

Hot Topics in Technology Due Diligence: Open Source Code

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A. Due Diligence Relating to the Use of Open Source Software

1. Preparing a Seller for a Buyer's Due Diligence Review

- (a) Compile a complete list of open source software that seller uses in its business. Include release/version number, licensor, and installation date.
- (b) Determine which open source code license agreement applies for each open source code product (*i.e. GNU General Public License (GPL), GNU Lesser Public License (LGPL), Berkley Software Distribution (BSD) License, Artistic License, etc.*).
- (c) Distinguish the difference between (i) open source used internally, and (ii) open source included with, or embedded in, seller's own products that are licensed to its customers.
- (d) If necessary, engage a third party to perform an audit of seller's products and systems to determine what open source code is being used by seller. Vendors such as Black Duck Software offer scanning products.
- (e) Determine if seller is in compliance with the terms of the underlying open source license agreements which terms may include:
 - (i) requirement to distribute source code to seller's customers
 - (ii) modification and copying limitations
 - (iii) proprietary notice requirements
 - (iv) distribution/licensing restrictions
- (f) Has seller implemented any policies or guidelines regarding the installation and use of open source? Such policies often identify the following:
 - (i) personnel authorized to approve in-bound licensing of open source software

- (ii) who (employees and third parties) will be permitted to have access to the source code
- (iii) what internal controls exist with respect to the ongoing modification of the open source software
- (iv) under what terms and conditions is open source software redistributed to end-users and channel partners
- (g) Has the seller received any communications from the Free Software Foundation (FSF) or other third party alleging violation of an open source license agreement?
- (h) Does the seller's end-user license agreements provide more protection than the underlying open source code license agreement such as expanded warranties and IP infringement indemnification?
- (i) If seller's own product is made available as an open source product have all contributors (employees and non-employees) to the source code assigned their ownership rights in the code to the seller?
- (j) Review seller's management presentations if they include a discussion of open source technology.
- (k) See **Attachment 1** for example of a due diligence request list relating to software products and intellectual property.

2. Does the Seller Have a "GPL" Problem?

- (a) If the seller's products include third party open source code that is subject to the GPL, is the seller required under the GPL to provide its own proprietary source code to its end users? Such requirement is known as the "**viral**" effect of the GPL.
- (b) Seller's counsel should become familiar with:
 - (i) distribution requirements under the GPL relating to the "linking" of the seller's own code to open source code (*see FAQs at www.gnu.org/licenses/licenses.html#GPL*)
 - (ii) distinction between "derivative work" under U.S. copyright law and the concept of derivative works and linking under the GPL and the FSF's steadfast position relating to this matter

- (c) Does the existence of GPL-code in seller's product have an impact on valuation?

B. Preparing for Negotiations

1. Representations and Warranties

- (a) Expect separate R&Ws relating to the use of open source code products which cover:

- (i) whether seller has an obligation to provide its (closed) proprietary source code to end users under an open source license agreement

- (ii) seller's ongoing compliance with open source code license agreements

- (iii) whether seller's own code was developed by non-employees pursuant to an open source project

- (b) See **Attachment 2** for examples of R&W language.

2. Exceptions to Representations and Warranties (Disclosure)

- (a) Thorough due diligence by seller on itself will allow for truthful, complete and accurate disclosure of exceptions to R&Ws.

- (b) Disclosure speaks to the R&Ws; broadly drafted R&Ws invites expansive disclosure. Multiple R&Ws may cover the same topic so make sure disclosure is all-encompassing.

- (c) If seller's own product is made available as an open source product pursuant to an open source license agreement are seller's channel partners in compliance with that open source license agreement? Does the seller pro-actively manage its partners' compliance with the terms of an open source license agreement?

- (d) See **Attachment 3** for an example of broad sell-side disclosure.

3. Economic Considerations

- (a) If a significant portion of the seller's product is based on open source products, has that been priced into the deal?

- (b) Consider appropriate limits (time and amount) for indemnification obligations.

C. Managing Open Source Risks

1. Embedding or Including Open Source. The presumption is that a vendor's software developers will want to include open source as part of its own proprietary closed-source products. Certain measures can be taken to limit the licensing risks (i.e. GPL-viral effect) and ownership concerns associated with the development and distribution of open source products. Such measures include:

- (a) Distribute the open source on different media.
- (b) Minimize mixing of code base; limit the co-dependency so that each code base operates on a stand-alone basis.
- (c) Educate employees and contractors (including off-shore developers) so that they appreciate the business and legal risks associated with the use of open source.
- (d) Police internal compliance with open source license agreements.
- (e) Track and control code changes to both the open source code and proprietary code.
- (f) Adopt a written open source policy manual covering the use, development, management and distribution aspects of the working with open source.
- (g) Audit entire code base prior to each new release and maintain an inventory of all open source that has been used.
- (h) All contributions by non-employees must assigned by the contributor prior to such code being accepted or utilized.

