

Technology Acquisition in M&A Transactions

Due Diligence of IP, Software, and Other Assets, Reps and Warranties, Transition Services Post-Closing

WEDNESDAY, JANUARY 15, 2020

1pm Eastern | 12pm Central | 11am Mountain | 10am Pacific

Today's faculty features:

John P. Brockland, Partner, **Hogan Lovells US**, San Francisco

Steven H. Goldberg, Partner, **Baker & Hostetler**, New York

The audio portion of the conference may be accessed via the telephone or by using your computer's speakers. Please refer to the instructions emailed to registrants for additional information. If you have any questions, please contact **Customer Service at 1-800-926-7926 ext. 1.**

Tips for Optimal Quality

FOR LIVE EVENT ONLY

Sound Quality

If you are listening via your computer speakers, please note that the quality of your sound will vary depending on the speed and quality of your internet connection.

If the sound quality is not satisfactory, you may listen via the phone: dial **1-877-447-0294** and enter your **Conference ID and PIN** when prompted. Otherwise, please **send us a chat** or e-mail sound@straffordpub.com immediately so we can address the problem.

If you dialed in and have any difficulties during the call, press *0 for assistance.

Viewing Quality

To maximize your screen, press the 'Full Screen' symbol located on the bottom right of the slides. To exit full screen, press the Esc button.

Continuing Education Credits

FOR LIVE EVENT ONLY

In order for us to process your continuing education credit, you must confirm your participation in this webinar by completing and submitting the Attendance Affirmation/Evaluation after the webinar.

A link to the Attendance Affirmation/Evaluation will be in the thank you email that you will receive immediately following the program.

For additional information about continuing education, call us at 1-800-926-7926 ext. 2.

If you have not printed the conference materials for this program, please complete the following steps:

- Click on the link to the PDF of the slides for today's program, which is located to the right of the slides, just above the Q&A box.
- The PDF will open a separate tab/window. Print the slides by clicking on the printer icon.

Technology Acquisition in M&A Transactions

Strafford Webinar Series

January 15, 2020

Presented by

Steven H. Goldberg, BakerHostetler | John P. Brockland, Hogan Lovells

Introduction and Outline

- Key types of technology and intellectual property assets and framework for analysis
- Due diligence of software, AI, and other technology and IP assets
- Representations and warranties particular to technology and IP assets
- Indemnity provisions particular to technology and IP-heavy acquisitions
- Ancillary agreements and post-closing transition common to technology and IP-heavy acquisitions

Before you Begin

- Get organized
- Understand the deal
 - Structure
 - Asset purchase
 - Share purchase
 - Merger
 - Carve-out
 - Size
 - Industry
 - Public vs private target

Before you Begin (cont'd)

- Understand buyer's goals and sensitivities
- Understand the target
 - Founders and company history
 - Key technology and IP Assets
 - Patents and litigation
 - Financial status
 - Competitors
- Identify and build team (corporate, technology & IP, privacy, employment, benefits, local counsel)

Key Types of Tech and IP Assets

- Technology
 - Software (source and binary code, documentation, etc.)
 - Inventions and know-how
 - Product designs
 - Names, marks, logos
 - Works of authorship
 - Data
- Intellectual Property Rights
 - Patents
 - Trademarks
 - Copyrights
 - Trade secret rights
 - Others

Frameworks for analysis

- Technology vs IP Rights
 - Technology is software, inventions, works of authorship, etc.
 - IP Rights is abstract rights—patents, copyrights, etc.
 - Often useful to distinguish the two
- Will IP be assigned (asset deal, forward merger) or stay with target company (share purchase, RTM)

Framework for analysis (cont'd)

- IP Rights generally can be assigned like other **personal property**
- **Unregistered IP and Technology** (trade secrets, unregistered copyrights, software, etc.)
 - Assignment in asset purchase agreement or bill of sale
 - Comprehensive definitions are key
- **Registered IP** (patents, registered trademarks, registered copyrights, domain names)
 - *Perfect* the assignment by recordation in applicable patent, trademark, copyright office
 - Domain name registration with registrar
- Technology created by **AI**
 - May not be protectable with IP Rights
 - Include with other transferred assets

Framework for analysis (cont'd)

- **Data**

- Protection by IP Rights somewhat uncertain (trade secret, copyright)
- Treated like other personal property; can be subject to regulation

