

Software License Due Diligence in M&A Deals: Evaluating Open Source and Other Software Assets

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Today's faculty features:

Christopher Barnett, Senior Attorney, **Scott & Scott**, Dallas

Robert Scott, Managing Partner, **Scott & Scott**, Southlake, Texas

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M&A Transactions and Software Compliance Due Diligence

Presented by:

Robert J. Scott, Managing Partner

Christopher Barnett, Senior Associate

www.ScottandScottllp.com

Speakers

Robert J. Scott



Christopher Barnett



Agenda

- Transaction Types & Deal Structures
- Key License Provisions
- *Cincom v. Novelis*
- *ACS v. Cincom*
- Deal Specific Issues
- Risk Assessment
- Risk Mitigation

Types of Transactions

- Stock Transactions
- Asset Purchase Agreements
- Reverse Triangular Mergers
- Statutory Mergers

Important License Provisions

- Definition of Licensee
- Scope of Confidentiality Provision
- Provisions related to Third-Party Access
- Outsourcing & Third Party Maintainer Provisions
- Transferability Provisions
- Definitions of Affiliate
- Anti-Reverse Engineering Provisions
- Indemnity and Holdback Provisions
- Choice of Law Provisions
- Accessibility of Source Code

Cincom vs. Novelis

- Cincom licensed software to Alcan Ohio. The license was non-exclusive and non-transferrable, and specified the allowed computers on which it could be installed.
- Before the re-organization, Alcan was wholly owned by Alcan, Inc., a Canadian organization.
- Alcan created a separate entity called Alcan of Texas, and it was also wholly owned by Alcan, Inc.
- Alcan Ohio merged into Alcan Texas.

Cincom vs. Novelis (cont'd)

- o Alcan Texas then merged into itself and three of its subsidiaries.
- o The result is that Alcan Ohio was now Alcan Fabrication Corporation.
- o Finally, Alcan Fabrication Corporation changed it's name, and then changed the name again to Novelis.
- o The software originally licensed was still installed on the same computer.
- o District Court said that Alcan Ohio's merger with Alcan Texas effected a transfer of the license under Ohio law and the Sixth Circuit confirmed.

Cincom vs. Novelis (cont'd)

Takeaways:

- Federal common law regarding IP, no right to transfer unless specifically granted in the license agreement. (However, state common law interprets the interpretation of the license).
- State law will also determine whether a merger results in the transfer of a license
- An unintended transfer may result in violation of the license agreement.

Outcome:

- The mergers effected a prohibited transfer under the terms of the license, and consequently, Novelis infringed Cincom's copyright.
- Acquiring company required to relicense software previously licensed.

ACS vs. Cincom

ACS either directly or through subsidiaries was delivering IT services to three companies (Pilkington, Hallmark, and SIRVA).

- Cincom licensed to Genix the right to use software used by Genix's customers. One of the customers was Libbey-Owens, Pilkington's predecessor.
- ACS acquired Genix Group.
- Hallmark was a customer of ACS.
- ACS signed a Cincom Ltd. License and NDA which gave ACS access to use products licensed to Hallmark-the license agreement was silent regarding right to transfer or assign.
- SIRVA was a customer of ACS.
- ACS signed a Cincom Ltd. License and NDA which gave ACS access to use products licensed to SIRVA-the license agreement was silent regarding right to transfer or assign.

ACS vs. Cincom (cont'd)

- ACS was acquired by Xerox.
- Cincom issued a demand letter to ACS stating that by consummation of the Xerox acquisition, any access or use of the Cincom software was infringing Cincom's copyright.
- Cincom required a new license agreement (and \$3.5M) to continue accessing the software.
- SIRVA, Pilkington, and Hallmark began ceasing use of the software as demanded.
- ACS filed declaratory judgment action in Northern District of Texas seeking a declaration that no additional license fee was owed.

ACS vs. Cincom (cont'd)

Takeaways:

- *Cincom Vs. Novelis* 6th Circuit Opinion remains prevailing law.
- An unintended transfer may result in violation of the license agreement.

Outcome:

- The matter was settled out of court.

Deal-Specific Issues

- Stock Transactions – look for change in control language, usually greater than 50%.
- Asset Purchase – look for assignment rights, silence is a problem.
- Joint Ventures – look for definition of affiliates and third-party access and confidentiality provisions.
- Mergers – review statutory merger statutes.

Assess the Risks

- Review the value of the software in question.
- Determine whether publisher typically allows transfer if asked.
- Review language in license agreement to determine definition of affiliate.
- Identify transfer fees outlined in license agreement, if any.
- Negotiate license agreement revisions, if possible.

Buyer's Risk Mitigation Strategies

- Review all deployments and entitlements pre-deal
- Add software asset schedules to deal documents
- Provide publisher notices and secure permissions
- Negotiate new license terms
- Include indemnification from seller
- Allocate pre-closing expenses to seller
- Use holdbacks or price adjustments to cover contingencies

Seller's Risk Mitigation Strategies

- Document deployments and entitlements as of closing date
- Add software asset schedules to deal docs
- Avoid broad reps and warranties about ownerships and right to transfer
- Require buyer to assume all liabilities arising after closing
- Identify which licenses can be transferred as of right
- Limit holdbacks and price adjustments

Questions?

Contact Information

Robert J. Scott, Esq.

Managing Partner

rjscott@scottandscottllp.com

(214) 999-2902

Christopher Barnett, Esq.

Senior Associate

cbarnett@scottandscottllp.com

(214) 999-2912

Scott & Scott, LLP.

550 Reserve Street, Suite 200

Southlake, TX 76092

www.scottandscottllp.com