BuchalterNemer
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Technology Industry Newsletter

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In This Issue

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From the Editor:

We hope you enjoy this edition of our Tech Newsletter. Please feel free to pass it along to anyone who you think may be interested in reading our collection of topical articles affecting technology companies today.

As technology continues to drive business innovation and growth, new and existing companies positioned to take advantage of the tech trends for 2016 will be better able to attract investors and customers, and to fuel tremendous growth. The proliferation of mobile devices, such as phones and wearables which include a varying amount of sensors, are part of an expanding computing environment that combines data streams and services. The large amounts of data coming from the Internet of Things (IoT), social media, and wearable devices creates opportunities for companies to develop analytical apps that deliver timely information to the end user. Big Data is becoming more connected through mobile devices and IoT sensors, and all that data creates opportunities for businesses to focus their marketing efforts to prospective customers, and develop in depth user profiles. New methods of reaching end user customers are growing to include the “endless payment” subscription model and the “pay-for-use” model. The subscription model creates a long term recurring revenue stream, and the customer gets access to the latest software, phones, hardware, etc. The pay-per-use model is expanding to such areas as services (Uber), people (movers), places (parking spots), and systems (cloud service). Smart machines with advanced algorithms combine advanced robots, virtual personal assistants and smart advisors to create a new age of machine assistants. Cloud and mobile computing are converging to allow customers to have coordinated access to any device, and organizations will need to apply more sophisticated risk assessment and mitigation tools, where every app will need to be self-protecting since firewalls are no longer effective.

All these trends create enormous business opportunities for new and existing businesses, and also present challenges. Technology companies must navigate the increasing legal and business complexities facing them today. Our Technology Industry Group is comprised of a dedicated team of attorneys with diverse backgrounds with many years of experience in all areas of the law which affect technology and emerging growth companies. We combine a client service team of talented professionals, with an understanding of a client’s business and markets, to provide efficient, effective and responsive services. Our attorneys think like entrepreneurs, with a practical, solutions-oriented approach. We offer a full range of legal services, including advice on structure and formation, angel, venture capital and private equity financing, private placements, corporate governance and control, distribution and licensing agreements, service agreements, joint venture arrangements, IPOs and recapitalizations, mergers and acquisitions, intellectual property (including patents, trademarks, and copyrights), insolvency and restructuring, labor and employment, social media (including regulatory issues), trade secret litigation, and eHealth advice and guidance.

We welcome you to reach out to our talented team of professionals should you have any questions or desire further input on any of topics covered in our Newsletter.

Vicki Dallas
Chair of the Technology Industry Group

Using the Internet to Raise Money: Securities Laws and Crowdfunding

Phil Schroeder

There are many services available to emerging companies to raise money through crowdfunding. As an entrepreneur or leader of a company evaluating these options, it is important to understand the basic legal foundations of these different options.

A significant dividing line between crowdfunding options is whether the person contributing money expects to participate in the profits of the business. If so and if the company is issuing an ownership interest to the investor in the business, the issuer must comply with both federal and state securities laws. This is sometimes referred to as the equity model of crowdfunding.

If the contributor has no expectation of earning a profit from its contribution, on the other hand, securities laws are not relevant. Two common forms of non-equity crowdfunding are the donation model and the rewards model.

The Donation Model
The donation model very simply involves a donation of funds to the company. The contributor does NOT receive any stock or ownership interest in the company or project, and by definition, there are no securities law issues with this type of fund raising.

The Rewards Model
The rewards model is very similar to the donation model except the contributor receives some token of appreciation. The rewards may vary depending on the amount of the donation and may or may not be related to the project that is being funded.

The donation and rewards models can be effective ways of raising money for projects that capture the interest of a broad audience, like creative projects involving music or movies, but it is less effective for ventures that do not have a compelling story to attract the interest of the crowd.

The Equity Model—Accredited Investor Model (Rule 506(c) Offering)
In the equity model of crowdfunding, investors will acquire an ownership interest in the company. Because the company is now issuing a security, it must comply with federal and state securities laws.

Prior to September 2013, companies that wanted to raise money in a typical private placement sale of securities were not permitted to conduct a general solicitation or advertise their offering on the Internet or elsewhere. In September 2013, however, the Securities and Exchange Commission relaxed the prohibition on general solicitations and adopted rules governing an equity model of crowdfunding.

This equity model of crowdfunding permits a company to advertise its offering as long as all of the investors are accredited investors and the company takes reasonable steps to verify that the investors are accredited investors.

