QuickLaunch University Webinar Series Transcript
Technology Licensing Considerations for Startups

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Ashwin: Hello everyone. Welcome to today's QuickLaunch University Webinar on Technology Licensing Considerations for Startups. My name is Ashwin Gokhale. I am a Partner in WilmerHale's Corporate Practice in Palo Alto. I'm joined today by my colleague, Ariel Soiffer, who is Counsel in our Corporate Practice in Boston.

Throughout the last year, we've explored many different legal issues faced by entrepreneurs and early-stage companies as they begin to build their businesses. If you're interested in listening to our previous sessions, there are links to the on-demand recordings on our website at wilmerhalelaunch.com.

For our agenda today, I'm going to start with just some fundamental basics of intellectual property and contracts because this presentation is designed for startup entrepreneurs who may not be attorneys. When we talk about licensing intellectual property and intellectual property rights, what are we talking about? Generally, these are the four major categories of IP: there are patent rights, covering rights and inventions; copyrights, covering works with authorship, which would include software, in addition to things you may traditionally think of as works with authorship, such as books and music; trade secret rights, which can apply to confidential information that the company thinks of as its “secret sauce” for its technology; and trademarks, covering the branding of a company and branding of its products and services.

Patent rights are intended to cover a new, useful and non-obvious invention. Getting a patent on an invention that you've created provides you with what we call a “negative monopoly,” which is the right to exclude other people from making, using, selling and importing that invention. A patent may or may not actually give you an affirmative right to practice that invention; to make and sell products that utilize that invention.

What you've invented may consist of a combination of preexisting technologies and components that may in and of themselves be innovative, and may be subject to the patent rights of others. You may need to obtain licenses to patent rights of third parties in order to be able to actually go to market with that invention. What is considered innovative over time is obviously subject to change; you should never assume that what you've created may not be patentable. We're often continually surprised by what the Patent Office will consider to be a patent. For example, at one point even the humble toilet paper roll was considered a patentable invention.

Patents are often critical for companies in order to obtain venture capital investments and drive enterprise value for startups. They can also be an important source of defensive value to the extent that you are sued by one of your competitors for patent infringement. In that case, having your own patents may give you some ability to file a counter suit and fight back. Patent rights can also turn out to be a source of independent licensing revenue, where a company's revenues from selling products and services may be not going as planned.

Next category of IP: trade secrets. Trade secrets, in general, are information that is in fact secret. The company derives some commercial value for maintaining that information to be secret. And the company uses reasonable efforts to maintain the secrecy of that information. A classic example of a trade secret will be the formula for Coca-Cola. Only third parties that have a need-to-know, such as bottling companies, are exposed to the precise formula. And the Coca-Cola Company uses a great deal of security measures, such as non-disclosure agreements, in order to maintain the confidentiality of that.

It is often the case that something that is subject to trade secret protection can also be patented, so it's often a decision that has to be made by the company. It will decide whether to keep the secret or try to patent it. The advantages that trade secrets have is that, in theory, a company can keep a trade secret confidential forever. Whereas patent rights, once a patent is issued, has a period of 20 years from the date a company applied for the patent in order to have that exclusive right; the ability to keep others from using it. Once that time period ends, competitors and others will be free to use that patented invention.

Trade secret protection often will have a lower cost as well because you don't have to spend a bunch of money on patent attorneys, pay a bunch of fees to the patent office in order to get the protectable rights. The cost is just whatever the cost turns out to be of securing the information from unauthorized access. And of course, there are certain rules that apply to what is subject to patent protection whereas those rules would not apply to trade secrets.

In terms of disadvantages, we talked briefly before about the idea that you can obtain licensing revenue from patent rights. That tends to be much more difficult to do with trade secrets because there isn't a defined, well-understood publicly-available asset under which rights are being granted. It's just inherently more complex to license a trade secret because that inherently involves disclosing and exposing that trade secret to another party.

It's also more difficult to transfer rights in M&A transactions because you, again, inherently need the company to understand what the trade secret is, which will involve, at some level, disclosing it. And then once the trade secret is disclosed, once it enters the public domain, you've now lost all rights to it. To the extent it was disclosed through some nefarious activity, breach of a duty by employee, you may have some legal claims you can make, but at the end of the day, the cat is out of the bag. The trade secret being out there means other people can use it.

