

The background of the slide is a dramatic sunset sky with soft, golden light filtering through the clouds. Overlaid on this are numerous colorful light trails in shades of red, blue, green, and white, which appear to be digital data paths or network connections. The trails are most prominent in the lower half of the image, creating a sense of dynamic movement and technology.

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TECHNOLOGY MAY-RATHON

AN OVERVIEW OF KEY ISSUES IN TECH M&A TRANSACTIONS

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Overview

- Introduction
- Deal Structure
- Consideration
- Antitrust / Pre-Merger Considerations
- Key Diligence Issues
- Heavily Negotiated Technology M&A Deal Points

Deal Structure

- Typical M&A – always be mindful of your deal structure
 - Asset Purchase: acquire only specific assets and liabilities; asset transfer is a function of contract; technology and other important assets must be transferable
 - Stock Purchase: best if target has few stockholders; technology and other assets transfer as a function of the deal structure (i.e., transfer of equity not assets)
 - Merger: state law mechanism; allows for cashout of unwilling stockholders; assets transfer as a function of the deal structure (i.e., transfer of equity not assets)
 - Joint Venture: similar to a new business formation; asset transfer is a function of contract (i.e., contribution of assets to JV); similar to asset purchase, technology and other important assets must be transferable
- Technology M&A can be any of the above OR can use a license or a technology transfer as a form of M&A
- Carveout Transactions – present unique issues around structure, license rights and employee matters. Typically required transactions services and licenses to shared IP.

Consideration - Basics

- Consideration
 - Cash
 - Stock
 - Debt
 - Assumption of liabilities

- Purchase price issues
 - Indebtedness
 - Working capital
 - Deferred revenue
 - Line item adjustments

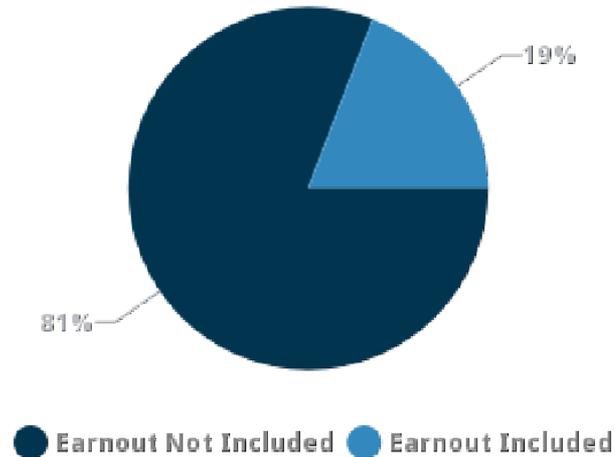
Consideration - Earnouts

- Earnouts
 - Payment Conditions
 - Milestone
 - Performance conditions
 - Buyer covenants
 - Post-closing control
 - Funding commitments
 - Key personnel
 - Availability for indemnification / offset rights

Consideration – Earnouts Trends

Frequency of Earnouts*

FREQUENCY OF EARNOUT PROVISIONS IN TECH AND OTHER DEALS (2012-PRESENT)

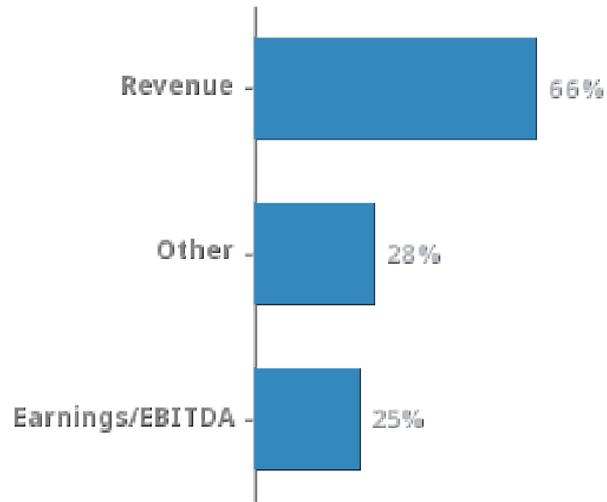


- Information courtesy of Fortis Advisors. 418 deals.

Consideration – Earnouts Trends

Payment Conditions*

FREQUENCY OF METRICS IN TECH AND OTHER DEALS (2012-PRESENT)



- Information courtesy of Fortis Advisors. 22 deals.

