Outsourcing

An *IAM* management report

Welcome

There is no doubting that these days outsourcing is a multi-billion dollar business. And it is not hard to see why, as companies are in a position to save substantial amounts of money when they send out work to be done by third parties at a fraction of the amount it would cost for the same to be done in-house.

But as outsourcing becomes an ever-more popular option for businesses – and many more types of increasingly sophisticated work are outsourced – so the dangers posed by getting the intellectual property component of a deal wrong are magnified. There are many instances in which companies have found that the intellectual property they own – or, often more precisely, think they own – actually ends up being owned by their outsourcing partner. This can be the case whether a function has been farmed out to an individual contractor down the road or where significant amounts of work have been entrusted to a large organisation based on the other side of the world.

In all outsourcing situations, therefore, it is vital that IP considerations are factored in at the earliest stage in any negotiations with a potential partner. The bottom line is that if you do not look after the IP issues, you may well find that it is not actually yours to worry about at all. And that could be damaging not just for profitability, but also for share prices, not to mention catastrophic for individual careers.

With all this in mind, *IAM* has teamed up with a group of expert correspondents to produce this special co-published management report on some of the key issues surrounding outsourcing. It covers three of the world's most popular outsourcing destinations – China, India and Mexico – and also takes a look at the increasingly popular subject of legal process outsourcing.

The contributors invited to submit articles for this report have acknowledged reputations in the outsourcing field and they offer a number of important insights. While none of the contributions can be a substitute for specific legal advice, and should not be read as if they are, this management report is nevertheless a valuable resource which, I hope, will help companies seeking to avoid the IP perils outsourcing can bring.

Joff Wild,
Editor, *IAM* magazine

Chapters

LPO: the next wave of outsourcing

By **Rob Stichbury**, CPA, London

Outsourcing is not a new concept. Many companies have been using external providers to fulfil highly administrative or poorly served functions of their business for most of our modern business history. What has changed in the past decade, however, is the type of function that is outsourced, as well as to where and to whom it is entrusted.

Since the late 1990s, outsourcing and offshoring have experienced a period of phenomenal growth. Today, the provision of third-party services is a global industry with various forms of highly skilled business and legal support located in cost-effective locations around the world. Most are in the key Asian territories of China, India and the Philippines, but increasingly, new businesses are setting up in Eastern Europe, Africa (most notably, Kenya and South Africa) and South America (Brazil).

The changing face of outsourcing

Initially a high proportion of outsourcing work focused on business process outsourcing or BPO; that is, simple business processes, such as back office functions, call centres, human resources and IT. Driven by board pressure to reduce overheads, over 4 million US jobs have been moved offshore in the past 10 years. This area of business is developing quickly and recent trends suggest that there has been a paradigm shift in the way companies outsource. The race for cost savings has given way to the race for top skills. Subsequently, providers are evolving to support Knowledge Process Outsourcing (KPO), providing highly skilled professionals, such as doctors, engineers, mathematicians and bio-scientists. Offshoring more cerebral tasks has many merits. For example, an A&E fracture clinic in the US can benefit from 24/7 assessment of digital x-ray imaging by outsourcing the work to experts in a different time zone.

The need for capacity, combined with intellect and workforce flexibility has led the KPO market to grow rapidly in the past three years to around US$ 3 billion spending in 2006. Success in this sector has also led to the more recent, but rapidly growing trend of legal process outsourcing (LPO). As with BPO, the minor or less sensitive work of a legal department initially lent itself best to outsourcing. Accounting, forensic accounting, legal drafting, legal research, document sifting, forensic analysis of administrative communications and printed material were regarded as acceptable tasks to outsource. However, the high demand for skills in the legal sector has opened the eyes of forward-thinking corporations and law firms to the greater bank of, previously under-used, legal expertise that exists in popular offshoring destinations. Higher value work is now being outsourced, particularly in the area of intellectual property, where companies and law firms are, for example, using offshore experts to mine patent portfolios.

IP currently accounts for over 45% of the LPO market and is expected to lead the growth in this sector in the next three to five years. The service mix already includes basic IP services, such a proofreading and paralegal support; but as low-end IP administrative tasks are outsourced with success, companies are electing to offshore more complex tasks to trusted suppliers, leveraging the experience and talent available to improve processes, and apply the benefits of scale and technology.

General Electric was one of the first companies to realise the potential of IP outsourcing, starting the trend back in 2001 by opening its own office in India. This was later spun out from a captive, only providing services to one company, to an independent third-party player now called Genpact. More recently, one major global technology

company doubled patent filings without increasing costs or compromising the quality of its IP by outsourcing to India. And today, over 100 US-based entertainment and broadcasting companies choose India for high-end legal research and substantial volumes of litigation work.

LPO for the IP industry

So does LPO work and is it suitable for the IP industry? The simple answer is yes. In our fast-paced industries, businesses need to strive for continual innovation in order to ensure competitive advantage. This translates into greater legal, particularly IP, activity. That's not just in the number of patents that companies seek to register and protect, but also, for example, in the trend to farm patent estates actively. Without external help managing the administrative side of the IP work, few corporations would be able to keep up with or afford to properly develop their IP portfolios.