It also means that, to the extent your competitors may hire away your employees, those employees may end up exposing that trade secret to competitors. Again, it would be in violation of an agreement with you, assuming you have the right type of agreements in place for your employees. It may also be difficult for your company to discover and actually do anything about the exposure. And a trade secret is something that is implemented in a product that stands out in the market to the extent that it is readily ascertainable through disassembling the product, and there is no contractual restrictions against doing that. Again, that becomes difficult to maintain trade secret protection.

Once people get their hands on a product that you've released, they're going to be able to figure out the trade secret. That's something that probably means you want to patent rather than keep it as a trade secret.

The nice thing about copyrights is you don't actually have to register your copyrights with the government in order to have protection. The instant you put pen to paper and write something down or write software code that meets a fairly minimal level of originality and creativity, you automatically have copyrights. And there still are advantages to registering with the government, doing so will greatly enhance your position to the extent that somebody infringes your copyright. If they copy your copyrighted material without your authorization, if you have registered that copyright and have put people on notice by marking the materials with your copyright notice, you'll be in a much better position of litigation because you'll be able to claim much higher damages that are available under some special statutes in the copyright law.

It's a good practice to provide copyright notices within your product, and that includes, of course, software. You should do that within your user interface, and within the documentation relating to your product. And you should also include those notices within your source code.

Trademarks are used to protect your brand. Trademarks are kind of a consumer protection issue as much as an intellectual property right. The intent is that consumers should be able to see a product on the market that is carrying a particular brand and know what company it comes from and know the source of it. Again, you don't actually need to register a trademark in order to have rights. Once you start using it in commerce, just that use establishes certain common law rights. But there are, again, some significant advantages to federal registration of your trademark with the patent and trademark office. By getting that registration in place, you are deemed to have a presumption of rights to use that trademark in the entire country. Whereas the common law rights will only attach protectable rights to the particular geographic area in which you have been using the mark.

When you're thinking about trademarks such as, what brand name to choose for your company and your products, it tends to be that the more abstract the name you choose, the better you are. Meaningless words and words unrelated to the business will have broader protection. Words that are very descriptive of the business such as "pets.com," will have a much narrower scope of protection. This means that other companies will have a higher degree of freedom to use a name that is quite similar to "pets.com," and you won't be able to stop them.

When we're talking about intellectual property licensing, which my colleague Ariel is about to get into, we're really talking about contracts. Entering into contracts with third parties that involve a grant of a license and the right you have to that company, or vice versa. In order to have a contract, a legally valid contract, there are certain elements that have to be met. There has to be an offer from one party to the other, outlining the terms of an agreement with sufficient clarity, and definitiveness.

There has to be some affirmative acceptance of that offer from the other party, and there has to be bilateral consideration. Each party in the agreement has to be getting something from the other party or giving something up that benefits the other party. What that consideration has to be, the law will generally not get in any judgments about that, so long as there is even something that each party is promising to do or not do, however small, that will be sufficient. With that background in place, I'm going to turn it over to my colleague, Ariel, to start talking about key licensing and deal terms.

Ariel: Thanks, Ashwin, so we're going to go through a few of the topics on key licensing and deal terms.

As we think about key licensing and deal terms, one of the things to think about it is how you start and end relationships. For example, if you are doing a services relationship, there might be a transition where you would see then your performance over time, and perhaps you would have some sort of a schedule or some sort of a transition plan that establishes how you're going to start your work.

Then there may be, sometimes, milestones associated with that, for example, you might say if we achieve these milestones early maybe we get a bonus, or if we achieve them late then we have to pay some sort of a credit. Those are the kind of terms that sometimes are involved in transition plans. There may also be termination rights associated with failure to complete transition in a timely manner. And sometimes there can be some allocation depending on who is responsible for the failure to meet the transition timeline.

Each agreement will have a term, and a term is how long the agreement is effective for. Because of antitrust laws for some larger agreements, you may have to wait before the agreement can become effective. This is particularly true in exclusive licensing agreement. You would have to make sure that you've cleared with the Department of Justice, and then you would be able to have your exclusive license commence. So, sometimes, the term doesn't start immediately when the agreement is signed.

The terms of your agreement can often be subject to renewal. For example, you might say, “we'll provide you services for a five-year term with a successive one-year renewal, which either party can opt out of on day 30-or-60 days' notice.” One of the important things to think about, as you're entering into a relationship, is what happens and how you may terminate the relationship. There may be termination rights related to convenience, which permits a party to terminate for any reason or no reason. And if you are the service provider, it may be a situation where someone says to you "Well, we don't want to let you terminate for convenience because you may be partway through your performance and that doesn't seem fair." And, on the other hand, if you're receiving services, you might have that same perspective.

