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Client Alert

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Assessing the Value of Intellectual Property Rights in M&A Deals Involving Government Contractors

Intellectual property ("IP") rights can be one of the most valuable assets of a government contractor. There are several factors potential buyers can use to properly evaluate a government contractor's IP in mergers and acquisitions deals.

Introduction

The value of a government contractor can take several forms. For example, the value can be based on the number of government contracts it holds with high monetary ceilings or contracts with long periods of performance. A contractor's value can also lie with its key personnel who have a trusted performance record and expertise that federal government agencies highly value. The IP rights associated with the products or services of a government contractor can also provide substantial value. This article will walk through the various factors to consider in mergers and acquisitions when assessing the value of a government contractor's IP.

How is the IP funded?

Buyers can assess the value of a government contractor's IP rights to products and services by determining whether the contractor's IP is privately funded or funded by the federal government. The government contractor should identify the rights given at its lowest segregable component to properly track the IP's source of funding.[1] Tracking the IP with great specificity is crucial. For example, this applies when the contractor must provide noncommercial computer software as part of its

contract terms. In this instance, it is important that the contractor list the individual modules for that software and provide justification for restrictions on the government's rights to use, reproduce or disclose those modules. Otherwise, if the contractor were to assert restricted rights on the whole software, the government may challenge that assertion and determine that at least some of the individual modules of that software were produced with government funds. This may result in the government obtaining more rights over the entire software than it would have otherwise had the contractor initially identified, segregated and explained the restrictions on the government's rights at the individual module level. Therefore, potential buyers should obtain information on how the government contractor ensures that its IP is properly identified and marked, and that sufficient records are maintained to justify the validity of any restrictive markings.[2]

Private Funding

If the IP is developed exclusively at private expense, the government may receive restricted or limited rights in the IP if the contractor takes the necessary steps to convey only limited or restricted rights by identifying and marking "noncommercial" technical data or software with the appropriate legend. Limited rights means that the government may use the data within the government but not release the technical data outside of the government.[3] Restricted rights means, *inter alia*, that the government may only use, modify and disclose the software within the government, run the software on one computer at a time, and only make the minimum copies for backup.[4] The only time restricted rights software or limited rights data may be released to other contractors is for emergency repair or overhaul or when the contractor is a covered government support contractor. Notably, the government contractor may further restrict the government's rights in technical data delivered in connection with products or computer software that qualify as commercial products.[5] For instance, the government normally acquires commercial computer software subject to the government contractor's standard commercial license, which typically will be narrower than the government's rights in noncommercial software.[6]

Mixed Funding – Department of Defense

If the IP is developed with both private and government funding under contracts with the Department of Defense ("DoD") and DoD agencies, the government may receive "government purpose rights" which, in the context of technical data, is the ability to use, modify, reproduce, release, perform, display, or disclose technical data within the government without restriction; and to release or disclose technical data outside the government and authorize persons to whom release or disclosure has been made to use, modify, reproduce, release, perform, display, or disclose that data for United States government purposes.[7] The government can have government purpose rights for five years or another negotiated period and can get unlimited rights upon expiration of that period.[8] Be aware that under contracts with civilian agencies, the data rights provisions do not provide for government purpose rights. Instead, the government may obtain unlimited rights in computer software or technical data first produced in the performance of the contract, irrespective of the source of funding.[9]

Government Funding

If the government fully funds the development of the IP, the government likely will receive unlimited rights. This means that the government can use, disclose, reproduce, prepare derivative works, distribute copies to the public, and perform publicly and display publicly, in any manner and for any purpose, and to have or permit others to do so.[10] In other words, the government can hand over IP to competitors for use in future government contracts or can make the

IP publicly available. Therefore, IP conferred with limited or restricted rights to the government can be the most valuable to potential buyers.

Other Federal Funding Agreements

The IP rules discussed above principally pertain to procurement contracts. The IP rules pertaining to the allocation of data rights and rights in patents and inventions will vary based on the type of funding agreement. For instance, government contractors that hold other transaction ("OTs") agreements with the various government agencies authorized to use these agreements can negotiate IP rights with the government and do not have to follow the regulations that govern traditional government procurement contracts. Under grants and cooperative agreements, on the other hand, the allocation of rights in patents and inventions is similar to the allocation of rights under procurement contracts, but the allocation of data rights differ.

