

**Morgan Lewis**

# **M&A ACADEMY**

**Technology in M&A Transactions –  
What Parties Care about When Buying  
and Selling Technology - 2023**

**Speakers:**

**Nancy Yamaguchi, Randall J. Wood, Richard M. Lee**

February 7, 2023

# Startup & Accelerate 2023

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## Technology in M&A Transactions

1. Basic M&A Deal Structures
2. Types of IP and Key Issues re: IP and Technology Licenses in M&A Deals
3. Principal Deal Terms
4. Controlling Stockholders in M&A Transactions
5. Key Takeaways from this Session

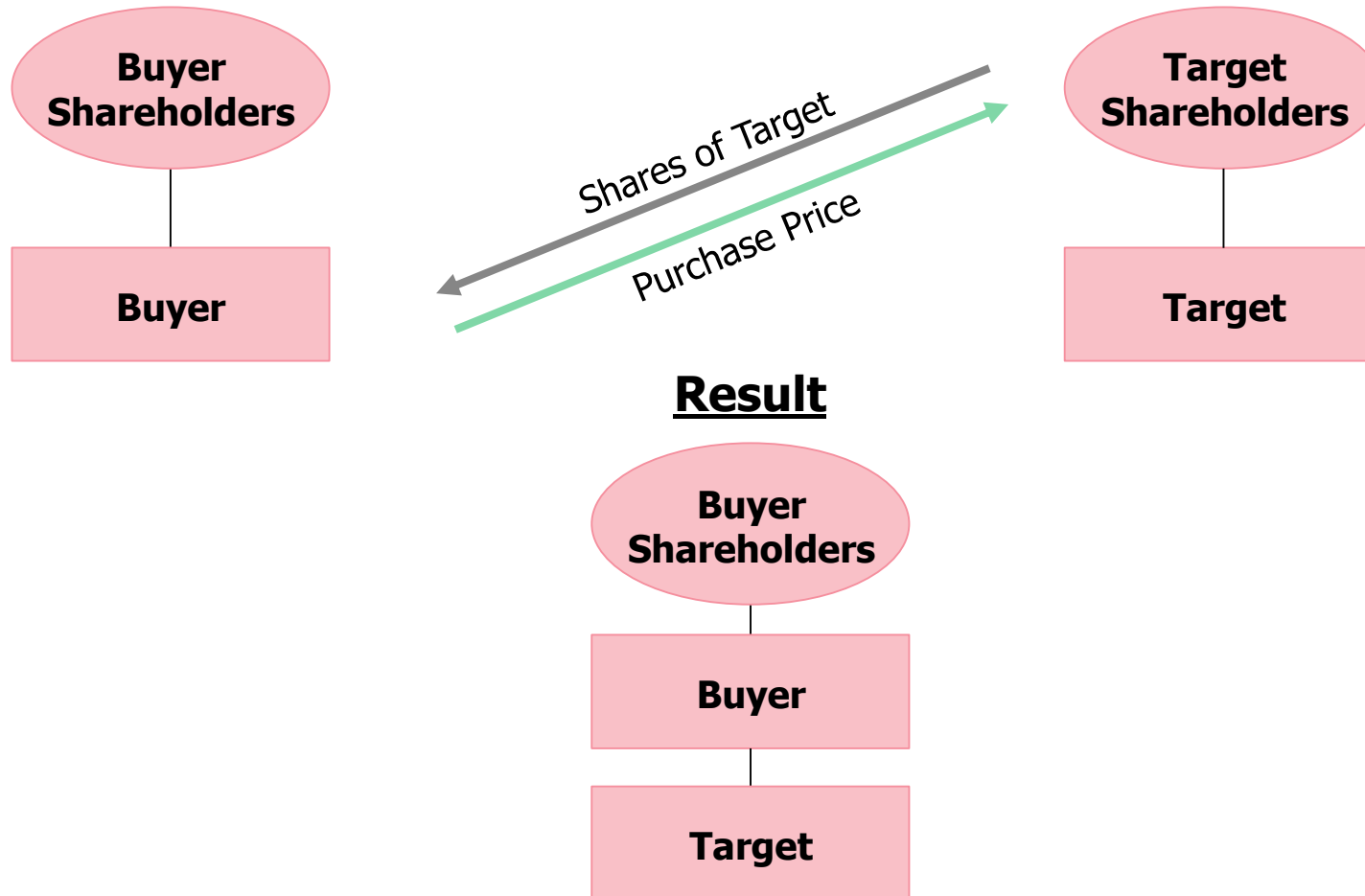
**SECTION 01**

# **BASIC DEAL STRUCTURES**



# Overview of Basic M&A Structures

## Stock Purchase

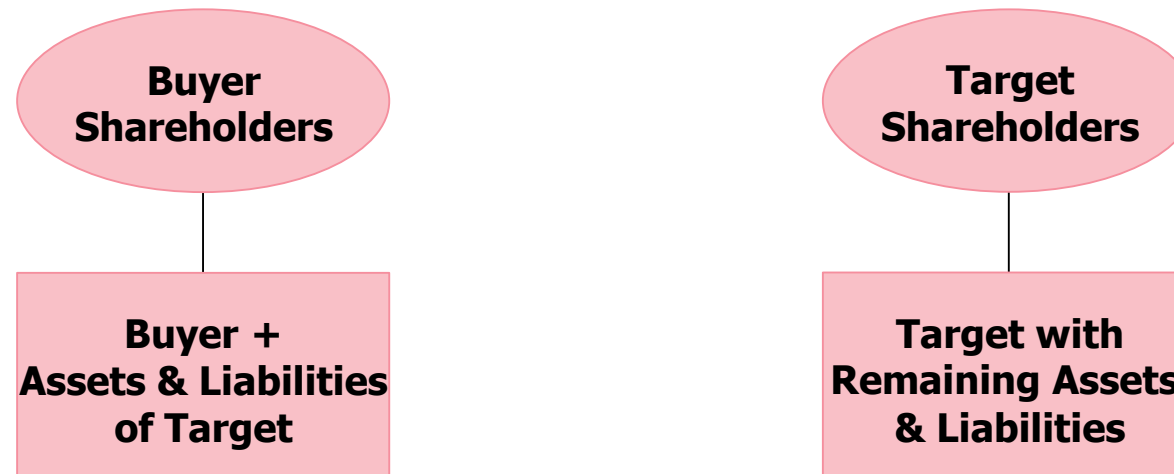


# Overview of Basic M&A Structures

## Asset Purchase

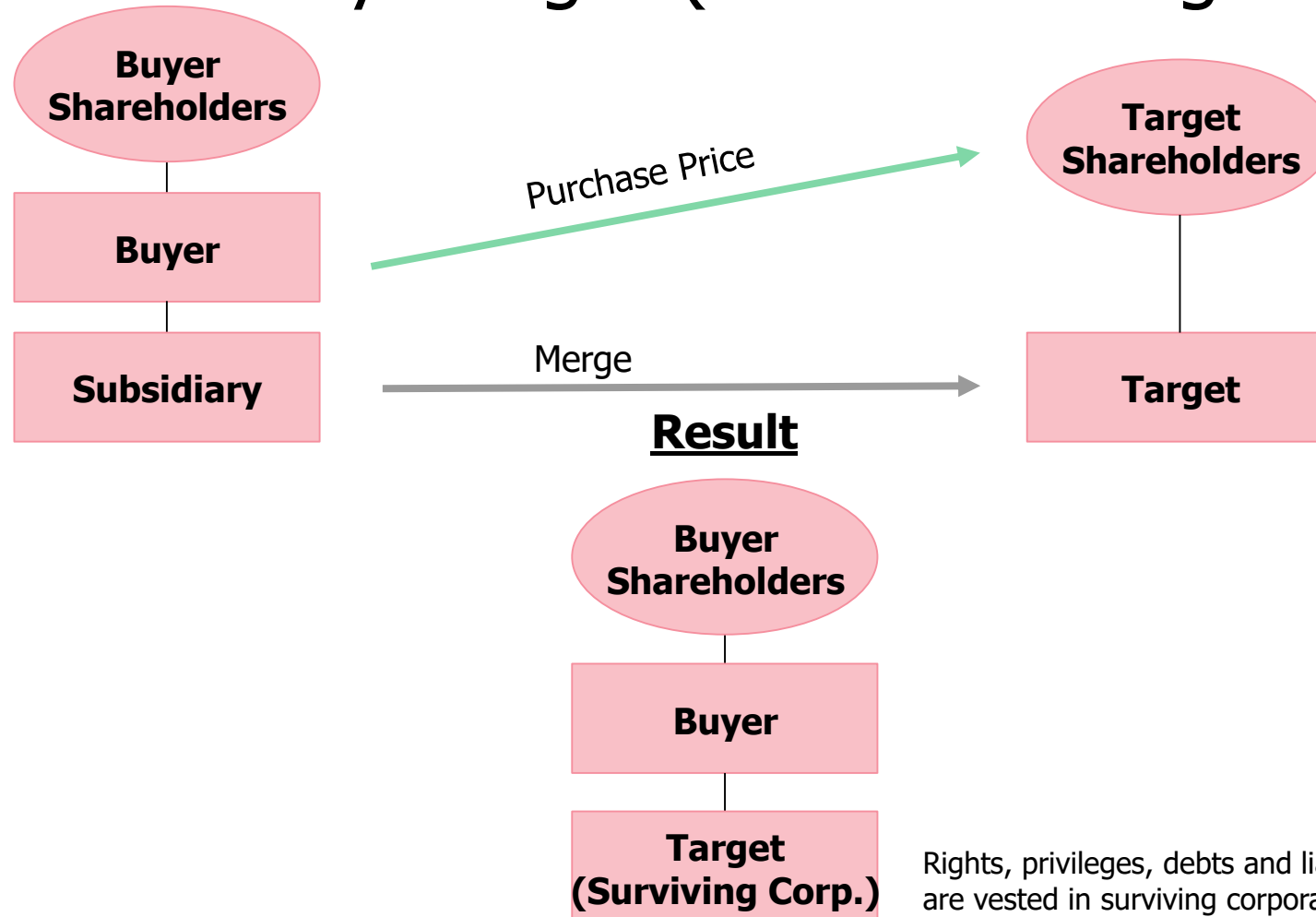