The quality of graduates in jurisdictions such as India equates to an immense pool of available technical talent. The competitive wage rates make it practical to pay staff to spend extra time on projects, ensuring thorough and well-analysed results. This is particularly true of tasks such as prior art searching.

An increased emphasis on M&A activity since 2004 has also spurred the need for more flexible resources. IP due diligence is fundamentally important in all M&A activity, and increasingly higher on the agenda in private equity and venture capital deals. This has big implications for IP departments as it also generates large volumes of work in tight timeframes, distracting staff from otherwise core activities. If forced to manage the work internally, companies are faced with increasing costs, backlogs and delays in work and compromises in the quality of the work being produced.

The rising cost of office space, the scarcity of skilled staffing in the developed world and the challenge to manage the peaks in workload all put pressure on a company's bottom line. LPO has enabled companies to increase productivity and capacity, to achieve scale and bandwidth to operations. It also satisfies board pressure to leverage IP and keep costs down, while still maintaining (or even improving) quality of work.

The growth in worldwide patenting activity over the past decade has also meant that national patent and trademark offices are struggling to keep up with the speed of innovation. In 2005 (the most recent data available), the European Patent Office had 119,800 patent searches pending, and this figure is due to grow by 24% each year. Similarly, in 2006, the US Patent Office revealed details of a backlog exceeding 700,000 patent applications and the situation looked all too familiar at the Japanese Patent Office (JPO) in 2005, when its backlog hit 790,000. At that point the JPO took action and outsourced 25% of its prior art searches to help get back on top of the escalating workload. The move to outsource and increase capacity at the JPO was welcomed by industry too, since application delays can mean that precious patent licensing opportunities are lost.

In such an aggressive environment, outsourcing is no longer a choice – the question is not whether a business should outsource, but instead, how best to do it. "We all know that outsourcing is not just about cost take-out anymore. Done right, outsourcing will make your organisation more nimble, more agile and more competitive," said Kevin Campbell, Group Chief Executive – Outsourcing, Accenture, earlier this year.

Choosing the right partner

Ultimately, it is the importance of quality, not cost, that is driving growth in the LPO marketplace. That's why companies looking to offshore or outsource key tasks should be looking for an experienced partner that is able to assure quality of work, as well as manage risk and guarantee data security, export control, interoperability of data and smooth transfer of work.

Leaders in the field

According to AT Kearney's annual global services index, India is the current global capital for outsourcing and offshoring, with other Asian destinations dominating the top five.

The outsourcing top 10:

1. India	**2.** China
3. Malaysia	**4.** Thailand
5. Brazil	**6.** Indonesia
7. Chile	**8.** Philippines
9. Bulgaria	**10.** Mexico

India has been the main destination for BPO for 10 years, thanks to its huge bank of experts, its staff resources and its widespread use of the English language. It also has a favourable business and tax environment, works to a common law system and, importantly, has a positive work ethic. The high-level work involved in KPO and LPO is viewed as a leading-edge career for many graduates in India.

When we compare the percentage of national workforces with a university degree and the total numbers in the population, it becomes clear why China and India will inevitably hold their dominant roles. India produces 450,000 graduates annually – including some 79,000 law graduates and 5,000 PhDs. China has a higher percentage of graduates in the workplace and nearly double the total number of graduates in work – 43 million versus 23 million for India. But critically, although China has more graduates, language skills and a conflicting legal system mean that India looks set to maintain its pole position. Until new jurisdictions build up the same level of expertise and resource, its domination in the offshoring market should continue for the next two decades.

The shift overseas

Forrester Research estimates that by 2015, as many as 3.3 million US jobs and US$136 billion in wages will move overseas. By 2020, it believes that the global outsourcing industry will reach US$1 trillion – that's the equivalent of the GDP of Spain or Mexico. LPO is expected to lead the field in the next three-five years. It is already estimated to be worth US$146 million annually (Value Notes, July 2007), but this is just the beginning. Industry sources predict that this will grow to US$600 million by 2010. This means that there is no shortage of offshore opportunities and that there will be LPO solutions to suit every need.

In the IP industry in particular, there is now also a growing trend towards multi-sourcing and multi-shoring, where corporations and law firms select not to outsource a variety of in-house tasks to one expert supplier or global jurisdiction, but instead select the best (or most innovative) supplier or the best jurisdiction for each task. Better still, they find a supplier that has the breadth and scope to provide the appropriate specialist mult-discipline expertise and a multi-shore option. IP service providers work on a variety of levels, but aside from CPA, there are only a few companies that can actually provide the global, multi-faceted approach to LPO that most businesses need.

At the very basic level, businesses should be outsourcing non-core and lower-value activities, leaving in-house staff to focus on their core and added value activities to drive earnings growth. Based on the concept that highly trained, outsourced IP specialists can lift the burden of managing the IP prosecution process, many law firms are also now choosing to offshore more key IP tasks. Clifford Chance is just one example of a global law firm that has chosen to partner with an India-based outsourcing company to manage its key financial services. US-based Schwegman, Lundberg, Woessner & Kluth (SLWK) is another, but it chose to establish its own captive IP outsourcing company in 1999 to achieve this.

