NASCIO Representing Chief Information Officers of the States

Research **Brief**

March 2005

NASPO National Association of State Procurement Officials

Negotiating IP on the Way to the Win-Win: NASCIO's Intellectual Property Recommendations

This document is intended to provide recommendations from NASCIO's IT Procurement Reform Committee on the ownership of intellectual property (IP) rights in state IT contracts.[1] *In spring 2004, the Committee conducted a survey of NASCIO state and corporate members regarding their approaches to certain IT contract terms, including liability limitations, intellectual property, warranties, liquidated damages, and most favored nation clauses. Section I includes general findings on IP ownership. Section II provides recommendations for state IT contracting to help bring states and contractors closer to IP ownership arrangements that are "win-win" for both parties to the contract.*

I. Summary of Procurement Survey Results

State Standards for IP—Overview of Survey Results:

- **Number of versions:** A majority of states and corporations use a single version of an IP clause.
- **Whether mandatory:** All corporate respondents who answered this question said that an IP clause is mandatory, and a great majority of states indicated it is mandatory.

[1] **A Note on the Scope of these Recommendations:** NASCIO does not intend for these recommendations to encompass the procurement of open source software. Open source software is subject to unique license agreements such as the General Public License. In contrast to proprietary software whose source code is owned by the developing entity, open source software is built upon the principle that the user of the software should be able to use, share, modify and/or enhance source code and that the source code is not the proprietary property of the contractor. Examples of open source software include Apache, the Linux operating system, Firefox, Mozilla, and OpenOffice. If you are considering the purchase of a license to open source software, please consult your legal counsel for the specific licensing models that may be appropriate. If you would like to learn more about open source, please see the "Open Source Legal Toolkit" of Massachusetts' Information Technology Division at <http://www.mass.gov/itd/legal/index.htm#toolkit> and Wikipedia.com at <http://en.wikipedia.org/wiki/Open_source>.

NASCIO/NASPO Headquarters: 167 West Main St., Suite 600 • Lexington, KY 40507
NASCIO: P: (859) 514-9153 • **E:** nascio@amrinc.net • http://www.nascio.org
NASPO: P: (859) 514-9159 • **E:** mtrail@amrinc.net • http://www.naspo.org

- **Origin of clause:** A majority of corporate respondents indicated that this clause is negotiated, while there was a split among states as to its origin. Most states cited either a statutory origin, origin in marketplace negotiations or "other" origin.
- **Prevalence in various types of contracts:** The responses indicate that an IP clause is prevalent in most types of IT contracts.

Effect of State Standard Clauses for IP—Overview of Survey Results:

- **Whether reduced competition:** There is substantial disagreement on this point. A majority of states indicated that this clause has no effect on competition, while a majority of corporate respondents indicated the reduction of competition.
- **Whether price difference:** On the state side, there was an even split as to whether there was a price difference as a result of this clause. However, a slight corporate majority said that there was a price difference.
- **Commercial norm:** A substantial majority of both states and corporations agreed that the commercial norm is for the contractor to retain title and for the state to take a perpetual, non-exclusive license.
- **State standard:** A small majority of state and corporate respondents believed that the state standard is for the state to take title.

II. IP Background and Recommendations

Background on the IP Issue: The ownership of IP created or used under a state IT contract is a vitally important issue for both states and contractors. On the one hand, a contractor's IP portfolio is a highly-valued corporate asset. Contractors invest significant sums of money in the development of IP and then seek to market their IP to multiple government and commercial entities in order to generate revenue. It is recognized that states also invest a substantial sum of money in the development of IP by contractors. Moreover, state governments may seek the ownership of IP to create efficiencies within the context of permanent budgetary challenges and other structural limitations. In instances where a state takes ownership of IP, the state may then permit other government entities to use the IP, thereby saving those government entities time and money in creating similar IT systems.

These recommendations seek to identify state and contractor interests regarding IP ownership and suggest realistic considerations to help make the negotiation of IP rights easier and more successful for all involved.