### Result



# Overview of Basic M&A Structures

## Statutory Merger (Reverse Triangular)



**SECTION 02**

**TYPES OF IP AND  
KEY CONSIDERATIONS RE:  
IP AND TECHNOLOGY  
LICENSES**



# Types of Intellectual Property Rights

## Patents:

Novel and useful inventions



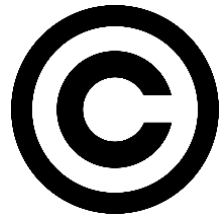
## Registered designs:

Shape and design



## Copyrights:

Works of authorship  
(including software)



## Trade secrets:

Know-how and  
confidential information



## Trademarks:

Identification to  
product source



\*Note: Uniform Trade Secrets Act – state law, but Defend Trade Secrets Act of 2016 is a federal statute that amended the federal Economic Espionage Act (EEA) (18 U.S.C. § 1831, et seq.). DTSA does not preempt state trade secrets law.

# Key Considerations re: Transferability of Key Licenses in M&A Deals

## In-bound licenses:

- Buyer's sole objective in making acquisition may be to acquire the key IP or technology license
- Licensor/IP owner may refuse to grant a license to Buyer, especially if Buyer is a competitor
- Buyer may want to acquire the license for its own R&D and products/services
- Buyer or target/licensee may have built a business around the IP or technology being licensed and the business and associated investments may be lost without the license

## Out-bound licenses:

- Buyer wants to keep for business and revenue generation post-closing
- Alternatively, Buyer wants to terminate license, especially if licensee is a competitor or related to a competitor
- Licensee or customer (other party to the outbound license) may want to terminate due to Buyer or refuse to terminate if Buyer requests termination

