Legal Structures for Outsourcing

BY FRED GREGURAS, STEVEN LEVINE AND S.R. GOPALAN
About the Firm

Fenwick & West LLP provides comprehensive legal services to high technology and biotechnology clients of national and international prominence. We have over 250 attorneys and a network of correspondent firms in major cities throughout the world. We have offices in Mountain View and San Francisco, California.

Fenwick & West LLP is committed to providing excellent, cost-effective and practical legal services and solutions that focus on global high technology industries and issues. We believe that technology will continue to drive our national and global economies, and look forward to partnering with our clients to create the products and services that will help build great companies. We differentiate ourselves by having greater depth in our understanding of our clients’ technologies, industry environment and business needs than is typically expected of lawyers.

Fenwick & West is a full service law firm with nationally ranked practice groups covering:
- Corporate (emerging growth, financings, securities, mergers & acquisitions)
- Intellectual Property (patent, copyright, licensing, trademark)
- Litigation (commercial, IP litigation and alternative dispute-resolution)
- Tax (domestic, international tax planning and litigation)

Corporate Group

For 30 years, Fenwick & West’s corporate practice has represented entrepreneurs, high technology companies and the venture capital and investment banking firms that finance them. We have represented hundreds of growth-oriented high technology companies from inception and throughout a full range of complex corporate transactions and exit strategies. Our business, technical and related expertise spans numerous technology sectors, including software, Internet, networking, hardware, semiconductor, communications, nanotechnology and biotechnology.

Our Offices

<table>
<thead>
<tr>
<th>Silicon Valley Center</th>
<th>Embarcadero Center West</th>
</tr>
</thead>
<tbody>
<tr>
<td>801 California Street</td>
<td>275 Battery Street</td>
</tr>
<tr>
<td>Mountain View, CA 94041</td>
<td>San Francisco, CA 94111</td>
</tr>
<tr>
<td>Tel: 650.988.8500</td>
<td>Tel: 415.875.2300</td>
</tr>
<tr>
<td>Fax: 650.938.5200</td>
<td>Fax: 415.281.1350</td>
</tr>
</tbody>
</table>

For more information about Fenwick & West LLP, please visit our Web site at: www.fenwick.com.

The contents of this publication are not intended, and cannot be considered, as legal advice or opinion.

© 2004, Fenwick & West LLP. All Rights Reserved.
Legal Structures for Outsourcing

I. Major Legal Structures ................................................................. 1
   A. Contract for services with a third party ................................................. 1
      1. Due Diligence .............................................................................. 1
      2. Comparison to other legal structures ........................................... 2
   B. Establish a subsidiary and then contract for services with the subsidiary .......... 4
      1. Key considerations ........................................................................ 4
      2. Comparison to other legal structures ........................................... 5
   C. Build-Operate-Transfer (“BOT”) Structure ........................................... 6
      1. Due Diligence .............................................................................. 6
      2. Comparison to other legal structures ........................................... 7

II. Agreement Considerations ............................................................ 7
   A. Contract for services with a third party ............................................... 8
   B. Contract for services with a subsidiary ............................................... 10
   C. Build Corporate Transfer Structure .................................................... 11
   D. Assignments .................................................................................. 11

III. Other Country Specific Issues ......................................................... 12
   A. India .............................................................................................. 12
      1. Establishing a Subsidiary ............................................................... 12
      2. Intellectual Property .................................................................... 13
      3. Tax Issues .................................................................................... 13
   B. China .............................................................................................. 13
      1. Establishing a Subsidiary ............................................................... 13
      2. Intellectual Property .................................................................... 14

IV. Summary ....................................................................................... 14
Businesses in the U.S. continue to shift a portion of their development, support and other operations offshore to countries, such as India or China, that offer a lower cost structure and a qualified labor pool. This memorandum briefly summarizes the three major legal structures that have been used by U.S. businesses for offshore outsourcing operations. Specific issues are then addressed for India and China.