NASCIO/NASPO Headquarters: 167 West Main St., Suite 600 • Lexington, KY 40507
NASCIO: P: (859) 514-9153 • **E:** nascio@amrinc.net • http://www.nascio.org
NASPO: P: (859) 514-9159 • **E:** mtrail@amrinc.net • http://www.naspo.org

A Word about IP Ownership Options:

In order to place the negotiation of IP rights in perspective, it is important to understand the options that states have regarding IP rights. First, by IP ownership, we mean the ownership of copyrights to works of authorship delivered or produced during an IT engagement.

- **State Owns IP/License to the Contractor:** With this type of arrangement, the state owns the IP that is the subject of an IT contract. However, the state then grants the contractor a license to use the IP developed under the contract with other customers, to create derivative works and to authorize others to use the IP. If the license to the contractor grants rights tantamount to ownership, then the concerns some contractors may have with surrendering IP ownership to the state may be mitigated, because the contractor has retained the freedom of action to use the IP in its own business.
- **Contractor Owns IP/License to the State:** With this arrangement, the contractor retains ownership of IP but provides the state with a license to use the IP. This arrangement tends to be favored by contractors, since it makes it easier for them to use the IP in projects for other clients. The contractor can grant the state a license tantamount to ownership in terms of the breadth of the rights. The benefit to the state of this arrangement is that the state does not have to assume the burdens of IP ownership, including the potential for copyright infringement lawsuits.
- **State Owns IP/No License to the Contractor:** With this type of arrangement, the state owns the IP that is the subject of an IT contract, but the contractor does not receive a license to use the IP for other customers or purposes. This type of arrangement may be disfavored by contractors seeking to protect their IP portfolios and the future revenue that may be derived therefrom. This type of arrangement could increase the total price of the IT contract due to the great value that contractors typically place on their IP portfolios. It could also decrease the number of contractors who are willing to make a proposal on a state IT contract.
- **State-Contractor Joint Ownership Arrangements:** This arrangement allows both the state and contractor to claim joint ownership over IP. An advantage of this arrangement is that it may create the opportunity for both the state and the contractor to benefit from the revenue generated by the redistribution of the IP to other states. However, the state and contractor should be careful to assess, at the threshold, how potential issues of IP indemnification and copyright infringement may be appropriately handled in the context of joint ownership.

NASCIO/NASPO Headquarters: 167 West Main St., Suite 600 • Lexington, KY 40507
NASCIO: P: (859) 514-9153 • **E:** nascio@amrinc.net • http://www.nascio.org
NASPO: P: (859) 514-9159 • **E:** mtrail@amrinc.net • http://www.naspo.org

Specific Recommendations:

A Word about State Legal Requirements & Consulting with Legal Counsel:

Since procurement and other legal requirements vary from state-to-state, there is the possibility that implementation of one or more of the recommendations below could conflict with a state's legal requirements. In order to identify and properly address any potential conflicts, state CIOs and others are encouraged to fully research their state's legal requirements regarding procurement and consult with their state attorney general, state procurement official, and any other state official with helpful expertise in the legal aspects of IT procurement if considering the implementation of one or more of these recommendations.

Recommendations for Determining the Appropriate Type of IP Ownership Arrangement:

- In its RFP (Request for Proposal), a state should specify the type of IP ownership arrangement that it is seeking and whether the IP terms and conditions are negotiable. This approach may reduce the likelihood of protests as well as the expense and time spent by the state and contractor regarding the negotiation of IP rights. The IP ownership arrangement should be chosen using the analysis suggested below regarding the nature of the state's procurement requirements (see section entitled "Recommendations on a Licensing Approach").
- In instances where the state is contemplating procuring services and related deliverables for which outright ownership may be warranted, states should consider the impact of sole state ownership over IP in light of whether the benefits of ownership outweigh the costs. Factors a state should consider include: (1) the cost of IP ownership, (2) the cost of alternative IP ownership arrangements, such as a licensing arrangement with the contractor, and whether a sufficiently broad license right can be secured, (3) the number of potential users of the IP, and (4) the potential risks associated with IP ownership, including possible IP copyright and patent infringement suits and future support and maintenance. A state's ownership of IP with no license back to the contractor could discourage some contractors from making a proposal on a RFP and could increase the total amount of a contract.
- State CIOs should work with state procurement officials and any other key stakeholders in determining the type of IP ownership arrangement that is appropriate for an IT system or project.
- A state should address IP ownership issues during the RFP phase to ensure an "even playing field" for the state and contractor and to help ensure state flexibility regarding IP ownership.