US Antitrust Considerations – Merger Control

- **Pre-Merger filing (“HSR Act” process)**
 - **Size threshold:** if transaction is >\$80.8 million,^{*} you likely need to file
 - **Filing the form:** requires submission of certain information and key strategy docs
 - **Automatic doc request and waiting period:** initial waiting period is 30 days
 - **“Second request”:** agency can ask for more info, impose an indefinite stay
- **Not just for mergers**
 - **Joint ventures** – formal ones and some informal ones
 - **Acquisitions of control** – can include some minority acquisitions
 - **Acquisitions of voting securities** – unless <10% and “investment only”
 - **Some exclusive licenses** – if rights are so broad that they approximate a sale

^{*} For 2017. Adjusted every year.

EU and ROW Antitrust Considerations - Merger Control

- **Merger Control:** Wide net (especially if JVs involved)
- **Process:** Filings/clearance timing considerations
- **Focus on Innovation:** Both for substantive analysis and any remedies
- **New thresholds:** Based on deal size to catch tech deals, in particular
- **Do Not Pass Go:** Game-changer transactions could be blocked
- **Misleading Information:** *Facebook/WhatsApp* fined €110 million by the EU

Antitrust Considerations – All Jurisdictions

- **Avoiding “bad” documents**

- Forms require submission of docs describing key strategies and competition
- Boastful language in such docs can lead to a long, expensive investigation
- Counsel your teams: no “locker room” talk (“we dominate,” “they can’t compete”)

- **Avoiding “gun jumping”**

- During the waiting period, you can’t begin to combine or transfer control
- Acquirer cannot supervise or direct the target’s employees
- Certain information sharing should be supervised by counsel

Diligence Approach / Deal Implications

- Approach on tech diligence is key
 - Timing considerations
 - Coordination between business and legal teams – detailed request list
- Buyer's perspective - diligence is never truly "done" until deal closes
- Impact on the deal – Consider whether any due diligence findings merit:
 - remedial action as a closing or signing condition
 - additional assignments by inventors or others
 - necessary licenses or amendments to existing licenses
 - third-party consents as closing or signing conditions
 - changes to representations and warranties
 - special escrow and/or special indemnification
 - post-closing covenants and/or liability for associated expenses
 - alternative integration approach

Key Diligence Issues – Contracts

- Detailed review of terms and conditions of IP related contracts
 - Inbound / outbound licenses
 - Employee / contractor IP assignments
 - Ownership documentation
 - Prior M&A agreements
 - Settlement agreements
- Key issues
 - Ownership issues, including for improvements
 - Scope of license grants
 - Confidentially / non-use obligations
 - Change of control provisions / anti-assignment provisions
 - Residuals clauses
 - Non-compete obligations / exclusivity restrictions
 - Source code escrow obligations
 - Most Favored Nations provisions
 - Limitation of liabilities
 - Breach of representations and warranties in customer and supplier agreements can result in costly indemnification obligations

Key Diligence Issues – IP

- Why care?
 - For technology companies, IP is one of the primary assets being purchased; buyers want the benefit of their bargain
 - Buyer may inherit liability for infringement, and litigation over ownership issues
- Four primary areas of focus for IP due diligence:
 - Ownership and control of IP assets
 - Strength and value of IP assets
 - Liability for infringement
 - Assignability

Key Diligence Issues – IP

- Ownership and Control of IP
 - IP due diligence request list should cover patents, trademarks, copyrights, trade secrets, and licenses
 - Make sure all registrations have been either obtained or applied for and are up to date with the appropriate filing office
 - Make sure a clear chain of title exists from the inventor, author, or previous owner to target company
 - Ensure that appropriate assignment documents are recorded in the public record if/as necessary; confirming the existence of an appropriate assignment from each and every inventor is critical with patents
 - Ensure that there are no encumbrances (run UCC lien searches), such as security interests or liens, on the assets or, if they exist, that they are understood and/or will be terminated at closing
 - Review trade secret policies and procedures, including the way in which target company handles trade secret information
 - Understand whether any public entity has funded the technology (i.e. a public university or the military) and, if so, the implications of such funding