Sometimes, each party wants the right to terminate for convenience, and we often see universities saying it's something that's important to them even when they're the ones performing the service. Termination for cause rights are typical in many of these kind of agreement because each party wants to be able to get out of the agreement if the other party is not performing. Those could be related to a particular standard of performance like a termination for material breach, or they could be related to failure to meet particular service levels or failure to meet milestones, as we discussed earlier, on transition, or various other cause rights that may be specifically set forth in an agreement.

Cross-termination is another thing to think about as you're thinking about termination rights. You may say, “we will have a master agreement under which we'll perform services, and there may be five different statements of work or SOWs. If there's a failure to perform under one of those SOWs, should that permit cross termination of each of the other SOWs even if they're unrelated services.” There may be reasons why a party might want that, and there may be reasons why a party might not want that.

Another thing to think about is, “what are the effects of termination?” When you're ending the relationship, do you have to return confidential information? That's very typical. And then there may be a list of other termination rights. For example, if you've been licensing someone under your trademark, they may be able to dispose of the inventory that they have an under those trademarks related to effective termination or exit rights.

If you're hosting someone's data, do you have to provide that data to your customer at the end of the relationship? Do you have to provide some sort of exit assistance? So, for example, there may be a transition period...just as there's a transition period into your services there may be a transition period out of your services where you have to continue to provide some services and then wind down the relationship. And it's often advantageous to sort out both the beginning and the end of the relationship as you're starting to work together.

On the next slide here, when there is license of technology, one of the things to think about, too, is what sort of knowledge and support might you be providing. For example, you may be providing a license to certain patents and certain software, and you might want to train someone on how to use your software or your patent. One of the reasons why you want to train someone is because you want to help that company become more able to use your software and understand the benefits of it, so that they don't decide to terminate the agreement or not renew it when the agreement comes up for renewal.

There may be other good reasons to do training as well, particularly if your software is complex to use. In certain kinds of licensing relationships, there's an explicit requirement of knowledge transfer. One of the things that Ashwin had mentioned earlier was that there may be patents and trade secrets and they may cover a similar territory. So, if you have a patent on something and a related trade secret, you might be required or want to provide access to your know how, or your trade secret as part of this relationship.

In software contracts, there's often a support and maintenance requirement where you would support and maintain the software that you're licensing to your customer. One of the things to think about is a support desk which typically would have requirements around when you are going to be responding to customer service questions, and whether it's via email or whether it's via telephone. There may also be a service-level agreement which might say how quickly you have to respond to particular questions and may support other standards for support that you would provide to your customers. Support and maintenance trends often also include upgrades and updates to the technologies that you're licensing to your customer.

The next sort of key term to think about here is what do we do with intellectual property. So, for example, in a development agreement and in many other kinds of agreements, we often divide intellectual property in two general categories: background IP and foreground IP. For background IP, we normally have that include at least partly existing intellectual property and then intellectual property created outside of the agreement. Sometimes people want improvements to be included even if those are created as part of the agreement. And that's often a highly negotiated point, because someone may say, "Look, if I'm paying for the development I want the improvements." So that's something to think about if you're contemplating the intellectual property term of your agreement.

Foreground IP is the intellectual property that's developed as part of the agreement, and then there are always questions around how that intellectual property is allocated. Sometimes you would say ownership based on inventorship which means that you would follow how inventorship is defined under U.S. patent law. Typically, that's the way you would do it.

Other times, you might say a particular party wants to own IP that's related to its original IP that it's coming into the relationship with. And there may be some situations where it's appropriate to have joint ownership. So that would mean both you and, say, your customer or your licensee would have joint ownership of IP that's developed under the relationship. And when you are thinking about joint ownership, there are concerns around that because the way that you can license joint IP or joint patents, in particular, is not in the same in the U.S. and in Europe. It's important to think about that. It's not the same under default law, but you may change that in a contract. Therefore, it's important to think about how you want to allocate your ownership rights if you are agreeing to joint ownership.

Then, you can also agree to have licenses. For example, you might say "we're granting you an exclusive license to our background IP," or to development in a particular field. And there's foreground IP that's related to our existing foreground IP, we'll also grant you an exclusive license to that foreground IP in the same field. Or you may ask for license-backed improvements that your customer makes because you would like to make sure that you can continue to develop intellectual property in your space.

