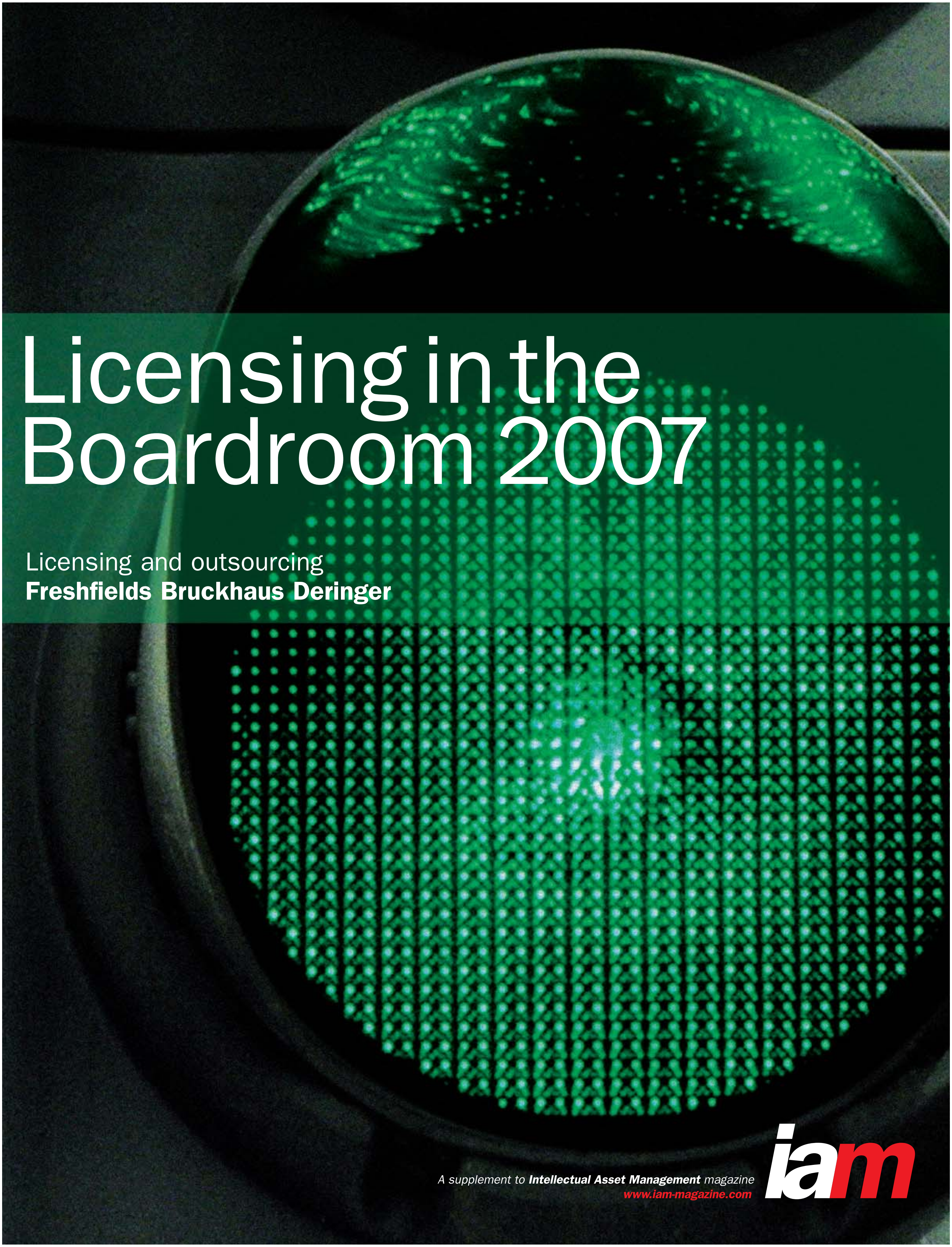

Licensing in the Boardroom 2007

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Licensing and outsourcing

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In outsourcing, a third party provides services for a company that has decided no longer to provide resources for these services within the company itself (the company). The main reasons for outsourcing business procedures are cost control, focus on a company's core competences, the use of external know-how and access to cutting-edge technology.

Very often the business unit being outsourced works with technology or software. Data processing and accounting departments are two of the more common outsourcing targets. In this context it is of major importance that the third party conducting the business process after the outsourcing takes place (the outsourcer) has the right of use for the software or technology in question. As a result, in almost every outsourcing deal of this kind, licensing forms an essential part of the outsourcing relationship.

