

Acquisition of a small software company in Singapore

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I. INTRODUCTION

1. Recently, the Grim Reaper visited Singapore's manufacturing industry in the form of COVID-19. Many would agree that it was a bloodbath for small and medium sized enterprises ("SMEs") that manufacture specialised parts.¹ Their Achilles' heel proved to be the disruption in global supply chains,² and the lack of a stable workforce in the fight against the pandemic. In their struggle for survival, some SMEs chose to retrench its workers. However, the more forward-thinking ones have invested in technology that increases their long-term productivity and growth potential.³ One way that an SME can invest in technology is through an acquisition of a software start-up that has great synergies with its businesses.
2. This article hopes to help Singaporean SMEs in their digitalisation efforts by sharing some legal and practical insights on the process of acquiring a software start-up ("**Target**").

II. DISCUSSION

3. We will first provide a brief overview of the acquisition process, before focusing on a few legal and practical considerations in the acquisition process and certain provisions

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¹ See Prakash Sakpal, 'Singapore's manufacturing begins to bear the Covid-19 brunt', *ING* (26 June 2020) <<https://think.ing.com/snaps/singapores-manufacturing-begins-to-bear-covid-19-brunt>> (accessed 19 September 2021).

² Choo Yun Ting, 'Singapore factory activity records slower expansion amid Covid-19 supply chain disruption concerns', *The Straits Times* (2 September 2021) <<https://www.straitstimes.com/business/economy/spore-factory-activity-records-slower-expansion-amid-covid-19-supply-chain>> (accessed 19 September 2021).

³ Sue-Ann Tan, 'More manufacturers transform themselves digitally amid pandemic', *The Straits Times* (18 October 2020) <<https://www.straitstimes.com/business/economy/more-manufacturers-transform-themselves-digitally-amid-pandemic>> (accessed 19 September 2021).

that can be included in the sale and purchase agreement (“SPA”) to protect the buyer of the Target (“Buyer”).

A. The Acquisition Process

4. The acquisition process consists of three stages:
 - (a) initial negotiations;
 - (b) due diligence; and
 - (c) completion.⁴

5. At the initial negotiations stage, the Buyer, the Target, and the seller of the Target (“Seller”) would generally enter into a non-binding preliminary arrangement, which will set out the parties’ understanding and the principal terms of the transaction.⁵

6. Next, the Buyer will perform due diligence on the Target. Due diligence is the process by which the Buyer conducts a detailed inquiry into the affairs of the Target before it decides whether to proceed with the acquisition.⁶ It helps the Buyer to obtain sufficient information on the conduct and affairs of the Target and determine the acquisition price.

7. Following the due diligence, the SPA will be drafted, negotiated, and executed if all goes well.⁷ The Buyer will then proceed to pay the consideration to the Seller⁸ while the Seller must transfer its shares in the Target over to the Buyer.

⁴ Wan Wai Yee, ‘Mergers and Acquisitions’ in Michael Hor, Tang Hang Wu and Nicholas Poon (eds), *Reading Law in Singapore, Second Edition* (LexisNexis, 2016), at pp 68-70. Available at https://ink.library.smu.edu.sg/cgi/viewcontent.cgi?article=3254&context=sol_research (accessed on 19 September 2021) (“Wan Wai Yee”).

⁵ Andrew Ang, Ong Sin Wei and James Choo, ‘Singapore’ in Will Pearce and Louis L Goldberg (eds), *Private M&A 2021* (Law Business Research, 2021). Available at https://www.wongpartnership.com/upload/medias/KnowledgeInsight/document/14293/2021_PrivateMergersandAcquisitions_Singapore.PDF (accessed on 19 September 2021) (“WongP 2021”).

⁶ Umakanth Varottil, “Due Diligence in Share Acquisitions: Navigating The Insider Trading Regime,” NUS Law Working Paper 2016/004, April 2016, <https://law.nus.edu.sg/wp-content/uploads/2020/04/004_2016_Umakanth.pdf> (accessed 19 September 2021).

⁷ WongP 2021, *supra* n 5, at p 257.

⁸ Wan Wai Yee, *supra* n 4, at p 70.

B. Legal and Practical Considerations in the Acquisition Process

8. Throughout all three stages, the Buyer should keep in mind many legal and practical considerations. Here, the writer shares three important considerations when acquiring a software start-up. These are intellectual property (“**IP**”) rights, contracts with customers and contracts with employees.

(1) IP rights

9. When acquiring a software company, it is crucial for the Buyer to ascertain if the Target owns the software and the related IP rights. To this end, the Buyer can obtain the details of registered IPs from the Intellectual Property Office of Singapore’s online portal.⁹

10. In the same vein, if the Target incorporates third party software, it is important to find out whether the Seller’s rights under such licences can be transferred to the Buyer upon the acquisition.¹⁰ If such licences could not be transferred, any additional costs incurred could be used to negotiate for a lower price for the Target.