And, as you can imagine, there are an infinite number of ways to allocate that foreground IP. This is just to give you a little bit of background in terms of some of the common concepts that you should be thinking about. One of the key terms to think about in any license agreement is confidentiality. It's important to consider, as you're thinking about confidentiality, what the definition is of "confidential information." Sometimes each party wants to make sure that they're only receiving certain types of confidential information under an agreement, or they're not repeating other types confidential information, so that they can make sure that there's no question about their own separate development.

You may have marking requirements, which means that you would have to label confidential information as confidential or proprietary in order for it to be kept confidential. And the risk to doing that is, if you're not careful about complying with the marking requirement, you could end up with a lot of information that you disclose becoming non-confidential. So, it's important to think about these terms and think about your company typical practices to understand whether a marking requirement is something that you would be able to accommodate.

There are often exclusions from the definition of confidential information. Sometimes they're not excluded from the definition of confidential information, but it just says, "information that fits into these exclusions will not be in confidential information," which works out be the same thing. These exclusions often include if the information is available for the public, if the information was independently developed, or if the information was disclosed from a third-party. There are variants on these, so each agreement has a little bit of a different flavor on it, but these are some of the key categories of exclusions that we see from the definition of confidential information.

Confidentiality terms can always include non-disclosure and non-use. The non-disclosure is often written as “a party won't actively disclose confidential information, and will use reasonable measures to protect the other party’s confidential information.” Non-use means that the party won't use the confidential information for its own purposes or for the benefit of others, but only for the purposes of the relevant agreement. In some agreements, especially in a software or another agreement where there might be personal information, it's important to think about data security and data privacy concerns and to allocate the responsibility for those as well.

Especially, as Ashwin will talk about a little while, in light of the EU's GDPR. And the data security and data privacy sections of an agreement may be very short in an agreement that doesn't have much to do with data security or data privacy, or they can be really long if there's a lot of exchange of personal information especially for example if you're in the ad tech industry.

And one of the things that many folks find difficult as you're starting on your first licensing agreement is how to allocate liability in a contract. There are three general classes of term that folks use to allocate liabilities, warranties, indemnities, and a limitation of liability. We've outlined a few of the possible items that you might have in an individual license agreement. But these can be all over the place and can be very comprehensive, or very light depending on the circumstances.

Some of the common warranties that we'll see are a warranty for IP infringement, which is a promise that the IP that you're providing to your customer, for example, does not infringe the intellectual property of a third party. You might or might not want to provide that IP infringement warranty depending on your company's circumstances, and how much certainty you have that there isn't a third party that might have the patent that would cover what you're providing to your customer.

Compliance with specifications is a warranty that we often see when a company is providing product, and you want to make sure that your product complies with specifications. And usually, that's for a defined time period, sometimes 12 months, depending on the type of product. There may also be performance standards, including that work will be done in a professional and workman like manner.

There are a variety of different kind of indemnities that you may have in a contract. An indemnity is a sort of a private insurance contract which is promised, that if something goes wrong the other side will cover you, typically from a liability or a claim brought by a third party. IP infringement is very similar to a warranty, but these would just cover you in the case of an intellectual property infringement claim brought by a third party.

When you're thinking about IP infringement indemnity, it's also important to think about if you're the one who's providing the IP if you want to think of ways to cut off the liability. For example, by saying that you can procure for your costumer an alternative, that does not infringe the third party's IP. There may be indemnities related to performance standards; for example, you may indemnify customers for your own gross negligence to willful misconduct.

Limitation of liability are ways for a company to say, “we're not going to agree to cover certain kinds of damages.” These are really important because if you don't have a limitation of liability and something goes wrong in the contract, you could be exposed to significant damages. An agreement will often have two types of limitations of liability. One is a liability cap, which says, with certain exceptions, “under no circumstances will a party will be exposed to more than ‘x’ dollars of liability.” And then there may be certain kinds of exclusions. So, for example, you would say, “we're not responsible for consequential or punitive damages which are different kinds of damages that you can be exposed to.” For example, you might also exclude loss of profits where you would say, “look, if our service is down and that causes you to lose profits, we don't want to be responsible for it.”

Because those kinds of damages can be really big, it's often very important to have a liability cap and a liability exclusion to make sure that you're appropriately capping your exposure. Then there are often exceptions to these caps or exclusions based on gross negligence or willful misconduct. Sometimes it's failure to comply with laws, sometimes confidentiality isn't there. Each of these exceptions are ways for a party to say, “look, this particular situation is something that should not be capped or should not be excluded and a party should be exposed to and the entirety of the relevant liability.”