There were practical reasons for setting it up in India, explains Steve W Lundberg, a founding partner of SLWK: "In the late 1990s there was a labour shortage in Minneapolis [home to SLWK's first office] of qualified personnel to carry out certain functions such as proofing and lower-level case management." Tapping into the bank of talent in India allowed the firm to increase capacity, improve cycle time and retain complete control, all without sacrificing quality or security. And, as corporations become more wary of the hourly charge of legal counsel, IP outsourcing also provided SLWK with the opportunity to pass on cost savings to its clients – a benefit that few competitors could provide at the time.

Pitfalls of outsourcing

Whether you choose to set up your own company or, more sensibly in today's marketplace, use an existing and experienced supplier, the same rules apply to outsourcing as they do to any key business task: focus on top quality; implement robust processes, certification, security and risk management practices; and apply good governance practices and appropriate technologies.

However, outsourcing is by no means a stroll in the park and there have been several high-profile failures where the wrong processes have been outsourced to the wrong areas. A good supplier will eliminate these difficulties and the chances are that if they are a global service provider, they will be able to select the best talent at the best locations for the required tasks. Companies shouldn't be afraid to scrutinise the security and confidentiality provisions when choosing a supplier. They should also definitely be looking for a proven track record of quality service delivery both on and offshore, guaranteed service level agreements, highly trained staff, state-of-the-art facilities and a technical infrastructure to support efficient service delivery.

Other criticisms of outsourcing from both management and consumers often focus on a central question: is the performance or quality of the outsourced service on a par with the expected standards of management and consumers? Sceptics often argue that high-value work is too complex or specialised to outsource, and that companies experience a loss of control over the quality. Many have experienced the less than customer astute call centre services from BPO outsourcing that have left behind a lingering air of disapproval.

A Gartner survey in 2005 highlighted issues experienced by Dell, JPMorgan and Capital One. Results showed that a mammoth 60% of customers switched services as a direct result of these companies outsourcing. The impact of this failure on business is clear and highlights the importance of outsourcing to the right provider. Working with a company that understands your business and core company values should eradicate the bad experiences. Companies spend much time and capital in terms of marketing and product research – outsourcing is also a significant and important business decision, which cannot be made in haste. There is no substitute for making the correct, in-depth analysis to select the right service area to transition. It's important to pick a long-term partner with top-quality processes, a good reputation and the size and ability to innovate and evolve with your business.

Outsourcing doesn't mean you relinquish responsibilities of risk or compromise confidentiality. The key is to be able to manage and track the progress of your

outsourced work. Many service providers have procedures and/or robust software systems in place that guarantee the highest levels of client confidentiality and professional delivery. These will also enable real-time workflow delivery, enabling executives to monitor the quality of their services in a fraction of the time that would be spent managing the function in-house.

So what does this mean for your business?

The outsourcing market is moving quickly and is learning from its mistakes, with LPO benefiting from the important lessons learned from BPO. The cumulative rise in resources and profit indicates that companies believe in outsourcing, but also that it works. So this is something you shouldn't ignore, but seriously consider as a viable route to expanding your business and increasing profitability.

Setting up an outsourcing programme takes time, but compared to hiring a new department or multiple numbers of specialist legal staff, the process is quicker and much easier to manage. It's also much more economical and makes you more agile in the market, enabling you to upscale or downscale as required. For the IP world, it holds real advantages as volumes increase and skilled professionals become harder to source.

Businesses should look at their current set-up, check their financial position, make sure they understand the outsourcing business and choose a provider with strong sector experience and a reputation for reliability. Industry experts are certain that LPO activity is nascent and companies and law firms that have not yet capitalised on the next wave of outsourcing might be surprised to hear that their competitors probably have.

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Outsourcing and offshoring transactions in China

By **Justin Davidson** and **Anthony Day**, DLA Piper, Hong Kong

China has long been recognised as a key jurisdiction for sourcing cheaper labour and materials, which has led to the huge boom in the manufacturing industry and the enormous growth that the region is currently experiencing (according to *The Economist*, exports for China last year totalled almost US$970 billion). However, it is only relatively recently that China has started to move into the more complex IT/technology outsourcing and business process outsourcing (BPO) fields.

Recent reports suggest that China is set to eclipse India as the outsourcing/offshoring destination of choice by 2011 (according to research by IT research agency the IDC); and with some of the largest Indian offshore providers such as Tata Consultancy Services and Infosys Technologies setting up offshore delivery centres in China to cope with customer demand (reinforcing the shift-change of China becoming the top offshoring destination), it is clear that it is becoming more important than ever to understand the myriad of issues that companies face in respect of the various competing IP rights and issues in a complex outsourcing/offshoring transaction in China.

IP rights that can be protected in China

China has IP laws that afford protection for a similar range of IP rights to those you would expect to gain protection for in most developed nations. As part of joining the WTO in 2001, China overhauled its legislation in respect of patent, registered design, trademark, copyright and confidential information to bring them into line with international norms and, in particular, compliance with the TRIPs Agreement.

The main issue that foreign companies face in respect of those IP rights is the actual enforcement of their IP rights where a third party is infringing those rights. We consider the options later and look at steps the Chinese government has taken to improve enforcement actions in light of the perceived high level of IP theft taking place (and lack of redress for IP infringement victims) in China.