Key Diligence Issues – IP

- Strength and Value of IP Assets
 - Consider whether certain IP assets are critical to the post-deal business objectives and, if so, whether further diligence is appropriate
 - Review the form of protection for IP assets and its strength and suitability generally
 - For patents, consider a review of prior art for validity, scope, and quality of patent claims
 - Perform similar review on trademark and copyright files
 - Analyze the market and whether competitors will have an easy time designing around the IP; what are the barriers?
 - Consider whether to request freedom to operate searches/right to use or opinions

Key Diligence Issues – IP

- Liability for Infringement
 - Identify actual or threatened litigation or claims against target
 - Identify actual or threatened litigation or claims made by target against third parties
 - Review all notices, letters, complaints, case files, and opinions (if any)
 - Review all settlement agreements and releases
 - Understand the status of any ongoing proceedings
 - Consider the merits of the claims and assess the potential outcome
 - Review potential insurance coverage

Key Diligence Issues – Open Source Software

- Many companies do not know what is in their code
- Many companies do not have open source policies (red-flag)
- Why care?
 - Buyer may inherit problems
 - Delayed revenue while fixing problems
 - Closing may be delayed or even prevented
- What types of problems can it cause?
 - Improperly incorporating certain open source policies can create an obligation (“tainting”) to release proprietary code under the same open source license; loss of exclusive rights
 - Open source does not typically push updates (e.g., no security updates or evolving vulnerability analysis)
 - Can result in inability to assert rights against others, or provide a great defense
 - Representations and warranties in customer contracts may be breached, resulting in indemnity liability
 - Reputational risk
- Keep in mind that while critically important to evaluate, not all open source is bad / deal killers

Key Diligence Issues – Open Source Software

- How to conduct open source due diligence?
- First, determine the value of software to target and how that software is used
 - is software a key asset?
 - is it revenue-generating?
 - what is the value of target's patent portfolio?
- Discuss with target developers how they use open source in writing code and what they think is in the code; target should disclose; recognize that target's disclosure will likely be incomplete
- For many technology acquisitions, a third-party audit/scan should be expected; be sure to build time (up to 2-3 weeks) and cost into process
- Target must provide a complete copy of the software to the scanning service
- Some surprises should be expected but discovery of rampant misuse of open source can delay or prevent the deal from closing

Key Diligence Issues – Open Source Software

- Upon receiving scan results, further discussion with target may be warranted
- Consider whether remediation is appropriate, and the timing and process
 - pre- or post-closing?
 - what resources will be necessary?
 - who pays?
- Advice to potential sellers: face the issue ahead of time; scan your code, know the issues and the risks, and fix them before they impact your deal

Key Diligence Issues – Data Privacy Compliance

- Why care?
 - Depending on the industry, poor compliance can directly impact revenue
 - Data privacy laws exist in approximately 100 countries worldwide
 - Enforcement is increasing
 - Sanctions are expensive and can bring business to a halt
 - Reputational risk of a breach can be severe
 - If there are problems, provide time to fix them early
 - Consider how target's compliance will fit into buyer's existing compliance structure
- Data privacy issues are particularly relevant in Big Data, SaaS, and cloud computing services deals, and/or in any industry/business that collects personally identifiable information (PII)

Key Diligence Issues – Data Privacy Compliance

- Data privacy questions to consider
 - Who is responsible for managing data privacy compliance?
 - What type of sensitive information does target have?
 - customer
 - healthcare
 - employee
 - financial
 - Is target in an industry that is heavily regulated?
 - What jurisdictions are relevant?
 - Does target have written policies? Are they compliant? Are they followed?
 - How does target approach cross-border compliance?
 - Has target developed a culture of compliance?
 - Has target ever had a breach and, if so, what did it do?

Key Diligence Issues – Data Privacy Compliance

- Data privacy documents to review
 - Local registrations with data protection authorities, or reasons for not registering
 - Sources of protected data and how it was obtained, how it is used, and how it is retained
 - Written policies
 - Security breaches and actions taken
 - Private and data protection audit results from prior years
 - Notices to individuals
 - Past complaints or claims
 - Penalties or fines

Heavily Negotiated Technology M&A Deal Points

- Heavily negotiated M&A deal points likely fall into four categories
 - Structure/purchase price
 - Representations and warranties
 - Indemnification
 - Covenants

- Structure/purchase price
 - Carevout transaction issues
 - Closing conditions
 - Earnouts
 - Employee retention incentive