11. Additionally, the Buyer should check if the Target has incorporated any open-source software (“**OSS**”) into its products.¹¹ OSS refers to software with source code that anyone can inspect, modify, and enhance.¹² Licences to use OSS sometimes may require licence recipients who develop proprietary software products on top of the OSS to make their proprietary software available to the public. This may potentially erode the Buyer’s competitive advantage in its acquisition. Buyers who discover such a

⁹ Andrew Ang, James Choo and Ong Sin Wei, ‘Q&A: due diligence for private M&A transactions in Singapore’ (Lexology, 2 October 2020) <<https://www.lexology.com/library/detail.aspx?g=674324c8-6e68-4696-aaec-9aca780ff84b>> (accessed 19 September 2021).

¹⁰ Brent Vegliacich, ‘Intellectual Property Due Diligence in Tech M&A Transactions’ (Selborne Legal Consulting, 2 June 2021) <<https://www.selborneconsulting.com/post/what-acquisition-attorneys-should-know-about-intellectual-property-due-diligence-in-tech-m-a-transactions>> (accessed 19 September 2021).

¹¹ Michael Cavaretta, ‘Open Source Issues in Mergers & Acquisitions’ (Morse Law, 6 January 2015) <<https://www.morse.law/news/open-source-issues>> (accessed on 19 September 2021).

¹² Opensource, ‘What is open source’ (Opensource) <<https://opensource.com/resources/what-open-source>> (accessed on 19 September 2021).

problem may try to detach the proprietary software from the OSS. If not, the Buyer must reconsider if the deal still makes commercial sense.

(2) *Contracts with customers*

12. If the Buyer intends to continue the Target's business post-acquisition, it is important to check if the Target's agreements with existing customers contain any Change of Control ("CoC") provisions. An example of a CoC provision will be a clause stating that "if a third party becomes the owner of more than 50% of the total fair value or total voting power of the Company, [an event happens]."¹³
13. Under such provisions, the customer can choose to terminate the contract following the sale of the Target.¹⁴ This can affect the valuation of the Target, especially if the Buyer values the Target by discounting its future cashflows from existing and future customer contracts. Where any CoC provisions exist, the Buyer should thus first try to obtain consent from the respective customers to the change in ownership.¹⁵

(3) *Contracts with employees*

14. Great software is often the product of talented employees. During the acquisition process, the Buyer should identify the employees responsible for the Target's success and convince them to stay. This can be done through a retention agreement with such employees.¹⁶

¹³ See Helen Middleton, 'Change of Control?' (Sidley Austin, July 2020)

<<https://www.sidley.com/en/insights/publications/2020/07/change-of-control>> (accessed 19 September 2021).

¹⁴ Fox Williams, 'Change of Control Provisions' (Fox Williams, 5 Jan 2016)

<<https://www.foxwilliams.com/2016/01/05/change-of-control-provisions/>> (accessed on 19 September 2021) ("Fox Williams").

¹⁵ Fox Williams, *supra* n 14.

¹⁶ Porter Wright, 'Retaining key employees in an acquisition' (Federal Securities Law Source, 8 August 2017)

<<https://www.fedseclaw.com/2017/08/articles/general-business-news/retaining-key-employees-in-an-acquisition/#page=1>> (accessed on 19 September 2021).

15. On the other hand, if the Buyer wants to get rid of certain employees upon acquisition of the Target, it is important to scrutinise the Target’s employment agreements. In some cases, the executives may have a clause in their employment agreements to protect them;¹⁷ for example, if a CoC results in them being fired, the clause will ensure that they receive a significant pay-out.¹⁸ In this situation, the Buyer could use this opportunity to negotiate for a lower purchase price of the Target.

C. Provisions to Protect the Buyer

16. After conducting due diligence, the Buyer should negotiate to include conditions precedent (“**CP**”), representations and warranties (“**R&W**”), and indemnity clauses in the SPA to protect itself.

(1) CP

17. During the acquisition process, the Buyer may find that there are issues with the Target. For example, the Buyer may want the Target to resolve certain employee disputes¹⁹ or acquire certain software licences before completing the acquisition. However, these issues can only be resolved after the transaction period. In this case, the Buyer can include CP clauses in the SPA. These clauses require certain conditions or events to occur before completion of the transaction.²⁰ Importantly, they allow the Buyer to

¹⁷ Corporate Institute of Finance, ‘Change of Control’ (CFI) <<https://corporatefinanceinstitute.com/resources/knowledge/deals/change-of-control/>> (accessed on 19 September 2021).

¹⁸ *Ibid.*

¹⁹ Mayor Brown, ‘Brief Guide to M&A in Southeast Asia’ (Mayer Brown) <https://www.mayerbrown.com/-/media/files/perspectives-events/publications/2018/05/brief-guide-to-ma-in-southeast-asia/files/brief_guide_to_ma_in_se_asia/fileattachment/brief_guide_to_ma_in_se_asia.pdf> (accessed 19 September 2021).