- **Privacy**

- Personal information protected by various laws
- Context specific
 - Protected Health Information (HIPAA)
 - Financial information (GLB)
 - Children (COPPA)
- General applicability
 - GDPR (EU)
 - CCPA (California)
 - Other jurisdictions
- Privacy policies / contracts
- Use of AI (automated decision-making and profiling)

Framework for analysis (cont'd)

- **Special carve-out problems**
 - Transferred Technology and IP Rights
 - Retained Technology and IP Rights
 - Shared Technology and IP Rights
- **Never as “clean” a break as expected**
- **Line drawing – requires business and technical input**
- **Licenses for shared IP (see below)**

Due Diligence

- **Why do it?**
 - Reps and warranties not enough
 - Problems are easier to fix early
- **Scope of IP Diligence**
 - IP chain of title and liens
 - IP-related contracts
 - IP litigation and threats
 - Open Source
 - Miscellaneous
- **Remember to**
 - Ask questions and follow leads
 - Seek to resolve or mitigate problems
 - Surface issues that may affect valuation

Due Diligence (cont'd)

- **Process**

- Buyer counsel coordinates with client on scope and materiality
- Diligence request list
- Start open source scan process early (if applicable)
- Initial conversation with target often helpful
- Searches in patent, trademark, copyright office databases
- Review materials
- Supplemental requests
- Reports
- Resolution / mitigation steps
- Changes to purchase agreement

Due Diligence (cont'd)

- **Initial Requests**

- Tailor to each deal
- Material Technology and IP Rights
- Key products
- Key third-party inputs
 - Software
 - SaaS, PaaS hosting, cloud, online services
 - Semiconductor IP
 - Data
 - CAD, IDE, and other tools
 - Infrastructure for design, development, support, hosting, delivery

Due Diligence (cont'd)

- **Initial Requests (cont'd)**

- Invention assignment agreements (employees, contractors)
- Open source
- Form agreements
- Channel partner agreements
- Material customer agreements
- Other outbound license agreements
- Standards bodies
- University / government funding and collaborations
- Litigation and threats

Due Diligence (cont'd)

- **Registered IP**

- Common issues include

- IP found to be unregistered, abandoned or expired
 - Pending applications set to expire or renewal, maintenance or other fees soon due
 - IP held in name of other parties (consultants, subsidiaries, affiliates, etc.)
 - Gaps in chain of title
 - Outstanding security interests

- Common resolutions

- Some applications / registrations can be revived
 - Schedule of upcoming fees and deadlines, smooth transition
 - Clean-up assignments of IP Rights (very common)
 - Payoff loans and lift liens

Due Diligence (cont'd)

- **Open Source**

- Diligence activities
 - Review policies
 - Open source scan (Black Duck, FossID, other)
 - Review list provided by target
 - Conversations with client and target
- Common resolutions
 - Scans find many false positives
 - Removal / replacement of code
 - Update license notices
 - Determine whether pre- or post- closing items

Due Diligence (cont'd)

- **Invention Assignment Agreements**

- Diligence activities
 - Agreements from founders, contractors
 - Form employee agreements
- Common Issues
 - Lack of present-tense assignment language
 - Non-competition, California Labor Code 2870 issues
 - Formalities in jurisdictions outside US
- Common resolutions
 - Cleanup assignments
 - Consider current vs former employees and contractors

Due Diligence (cont'd)

- **Material IP Agreements**

- Common Issues
 - Change of control / assignment provisions
 - Termination for convenience or “easy” termination
 - Overly-broad outbound licenses
 - Source code escrow / delivery
 - “All you can eat”, unlimited use, MFN provisions
 - Licenses that affect acquirer IP
 - Assignments of target company IP, improvements
- Common resolutions
 - Consents / waivers
 - Termination of unfavorable agreements (where possible)

Due Diligence (cont'd)

- **Privacy**

- Common Issues

- Compliance with relevant privacy and security laws
 - Privacy policies inconsistent with actual or planned transfers and uses of data (by target company and buyer)
 - Privacy policies out of date or inconsistent with applicable laws
 - Agreements with third-party recipients of data inconsistent with obligations to protect personal information collected by the target company
 - Agreements with third-party providers of data inconsistent with actual or planned transfers or uses

- Common resolutions

- Update policies
 - Terminate or renegotiate contracts where possible
 - Segregate data that cannot be used as planned

Representations and Warranties Particular to Technology Assets

- **Functions / Purposes of IP Reps**

- Public vs. Private Company Acquisition
- Closing Conditions
 - One party can refuse to close
 - Materiality standard
 - Reps “speak” twice
- Indemnification
 - Escrow / Caps / baskets
 - Special indemnity
 - RWI

- **Disclosure Schedule**

- Required lists
- Exceptions to the warranties
- Highly negotiated
 - Responsiveness
 - Scope limiting language
 - Privilege / Admissions
 - FIPO

Representations and Warranties Particular to Technology Assets

- **Commonly Negotiated Qualifiers**

- **Materiality**

- E.g., “in all material respects” or “material”
- E.g., “would not result in a Material Adverse Effect”
- Why seller wants it
- Is materiality scraped?

