Client Alert

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Knowledge is Power

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Knowledge and intellectual property rights are both important elements of any outsourcing transaction but each is addressed in different ways. Many organizations involved in outsourcing over-value (and over-protect) IPR and under-value (and, therefore, under-protect) knowledge.

As outsourcing has evolved to encompass elements of hybrid cloud, multisource and service integrator models, and robotic process automation, the approach adopted by outsourcing parties to knowledge and intellectual property rights needs to be reconsidered.

Success in modern outsourcing relationships increasingly depends on the unrestricted flow of knowledge – both between customer and service provider, and, in models based on multisourcing and service integration and management (SIaM), between and among service providers. To an outsourcing customer, knowledge about the services received is vital to be able to monitor and manage service delivery, comply with regulatory or compliance obligations, match performance to payment, and to ensure continuity of service between providers.

For purposes of this article, we define "knowledge" as information generated or shared between the parties to an outsourcing relationship that is not otherwise subject to intellectual property protection (*e.g.*, pre-existing copyrights, patent rights or trade secrets), and that is derived from the normal interactions involved in the delivery and receipt of outsourcing services.

Outsourcing contracts consistently under-value (and, therefore, under-protect) knowledge – often at the expense of long discussions about intellectual property rights which, in many outsourcing scenarios, are often of limited value.

How did the outsourcing industry let knowledge fall into its blind spot and what can be done about it?

IPR

The issue of ownership and rights to use intellectual property rights ("IPR") has long held the spotlight as a key issue in many outsourcing transactions, and IPR has conventionally been more highly valued than basic information and knowledge about the subject-matter of the outsourcing relationship. This relates back to the origins of outsourcing which, in its early days, focused heavily on IT and, especially, the implementation or management of software platforms. Customers were more "hands-off" than they are now and expected the service provider, as the expert, to do its job. The first generation of large outsourcing service providers was overwhelmingly technology-based, and consisted of companies that had built successful businesses by focusing on the protection, licensing and continued ownership of the IPR in their products. Accordingly, there was a big focus on ensuring that IPR was protected.

IPR may be inherently intangible, but at least IPR has recognized forms and therefore lends itself to some form of definition and contractual control – and, importantly, some element of valuation. The IPR clause often sits at the heart of any contract in the outsourcing world because service providers will want to make sure that they don't lose their hard-earned IPR and, thus, seek to grant only a license in certain pre-defined limited terms. From an outsourcing customer's perspective, it feels as if it's investing time and effort in a particular product and, depending upon the extent of that investment, if new elements are created, then it should own IPR in those new elements. The common refrain is: why shouldn't the customer receive rights resulting from its investment?

In many forms of outsourcing, this approach is now outdated with the result that IPR is often over-protected. Clearly, there are exceptions to this, especially certain IPR-heavy contexts such as application development and maintenance, or certain forms of knowledge processing outsourcing, such as clinical trial outsourcing or R&D outsourcing.

In most outsourcing contexts, however, relatively little in the way of new IPR tends to be created, but the attitude of parties regarding these IPR concepts has not really evolved. Customers still put significant stock in ownership of the work product that they claim to have paid for – and service providers still insist on ownership of as much as possible of what may be created.

Traditional wisdom has been that if one company commissions another to develop an IT solution then the client – not the developer – should own the software that's created. As a result, countless hours of contract negotiations are spent on arguing about IPR ownership. But, as is so often the case, traditional wisdom is (mostly) mis-placed. So why do we waste our time when we all have better things to argue about?

Well, to start with, there's a lot of value in IPRs. It's not wrong to care about IPRs. For a technology business – or, indeed, even a non-technology business – IPRs represent value. M&A and buy-out activity in the technology and service provision sector has been high in the past two to three years, and IPRs are always prized – and priced – highly.

Any form of IPR – whether patent, copyright, trademark or design – represents an exclusive right to use a particular product, invention, work or brand; and, more importantly, the right to prevent others from doing so. But, too often, moral righteousness gets confused with commercial reality when it comes to issues of ownership of IPR. Many businesses instinctively feel that if they pay someone else to develop a product or create software, then they ought to "get" what they pay for – and thus draw a direct link to insisting on ownership.

It's indisputable that, under certain circumstances for some types of intellectual property created in the course of outsourcing transactions, the proposition that a customer must have a monopoly right may still be correct. But it's questionable whether that remains true in most cases, particularly as it relates to copyright in developed software that is derived from an underlying work. In almost every case nowadays, an organization can obtain virtually all the benefits of IPR by taking an appropriate license – and can do so more cheaply and more effectively than by insisting on ownership.

