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TECHNOLOGY LICENCES IN THE EVENT OF BANKRUPTCY

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The owner of a technology protected by an intellectual property right (copyright or patent) or protected by secret (trade secret) may grant a licence to a licensee. A licence does not transfer the ownership of the technology, but rather authorizes the licensee to use it while preventing the owner from enforcing his ownership rights to impede the licensee's use thereof. In this way, the supplier/licensor retains all the ownership rights to his technology while granting rights of use to the licensee for a consideration. However, the terms of this contractual relationship, which benefits both parties to the transaction, should be carefully considered by the future licensee. In particular, he should consider the scope of the stipulations that should be included in the licence agreement to ensure that he is afforded all necessary protection in the event of the licensor's bankruptcy, and that such bankruptcy does not compromise his right to the use of the technology.

In this respect, the fate of licences in the event of the licensor's bankruptcy has become less of a cause for concern for licensees since the coming into force of certain amendments to the *Bankruptcy and Insolvency Act* (the "BIA") on September 18, 2009.

Now, as before the amendments, a licensor who experiences financial difficulties retains the right to terminate the licence agreement. However, a new protection has been given to the licensee: the right to continue to use the intellectual property rights granted under the terminated licence, and to enforce his right to its exclusive use, subject, however, to his compliance with the terms of use in the licence agreement. The time period covered by the new protection includes any extension allowed under the agreement.

However, some deficiencies remain in the legislation so that the licensee is still not afforded complete protection in the insolvency of the licensor:

- The scope of the protection is uncertain due to the lack of definitions for some of the expressions used in the BIA ("use" and even "intellectual property");
- The protection is restricted to specific contexts: reorganization by way of a proposal or the filing of a notice of intention, and not in the case of the licensor's bankruptcy;

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- No protection is afforded to the licensee to ensure the licensor complies with other ancillary obligations (for instance, the contractual obligation to provide software maintenance). However, the licensee is still required to comply with his own obligations in order to preserve his right of use. Since the fees for such services are not always distinguishable from other fees payable under the agreement, such as the royalties themselves, a licensee who wants to preserve his right of use may have no option but to continue paying for services which are no longer provided to him;
- The new protection is subject to the transfer of the insolvent licensor's assets to a third party in the context of the licensor's reorganization. In such a case, the licensee's full right of use may be lost.

In order to protect his rights to the maximum possible extent, an informed technology licensee should:

- Try to obtain a security interest in, or even ownership rights to, the intellectual property and not only rights of use under a licence agreement;
- Ensure that the agreement does not provide for the automatic termination of the licence in the event of financial difficulties or the bankruptcy of the licensor;
- If the licence deals with software, enter into an escrow agreement with respect to the source code;
- Clearly identify and distinguish between the royalties to be paid for the use of the property and fees for other services, such as maintenance fees.

Technology licensees must therefore be proactive in protecting their rights in case of the licensor's bankruptcy. In view of the above deficiencies in the legislative amendments concerning licences, only well-informed licensees will be in a position to protect their rights effectively.

NEW QUEBEC BUSINESS CORPORATIONS REGIME

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Do you know that the days when companies, often businesses with only one shareholder, had inactive boards of directors will soon be over? In fact, the requirement that a company have a board of directors, even though it makes no real decisions, will be a thing of the past.

The new *Business Corporations Act* (Bill 63) [the "Act"] substantially reforms the law applicable to businesses incorporated as for-profit companies, which had undergone no major changes since 1979.

The new Act modernizes the internal management of business corporations by specifying the norms for the use of shareholder agreements, which will allow shareholders, among other things, to withdraw all powers from the directors and to decide not to elect directors. It also eliminates the financial tests for granting financial assistance to shareholders. The internal functioning of corporations having only one shareholder also becomes a lot simpler. The sole shareholder, instead of holding annual meetings and other meetings during which he is the only one making decisions, may henceforth, from the outset, eliminate the board of directors, the auditor and the annual meetings, and is no longer required to comply with the internal by-laws or hold meetings of the board of directors.

Over the last few years, governance principles have been strengthened. The new Act reflects this new trend. The duties and obligations of directors are expanded, but their means of defence and their resources are improved, among other things, by requiring the corporation to advance the costs of their defence.

Also, with respect to governance, the Act aims to provide better protection to minority shareholders by offering them various means of protecting themselves, such as the exercise of recourses against unfair conduct that causes them harm. The Act also provides for voting by shareholders, even those who do not otherwise have the right to vote, on fundamental measures such as modifications of shareholders' rights. In the event of dissent, shareholders may require that their shares be repurchased if the corporation changes its structure or activities.

One of the avowed purposes of the new Act is to provide healthy competition to the *Canada Business Corporations Act*. Indeed, over the last few years, an increasing number of businesses were electing incorporation under the federal statute, which was newer than the Quebec statute, certain sections of which were 46 years old.

The new Act is decidedly modern and technologically oriented. Thus, it allows for incorporating corporations online, participating in and voting at shareholders and board meetings through the use of electronic means, issuing shares without certificates, and communicating information electronically to the enterprise registrar.

