MOORE BLATCH

TECH UPDATE

Winter 2017

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NEW LIVE REPORTING OBLIGATIONS

BUSINESS OWNERS: ARE YOU AWARE?

On 26 June 2017 the Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017 came into force in the United Kingdom.

Companies House have stated that the purpose of this legislation is to increase the transparency surrounding who owns and controls companies in the UK. Business owners are advised to be aware of these changes. We also advise reviewing your Persons of Significant Control (PSC) Register to ensure it is up to date.

The previous position

Since 6 April 2016, UK companies have been obligated, through filing their annual confirmation statement (formerly 'annual return'), to disclose to Companies House who the persons of significant control are in respect of their business.

The new position

From 26 June 2017 businesses will no longer be able to choose to wait until their next confirmation statement to update Companies House. Under the new regulations, companies are obligated to update Companies House every time there is a change.

In practical terms, this means that every time your business participates in a transaction that, for example, impacts the percentage shareholdings in your business and affects the PSC position, it is now necessary to update the PSC register within 14 days of the triggering transaction. There will be another 14 days to send the information to Companies House using the relevant PSC forms.

What happens if I do not comply?

Failure to provide accurate information on the PSC register and failure to comply with notices requiring someone to provide information are criminal offences which may result in a fine and/or a prison sentence of up to two years.

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LARGEST DATA BREACH IN HISTORY

YAHOO FACES COURT ACTION FROM OVER HALF A BILLION USERS

The judgment in the Northern Californian court on 30 August 2017 was made in respect of three data breaches of Yahoo's data security system which resulted in millions of users' data being exposed to hackers.

Claimants can pursue breach of contract and unfair competition claims with the classes of claimants including a US citizen class, Israel citizen class, Australia, Venezuela & Spain citizens' class, and a Small Business Users class. Each of these classes consists of all Yahoo account holders whose data protection was breached.

Many of Yahoo's users suffered financial injury as they fell victim to identity and credit frauds, plus theft of funds. These attacks impacted Yahoo users across an international scale, as indicated by the global classes of claimants.

The breaches in data security occurred in 2013 and 2014, with a third attack in 2015/16. The breach in 2013 occurred when hackers gained access to more than one billion Yahoo accounts, resulting in the theft of sensitive personal information. This breach was not disclosed by Yahoo until December 2016.

In 2014 hackers gained access to approximately 500 million Yahoo user accounts, resulting in similar damage to users; this breach was not disclosed by Yahoo until September 2016.

The third data protection breach occurred across 2015 and 2016 when hackers imitated Yahoo's cookies, allowing hackers to access users' accounts without the need for a password and then maintain access to accounts over a long period of time.

Importantly, the Judge noted that Yahoo's delay in notifying users of the breaches prevented them from taking measures, such as changing their passwords, to protect their accounts.

The claimants allege that as a consequence they are now at risk of future identity theft, alongside the damage already experienced.

Yahoo has doubtless already suffered reputational damage regarding both its security levels and its openness with users. As the Judge has allowed the claims to progress, this is unlikely to be the only consequence they will face as claimants seek compensation for their loss.

This case will be interesting to follow as it may create a backdrop for litigation in other jurisdictions, such as the UK, as investigations into the data breaches have since confirmed that all three billion of Yahoo's users were in fact affected, in what has now been labelled the largest data breach in recorded history.

Had the General Data Protection Regulations (GDPR) already been in force, Yahoo would have violated serious obligations, including notification to customers of a data protection breach within 72 hours. Although the GDPR is not retrospective, it would have cost Yahoo 4% of its global group revenue or £20 million, whichever is greater, in respect of its users domiciled in Europe.

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£500M OF DEALS IN JUST 18 MONTHS

WITH AN NET PROMOTER SCORE OF 81

Moore Blatch has extensive experience in IT transactions and helping clients to achieve the best price.

At times you simply need a lot of legal input: recently we advised on the £57 million sale of Trustmarque Solutions Ltd to Capita. When we acquired Trustmarque we did so on just days' notice, having to put 20 lawyers on the Trustmarque deal for a week whilst at the same time maintaining one principle point of contact to ensure our client was never overloaded with correspondence from multiple sources.