²⁰ *Halsbury’s Laws of Singapore* vol 7 (LexisNexis Singapore) at para 80.473 (“*Halsbury’s*”). See also Weightman, ‘Legal Analysis: Why it’s important to get condition precedents right’ (Weightmans, 7 January 2019) <<https://www.weightmans.com/insights/legal-analysis-why-its-important-to-get-conditions-precedent-right/>> (accessed 19 September 2021).

withdraw from the acquisition when the required conditions are not fulfilled²¹ while retaining a degree of certainty that the transaction will go through.

18. To add CP clauses in the SPA, the Buyer can stipulate that “completion shall be subject to and conditional upon the satisfaction of the following conditions”, along with a list of the conditions that the Buyer requires.

(2) *R&W*

19. In the acquisition, the Buyer relies on information provided by the Seller, as the Buyer may not have access to or may find it too expensive to obtain intricate details of the Target. As such, it may be possible that the Buyer’s information on the Target is inaccurate or false. This misinformation may have a direct impact on the valuation of the Target or may even result in the acquisition being undesirable. Therefore, it is important for the Buyer to receive assurances regarding the situation of the Target by including R&W clauses in the SPA.²² If these assurances are breached, the Buyer could claim for damages against the Seller or may even rescind the contract.²³

20. To include R&W clauses in the SPA, the Buyer can stipulate that “the Seller and the Target hereby, warrants and represents to the Purchaser in the following terms”, with a list of assurances that the Buyer requires. The assurances can include:

- (a) clean title to shares;
- (b) valid ownership and no infringement of IP rights;
- (c) no undisclosed licensing of the Target’s IP;
- (d) compliance with data protection laws; and

²¹ Tom Swinnen, ‘Conditions Precedent: Necessary Deal Breakers’ (EY Law)

<<https://www.eylaw.be/2019/09/12/conditions-precedent-necessary-deal-breakers/>> (accessed 19 September 2021).

²² Hans-Ulrich Theobald, ‘M&A Vocabulary – Explained by the experts: Reps & Warranties’ (Rödl & Partner) <<https://www.roedl.com/insights/ma-dialog/2019-08/vocabulary-reps-warranties>> (accessed on 19 September 2021).

²³ Practical Law, ‘Glossary: Representations and Warranties’ (Thomson Reuters)

<[https://uk.practicallaw.thomsonreuters.com/8-382-3760?transitionType=Default&contextData=\(sc.Default\)>](https://uk.practicallaw.thomsonreuters.com/8-382-3760?transitionType=Default&contextData=(sc.Default)>) (accessed 19 September 2021).

(e) no on-going litigation.²⁴

(3) *Indemnities*

21. To allocate risks in the acquisition process, parties often include indemnity clauses in the SPA. An indemnity is an undertaking that one party (e.g., the Seller) must pay in specific circumstances,²⁵ for example when the Seller breaches the R&W clause. This allows all parties to be clear on who should bear the burden of loss in those situations. This reduces the likelihood of future disputes if the Buyer suffers a loss following the acquisition.
22. Using the same example of the R&W clause, the Buyer could specify the amount of damages to be paid by the Seller if the Seller makes a misrepresentation or breaches a warranty. This could be done by stipulating in the SPA that “the Seller agrees to pay to the Buyer [\$1,000,000] which the Buyer may pay or have to pay as a result of [the Seller breaching a warranty clause]”.
23. However, the specified amount of damages must be a “genuine pre-estimate of the loss that the innocent party would suffer pursuant to the breach”.²⁶ Otherwise, the Singapore courts may find the indemnity clause to be unenforceable.²⁷

III. CONCLUSION

24. Acquisitions are always exciting, as they represent the expansion of the Buyer’s business. When performing due diligence during the acquisition process, the Buyer should scrutinise the IP rights of the Target, the contracts with the Target’s customers

²⁴ Stephanie Keen, Adrian Chan and Matthew Bousfield, ‘Private mergers and acquisitions in Singapore: overview’ (Thomson Reuters, 1 Feb 2020) <[https://uk.practicallaw.thomsonreuters.com/9-543-1146?transitionType=Default&contextData=\(sc.Default\)&firstPage=true#co_anchor_a293471](https://uk.practicallaw.thomsonreuters.com/9-543-1146?transitionType=Default&contextData=(sc.Default)&firstPage=true#co_anchor_a293471)> (accessed on 19 September 2021).

²⁵ Practical Law, ‘Glossary: Indemnity’ (Thomson Reuters) < [https://uk.practicallaw.thomsonreuters.com/5-107-6256?transitionType=Default&contextData=\(sc.Default\)&firstPage=true](https://uk.practicallaw.thomsonreuters.com/5-107-6256?transitionType=Default&contextData=(sc.Default)&firstPage=true)> (accessed on 19 September 2021).

²⁶ *Denka Advantech Pte Ltd and another v Seraya Energy Pte Ltd and another and other appeals* [2021] 1 SLR 63, at [153].

²⁷ *Ibid.*

and its employment agreements. If the Buyer uncovers any issues during the due diligence process, the Buyer should protect itself by using CP, R&W, and indemnity clauses in the SPA. More importantly, SME owners considering buying a software start-up should always seek legal advice to ensure their business interests are well protected.