Ownership of IP rights

Ownership of IP rights is always a hotly contested subject in any outsourcing transaction, irrespective of the country in which the services are being provided, especially if the services to be provided are IP or technology intensive. There is always a constant battle between the demands of the customer – wishing to gain competitive advantage from the outsourcing arrangement, by leveraging upon the supplier's bespoke knowledge and expertise to develop products for it, so that it will help it become more market competitive; and the concerns of the supplier – that it does not want to give away ownership of its core commercial products and services (its crown jewels) to the customer, the ability to increase revenue from the arrangement and reducing the chance of its crown jewels being leaked to competitors.

Ownership of IP rights will be determined on a number of competing factors; for example, the relative bargaining powers of the parties, the nature of the services being provided and the extent to which the customer may be perceived as a competitor of the supplier. In China, it generally follows the market standard position that, in respect of the supplier's core products and its standard commercial offerings, the supplier will remain the owner of the IP rights in such products and will provide a licence to the customer to use such products, so that the customer can receive the benefit of the services provided under the outsourcing arrangement.

More problematic are bespoke work products commissioned by the customer, where the customer naturally wishes to own the IP rights in such products, as it has paid for the development of the products and may wish to commercialise these products to gain competitive market advantage. Figures 1 and 2 highlight a common approach used by parties in Chinese outsourcing arrangements to try to steer through this issue. If the core supplier product represents a relatively small portion, in terms of both the IP rights and commercial value, of the overall work product, then the ownership of IP rights will usually vest in the customer and vice versa. A subsequent licence back to the supplier to use customer-owned work products, or to sub-license such work products to its other customers, is also a common hot topic of debate.

Figure 1. **Customer-owned work product**

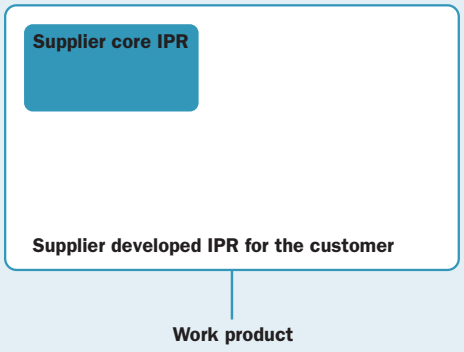
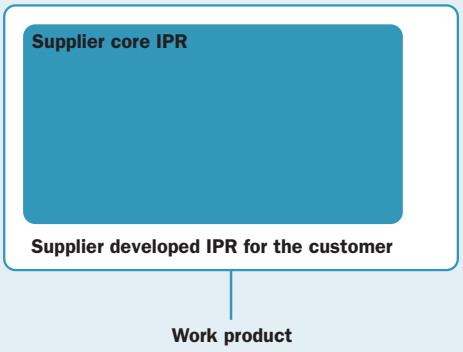


Figure 2. **Supplier-owned work product**



Chinese copyright

Suppliers should always ensure that relevant clauses are put in place in all employment contracts, to ensure that all rights are expressly assigned back to the supplier and all moral rights are waived. They also need to be very careful when contracting with subcontractors to commission specific projects/work products, to ensure that their subcontracts either assign the correct rights back to the supplier or contain wide licence rights, so that the supplier is not inadvertently in breach of its obligations under the main outsourcing agreement. This is particularly important where the customer wishes to own all IP rights in certain work products, and the nature of the services provided requires the supplier to use a number of contractors or other temporary third-party staff.

Control of the use of IP rights and joint ventures

Depending on the nature of the outsourcing deal, each party will often wish to have a significant amount of control over how the other party uses its IP rights. For example, in a co-branded credit card outsourcing deal, a customer may have particular concerns over how the supplier may use its trademarks and brand to promote sales to end customers, and the potential damage to the customer's brand that the supplier may cause. Similarly, in a joint venture (JV) arrangement where a foreign company has entered into a deal with a Chinese party to utilise its local knowledge and expertise, the foreign company will undoubtedly be worried about the potential for the leakage of key IP rights to the Chinese JV partner's parent company, thereby reducing the competitive advantage of the JV arrangement.

On the other hand, suppliers may be concerned about the ability of the customer to provide the benefit of the services, including the relevant licences and IP rights, to a wide number of customer affiliate companies and other service recipients, potentially cutting short business opportunities for the supplier with those linked companies (eg, the customer may be receiving the services at discounted rates, which the supplier may not ordinarily have offered to these linked companies).

The key for each party is to ensure that its respective rights and obligations are clearly set out in the outsourcing arrangement and the parties work through the flow of IP rights under the agreement, to make sure that their competing interests are protected.

Protecting against IP theft in China

For many customers looking to benefit from the cost savings of outsourcing/offshoring to China, especially those with a strong IP portfolio, IP theft represents a real threat to any potential business case. Customers will be comforted to hear that Chinese enforcement authorities are taking IP theft much more seriously than before and any potential customer should look to utilise the following three types of protection in order to reduce this risk:

- Legal protections: Pre-emptive registration of key IP rights in China before entering into the outsourcing agreement (this is advisable, even though the subsequent grant of trademarks/patents may take a long period to be awarded, because China works on a first come, first served basis); and actively bringing enforcement

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proceedings against infringing parties (see below for further details).