Heavily Negotiated Technology M&A Deal Points

Employee Retention

- Employees are particularly valuation to tech companies
- Acquisitions are stressful on target employees
 - uncertainty about future role, job prospects, career path
 - larger organization with a different reporting structure
 - change in culture
- Focus early on who is important to keep, and how best to do so
 - What entity will he/she work for?
 - Salary, cash bonus, retention bonus, equity cashout, equity with vesting
 - Assumption of existing plans, versus need (or desire) for new plans with a strong retentive component
- Provide assurances about future location, job description, culture and resources
- Provide assurances about future benefits
- Balance the “deal reward” and the “retention component” to maximize likelihood that key employees will stay

Heavily Negotiated Technology M&A Deal Points

Representations/warranties

- Subject matters
 - Sufficiency of IP and title to IP
 - Presence and terms of employee/independent contractor IP assignment provisions
 - Compliance with law and contractual terms/conditions
 - Non-infringement (in-bound and out-bound)
 - Presence/ catalogue of open source software
 - Data privacy
 - Obligations to third parties
 - Source code escrow
 - Exclusivity / non-compete obligations
- Qualifications
 - Knowledge, materiality and MAE

Heavily Negotiated Technology M&A Deal Points

Indemnification Considerations

- Stand-alone IP indemnification
- Scrapes (knowledge and/or materiality)
- Survival periods
- Caps, general baskets/deductibles and minimum claim threshold
- Whether IP reps are “fundamental”
- Control of defense of third party claims (i.e., (IP infringement claims)
- Fraud considerations (i.e., is it defined, and who is liable when it is committed (big focus for PE/VC sellers))
- Attorney-client privilege

Heavily Negotiated Technology M&A Deal Points

Stand-Alone Indemnitees*

FREQUENCY OF STAND-ALONE INDEMNITIES (2012-PRESENT)

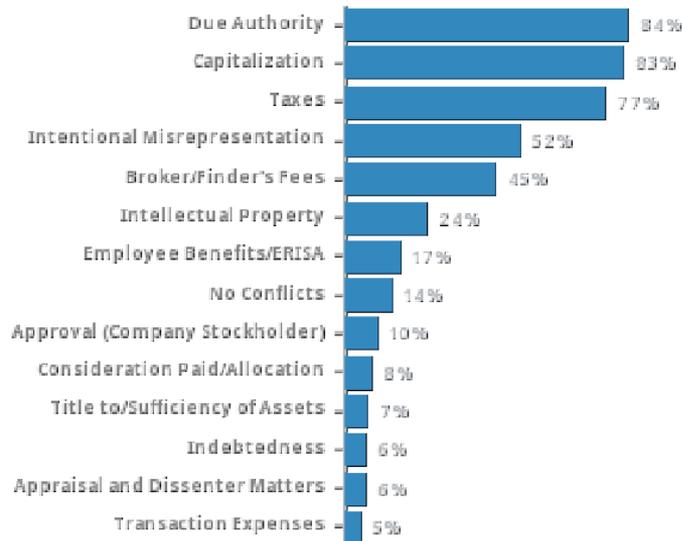


- Information courtesy of Fortis Advisors. 285 deals.

Heavily Negotiated Technology M&A Deal Points

Basket Carveouts*

FREQUENCY OF BASKET CARVEOUTS (2012-PRESENT)

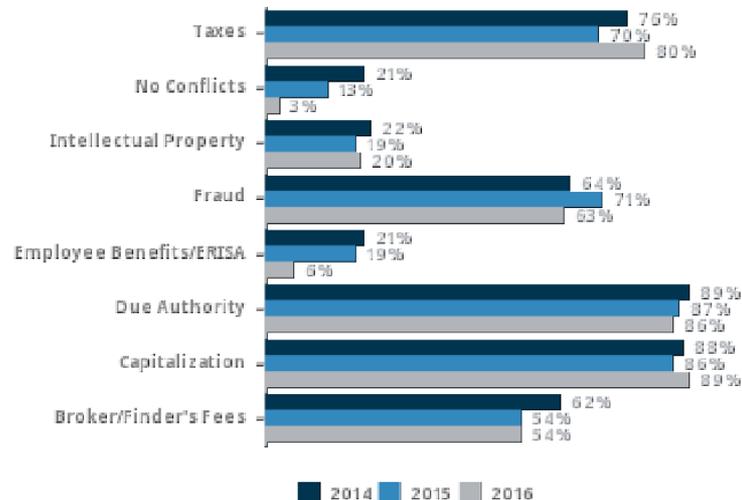


• Information courtesy of Fortis Advisors. 281 deals.