I. Major Legal Structures

The three major legal structures for establishing offshore operations are: (i) contracting for services with a third party, (ii) establishing a subsidiary in the country where the services will be performed and contracting for services with the subsidiary, and (iii) the “build, operate and transfer” model, i.e., contracting for services with a third party with an option to acquire the services operation.

A. Contract for services with a third party

In this structure, the U.S. company contracts with a third party to provide services. The third party is an independent contractor, using its own infrastructure and employees, to perform the services. This is usually the structure to start with in outsourcing rather than prematurely creating the infrastructure of a subsidiary.

1. Due Diligence

One of the major considerations under this structure is the track record of the service provider. There are enough recent newspaper stories about failed offshore outsourcing projects that due diligence should be taken very seriously. Careful due diligence must be done on potential service providers in terms of financial stability, employee mobility, intellectual property protection and performance on similar projects. Useful areas to evaluate are:

Financial Status:

- What is the financial condition of the service provider?
- Is there risk of it ceasing business operations?

Performance Record:

- What similar projects has the service provider performed? For example, is this type of service within the providers “sweet spot”?
- Does the service provider have a specialty or “niche” that is hard to find?
- What do customer references say about quality of work, protection of intellectual property and employee mobility issues?
■ What metrics will be used to measure the performance of the service provider (e.g., conformance with statement of work, time to implement, customer evaluations)?

■ Does the service provider have quality process certifications such as SEI CMM certification for software (Level 3 or better)?

■ What is the size of the company in terms of number of employees (companies with less than 200 employees may not have mature processes)?

■ What is the service provider’s process for protecting the intellectual property of its customers?

■ What are the service provider’s operational procedures and technical safeguards for handling confidential information and/or intellectual property (e.g., firewalls, other physical and electronic security)? The U.S. company’s CIO (or equivalent) should be involved in this evaluation.

■ Is English language capability required for the service delivery? What is the service providers’ track record on English language?

■ Does the service provider use subcontractors or only employees?

**Location/Infrastructure:**

■ Does the location where the work will be performed have adequate infrastructure for phone services, data communication bandwidth, etc.?

■ Does the location have a qualified labor pool and what is the workforce mobility rate?

2. Comparison to other legal structures

**Advantages:**

■ Time to implement. This structure is the fastest of the three major structures to implement as the third party usually has pre-existing personnel and infrastructure which can be quickly engaged. The U.S. company does not have to establish the legal formalities of a subsidiary or build local infrastructure.

■ Cost. Both startup and recurring costs need to be considered. This structure is likely to appear to be the most expensive of the three major legal structures but the costs of establishing and operating a subsidiary are often underestimated. Larger service providers with substantial revenues and well-established
reputations may be more expensive than smaller suppliers but provide the advantage of greater performance reliability.

- **Flexibility.** This structure provides a way to quickly ramp up or ramp down without needing to keep a “bench.”

**Disadvantages/Risks:**

- **Control.** The U.S. company will have less control than in the subsidiary structure as the services will be performed by an independent third party. The degree of control may be a valuation consideration if an acquiror targets the U.S. company for an acquisition. Under the subsidiary structure, the employees performing the services would be employed directly by the subsidiary. The U.S. company would have more ability to oversee performance of the services. In the third party provider structure, the U.S. company has less ability to (i) measure performance in real-time and quickly take corrective actions, (ii) implement its own policies to protect intellectual property and confidential information and (iii) closely monitor employee performance.

- **Intellectual property.** The U.S. company will also have less control over intellectual property protection procedures. The service provider’s track record for protecting intellectual property is very important as a practical matter. It is also important to understand the country’s legal framework for intellectual property protection (such as moral rights and ownership assignment requirements) including the adequacy of the enforceability mechanisms. The intellectual property risks are increased to the extent the service provider uses contractors (non-employees) to perform services. Ownership of work performed by contractors may be more difficult to obtain under the country’s intellectual property legal framework.