NASCIO/NASPO Headquarters: 167 West Main St., Suite 600 • Lexington, KY 40507
NASCIO: P: (859) 514-9153 • **E:** nascio@amrinc.net • http://www.nascio.org
NASPO: P: (859) 514-9159 • **E:** mtrail@amrinc.net • http://www.naspo.org

Recommendations on a Licensing Approach:

- States are encouraged to consider a licensing arrangement with a contractor in which the contractor retains ownership of its IP and grants the state a license to use the IP. Although this approach is favored by contractors, because it protects their ownership rights with respect to their IP portfolios, there are certain exceptional circumstances that may warrant a state taking IP ownership. However, if a state chooses to seek a license right from the contractor, then the state should clearly provide in its RFP what rights it expects to be granted via the license (see the section of this brief entitled, "Recommendations on Defining License Rights," for more detailed information about use, redistribution and other rights that a contractor may grant to a state with a license).
- The benefits of taking this approach include: (1) lowering the overall contract cost by allowing contractors to retain their IP and the right to market it to others, (2) increasing the pool of contractors willing to make a proposal for a state IT contract, (3) avoiding potential liability in the event of an IP infringement suit by a third party against the owner of the IP, and (4) avoiding administrative and resource burdens associated with future support and maintenance issues.
- California and New York generally have begun to take this approach in most IP negotiations. The U.S. Department of Defense also has opted to take a license for the use of IP in many cases.
- If an IT system or project is federally funded, then a state should determine if any federal laws or regulations mandate the type of IP arrangement into which a state can enter. It may be an exceptional circumstance where a federal law or regulation mandates a state to require a broad license to IP produced at the government's expense.

A Suggested Analysis for State License Rights:

In determining IP rights, states are urged to examine the particular requirements of the contract because, in many cases, that will determine the appropriate approach to IP. The following examples may assist in this analysis:

Procurement of Commercial Software and Ancillary Services: Commercial off-the-shelf software (COTS) is virtually always subject to standardized licensing agreements. While, in certain instances, the terms of the license may be negotiated, particularly regarding financial terms, contractors should not be expected to divest themselves of ownership of COTS software enhancements or derivative works of such software. Likewise, contractors should maintain ownership over deliverables related to the maintenance, installation and configuration of COTS software.

Procurement of Standardized IT Services (such as Hosting or Disaster Recovery Services): These offerings typically do not pose difficult IP issues, and states can receive appropriate use rights through the licensing of IP embedded in the service.

NASCIO/NASPO Headquarters: 167 West Main St., Suite 600 • Lexington, KY 40507
NASCIO: P: (859) 514-9153 • **E:** nascio@amrinc.net • http://www.nascio.org
NASPO: P: (859) 514-9159 • **E:** mtrail@amrinc.net • http://www.naspo.org

Procurement of Consulting Services Involving Customized Deliverables: In this instance, a state may legitimately require ownership of certain deliverables; however, unless the state has a compelling need to exclude contractors from using the deliverables, a license back to the contractor may facilitate competition and a faster resolution to negotiating terms.

Procurement of Systems Integration Services: This is the most complex area. A systems integration contract may involve COTS software and ancillary services, custom deliverables produced in accordance with specific state requirements, and deliverables that combine newly created IP with pre-existing contractor IP. Standardized IP clauses may be inadequate for this situation, and states should consider implementing a clause based on the categories of ownership described above in which particular types of IP can be designated as being licensed to the state, owned by the state (with, as appropriate, a license back to the contractor) or jointly owned. States should anticipate the negotiation of IP rights for complex engagements.

