

Software Outsourcing— Business and Legal Issues Checklist

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Introduction

Outsourcing particular business functions is not something new. In the late 1970's and early 1980's many companies "outsourced" many of their "back-office" functions to service bureaus that performed these services for many customers, thereby gaining economies of scale from their investment in what was then, and is still, expensive mainframe computer hardware and software systems. Similarly, in the 1980s, large U.S. integrated circuit chip ("chip") design companies began moving manufacturing of their chips to offshore fabrication facilities (or "fabs") that also leveraged economies of scale to produce large volumes of chips for many chip companies. This eliminated the need for chip companies to raise capital or spend the time necessary to establish their own manufacturing capabilities. The benefit for these companies included reducing their costs to produce their chips, while freeing up capital and time to develop newer and better chips. Today, almost every new U.S. chip company is "fabless;" they design their semiconductor products and turn to offshore fabrication facilities to produce them. This model for outsourcing allowed the U.S. chip design industry to remain vibrant and it continues to attract investment capital.

While outsourcing is not itself a new business phenomenon, turning to non-US, offshore companies to perform non-manufacturing outsourced functions is the recent twist, which adds layers of business and legal complexity to the process. As the global economy continues to grow and develop, more companies are evaluating other parts of the world with lower cost business and technology talents where they can parse at least certain parts of non-manufacturing operations currently performed in the U.S. Many experts assert that the current "jobless" economic recovery in the U.S. reflects that companies are meeting increased demand for their goods and services by looking offshore for more cost effective "suppliers."

Over the last ten years, outsourcing has captured the attention of many in the software development industry. Initially, most software-related outsourcing occurred domestically, with companies outsourcing certain development projects to domestic entities - often specialized "body shops." For example, a company needing Java development assistance could find a local company with the right expert team of software engineers to get the job done easily and quickly, instead of having to staff up its own development organization with Java experts that would only be needed for a limited time period. Hence, these outsourcing activities were primarily undertaken to help a company reduce its cost structure and/or move non-core development activity outside the organization, so the company could focus on its core architecture development.

More recently, software development outsourcing is undertaking a transformation already seen in other industries, namely, core development outside the U.S., *i.e.*, offshore, by contracting with third parties, *i.e.*, outsourced. Primary reasons for offshore outsourcing in software development include potentially less costly development resources in other parts of the world, *e.g.*, India, Eastern Europe or Russia for more complex software development, and specialized talent not widely available elsewhere, *e.g.*, China for Asian language software development or Mexico for Spanish language software development. As more and more companies seek to do some offshore software development, questions arise as to what a software company should consider before deciding to outsource software development activity offshore.

With this background in mind, the checklists below provide a starting point of "top-10" business and legal issues a company should evaluate before deciding whether to engage in offshore outsourcing for software development. For convenience and ease of organization, the list is broken down into business considerations followed by legal considerations.