In software development projects, this intellectual property risk can be partially managed by having core development done in the U.S. and dividing up responsibility among different service providers for other development. However, the U.S. company may then need to increase internal resources (and cost) to integrate the work product of the different service providers.

- **Business risk.** This is evaluated by the quality of the track record of the service provider, its performance on similar projects and financial condition.

The U.S. company will need to supervise performance closely to ensure timely delivery of work product or services. Metrics need to be established and used to measure performance for services other than development. The U.S. company has more ability to monitor and directly manage employees in the subsidiary structure.
■ Crime/privacy issues. The U.S. company may be providing the service provider sensitive data (or having sensitive information developed/prepared by the service provider), such as medical records, tax returns, etc. Under this legal structure, there may be a greater risk of misappropriation or theft as the U.S. company has less ability to monitor, directly supervise and establish its own procedures for the handling of confidential information. These risks can be minimized, though not completely eliminated, by retaining sensitive data in U.S. servers and providing limited (no-download) access to the service provider.

B. Establish a subsidiary and then contract for services with the subsidiary
In this structure the U.S. company establishes an offshore subsidiary that is wholly-owned or at least controlled by the U.S. company. The subsidiary is a separate legal entity in the country where it is incorporated. This approach makes the most business sense as the U.S. company matures and gains experience with outsourcing under the third party service provider approach. The greater degree of control from having a subsidiary may be a valuation element in an acquisition of the U.S. Company. This structure generally provides a greater ability to manage the day-to-day operations of the offshore services, but will require more time and resources to be devoted by the U.S. company. The U.S. company should not assume that the subsidiary will perform without oversight. The U.S. company has greater control over the employees providing the services and implementing procedures for the handling of intellectual property and confidential information. The due diligence for this structure is primarily on the management team of the subsidiary and the legal and other infrastructure where the subsidiary will be located.

1. Key considerations
Some of the key considerations of this approach are:

■ Subsidiary location. The availability of a reliable employee pool with required skill sets for the services is an important factor. The ability to implement necessary technical network and other security should also be considered.

■ Local management. The subsidiary will usually have a local manager to run day-to-day operations as a practical matter. The managing director, general manager (or similar title) plays an important role in managing operations and a pre-existing relationship with this person is an important practical consideration. This person must be carefully chosen because the managing director may bind the subsidiary with third parties based on the legal theory of apparent authority, notwithstanding restrictions that may be placed on his authority by the subsidiary’s board of directors and/or in his employment agreement. The place of residence of this key person may in part drive the decision of where to locate the subsidiary.
Costs and time involved in the incorporation process. This varies significantly by country and by geographic location within a country. There are more governmental approvals needed for the incorporation process in countries outside the U.S. than in the U.S. The process of winding down a company is also more difficult and time consuming in countries outside the U.S.

2. Comparison to other legal structures

Advantages:

■ Control. The U.S. company has more ability to closely manage the subsidiary operations but should not assume more effective management will occur without careful oversight. The management of the U.S. company must communicate regularly and effectively with the management of the subsidiary and needs to visit the subsidiary operations on a regular basis. This greater degree of control enables the U.S. company to monitor the performance of the subsidiary and assure alignment of performance objectives with the U.S. company. Having a subsidiary with more control (rather than a third party service provider relationship) may increase the value of the U.S. company in an acquisition.

■ Intellectual property. The U.S. company will have greater flexibility to implement its own procedures for the handling of sensitive data and intellectual property. It also has greater control over whether any subcontractors are used by the subsidiary.

Disadvantages/Risks:

■ Time to implement. The subsidiary structure will usually take the longest time to implement. The amount of time necessary to complete the administrative and legal formalities to establish the subsidiaries varies by country and by region within each country.

■ Cost. Both startup and recurring costs need to be carefully calculated to have a true cost comparison with the third party provider structure. There are startup costs involved in terms of both (i) completing the legal and administrative formalities in establishing the subsidiary and (ii) locating office space and building out the subsidiary’s infrastructure. If the subsidiary is a small operation, it will not have the benefits of economy of scale that a large service provider enjoys. Hence, recurring cost savings may not be easy to achieve for small operations.

