

Opening Up a Proprietary Product: Legal Due Diligence

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May 22, 2007

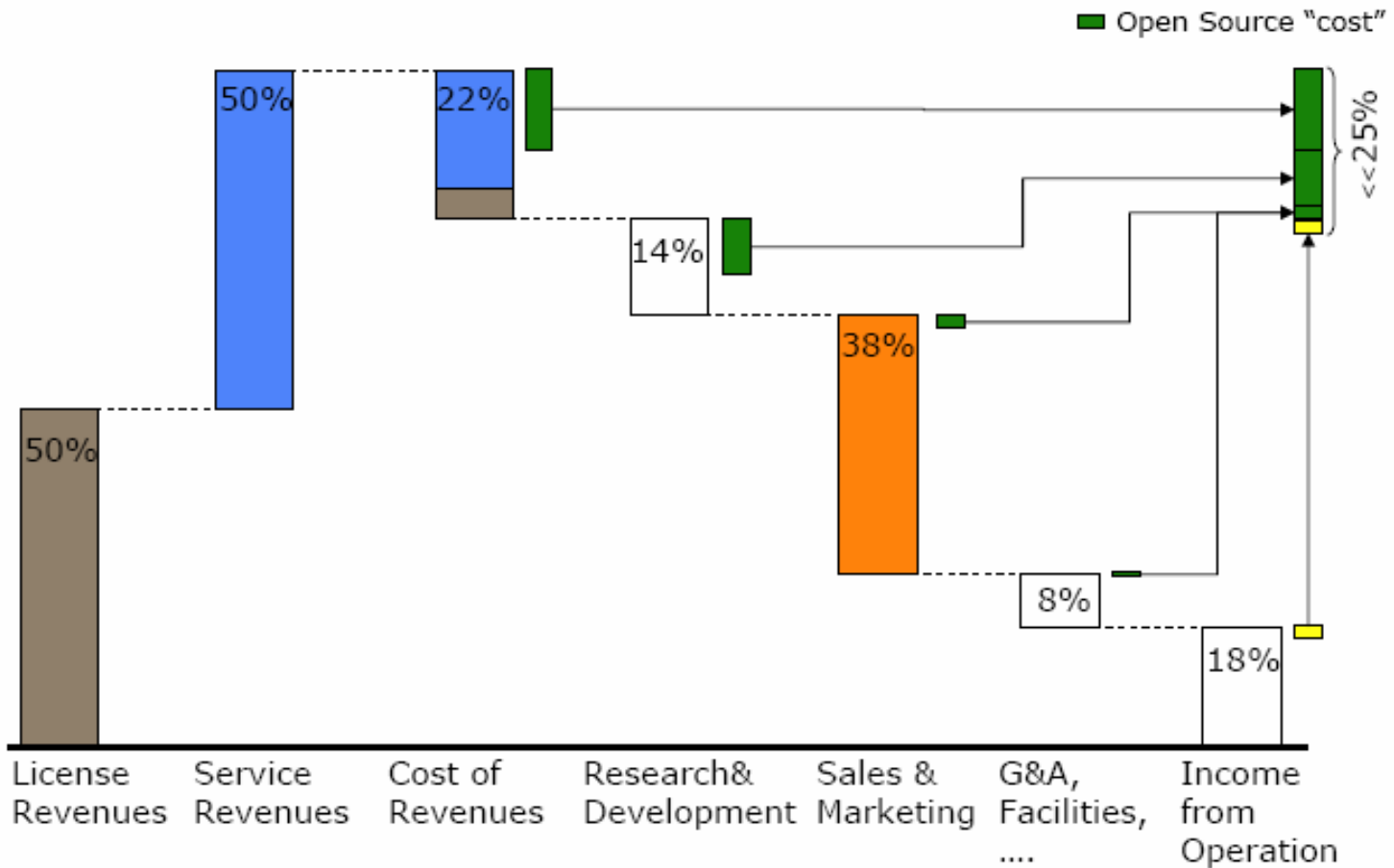
DLA Piper US LLP

- **Second Largest Law Firm in the World**
 - 3200 attorneys
 - 24 countries/63 cities
- **Strong Intellectual Property Practice (165 lawyers):**
 - 40 IP Transactional Lawyers
 - 45 Patent Prosecution Attorneys
 - 80 IP Litigation Attorneys
- **Strong Open Source Practice (5 partners):**
 - Assisted Sun with Open Solaris
 - GC of Open Source Initiative/Chair of Committee C for GPL Review
 - Represent many venture backed companies: SugarCRM, Zimbra, Cleversafe, rSmart, Socialtext, Hyperic
 - Represent many large companies: Sun, Zoran, Sony Electronics, Palm
- **Strong Mergers & Acquisition Practice (274 lawyers)**
 - 2006: 1st in US and Globally in completed M&A deals (mergermarket)

Advantages of Open Source

- **Leverage “community” contributions**
 - Red Hat estimates that it spends \$60M in R&D but gets the advantage of R&D in Linux worth \$1B
- **Swifter sales cycle: try before you buy**
- **Reduced distribution cost by avoiding large sales force**
- **Assistance in tracking and resolving errors**
 - With enough eyeballs, all bugs are shallow”
- **More immediate feedback on desired functions**
- **Branding advantage of being “open source”**

Economics of Software Business: Comparison (from Optaros)



Primary Revenue Source after Transition from Proprietary to Open Source (451 Group)

- **Commercial license**
- **Customization**
- **Support**
- **Proprietary add ons**
- **Consulting**
- **Transition Issues:**
 - Third party licenses
 - Unclear title to code
 - Open source code
 - Example: Solaris took three years to clean up

Due Diligence Factors

- **Nature of third party open source licenses for modules**
 - Copyleft: GPL, MPL, CDDL
 - Notice: Apache, BSD, MIT
- **Nature of interaction of modules: key to analysis of copyleft licenses**
 - GPL: Derivative work
 - MPL: File changes (with some ambiguity)
 - CDDL: File based
- **Notice license obligations**
- **Other third party licenses**
 - Proprietary or other commercial licenses may require deletion of code from the product
- **Downstream license which is consistent with upstream obligations**