The type of due diligence required to verify that an investor is an accredited investor may vary based on an objective determination by the issuer of the securities in the context of the particular facts and circumstances. The factors to be considered in this analysis are:

- the nature of the purchaser and the type of accredited investor that the purchaser claims to be;
- the amount and type of information that the issuer has about the purchaser; and
- the nature of the offering, such as the manner in which the purchaser was solicited to participate in the offering, and the terms of the offering, such as a minimum investment amount.

For example, if the terms of the offering require a very high minimum investment amount and a purchaser is able to meet those terms, then the likelihood of that purchaser satisfying the definition of accredited investor would be relatively high and it may be reasonable for the issuer to simply confirm that the purchaser's cash investment is not being financed by a third party to verify the purchaser's status as an accredited investor.

Generally, however, additional due diligence will be required and the SEC gave the following, non-exclusive, examples of the kinds of due diligence necessary:

- to verify that an individual meets the minimum annual income test, the issuer may review the investor's federal tax returns, Form W-2's, Form 1099's, or Schedule K-1's for the last two years, and
- to verify that an individual meets the minimum net worth test, the issuer may review the investor's credit report, bank statements, brokerage account statements, and appraisal reports issued by third parties, as applicable.

The Equity Model—Proposed New Rules
The SEC has proposed rules for a second form of equity crowdfunding. **As of the date of this publication, these rules are not yet finalized and you cannot raise money using this form of crowdfunding.**

Like the Accredited Investor model described above, the proposed rules permit a general solicitation of securities; however, the investors do NOT need to be accredited investors. Instead, the issuer must comply with certain other restrictions. Some of the more important restrictions are that:

1. The offering must be conducted online.
2. The company is limited to raising $1,000,000 in a 12-month period using this type of offering.
3. Even the most affluent investors would be limited to investing up to $100,000 in any 12-month period in these types of offerings, and the limits would be lower for investors with lower net worth or annual income.
4. Finally, the company will be required to file its offering documents with the SEC, and after the offering, the company will be required to file annual reports with the SEC.

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Are Big Changes on the Horizon for Trade Secrets Litigation?

Paul Fraidenburgh

Identical bills pending in the U.S. House and Senate are aimed at expanding and altering the substantive and procedural remedies available to businesses seeking to defend their valuable trade secrets through litigation. On July 29, 2015, bipartisan leaders in each house of Congress introduced proposed legislation titled the Defend Trade Secrets Act of 2015 (“DTSA”). If enacted into law, the DTSA would empower companies to protect their trade secrets in federal court by creating a federal private right of action for the misappropriation of a trade secret that is “related to a product or service used in, or intended for use in, interstate or foreign commerce.”

Under existing laws, trade secrets litigation is most frequently initiated in state court and prosecuted under a patchwork of state statutes, most of which mirror or closely track the Uniform Trade Secrets Act (“UTSA”). “Unfortunately, in today’s global information age, there are endless examples of how easy—and rewarding—it can be to steal trade secrets,” said Senator Orrin Hatch, R-Utah, a primary proponent of the new bill, in a statement. “Yet there are no federal remedies available to help victim companies recover from their losses. The Defend Trade Secrets Act of 2015 establishes a uniform standard for what constitutes trade secret theft and will give U.S. companies the ability to protect their trade secrets in federal court.”

In addition to opening the federal courts as a forum for businesses seeking to protect their trade secrets and recoup damages through litigation, the DTSA would also create a five year statute of limitations for bringing such claims (as opposed to the three year statute that currently exists in most states). In situations where injunctive relief is necessary to prevent an immediate and irreparable injury to the owner of the trade secret, the DTSA equips plaintiffs with a mechanism for pursuing an ex parte “seizure of property necessary to prevent the propagation or dissemination of the trade secret that is the subject of the action.” Unlike the UTSA, the DTSA would allow broader recovery for plaintiffs because it would not expressly preempt additional causes of action arising from the same set of facts as the misappropriation. Thus, the DTSA marks a significant expansion of remedies for employers suing employees or businesses suing competitors for trade secret misappropriation.

The identical DTSA bills have been referred to their respective judiciary committees and continue, for now, to receive bipartisan support in Congress.