# Representative Case Law

- **SQL Solutions, Inc. v. Oracle**, No. C-91-1079, 1991 WL 626458 (N.D. California, 1991)
- **Florey Inst. of Neuroscience & Mental Health v. Kleiner Perkins Caufield & Byers**, 31 F. Supp. 3d 1034 (N.D. California, 2014); No. CV 12-6504, 2013 WL 5402093 (N.D. California, filed Sept. 26, 2013)
- **Meso Scale Diagnostics, LLC v. Roche Diagnostics GmbH**, 62 A.3d 62 (Delaware Court of Chancery, March 8, 2013)

# SQL Solutions Case

- “Whether the transfer of rights is prohibited depends on the law to be applied. Federal copyright law provides a bright line prohibition against transfer of copyright license rights.”
- The court found that “federal copyright law is applicable to the transfer of the copyright license right which occurred in this case,” and that “an **illegitimate transfer occurred when D&N became SQL.**”

# Florey Institute case

- “In a reverse triangular merger, the target corporation continues to own its assets even though the acquiring corporation owns all of the target’s stock.”
- The court indicated a “reverse triangular merger, which leaves intact the acquired corporation, does not effect a transfer of rights from the wholly owned subsidiary to its acquirer as a matter of law” and analogized reverse triangular mergers to stock deals.

# Meso Scale Diagnostics case

- Court refused to adopt the approach in SQL Solutions and viewed reverse triangular mergers as being parallel to acquisition of stock in a target corporation (i.e. ownership of the target corporation changes, but the target corporation itself remains “as is”)
- Refers to stock deals: “under Delaware law, **stock purchase transactions, by themselves, do not result in an assignment by operation of law.**”
- Similar holding as Florey case – reverse mergers equivalent to stock acquisitions (i.e. changes in ownership, but licensee remains the same)

**SECTION 03**

# **PRINCIPAL DEAL TERMS**



# IP Diligence Concerns

## Principal Diligence Concerns:

- Any proceedings, threat letters, invitations to license?
- Any third-party consents required for the transaction?
- Any automatic terminations triggered by the transaction?
- Any terms under existing agreements that restrict how the business may be operated?
- Any concerns with acquiror's IP being covered by the target's existing agreements that extend to "affiliates"?
- Any critical third-party IP and inbound licenses?



# Representations and Warranties

## IP-Related Reps:

- Ownership of IP
- Non-infringement
- Inbound/outbound licenses
- Sufficiency of IP
- Validity and enforcement
- Registered IP
- Open source
- Source code escrow

# Representations and Warranties

## Qualification to the Scope of Reps

- Knowledge qualifiers, and definition of knowledge
- Materiality qualifiers
- Material Adverse Effect (MAE) qualifiers, and definition of MAE
- Lookback periods and applicable date of reps

## Reps and Warranties Insurance

Underwriters will require qualifiers to avoid covering overly aggressive reps (e.g., IP infringement reps without knowledge qualifiers will not be accepted).

# Covenants

- Affirmative Covenants
  - Require amendment or termination of specified IP agreements
  - Require continued maintenance and enforcement of acquired IP
  - Require removal of copyleft code
- Negative Covenants
  - No IP transfers or outbound licenses other than permitted exceptions
  - No amendment or termination of IP licenses without buyer's consent

# Closing Conditions

## IP-Related Closing Conditions:

- Remediation of specified IP issues (e.g. ownership or open-source).
- Execution of ancillary IP agreements (e.g. transition service agreement, IP licenses or assignments).
- Third party consents have been obtained, required amendments and terminations have been completed.

## General Closing Conditions:

- Reps and warranties remain true as of the closing.
- Covenants have been performed.

**SECTION 04**

# **CONTROLLING STOCKHOLDERS IN M&A TRANSACTIONS**

# Controlling Stockholders in M&A Transactions

- Fiduciary duties – corporate fiduciaries (i.e. directors, officers, controlling stockholders) must act in the best interest of the corporation and all of its stockholders
- Standards of Review:
  - Business Judgment Rule (BJR) – presumption that corporate fiduciaries acted on an informed basis and with the honest belief that the transaction was in the best interest of the corporation and its stockholders. No BJR protection if corporate fiduciaries have a conflict of interest in the transaction (i.e. not disinterested and independent).
  - Enhanced Scrutiny – in a sale of control over the corporation, corporate fiduciaries become subject to heightened duties due to a specter of conflict of interest that they may act in their own selfish interests to the detriment of the stockholders (so-called “Revlon Duties”).
  - Entire Fairness – “most onerous standard” under Delaware law because conflicts of interest exists (e.g. controlling stockholder stands on both sides of the deal or receive unique benefits from the deal not shared with other stockholders) and the court will review the transaction to determine whether it was fair to the stockholders. Defendants must prove “entire fairness” of the transaction by showing fair dealing and fair price.