- Contractual protections: In addition to the standard contractual protections that a customer would expect to include to protect its IP rights – such as strict confidentiality provisions, warranties and indemnities for breach of its IP rights and a corresponding third-party IP rights infringement indemnity from the supplier, to protect the customer against any third-party IP claims brought against it – the customer may wish to consider other contractual protections, such as: (1) the right to audit the supplier regularly to investigate any potential IP theft; (2) entering into separate non-disclosure agreements with supplier key personnel, to reinforce the importance the customer places on IP theft and to ensure strict adherence with the confidentiality provisions; and (3) an injunction clause as discussed under "Enforceability of rights in China" below.

Figure 3. **Enforceability issues: concept of third party beneficiary not valid in China**

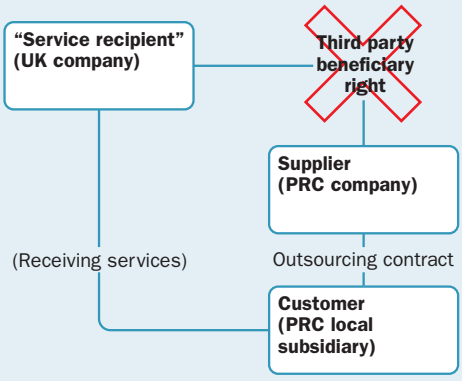
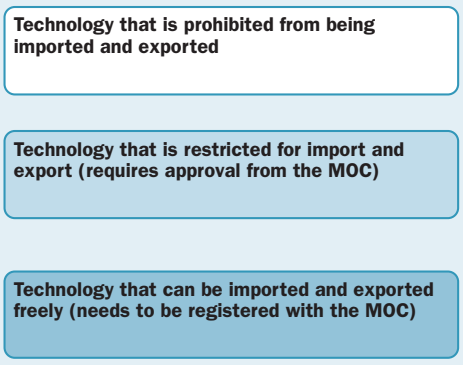


Figure 4. **Chinese import/export technology transfer restrictions**



- Practical measures: Only allowing the supplier to have limited security access, restricting networks and using encryption technology to ensure that core IP rights are safeguarded. Instituting an intellectual property rights education programme with your Chinese supplier can also avoid plain ignorance of the importance of your IP rights – not just a one-off training session though, as staff turnover in China is high.

Enforceability of rights in China and third-party beneficiaries

Enforcement in China is often thought to be difficult, time consuming and expensive, leaving many with the impression that IP theft is out of control and that the Chinese authorities do little to assist or protect.

In fact, enforcement of IP rights in China offers an alternative mechanism not available in many countries. All countries offer the litigation route, in some shape or form, but China also has state bodies responsible for the enforcement of the individual IP rights, such as the Administration of Industry & Commerce for trademarks, the National Copyright Authority for copyright and the Intellectual Property Office for patents. The rights owner can take a complaint to these bodies and, if satisfied as to the merits, they will conduct an immediate raid and enforcement action on the rights owner's behalf. It is quite a rough and ready justice, but no damages are imposed and their enforcement action has no permanence. For those two remedies, the court is the only route. Pre-registration of IP rights is still the most prudent step to ensure protection as each of these bodies will want to see this as a prerequisite in China.

In most outsourcing transactions in China any disputes will be settled by way of arbitration, in order to assist with the enforceability of judgments by overseas companies. However, to provide additional protection for a foreign party it is helpful to have a clause specifying that either party can seek injunctive or interim relief, and notwithstanding the choice of law clause, for injunctive relief the courts in the country where the relief is being sought will have authority to determine whether to grant an injunction or not. This can help prevent against delaying tactics by clever would-be infringers, where one party is seeking an injunction to prevent infringement taking place in another country.

Another concept that is available under some laws, such as English law, but not valid in China, is the enforcement of rights by affiliate/parent companies or service

recipients as third-party beneficiaries to the contract, without having to be a direct contract party. As indicated in figure 3 on page 79, under Chinese law there is no concept of third-party beneficiaries and if a parent company wishes to enforce its rights against a People's Republic of China (PRC) company it will need to ensure that it is a direct contract party.

Third-party licences/rights to use

As in any outsourcing transaction, particularly so for IT outsourcing arrangements, the customer will need to ensure that it has obtained the relevant licence grants, or rights to use for any third-party technology or software that the supplier needs to use to provide the services. The supplier will be particularly concerned in IT outsourcing arrangements to ensure that the customer has acquired these relevant consents – to reduce the chances of it facing an infringement claim from a third party – and also that the consents are wide enough to allow the supplier to perform the services contemplated; for example, access to the source code to enable the supplier to maintain and develop third-party software.

Chinese technology transfer restrictions

In IT/manufacturing/technology and even some BPO transactions, parties contracting in China have to be aware that the PRC Technology Import/Export Administration Regulations ("Technology Transfer Restrictions") may affect their outsourcing arrangement, where a foreign entity is licensing technology to a Chinese company, or the foreign entity wishes to own the IP rights in technology/work products developed by a Chinese supplier.

