EFFECTIVE NEGOTIATION OF IP TERMS IN OUTSOURCING CONTRACTS

When negotiating contracts for outsourced services, few topics generate more animated discussion than intellectual property. Customers wax eloquent about owning what they pay for. Their counsel offer up forms asserting exclusive rights in anything and everything created during the contract term. Room temperatures and blood pressures rise – for the most part, unnecessarily.

How then to square the circle and reconcile competing interests? We recommend breaking issues into manageable pieces, emphasizing both sides' business needs, and crafting definitions that help to simplify negotiation of unavoidably complex terms governing intellectual property (IP).

Suppliers are anxious to protect rights in their tools, commercial offerings and proprietary methods, including incidental improvements that occur when serving customers. These rights, coupled with their employees' skills and experience, are the suppliers' stock-in-trade – the foundation for an ongoing business and, increasingly, commercial software products and services.

Customers are anxious to preserve rights in their own proprietary technologies and to secure rights in new developments during and after the contract term, when they may engage others to maintain and enhance what they have received.

To begin with, business people may need reminding that ownership involves bundles of rights that may be apportioned in various ways to suit situations and needs. Just as one may commute in a leased car, live happily in rental housing or erect buildings on leased land – no matter whose name appears on the title – customers and suppliers may use, maintain and enhance intellectual property, whether owned or licensed on appropriate terms.

Rather than debate arcane terms, we prefer to start with a business conversation.

- What are we talking about? Documentary deliverables or software? A tool, a commercial product, or a branded service based upon proprietary and commercial technologies? A custom application? A customer-specific implementation of a commercial enterprise system? Improvements to the customer's proprietary systems?
- Who needs what rights during and after the contract term? Both sides must carry on after the contract expires and rarely, if ever, do the parties compete.
- How should those rights be protected? By copyright (which does not protect underlying ideas)? As trade secrets (an adaptable creature of the law of contracts)? Might there be patentable inventions (with a practical 20-year monopoly)?
- To which party do intellectual property rights matter most? Which party is best able to exploit them commercially? To use them internally? Software tools may not matter much to customers who lend money or sell retail goods so long as they can use, maintain and enhance custom code written for them by their suppliers. However, those same customers may regard analytics concerning their customers' credit or buying habits as sources of competitive advantage, not to be shared with their competitors.

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Answers to these and other practical questions provide a useful framework for negotiation of contract terms.

Contracts often group intellectual property in four categories: the customer's, the supplier's, third party materials and new developments. The first three are relatively straightforward.

Customers own what they bring to the engagement, including further developments and derivative works created by the supplier (but excluding any supplier intellectual property that may be embedded, with consent, and licensed to the customer during and after the contract term). Suppliers are commonly licensed to use the customer's intellectual property, to the extent necessary to perform maintenance, development and other services.

Similarly, suppliers own what they bring to the engagement, including proprietary tools and methods, commercial software and other products and services. These may be licensed to the customer during the term. Afterward, commercial products and services may be available under standard terms, but internal tools (which are rarely documented and supported as commercial products) may be available, if at all, only on a limited, transitional basis. This limitation need not worry the customer, so long as there are commercial substitutes for the supplier's tools or competing suppliers offer comparable tools and capabilities.

Third party software and services are governed by relevant third party contracts. Commercial issues include costs of licenses or consents (which, one way or another, the customer ultimately bears, as consent costs nominally absorbed must be recovered through charges); transferability (which depends upon third party contracts); and availability after the contract expires. Suppliers take pains to avoid financial or other responsibility to supply third party products after contracts expire, because of the uncertainty – not only about costs, but about the changing market for software and related services. So long as the software (or good substitutes) are available commercially, the customer need not fear being 'locked in' by any supplier.

Rights in new developments present the greatest challenges, but these can be solved with goodwill, common sense and some contractual dexterity.

Customers often begin with forms asserting ownership all rights in any new developments, including both specially commissioned works (that is, developments created just for the particular customer) and occasional or incidental developments that may occur in the course of performance. Often, the customer's primary concern is the right to use customer-specific new developments in their own businesses, with full rights to support, maintain and enhance those new developments, even after the contract expires. Outright ownership is rarely required for these purposes, although a supplier could cede all rights in custom developments, reserving a license that permits the supplier to use its creation elsewhere (though without compromising the customer's confidential information). Or the supplier could transfer the copyright in code and documentation but remain free to provide similar solutions to other customers, since copyrights do not restrict use of underlying ideas. Many sensible variations are possible, depending on the circumstances. [1]

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1 Joint ownership often seems attractive but is rarely a good idea. Rules vary considerably depending upon applicable law (US practice differs considerably from Europe) and the kind of intellectual property (rules for copyrights and patents differ). There are many complexities about rights to license, consent, reporting, shares of royalties and much else; particularly after the business relationship concludes.

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How to get there – and in competitive pursuits based upon the customer's paper? We have enjoyed reasonable success with the following methods.

Focus first upon crucial definitions of 'Deliverables,' 'New Developments' or 'Work Product, rather than redline, rewrite and reverse corresponding portions of the contract. Suppliers can often accept the substance of customer-oriented terms regarding rights in 'Deliverables,' 'New Developments' or 'Work Product,' so long as those defined terms are limited to specially commissioned works created expressly for the customer, excluding embedded supplier IP and incidental developments of the supplier's tools, methods, products and other supplier IP, which the customer may be licensed to use in its own business after the contract expires.

Often, suppliers' interests can be protected by judicious edits to definitions, without a frontal assault – complete with bloody redlines – upon the text of the agreement. Scorecards kept by consultants or procurement departments may note agreement in principle that 'Deliverables' belong to the customer, without either extensive edits or dwelling on edits to fine print in the definitions – edits that are easily explained and may not be particularly controversial. Few customers seek rights in suppliers' tools, methods, software products or branded service offerings, so long as they can carry on after the contract expires with liberal rights to use anything developed just for the customer.

Next, so far as possible, transform discussion at the negotiating table into a business conversation. Acknowledge customers' rights in further developments of their own intellectual property and new developments. Explain how they can carry on after the contract concludes and even engage competitors without permanent dependence upon a single supplier. Disarm needless fears and explain what suppliers need to sustain their businesses, such as rights in their proprietary methods and technology, including incidental improvements.

Finally, break complex subjects into manageable pieces, emphasizing practical business considerations. Just as customers need to support and further develop their systems, suppliers must be free to pursue other opportunities, using the same methods, tools and personnel (without, of course, compromising the customer's confidential information or infringing its intellectual property rights). Both sides have businesses to run and legitimate interests that deserve protection during the contract term and afterward.

No tactic can banish complexity, but the approach suggested can reassure customers, focus attention where it belongs – upon sensible allocations of rights that protect both sides' interests – and avoid needless acrimony, especially during the competitive phase of negotiation and selection.