# Controlling Stockholders in M&A Transactions

- In most technology M&A deals, there are “controlling stockholders” (e.g. high profile founder or serial entrepreneur, venture capital investor, strategic investor) that may have conflicts of interest in a sale or merger of the company. Even minority stockholders may be deemed to have “control.”
- What is “control”
  - Ownership of 50% or more of the voting securities; or
  - Exercises **control over the business and affairs of the corporation** (i.e. minority stockholders may have “control” if they exert such power and influence over the business affairs of the company equivalent to having majority voting control)
- Implications of “control”
  - Controlling stockholder owes fiduciary duties to the corporation and all of its stockholders
  - Controlling stockholder will be scrutinized under the **“entire fairness” standard**, especially where the stockholder stands on both sides of the deal (e.g. sale of company to an affiliate, going private transactions) or receives unique benefits not shared with other shareholders (e.g. more monetary consideration, retention of control in surviving company, selling the company prematurely in order to close the fund)

# Controlling Stockholders in M&A Transactions

- “Control” by minority stockholders found under these scenarios:
  - Right to elect a majority of the Board of Directors
  - Domination and coercion over the Board of Directors
  - Close personal relationships with members of the Board of Directors
  - Veto rights to block the company from raising new financing
  - Commercial relationships with the company through material agreements
  - “**Outsized influence**” over the company
- Control Group
  - Even where a single stockholder may not have “control” itself (whether through ownership of voting securities or exerting influence), coordination and working with other stockholders in a transaction may create a “**control group**” and collective controlling stockholder status
  - A “control group” exists if “**legally significant connection**” to work towards a common goal (Sheldon v. Pinto Tech. Ventures, L.P., Del. 2019); “connection” may be created through contract or even verbal agreement, common ownership, history of making joint investments in multiple entities, joint negotiation and execution of definitive deal documents, describing parties as “strategic partners” or “investment group”



# In re Pattern Energy Group Inc. Stockholders Litigation (Del. Ch. May 6, 2021) Non-Stockholder Deemed “Controlling Stockholder”

- Under certain facts, **even non-stockholders may be deemed a controlling stockholder** through exerting **“soft sources of power”** which includes, among other things, long historical relationships between the non-stockholder and the management, control over the company’s supply chain and consent rights
- Former stockholder and lead plaintiff brought post-closing class action claims against Pattern Energy Group Inc. (the “Company”), its private equity investor (“Riverstone”), its upstream supplier (“Developer 2”), the special committee of the Board of Directors of the Company, and the conflicted directors and officers for breach of fiduciary duties in a cash acquisition of the Company by the Buyer
- Buyer is a pension fund that previously invested over \$700 million in Riverstone funds and a financial buyer that would leave intact the business and operational relationship that Riverstone and Developer 2 historically maintained with the Company
- Another bidder, Brookfield Asset Management (“Brookfield”), was a strategic buyer that proposed superior value to the stockholders, but since Riverstone and Developer 2 were no longer stockholders at the time of the transaction, they would be cut out of the deal if Brookfield was selected as the buyer
- Riverstone preferred Buyer over Brookfield because a deal with Buyer would accomplish Riverstone’s goals of taking the Company private and consolidating with Developer 2

