



message from partner in charge

Summer traditionally brings a slowdown to the pace of business, but that has not been the case at Pepper's New York office. In addition to serving clients, we are busy packing for our move on September 14 to the beautiful New York Times building. Our new address is:

Pepper Hamilton LLP
The New York Times Building
37th Floor
620 Eighth Avenue
New York, NY 10018-1405

Fortunately, our phone and fax numbers will NOT change.

I also am delighted to announce that our office has continued to grow, with the addition of several outstanding lawyers. In addition to welcoming our newest attorneys, this edition of the *New York Update* outlines the issues astute dealmakers need to consider in how the use of open source software can complicate – or in some situations derail – corporate M&A and other transactions. Our energy group also reports on the New York State Public Service Commission's move to adopt an energy efficiency portfolio standard, which is designed to help reduce New York's energy consumption.

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Open-Source Software Issues in M&A Transactions

Open-source software has become a key issue in M&A transactions, especially those involving midmarket software businesses. Many dealmakers know that the presence of open-source code can derail a merger or acquisition. The danger exists when a programmer has embedded source code with a particular kind of opensource license, accidentally creating “free ware” instead of a commercial product. The end result can be costly, negating potential revenue to the bottom line of the newly acquired software company.

But that doesn't mean that transactions involving open-source software should be avoided. Instead, sellers of software companies must understand and manage the use of their code to prevent the erosion of value to their technology product. Meanwhile, buyers must conduct audits to understand the liability they may acquire in any M&A transaction involving technology.

The open-source movement dates back to the early 1980s. It was founded on the belief that increased rights to access, share and modify source code will foster greater innovation. Source code (human-readable code as opposed to machine-readable object code) allows programmers to customize and build software products.

The Open Source Initiative (www.opensource.org) outlines the principles that a code must meet to qualify as an open-source code license, including free distribution, availability of source code and permission to make derivative works.

Open-source code licenses exist for dozens of well-known products, including Apache, Apple, GNU, IBM, MIT, Nokia and Sun. Open source also is routinely found in the programmable microprocessors that operate navigational devices, Web servers, CRM applications and cell phones.

Open source has clearly been a boon to technology development, but it doesn't come without some hidden costs. **Sun Microsystems Inc.** CEO Scott McNealy once quipped, “Open source is free like a puppy is free.” It comes with a

binding license, the terms of which can wreak havoc during a transaction. From a programming perspective, the most common — and the most dangerous — open-source license is the GNU General Public License, or GPL. This license preserves “openness” by requiring modified software to be redistributed on the same terms at no charge.

Theoretically, if a programmer embeds even a small amount of open source into a proprietary software product, then distributes it commercially, the entire product may become subject to a GPL, meaning further copying and distribution of the whole product must be free.

This contamination of a software product’s proprietary code by open source is the key reason for scrutiny in merger and acquisition transactions. Whether the code is embedded, distributed with or is separate from the proprietary product becomes key as to whether the viral nature of the GPL or other open-source license applies. Fortunately, due diligence is becoming easier and more prevalent, thanks to technology. Software such as Black Duck Software can analyze whether the product has open source embedded in it or distributed with it and can identify which license the software is subject to.

Once code review is complete, the issue becomes remediation. If open source is used for noncritical aspects, the transaction generally proceeds without any issues. However, if removing code from a product results in a loss of functionality, that may affect valuation or significantly delay closing. Remediation also may require compliance with

strict license requirements. Another approach is to eliminate the noncomplying code or rearchitect the product to allow the open-source component to be independent.

Much of the remediation effort will depend on whether the software being acquired is the reason for the acquisition or just a tagalong. But in transactions where the acquired software product will be merged into the acquiring company’s software, the danger of contamination goes up — and the need for an open-source audit becomes critical.

It is not simply the discovery of open source that can quash a deal, but what executives selling the software business have to say about it. How a company has managed the use of open source speaks volumes about whether proper business controls were in place: That, in turn, can affect confidence in the management team.

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Peppercast: Mandatory Fee Arbitration Agreements

Michael Meeks, a partner in Pepper Hamilton’s Commercial Litigation practice group and a resident of our expanding Orange County California office, and Eric Goldberg, an associate with Pepper’s Philadelphia office who concentrates his practice in commercial litigation, discuss an interesting matter that arose out of the divorce proceedings between Bruce Springsteen’s keyboardist, Danny Federici, and his wife Kathlynn Federici.

The matter is *Federici v. Gursej Schneider and Company*. Federici raises the issue of the enforceability of a mandatory fee arbitration agreement between Kathlynn Federici and the accounting firm she retained during the divorce.

Listen today by visiting the Commercial Litigation section of www.pepperpodcasts.com.

Pepper Boosts New York Presence with Four High-Profile Attorneys

Pepper Hamilton LLP is pleased to announce that four experienced attorneys recently joined the firm's New York office.

Carol M. Degener, who joined the firm as of counsel from Seward & Kissel LLP, has a broad corporate and corporate finance practice that includes the establishment and operation of hedge funds and fund of funds. Her practice includes working with SEC-registered investment advisers and commodity pool operators. Carol is a graduate of Harvard Law School, Columbia School of International and Public Affairs and Barnard College.

