rights claims.

The Basics

The basic concept of these very long contract clauses (DFARS 252.227-7013, -7014; FAR 52.227-14) is simple, at a high level. If a contractor at any tier develops an item, component, process or software at "private expense," then, generally, the contractor can "limit" the government's rights in the technical data associated with the item and can "restrict" the government's rights in software. This means the government generally gets a license to use the data and software within the government but cannot make them available for competitive procurements. In other words, the contractor is in a sole-source position with respect to these data and software. This recognizes that the holder of intellectual property rights (most privately developed data and software are trade secrets and subject to copyright protection) is entitled to protection of those rights and to the competitive advantage gained by having them. Conversely, if the government has paid entirely for the development, it gets the broadest license right in the contractor's intellectual property. But there the perceived simplicity ends, and one gets into the nuances that trip up contractors and FCA plaintiffs.

For example, at the U.S. Department of Defense, whenever a contractor is proposing to deliver either technical data or computer software in which it is asserting limitations or restrictions on the government's rights of use, the contractor must state in its proposal what those constraints are and describe the bases for them. There are similar provisions under the Federal Acquisition Regulation data rights provisions, which apply to "civilian" agencies but not to the DOD (a common misunderstanding in itself). Obviously, if these representations are false or reckless, they could lead to FCA liability.

But what does a contractor actually have to do to assure its representations are correct? It has to know when the thing was developed and who paid for it; and it must know the answer to those questions at the lowest segregable component level — meaning subcomponents for hardware and subroutines for software. In turn, this means the contractor not only must understand the definitions of "development" and "private expense" but also be able to assure that its engineering, technical and finance community have accurately tracked the stages of development and the source of funds at the lowest component level. If this begins to sound challenging, you can be assured it is. It requires discipline at all levels to engage in mundane recordkeeping about test results and analyses, as well as accounting charge numbers. That is not something talented engineers and designers typically are keen on. They are here to advance the state of the art, not to keep the books, or so they tend to think. Therefore, reliance on them can get dicey. One needs to educate them about these issues and to have contracts folks looking over their shoulders to assure accurate records.

Private Expense

Moreover, the definitions of development and private expense are often misunderstood, if understood at all. One of the most common misconceptions is that if any government money is involved, directly or indirectly, in the development process, then development did not occur entirely or exclusively at private expense, and, therefore, the contractor cannot limit or restrict the government's rights. This is incorrect. Direct payments for development under a prime or subcontract are not private expense. But performing development that is properly chargeable to indirect cost accounts — e.g., independent research and

development or overhead — is private expense, even when the government reimburses the contractor for those indirect costs in whole or in part. FCA plaintiffs, as well as many contractor personnel, get this wrong every day.

Thus, the fact the government paid for some aspect of development indirectly does not alter a contractor's ability to — and it is not an FCA violation to — assert limited or restricted rights in the development — assuming the development was completed on indirect accounts or without direct funding under a contract. Furthermore, because one must engage in this analysis at the lowest component level, it may well be that the government has "unlimited rights" in some components or subroutines whose development it funded directly under a contract, but not in others that it did not. It therefore is not an FCA violation for the contractor to assert its limited or restricted rights in privately developed portions of uniquely governmental end items or software.

Development

The concept of "development" poses similar challenges. Development is not defined within the FAR data rights provisions. It has, however, been analyzed and defined extensively at the DOD, and there is no reason to doubt the DOD's concepts would be applied to issues under the FAR. Although there are some variations with respect to computer software, the basic concept is that development occurs "when the item, component, or process has been analyzed or tested sufficiently to demonstrate to reasonable people skilled in the applicable art that there is a high probability that it will operate as intended." DFARS252.227-7013(a)(7). A few key points follow from this. First, if development occurs when there is a "high probability" of operating as intended, then development for purposes of asserting limited or restricted rights can occur before the thing is manufacturable or producible. Therefore, it is not a false claim to assert limited or restricted rights even if the government pays entirely to take the item from a prototype or beta version into production. Second, a contractor can achieve a state of development that will allow a contractor to restrict or limit the government's rights, even though the government funds improvements of the item under a contract. The principle is that once the core development occurs, further refinements or improvements are not development.

Delivery

Assuming the contractor understands these definitions and distinctions, and assuming it has properly asserted its rights, the contractor must thereafter mark any data or software it delivers to the government with the exact marking or "legend" specified in the data rights clauses. The legends vary depending on whether one is delivering software or technical data, and they vary between the FAR and DFARS. If a contractor fails to do this, it can lose its ability to assert limited or restricted rights. That is straightforward enough and well understood.

Not as well understood, however, is the extent of government's right to obtain delivery of the contractor's data or software in the first instance. There is a misconception that the government is entitled to delivery of any data or software in which it obtains rights. This is not true. There is not one word in the basic data rights clauses that requires a contractor to deliver to the government the technical data or computer software in which the government obtains rights under the clauses. Those provisions define the government's license rights, not its delivery rights.

This means that even when the government obtains the broadest license rights in data or software ("unlimited rights"), because it has paid entirely for the development of an item or software, it does not have any right under the basic data rights clauses to require the contractor to deliver the thing the

government has paid to develop. This perplexes government and contractor personnel, but is a fact of the clauses and of the structure of government contracts. Data deliverables are supposed to be specified elsewhere in the contract. For example, if computer source code was never specified as a deliverable, the government might or might not have some form of license rights in it under the data rights clauses, but it would not have the source code itself nor a right to obtain the code under those clauses. Therefore, declining to deliver the information is not a contractual failure and thus certainly not an FCA violation. The government can remedy this by putting in "deferred ordering" or "deferred delivery" clauses, which permit the government to get the data and software if it otherwise neglected to specify them as deliverables.

Commercial Software

The final misconception that leads to FCA cases, including Honeywell, has to do with commercial computer software. For simplicity, we will assume that commercial computer software essentially is defined as a commercial item under the FAR, although there are some definitional variations at the DOD. Now, then, there is the misperception that if software is developed under a government contract, it cannot subsequently be sold back to the government as a commercial item. That is incorrect, but is often driven by the erroneous assumption that commercial computer software has to be developed at private expense. In fact, there is nothing in any definition of commercial items or commercial software that requires commercial computer software to be developed at private expense. Thus, even though development of software may have been paid for in whole or in part by the government, this does not preclude the software from later becoming commercial software. Nor, accordingly, is it a false claim to assert commercial rights in that software.

Relatedly, there is the mistaken view that if software is sold to the government as a commercial item, any cost the government previously paid for the software's development must be excluded from the price the contractor offers the government. This, too, is incorrect. If software is commercial, then under the regulations it can be priced commercially — that is, at a fair and reasonable price, independent of whatever the costs were (or who paid for them) to develop the software. Commercial items are sold at commercial prices, and it is not a false claim to do so. This can be discerned directly from various portions of FAR Part 15, which is the measure of price analysis for civilian and DOD acquisitions.

Suggestions

In sum, it is essential for contractors to understand their rights and obligations under the data rights provisions, and to be scrupulous in keeping the detailed records necessary to justify proper assertions of limited and restricted rights. Doing so will help avoid FCA liability. The corollary is that plaintiffs attorneys and government lawyers alike need also to invest the time to understand these rights and obligations. Otherwise, they may be pursuing FCA cases that never should have been brought in the first instance.

—By W. Jay DeVecchio, Morrison & Foerster LLP

Jay DeVecchio is a partner in Morrison & Foerster's Washington, D.C., office and co-chairman of the firm's government contracts and public procurement practice.