In addition, we helped develop an employee share scheme to incentivise management in a very tax efficient manner for Adapt, ahead of their sale to Datapipe. A good management incentive scheme can mean that 2 + 2 can equal more than 4!

Preparation is everything. Putting in place proper documentation on customer contracts, as we did when we advised Blue Chip on their sale to GCI, enables businesses to maximise their sale price, but also simplifies the whole due diligence process.
We don't aim to be cheap, but we do pride ourselves on being incredibly good value for money, exemplified by the fact that our partner rates are little more than the charge out rate of newly appointed City trainees.

Most of the deals that we get involved with flow from relationships that go back between 5-20 years. For instance in relation to the acquisition of Phoenix, next year we celebrate 20 years of acting for Bytes.

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THE DIGITAL ECONOMY ACT

INTRODUCING THE “NEW CODE”

The 27th April 2017 brought the Digital Economy Act, a refreshed version of the previous Digital Economy Act of 2010. As well as updating sentencing for criminal copyright infringement, the most interesting aspect is the so called “New Code”, which replaces the existing electronic communications code found in both the Telecommunications Act 1984 and the Communications Act 2003.

The Electronic Communications Code (ECC) has not been brought up to date since its founding in 1984, with only minor alterations being made between then and now. However, the new act brings about necessary changes. In short, the new ECC makes the process of erecting mobile masts infinitely easier.

The “New Code” is as follows:

1. Landowners no longer need to seek to exclude telecoms leases from the security of tenure provisions of the Landlord and Tenant Act 1954

2. New leases for telecoms cannot limit rights of the operators to assign the lease in future or enforce any circumstances for such assignment to a different telecoms operator

3. Telecoms operators can now share the occupation of land with other telecoms operators at the same time – this could reduce landowner’s income from the leases in the future

4. Operators can now upgrade the relevant equipment providing it does not have “more than a minimal adverse impact” on the aesthetics of the equipment and the changes must also place no extra burden on the landowner

5. New telecoms leases will count as overriding interests, thus capable of binding successors in title, even where they are not registered

6. Where the landowner and operator cannot agree terms, the court now has the power to enact the new code onto the landowner. This occurs under two conditions; firstly, if the financial compensation is adequate to overcome any prejudice caused to the said landowner, and secondly where the public benefit to the new code would outweigh the prejudice to the landowner

7. When it comes to ending a lease granted with the new code the landowner must provide a minimum of 18 months notice to the operator. Additionally, the landowner must have fulfilled one of the following:

    - Breaches in obligations
    - Delays in rent payments
    - Redevelopment of the land

If any of the above are satisfied then termination under the new code is possible.

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DATABASE RIGHTS

TECHNOMED V BLUECREST HEALTH SCREENING

Databases can be protected by database right and/or copyright. A recent spat between the supplier of an internet-based electrocardiogram (ECG) reporting system known as the "ECG Cloud" has led to the conclusion that a simple PDF document relating to the ECG Cloud was protected by both database right and copyright.

Background

Technomed supplied Bluecrest Health Screening with a PDF relating to their ECG Cloud product which enabled ECG readings to be analysed remotely by a qualified specialist who could review patient data and select a classification from a range of options made available by the system.

The system produced an Extensible Mark-up Language (XML) file with a standardised XML format. The XML file was used to generate a report for the patient or specialist. The parties fell out commercially and Bluecrest obtained its heart screening services from a competitor of Technomed (Express), providing Express with a copy of the PDF and explanatory documents relating to ECG Cloud. Technomed claimed that its database right and copyright had been infringed.

Decision

1. The court decided that the static PDF document was protected by database right: it satisfied the definition of a database and that it was a collection of independent works arranged in a systematic way which could be accessed individually by electronic or more traditional means, which included reading. There had clearly been investment in the creation of the database which was essential for the database right to arise.

2. The court further held that the PDF document also enjoyed copyright protection as the selection and arrangement of information demonstrated sufficient intellectual creation by Technomed.

3. The court also decided that Technomed enjoyed copyright in the XML format used – copyright existed because the XML format contained content revealing the intellectual creation of its author and it was not just a pre-determined structure determined by the XML programming language.