■ Flexibility. The subsidiary has the cost and risk of maintaining a “bench” of people who may only be needed on projects from time-to-time rather than on a daily basis.
Management resources. The management of the subsidiary usually requires a significant amount of time and resources of the U.S. company. U.S. management will need to devote substantial attention to oversight of the subsidiary in order to ensure it performs to the U.S. company’s expectations. U.S. company management should not assume basic physical and technical security or intellectual property protection safeguards will “automatically” be implemented because it is a subsidiary.

Local management. The local managing director must be carefully chosen because he will be responsible for running the daily operations of the subsidiary and may bind the subsidiary with third parties.

C. Build-Operate-Transfer (“BOT”) Structure
The BOT structure is a hybrid of the first two structures. The third party service provider, an independent contractor, initially establishes a team to provide services to the U.S. company. The team is usually dedicated to the U.S. company and may be segregated on a floor of the service provider’s facility or in a separate facility. The operation may have “perimeter” security such as restricted access to the floor or floors on which the team works. Some persons on the dedicated team, such as management level, accounting and other administrative type employees, may not be solely dedicated to the team in order to reduce overhead costs. In addition, the U.S. company will have an option built into the agreement by which it can elect to purchase the business unit represented by the dedicated team. Prior to the transfer, this structure is basically the same as the third party service provider structure and is the subsidiary structure following the option exercise.

In our experience, this structure is not often used and can involve a complicated transition process. The option price will usually be a multiple of months of service fees for the team plus the cost for the infrastructure. Typically, the option price will decline over time as the U.S. company continues to engage the services of the dedicated team as a third party service provider.

A subset of the BOT structure is when the U.S. company has the right to solicit and hire certain employees of the third party service provider. The price is often a multiple of months of service fees for the employee and is usually based on the length of time the third party provider has provided services to the U.S. company.

1. Due Diligence
The due diligence investigation on the possible service provider is generally the same as under the third party service provider structure with the added element of the transition phase. The provider’s track record in other transitions should be reviewed.
2. Comparison to other legal structures

Advantages:
- Time to implement. The initial services phase can be quickly implemented since the third party usually has pre-existing personnel and infrastructure which can be quickly engaged. The negotiation of the transfer price and specification of the transfer process are likely the pacing items.

- Cost. Costs will be higher the more dedicated and segregated the service provider’s team will be during the third party service provider phase. The U.S. company may be required to pay certain start-up costs in their entirety at the outset of the agreement. There could be additional oversight costs as compared to a non-BOT arrangement.

Disadvantages/Risks:
- The risks are the same as in the third party service provider structure with the addition of the transition risk. The transition needs to be carefully planned and executed in order to avoid a business disruption. The transitional needs should be thought through at the time of entering into the BOT agreement. This includes questions such as – will the employees move willingly? Compensation to employees for ESOP and retirement benefits earned prior to transfer? Is the team complete or are senior managers retained by the service provider? What is the incentive to the service provider to minimize team turnover? Is the infrastructure really transferable? Are the processes portable and self-contained?

II. Agreement Considerations

Agreement provisions will differ based on whether the transaction is for the development of software or design of an integrated circuit, pre-clinical trial animal testing or some form of business processing such as insurance claim processing or tax return preparation. Intellectual property will be involved in all of these services. Technical support scripts, protocols for pre-clinical animal testing and other intellectual property needs to be protected. One often overlooked agreement provision is detailed physical and technical security safeguards. While the U.S. company should address these safeguards in every agreement, it is even more important when the service provider will have access to sensitive personal or business information. A master agreement is often used when there will be multiple transactions among the parties. For more information on service agreement provisions see Key Service Agreement Issues: Service Providers Checklist, http://www.fenwick.com/docstore/Publications/Corporate/Key_Service_Agreement.pdf.
A. Contract for services with a third party

A master agreement may be entered into between the U.S. company and the service provider when a multiple project relationship is contemplated. Each project to be performed for the U.S. company can then be described on an exhibit attached to the master agreement (the “statement of work exhibit”). Many of the provisions of the agreement will depend on the type of services being produced.