The real questions to ask when negotiating the IPR element of an outsourcing arrangement are: what do *I* need to do with these IPRs? And do I really want to prevent *you* or others from doing anything with it?

Take the scenario of a software provider engaged to develop customized applications as part of an application development and maintenance (ADM) outsourcing. Almost always, that development will be simply a layer of programming that sits, like icing on a cake, on top of a provider's standard offering or standard toolkit. In almost every case, the custom app development will not be able to function without the underlying program. So whatever has been developed is likely to be of little or no useful purpose without the underlying base product. If the customer insists on owning the developed application, for fear of a challenge to its right to use similar creations, the provider will be less likely to develop a product that will fully integrate with the base product. Instead, it is incentivized to develop software that operates more on a stand-alone basis, and the customer may not get the benefit of all that this product would have to offer if it had been more closely aligned with the base product, including the ability to receive fully-trained support, periodic upgrades, quality assurance, etc. Thus, while the customer may "own" the developed work, it may be operating with software that is less than optimal for its business.

The customer ought to consider instead deprioritizing ownership and insisting on a wide license to use and modify what's developed, together with an on-going license to use the base layer of software for all its business purposes. If it has that, then it essentially has secured a complete protection in terms of value of the product itself. Additionally, the service provider is incentivized to create something that's fully integrated and, because it will own the developed application and so may have the ability to use it elsewhere, it will be able to factor in future reusability into the cost of development. So the product ought to be cheaper and better.

In most cases, the customer really ought not to care whether the developed product is used for third parties. Admittedly, that's not always the case and there will always be examples where, for example, a financial institution is concerned about retaining a competitive edge over the competition. But that's usually fairly short-term and doesn't last more than a number of months, and can usually be covered by restrictive covenants on the provider not to recycle the developed software application for a period of time. But even then, there's no copyright in ideas so a general concept that's been developed is unlikely to be prevented from leaking out anyway.

Admittedly, much of the focus on IPR in outsourcing negotiations comes from service providers. Many outsourcing service providers have institutionalized their approaches to IPR and operate within rigid guidelines. Service providers are increasingly recognizing the potential future value of IPR and have set up internal processes to harvest – and avoid leakage – of potential rights. IBM, for example, has been among the top patent filers in the world for many years now. This makes discussion with some service providers about IPR laborious and time-consuming.

KNOWLEDGE

Knowledge has long been the poorer cousin to IPR in outsourcing transactions. But its time is now. It is widely recognized as important but is often considered too difficult to tackle in agreements. Often, the concept is dealt with merely as know-how and comes within the IPR definition (which is wrong in itself), or worse still, only as "confidential information."

In terms of value creation and business objective realization, knowledge rather than IPR is what CIOs and customers' boards ought to be concerned about in most forms of outsourcing. Outsourcing agreements need to adjust to reflect this.

There are a number of key features of knowledge which ought to be better recognized by parties to any outsourcing project.

1. *Knowledge is like … oxygen*. It's everywhere, and more knowledge accrues the longer an outsourcing relationship endures. Knowledge's ubiquity is part of the problem: firstly, how do you determine what's important and what's not and, secondly, how do you gather it in one place to deal with it, both contractually and practically? In many cases, the answer to that second question is: you don't. It's vital to address knowledge across the entire relationship and, by extension, across the agreement. The downside is that knowledge can't be addressed in one place in an agreement like IPR. You need to consider knowledge wherever it arises. Any outsourcing contract will be a collection of subject-matter-specific schedules. During the pre-contract negotiation process, each of these subject-matter domains should be addressed to take into account any specific issues where knowledge is impacted. The parties should address how knowledge in each domain will be addressed specifically from the perspective of both knowledge preservation and collation, and future usage rights.

2. *Knowledge is like … ice cream*. It comes in many different flavors. Know-how involving the performance of a specific process, for example, should be treated differently from information relating to service provider staffing levels, service history or performance. It's important to identify the different ways in which information about the outsourcing relationship and its various aspects may be created and deal with each in an appropriate way.

3. *Knowledge is like … a long car journey with your kids*. It helps to plan before you set out if you want to stay sane. Planning for knowledge capture should start even before the contract is awarded. Any thorough outsourcing evaluation process ought to cover what processes and resources the service provider will implement to ensure that knowledge is captured and shared with the customer. Customers should be clear in their requirements – and ought to accept an element of cost attributable to the knowledge capture process. Too often, a customer will either not focus sufficiently on knowledge capture or regard knowledge requirements as subservient to core service delivery requirements. Customers should not simply take whatever the service provider will offer baked into the charges. Knowledge capture ought to be part of the essential non-functional requirements, and service providers ought to be evaluated on the scale and effectiveness of the resources that they will put into it.

