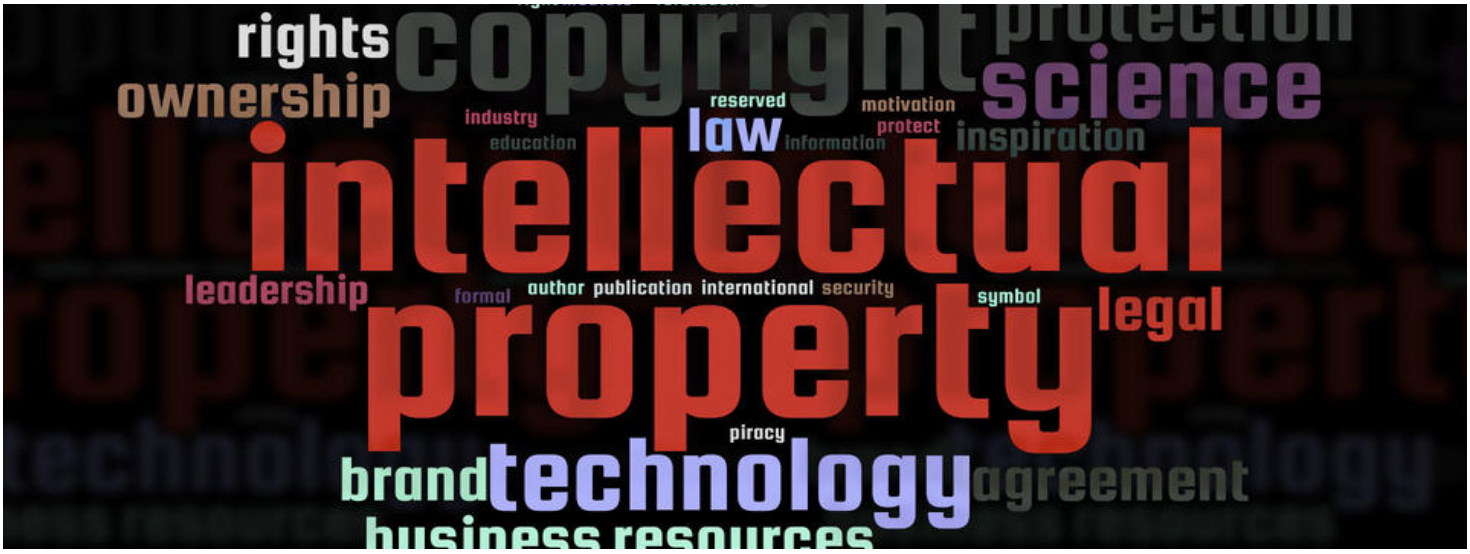

SUGGESTED REVISIONS TO THE INTELLECTUAL PROPERTY REPRESENTATIONS IN THE NVCA MODEL STOCK PURCHASE AGREEMENT FORM

INTRODUCTION AND OVERVIEW

The National Venture Capital Association model Stock Purchase Agreement ("Model Form") was recently updated causing many lawyers to take another look at surely one of the most relied upon model legal agreements to close private financing rounds. It is my view that there are some areas where the model intellectual property representations included in the Model Form could be improved and clarified to best match the expressed goals of the National Venture Capital Association, namely to reduce transaction costs by proposing fair terms that would require disclosures to guide investors in assessing risk.

This article is not intended to be a complete list of all the areas in which the intellectual property representations in the Model Form could be improved but focuses on a select group of issues. This author agrees with the general principal that each of the representations in the Model Form – including the intellectual property representations - should be tailored to the particular industry and the type of intellectual property risk and the widely varying nature of how intellectual property is used particularly reinforces this principal. Space constraints prevent quoting large portions of the Model Form and it is always helpful to read these suggested revisions within the context of the entire Section 2.8 of the Model Form.

ENCUMBRANCES ON COMPANY INTELLECTUAL PROPERTY

"Company Intellectual Property" of the Model Form is defined[1] to include both intellectual property that is company owned and intellectual property used by the company via a license (such licensed intellectual property is "Licensed IP"). Section 2.8(c) of the Model Form is a representation that the Company must make about the existence of options, licenses, agreements, claims, encumbrances or shared ownership interests ("Encumbrances") that apply to Company Intellectual Property.

The practical reality is that it is not reasonable for the Company to know about the existence of Encumbrances for Licensed IP because most licensees are not in a position to obtain nor are provided such information. Furthermore, Encumbrances do not necessarily negatively impair the Company's use of Licensed IP. The Company is also asked in this section to represent that it has not entered into any licenses for intellectual property and given that practically every technology company obtains licenses to third party intellectual property, the representation should instead focus on whether these licenses are valid.