The new Act has come into force on February 14th, 2011, and bring a breath of fresh air, giving a new lease on life to business law.

THE SHAREHOLDER AGREEMENT: THE "SPECIFICATIONS" OF THE PRIVATE CORPORATION SHAREHOLDER

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Just like an engineer who would not undertake a technical project without having first established its rules and parameters and the necessary steps to complete it, an entrepreneur who sets up a corporation together with other shareholders should never do so before having first established certain rules and parameters in an agreement entered into between himself and the other would-be shareholders. In fact, contrary to publicly listed corporations, whose shareholders are independent of each other, the ties that bind shareholders of most privately corporations require that their relationships be governed by the same spirit of cooperation as applies among professionals involved in an elaborate technical project: either they manage to agree on the direction and measures to take or the project will fail!

However, good relationships do not happen by chance but rather they often result from the fact that all involved know the rules of the game in advance. That is where a shareholder agreement becomes important since it allows all of the shareholders to set out in advance certain fundamental rules for managing the corporation they jointly hold. In addition, in the event that a disagreement arises that cannot be resolved, it can determine in advance the terms under which a shareholder may leave the common project, that is to say the corporation, without bringing about its demise.

The shareholder agreement may prevent conflicts, in particular by forcing the shareholders to commit themselves in advance as to how they will exercise their voting rights. It may, for instance, determine who will be the officers of the corporation or the number of representatives each shareholder will be entitled to have on the board of directors. It may also restrict certain powers of the directors by subjecting certain of their decisions to approval by a vote of the shareholders (whether by a simple or a special majority) and thus protect the minority shareholders against decisions of the directors appointed by the majority shareholders.

In the event that the agreement fails to prevent conflicts between the shareholders and one arises, it can provide a way out. For example, if two shareholders each hold 50% of the voting stock of the corporation, they fail to agree on decisions to be made, a stalemate ensues, and neither of them is interested in selling his shares, a shotgun clause in their shareholder agreement will allow them to resolve the impasse without resorting to the courts, by instead forcing one of them to sell his shares to the other using a neutral process established in advance in the agreement.

The shareholder agreement is essential not only because it can offer solutions to conflicts, but also because it can achieve other objectives, as illustrated below.

The shareholder agreement may allow the shareholders to preserve the private nature of the corporation by imposing restrictions, such as pre-emptive rights or rights of first refusal, on issuances of additional shares of the share capital of the corporation or transfers of shares by existing shareholders. This may be attractive for the shareholder who has developed an innovative technology and transferred it to a corporation he has founded and controls. Conversely, it may be somewhat less interesting for his fellow shareholders who participate in financing the development of the invention and invest in the capital of the corporation, to the extent that such provisions enable the founding shareholder to retain control of his invention by retaining control of the corporation.

However, if the invention has been developed by several persons who have equal shareholdings in a corporation, it may be desirable for them to maintain this balance of power by avoiding one of them holding more voting rights than the others. The shareholder agreement can provide for the continuation of the holding of the shares, and thus the voting rights, in this proportion, by subjecting any additional issuances of shares, or transfers of shares by existing shareholders, to pre-emptive rights or rights of first refusal.

Another significant objective that is usually achieved by the shareholder agreement is to protect the interests of minority shareholders by subjecting certain decisions of the directors to approval by a special majority of shareholders. To the extent that a minority shareholder holds a sufficient number of shares, he will be able to ensure that certain transactions cannot be carried out without his agreement.

The most detailed shareholder agreements sometimes also have the objective of determining or confirming the expected participation of each shareholder in various aspects of the corporation, such as management, operations and financing.

Finally, in most cases, the shareholder agreement ensures the existence of a market for the shares of the corporation. This objective is accomplished by the establishment of piggyback or drag-along rights. For example, Anakin is the majority shareholder of a corporation that has invented a laser sabre. After his corporation has obtained a patent that enables it to develop the sabre, Anakin receives an offer from Empirosoft to purchase all the shares of the corporation. Anakin would like to cash in on this offer but his fellow shareholders, although they are minority holders, refuse to sell their shares. However, if the shareholders of Anakinco have entered into a shareholder agreement, it likely contains a drag-along right that enables the majority shareholder who receives a bona fide offer for all the issued and outstanding shares to force the minority shareholders to sell their shares under the same terms and conditions. Thanks to the shareholder agreement, Anakin may therefore seize the unique opportunity to sell his shares at a high price.

These are only a few examples of the various applications of shareholder agreements that may solve conflicts in the management and ownership of the corporation during its existence.

In fact, the objectives and effects of the shareholder agreement will vary according to the type of agreement implemented. Consequently, it is the specific needs and circumstances of the corporation and its shareholders that will dictate the type of agreement chosen. Therefore, we cannot insist enough on the dangers of using standard forms of contracts because the drafting of contracts requires the exercise of considerable judgment combined with competence and experience. These dangers are all the more significant when shareholder agreements are drafted because the circumstances in which this type of agreement is negotiated and entered into may vary significantly from one situation to another. The drafting of an effective and useful shareholder agreement should be done by an experienced lawyer who will take into account the characteristics of the business concerned and the specific circumstances of the shareholders.

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