As you're thinking about a license agreement, of course, one of the things to think about is the scope of the license that you're granting. First, you have to think about, well, what you actually granting a license to. You may want to grant a license to your patent, to your know-how, copyrights or other material.

One of the things to think about is, are you granting a non-exclusive license which is more common in the pet industry or an exclusive license which is more common in the biotech industry? Under certain, rare circumstances, you might also grant a co-exclusive license which says your licensee has the right to use the license subject matter, but you also retain that right as well. So, typically, we see non-exclusive licenses a lot more in the tech industry where you're granting a right for someone to use your IP, but not exclusively. And in the biotech industry, it’s much more common to see an exclusive license where it would be very hard to commercialize a drug, for example, if a third party can also end up commercializing a similar drug.

A license may have field or territorial limitations. So, you might say, for example, “you're allowed to use this license subject matter only in the field of human use but not in the field of animal use.” There may be territorial limitations where you may say, “we want to be able to have exclusivity in the U.S., but we'll grant you exclusivity in Europe.” And Ashwin will talk about some of those considerations around territorial limitations in a minute as well.

There may be licenses that are either perpetual or term-limited, so, for example, if you grant a software license you might say, “we'll grant you a software license during the period in which you're paying us a fee.” A license can be revocable or irrevocable because you may say, “we need to revoke a trademark license, for example, if somebody is using our trademark in a way that's not consistent with our standards.” It's important to consider whether you want to be able to revoke a license, and whether it's reasonable to do so under the circumstances of the entire license, or whether that's actually more what should be considered a termination event instead.

There may be retained rights. So, for example, the government may have funded an invention and have retained a license to perform under the relevant invention. Or a university licensor may say, "we want the right to continue to practice this invention for research purposes and to grant similar rights to our third-party licensors."

There may be a grant-back of rights. So, for example, you may say, "we want to receive certain license rights back from our customer to whom we're licensing certain rights." In certain instances, there might be restrictions on sub-licensing or distribution rights. You might say, "we want you to not be able to sublicense these rights without our consent, and in other circumstances that might not be reasonable." It's important think about how you want sub-licensing to be carried out, and how you want distribution to be carried out, in your particular circumstances.

One of the things to think about is how you get paid based on your license. For example, there might be a royalty on net sales. Royalty on net sales is often structured as a tied royalty which might have higher royalties or lower royalties depending on the particular economics. As the amount of sales goes up, either over a year or through the course of the agreement. There may be a royalty term that's equivalent to the term of the coverage of the patent often, or it may be a certain period after a first commercial sale, for example, of a drug.

There may be reductions to royalties if third-party patents or third-party technologies are required for license among other potential reductions for an end product. You may also want to be able to have reached your royalty so, for example, if your licensee further licenses the technology to a sub-licensee then you might want to be able to get a royalty on those net sales as well.

And you may also want to think about sub-license income. So, if you license the technology to someone and that company then further licenses it on to a third party, that you only get a royalty on net sales and they structure the license with their sub-licensee such that they're mostly receiving milestone or an annual royalties, you might not get as significant a portion or as much of the money as you think you ought to. You might also want to capture some percentage of their sub-license income.

As you're thinking about a royalty on net sales, one of the things to think about is, could you be putting your patents at risk? So, if you're licensing a patent and you don't have a reduction in the royalty after your patent expires, you could be accused of conducting patent misuse and, if you do that in a non-instance, you might lose your right to your patent.

One of the other things to think about in terms of your fees is, are there any and minimum payment commitments? For example, there may be a minimum annual fee for and a minimum number of units that are sold. You may also have lump-sum fees, milestones, and other significant payments. Finally, one other thing to think about is the most favored nation clause, which would say that a company agreed not to provide lower fees to another company without also extending those lower fees to this current customer or licenses.

A license may have diligence requirements. Those diligence requirements, which are more common in exclusive license, can include general or specific diligence standards, such as reaching first commercial sale by a certain date. Diligence standards can effectively be handled also through minimum fees. So, if you have a certain amount of minimum fees that can effectively force your licensee to be diligent in commercializing your technology. You might also want your licensee, especially an exclusive licensee, to agree that they won't license similar technology from a third party as a way to effectively be granting you some exclusivity as well.