Commentary

This decision is a reminder that there are important economic benefits if a party can show that it owns a database right and/or copyright in a database.

While most people link database right to large, complex electronic databases, the wide legal definition of database and the fact that access can be by traditional means (i.e. reading) means that lists and documents can enjoy this protection. Being low-tech is no bar to qualifying for the database right.

As a result of the relatively new database right, copyright protection for databases now requires a higher degree of originality than is normally the case for copyright protection: nonetheless, in this instance the court was convinced that the selection and arrangement of information displayed sufficient intellectual creation by Technomed and so qualified for copyright protection. Copying of the PDF by Express therefore amounted to infringement of database right and copyright.

It should also be noted that copyright existed in the considerable explanatory materials supplied by Technomed to Bluecrest Health Screening, and infringement (with a right to damages) occurred when they were copied by Express.

Finally, the ruling shows the potential for infringing another party's intellectual property (and so becoming liable to damages) when a business relationship breaks down with no ongoing contractual right to use the intellectual property – as far as possible, some form of licence/permission should be obtained from the IP owner, if only for a limited period.

- A simple list or document can enjoy database right and copyright protection
- Pre-condition for database right is showing that significant investment has taken place
- Copyright protection of a database does not automatically arise becuase it satisfies the database right
- Explanatory materials likely to have copyright protection too if they display some intellectual creation by the author
- Secure rights to continue to be able to use intellectual property rights if a supply agreement ends

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SPINNING OUT WITHOUT FALLING OVER

When a spin-out company is successful the results can be spectacular. In 2014 Zynga Inc acquired NaturalMotion, a leading games and technology company from Oxford University Innovation whose game titles include Dawn of Titans and CSR Racing, for more than US$527 million.

University spin-outs are growing with companies such as Applied Graphene Materials and PureLiFi hitting mainstream news. In the UK, spin-out programs are centered on university campuses and supported by two key government initiatives, the Enterprise Fund and University Challenge Scheme.

The UK has the highest number of spin-out support programmes in Europe, with the main players being Oxford and Cambridge University. As well as benefiting universities, businesses and investors, the success of spin-outs is making an impact on regional and economic development too. On the back of this success more and more universities and investors are looking into the possibility of spin-outs of their own.

Since 2000, Southampton University has spun out 27 companies and taken an equity position with 13. Four of their spin-outs have floated on London's Alternative Investment Market (AIM) with a combined market value of £180 million. However, as those in this industry know, the path to success can be hard work and fraught with pitfalls. As such, many potentially promising start-ups fail.

One of the main difficulties that many young start-ups can face is an unrealistic expectation as to the precise deal that is on offer. This is because the three main players within a spin-out - the university, the academic founders and the investors - invariably approach the commercial negotiations with different objectives and expectations.

Agreeing common objectives at the outset is crucial to help avoid serious problems down the line. Just as crucial is an understanding of the differing pressures and perspectives of each party.
Universities often find themselves having to balance conflicting objectives: on the one hand wanting to exploit the commercial opportunities their research offers, research that, in many cases, will have been publicly funded; whilst on the other maintaining their commitment to further research and education.

The marriage between business and academia is not always an easy one and can too easily break down. Finding the right match between investors and university is of paramount importance if a new spin-out company is to survive and thrive.

Universities, whose primary focus is teaching and the dissemination of ideas, might not always be in a position to grant the type of rights a company might want. Spin-outs are established to develop a new technique or technology. As such the IP involved is usually a patent, associated know-how and, in some cases, data (for example clinical trial information that is not publicly known).

Where the technology includes software then the IP may include copyright. Even if some of the technology is patented or the subject of patent applications, the spin-out company may still wish to keep much of the IP secret to both protect unpatented know-how and to reduce the risk of competitors stealing ideas before the product is launched. The founders and investors will, therefore, want robust confidentiality commitments from the university. However, a university may resist strong confidentiality obligations arguing that it needs the right to use the technology for teaching and research.

The academics find themselves with conflicting interests. There is often a divergence between the academic's need to publish, and the company's need to keep a patentable know-how secret in order to secure patent protection. A new product could take years to come to market during which time the academics may not want to be prevented from publishing research papers that relate to the new business.

