



DEWEY & LEBOEUF

Open Source Due Diligence in M&A,
Financings, and OEM Deals

Open Source Business Conference

March 18, 2010

Introduction / Outline

- Transactional Background
- Diligence Methods
- Code Scans
- Common and Emerging Issues
- Results of Diligence
- How to Prepare
- Questions

Transactional Background

- Open Source diligence is relevant in different transactional contexts
 - M&A Deals
 - Financings
 - OEM/Distribution Deals
- Why Due Diligence is Important

Transactional Background – M&A

- Fundamental tension
 - Buyer’s perspective – want a “clean company” with no surprise problems that were not accounted for in price
 - Seller’s perspective – want a “tight deal” with certainty to close at the agreed price
- Structural Components
 - Representations and Warranties
 - Disclosure Schedule
 - Indemnification (private companies)

Transactional Background – Sample Open Source Warranties

“Except as specified in Section ___ of the Disclosure Schedule, no Company Software contains, and Company does not *[use], distribute, or otherwise make available*, any Open Source Code.”

“No Company Software is subject to any “copyleft” or other obligation or condition (including any obligation or condition under any open source or free software license such as the GPL or LGPL) that (a) requires or could require, or conditions or could condition the use or distribution of such Company Software on, *the disclosure, licensing, or distribution of any source code for any portion of such Company Software* or (b) otherwise imposes or could impose *any limitation, restriction, or condition* on the right or ability of the Company to use or distribute any Company Software.”

Transactional Background – M&A

- **Functions of Reps and Warranties**
 - Elicit Disclosure
 - Walk Rights
 - Risk Allocation (Indemnification)
- **Reps and Warranties are Imperfect**
 - Level of detail in disclosure
 - Basket / Cap Limitations
 - Proof problem
 - Hard to walk away
- **Bottom line: even in a private company deal with strong warranties, the Buyer's recourse is limited by many factors – *diligence is key.***

Transactional Background – Financings

- Typically include Open Source warranty and disclosure
- Deal size is smaller
- Investor's risk is mitigated:
 - Investor will have ongoing control
 - Early stage company—problems can be fixed
 - Not integrating with other products
 - Taking a percentage, not whole company
- Diligence is typically less intense than in M&A

Transactional Background – OEM Deals

- Open Source warranties becoming standard
- Diligence becoming more common, at least in some industries
- Deal size is smaller than M&A
- Licensee's risk is higher in some ways:
 - No control over licensor company
 - No access to source code for proprietary components
 - Integrating with other products proprietary to the licensee
 - Licensee may be a higher-profile, deeper-pocket company
 - Licensee can't "hide" behind licensor if there is an infringement problem

Diligence Methods – What to Expect

- Diligence is about
 - Obtaining information
 - Analyzing information
 - Identifying issues
 - *Solving issues*
- Attorney conducting diligence needs an active mind-set:
 - Follow threads
 - Ask follow-up questions
 - Approach information from different angles
- Set expectations up front

Diligence Methods – What to Expect

- Tools Available
 - Product Literature / Documentation
 - Diligence Request
 - ◆ What code is used
 - ◆ What license applies
 - ◆ How is it used
 - ◆ With what does it link / interoperate
 - Bill of Materials (BOM) / List of Open Source from the Target
 - Interviews with Target Personnel
 - ◆ Need to learn how pieces fit together—context
 - ◆ Attorney needs to be able to “translate” into legal code
 - Code Scans

Diligence Methods – What to Expect

- Tools Available—Code Scans
 - Software tools scan code for indicators of open source (e.g., copyright notices, filenames, code strings)
 - Can be done without disclosing source code
 - Generate a (very long) spreadsheet
 - Requires substantial effort and expertise to winnow “hits”, identify actual issues or problems
 - Iterative conversation between buyer and seller
 - Desired end result is a verified BOM for the product
 - Consider NDAs

Common / Emerging Issues

- *Open source terms that are acceptable for a startup, may not be acceptable for a large, established company.*
- Copyleft
 - Types of copyleft
 - Critical to understand use case
 - ◆ Operating system / Application
 - ◆ Application / Library
- LGPL
- Branding / Attribution
- Patent Retaliation Clauses
- Code for which there is no license

Results of Diligence

- Disclosure Schedule
 - Seller generally wants to make broad statements
 - Buyer generally wants to make sure nothing that has not been reviewed is on the schedule
- Remediation Plan
 - Detailed plan for changing the product to solve diligence issues
 - Closing condition?
 - ◆ Buyer wants this
 - ◆ Seller should be cautious
- Special Indemnification
- Signed deal...

How To Prepare

- Seller
 - Create your own BOM
 - Stay organized
 - ◆ Track usage in versions
 - ◆ Track licenses
 - Have a policy on open source usage. Follow it.
 - Have senior engineers who are knowledgeable about the product ready to come “over the wall” in the transaction process.
 - Anticipate Buyer’s concerns
 - ◆ Why is remediation not required
 - ◆ Alternate sources of same functionality
 - ◆ Level of effort to remediate potential problems

How To Prepare

- Buyer
 - Review product documentation in advance
 - Have knowledgeable engineers on the deal team
 - Know Buyer products that will integrate with acquired products

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Questions?

Offices Worldwide





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