I'm going to skip over the considerations in the university-licensing context in light of time. There may be personnel terms as part of a license as well. It's often the case that you would have a non-solicit or no-hire. So, the non-solicit or no-hire says we won't solicit other personnel from the other party, and no hire says you won't hire folks from the other party.

There may be key personnel terms which would say, for example, that someone has to stay on your account for a certain fixed period. In certain contexts, especially in the financial industry, folks will want background checks to be able to understand that the folks that are providing services are able to provide services under applicable law. And there may be terms related to replacement of personnel, for example, you might say that you want the right to replace personnel who are providing services to you if you don't think that their services are adequate.

A right of first refusal is another term to just keep a lookout for. If there is the right of first refusal or a ROFR, that can permit a party to place a bid before an asset can be shopped to others. So, a licensee might want to have something like this to prevent licensing in adjacent fields. But a licensor should be aware that this can discourage other bidders because another bidder might not want to bid it knowing that a licensee would have priority. It's important to think about limits on it, like how long a ROFR can last or can be exercised, and if there are requirements that you have to take the offer from the licensee if then the licensee offers a better offer.

And there is a variant, which is called the right of first negotiation, which permits the beneficiary to negotiate in good faith instead of making an offer. That's sort of a softer version of a ROFR. I'll turn it over to Ashwin now to talk about M&A considerations.

Ashwin: Thanks, Ariel. So, many of our startup clients are hoping to build their company up to a point where they'll go public or more frequently these days given, how difficult it is to take a company public, be acquired by a larger company and achieve liquidity for investors.

The way an M&A transaction will work is that, after you sign a term sheet with an acquirer, they'll undertake what's called “due diligence.” And that involves looking at all of your company of operations in full, from the financial side, business and product side, and legal side. What that will include, for a startup company is reviewing all of your commercial agreements including license agreements. So, there will be a team of lawyers looking at all of your contracts and looking for problems that there may be that the acquirer needs to be aware of and may or may not want to take on or require you to fix before closing the transaction.

Those issues would include things like, as a scope of license rights that you have for intellectual property, software and other things that you license from third parties. All those rights actually adequately cover the scope of use that you're making.

It would include, “have you entered into an agreement that purports to create some sort of effect on the acquirers own IP?” Can the agreement be assigned (which means transferring the agreement from your startup to your acquirer)?

Do the agreements put restrictions on your business operations? Are there other clauses in the agreements that are specifically triggered by an acquisition at your company?

So, things to kind of be aware of today when you're entering into a license agreement that may affect your M&A transaction later: One of the big ones is an agreement that purports to be between not just your company and a third party, but between your company and all of its affiliates and the third party. Oftentimes, agreements will be structured that way, and you as a startup company will look at them and say, “well, no big deal, we don't have any affiliates so who cares?” Or the agreement may be between you, your company and the other party but the license grant points from your company and that party may say that it's a license grant under not just your company's intellectual property rights, but the intellectual property of your company and all its affiliates.

Once your company is acquired down the road, your company now does have an affiliate, since the company that acquired you will qualify as an affiliate and other subsidiaries will be affiliates. And that may be a problem, since your new parent company may well now want to have counter parties that you grant licenses to, that have licenses under all of its IP under its all other subsidiary IP. It may be involved in patent litigation with those parties and to grant a license under a patent like that would really take the rug out of that litigation.

There may be other competitive reasons why it doesn't want that. So, you should generally avoid agreeing to contracts that purport to grant a license that are all affiliate IP in general. If it's granting a license under IP held by your company subsidiaries, current and future, being companies that are owned, controlled by your entity and not entities that actually control your entity, or entities that are in a common control with your entity, that tends to be a lot safer.

If you’re using in-licensed IP, if you've licensed some software from a third party for using your product, and there's limitations, if you haven't kept track of those limitations ensure you're not exceeding them, and now and acquirer in due diligence discovers that you are, they may say that's a problem that you have to go fix before the transaction can close. You are much better off not having to deal with issues like that, going back to licensors and trying to get an amendment to an agreement done as part of getting potentially a significant acquisition done. You want to have as few hiccups in that process as possible.

Use of an open source tends to be a big one. You know, acquirers will nearly always want to see a full list of all the open source software that your company uses, certainly all of the open source software that is incorporated into the company's products or used in the development of those products. So, if you haven't maintained, as you go along in your product development process, maintained actual records of those things, you will be hard-pressed to generate that list. And the inability to quickly generate that list for your acquirer's attorneys who are doing the due diligence process in and of itself says something.