- **Knowledge**

- Usually defined
- Renders many reps pretty toothless for indemnification purposes

- **Dating the reps**

- E.g., “as of the date of this Agreement” or “in the three years preceding the date of this Agreement”
- Why Seller wants it
- Fair ask for listing reps

Representations and Warranties (cont'd)

- **Listing Reps**

- Types: Registered IP, Inbound Licenses, Outbound Licenses, Standard Form Agreements, Open Source, Standards Bodies, etc.
- To provide information to validate diligence findings
- Not a substitute for diligence (disclosure schedules often come too late)
- Tailor so that they provide useful information and don't create unnecessary work for either party

Representations and Warranties (cont'd)

- **Risk-related Reps**

- **Sufficiency of IP Assets** – Purchased assets, together with rights provided to the Buyer under any ancillary agreements, constitute all of the IP and IT assets and rights necessary to operate the purchased business post-Closing in the same manner as the Seller operated prior to the transaction.
- **IP Ownership** – Seller is the sole and exclusive owner of each item of IP included in the purchased assets / IP in its products or that it purports to own, free and clear of all liens.
- **Validity and Enforceability** – Purchased IP assets are valid and enforceable and not subject to any pending or threatened claim challenging their validity or enforceability.
- **Non-Infringement of Third Party IP** – The purchased assets / products and services of the Seller's business / operation of the purchased business do not infringe, misappropriate or otherwise violate any other party's IP rights, and there are no claims pending or threatened.
- **Infringement of Seller IP** – No other party infringes, misappropriates or otherwise violates the IP rights included in the purchased assets / IP rights of the Seller, and there are no claims pending or threatened.

Representations and Warranties (cont'd)

- **Risk-related Reps (cont'd)**

- **Protection of Trade Secrets and Confidential Information** – Seller has taken reasonable measures to protect its trade secrets and other confidential information. (Trade secrets lose IP status if not protected.)
- **No Adverse Effect on Buyer's IP** – The closing of the transaction will not result in the imposition of any lien on or license of the Seller's IP or the Buyer's IP or otherwise impose restrictions on Buyer's independent operations. As to Buyer's IP, this representation addresses the risk of springing out-licenses. It can be controversial.
- **Reps on the IP Agreements** – All IP and IT agreements in the purchased assets / material to the acquired business have been provided, are valid and enforceable and there has been no breach, no notice to terminate or materially alter terms. Material IP and IT agreements will also usually be covered by the more general representations concerning material contracts.

Representations and Warranties (cont'd)

- **Reps on Specific Topics**

- **Proprietary Software and IT Systems** – There are no viruses/malware in Target's proprietary software; no unauthorized access (or attempted access) of Seller's IT assets has occurred.
- **Open Source** – All open source and relevant licenses have been disclosed and listed. Seller has complied with all open source licenses. Seller's use of open source does not create "copyleft" problems.
- **Bugs / Product Defects** – Except as disclosed, Seller's products are free of material defects and conform to warranty obligations.
- **Source Code** – Source code to Seller's products has been protected and is reasonably documented and is not subject to escrow or other disclosure obligations.
- **Employee / Contractor Agreements** – All developers of IP for the Seller have signed valid and effective assignments of IP and waivers of moral rights.

Representations and Warranties (cont'd)

- **Reps on Specific Topics (cont'd)**

- **Privacy** – An increasingly important topic. Some typical reps follow.
- **Compliance** with privacy laws and regulations, including the GDPR and CCPA, any sectoral laws that are applicable (e.g., HIPAA as to protected health information, GLBA as to financial information). The Seller is not and has not been alleged to violate any data protection laws, and the transactions contemplated will not result in violation of data protection laws.
- **Notices** – Seller has, at all times, provided all legally-required notices and obtained legally-required consents as required by applicable laws in connection with Seller's collection, storage, transfer, retention, disposal and other processing of Personal Data, including without limitations with respect to text message and email communications (marketing and non-marketing).
- **Privacy Policies** – Seller has a privacy policy and privacy policy of Seller includes all legally-required disclosures, and such disclosures are not materially inaccurate, misleading, deceptive or in violation of any applicable laws. Seller complies with its privacy policy.
- **Data Breaches** – There has been no breach of, or unauthorized access to, or use of, any personal or sensitive information
- **No Claims** – No claims have been asserted or threatened against Seller by any Person alleging a violation of any of the foregoing.