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ATTACHMENT 1

Sample Software Product & IP/Technology Due Diligence Request List

In connection with the proposed acquisition, please provide for our review any and all documents described below. For purposes hereof, the “Company” shall include any parent or subsidiary of the target, unless otherwise indicated. If the documents described were previously provided to us, please so indicate. Upon review, we may request additional documents.

<u>Provide/ Discuss</u>	<u>Agmt. Rep/Warr.</u>	<u>Not Applicable</u>	A. <u>Material Commercial Contracts and Agreements; Information and Literature:</u>
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	1. List of major suppliers, content providers, distributors and manufacturers.
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	2. Contracts, understandings, or proposed transactions with major distributors, VARs, OEMs, strategic partners, or other resellers, sales representatives or sublicensors.
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	3. Agreements, contracts, understandings or proposed transactions with major customers. Major customers would include, without limitation, any of target’s top 25 customers by revenue over each quarter during the current fiscal year and the last two fiscal years.
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	4. Standard end-user software licenses and other sample contracts with end-user or other customers.
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	5. Standard maintenance, support or service agreements with resellers and end-user customers.
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	6. Contracts, understandings or proposed transactions with major suppliers, content providers or manufacturers.
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	7. Sample contracts with other suppliers, content providers, distributors or manufacturers.
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	8. Distributorship or reseller agreements in which the Company is distributor or reseller.

<u>Provide/ Discuss</u>	<u>Agmt. Rep/Warr.</u>	<u>Not Applicable</u>	
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	9. Licenses of third-party owned software, technology or other intellectual property licensed to the Company.
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	10. Licenses of software, technology or other intellectual property by the Company to third parties (other than agreements listed above).
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	11. <i>List of open source code products used by the Company and all open source code licenses thereto (i.e. GPL, LGPL, BSD).</i>
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	12. <i>List of all employees, end-users, channel partners and other third parties that have access to, or have rights to obtain, the source code to the Company's software products.</i>
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	13. Agreements with subsidiaries, affiliates or shareholders relating to any of the foregoing.

<u>Provide/ Discuss</u>	<u>Agmt. Rep/Warr.</u>	<u>Not Applicable</u>	B. <u>IP, Products and Technology:</u>
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	1. List of principal products and/or services (i.e., product price lists) with short description of each.
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	2. New products, projects, sales or distribution methods which the Company proposes to announce in the next two years and forecast revenues from these products or methods.
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	3. Copies of any internal or outside studies of the Company or the market for its products and/or services.
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	4. Product literature distributed or to be distributed to the public and advertising and marketing literature.
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	5. Product price list, ASP and units sold (for each of the products and materials).

<u>Provide/ Discuss</u>	<u>Agmt. Rep/Warr.</u>	<u>Not Applicable</u>	
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	6. Product roadmap (detailed product roadmap and products descriptions).
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	7. Provide a list of existing and pending patents (including maturity of patents), trademarks, service marks, trade names, domain names, registered copyrights, and application and registration/serial numbers for all of the foregoing.
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	8. List of products / services not protected by patents.
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	9. List of inbound and outbound technology licensing, their use and importance.
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	10. Organizational chart for R&D organization, list of staffing by location, description of roles and responsibilities of management and copies of resumes for management personnel.

ATTACHMENT 2**Sample Representations and Warranties Regarding Use of Open Source****Example #1**

Seller represents and warrants that the Software owned or purported to be owned by the Seller or distributed by the Seller as a Seller product (the “Seller Software”) was: (i) developed by employees of the Seller within the scope of their employment; (ii) developed by independent contractors who have assigned their rights to the Seller pursuant to written agreements; or (iii) otherwise acquired by the Seller from a third party who assigned all Intellectual Property rights in the Seller Software to the Seller. None of the Seller Software, or any portion thereof, is, in whole or in part, subject to the provisions of any open source or quasi-open source license agreement (including, for example, the GNU GPL or LGPL licenses). The Seller has made no submission or suggestion and is not subject to any agreement with standards bodies or other entities which would obligate the Seller to grant licenses to or otherwise impair its control of its Intellectual Property or the Seller Software. Except for the warranties and indemnities contained in those contracts and agreements set forth in Section_____ Seller Disclosure Schedules or this Agreement, warranties and indemnities in the Seller’s standard customer and reseller agreements, and warranties implied by law, the Seller has not given any warranties or indemnities relating to products or technology sold or services rendered by the Seller.

Example #2 - *[From Agreement and Plan of Merger between Oracle and Siebel Systems, filed on Form 8-K with the SEC on 9/12/05]*