And if you can't produce that list, it will instantly raise a red flag in the other lawyers’ minds; that this company hasn't had good processes internally of keeping track of things and we're going to have then to dig deeper into the open source stuff and potentially other things than we otherwise would have.

So, it's a good idea to ensure that all of your developers are trained that if you want to use open source software: here is the approval process and here is who you need to submit a request to internally. And somebody needs to be kept in charge of maintaining a spreadsheet that lists each item of open source that the company uses, where it was acquired, the name of the open source license agreement that gives open source code, how that open source code has been used by the company, how it's been modified by the company, to what extent has it been combined with other proprietary source code of the company, and how they've been distributed by the company.

Now the main reason, on the last few points on how has the open source code's been combined with the company's proprietary code, how has it been distributed, is that there are some open source licenses, the most famous ones being the general public license or GPL, and the lesser general public license or LGPL, that impose significant requirements what are often called copyleft requirement on software code that is combined, and then distributed with the open source code license under the GPL or LGPL.

Those requirements include a requirement that all that code, including the proprietary code that your company has written, be disclosed in source code form to any subsequent downstream licensee of that software. So, that means you have, what you believe and intend to be, a commercial software product. It's not intended to be an open source product, you consider the source code to be your confidential information, you don't want other people to use it, you don't want your competitors to get their hands on it.

If you've incorporated code license under the GPL into that software product and then allow that software product to leave your organization by giving it to customers or otherwise, you now have a problem. You've now agreed under the GPL that you're going to distribute the entire source code to those licensees under the terms of the GPL. And they, in turn, have an obligation and the right to make modifications to it and they, in turn, would have to disclose it again to their subsequent downstream licensees.

So, there have been cases in the past where owners of open source code who were leased in a GPL have taken actions against companies who have used their open source code licenses in the GPL, and not complied with those requirements. Most often where that ends up going is that the offending company is forced to remove the GPL code from their product and replace it with code they've written themselves, or other codes they've obtained from elsewhere that doesn't include those types of requirements that they don't want to comply with.

If this type of issue is discovered as part of an M&A transaction, depending on who your acquirer is and what their aversion to risk is or isn't, that again may be something where they say, “look, you have to fix all these problems or we're not closing this transaction.” Again, potentially a major speed bump in getting a transaction done. The more of those speed bumps you have, the more deal risk overall there is, and you don't want that to happen. And you can generally expect if you are a software company, it is quite common for an acquirer to actually require that your source code be scanned for use of open source. There are third parties that offer these services, and so they will discover all the open source that you're using through that code scan.

And if you haven't had an approval process, haven't been keeping records of what you're using then, you can expect that code scan is going to include some surprises for your company as well and you really don't want that.

Other provisions in your license agreements and other commercial agreements to be aware of that can create issues in an M&A transaction: the assignment clause is a big one. This is a clause that usually appears at the end of an agreement, but these types of issues around assignment can appear elsewhere including termination and provision. So, the assignment clause governs your company's ability to transfer those agreements to a third party.

It's often a more complex legal analysis than many people may realize on whether or not a given M&A transaction actually constitutes a "assignment" of your agreement. But, in general, to be safe, you're going to want to ensure that agreements are assignable by a company in the context of an acquisition of your company. Whether that's acquisition of all your company's stock or a reverse triangular or forward merger of your company into or with another entity. Or also a sale of all the assets of your company which will almost always be an assignment of a contract that you need to undertake.

If the counterparty has the right to restrict the assignment of that contract, you have to go to them for consent in order to get that contract assigned as part of the M&A transaction. That can again become a bit of a speed bump. You now have to go hand in hand with this other company and say, “hey, we're trying to sell our company, the acquirer wants to know if this agreement is going to stay in place post-transaction, will you consent to that?” Most of the time, speaking the abstract here, we do see counterparties generally agreeing to that. But we've also certainly seen our share of horror stories where maybe it's a customer who says, "That's great, but if you want that to happen we're going to have to renegotiate some of the pricing, or other terms in this agreement." You really don't want that, and you have no leverage in that situation.

I've also seen, in my practice, situations where a company that's in-licensed critical technology from another company that's used in the product, that if you were to lose that license, you would no longer have a product to sell. I've seen companies in that position say, “if you're getting acquired, we need to now renegotiate pricing or other terms as well, raise the price on you.” And you're in a very low leverage situation at that moment. And so, ideally, to the extent you can, you haven't created that situation with these consent rights.