This article looks at typical licensing issues in standard outsourcing situations with a focus on how the right of use finds its way from the intellectual property rights owner to the outsourcer. It addresses some of the main issues to consider when drafting the outsourcing and licensing agreement, and outlines some exit strategies. It examines these issues in terms of an information technology outsourcing process where software use is the main issue.

Two standard situations can be identified as the starting point of such outsourcing projects if a company already uses software in the business unit to be outsourced:

- The company created the software used in the outsourced business unit and owns the related IP rights.
- The company uses software on the basis of a licensing agreement with a third-party software provider that will now be made available (also) to the outsourcer.

Company as proprietor of IP rights

Where the company created the software and owns the related IP rights, there are few problems related to giving the outsourcer a licence and enabling the latter to run the outsourced business unit as the company did before. It is advisable for the company to limit the right of use: first, to the extent necessary for the execution of services for the outsourced field of business; and second, with regard to duration by linking the term of the licence to the term of the outsourcing relationship.

The company also needs to consider whether to keep the right of use for its own business so that it can further process the work delivered by the outsourcer. This can be achieved either by reserving a right of use in the licensing agreement with the outsourcer or – where the IP right was previously the subject of an exclusive licence to a third party – by obtaining consent from the exclusive licensee to the effect that the company shall be granted the right to use its own IP right, in addition to the existing exclusive licence and the non-exclusive right of use transferred to the outsourcer.

If the company has already granted a third party an exclusive licence for its software merely reserving the right of use for the company's own business and, as is often the case, the initial licensing agreement between the company and exclusive licensee does not allow the transfer of such right of use for outsourcing transactions, the consent of the exclusive licensee may be needed to transfer the right of use from the company to the outsourcer.

IP rights owned by third party

The situation is more complex if the company has licensed the right of use for the software from a third-party software provider. Again, two different situations can be identified: either the company purchased the software or the company uses the software on the basis of a licensing agreement with continuing obligations, such as royalties payments, making it similar to a lease.

Company as purchaser of product incorporating third-party IP rights

In the software business, most standard purchase agreements and/or sellers' general terms and conditions contain clauses that restrict the licensee's right to transfer the software or the right of use to third parties without the consent of the software provider. It should be noted that through the outright sale of software, under the IP regulations of certain jurisdictions making software subject to copyright, the incorporated IP right is regarded as exhausted with the result that such restrictions are likely to be invalid from an IP (or antitrust) law point of view. However, the parties to the initial software purchase can still agree on such restrictions provided that such terms form part of the purchase agreement. This integration of the terms and conditions in the purchase agreement can again be problematic under the laws of general terms and conditions of some jurisdictions (the area of shrink-wrap licences being a case in point). Generally speaking, in most cases where a company has purchased a product incorporating third-party IP rights, it will have the right to transfer the product, *ergo* the software, to an outsourcer if the former does not keep a copy of the software.

In many cases, it will remain necessary for a company to keep the right of use for the software; for example, as stated before, to process the outsourcer's work in the given IT framework. This is often achieved through a back licence for the software so that the company keeps a right of use for the software previously purchased and then transferred to the outsourcer. Again, in some jurisdictions back licensing of purchased software to the company may not be permitted after the latter has transferred the right of use to an outsourcer. In such scenarios, exhaustion of the IP right (copyright), as described above, may not cover the right to distribute the software through a licensing process. Therefore, the company would need approval from the initial IP rights owner to keep the continued right of use in these jurisdictions.

A third option for a company that wants to keep the right of use for software it has previously purchased is the granting of a (sub-)licence to such software. As this creates an additional user for the software, it can again trigger further remuneration duties and will need the consent of the initial IP rights owner and seller of the software, unless explicitly made possible by the terms of the initial software purchase agreement. This will rarely be seen in standard software purchase agreements.

Company as licensee to third-party IP rights

If a company initially leased software through a licensing process, there are two ways the outsourcer can make use of the licensed right: by transfer of the initial licensing agreement or through a sub-licence granted by the company.

If the company no longer needs to use the software – for example, after outsourcing a complete business unit – transferring the initial licence can be a good way to enable an outsourcer to continue the operation of the outsourced business unit. It may also be in the interest of a company to transfer an existing licence to the outsourcer to ensure continuity of quality and content of the outsourced business unit. As the transfer would change the parties to the agreement, the owner of the IP right and initial licensor will have to give consent to the transfer. Where an exclusive licence is in play, the initial licensing agreement will often already contain a clause allowing the licensee to transfer its rights in an outsourcing scenario.