- The statement of work exhibit will include a detailed description of the services to be performed, including: detailed specifications of the work product; deliverables, delivery schedule and milestones for completing the work product; schedule of project meetings and reports to be provided by the service provider; and pricing. A statement of work will be used in the case of software development, integrated circuit design services and other situations where work product will be delivered.

- Acceptance. The U.S. company should have a specified acceptance period following delivery of the work product to evaluate quality and to require the service provider to make additional modifications to the work product if it does not conform to the specifications.

- Warranties. The U.S. company will want a performance warranty that the work product is free from defect for a period following acceptance. The service provider should also warrant that the work product will not infringe the intellectual property rights of third parties. The service provider will seek to limit the amount of potential liability under the warranties and to limit the performance warranty to a limited specified time period.

- Service Level Agreement. There will be service level performance requirements tailored to the type of service where no work product will be delivered, such as tax return preparation or financial services.

- Payment terms. Pricing may be fixed price, time and materials or by unit of production such as per tax return. Payment timing is often tied to performance milestones when software or other development is involved.

- Ownership of work product. Ownership of all work product must be assigned to the U.S. company (or whomever it designates), including all intellectual property developed or created by the service provider. The service provider may seek to retain ownership of any pre-existing “base software” or core “IP”, in which case the U.S. company should obtain a world-wide fully-paid perpetual license to any intellectual property rights of the service provider that the U.S. company needs to conduct its business.
■ Employee invention assignment and confidentiality. The service provider should be required to have each employee and contractor of the service provider assign all of its intellectual property rights to the service provider and enter into confidentiality obligations at least as restrictive as the agreement between the service provider and the U.S. company. The third party should agree not to subcontract or otherwise use any non-employee service providers to perform the services, without the written consent of the U.S. company. The assignment of intellectual property rights should address “moral rights” ownership under the laws of the country where the services will be provided.

■ Liability for infringement of third party intellectual rights. The service provider should agree to indemnify the U.S. company if it breaches third party intellectual property rights. Often the service provider will want a cap on the amount of exposure but the U.S. company should negotiate an unlimited indemnity right at least for copyright and trade secret claims.

■ Confidentiality provisions. The service provider must not disclose any confidential information of the U.S. company or use any confidential information except as required to perform the services. The service provider may try to limit the period of the confidentiality obligation following the end of the engagement. The obligation should continue for at least three (3) years.

■ Non-competition/Non-solicitation provisions. The service provider should agree that it will not seek to take away or interfere with any customers of the U.S. company, or solicit or hire the employees or contractors of the U.S. company during the agreement and for a period of at least one (1) year.

■ No assignment by service provider. The service provider should be prohibited from assigning its obligations under the agreement without the prior written consent of the U.S. company and any attempt to do so should be void.

■ Taxes. The agreement should provide that the service provider will be responsible for all taxes due on payments received under the agreement. There should not be any local country withholding taxes on a services transaction as long as there is no license involved.

■ Governing law/jurisdiction. The U.S. company will want the parties to agree to settle any dispute in a U.S. jurisdiction (state) based on U.S. governing law. The governing law provision should expressly exclude the application of conflicts of law principles.
The intellectual property laws of the jurisdiction where the work is performed will apply regardless of what the agreement provides. Accordingly, the U.S. company must understand the “work for hire,” moral rights, assignment of ownership and other statutory framework applicable to intellectual property in the country where the work will be done.

- Compliance with law. Both parties should agree to comply with all applicable laws and regulations, including any currency exchange and export control restrictions and agreement registration requirements.