Recommendations on Defining License Rights:

- Depending on its terms, a license can be tantamount to ownership, since it can bestow upon a state all of the benefits of ownership without actually transferring title to the state. States must take care in scoping their license rights to ensure that they have the necessary rights to effectively deploy the technology acquired under the contract to meet the state's needs.
- One type of license that a contractor may grant to a state is a license for "government purposes." This type of license permits the state, including its agencies and even local governments, to use the IP as long as it is for a "government purpose." The term "government purpose" should be clearly defined in the RFP and contract. A contractor may have an incentive to permit sharing via a "government purpose" license where there is a possibility of future modifications or support and maintenance. California has taken this approach.
- If a state chooses to pursue a "government purpose" approach or a joint ownership approach, issues that it should address include:
  - **Redistribution Rights:** A state should clearly define whether it will have the right to redistribute IP to other entities, such as other state agencies or local governments.
  - **Modification Rights:** A state should clearly define whether it can modify IP or create derivative works without a contractor's permission.
  - **Length of a License:** A state should clearly define the length of a license in terms of whether it will last for a specific number of years or whether it is non-expiring.
  - **IP Indemnification/Copyright Infringement:** A state should assess and, if appropriate, include contract language regarding the rights and obligations of both parties in the event that IP indemnification or copyright infringement issues arise.

NASCIO/NASPO Headquarters: 167 West Main St., Suite 600 • Lexington, KY 40507
NASCIO: P: (859) 514-9153 • **E:** nascio@amrinc.net • http://www.nascio.org
NASPO: P: (859) 514-9159 • **E:** mtrail@amrinc.net • http://www.naspo.org

- For IP owned by a contractor under the terms of the contract, the payment of royalties to a state by the contractor upon redistribution or use of IP is typically disfavored by contractors due to legal, financial and administrative concerns.
- A state should have the right to own or have a perpetual license to any customizations it performs or enhancements that it creates. If a state has a license for any such customizations or enhancements, then the state also should have the right to modify those customizations or enhancements at its own discretion. Note that the type of service or technology procured may play a role in the ease or difficulty of negotiating this point. For example, it may be more difficult for a state to obtain ownership to enhancements or modifications to COTS because of the high degree of standardization of those contracts. However, with other types of contracts, such as contracts for consulting services, the type of ownership (state ownership with a license to the contractor, for example) may drive the negotiation of state ownership of customizations and/or enhancements.

Recommendations for Addressing the Source Code Escrow Issue with Commercial Off-the-Shelf Software:

- In some cases, states may request that a contractor place its source code in an escrow that would be accessible by the state if certain events occur, such as a contractor's bankruptcy. In the current IT market, large contractors are less likely to provide a state with a source code escrow, while smaller contractors may be more likely to put their source code in escrow.
- A state should consider whether it needs the protection of a source code escrow and then clearly state that policy in its RFP, including whether the state will bear the administrative costs of an escrow agreement or for collecting the source code.
- If a state determines that it needs a source code escrow, the state should consider allowing the contractor to respond in its proposal with the types of parameters that it would consider regarding a source code escrow.

Recommendations on the Standardization of State IP Terms and Conditions:

- A state should consider establishing a standard set of terms and conditions for the treatment of IP in IT contracts. If the treatment of IP for a specific IT project differs from the state standard, then the state CIO should have approval authority over any such deviations. States should focus on developing IP clauses for different use scenarios, such as consulting services, standard IT services, COTS software acquisition and system integration.
- The benefits of standardizing a state's IP terms and conditions for IT contracts include: (1) reducing the amount of time spent negotiating IP terms and conditions, (2) helping to promote among the relevant state attorneys an understanding of the motives behind contractors' desire to retain ownership or license rights to IP, and (3)

NASCIO/NASPO Headquarters: 167 West Main St., Suite 600 • Lexington, KY 40507
NASCIO: P: (859) 514-9153 • **E:** nascio@amrinc.net • http://www.nascio.org
NASPO: P: (859) 514-9159 • **E:** mtrail@amrinc.net • http://www.naspo.org

providing contractors with a better understanding of the state's desires with respect to IP ownership and licensing.

