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OUTSOURCING OF SOFTWARE DEVELOPMENTS BY CANADIAN COMPANIES TO OFFSHORE JURISDICTIONS

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In today's global economy, the outsourcing of software development work to offshore jurisdictions is a strategic tool that can provide a competitive advantage for many Canadian companies. In addition to the potential cost savings, outsourcing can also provide access to world class expertise and development technologies, and allows a corporation to focus on its core competencies and business activities. With this opportunity, however, comes certain difficulties and challenges.

The 2008 Deloitte Consulting Outsourcing Report, entitled "Why Settle for Less", surveyed 300 senior executives at companies in the U.S., U.K., Germany and Canada that spend at least \$50 million annually on IT outsourcing initiatives. 83% of all respondents reported their outsourcing projects had met their ROI goals of slightly above 25%. However, 39% reported terminating at least one outsourcing contract and transferring it to a different provider. Though most customers appear to be achieving a perceived return on investment, there are definitely some unique challenges inherent within IT outsourcing. Some of these challenges can be mitigated through due diligence, selecting the right developer and maximizing intellectual property and contractual protection.

In the 2008 Deloitte Consulting Outsourcing Report, 35% of those surveyed said they should have spent more time on the service provider selection process. If a customer is unfamiliar with the foreign market, it may wish to retain a business advisor that is familiar with the applicable market. The advisor can prepare a list of potential qualified software developers and review each potential developer's overall reputation, financial stability, place in the market and ability to provide the required services. References from past and current engagements can also be requested from the developer(s). Legal counsel can be invaluable in directing the due diligence process and reviewing the resulting information and searches. Canadian counsel may need to liaise with counsel in the foreign jurisdiction.

The customer may also consider preparing a request for proposal (RFP) describing specific requirements and inviting responses from suitable developers. Including key agreement(s) as part of the RFP enables the



customer to control the documentation and incorporate the legal terms as part of the service provider evaluation process. The RFP should remain non-binding in nature, and not obligate the customer to accept any proposal. The final agreement should still remain open to further negotiations between the customer and the selected developer.

In selecting a software developer, it is also a good idea for the customer to conduct a comprehensive review of the security and intellectual property protection program of the developer to evaluate its ability to safeguard the customer's confidential information, software source code and trade secrets against misappropriation, misuse, loss or damage. The customer may wish to have on-site involvement during the early and late development stages to ensure that suitable security measures are in place.

Before drafting an outsourcing contract, legal counsel needs to understand the client's outsourcing goals and priorities. As outsourcing often involves a long term relationship, the contract needs to accommodate changes in circumstances during the term. Important terms to address in the contract are the detailed scope of services to be performed, acceptance testing criteria of the customer, fee reductions if the developer fails to meet prescribed milestone dates, change processes, and a continuing warranty from the developer following acceptance by the customer. The agreement must also include the requirement of regular reporting by the developer to the customer.

Since most development work involves early stage ideas and designs, the customer will wish to broadly define "confidential information" to include all proprietary intellectual property, software, specifications, designs, plans, or other technical or business information and trade secrets. However, disclosure should be limited to only confidential information that is required for the developer to perform the services. The developer's employees should also be bound by strict confidentiality obligations, and there should be no sub-contracting to any independent contractors. At the end of the relationship, all confidential information should be returned to the customer.

To avoid the creation of new intellectual property (IP) being governed by foreign laws, the customer will want to have its home jurisdiction as the governing law. The customer should ideally own all improvements to its proprietary IP, as well as any new IP developed by the developer during the outsourcing. Assignments of intellectual property relating to the new IP and improvements should be obtained from the developer, as well as the developer's employees. Joint ownership of intellectual property rights should be avoided to enable the customer the ability to freely use and commercialise its own IP, improvements and any new IP.

The legal and practical challenges of outsourcing need to be managed and understood within the customer's overall strategic objectives. Strong communication throughout the project is essential to a successful



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outsourcing arrangement. With appropriate planning, resources and documentation, outsourcing of software development can provide an effective tool for Canadian software companies.

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