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What Every Technology Company Needs to Know About Assumption, Assumption and Assignment, Or Rejection Of Its Contracts In Bankruptcy

Shawn Christianson, Valerie Bantner Peo and Ivo Keller

Technology companies can preserve both significant sums of money and valuable intellectual property rights if they take action when a customer or business partner files for bankruptcy protection. Far less effort is usually required to preserve these rights than what may be involved in a major piece of litigation; but, in almost every case, the company must take timely steps to ensure that its interests are protected. The following is the second part of a brief, three-part overview of the measures that technology companies can take, and the procedures they should be aware of, to protect their rights in this area of law. Part One, published in Buchalter Nemer’s Tech Industry Bulletin for March and April 2015, discussed claims which creditors can assert against the estate of a bankrupt customer or business partner. This section will focus on the effects of the decision by the company in bankruptcy to assume, assume and assign, or reject intellectual property contracts in the bankruptcy process.

The most valuable asset a technology company holds is often its intellectual property (“IP”), which the Bankruptcy Code defines to include patents, copyrights, and trade secrets. Frequently, technology companies enter into contracts related to their IP, such as licenses or subscription services. These contracts often are entitled to special status in a bankruptcy case.

The Bankruptcy Code requires the bankrupt company to elect either to retain its rights, and be bound by the terms of the contract going forward (i.e., “assume” the contract), or to disclaim any interest in (i.e., “reject”) the contract. The bankrupt company may also attempt to assign its IP contracts to a third party (i.e., “assume and assign” the contract), for example, as part of a larger sale of most or all of the bankrupt company’s assets.

In order to assume, or assume and assign, a contract, the company in bankruptcy generally must pay all outstanding amounts owed under the contract. In other words, even though other creditors may only be paid a fraction of their claims against the bankrupt company, a creditor whose contract is assumed must be paid sums equal to the “cure” of any existing defaults under the contract. Often this results in payment in full. However, it is imperative that the company whose contract will be assumed press its claim for the cure payment. Failure to

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object to an incorrect payment amount before the bankruptcy court approves the amount typically will result in waiver of any right to seek full payment later.

On the other hand, if the bankrupt customer or business partner chooses to reject the contract, the technology company has a right to file a claim for the losses that it may suffer as a result of its contract being rejected. If no one objects, or if any objections are overcome, such claims will be paid pro-rata with other general creditors of the bankrupt company. Savvy technology companies should recognize that rejection is treated as a breach of the contract, and should assert a claim for all damages that arise out of the breach, in addition to unpaid invoices.

Thus, whether a company's IP contract is assumed, assumed and assigned, or rejected, it is crucial for the technology company to act quickly to assert its rights, protect its IP, and preserve its right to receive payment.

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Service, Vendor and Enterprise Agreements

Manny Fishman

Start ups want everything to go quickly, and the agreement that everyone seems to focus on to provide or obtain a service to and from another start up is the service agreement. Sometimes the agreement is referred to as a vendor agreement or an enterprise agreement or a scope of work. Whatever the term used, the agreement accomplishes two main purposes: what is the scope of services being provided to a third party and the pricing governing the services, and what are the terms and conditions that govern the services being provided.

While this sounds simple, the agreement usually turns into a battle of forms.
Let's start out with the basics. You need an "exhibit" that describes the actual services or deliverables being provided, the pricing for the service, and any "SLA" (service level agreement) that applies. The Exhibit can be written in simple English: "company will provide 'x' number of widgets to Client each 24 hours and each widget will be delivered within 15 minutes of the scheduled time." You can be specific or vague as to what the "widget" is. Identify your price and identify when you expect payment (net 5 business days, net 15 business days. Money to be paid by PayPal, check, wire transfer, etc.) You need to come up with a solid exhibit.

Now that you have done that, you need to spend an hour or two with a lawyer and role play what general terms are a "must have" for your company. The terms and conditions are all legal terms that protect one party or the other. For example, are there representations and warranties that govern your service or product, or is the service or product being provided with no warranties? If you are on the receiving end of the services, do you require certain representations and warranties from the other party? What insurance do you have and what insurance do you require that your counterparty has? Is there intellectual property involved such that a separate software agreement is required or not? What is the term of the agreement—can either party terminate at any time or is there a fixed period following notice that is needed? One of the important provisions is whether you place a maximum amount on your liability in the event of a breach of the contract. It is not uncommon to see a limit that does not exceed the value of the services being provided or waiver of special or what lawyers refer to as "consequential" damages. What insurance do you carry and what insurance do you require your counterparty to carry? Finally, you should consider whether you or your counterparty is the exclusive provider of the services under the agreement.