- States should be aware that it may be difficult to achieve a high degree of standardization for IP terms and conditions, since some situations, such as for homeland security-related IT systems and projects, may warrant flexibility with respect to IP ownership. Hence, any state IP standard should allow for such exceptional situations.

Recommendations on IP and the State Attorneys:

- State CIOs should educate procurement and other attorneys on the contractors' motives with respect to IP ownership. By increasing attorneys' understanding of these issues, they will have a better context in which to ensure that state IP terms and conditions satisfy all legal requirements and protect the state, yet attempt to allow for IP arrangements that may be more amenable to IT contractors.
- Creating a centralized pool of legal expertise within the State CIO's office can help a state take a more consistent approach to IP.

A Note on a Novel Approach:

On a more philosophical note, there have been discussions within the IT procurement community throughout recent years regarding whether states should place their IP in the public domain. Supporters argue that the IP associated with state IT projects has an inherent value to society as a whole and hence should be made available to citizens as part of the public domain. Another potential benefit of that approach would be the streamlining of the negotiation process for IT contracts by avoiding time and resources spent haggling over such issues as the redistribution of IP and the payment of royalties. However, those who do not support the placement of state IP in the public domain argue that: (1) contractors have a right to protect their IP, especially where pre-existing contractor IP would be incorporated into IP potentially placed in the public domain, (2) contractors have a right to receive an adequate return on their investment of time and resources, and (3) states have a legitimate interest in the reuse and remarketing of the IP that they own.

Recommendations on the Role of the State CIO:

- State CIOs should educate procurement and other officials, including attorneys and other key players, on the costs and risks to the state of IP ownership and the motivation behind contractors' desire to retain IP ownership.
- CIOs should also educate Governors and legislators regarding the trade-offs involved in IP arrangements that may be a departure for a state regarding its IT contracting process.

NASCIO/NASPO Headquarters: 167 West Main St., Suite 600 • Lexington, KY 40507
NASCIO: P: (859) 514-9153 • **E:** nascio@amrinc.net • http://www.nascio.org
NASPO: P: (859) 514-9159 • **E:** mtrail@amrinc.net • http://www.naspo.org

What CIOs Need to Know

- States should seriously consider taking a license for IP, as opposed to taking ownership over IP, in order to reduce the overall cost of IT contracts and increase the pool of contractors willing to make a proposal for state IT contracts. However, exceptions to this recommendation exist, such as in instances where highly customized deliverables are produced. Note that states must take care in scoping their license rights to ensure that they have the necessary rights to make use of the IP and receive the anticipated benefits of the IP.
- If a state is considering taking ownership of IP, the state should carefully weigh the potential costs, benefits and risks.
- States should clearly state within their RFPs the terms that they are seeking with respect to IP ownership rights and whether those terms are negotiable.
- States should consider developing a standard approach to IP terms and conditions. However, the standards should provide room for exceptional situations which warrant a state taking ownership over IP.
- State CIOs should work to educate Governors, legislators, state procurement officials, state attorneys general and others within the legal community about the motivations of the state and the contractor community regarding IP ownership and the risks and benefits of the various ownership approaches a state may take regarding IP.

These recommendations were developed by NASCIO's IT Procurement Reform Committee in consultation with NASPO (the National Association of State Procurement Officials) and have been endorsed by NASPO.

NASCIO is the **National Association of State Chief Information Officers** and represents the state chief information officers from the 50 states, five U.S. territories and the District of Columbia. Other IT officials participate as associate members and private sector representatives may become corporate members.

NASPO is the **National Association of State Procurement Officials** and represents the directors of the central purchasing offices in each of the 50 states, the District of Columbia, and the territories of the United States.

AMR, Inc. *is* ***Association Management Resources, Inc.*** *AMR provides NASCIO and NASPO with full management services. For more information about AMR, please visit www.amrinc.net.*

NASCIO/NASPO Headquarters: 167 West Main St., Suite 600 • Lexington, KY 40507
NASCIO: P: (859) 514-9153 • **E:** nascio@amrinc.net • http://www.nascio.org
NASPO: P: (859) 514-9159 • **E:** mtrail@amrinc.net • http://www.naspo.org