B. Contract for services with a subsidiary

The relationship between the parent and subsidiary must be “arms-length” for tax purposes. This means the agreement must contain provisions that would be normally found in agreements between two unaffiliated parties. Thus, many of the provisions described under the third party service provider structure are also in the agreement with a subsidiary. Some of the key agreement provisions with a subsidiary that are different from or in addition to those in the third party service provider structure are as follows:

- Payment. The U.S. Internal Revenue Service and the local income tax authorities may scrutinize transfer pricing among the companies. The agreement will usually include a cost-plus provision, in which the U.S. company agrees to pay service fees to the subsidiary equal to the subsidiary’s costs and expenses plus a profit, such as 10%. The subsidiary should provide detailed reports (on a monthly basis or some other short time period) of the subsidiary’s costs and expenses incurred in performing the services.

- Work direction and quality. The subsidiary will agree to provide services as directed by the U.S. company. The agreement with a subsidiary is usually a more general services agreement rather than pursuant to a detailed “statement of work” or project oriented.

- Confidentiality. Since the subsidiary is a separate legal entity, it must agree to keep all information provided by the U.S. company as confidential, including any intellectual property and business information, and agree to use such information only for purposes of providing the services. This obligation also must be implemented with the subsidiaries employees.

- Intellectual property ownership. The parent corporation does not have ownership of intellectual property developed by the subsidiary merely because it owns the subsidiary corporation. The subsidiary will usually assign ownership of all intellectual property developed or created by the subsidiary to the U.S. company (or its designee). Exceptions are when the U.S. company has an off-shore
intellectual property holding corporation for tax purposes or there are favorable tax consequences for holding the intellectual property at the subsidiary level. This obligation must be implemented with the subsidiaries employees.

C. Build Corporate Transfer Structure
The agreement provisions described for the third party service provider structure are applicable with the addition of provisions covering the option to buy and transfer the operation. The additional agreement provisions are the option process and pricing and transition process. The transition should be carefully covered in the agreement so that operational disruptions are minimized. Following the transfer, the subsidiary structure agreement provisions would apply.

D. Assignments
Contractual requirements for obtaining ownership of results of outsourcing services differ for contractors and employees. A subsidiary is treated as an independent contractor service provider not an “employee.” Unless these requirements are met, the U.S. company may not own the results of the work even if it paid for them. The following chart summarizes ownership assignment requirements in China, India and the U.S. for both employee and independent contractor relationships. The factors in the columns from left to right address these issues:

1. whether a written assignment made prior to the completion of the results is effective or if a second written assignment is needed after completion of the results;

2. the geographical scope of the assignment;

3. if there is any obligation to exercise the rights assigned; and

4. the duration or time period of the assignment.
印度的作业要求与美国和中国的作业要求大不相同。中国的作业要求更像是美国的要求。美国公司必须确保承包商与员工和分包商的协议中有适当的作业条款。

### III. Other Country Specific Issues

#### A. India

印度的外包优势包括软件开发和BPO。集成电路设计和一些药物发现过程服务也在印度进行。印度的主要语言是英语，特别是BPO服务。

1. **Establishing a Subsidiary**

许多美国公司在班加罗尔建立了运营，因为其熟练的劳动力、通信基础设施和商业友好的环境。然而，班加罗尔正在成为一个昂贵的商业地区。员工流动性也是一个问题。办公室租赁、办公室和通信基础设施以及人力资源成本在班加罗尔比在印度其他地区更高。美国公司越来越多地考虑在印度的其他地区建立运营，如

---

<table>
<thead>
<tr>
<th>Employee</th>
<th>Contractor</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Following Completion of Work (1)</td>
</tr>
<tr>
<td>China</td>
<td>Copyright – Yes unless assigned in writing</td>
</tr>
<tr>
<td></td>
<td>Patent – No unless assigned in writing</td>
</tr>
<tr>
<td>India</td>
<td>Copyright – Yes</td>
</tr>
<tr>
<td>U.S.</td>
<td>Copyright – Yes unless assigned in writing</td>
</tr>
<tr>
<td></td>
<td>Patent – No unless assigned in writing</td>
</tr>
</tbody>
</table>