# In re Pattern Energy Group Inc. Stockholders Litigation (Del. Ch. May 6, 2021) How Riverstone became a Non-Stockholder

- In 2012, Riverstone formed the Company to operate energy projects developed by another Riverstone entity called Pattern Energy Group LP (“Developer 1”)
- Developer 1 created and constructed renewable energy projects, and the Company operated the projects and had a right of first offer to purchase and operate all of Developer 1’s projects
- The Company and Developer 1 operated as a “single entity.” For example:
  - The Company had the same office as Developer 1 and a management services agreement with Developer 1
  - Riverstone and the Company had “a great number of overlapping fiduciaries” who were officers that have a long history with Riverstone as co-investor, partner, employer, sponsor and “financial patron”
  - Majority of the directors on the Company’s Board were appointed by Riverstone, including one director who had been serving as Riverstone’s Managing Director and partner in charge of expanding Riverstone’s energy business
- In 2013, the Company becomes public via an IPO; after the IPO, Riverstone still indirectly controlled the Company via Developer 1, which held a 67.9% majority interest in the Company
- Developer 1 thereafter wound down its business and sold its equity in the Company over time such that Riverstone had **no equity interest in the Company through Developer 1 at the time of the challenged deal**
- As for the supply chain relationship, **another Riverstone entity, Pattern Energy Group Holdings 2, LP (“Developer 2”), replaced Developer 1 to become the Company’s upstream supplier** of energy projects that the Company would operate, and Developer 2 acquired all of the assets of Developer 1

# In re Pattern Energy Group Inc. Stockholders Litigation (Del. Ch. May 6, 2021)

## Riverstone's Leverage over the Company through Supply Chain

- In 2018, the Board of Directors of the Company decides to initiate a sale of the Company, and after the sale to Buyer, the plaintiffs bring a breach of fiduciary duties claim
- The Chancery Court denied the defendants' motion to dismiss because "Plaintiff may establish that the Officer Defendants and Entity Defendants constitute **a control group owing fiduciary duties**" and explained that the **entire fairness standard of review** may apply "because discovery may reveal that a control group, consisting of the Entity and Officer Defendants, stood on both sides of the transaction"
  - Entity Defendants: Riverstone, Developer 1, Developer 2
  - Officer Defendants: Officers and directors of the Company who formed and managed Developer 1, Developer 2 and the Company together with Riverstone and had a close, historical relationship with Riverstone
- "Here, Plaintiff's control group theory aggregates the Officer Defendants' stock holdings and management roles with the Entity Defendants' **contractual, operational, and structural pull**, even though the Entity Defendants are **not stockholders**."
- "Riverstone controlled Developer 2, **an essential part of the Company's upstream supply chain**, supporting the inference of even more Riverstone 'leverage over' the outcome of the sales process...Riverstone pervaded the Company's C-suite, boardroom, and supply chain."
- The Court pointed out that "**liability for breach of fiduciary duty therefore extends to outsiders who effectively controlled the corporation**."

**SECTION 05**

# **KEY TAKEAWAYS**



# Key Takeaways – Buyer

- If motivation to acquire the target company is a key IP and technology license (especially in life sciences industry), review in detail history of transfer/assignment, restructuring and prior deals affecting license
- Due diligence action items:
  - Involve IP licensing expert early in the due diligence process
  - Carefully review anti-assignment, change of control and termination provisions
  - Confirm whether or not consents from the IP owner/licensor were obtained
- Deal structure:
  - Preference for acquisition through a stock deal or reverse merger
  - In asset deal or forward merger, need to obtain consents
- Understand economics of underlying licensing deal:
  - Rights of IP owner/licensor to royalties, up-front payments, milestone payments
  - Require seller to make payments to IP owner/licensor as part of purchase price?
- Require licensor consent as closing condition
  - If consent is not obtained, consider whether an equivalent license is available for Seller to source
  - Negotiate other remedies – purchase price reduction; indemnification for infringement or other damages

# Key Takeaways – Seller

- Seller as licensee to key IP and technology license
- Obtain broad consents from IP owners/licensors
- Ensure that all payments (e.g. royalties, milestone payments, etc.) have been made and understand future payments that Buyer would assume
- Prepare for Buyer team's due diligence review:
  - Rely on IP licensing expert prior to commencement of due diligence
  - Carefully review anti-assignment, change of control and termination provisions and develop a clear position to take vis-à-vis Buyer team
  - Review past consents granted or refused and look for “transfer fees” or “change of control fees”
  - Explore whether replacement licenses are available
- Deal structure – review proposed structure and assess likelihood of objection by IP owner/licensor
- Disclosure schedule – list of key licenses that require consent
- Transition Services – consider whether short-term license by way of transition services is a possible solution

