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IP
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When Your IP Is Far Away

To safeguard IP assets in an outsourcing deal, develop a strong contract and an even stronger business relationship.

By Bruce F. Metge

Intellectual property and offshoring are two great things that go great together. The portability and repeatability of intellectual property assets—think, especially, computer software—make them practical for outsourcing arrangements, either domestically or abroad.

But portability and repeatability also create some unique risks to preserving intellectual property's value. IP assets are all too easy to "share" with unauthorized users. And that's why so many people these days are concerned about sending or creating IP assets "away from home."

Often, the savings of outsourcing are worth the IP risks. There is, after all, no such thing as a free lunch. But mitigating the downside of outsourcing is a necessary and complex task.

Caution Is Called For

By entering into an offshoring arrangement, a company can lose direct control over its intellectual property, which becomes available to the third-party vendor (or customer, in the case of the vendor's intellectual property), its employees, and potentially others. Use of the intellectual property is governed by the terms of the agreement between the customer and the vendor, the applicable law or laws of the relevant states and countries, and the relationships that the third party has with its current and future employees and current and future customers (or vendors). Every natural and corporate person becomes a potential weak link in the chain of IP protection.

Such risks cannot be eradicated entirely, but they can be reduced with careful planning and documentation. More specifically, preserving IP rights in the context of an offshoring arrangement requires a detailed knowledge of the goal of the arrangement, a commitment to effective relationship building, a practical and legal understanding of what remedies will be effective under the circumstances, and the creation of redundant contract solutions to potential issues.

Only through this layered approach to anticipatory problem solving will companies be likely to preserve the short-term benefits of these offshoring arrangements over the long haul.

What Can Go Wrong

A case in point: The ABC Co. has entered into an offshoring agreement with a vendor outside the United States for certain critical early-stage analyses that require large amounts of software engineering time and effort. The upfront savings from offshoring are too significant to bypass, in an estimated ratio of 5-to-1 on core costs.

ABC's proprietary information and software code are shared with the vendor in the normal course of the arrangement. The agreement provides that all work on the project belongs to ABC. It further requires that all disputes must be resolved in U.S. federal court in the state of ABC's headquarters, and does not provide for arbitration.

The project is completed with some excellent and unanticipated results, creating in the process some valuable new tools for future projects. ABC is initially quite happy. Then ABC learns that a competitor, the XYZ Co., has retained the same offshore vendor to do a similar project and now is availing itself of ABC's intellectual property through the vendor. ABC moves quickly to sue the vendor in ABC's local federal court.

Result? Depending on the country where the work was performed, the result easily could be that ABC obtains a favorable judgment in the United States, only to learn that the court in the foreign jurisdiction either will not recognize a U.S. court judgment, or suffers from a serious delay in its docket (think years), or both. Thus, ABC has no practical recourse to protect its property. The company may no longer even be able to gain full access to that property for its own use.

From the darkest perspective, ABC has just spent time and money to enrich its competitor—an effort not likely to win approval from top management, shareholders, or the market. And if ABC has put a value on the proprietary software on its books, those books may now be inaccurate. This could create domestic reporting issues if ABC is publicly traded.

Here's the Plan

Could this result have been avoided? Yes.

If the customer-vendor relationship had been stronger, the chances of the vendor turning around and using ABC's intellectual property with its competitor would have been significantly diminished. If a critical project had to be turned over to the new vendor, then additional protections should have been written into the contract. In short, the crown jewel should always be protected with multiple layers.

To avoid becoming the next ABC, companies should consider these steps in establishing any outsourcing arrangement that does or might involve valuable IP assets:

- *Document the intellectual property.* Keep appropriate records—formal, informal, or both—of all trade secrets, trademarks, copyrights, and patents that come into play in the outsourcing relationship. Register the intellectual property at home and in the countries where the company does business. And if registering intellectual property in the country where the outsourcing vendor is located is cost-prohibitive or otherwise not possible, that's a fact that should be considered in assessing the risk of the arrangement.
- *Deal with reputable and reliable parties.* There are many ways to perform diligence on a potential business partner, from simple Web-based searches and credit checks to retention of expert consultants to engage in "granular" review of a party's background. Don't be penny-wise and pound-foolish: Spend the money for the level of inspection warranted by the value of the intellectual property at risk.
- *Work with a vendor with whom you have or can develop personal relationships at one or more levels of the vendor's personnel.* Indeed, wait for such relationships to develop before sharing critical intellectual property. There is no substitute for mutual experience in an offshoring arrangement.

The fact is that it is not common sense to provide any vendor with critical business information or intellectual property on the maiden voyage. Customers experienced in offshoring arrangements build the relationship of trust over time, and start with small noncritical projects.

- *Identify in the contract the specific intellectual property that may be shared through the outsourcing arrangement, and identify who owns which property.* Play out the "what if" situations. Establish rules for what happens to improvements and modifications to the intellectual property as the relationship progresses. Specify what happens to the property and related records in the event of a breakup.
- *Be aware of the intricacies of international law.* The laws of other countries do not always play well with the laws of the United States. For example, there are legal provisions in India that may render U.S. court judgments unenforceable in that country.

Beware that the protection of all kinds of information varies around the world. If an American company seeks to place a whistle-blower call center in France, for example, it may find that the French government considers the anonymity of those calls to be potentially in violation of the European data protection regime. Such a view may be adopted by other European jurisdictions.

- *Consider a mandatory arbitration clause in the contract.* Mandatory arbitration, joined with a favorable choice-of-law clause, can resolve disputes even in jurisdictions that do not recognize U.S. court judgments. In India, for instance, the courts will generally enforce an arbitration decision between two parties to a contract.
- *Last but not least, make sure that the company's intellectual property will not be made available to its competitors.* Diligence as to the employees of a future business partner, and its employment agreements and controls, are a part of this exercise. After the company's property has left the building in the hands of a business partner's disgruntled employee, even a successful suit for breach of contract may be small solace. If it is possible and appropriate, specify who at the third-party vendor is allowed access to valued intellectual property.

Another way to protect against catastrophe in significant offshoring arrangements is to write into the contract a provision permitting the customer to take possession of the vendor's shop under business-threatening circumstances, such as the vendor's loss of funding or business interruption for reasons related, or even unrelated, to the customer's business.

Clearly, many of the best ways to address the future risks of an outsourcing arrangement relate to the contract itself. But an offshoring agreement marks the beginning, not the end, of a relationship. So the agreement should not be the sole repository of solutions to IP risks. Successful offshoring depends on good contracts and good relationships.

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