Finally, there are several "miscellaneous" provisions that need to be in any contract to make it enforceable, and a service agreement needs to have those as well.

The bottom line is that the business terms of a well drafted vendor or service agreement can be stated in 2 pages, one of which is to describe the services to be provided and payment structure and a second page to put names and contact information of business people involved, payment and notice addresses, effective date and term of the contract. The General Terms and Conditions can be attached and may run anywhere from 3 to 5 pages in small type. Going through the process of identifying key Terms and Conditions for your company is the value that is created in developing this agreement. You will likely use it often to start any business relationship and it will help you negotiate deviations from the base agreement.

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New FTC Guidelines for Promoting Products on Social Media

Philip Nulud

Social media can be used in a multitude of ways for savvy brands to promote their products. They can loan out a new phone, provide free access to an app, provide free products, etc., in exchange for publicity on social media. While social media has its own methods of operation, the Federal Trade Commission (FTC) guidelines must be taken into account when handling these promotions.

Under Section 5 of the FTC Act, 15 U.S.C. § 45, the FTC is given the power to direct persons and companies away from using unfair methods of competition in or affecting commerce, and unfair or deceptive acts or practices in affecting commerce. This encompasses advertising and social media.

One of the FTC's main concerns is that consumers may be misguided into believing that an endorsement is the honest opinion of an endorser when in actuality, there is a relationship between an endorser and a company and/or marketing firm that is employed by the company. If a relationship exists or an agreement has been made, the FTC requires that the endorser disclose this information.

It is common practice for companies or advertisers to loan or provide products, services or discounts to individuals who have a broad reach online. For example, a popular electronics reviewer with a blog with hundreds of thousands of followers are often given free products or are loaned the latest products in exchange for posting reviews, videos, pictures of the product or even pictures of themselves using the product on their accounts. The FTC is concerned that consumers will be deceived by these such posts.

As a result, the FTC has released guidelines that advise the endorsers, marketers and companies that they must disclose a relationship if the relationship is not apparent to consumers. (https://www.ftc.gov/tips-advice/business-center/guidance/ftcs-endorsement-guides-what-people-are-asking#contests) Thus, if a blogger is writing a review, they must disclose whether the product was provided to them by a certain manufacturer or at least disclose their relationship (i.e. if they're sponsored or employed by the manufacturer).

In some forms of social media such as Twitter, Pinterest and Instagram, there is a limited amount of space in which one can post something, which makes disclosing this information more difficult. Further, the FTC has not mandated the specific wording of disclosures. However, it advises that inserting short statements such as "#sponsored", "#promotion", "paid ad" or even "ad," may be enough to disclose a connection between the endorser and company.

Many bloggers and social media users feel that having such tags or wording would make their social media accounts feel non-organic or worse, they would be labeled a "sell-out." While the FTC may choose who they would like to pursue, the guidelines still apply to bloggers and social media users. As a practical matter, the FTC has indicated that their enforcement efforts will focus on the companies and/or marketers whose products are the subject of the blogs.

Thus, while it certainly takes away from their organic publicity, companies should make an effort to advise the bloggers, reviewers and other social media that they must disclose their relationship or if they received a particular item from the company or its marketing firm. Particular hash-tags such as "#sponsored" can be used, or even perhaps much more obvious hash-tags such as "ProvidedToMeBy[insertcompanyname]forfree". Recently, some reviewers have begun to use the term "(Sponsored) on the titles of their respective videos on YouTube. Companies and marketers know that they cannot control what is said on social media and that their endorsers may not follow these guidelines, but they must be mindful of these FTC guidelines in order to prevent being subject to an enforcement action by the FTC. The FTC advises that companies educate and instruct endorsers of such guidelines, make periodic attempts to search for what is said and if there is a problem, follow-up on it. Thus, at a minimum, companies should make a concerted effort to expressly communicate to endorsers that they must adequately disclose the relationship to consumers. The companies should then monitor the posts. Further, if the company re-tweets, re-grams, or re-pins an endorsed post, they need to also disclose the relationship.

Thus, companies and marketers should take note of the FTC's guidelines and integrate them into their marketing plans and make the appropriate disclosures.