Indemnification Provisions

- Indemnification remains most common remedy for Buyer for breach of representations or warranties.
- Representation and Warranty Insurance is increasingly common.
 - In lieu of or in addition to indemnification
 - RWI provides less comprehensive coverage
 - Known issues
 - Breach of covenants
 - Exclusions
- Unlike “commercial” contract indemnity, M&A indemnity not limited to third party claims
- Damages defined broadly
- No indemnification in public-company acquisitions
- Anti-Sandbagging – Seller may try to limit the circumstances under which a Buyer can bring a claim if the Buyer “knew” about a claim prior to Closing. While anti-sandbagging provisions are increasingly rare, if the Agreement contains an anti-sandbagging provision, additional emphasis needs to be placed on the diligence process and review of the disclosure schedules to ensure the Buyer is aware of all possible IP related issues.

Indemnification Provisions

- **General indemnification**
 - Covers breach or inaccuracy of representations and warranties
 - Qualified by disclosure schedule
 - Materiality “scrape”
 - Subject to baskets/deductibles and caps
 - Subject to survival period
 - Some reps may get special treatment – including IP
- **Specific Indemnities** – Cover certain matters discovered during the diligence process and any “event, act or circumstance” arising from the matter. Highly negotiated and deal-specific.
- **Privacy** – Privacy representations for GDPR compliance and cyber security are often excluded from RWI. Buyer may seek specific indemnity.

Ancillary Agreements and Post-closing Transition

- **License Agreements**

- Typical in carve-out transactions and asset purchases
- Provides a way to deal with “shared” IP used by both the transferred business and retained businesses
- One party takes ownership of shared IP and the other is licensed
- Often heavily negotiated
- Can be exclusive or non-exclusive, time-limited or perpetual, royalty-free or royalty-bearing
- Licensor party is concerned about overly-broad license diminishing value of IP
- Licensee party is concerned about freedom of action for its acquired or retained business

Ancillary Agreements and Post-closing Transition

- **Delivery**

- In carve-out transactions and asset purchases, the Seller must deliver the acquired assets
- Include a covenant to deliver technology, data, and physical assets
- It may be beneficial to specify electronic delivery where possible

Ancillary Agreements and Post-closing Transition

- **Transition Services Agreement**

- Typical in carve-out transactions and asset purchases
- Provides for sellers' continued performance of certain critical shared business functions during a transitional period after closing
- Pricing often based on cost (or approximation) without profit / markup.
- Standard of performance often less than a commercial transaction
- Services covered by a TSA often include (i) IT (including target company's access to software and other IT assets retained by Seller); (ii) Hosting; (iii) HR / Payroll; (iv) accounting; (v) use of facilities
- Consents from third-party licensors or service providers are often required, and responsibility for these services is often negotiated
- Hosting – Transitional hosting services may be needed if third-party hosting agreements will not transfer

Ancillary Agreements and Post-closing Transition

- **Recordation of assignments and other filings**– for registered IP and domain names
 - Short-form assignment delivered at closing, suitable for recordation
 - Perfects assignment – making it valid against subsequent *bona fide* purchasers
 - Exclusive licenses can also be recorded
 - Different jurisdictions will have differing formalities that must be observed (e.g., stamp paper, recitation of consideration, notarization); consult local counsel
 - Other filings may be required to address chain of title issues, failure to name inventors on patents, release of security interests
- **Shared Agreements**
 - Some contracts service both transferred and retained businesses
 - “Splitting” contracts is complicated and requires consent of the counterparty
 - Parties often negotiate covenants, sometimes in a TSA, under which one party agrees to use reasonable efforts to extend certain rights and benefits under shared contracts to the other party
 - The purpose of the covenant is to permit the party not acquiring or retaining the contract to negotiate a new contract with the counterparty
 - These covenants are often time-limited

Thank you!

- John P. Brockland, Hogan Lovells
john.brockland@hoganlovells.com
- Steven H. Goldberg, BakerHostetler
sgoldberg@bakerlaw.com