Joseph F. Voyticky joined Pepper as of counsel from the New York office of Allen & Overy LLP, where he concentrated on structured finance, global loans and leveraged finance. His practice also includes working on unsecured credit facilities, receivables purchases and sales, synthetic leases, leveraged leases and restructuring transactions. Joe is a graduate of Union College and Harvard Law School.

Mitchell S. Ames and **James H. Stevralia** joined Pepper as partners from Hogan & Hartson LLP. They add depth and breadth to the office's full range of corporate, finance, securities, securitization and business transaction services. Mitchell has been involved in many of the highest profile business and reorganization transactions of the past 10 years, and has been recognized by *Chambers USA* as a leading media transactional lawyer. Jim assists U.S. businesses of major international listed companies and domestic entities with mergers and acquisitions, new venture structuring, and the effective utilization of tax losses and credits. He also assists clients in federal and state tax audits, state tax board hearings, federal appeals and Tax Court litigation. Mitchell is a graduate of New York University School of Law. Jim is a graduate of Fordham University School of Law and earned an LL.M. in taxation from New York University School of Law.

Upcoming Events

Pepper Hamilton is a gold sponsor for The Deal's "Innovative Deal Financing Conference."

September 25, 2007

The Harvard Club, New York City

During the conference, Pepper partner **Jim Epstein** will be speaking on the topic "Bettering Your Dividend Recap Plays." For more information, visit www.TheDeal.com/financing07.

Pepper Hamilton is a sponsor of the "IMN Summit on Real Estate M&A, Private Equity & REIT Privatization."

September 19-20, 2007

Marriott Marquis, New York City

During the summit, Pepper partner **Michael Friedman** will be speaking on the "Disclosure Matters and other SEC Considerations" panel.

Visit www.imn.org for more information.

Pepper Hamilton will sponsor these upcoming Capital Roundtable Events:

Private Equity Investing in Health Care Services Companies

Workshop: October 16, 2007 - Featuring Pepper partner **Chris Miller**

Masterclass: October 17, 2007 - Featuring Pepper partner **Jim Epstein**

Private Equity Investing in Medical Device and Product Companies

Masterclass: October 18, 2007 - Featuring Pepper partner **Chris Rossi**

Workshop: October 19, 2007 - Featuring Pepper partner **Jeff Libson** and **Chris Rossi**

Visit www.capitalroundtable.com for more information about these events and to register.

Pepper partner **Steven Bortnick** will be speaking at Financial Research Associates' "The Investor Forum on Private Equity Portfolio Management."

November 14-15, 2007

The 3 West Club, New York City

Visit www.frallc.com for more information.

New York PSC Initiates Proceeding to Design an Energy Efficiency Portfolio Standard¹

The New York State Public Service Commission (Commission) initiated a proceeding to design an electric and natural gas Energy Efficiency Portfolio Standard (EPS). The EPS will establish targets for energy efficiency, similar to the existing Renewable Portfolio Standard and other programs, intended to reverse the pattern of increasing energy use in New York. The Commission determined that New York possesses sufficient potential energy efficiency resources to reduce electric usage by 15 percent of projected levels by 2015. The Commission noted these targets cannot be met by Commission action alone, or solely by ratepayer funding. Also anticipated are legislative actions to strengthen building codes and raise appliance efficiency standards, and municipal and local initiatives.

The Commission instituted an EPS proceeding so that interested parties can work together expeditiously to meet the state's goal of reducing electric usage by 15 percent of projected levels by 2015. The Commission's EPS proceeding initially will address end-use efficiency. While end-use efficiency can be understood to include performance standards, technology standards and consumer information, this proceeding will consider a range of resources to reduce electricity and gas demand. The proceeding also will investigate the various methods available to obtain and fund the energy efficiency resources.

The Commission directed staff to prepare energy efficiency program design proposals, with associated benefit and cost analyses, to focus the proceeding and move it expeditiously. The process also will provide opportunities for public input. This proceeding will include development of target goals and timetables for natural gas usage efficiency. Since gas supply is somewhat constrained and expected to remain so, reductions in gas demand can produce reductions in the market clearing commodity price, resulting in significant overall benefits to all gas consumers beyond those captured through reduced end-use consumer usage. For both electricity and gas efficiency, the relationship will be explored between generic targets and objectives, and individual utility programs established in the context of rate cases.

Currently, 10 states have adopted or are considering energy efficiency portfolio or resource standards. In addition, a number of states now have greenhouse gas emission reduction programs. Jurisdictions with specific energy efficiency

savings targets and timetables either under consideration or in place include: California, Connecticut, Hawaii, Illinois, Minnesota, Nevada, New Jersey, New York, Pennsylvania, Rhode Island, Texas, Vermont, New York City and the European Union.

Endnotes

- 1 New York State, Department of Public Service, viewed 26 September 2007, <http://www3.dps.state.ny.us/psc-web/WebFileRoom.nsf/ViewCat?ReadForm&View=ArticlesByCategory&Cat=Notices&Count=10>

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