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First Circuit Finds Implied Duty to Develop and Promote Acquired Technology under Massachusetts Law

The United States Court of Appeals for the First Circuit recently ruled that, under Massachusetts law, certain agreements for the purchase of technology imply an obligation of the acquirer to exert reasonable efforts to develop and promote the purchased technology. While this obligation has been recognized by courts in California, *Sonoran Scanners Inc. v. PerkinElmer Inc.*, N. 09-1089 (1st Cir., opinion issued October 29, 2009) marked the first decision in which a court has recognized this implied contract term under Massachusetts law in a contract for the purchase of high-tech assets.

The Technology Purchase and Ensuing Dispute

In 2001, PerkinElmer, Inc., a publicly traded Massachusetts corporation, purchased substantially all of the assets of Sonoran Scanners, Inc., an Arizona corporation. Prior to that time, Sonoran had developed a computer-to-plate (CTP) printing technology that offered a high-speed printing alternative to newspaper and graphic arts companies. In mid-2000, despite an investment of approximately \$3.5 million in the CTP technology by Sonoran's founder, Sonoran had yet to sell a single CTP unit, was running low on cash and sought a purchaser to undertake the continued development and marketing of the technology.

PerkinElmer was the eventual purchaser, paying a purchase price of \$3.5 million, much of which went directly to Sonoran's creditors. In addition, pursuant to the asset purchase agreement PerkinElmer agreed to make earn-out payments of as much as \$3.5 million to Sonoran, depending on future sales of the purchased technology. PerkinElmer also entered into an employment agreement with Sonoran's founder pursuant to which he was to serve as manager for the CTP business and was eligible to receive bonuses of as much as \$6.6 million based on CTP sales.

The CTP business, as operated by PerkinElmer, failed. Between 2001 and 2004 only one CTP unit was sold, and PerkinElmer made no earn-out or bonus payments. Late in 2004, PerkinElmer sold the CTP technology to a third party and laid off the associated staff, including Sonoran's founder.

In November 2006, Sonoran and its founder sued PerkinElmer in the United States District Court for the District of Massachusetts, alleging breach of the express terms of the contract; breach of the implied covenant of good faith and fair dealing; a statutory deceptive trade practices claim; and finally, breach of the implied

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terms of the asset purchase agreement by failing to make good faith, reasonably competent and diligent efforts to develop, market and sell the CTP products. The District Court granted summary judgment in favor of PerkinElmer on all four grounds, and, among other things, ruled that no implied obligation to develop and promote the CTP technology existed under the contract.

The First Circuit Decision

Sonoran appealed the grant of summary judgment on all counts. The First Circuit affirmed the lower court's ruling on three of the counts, but reversed with respect to the fourth claim, holding that PerkinElmer had "an implied obligation to exert reasonable efforts to develop and promote Sonoran's technology."

In reaching this conclusion, the court examined a Massachusetts common-law rule stemming from a case where a party that obtained an exclusive right to manufacture a product under a patent was found to have an implied obligation to use reasonable efforts to market the patented process. PerkinElmer, who paid \$3.5 million for the CTP technology, argued that the reasonable efforts obligation only arises where no other consideration supports the existence of the contract. The First Circuit stated that while other jurisdictions have taken such an approach, Massachusetts precedent had not.

The First Circuit found that the key under Massachusetts law is that the contract as a whole must make it certain that the reasonable efforts term is implied. In finding that such a term was implicit in the Sonoran transaction, the court looked to four aspects of the purchase agreement: (1) the earn-out compensation was substantial in relation to the up-front payments made by PerkinElmer; (2) a significant portion of the closing consideration was paid to Sonoran's creditors and did not benefit Sonoran's shareholders directly; (3) the purchase agreement contemplated a campaign to market the CTP technology over five years; and (4) the contract lacked any language which would negate the existence of an obligation by PerkinElmer to use reasonable efforts to promote the technology or which would grant PerkinElmer absolute discretion as to the operation of the CTP business.

As the factual question of whether PerkinElmer did or did not utilize reasonable efforts in promoting

sales of the CTP machines remains, the First Circuit remanded the case to the District Court.

What This Means for Your Business

The *Sonoran Scanners* decision, which is viewed by many as being at odds with the weight of decisions from around the country, may promote litigation by encouraging plaintiffs to look to the courts to find implied obligations to promote purchased technology in contracts where no such express obligation exists. Acquisitions of startups involve inherent risks, as illustrated by the failure of PerkinElmer's \$3.5 million investment. *Sonoran Scanners* may magnify that risk in the view of potential buyers. Accordingly, the First Circuit's decision could precipitate a decline in startup acquisitions and a market that is even less seller-friendly.

Both purchasers and sellers who are considering buying or selling technology with an expectation that the technology will be further developed or promoted by the acquiring party should ensure that the purchase agreement includes express language defining what obligations, if any, the parties have to develop and market the products post-closing. In addition, *Sonoran Scanners* suggests that purchasers should include language negating the existence of any implied obligations or explicitly describing the scope of any such obligation and should be cognizant of the mix of consideration paid, keeping in mind that amounts paid to creditors or amounts which are expected to be paid in the form of earn-outs or transferred-employee bonuses may increase the likelihood of a finding of an implied obligation under the contract.

If purchasers are not careful to structure technology acquisition deals in such a way as to avoid the implied obligation to market and develop acquired products, they may face substantial risks of costly lawsuits, magnifying the negative consequences of potentially losing investments. Clients should specifically consider the *Sonoran Scanners* factors while structuring the business terms of any potential acquisitions, and should consult with their legal advisors to make sure purchase agreements make explicit the obligations of the parties or clearly negate any implied obligations.

If you have any questions or would like to learn more about the issues raised by this Advisory, please contact any of the attorneys listed above.

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