# Key Takeaways – Control Issues

- Understand Who May “Control”
  - A person or group with majority voting control *or* the ability to exert power and influence over the business affairs of the company
  - Be aware of control groups
- Implications of “Control”
  - A controlling person or group owes fiduciary duties to the corporation and all of its stockholders
  - More stringent standards of judicial review
- Process
  - Engage with M&A counsel to identify potential control issues early
  - Run the M&A sale process with necessary legal protections to limit claims for breaches of fiduciary duties and reduce the judicial standard of review

# Key Takeaways – Diligence

Key contractual language for due diligence review:

- “transfer and assignment”
- “non-transferable” and “non-assignable”
- “assumes” “accepts” “vests”
- “rights and interests” and “obligations and duties”
- “successor and assignees” (could be interpreted as permitting assignment)
- transfer by “operation of law”
- assignment “in whole and in part”
- license is “personal” to licensee
- definition of “Change of Control”
- termination upon a “Change of Control”
- “restructuring and reorganization”
- transfer and assignment to “Affiliates”
- What law governs?



# Key Takeaways – IP Owner/Licensor

- In the key license agreement:
  - Prohibit changes in licensee ownership via clear “Change of Control” provision
  - Prohibit “assignment by operation of law,” but clearly define what this means
  - Include express provision that mergers (including reverse mergers) and stock deals constitute “assignment” requiring the licensor’s consent
  - Negotiate what constitutes “Change of Control”
  - Add termination provision where the license automatically terminates or terminates at the discretion of licensor upon “Change of Control”
  - Be careful with “successors and assigns” language
  - Require any transferee of license to abide by the terms and conditions of the license agreement
  - If the license is transferred to a third party or the licensee is acquired by a third party, require the original licensee to be responsible for the third party’s compliance with the license agreement
- Documentation of concerns re: payments due for IP (e.g. recitals in license agreements; emails and memos; strong payment provisions)
- Regular and frequent communication with the licensee that may be a target of acquisition by a third party

A long-exposure photograph of a highway at night, showing vibrant red and blue light trails from cars moving away from the viewer. The trails are dense and create a sense of motion and speed. The background is dark, making the light trails stand out prominently.