4. *Knowledge is like … passing exams*. It's as much about how you've prepared over the period of study as what happens on the day you're tested. Knowledge aggregation and dissemination isn't just about the customer's ability to exit the agreement, or any assistance involved in such exit. Leaving it to the end of a relationship is parking the issue until it's too late. The end of the relationship is fraught with too many other issues to address appropriately the gathering and transferring of knowledge. In addition, to the extent that the provider believes there is a strategic advantage in not transferring the knowledge, or is concerned that a successor provider which is likely to be one of its competitors will benefit from such knowledge, the provider may be reluctant to transfer important elements of information.

5. *Knowledge is like … a garden*. It needs to be nurtured. No jokes, please, about the quality of the manure that goes into it. The gathering, storing and transfer of knowledge should be embedded within the

Governance process. Many outsourcing parties appoint specific data guardians with responsibility for oversight of the handing of personal data. It makes sense to do the same in respect of knowledge – and it would help if both customer and service provider appointed account executives having specific oversight responsibility with respect to the gathering, storing and transfer of knowledge, and also with an obligation to report up to the outsourcing oversight committee and ultimately the customer's board. Procedurally, it is routine now to test business continuity plans regularly to make sure that they are still fit for purpose. It's becoming more accepted that one should do the same for exit plans. And, similarly, testing the effectiveness of the knowledge capture processes on an annual basis ought to be a key part of long-term outsourcing health-check procedures.

6. *Knowledge is like … living in a commune*. Knowledge that's part of the relationship should be a shared resource, unless of course it is clearly confidential or proprietary. The parties should have a clear means of delineating what is confidential or proprietary, and what is not. The possession of knowledge ought to be less about whether a party has an unfettered right to use knowledge, and more about how knowledge can be used to improve service delivery, enhance the customer's operations and create better and more efficient processes for the provider. It's a myth that the most valuable knowledge in an outsourcing contract is inherited or is brought to the party by a service provider. Most of what the customer really cares about is the knowledge about the way processes are delivered; that is, how the provider's processes and methods combine with the customer's organization is what creates the value in knowledge – each on a stand-alone basis carries significantly less value. It's wrong to think that information about the way in which a key part of any organization works is somehow knowledge or "know-how" that belongs to the service provider.

7. *Knowledge is like … Kentucky Fried Chicken*. Sometimes, there really is a secret recipe and, if there is, then different rules apply. And, yes, we know that we're contradicting the previous point – and although the general rule should apply in most circumstances, the parties must be vigilant to identify where information they bring to the table does or does not have independent value. So if there really is a secret sauce that the service provider brings (*e.g.*, specific improvements that it makes and for which it wants some protection and which it doesn't want to be handed to a competitor), then those can be dealt with differently. This doesn't mean that the service provider should have the absolute right in all circumstances. Service providers ought to be allowed a mechanism to identify in advance where such secret sauce may exist and to have the existence of that mechanism factored into pricing. The onus on the service provider should be clearly set out in advance and, similarly, the parties ought to agree upon no-go areas: protecting a new methodology developed elsewhere in its organization may be valid, but excluding core data about staffing and resourcing levels should be quite another.

CONCLUSION: GETTING THE BALANCE RIGHT

Fundamentally, the over-focus on IPR in many outsourcing contracting relationship distracts from what actually ought to be the key issue for an outsourcing customer – that is, capturing and protecting the knowledge that gets created through a process or contracting relationship and, especially, ensuring the continuity of that knowledge. It's what exists in people's heads, or what process flows or procedures actually happen in practice. That

knowledge often doesn't rise to the level of protectable IPR and is even more intangible than IPR. It's this intangibility that leads to knowledge being the poor relation to IPR in many outsourcing relationships.

As modern organizations evolve, they ought to take the more mature view that, except perhaps in relation to specific important items of IPR in which they proactively invest, ownership of IPR is less important than devoting time and appropriate resources to practical ways of identifying and securing the knowledge in the way their organization actually works.

Knowledge pervades an outsourcing relationship. It's what lubricates the wheels. Outsourcing in the modern era depends heavily on processes and on ensuring continuity of those processes – which means continuity of knowledge and capturing and institutionalizing knowledge. Outsourcing customers ought to worry more than they do about knowledge, and take greater steps to ensure that key knowledge stays within the organization, especially to ensure clear obligations on service providers to make certain that they don't take that knowledge away during, or at the end of, their relationship.

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