



Selecting An Outside Product Development Company *Achieving Your Goals With Minimal Risk*

Michael N. Perugini
President

No one understands your company's competitive landscape better than you! New product development is the life-blood of your company's future. Managing a new products time-to-market and time-to-volume while controlling costs are essential to your company's success. To ensure growth and compete globally in highly competitive and technologically complex equipment markets, successful companies must extend their internal engineering resources by utilizing competent *hands-on* contract engineering talent.

So how do you go about choosing a development partner wisely?

If your development partner will play a critical role in developing a core piece of technology for an entirely new product, make certain that the firms you select as candidates have *demonstrated proficiency* in the required engineering disciplines and technologies. If you have a relationship with a firm whom you *trust* and have had success with in the past, by all means stay with them. If you're new to the *outsourcing* game, select product development candidate firms with years of successful operation. *Be diligent!* The onus is on *you* to check their references. In doing so, look for situations where the development partner made significant contributions which closely match your needs. Once you've narrowed the selection down to an ideal candidate, you've made great strides toward achieving your new product development goals.

You must follow two rules to ensure a successful relationship with your development partner:

Rule #1, Always remain involved in the project, and, Rule #2, Always remain involved in the project!

Although it may be tempting to throw a job *over the fence*, your staff, the project, and your customers will benefit from your involvement and ongoing management. *Remember...* At some point in time, you and your staff will have to articulate the new products features, benefits, and project status within your company and to those customers. As a final point, it's imperative to augment your ongoing management with *trust*. Give your development partner credit for possessing the professional ethics and motivation to ensure your company's success. Trust is an essential element in this relationship.

Your safety net (or not) – the iron clad contract!

This approach is destined to fail as it invariably defines all possible concerns from one perspective in a veiled attempt to manage risk. Not wanting to seem cavalier, and certainly not meant as a challenge to members of the legal profession who may read this, it is not practical to prepare a contract which satisfies every conceivable instance, consequence, or breach which may occur during the course of this relationship. However, a few *basics* should be explained so that you and your development partner have an appreciation for each others view point.

Basics #1: Fixed Price vs. Time and Materials

To control your costs and better understand what you're paying for, it makes sense to contract for services at a fixed price. So why do contract development companies prefer working on a time and materials basis? Do contract developers try to take unfair advantage of you? Are their internal processes out of control?

Reputable contracting firms are not out of control or unjustly billing for padded services. After all, contracted product development is still product development and not an exact science. Design goals, driven by product features and benefits, usually change during the product design cycle. Partly because things change and partly because your new product may require applying an emerging technology which extends beyond your current man, machinery or facility capabilities. Engineering is a complex exercise in problem solving. As the product design progresses, some problems will be resolved quickly and others will not. In certain instances, product development must adapt to changing markets and customer needs that become apparent only after the project has begun. Experienced contract developers can only provide a highly educated estimate of the time and materials required for any given project.

Fixed-price quotes are the exception rather than the rule. But, if you feel you really need a fixed price quote, it's important that you provide an extremely detailed product specification, and pursue a path of proven tools, using proven technology. Do your best to define tasks in sufficient detail to allow their management at the individual or small-group level. Why? The effort will allow your development partner to minimize *its* risk and supply you with a reliable quote that will work for both parties.

If you go instead with a time and materials basis, your development partner will typically supply an estimate as to the project's overall cost. While the final, total cost of the project may be in excess of the estimate, it may actually come in below. To minimize your risk ongoing, conduct regular project reviews in which the developer reports on progress against estimates. As you do, make sure your development resource flags potential overruns at the earliest possible moment, to protect against surprises.

What you *really* should look for in a development agreement:

- Clear and detailed description of deliverables
- Clearly stated confidentiality obligation
- Warranty of original design (no known infringement)
- Detailed schedule with measurable milestones
- Assignment of copyrights, patents, and other intellectual property rights to hiring company
- Clearly stated termination clauses
- Mutual agreement for non-solicitation of employees

Basics #2: Liability/indemnification for Patent Infringement

Your attorneys may insist that the development contract require the contractor to indemnify you from, or carry liability insurance against, patent infringement. It seems reasonable. It's also unworkable. For starters, there simply are no insurance policies available that protect against patent infringement. Your contract developer will not be able to supply it. The closest such insurance is protection from "errors and omissions," which could compensate you if the developer neglects to adequately support your patent filing and patent search efforts.

How can you protect yourself? Exactly as you should with an internal development project. Whenever a development effort produces an original technology, design, or process that can be protected, you should start the patent process. The first step is to work with an attorney to obtain a patent search, which is a check to see whether your new technology infringes on an existing patent and to assess the likelihood of a patent grant. You can then continue by having your attorney file a patent application with the U.S. Patent and Trademark Office. The application, which will detail the unique aspects of the technology, design, or process, remains confidential

while moving through the review process, which can take two or more years. Information in the patent filing becomes public *only if the patent is granted*. Once granted, the patent protects its holder from the date of the original filing, not the date of the grant; because of this, a company can unknowingly infringe during the period in which patent information remains confidential. That's the main reason insurance policies against patent infringement are unavailable.

Patents can be very important components of your overall intellectual property. It is in your best interest to pursue *winning* them, rather than focus on indemnification against infringing on them. When working with an established contract development group, you'll be able to tap into the expertise of engineers who have been involved in a great many patent searches and filings on behalf of others. If you do force a contract development group to indemnify you against infringement, their only recourse will be to conduct their own, separate patent search, which still can't guarantee anything, but will surely be rolled into your project costs.

Basics #3: Non-compete Clauses

Everyone in the contract development business is more than happy to sign a reasonable non-disclosure agreement. They couldn't survive by blabbing your secrets, anyway. The minute a contract developer gets known for compromising client intellectual property is the minute it begins to die. Non-compete clauses are a different matter. The fact that a development group offers talent of value to your industry and product category is a big part of what attracts you to them in the first place. To retain that talent, the contract developer must re-use it – and that may occasionally be with companies that are, to some degree, your competitors. When that happens, a reputable firm will honor your confidentiality completely and fully, and will be careful not to compromise your intellectual property. But a forced non-compete can severely compromise their ability to offer the talent that anyone, including you, needs to create products of real value.

Basics #4: Project Halts

Finally, your arrangement with a contract development firm should include equitable measures for abruptly ending a project. It's not unusual for a company to kick off a development effort, only to have to put the project on temporary or permanent hold later due to market changes or other competitive realities. There's nothing wrong with that. It's obviously best to stop funding a dead opportunity. On the other hand, you'll want your development partner to work diligently for the duration of the project, without concern for whether funding could dry up without notice. You wouldn't think of stopping payroll to your internal engineers the day a project gets terminated; you should build into your contract a reasonable and fair shut-down period.

The Contract must create a Win-Win Situation

In general, engineers do not relish dealing with contracts. What they really live for is creating products that are faster, smarter, cheaper, simpler, cooler – and ultimately help you make money. As in all negotiations, an understanding and appreciation of the other side's value proposition can help establish a mutually satisfying relationship, allowing you to get the results you need.