To complicate matters even further, IP rules also may vary between agencies. For example, whereas government contractors—both large and small—normally may elect title to inventions developed under grants, for cooperative agreements, and contracts with most federal agencies, the IP rules pertaining to the Department of Energy typically give the government title to any such inventions, except for nonprofit organizations or small businesses.[11] Similarly, inventions made in the performance of a contract with NASA become the exclusive property of the government unless it grants a waiver.[12] In situations with DOE and NASA funding, a prospective buyer should ask whether these agencies have granted any waivers.

Government contractors may also have IP developed through Cooperative Research and Development Agreements, Technology Investment Agreements, the Advanced Technology Program, or technology transfer programs for small businesses, all of which have their own system of delineating IP rights between the contractor and the government. In these instances, potential buyers should obtain information demonstrating that the government contractor has used all the appropriate tools at its disposal in preserving its IP rights based on the type of contracting vehicle it has with the government. Buyers should also see whether the government contractor develops a substantial portion of its IP portfolio with agencies that have regulations allowing them to obtain more IP rights.

Tracking and Record Keeping

If the government contractor has received government funding for research and development, it is important to determine if the contractor has properly tracked whether its deliverables were privately or publicly funded or both. Proper tracking can include clear documentation showing that the company has segregated government-funded work from privately funded work and the procedures used to segregate that work. The absence of any clear delineation between privately funded and government funded research and development could make it more difficult for contractors to properly assert its rights for this research and development and could diminish its value.

For these reasons, potential buyers should identify the source of funding for the government contractor's IP and how the contractor keeps records of the IP's source of funding.

Does the government contractor meet the requirements of the Bayh-Dole Act?

The Bayh-Dole Act governs IP rights in "subject inventions" which are inventions conceived of or first actually reduced to practice in the performance of a federal grant, contract, or cooperative agreement. The subject invention does not have to be purely federally funded.[13] The Act allows the government contractor to properly elect to retain

title to any invention made in the performance of work under the federal funding agreement after the contractor or grantee makes the required disclosures to the government.[14] How and when to elect title depends on the federal agency. By law, the government shall have at least a nonexclusive, nontransferable, irrevocable, paid-up license to practice, or have practiced for or on behalf of the United States, any "subject invention" throughout the world.[15] If the government contractor fails to properly disclose or elect title to the subject invention within the specified time periods or fails to file a patent application, the government may obtain title to the subject invention. Therefore, potential buyers should request records of all of the government contractor's subject inventions, all written elections that it properly obtained title for subject inventions supported by federal funds, any requests by a government agency to obtain title for a subject invention, and all patents and patent applications licensed to the government contractor and its subsidiaries.

Domestic Manufacturing Requirement

The Act also prohibits a contractor who receives title to a subject invention from granting any person an exclusive license to use or sell the subject invention in the United States unless such person agrees that any products embodying the subject invention or produced using the subject invention will be "manufactured substantially" in the United States.[16] Although the Act does not define was "manufactured substantially" means, the guidance and case law developed through the Buy American Act and Trade Agreements Act is a helpful reference.

March-in Rights

If the contractor fails to obtain an agreement from the exclusive licensee or if the exclusive licensee fails to abide by this domestic manufacturing preference, the government may exercise its "march-in" rights requiring the contractor or exclusive licensee to grant a license to another responsible applicant, or do so itself, creating competition in the domestic market.[17] The government, however, may grant a waiver for this domestic manufacturing requirement if the government contractor has shown that it made reasonable but unsuccessful efforts to grant licenses on similar terms to potential licensees that would be likely to manufacture substantially in the United States, or that manufacturing in the United States may not be commercially feasible.