Section 4.20(g) of the Siebel Disclosure Schedule contains a true and complete list of the Siebel Software Products that are included in the 7.8, 7.7 and 7.5 releases of such products that are generally available as of the date of this Agreement. Other than under (a) a source code escrow arrangement under which a third party is the escrow holder, and pursuant to which certain Siebel customers are entitled to receive access to the escrowed source code in the event of failures of customer support or bankruptcy or insolvency, (b) development arrangements under which third parties assist with the development of the Siebel Software Products, or (c) source code that is shipped as part of the generally available Siebel Software Products, no parties other than Siebel or any of its Subsidiaries, possess any current or contingent right to any source code that is part of Siebel Software Products. Siebel Software Products do not contain any software code that would subject the Siebel Software Products to a requirement that the Siebel Software Products be licensed to or otherwise shared with any third party as Publicly Available Technology. “**Publicly Available Technology**” means any software or technology (including but not limited to computer software programs, applications, algorithms, models, databases or documentation) (collectively, “**Technology**”) that requires as a condition of use, modification and/or distribution of such Technology that other software or technology incorporated into, derived from or distributed with such Technology (i) be disclosed or distributed in source code form; (ii) be licensed for the purpose of making derivative works; (iii) be licensed under terms that allow reverse engineering, reverse assembly or disassembly of any kind; or (iv) be redistributable at no charge. Without limiting the generality of the foregoing, “**Publicly Available Technology**” includes any Technology that is distributed under any of the following open licenses or distribution models: the GNU General Public License (GPL), GNU Lesser General Public License or GNU Library General Public License (LGPL), Mozilla Public License (MPL), BSD licenses, the Artistic License, the Netscape Public License, the Sun Community Source License (SCSL) the Sun Industry Standards License (SISL) and the Apache License.

ATTACHMENT 2

(cont'd)

Sample Representations and Warranties Regarding Use of Open Source

Example #3

The Seller's Disclosure Schedule identifies each material item of Seller Intellectual Property, and each item of Licensed Open Source Materials and Seller Open Source Materials, that is owned by a party other than the Seller and the license or agreement pursuant to which the Seller uses it (excluding off-the-shelf software programs licensed by the Seller pursuant only to "shrink wrap," "click wrap," or other standard or mass market license agreements). Except for the Licensed Open Source Materials and the Seller Open Source Materials, the Seller has not disclosed the source code for any material software developed by it, or other material confidential information constituting, embodied in or pertaining to such software, to any non-Seller person or entity, except pursuant to the agreements listed in the Seller's Disclosure Schedule or pursuant to a written agreement containing terms sufficient to protect the confidentiality of such information in accordance with accepted industry practices, and the Seller has taken reasonable measures to prevent disclosure of such source code. The Seller has taken commercially reasonable steps to ensure that portions of Seller Deliverables and Seller Intellectual Property that are not Commercially Available Technology, Licensed Open Source Materials or Seller Open Source Materials are not covered by or otherwise subject to any open source license, such as the GNU General Public License or the BSD license.

Example #4

Schedule _____ of the Schedule of Exceptions lists all software that is distributed as "free software," "open source software" or under a similar licensing or distribution model ("**Open Source Software**") and that is used by the Seller in its products that are distributed to end-users, and describes in general terms the manner in which such Open Source Software was used, including but not limited to whether (and if, so, how) such Open Source Software was modified or distributed by the Seller. Except as set forth on Schedule _____ of the Schedule of Exceptions, the Seller has not (a) incorporated Open Source Software into, or combined Open Source Software with, any of the Seller's Intellectual Property; (b) distributed Open Source Software in conjunction with any such Intellectual Property; or (c) used Open Source Software that creates, or purports to create, obligations for the Seller with respect to any Intellectual Property of the Seller or grant, or purport to grant, to any third party, any rights or immunities under such Intellectual Property (including, but not limited to, using any Open Source Software that requires, as a condition of use, modification, and/or distribution, that other software integrated with, derived from, or distributed with such Open Source Software be (i) disclosed or distributed in source code form, or (ii) redistributable at no charge).

ATTACHMENT 3

Sample Disclosure Relating to Use of Open Source

The Seller estimates that approximately _____% of the current Product code base was created exclusively by the Seller, approximately _____% of the current Product code was created by the combined efforts of the Seller and the open source community, and approximately _____% of the current Product code base was created solely by the open source community. The Seller makes no representation or warranty that 100% of the current Product code base was created by the Seller or that the Seller is the sole copyright owner of the entire code base of Product. The Seller believes that the portions of the Product code base created by anyone other than the Seller is required to be licensed by the Seller pursuant to the GPL.

The software program Linux is included in the Seller's products and is licensed under the GPL. The GPL is the subject of litigation in the case of The SCO Group, Inc. v. International Business Machines Corp., pending in the United States District Court for the District of Utah. It is possible that the court could rule that the GPL is not enforceable in such litigation. Any ruling by the court that the GPL is not enforceable could have the effect of limiting or preventing the Seller from using Linux as currently used.

The author of the GPL is the Free Software Foundation ("FSF"). The FSF maintains that if a software program links in a certain way to an open source program licensed under the GPL then such program is considered to be a derivative work of such open source program and thus required to be licensed under the GPL. The Seller does not agree with this interpretation and believes that its rights of ownership with respect to derivative works of its software products is based in copyright law rather than an interpretation of linking under the GPL. The Seller believes that the FSF does not have the standing to require the Seller to make all of its products available pursuant to the GPL; however, if a court were to agree with this position put forth by the FSF, then such ruling could result in the Seller having to make all of its products available pursuant to the GPL, rather than pursuant to the proprietary, closed-source license agreements that it currently utilizes.