A termination right where the counter-partied agreement can terminate the agreement upon an acquisition of your company will have a similar effect to that consent right, because if that agreement and the IP right that you're receiving under that agreement are essential to the operation of your business, an acquirer will look at it the same way as the consent right. They're going to say, “you need to go to that company and get them to waive that termination right in writing as a condition of us closing this transaction.”

Termination of a convenience right may have a similar effect. If you're in-licensing crucial technology from another company that is part of your product, or critical to the development, or operation, or availability of your product, you really don't want that company (M&A considerations aside), to have the ability to just terminate that agreement for convenience. And if you have that, and an acquirer sees that they may, again, say, “well, we need you to go to that company and get that term amended or at least get them to agree they're not contending to exercise that in connection with this transaction.”

Similarly, if a company is acquiring your company because they're truly interested in the business you're operating and the revenue streams you have and they want to ensure those revenue streams are there, agreeing that your licensees or customers can terminate their agreements for convenience is really reducing the assurance that that revenue still going to be there. So that's something you want to avoid.

Long non-terminable obligations to continue providing a product, a service or support for a product or service, may be something that today your customers want, and you may want to provide because you're eager to get customer deals done. You should be aware that there can be often a tension between something an acquirer wants to do with your company going forward, and what it is you want to do today.

These tensions tend, to be frank, be difficult to resolve. But we are more and more seeing in our practice, in particular with startups in the artificial intelligence space, where this type of issue has arose I've been a part of a number of transactions in the past couple years where our client, the seller, was pursuing a business model with products, services, customers, really in technology. And now an acquirer comes along and it’s a deal everyone wants to do, but the acquirer is not interested in pursuing that business model. The acquirer want to acquire this company to use its technology for some internal purpose, and that doesn't really get sussed out until you're further along in the deal, and the acquirer says, "okay, we've see all of these customer contracts you have, we're going to need you to go ahead and terminate all of those."

And it would be atypical in most cases for you to actually have the ability to do that. So, this is something that if you think that's what the acquirer wants to do, kind of getting that issue dealt with upfront is better rather than having it come up later.

Business restriction on affiliates, again, goes back to the issue of clauses in your agreement, applying to affiliates in your company in addition to your company itself. To the extent you're agreeing to some form of non-competition or other restriction on your business, make sure that only applies to your company and not to affiliates. And if you're a software company you may be required by a customer to answer and do a source code escrow provision covering the customer getting access to your source code in the event that you go bankrupt or stop providing support. You may find, because you're a startup, the big customers say, “well, we want that to apply even if you get acquired as well.” Definitely something to avoid.

I know we're running out of time here so I'll try to cover some issues that can arise in cross-border transactions very briefly. When you're entering into an agreement with a third party to have intellectual property developed for you or your licensing technology from a third party, you need to be aware that the intellectual property laws in other countries can really vary very significantly from what they are in the U.S. Local law will ultimately matter, the law of the jurisdiction which the IP was developed or is owned is going to matter.

Just to go over some differences between other countries and U.S. law: in some countries, IP cannot actually be assigned. So, if you believe you've engaged with a third party to produce IP for a company and the contract says your company owns it, that may not actually be the case in some countries. An IP can only be licensed in which you actually need to have an exclusive license.

There may be moral rights of an author that can't be assigned, and you need to have a waiver of those rights. Those moral rights can create the ability for the original creator of that IP to impose restrictions on what your company does with it down the road. There may be requirements for inventors to be compensated for stuff when used in that patent right, even though the patent rights have been assigned. License agreements may need to be registered, and you may not have protections if a company that's licensed IP to you goes bankrupt.

On distribution/reseller relationships: In a lot of other countries, if you agree that a third-party, in, let's say, France, is going to have the right to distribute your product, depending on the situation, there may be laws that apply by default that may be come as quite a shock, that require you to make certain payments to that distributor upon the termination of that relationship, impose restrictions on your ability to terminate that relationship. And there may be certain things you need to do in order to ensure that you have the ability to actually enforce your rights under an agreement with an entity in another country.

You may want to consider entering into an arbitration provision if the country is in a nation that is signed up to a UN convention on arbitration that may increase your ability to actually get an arbitration order enforced in local court. Of course, today, when you're dealing with European Union, you also have to be very aware of privacy issues around GDPR, which is outside the scope of this presentation. If it's a significant deal, there's no substitute for retaining a local lawyer in that country to advise you.

That brings us to the end. We're not able to get questions, but if you do have burning questions that you want to ask, our contact information is here, feel free to reach out.

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