There are other situations where the government can exercise its march-in rights and take title to the subject invention or grant licenses to itself. This can occur when the government contractor (or its exclusive licensee) has not taken reasonable steps within a reasonable time to achieve practical application of the subject invention, the contractor did not reasonably satisfy national health and safety needs, or the contractor did not reasonably satisfy regulatory requirements for public use specified in federal regulations.[18] The government, however, has rarely, if ever, used these march-in rights. Regardless, information on whether the government contractor has put its subject inventions to practice at a reasonable time and that it has reasonably complied with all regulatory requirements will help a potential buyer determine if the contractor has done all the necessary steps to protect its title on all subject inventions developed through the Act.

Does the company deliver technical data or computer software?

As previously noted, when government contractors deliver commercial technical data and computer software as part of its contract performance, the government usually acquires rights to that data or a license to that computer software that the government contractor customarily provides to the public, or in the case of DoD contracts, rights in technical data that are narrower than the government's rights to non-commercial technical data.[19] For non-commercial

technical data or computer software, however, the government can obtain certain rights depending on the source of funding as discussed above.[20] Because of this, government contractors should include an assertion of rights table in its government contracts to ensure that the government is clear about its rights in the technical data or computer software of the contractor and third parties delivered under the contract.[21] The government contractor should also ensure that the technical data or computer software is properly marked to show that it is subject to restriction.[22] Failure to properly include an assertion of rights table or to properly mark the IP may allow the government to assert unlimited rights in the technical data or computer software so potential buyers should obtain all information it can to determine whether the contractor has properly disclosed and marked the IP delivered to the government and maintained sufficient records to validate any restrictions.

Buyers should also determine whether the government contractor has a system to review government proposals to identify where it can limit the scope of deliverables. For example, is the contractor in the practice of delivering source code or sensitive technical data? A contractor who has never delivered source code and is not contractually obligated to do so through deferred ordering, has reduced the risk to the related IP.

For these reasons, whether the government contractor utilizes all the tools at its disposal to protect and control the distribution of its IP has a direct effect on the value of that IP and ultimately the value of the government contractor.

Conclusion

Many government contractors have created successful businesses by developing valuable IP for government agencies. Potential buyers of government contractors can assess that value by obtaining as much information as it can on the contractor's IP and how it manages that IP. Buyers will be able to make informed decisions in mergers and acquisitions when it can obtain relevant information on how the government contractor funds the development of its IP, ensures that it obtains or retains title to the IP, and how it manages IP delivered to the government.

[1] DFARS 227.7203-4(b); 252.227-7013(a)(8); 252.227-7014(a)(8); 252.227-7017.
[2] DFARS 252.227-7013(g)(2); DFARS 252.227-7014(g)(2).
[3] FAR 52.227-14.
[4] FAR 52.227-14, Alt III; DFARS 252.227-7014(a)(15).
[5] FAR 2.101 (defining commercial products and services).
[6] FAR 12.212(a); 27.405-3(a).
[7] DFARS 252.227-7014.
[8] DFARS 252.227-7013.
[9] FAR 52.227-14(b).
[10] FAR 52.227-14.
[11] 10 CFR § 784.3.
[12] 51 U.S.C. § 20135.
[13] Public Law 96-17, §6(a), Dec. 12, 1980, 94 Stat. 3020; codified at 35 U.S.C. § 200, *et seq*.
[14] The Bayh-Dole Act, 35 U.S.C.A. § 200 *et seq*., applies to non-profit organizations and small business. As a matter of policy, the President extended coverage of the Bayh-Dole Act to include businesses of any size by the Presidential Memorandum on Government Patent Policies of the Heads of Executive Departments and Agencies (Feb. 18, 1983) and by Executive Order 12591 in 1987.
[15] 35 U.S.C. § 202(a).
[16] 35 U.S.C. § 204.
[17] 35 U.S.C. § 203(a)(4).
[18] 35 U.S.C. § 203(a).
[19] FAR 12.211, 12.212
[20] DFARS 252.227-7013, 252.227-7014.
[21] FAR 52.227-15(b); DFARS 252.227-7013(e), 252.227-7017(d).
[22] FAR 52.227-14, Alt. II, Alt. III; DFARS 252.227-7013(f).