印度的作业要求与美国和中国的作业要求大不相同。中国的作业要求更像是美国的要求。美国公司必须确保承包商与员工和分包商的协议中有适当的作业条款。

### III. Other Country Specific Issues

#### A. India

印度的外包优势包括软件开发和BPO。集成电路设计和一些药物发现过程服务也在印度进行。印度的主要语言是英语，特别是BPO服务。

1. **Establishing a Subsidiary**

许多美国公司在班加罗尔建立了运营，因为其熟练的劳动力、通信基础设施和商业友好的环境。然而，班加罗尔正在成为一个昂贵的商业地区。员工流动性也是一个问题。办公室租赁、办公室和通信基础设施以及人力资源成本在班加罗尔比在印度其他地区更高。美国公司越来越多地考虑在印度的其他地区建立运营，如
the cities of Pune, Chennai and Hyderabad that have lower costs, less competition for employees and a less mobile workforce.

India, in contrast to China, is not considered a major market so the subsidiary will likely only have a services fulfillment function.

For more detailed information on establishing a subsidiary in India, see An Updated Guide to Establishing a Subsidiary in India, [http://www.fenwick.com/docstore/Publications/Corporate/Establishing_Subsidiary_in_India.pdf](http://www.fenwick.com/docstore/Publications/Corporate/Establishing_Subsidiary_in_India.pdf).

2. Intellectual Property
As a practical matter, intellectual property is respected in India by most service vendors. The practical consequences for their business and the country of not protecting intellectual property is too severe.

India is a member country of the Berne Convention and Universal Copyright Convention, the Paris Convention, Patent Cooperation Treaty ("PCT") and World Trade Organization ("WTO"). The Berne Convention and UCC provide for national treatment of an author of a member state. The India copyright law provides moral rights to an author of a work. In practice, however, the risk of an author asserting moral rights can be minimized if the assignment agreement with the author contains an irrevocable waiver and agreement to never assert moral rights. This should be included in each employee’s invention assignment agreement and in agreements with consultants.

3. Tax Issues
The Indian subsidiary that only provides backend fulfillment services for the U.S. parent company is usually not a “permanent establishment” of the parent for tax purposes in India. The actions of the Indian subsidiary may sometimes constitute a permanent establishment. For example, if the India subsidiary exercises authority to conclude contracts, secure orders or deliver goods on behalf of the parent.

B. China
China’s outsourcing strength is manufacturing. Integrated circuit design, software development and some drug discovery process services are also done in China. BPO services which require an English language capability are not generally offered.

1. Establishing a Subsidiary
In contrast with India, a Chinese subsidiary might play some role in developing and supporting the local China market for the U.S. company.

A Cayman Islands company is often used as the holding company when the entire business group is being formed. The China operations are a subsidiary of the Caymans Company. This structure provides a more flexible exit strategy. For more detailed

2. Intellectual Property

China has the same intellectual property infrastructure as India. China is a member of the Berne and Universal Copyright Conventions, Paris Convention, PCT and WTO. Intellectual property is at a greater risk in China. Enforcement of intellectual property rights, both legally and practically, is still a significant problem in China.

IV. Summary

This memorandum has briefly summarized the major structures used by U.S. companies for offshore outsourcing operations. The advantages, disadvantages and risks of each structure have been described. Obtaining ownership of intellectual property is key business objective in each structure. In considering the alternatives, a U.S. company should focus on getting business results and build infrastructure only when clearly needed.

If you have any questions about this memorandum, please contact Fred M. Greguras (fgreguras@fenwick.com) or Steven S. Levine (slevine@fenwick.com) of Fenwick & West LLP (telephone: 650.988.8500) or S. R. Gopalan of Dawn Consulting in Banglore, India (srg@dawnconsulting.com).