Community

- **Critical to success**
 - Finding bugs
 - Contributing new code
 - Branding
- **OS Communities are interconnected and reputation is critical**
- **Need community manager**
- **Techwhale Example**
 - CRM product based on .NET released under February 2004 on open source basis
 - No community developed and has returned to a proprietary model

Open Source Business Models

- **OS business models continue to be works in progress**
- **Most common models**
 - Commercial (“Teaser”) model
 - Dual Licensing
 - Subscription
 - Value added services
 - Training
 - Hosting
 - System integration
- **Most companies use a combination of business models**

Commercial (Teaser) Business Model

- **Use “open source” software as a teaser for commercial version**
- **Difference between “teaser” and “dual licensing” is under debate;**
 - Some commentators describe SugarCRM as “teaser” but others view it as dual licensing
 - Commercial version with more functionality
- **Key OS License Choice: Drive enterprise users to commercial version**
 - GPL
 - MPL with attribution
- **Revenue sources**
 - Commercial license fees
 - Support for OS version
 - Customization for OS version
 - Training for OS version

Dual Licensing Business Model

- **Provide same product under open source license and commercial license**
 - MySQL
 - SugarCRM
- **Key OS License Choice: Drive enterprise users to commercial version**
 - GPL
 - MPL with attribution
- **Revenue sources**
 - Commercial license fees
 - Support for OS version
 - Customization for OS version
 - Training for OS version

Subscription Business Model

Provide a stack of multiple components; available for products which you do not control such as Linux (similar to system integrators)

- Red Hat
- SpikeSource
- Zimbra/SugarCRM
- **Provide supports and update**
- **Some companies use the model even though they control the software because of its attractiveness to users (SugarCRM)**
- **User advantage: low cost to client, no initial license fees**
- **Key OS License Choice: License of supported product**
- **Revenue sources**
 - Subscription fees (which include maintenance/support)
 - Different levels available
 - Customization
 - Certified binaries

