

Open Source Due Diligence in M&A Transactions

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Why focus on OS in acquisition?

- Companies with substantial investments in community
 - Trial by Blog
- Heightened focus on code base following transaction
- Remediation may require access to original developers
 - Important information regarding processes and adoption may be lost if not captured
- Relevant to evaluation of quality of information coming from target
- Valuation
- Patent licenses

Why compliance concerns with open source software?

- Absence of control over code available for download without charge
 - Not all “open source”
- Old assumption that licenses are not enforceable
- Absence of honest communication between developers/management
- Developer fear of delay caused by review
 - Quality of source makes re-use enticing
 - Inefficient processes drive use underground
- Code coming from prior acquisitions
- Old code, old problems

Due Diligence Procedures

- Executive Interviews
- Preparation of Schedules
- Drafts of Reps and Warranties
- Checklists
- Certificates of Originality
- Code Scans
- Development Interviews
- Remediation Plans
- Escrows/Hold Backs

Select from options based on:

- Type of transaction
- Intended use of asset
- Timing considerations
- Attorney client privilege
- Continuing infringement
- Valuation
- Leverage

Transactions

- Mergers
- Development
- Acquisitions
- Spin-Offs
- Joint Ventures
- Strategic Alliances
- OEMs
- End Users

OS Due Diligence Process

- Traditional due diligence
 - Inquiries, schedules, warranties, indemnities
- Confirmation of Target's information
 - Keyword Search - string searches for terms that indicate license obligations or copyright ownership (example: FOSSology)
 - Automated code scans – Source and Binary
 - Identify APIs and dependencies
- Review of contributions to OS projects
- Remediation Plans

Pedigree Reviews

- Establishes Ownership of the Open Source
 - Where did the code come from?
 - Check for copyright notices (or the lack thereof)
 - Consider how long it has been available
 - Identify Maintainer and understand the Maintainer's acceptance policies
 - Contact Maintainer for confirmation or alternative license
- Tasks in Pedigree Review
 - Code Scans
 - Web Investigations
 - Project Inquiry
 - Contribution policies

Project Contribution Practices

- “Developer’s Certificate of Origin,” used for Linux kernel, requires a contributor to certify that the code was either:
 - created by the contributor who has a right to contribute it,
 - created by a third party, who has previously certified it, or
 - is based on a work licensed under an open source license and under which the contributor is licensed.
- FSF requires assignment of contributions to projects it owns
 - Typically, assignor represents that he has all rights necessary to make the assignment.
- ASF’s Contributor’s License Agreement requires a statement
 - Different forms for individuals and corporations
 - Verifying that you are legally entitled to make the contributions,
 - Verify that the contributions you make are your own.
 - Binding employer corporations and their affiliates to grants
- Many OSS projects have similar procedures, many do not

Code review in M&A

- Who does the code review
 - Target or Acquirer; Outside, in-house or consultant?
- Where is the code review conducted?
 - Target or Acquirer; Outside, in-house or consultant?
- When is the code review conducted?
 - Prior to pricing; after term sheet; final pre-closing; post-closing

Managing the code review

- Access to the results of the code review
 - Target or Acquirer; Outside, in-house or consultant?
- When does remediation occur?
 - Prior to pricing; after term sheet; final pre-closing; post-closing
- Who does the remediation?
 - Target's developers; Acquirer's developers; consultant

Process Examples

- Require code review by Target
 - Prior to representation but no delivery of results
 - Affects knowledge qualifier
 - Avoids risk shifting to Acquirer
- Perform review post closing
 - Deduct remediation costs from holdback
 - Impact on valuation limited by amount of holdback
- Perform review as part of due diligence
 - Becomes part of “go” /“no go” decision
 - Difficult to retain attorney/client privilege
 - Transfers some/all of risk to Acquirer
 - Opportunity to renegotiate valuation
 - Can complete all remediation prior to closing

Due Diligence Sensitivities

- Intended use of code base
 - Temporarily filling hole in product line
 - Merging code bases
 - New line of business
- Make vs. buy analysis
- Sophistication of acquiror
 - Target's use may be inconsistent with current policies
 - Investment in community heightens impact of compliance misstep

Pre-Close/Transition

- Compile list of Open Source
 - Determine what needs to be removed and when
- Compile list of licenses and attributions
- Confirm and compile corresponding source
- Obtain alternative license
- Remediate

Remediation

- Remediation plan
 - Further research of options
 - Removal of code
 - Restructuring of architecture
 - Issuing patch
 - Releasing source code
- Timing
 - Delay closing / contributory infringement
 - Post closing / direct infringement

Summary

- Open source is pervasive and ubiquitous
- Compliance is important in M&A and other transactions
- Adopt a plan and maintain it
 - Incorporate compliance into development process
- Focus on process rather than policy statement
- Regularly audit compliance
- Automate and routinize
- Adopt community norms

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