

Inoculating Your Purchase – Contractual Protection from Viral Licenses in M&A Transactions

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It's difficult to make a phone call, browse the Internet, or use your car without encountering open source software (OSS). Samsung phones utilizing Google's Android operating system enjoy a 22.7% global market share, WebKit powers Apple's Safari and Google's Chrome browsers, and Ford recently released the software that supports its infotainment systems to the open source community. Yet, open source software often is misunderstood, and its effect on a target company's valuation frequently is overlooked in M&A financial models.

Unsurprisingly, the value of a commercial software company as an M&A target may be greatly diminished if it is obligated to release its software for free, yet numerous OSS licenses mandate this result. To ensure a buyer is protected in a technology-focused M&A transaction, it is crucial to include language addressing OSS in the purchase or merger agreement.

What Is Open Source Software?

"Open source" software is distributed under licensing terms that ensure everyone can use, modify, and redistribute the source code of that software without the payment of fees. There are numerous benefits to the OSS model. For instance, the worldwide programming community can rapidly modify and develop OSS, increasing its capabilities and security and diminishing

the likelihood of errors. Further, both developers and businesses alike often are quick to adopt high-quality OSS, as it allows them to save valuable resources and time relative to relying on proprietary fee-based software.

But "no fee" does not mean "free." While certain "permissive" OSS licenses place minimal requirements on licensees, other "restrictive" OSS licenses may place onerous demands on licensees. The MIT, BSD, and Apache OSS licenses, for example, typically only require that copyright notices, warranty disclaimers, and copies of the applicable license be included in software incorporating that OSS. On the other hand, if software derived from or containing code licensed under the GNU General Public License (GPL), is distributed, it must be done at no cost under the same license. Such "copyleft" licensing models – often referred to pejoratively as "viral" licenses – are more likely to affect a company's value and therefore raise significant concerns in M&A transactions. In that context, having appropriate contractual protections is paramount to ensure the impact of OSS is minimized.

A Buyer's Protections

Due diligence necessarily is an imperfect process, and the potential acquiror of a software company should consider negotiating adequate representations and warranties to protect against uses of OSS that can result in loss of rights or other adverse consequences to target or buyer.

Buyer may require the target to bear responsibility for these risks, on the grounds that the target chose to include OSS in its products. Buyer's counsel

may seek representations and warranties focusing on the target's compliance with OSS licenses, and that its use of OSS will not result in any obligation to distribute its proprietary code or restriction on commercializing its products. Further, if these statements prove to be untrue, the buyer will look to include OSS indemnification within the scope of target's IP indemnity obligations.

Target likely will seek to resist liability, on the grounds that the use of OSS is a risk of doing business in the software industry, and the enforceability of OSS licenses remains unsettled and has not been widely litigated. Target's counsel may argue that target should not be liable for immaterial breaches of its representations and warranties, and that those statements should be limited to facts within the target's actual knowledge.

Below are buyer-friendly definitions and representations for M&A purchase agreements taken from actual agreements in the technology industry. Note in particular the focus on identification of relevant OSS, compliance with the terms of OSS licenses, and the potential for copyleft obligations or other adverse consequences of OSS use. As with many issues in purchase and merger agreements, the ultimate resolution of OSS concerns will depend in part on each party's leverage and willingness to accept and allocate risk.

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OSS can provide a company and its acquiror with numerous benefits, but an M&A buyer should consider negotiating appropriate contractual protections up front to ensure OSS licensing obligations don't prevent it from obtaining the value expected from its acquisition.

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