There is also concern that the failure rate is too high to warrant a significant number of investments. "Historically, there has been criticism that strong university research in the UK has been very poor and very slow at getting to market," says Neil Crabb, chief executive of Frontier IP, the AIM-listed IP commercialisation company. The research suggests that a lack of entrepreneurial orientation by the researchers promoting and managing the spin-out companies is to blame.

The manner in which the IP is transferred to the new company can also be the subject of disagreement. The new company and its founders are likely to want either an outright assignment of the IP or an exclusive licence to use the IP. Both these options offer obvious attractions to potential investors and distributors, as well as potentially allowing the new company to charge higher prices for its product which can help recoup initial financial outlay. However, an assignment or exclusive licence can limit the university's ability to both carry out research on the technology and to share that technology. From the outset, the commercialisation needs to be handled in a way that manages these conflicting demands.

Despite leading with its spin-out programmes in Europe, the overall number of UK spin-outs remains low. The University of Oxford had the highest number, launching 62 in the past decade. This compares to 32 spin-outs from Stanford in California in 2016 alone. The problem, says Rich Ferrie, director of operations at the University of Manchester's intellectual property office, is "that investors in UK spin-outs tend to be risk-averse, which leads to a lack of funding".

Another challenge is faced when disagreements arise between the academic founders and the other owners of the business after the new business is set up; business owners are typically focused on getting the product to market as quickly as possible, whereas academics can be more focused on perfecting the product itself. Or, indeed, they may want to take the product in a different direction. Should this cause a split the investors and other business owners risk not only losing the academic founders who have the expert knowledge on which their spin-out company depends, but they also run the risk of the academic founders setting up a competing business.

For this reason investors will often secure a promise from academic founders that they will not compete with the spin-out company. Like so much concerning the setting up of a spin-out this is another area which has to be handled with care if it is not to become a major issue as the young business starts to progress.

A non-compete restriction which prevents academic founders from having competing interests can lead to some academics feeling that their academic freedoms are being curtailed. Moreover, the covenants do not only apply to founders whilst they are involved in the business, they often extend for months or even years after a founder leaves the business, preventing them from setting up or being involved in a competing business in that time.

The reason for this is that the founder's knowledge of the technology and the market and other skills developed through running the spin-out company puts them in a good position to compete with the spin-out company. Business owners need to tread carefully here; a non-compete restriction should only apply for a limited time and should be no wider than is necessary to protect the legitimate business interests of the spin-out. If it is too wide it will be an unlawful restraint of trade. Finding a balance that reflects the interests and ambitions of all parties is key.

Another common problem is the founders' lack of business expertise: last year The Enterprise Research Centre (EWC) reported that for 20% of spin-outs, the founders had no business expertise. As long as the right advice and guidance is on offer, this lack of experience should not become an issue. What, perhaps, is more worrisome was their finding that the average time commitment for founders was 20%."

As the EWC pointed out, it is impossible for a new venture to establish itself on the effort of one day per week. There is often an underestimation as to the amount of time and effort it takes to get a spin-out off the ground. Andrea Alunni, seed investment manager of Oxford University Innovation, freely admits that "the amount of work that goes into setting up a new company to flourish and succeed is enormous."

When it comes to the launch of any company, spin-out or not, everyone wants to do a good deal. Plainly, no one sets out on this challenging path wanting a bad deal in place, but the excitement and enthusiasm that often accompanies the launch of a new spin-out company can cause people to rush into something that, with considered thought, may be best not embarking on at all. Some seasoned investors have learned to fail well. "We fail early, fail cheaply and fail professionally" states IP Group plc's chief financial officer Greg Smith who in 2015 raised £128 million for its investments.

But with detailed and considered planning at the earliest stage with an understanding amongst all parties as to the deal that is on offer there is no reason why groundbreaking research cannot be transformed into a groundbreaking company with global appeal.

Action list:

- Agree long-term direction of the business
- Secure a transfer of intellectual property that suits the needs of the spin-out, investors and founder academics
- Obtain appropriate confidentiality commitments from the academic institution
- Secure appropriate non-compete covenants from the founders
- Ensure sufficient business expertise is available

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