



March/April 2015

Corporate: Negotiating Strategies for the Sale of Technology Companies

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The number of mergers and acquisitions of private technology companies continue to increase. Established companies often have inadequate in-house development resources, a large pile of cash, and a need to prove to their shareholders that they have potential for future growth. A target company (Target) may never fully understand all of the dynamics of what makes it attractive to a potential acquirer (Acquirer), but there are tools Target should implement to improve its chances of a successful sale.

Identify the strategic reason for the acquisition

Target may want access to complementary products and markets, improved distribution capacity and customer base, access to capital without further dilution to founders and investors, an established infrastructure to accelerate growth, as well as liquidity for founders and investors. An Acquirer is more likely to make an acquisition to gain creative, technical or management talent, acquire key technology, distribution channels or sources of supply; and/or expand or add new product lines. Often, an Acquirer will make an acquisition to get to market more quickly, or to eliminate a competitor.

Identify the attributes of Target that are most valuable and initiate internal due diligence

Having proprietary technology is always a competitive advantage, particularly when such technology is a market leader in a fast growing market segment. Initiating legal and financial due diligence prior to going to market is extremely important so that any problems/issues can be identified and remedied prior to Acquirer commencing its own extensive due diligence.

Due diligence checklists prepared by an Acquirer generally include legal and business matters. The purpose of collecting information from the due diligence process is to address the strengths and weaknesses of Target, enabling an Acquirer to

determine “fit” between Target and Acquirer, and to validate the valuation and allocate risks inherent in the transaction.

Internal due diligence should include the preparation of a comprehensive list of all IP assets, including patents, patent applications, trademarks, service marks (registered and unregistered), fictitious name filings, internet domain names, software and databases, registered and unregistered copyrights, trade secrets, proprietary know-how, technology or processes, and rights of publicity, each for federal, state and foreign jurisdictions. All IP should be reviewed for filing dates, renewal periods, security interests, validity, enforceability, and freedom to use. Anti-assignment clauses in IP licenses and other contracts that may be triggered on a change in control should be addressed and the process for obtaining any requisite consents should be clarified. Invention assignment and confidentiality agreements need to be reviewed for all employees and consultants that have contributed to the development of the IP. License agreements (which may affect field of use and other restrictions) and other IP-related agreements also need to be reviewed, including research and development agreements, joint venture or other strategic partnership arrangements, co-marketing agreements, manufacturing, supply, distribution agreements, and covenants not to sue.

Identify the most advantageous deal structure for Target

The typical forms for structuring acquisitions are stock sales, asset sales or mergers. Transactions can be taxable, or all or partially tax-free depending upon structure. It is important to check with tax and legal advisors to determine the best form for the structure of the deal before approaching an Acquirer, so that Target is best equipped to evaluate competing offers.



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Tech Industry Bulletin



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Identify negotiating strategies

Acquirer will negotiate for broad representations and warranties regarding the disclosure of transferred IP, the sufficiency of IP assets, IP ownership, validity and enforceability, non-infringement, and level of protection of trade secrets and confidential information, with limited materiality qualifications and limited knowledge qualifiers. Joint and several liability for representations and warranties will be requested, with low caps and baskets for indemnity provisions, and indemnification beyond the applicable escrow or holdback amounts. Target should attempt to narrow all of these by arguing for more limited or narrow representations which are knowledge based with materiality qualifiers, and incorporating limitations on the survivability of the representations and warranties. Target should negotiate for a maximum liability cap for indemnifications claims, baskets (minimum claims which must be met before Acquirer can make any claim), and deductibles (where the Acquirer can only make claims above a certain threshold amount).

Planning for the acquisition process up front will enable Target to be proactive in its negotiations with Acquirer. It will also pave the way for a smoother acquisition process resulting in a successful closing that meets the objectives of Target's shareholders.



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