Figure 4 highlights the three types of technology that are covered by the Technology Transfer Restrictions: (1) prohibited technology, which is not allowed to be imported or exported into or out of China (eg, nuclear waste recycling technology); (2) restricted technology, which can be imported or exported only with express approval from the Chinese Ministry of Commerce (MOC); and (3) non-restricted technology, which can be imported and exported freely, but for which the licence needs to be registered with the relevant branch of the MOC.

The Technology Transfer Restrictions no longer limit the term of a technology transfer contract to 10 years, but do have certain prohibitions on what can be imposed on the PRC party. One important prohibition is on requiring the supplier to assign all the rights in any improvements to the licensor during the term of the contract. This can present serious problems for the party that owns the underlying IP rights in the technology, particularly in respect of safeguarding their revenue streams at the end of the contract.

Failure to comply with the Technology Transfer Restrictions, depending on the level of the breach, can lead to criminal and civil penalties, including fines and (in more extreme circumstances) revocation of a company's permit to carry out foreign trade.

Parties also need to be careful where technology is licensed by a foreign entity to a Chinese company at a cost, or the mechanics of the pricing offset the value of the licensed technology against the charges, as this can trigger China's strict foreign investment restrictions.

Exit provisions – treatment of IP rights

In any complex outsourcing arrangement it is always key to have a clear understanding of how the various IP rights will unravel on exit. For the customer, ensuring that it has sufficient licence rights either to transfer the services back in-house or to effectively transition them to a replacement supplier (often a competitor of the supplier) on exit is absolutely essential. Similarly, the supplier will naturally be concerned that it does not want a competitor to potentially have access to its crown jewels. This becomes even more complicated when there is the possibility that the Technology Transfer Restrictions may kick in; for example, if both parties are Chinese companies, but a replacement supplier is to be an Indian outsourcing services provider.

Unfortunately there is no set answer to how to deal with IP rights on exit, but as long as the parties think carefully about how the flow of IP rights will work, and whether any third parties will also require access to such rights, they should be able to agree upon a pragmatic and commercial solution.

It is important to remember that with the increasing significance placed on outsourcing/offshoring in the region, and the central place that China is taking on the global business stage, understanding the IP issues in a complex Chinese outsourcing transaction can provide the empowered party with considerable commercial advantage and help unlock greater benefits and cost savings for the future.

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IP issues in outsourcing to India

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India's progress in the outsourcing industry has been outstanding by all standards. Although it only began seven years ago, the Indian business process outsourcing (BPO) industry has already outgrown its teen years and has shown tremendous maturity as compared to its competitors.

Needless to say, India's explosive growth is the result of the competitive advantage it offers in terms of things such as technological innovation, a highly skilled talent pool, cost effectiveness, quality control, fluent English capability. Further, with the backing of a formidable educational system churning out approximately 2 million graduates and 120,000-plus engineers every year, the outsourcing industry has miles to go. Filled with confidence, the India outsourcing industry is now looking to niche areas such as clinical trials, legal process outsourcing, risk management, financial management and hospitality, and vendors are increasingly turning to advisory roles and becoming strategic partners of their customers.

It is not surprising that 80% of US companies have ranked India as their first choice for outsourcing, particularly in software development. With revenues of US$39.6 billion recorded in the financial year 2006-2007 by the IT and IT-enabled services (ITES) sector, India maintains its lead as the IT superpower and a global outsourcing hub. Domestic IT giants such as Infosys, TCS, Wipro and Satyam are now global companies.

Intellectual property creation and protection are key to any outsourcing deal. With outsourcing contracts being negotiated and executed on a daily basis, information, data and IP rights are been exchanged and transferred at the speed of light; but with this comes legal complications unless deals are carefully negotiated. Negotiations become more complicated when multiple IP rights of various parties are involved, requiring further diligence and safeguards.

Contracts – choice of law

While standardisation of contracts has become the norm in the outsourcing industry, it is still challenging to draft strategic clauses which sufficiently cover the risks, safeguards and remedies for the parties. It becomes more complicated when the contractual rights and performances transcend national boundaries, as is the case with any transnational outsourcing relationship. In such situations choice of law assumes greater importance and becomes a strategic negotiation point for the parties.

Indian courts have always upheld the parties' choice of law to a particular jurisdiction to the exclusion of other courts. However, the issue is not as simple as it seems. In the context of outsourcing, where an Indian entity is a party, such a choice of law clause will not take away the applicability of the Indian law to the contract made in India or to be performed in a part or the whole of India. This means that the ordinary/general jurisdiction of a competent Indian court will not be ousted merely because the parties have agreed to a specific foreign law and jurisdiction. This is called the Court of Natural Jurisdiction (CoNJ) principle and comes into play when one or both of the parties to the contract approach the CoNJ first rather than the court of choice.

While the CoNJ will normally not prevent a party to a contract from approaching the court of choice, except in exceptional circumstances, such as to prevent injustice, the CoNJ will usually consider factors such as: (1) the balance of convenience; (2) the interest of justice; and (3) and the circumstances of a case. The test would

usually be whether the foreign proceedings will be vexatious and oppressive.