To address the above issues, Section 2.8(c) can be revised to (i) limit the representation about Encumbrances to just Company owned Intellectual Property; (ii) insert a requirement that Company schedule out material third party licenses, and (iii) include a representation that such licenses remain valid and the Company is not in breach of such third party licenses. Adopting these revisions would eliminate a requirement that the Company cannot reasonably meet while also improving the disclosures provided to investors.

DEFINITION OF COMPANY INTELLECTUAL PROPERTY

"Company Intellectual-Property" is defined to include the traditional categories of intellectual property with an option to include mask works but with no option to include rights of publicity. Mask works is a category of intellectual property unique to semiconductors that is generally only material for a narrow group of technology companies. A larger group of investment targets will use or produce content or engage in social media marketing campaigns where the risk of violating rights of publicity are greater. Since there is not universal agreement as to whether rights of publicity are intellectual property or propriety rights, the definition of "Company Intellectual Property" should be expanded to include an optional provision to explicitly include rights of publicity.

OPEN SOURCE

The purpose of the open source representation in Section 2.8(g)[2] of the Model Form is to elicit disclosures related to the use of open source software which ultimately would require the Company to (i) distribute or make the Company's proprietary software available under the terms of open source licenses or (ii) disclose the Company's proprietary source code. There are four specific types of obligations enumerated in Section 2.8(g) that Company is required to disclose they must meet in connection with their use of open

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source software. These obligations were chosen because the undertaking of such obligations by Company could decrease the value or trade secret protection of a Company's proprietary software and it is reasonable for an investor to want to dig further into the effect of meeting such obligations.

The obligations in Section 2.8(g) are purposely limited however to use of open software that is "… used in connection with any of its products or services that are generally available or in development …" [emphasis added]. This qualifier was added likely assuming that any open source activities not involving a current product or service would not lead to any necessary disclosures that an investor would want consider material.

The underlined qualifier should be deleted because it unnecessarily narrows the representation and does not address at least two other uses of open source software the Company may have taken which are not in connection with its currently available or developed products or services and yet may still require the Company to release Company owned software under open source license terms. The first scenario is use of open source software by the Company in connection with an already developed product that is no longer a currently available product. This past use of open source software could require the company to have to engage in any of the four enumerated obligations listed in Section 2.8(g) but would not have to be disclosed under the current suggested language of Section 2.8(g). The second scenario is the Company, arguably and likely through actions of a group of its developers, simply makes contributions to an open source project not in conjunction with any development of a Company product causing such contributions to be released under the terms of an open source license.

RIGHTS TO USE SOFTWARE ON COMPUTERS AND DEVICES

Section 2.8(d) of the Model Form addresses whether the Company has obtained licenses to all software used on Company owned or leased computers and software-enabled hardware. This subsection of 2.8 is devoted to a relatively narrow license risk that is often immaterial and can be remedied in my experience because almost every Company will use software to perform "day to day" business operations but unless such software is actually distributed, modified or included within a product, remedying license deficiencies is often handled through simply purchasing additional license rights.

Many of the disclosures that would be obtained from Section 2.8(d) would also be covered if the language in the first sentence of Section 2.8(a) addressing the concept of whether Company has obtained "sufficient" intellectual property rights is included.

To the extent that investor counsel has concerns about obtaining disclosures about use of software, the representation should be expanded to address the use of software running in the cloud and strong consideration should be given to address software that is distributed within a product. The current language of Section 2.8(d) does not explicitly cover distributed software where most of the legal risks of inadequate licensing rights would be more material and more difficult to remedy. It is also not clear whether software running in the cloud would be considered run on a "company owned" or "company leased" device and this can be clarified.

CONCLUSION

Overall, the Model Form does a good job of providing a baseline of representations for intellectual property but there are areas where the suggested terms can be improved or clarified. As noted above, I would recommend revisions to address the following: encumbrances on Company Intellectual Property; inclusion of rights of publicity in the definition of Company Intellectual Property; changes to the Open Source representation; and updates to address software used in the cloud or distributed within products.

Endnotes:

1. There are two options for qualifying the intellectual property that is included within the definition – intellectual property that are either (a) "[… owned or used by]" the company or (b) " [as are necessary to]…" the company in the conduct of the company's business. But in either option, the intellectual property would also include intellectual property not owned by the company.
2. This is based upon the suggested version of 2.8(g) and not the footnoted alternative language.