Where a company wants to keep the right of use of the software to continue to operate the outsourced business unit, one option is to give the outsourcer a sub-licence. This is possible only if the main licensing agreement between the IP proprietor and the company contains a provision allowing the company to grant sub-licences. Again, such right will often be included if the initial licence is exclusive. If not, it might be advisable for an outsourcer to get a direct licence from the IP rights owner to ensure independency from the company as a sub-licensor. As an alternative, the company can ask for the initial licensor's consent for the company to grant sub-licences. This again will often affect the company's royalty obligations, as it widens the scope of rights granted to the company.

Responsibility under the outsourcing agreement

Depending on who the parties to a licensing string are, it will be necessary to implement a system of rights and duties into an outsourcing contract, as well as in the licensing terms.

Company as licensor to outsourcer

If the company acts as licensor for software provided to the outsourcer for execution of the services due under the outsourcing agreement, it remains the company's duty to ensure full validity of the IP rights in play and to transfer the right of use to the outsourcer. Further, the company should set up guidelines for the outsourcer on the scope of the right of use and performance under the licensing agreement. For example, the agreement should state whether or not the outsourcer is entitled to have services due under the outsourcing agreement executed by subsidiaries or third parties. Another issue relates to the source code, which a company will generally not want to share with the outsourcer. Where source code is provided to the outsourcer for special interest reasons – for example, programming, updating or other duties related to the licensed software – the company should make sure to carefully draft the events in which the outsourcer has access to the source code to avoid abuse. This point is also important with regard to the termination of the outsourcing relationship and the question of whether or not the company is entitled to use any upgrades in software technology or improvements made by the outsourcer (see below).

The outsourcer as licensee will normally have to pay royalties, although in general no remuneration is due simply because the outsourcer would otherwise calculate this amount against the amount due for the outsourcing activity.

IP rights owned by third party

If the outsourcer assumes the company's role after transfer of the initial licensing agreement between the company and a third-party software provider, the outsourcer takes over the full catalogue of rights and duties as set forth in the initial licensing agreement. It is vital for the company, however, that the licence stay active for the term of the outsourcing relationship to guarantee business continuity. It is, therefore, advisable for the company to set up a provision in the outsourcing agreement according to which the outsourcer will have to continue to execute the licence and act appropriately to avoid termination by the third-party licensor because of breach of contract.

Exit strategies

Where the company owns the IP rights that are the subject of the outsourcing relationship, it is advisable to implement a clause in the licensing agreement according to which the licence will automatically be terminated in the event of termination of the outsourcing relationship. In this way, the company can ensure third parties do not profit from the outsourcer's services and that further know-how is not created in the outsourcer's business with regard to the licensed rights that may potentially lead to the outsourcer developing competing software. The company should consider other exit scenarios, such as continued

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underperformance and breach of fundamental contractual duties, so as not to become bound to a non-performing contractual party.

Where the company transferred its initial licence with regard to third-party rights to the outsourcer, the outsourcing agreement should contain a right of first refusal for the company to re-enter into the licensing relationship after the outsourcer exits the outsourcing deal or the licensing agreement is otherwise terminated. In this way, the company can make sure its business stays active even if the outsourced business unit or process has to be re-integrated into the company's business or executed by a new outsourcer that, again, will be able to enter into the licensing agreement.

As mentioned above, the parties should prepare for the time after termination of the outsourcing relationship. One of the most important points here is the question of what happens to upgrades in software technology or improvements and additions made by the outsourcer during the term of the outsourcing relationship. Where the business unit is reintegrated into the company's business, the company is well advised to oblige the outsourcer to provide these software improvements to the company and help migrate databases and system upgrades. The outsourcer, on the other hand, should think about a clause in the outsourcing agreement to the effect that where the outsourcer is substituted after termination of the initial outsourcing agreement, upgrades and improvements will not be shared with the future outsourcer without remuneration, if at all.

Summary

Some of the key issues in outsourcing processes where IP and/or IT is involved relate to licensing. The stream of the IP rights in question needs to be carefully identified to allow the outsourcer to perform its duties under the outsourcing agreement and at the same time provide security for the company that quality is maintained after the business unit is outsourced. Thorough drafting of the outsourcing and licensing or IP transfer agreements can resolve these issues to the best interest of both parties.

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