As for the enforceability of foreign judgments in India, this can only be done in two ways. The first is if India and the country granting such an order have a reciprocity treaty for foreign judgments. The second is by instituting a fresh suit in India on the basis of a foreign decree or judgment, which may be construed as a cause of action for the said suit. In case of non-reciprocity, the foreign decree or judgment will be treated as another piece of evidence in the Indian suit; although there are certain exceptions for situations where foreign judgments are not considered conclusive.

Intellectual property – ownership

The issue of ownership of IP rights in outsourcing is inevitable. To have smooth sailing from beginning to end, outlining the ownership issues at the early negotiation stage is advisable. Invariably, the customer brings to the table a larger pool of its own intellectual property in the form of trade secrets, data, know-how, confidential information, software, patents, trademarks, copyrights, databases, etc, which are to be shared with the vendor in carrying out the outsourced obligations. The vendor may also contribute its own share of intellectual property.

While existing intellectual property of the parties does not pose many problems, the negotiation takes place on the issue of: (1) third-party intellectual property and flowing rights and restrictions; (2) new intellectual property created from the work; and (3) new improvements made to the existing intellectual property.

The following guidelines are fundamental to avoiding any future disputes between the parties involved:

- Conduct an IP audit to identify and document the ownership of the existing IP rights owned by the customer as well as the vendor. The early audit will reveal important information on term, validity and scope of the intellectual property.
- To identify and document the ownership of all third-party IP rights which are currently licensed to the customer or the vendor. The nature and scope of licensed rights, including the limitations and restrictions, need to be clarified for the purposes of usage and transfer.
- It is common to expect creation of new intellectual property during an outsourcing relationship. The parties should not only acknowledge such a possibility but should, in unambiguous terms, negotiate and outline the ownership of the same and *inter-se* licensing rights between the parties.
- The negotiations could be challenging when the issue of improvements to the existing intellectual property comes to the table. The parties need to capture the potentiality of the same in clear terms and negotiate the ownership of such improvements before closing the deal. The improvements made to third-party licensed intellectual property may require assignment back to the original rights holder, and this should be captured in the clauses.
- Other relevant issues are formalities pertaining to assignment, licensing, joint ownership, work-for-hire, grant-back licences, filing and registration. These need to be captured by specific clauses in compliance with the intellectual property laws of India.

Intellectual property – assignment and licences

Assignments *inter-se* the parties are common in any outsourcing arrangement involving IP rights and it is important that they are in compliance with the requirement of Indian law to acquire validity. For example, the Indian Patent (Amendment) Act 2005 requires that all patent assignments should be in writing and signed, and that their title be registered under the Act to be held admissible in evidence before a court of law; whereas the Copyright Act 1957 prescribes certain presumptions relating to the mode of assignment unless otherwise agreed between the parties. These include:

- That all assignments of the copyright in any work shall be invalid if they are not in writing and are not signed by the assignor or by its duly authorised agent.
- That if the period of the assignment is not specified, it shall be deemed to be five years from the date of the assignment.
- That if the territorial extent of assignment of the rights is not specified, the law will presume to cover only Indian territory.
- That if the assignee fails to exercise the rights assigned under the agreement within a period of one year from the date of assignment, the assignment in respect of such rights shall be deemed to have lapsed after the expiry of the said period.

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He joined the firm in 1999 and specialises in trademark and copyright advice and litigation, internet and information technology issues, and anti-piracy enforcement. Keshav's work also involves IP assignments, licensing and related transactional work. He regularly advises Microsoft and the Business Software Alliance (BSA) on various issues pertaining to software piracy in India, and has been instrumental in obtaining several judgments on damages granted by the Delhi High Court against violation of copyrights in software. Keshav speaks and writes frequently on IP law and related areas.

Keshav graduated in law from Campus Law Center, University of Delhi in 1999 and completed his masters (LLM) in IP law from the Franklin Pierce Law Center in 2002 as part of his study sabbatical. He worked with Cowan, DeBaets, Abrahams & Sheppard LLP in New York City in 2003-2004 before returning to Anand and Anand.

Keshav obtained his licence to practise before the New York State Bar in 2003 and is actively involved with the activities of the Licensing Executives Society (LES).

Under the Trademark Act 1999, the registered trademark can be assigned or licensed with or without the goodwill of the business concerned or in respect of either the goods or services for which the trademark is registered. This is permissible for assignment or licensing of unregistered trademarks as well.

The Act also requires that the licensee and the assignments for registered trademarks should be registered with the Registrar of Trademarks. The assignees or the licensees in such cases are called registered users. The Supreme Court of India has stated that if the licensor has maintained quality control over the goods and services of the licensee, then the licensee's use is tantamount to that of the licensor, even if there is no registered user agreement.

Protection of databases versus data

It is important to understand the difference between the protection of databases and the concept of data protection under Indian law. While the former pertains to compilations, including computer databases, which are protected as a piece of literary work under the Copyright Act 1957, the latter covers collection, storage and transmission of private and personal information of the citizens of any country.

Under the Copyright Act 1957, databases have to stand the test of originality, although the levels have not been kept very high. For example, in the matter of *Burlington Home Shopping Pvt Ltd v Rajneesh Chiffs*, the High Court of Delhi granted protection of databases comprising the names and address of the plaintiff's customers. At present, the law in this area is fluid and no clear parameters have been provided by the courts.