# QUESTIONS?

# THANK YOU

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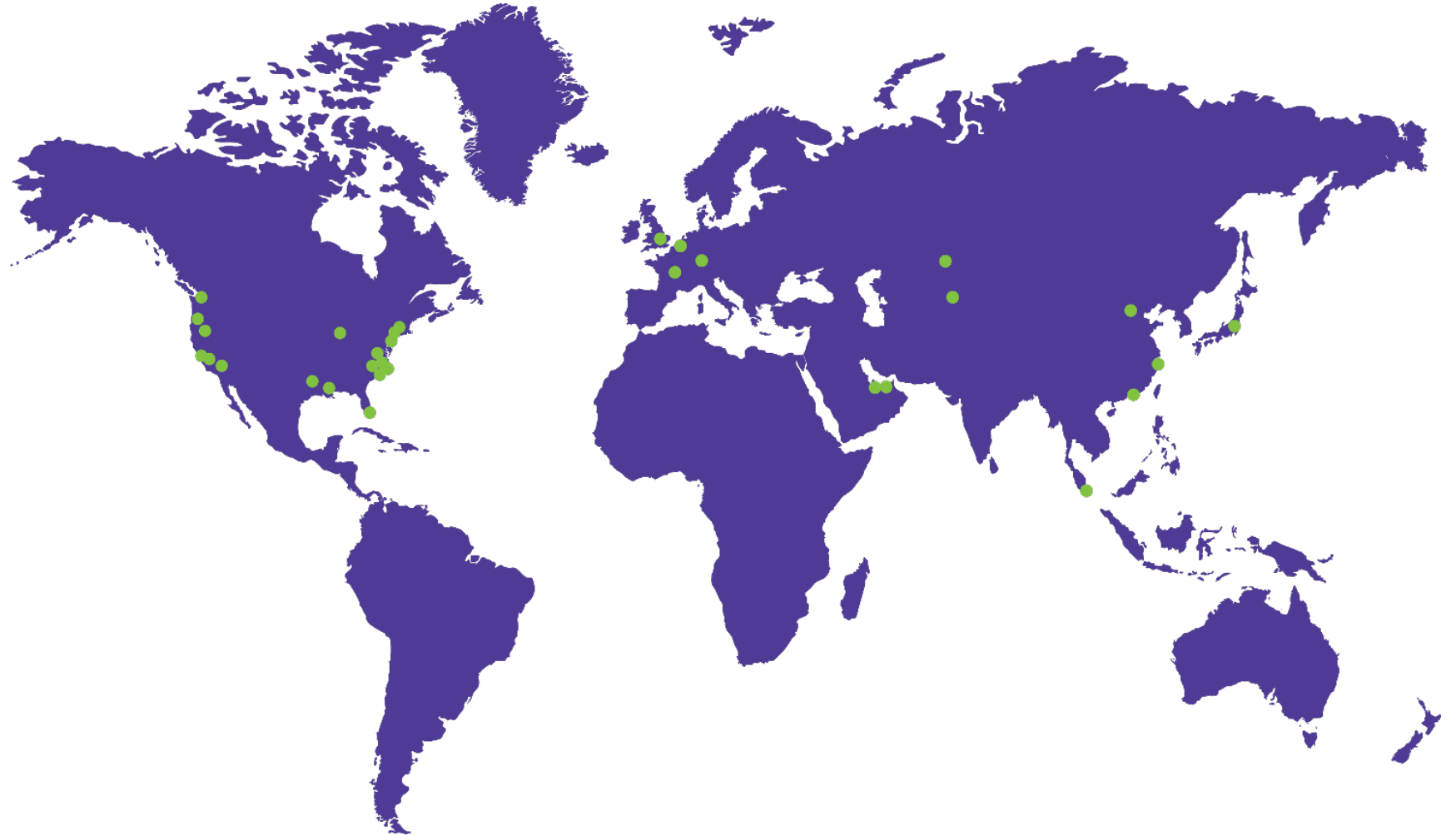
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# Biography



## **Nancy Yamaguchi**

San Francisco

T +1.415.442.1242

E [nancy.yamaguchi@morganlewis.com](mailto:nancy.yamaguchi@morganlewis.com)

Nancy Yamaguchi advises global technology companies on cross-border mergers and acquisitions (M&A), strategic and venture capital investments, joint ventures, strategic alliances, technology transactions, and licensing. With more than 20 years of experience, Nancy is a trusted advisor to private and public multinational companies, especially those based in the United States and Japan, on all aspects of their corporate legal needs, including inbound and outbound M&A transactions. Her clients include companies in the semiconductor, automotive, banking and fintech, IT and software, biopharmaceutical and medical technology (medtech) industries.



# Biography



## **Randall J. Wood**

Orange County

T +1.949.399.7134

E randy.wood  
@morganlewis.com

With experience in closing more than 150 corporate transactions, Randall J. Wood has advised on deals having an aggregate value in excess of \$20 billion. His practice focuses on mergers and acquisitions, private equity transactions, venture capital financing, and emerging business matters. He also assists clients with general corporate counseling and governance, and SEC registered offerings, reporting, and compliance. Randy represents private companies, public companies, and investors in domestic and international deals involving many industries, including technology, manufacturing, consumer/retail, pharmaceuticals, and life sciences.



# Biography



## **Richard M. Lee**

Silicon Valley

T +1.650.843.7572

E richard.m.lee

@morganlewis.com

Richard M. Lee focuses his practice on mergers and acquisitions, growth equity investments, and technology transactions. He has particular experience in leading cross-border acquisitions for technology companies, and late-stage venture capital investments. His clients span industries including software, ecommerce, telecommunications, robotics, fintech, biotech, pharmaceuticals, and digital health.