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State Law Obstacles to the National Distribution of eHealth Medical Devices Directly to Consumers

Kitty Juniper

The latest and greatest eHealth medical devices directed to consumers are technologically advanced and consumer-friendly. They have the capacity to diagnose certain health conditions and generate treatment plans and prescriptions—without licensed health care practitioners. State professional practice laws often require that licensed practitioners be involved with the consumer's use of these sophisticated devices. These laws vary by state and product category, making it difficult for companies to use one national business model. Prior to entering the market, companies with these device types are advised to develop strategic regulatory plans, business models and government relations strategies, based on their assessment of state professional practice and telehealth laws.

eHealth Medical Devices

Using eHealth medical devices, consumers can receive care at their convenience and in their location of choice, by using devices and Internet software that collects and transmits data to the device company or its designee. For instance, Opternative, Inc. offers an online refractive eye exam (as compared to a comprehensive, ocular health exam) in 27 states. A consumer between the ages of 18 and 40 who meets specified health conditions and has a computer and a smart phone can purchase the refractive exam and receive a digital eyeglass prescription for $40 and a contact lens prescription for $20 more. Licensed practitioners review the collected data and approve the prescriptions before electronically transmitting them to patients as state laws require. The company's website states that its clinical study shows that the online refractive exam was statistically equivalent to a refractive exam in a licensed practitioner's office. Licensed practitioners are not convinced, however. In Michigan, they convinced legislators to ban the use of automated eye exams.

The nature and extent of a licensed practitioner's involvement with an eHealth medical device will depend on the device's capabilities and each state's professional practice and telehealth laws.

State Professional Practice Laws

Violations of state professional practice laws may be classified as misdemeanors. These laws require that persons who perform or offer to perform certain medical tests, make diagnoses and provide treatment, including prescriptions for ancillary products, have appropriate state professional licenses. Device companies that advertise and sell consumers devices that perform any one of those acts and that are not used by or under the supervision of licensed practitioners, may be illegally engaged in the professional practice related to the device. Likewise, unlicensed persons affiliated with the device company who help consumers perform tests using the device may violate the professional laws or aid and abet others who do so.

Corporate practice of medicine laws may restrict how companies structure their business relationships with licensed practitioners. Where these laws exist, they govern whether the company can employ or contract with licensed practitioners.

EHealth device companies need to determine the applicability of each state's professional practice laws to their devices prior to developing their business models and marketing plans. Depending on the device, there are various models that companies can consider, including telehealth, brick and mortar clinics with management services arrangements and franchise approaches.

Telehealth Laws

Medical device companies can use telehealth approaches to involve licensed practitioners in the delivery of care with their devices. Using the device-generated data, licensed practitioners located remotely may be able to make patient diagnoses and sign prescriptions, in compliance with state law.

State telehealth laws vary with regard to licensure, informed consent, commercial reimbursement parity, the establishment of a physician-patient relationship and location restrictions, among other things. Licensure laws that require remote practitioners to be licensed in the state where the patient is located, create barriers to efficient national telehealth models.

Two bills pending in Congress seek to eliminate licensing restrictions with regard to Medicare and Department of Veteran's Affairs health professionals. The TELE-MED Act (H.R. 3018 and S. 1778) and the Veterans E-Health & Telemedicine Support Act or VETS Act call for providers delivering those services to be licensed in only one-state. If these laws pass, they may encourage states to enact laws that provide for reciprocity in licensure for other services that are not reimbursed by a government program.

Compliance with Marketing and Advertising Laws

Companies marketing eHealth devices that could infringe upon a practitioner's scope of practice should proceed cautiously when entering new markets. Professional competitive dynamics can easily lead to legal and political challenges to consumers' use of the devices without the involvement of licensed professionals. Device companies should be diligent in ensuring that all marketing and advertising claims are accurate and properly substantiated; any device limitations, e.g., user restrictions, should be adequately and conspicuously disclosed. Strict compliance in these areas may help to alleviate health and safety challenges from practitioners and regulatory boards to the business model used.

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About Buchalter Nemer

Buchalter Nemer is a full-service business law firm that has been teaming with clients for over six decades, providing legal counsel at all stages of their growth and evolution, and helping them meet the many legal challenges and decisions they face.

The firm is consistently ranked among the leading law firms in California by Chambers and Partners, Best Lawyers, The Daily Journal and the Los Angeles Business Journal. It is also ranked among the leading firms nationally by American Legal Media and the National Law Journal.

Buchalter Nemer represents technology companies at all stages of development, from entrepreneurs to public corporations, as well as the industry's leading investors. We provide a full range of legal services, including: advanced technologies, intellectual property, mergers & acquisitions, corporate governance, start-ups, emerging companies and venture capital, private equity, labor & employment, domestic & international tax.

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