Value Added Service Business Model

- **Provide services such as support, hosting and customization and use other revenue streams such as advertising**
 - SourceForge
 - Collabnet
- **Key OS License Choice: License of supported product**
- **Revenue sources**
 - Advertising
 - Hosting
 - Support/maintenance

Governance

- **Who manages the project (i.e. core contributors/board)**
- **Who decides which bug fixes/contributions are in the next draft**
- **What about core contributors who are not employed by the company**

Is OS Software a Commodity?

- **No switching costs**
- **Market prices are functions of changes in supply/demand**
- **Producers cannot effect demand, only supply**
- **Pricing moves quickly to find a point of supply/demand equilibrium**
- **Excess profits quickly disappear and profits revert to mean in the economy (8% in US economy)**
- **Lowest cost producer wins**
- **Brent Williams (analyst): No**

Best Practices for Transitioning Software to OS Business Models

- **Understand the business reason**
- **Ensure that the code is accessible**
- **Nurture the community**
- **Choose the appropriate license**
- **Establish policy for dealing with contributions**
- **Create a plan and work with customers and community**
- **Don't rely on community for major contributions**
- **Ensure that support is available and don't depend on the community**

General Public License: History

- **GPLv2: Developed in 1991**
- **Contains a great deal of political dialogue**
- **Scope of “based on” work**
 - Ambiguity of “derivative work”
 - Use of “collective work”
 - Linking issues
- **Disclaimer of all warranties**
- **Disclaimer of liability**
- **Patent license: uncertain**

General Public License: GPLv2

- **Never enforced in US court (two victories in Germany)**
- **Potential problems**
 - Scope of “based on” (definition of derivative work/collective work)
 - Many potential enforcers for some projects, like Linux
 - Ambiguity of treatment of patents
 - Lack of choice of law
 - Legal effect of FAQs
 - Automatic termination
 - No choice of law

GNU GPLv3

- **First Published in January 2006: Open Review Process**
 - First revision June 2006
 - Final draft version March 2007
 - Sixty day review period and thirty day final review period
- **Adoption not clear: Linux kernel developers rejected Draft 2 last fall**
- **Scope: Shift from derivative work to “modification”**
- **Modification to permit compatibility with certain other license**
 - Warranties
 - Trademark use/attribution
 - Prohibition of trademark use
- **Prohibition of use of GPLv3 licensed software for DRM**

GNU GPLv3

- **“ASP loophole” is not resolved; option to “link” with Affero license**
- **Assignment**
- **Termination**

M&A: New Issues

- **M&A Open Source Issues**

A few have been discussed publicly

- Cisco: Linksys
- - IBM: Think Dynamics (30% reduction in price)

Many more problems have occurred that have not been discussed

- **M&A Risks**

- Lose deal
- Delay deal
- Reduced price

Elements of an Open Source Strategy

- **Corporate strategy – Is open source an enabling technology or business model?**
 - Business model
 - Product strategy
 - Licensing model
 - Community strategy
 - Implementation/Go-to-market
- **Special considerations**
 - External
 - M&A
 - Partnering and channels
 - Internal
 - Research and development
 - Sales and marketing
 - Compliance

Reasons for an Open Source Policy

- **Role of a policy**
 - Manage risk
 - Ensure strategic flexibility
- **Unusual OSS risks**
 - Automatic termination of GPL
 - Uncertain scope of GPL
 - Broad scope of patent termination in MPL
 - Forking of code
- **Customers are demanding to know what is in your product**
- **Compliance important for financings/M&A**
- **IT staff turn over and difficulty of following up**
- **FSF undertakes 50 enforcement actions a year (Cisco: Linksys)**

Conclusions

- **Open source business models are under development**
- **Most companies use a mixture of models**
- **Proprietary companies may have no choice: they can't compete if a competitor adopts an open source strategy**