

## Technology

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### Recent Lessons for Technology M&A

Recent activity in the U.S. courts has highlighted a number of key considerations for technology startups, their founders and potential acquirors. The importance of thorough due diligence regarding intellectual property ownership and the enforcement of non-disclosure provisions have been showcased in the US\$500 million jury award against Oculus VR Inc. (“**Oculus**”), the Facebook-owned virtual reality (“**VR**”) company, and in Vancouver-based Investel Capital Corporation’s (“**Investel**”) lawsuit against Snap Inc. (“**Snap**”), the company behind the ultra-successful smartphone application Snapchat.

#### The Oculus Jury Award

ZeniMax Media Inc. (“**ZeniMax**”) sued Oculus alleging Oculus and founder Palmer Luckey used intellectual property created by ZeniMax to develop the hugely-successful Oculus Rift VR Technology (the “**Rift**”).

ZeniMax invested tens of millions of dollars in researching and developing VR technology over several years. In 2012, ZeniMax programmer John Carmack began corresponding with Luckey, who was developing the Rift. Carmack believed he and the ZeniMax team would be valuable in moving the technology forward. ZeniMax agreed to disclose to Luckey its proprietary hardware and software enhancements to assist him in transforming the Rift from a prototype into functional physical hardware with specialized software. Luckey agreed the technology was not to be disclosed to third parties.

Shortly after showcasing the Rift at a trade show to great acclaim, Luckey formed his company, then Oculus LLC, to commercialize the Rift. Oculus hired Carmack and other ZeniMax employees. In March of 2014,

Facebook Inc. moved quickly to acquire Oculus for US\$2 billion, confirming the enormous value of the intellectual property.

ZeniMax was never compensated by Oculus for its instrumental contributions to Oculus and the Rift. Shortly after Facebook acquired Oculus, ZeniMax sued Oculus claiming it owned many of the technologies used by ex-employees in developing the Rift. A Texas jury awarded ZeniMax US\$500 million in damages for Oculus’ and Luckey’s breach of the non-disclosure agreement and for copyright infringement, finding also that certain information concerning these breaches was available to Facebook as part of its acquisition due diligence.

#### The Snapchat Lawsuit

In early February, 2017, Investel filed a lawsuit with the U.S. federal court for patent infringement against Snap. The lawsuit was filed a day after Snap officially filed for a U.S. initial public offering that could raise an estimated US\$3 billion – setting its valuation between US\$25 and US\$35 billion.

Investel claims to have invented and to own the rights to location-based filters that Snap calls “geofilters,” which are used to integrate location-based advertisements into user-generated social media content. This technology is instrumental in Snapchat’s monetization and is described in Snap’s IPO filing. Investel had plans for a U.S. and Canadian commercial launch in the Fall of 2016, of iFramed, its product based on the same technology. Investel’s launch was allegedly delayed because Snap launched a massive campaign introducing its own geofilters as part of Snapchat. As such, Investel claims that Snap’s actions have prevented it from raising capital and launching its business.

This U.S. lawsuit mirrors Investel’s Federal Court of Canada lawsuit against Snap from August, 2016, which the Canadian court has allowed to proceed.

# Goodmans<sup>LLP</sup> Update

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Interestingly, Snap did not mention the original Canadian lawsuit in its IPO filing.

How the courts rule on these lawsuits will depend on the evidence brought forward, and should have a substantial impact on the valuation of both companies.

## **Key Takeaways for Buyers**

Some key takeaways from these high profile cases for potential buyers revolve around whether the intellectual property rights the buyer seeks to acquire are encumbered or could be challenged in any way:

1. Potential purchasers should seriously consider any history of a dispute when assessing a target companies' ownership rights to its key intellectual property. Disputes should not always be regarded as unfounded and manufactured by a "jealous" or "bitter" ex-founder or employee. Failing to adequately review potential ownership issues that arise in due diligence can create serious problems down the road.
2. A buyer should review carefully all non-disclosure provisions entered into by a target and its employees to ensure they have not been violated in the process of developing the technology.
3. A buyer must not be hasty by rushing an acquisition because missing some key information in due diligence that should have been uncovered, can prove to be very costly.

## **Goodmans Tech Group**

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