Heavily Negotiated Technology M&A Deal Points

3 Year Trend for Basket Carveouts*

FREQUENCY OF BASKET CARVEOUTS (YEARLY BREAKDOWN)

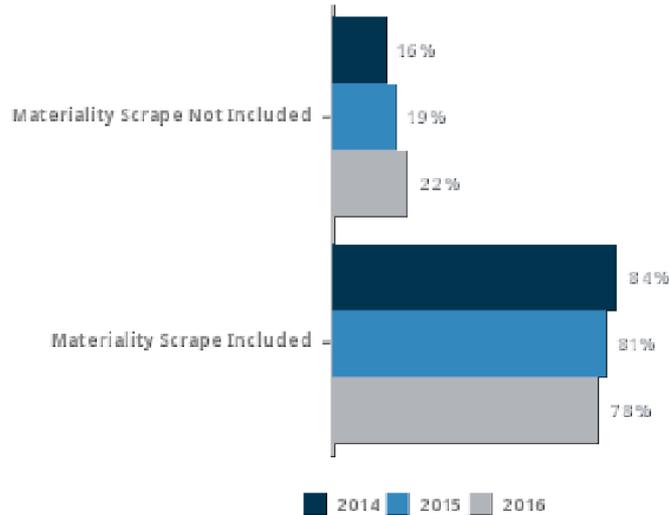


• Information courtesy of Fortis Advisors. 325 deals.

Heavily Negotiated Technology M&A Deal Points

3 Year Trend for Frequency of Materiality Scrape*

FREQUENCY OF MATERIALITY SCRAPE PROVISIONS (YEARLY BREAKDOWN)



• Information courtesy of Fortis Advisors. 333 deals.

Heavily Negotiated Technology M&A Deal Points

Substance of Materiality Scrape*

APPLICABILITY OF MATERIALITY SCRAPE PROVISIONS (2012-PRESENT)

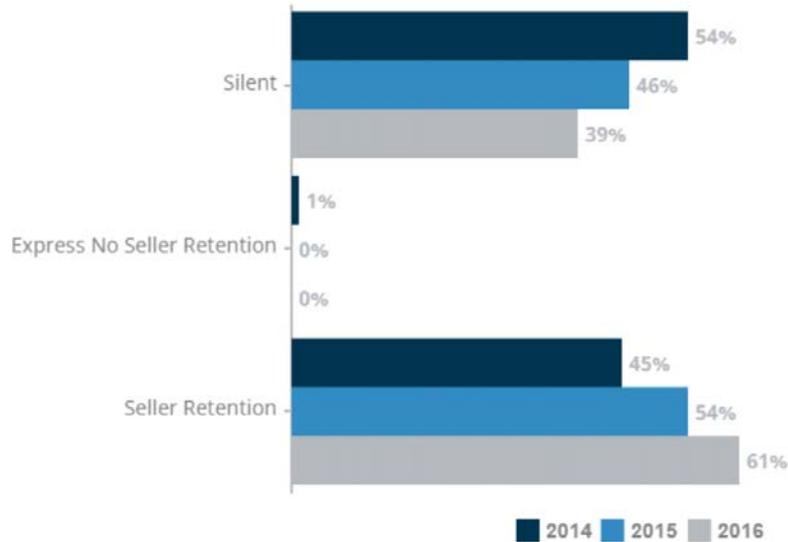


• Information courtesy of Fortis Advisors. 292 deals.

Heavily Negotiated Technology M&A Deal Points

3 Year Trend on Attorney-Client Privilege*

FREQUENCY OF SELLER RETENTION OF ATTORNEY-CLIENT PRIVILEGE (YEARLY LOOK)



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- Information courtesy of Fortis Advisors.

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QUESTIONS?

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Hill Wellford advises clients on antitrust matters, especially where US Department of Justice (DOJ), Federal Trade Commission, and foreign agency enforcement intersects with technology, standard-setting, pharmaceuticals, and patents. His practice includes matters in the Americas, Asia, and Europe, and his experience includes mergers and acquisitions, criminal investigations, civil conduct challenges, and jury, bench, and administrative trials. Hill also counsels agency-appointed trustees overseeing merger divestitures. Hill is the Washington, DC office leader for the firm's antitrust practice.

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