With regard to data protection, India does not have any privacy laws protecting private information of the public. The lack of data protection legislation became a major point of debate in industry and was fuelled by some incidents of data theft and misuse by the employees of BPOs. It was highlighted that the provisions of the Information Technology Act 2000 were inadequate to deal with the privacy issues pertaining to data protection. At one time it was estimated that this lack of data protection was causing the loss of business opportunities worth more than US$100 million.

The debate led the government to review the Information Technology Act 2000, as well as other statutes such as the Indian Penal Code and the Contract Act, to see whether suitable amendments were possible to bring India up to European Union, UK and US standards. For example, the European data directive makes it mandatory for any company sending data of a citizen to a vendor located in a foreign destination, such as India, to ensure that a commensurate level of protection is made available in that foreign country, failing which the transfer of the data will not be permitted.

The government of India has yet to come up with any clear amendments to the existing laws on data protection. In the last few years, a few new cases of data theft have been reported and their prosecution is currently pending, but largely the security and protection issues are being tackled using the provisions of the Information Technology Act 2000, as well as the Indian Penal Code, with quick action taken by the enforcement agencies creating sufficient deterrence in the industry. In the current legal scenario, however, prevention is better than cure remains the right mantra, and should be done by means of regular audits, policies on zero violation and heavy penalties for breaches.

Trade secrets and confidential information

There is no specific trade secret law in India and thus parties need to pay extra attention to ensure robust protection. In India, the take home news is the courts' pro-activeness in granting protection to trade secrets and willingness to treat breach of confidentiality as a separate tort independent of breach of contract. The courts have repeatedly held that the vendor has both a contractual and a fiduciary relationship with the customer and is thus liable for the tort as well.

Additionally, the Indian courts have been sensitive and receptive to the issue of breach and the importance of quick interim reliefs to protect trade secrets and confidential information. In many cases involving theft or misuse of confidential information, the courts have not been hesitant to issue *ex parte* interim injunctions against defendants to prevent further illegal transfer or misuse.

It has been agreed that contractual security, such as non-disclosure agreements, while important, is not sufficient to provide all-encompassing protection to trade secrets and sensitive information. Experience shows that proper protection can be put in place only if contractual security is complemented by two additional layers of security:

- Network and code security to ensure that the vendor has deployed sufficient technological measures to monitor and prevent unauthorised access to the systems. Specifications as to the control procedures, security guidelines and the back-up program are of importance. The vendor network systems and the infrastructure facilities should be subject to inspection and verification by the customer's officials or its authorised representatives.
- Physical security provides the final ring of protection. Besides a 24-hour obligation, provision in the agreement should cover measures expected at the entry-exit points, work area security, procedures for storage and authorised access mechanisms to confidential information, among others. Finally, it should be incumbent on the vendor to keep its security technology updated in order to tackle all emerging threats, as well as internet and computer viruses.

Recourse to legal remedies

An arrangement is not complete without this question being answered: what legal remedies can the system provide to obtain quick relief in the case of a breach or violation? The Indian legal system and judiciary score very high in the area of interim remedies pertaining to intellectual property disputes. The Indian courts, in particular the Delhi High Court, have been quick to respond to instances of intellectual property violations and have repeatedly granted *ex parte* temporary injunctions preventing further infringement and misuse. The temporary injunction comes in very handy and allows the right holder to prevent further loss or damage, and provides confidence while contracting.

Over many years, the courts have been granting unique remedies to the benefit of intellectual property owners. These range from appointing court commissioners to enter an infringer's premises, without notice, to carry out inspections and preserve evidence through seizure and sealing; to providing extraordinary common law remedies such as John Doe or Roving orders against unknown parties, where the court commissioners are empowered to visit any premises where they have "reason to believe" that an infringement is being committed. Other unique remedies involve Mareva injunctions, where the assets used for infringing activities (such as bank accounts) of the defendant can be frozen; and Norwich Pharmacal orders, where third parties such as customs and excise officers can be directed to disclose details regarding the movement of goods, quantities, values and supporting invoices relevant to the instance of infringement.

Lastly, the most encouraging development over the last 50 years of IP enforcement in India is the new trend towards granting damages for violation of intellectual property. Traditionally, the Indian courts have been reluctant to punish IP infringers with awards of damages and, as a matter of practice, have only restrained them permanently with minor costs. But the trend reached a watershed with the Delhi High Court passing the first IP judgment ever on damages in India in 2005. Following closely on its heels, similar awards have since been made, so that now a total of approximately 27 judgments involving IP infringement cases and awards have been handed down; and the number is growing.

Conclusion

The Indian outsourcing industry has made a great beginning and has generated lots of confidence. With more and more countries joining the outsourcing bandwagon, and as knowledge process outsourcing emerges as the future of the BPO industry, India will continue to faces challenges from rival nations, while still moving up in the value chain to support cutting-edge outsourcing areas such as R&D, management and accounting services.

It is inevitable that this growth will make intellectual property the most valuable asset for outsourcing players, and negotiations around it will become more and more strategic and competitive. The customer and the vendor will have to follow an all-encompassing, integrated IP policy to generate more IP, mitigate IP-related risks and bring competitiveness to their relationship in the outsourcing market.

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