

SEC Guidance on International Intellectual Property and Technology Risks: First Analysis

A Lexis Practice Advisor® Article by
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Introduction

This article discusses guidance (IP/Technology Guidance) that the Division of Corporation Finance (Division) of the Securities and Exchange Commission (SEC) issued in late December 2019 discussing disclosure obligations that companies should consider relating to intellectual property and technology risks associated with international business operations, particularly in jurisdictions that do not have levels of protection comparable to protections for corporate proprietary information and assets in the United States. This guidance is contained in [CF Disclosure Guidance Topic No. 8](#).

As Division guidance, the IP/Technology Guidance did not create any new or additional disclosure obligations. Rather it reflects that the SEC's "principles-based disclosure regime, rooted in materiality, recognizes that a variety of new risks may arise over time" which "may affect different companies in different ways." The IP/Technology Guidance is currently in effect.

For a general discussion on how to draft risk factors, see [Risk Factor Drafting for a Registration Statement](#). For a discussion on how to respond to SEC comments, see [IPO Prospectuses: Avoiding and Responding to Common SEC Comments](#).

Background

The IP/Technology Guidance followed other recent statements and guidance issued by the SEC and its staff discussing a number of evolving risks "to assist public companies both in assessing their materiality and in drafting related disclosure that is material to an investment decision." For example, the SEC issued its [Commission Statement and Guidance on Public Company Cybersecurity Disclosures](#) in February 2018. See also [Division Director William Hinman's speech](#) on applying a principles-based approach to disclosing complex, uncertain and evolving risks and [SEC Chairman Jay Clayton's speech](#) discussing, among other things, Brexit, LIBOR transition and cybersecurity risks. The IP/Technology Guidance has continued these efforts, elaborating on aspects of intellectual property and technology issues specifically arising from international operations.

Initial Guidance

The IP/Technology Guidance identified sources of international intellectual property and technology risk, such as direct intrusions by private parties and foreign actors, including those affiliated with or controlled by state actors, through both cyber intrusions and physical theft. In addition, the IP/Technology Guidance discussed sources of indirect risks—such as reverse engineering by joint venture partners or other parties, as well as requirements to compromise protections or yield rights to technology, data or intellectual property—that companies may face in order to conduct business or access markets in foreign jurisdictions, examples of which include:

- Patent license agreements in which a foreign licensee retains rights to improvements on the relevant technology
- Foreign ownership restrictions
- Terms favoring foreign persons, such as access and license provisions as conditions to conducting business in foreign jurisdictions-and-
- Regulatory requirements restricting the ability of companies to conduct business unless they agree to store data locally, use local services or technology, or agree to terms that could involve sharing of intellectual property

The IP/Technology Guidance also encouraged companies to assess their risks and disclosure obligations relating to potential theft or compromise of technology and intellectual property arising from their international operations and how these risks may impact their business, including financial condition and results of operations, reputation, stock price and long-term value. In that regard, the IP/Technology Guidance suggested various questions that companies should consider, including:

- Is there a heightened technology or intellectual property risk to the company from maintaining significant assets, or earning material revenue, abroad?
- Does the company operate in an industry or foreign jurisdiction where its technology or intellectual property is particularly susceptible to theft or to forced transfer?
- Has the company entered a license agreement with a foreign entity or government that provides such entity with rights to improvements on the underlying technology and/or rights to continued use of the technology after the licensing term expires?

- Is the company subject to requirements that foreign parties must be controlling shareholders or hold a majority of shares in a joint venture or that a foreign party retain certain ownership rights?
- Has the company been required to yield rights to technology or intellectual property as a condition to conducting business in or accessing markets located in a foreign jurisdiction?
- Is the company operating in foreign jurisdictions where the ability to enforce intellectual property rights is limited, either as a statutory or practical matter?
- Have conditions in a foreign jurisdiction caused the company to relocate, or consider relocating, operations to a different host nation, and, if so, has the company considered related material costs?
- Does the company have controls and procedures in place to adequately protect technology and intellectual property from potential compromise or theft, including those designed to detect malfeasance by insiders, corporate espionage events, unauthorized intrusions into commercial computer networks, and other forms of theft and cyber-theft?
- What level of risk oversight and management do the board of directors and executive officers have with regard to the company's data, technology and intellectual property and how may these assets be impacted by operations in foreign jurisdictions where they may be subject to additional risks?

The IP/Technology Guidance reminded companies that risks that are material to investment and voting decisions should be disclosed and that disclosure about such risks should be specifically tailored to a company's unique facts and circumstances. It also noted that where a company's technology, data or intellectual property is being, or previously was, materially compromised, stolen or otherwise illicitly accessed, hypothetical disclosure of potential risks is not sufficient to satisfy a company's reporting obligations. Moreover, the IP/Technology Guidance reminded companies to consider whether disclosure may be necessary in its management's discussion and analysis, business section, legal proceedings, disclosure controls and procedures, and/or financial statements in light of existing rules and regulations and the SEC's statements regarding cybersecurity and evolving business risks in general.

Looking Ahead

The IP/Technology Guidance signals that the SEC will be looking for disclosure in this area by companies in appropriate circumstances. Companies that do business in non-US jurisdictions should review the IP/Technology Guidance carefully and assess whether they are affected by any of the risks discussed. If they are, they should evaluate how they are overseeing and managing such risks and whether they need to add or expand their risk factor disclosures.

Companies impacted by the IP/Technology Guidance should consider its disclosure ramifications whenever they are preparing an SEC document that requires risk factor disclosure, such as annual reports on Form 10-K, quarterly reports on Form 10-Q or certain registration statements

under the Securities Act of 1933. As the Division expressly advised in the IP/Technology Guidance, companies “should continue to consider this evolving area of risk and evaluate its materiality on an ongoing basis.”

It is likely that the SEC will be issuing comments based on the IP/Technology Guidance. It will be useful for companies with international operations involving technology or intellectual property to monitor these comments.

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Laura Richman's wide-ranging corporate and securities practice has a strong focus on corporate governance issues and public disclosure obligations. Laura's practice includes Securities and Exchange Commission reports, such as proxy statements and annual, quarterly and current reports. She advises on executive compensation disclosure, insider trading regulation and Dodd-Frank and Sarbanes-Oxley compliance. Laura represents listed company clients with respect to stock exchange compliance matters. She advises clients on governance policies and other board and shareholder matters. In addition, her practice includes representing clients on transactions such as securities offerings and mergers and acquisitions, as well as providing general securities, corporate, limited liability company and contract advice. Laura has practiced with Mayer Brown since 1981.

With regard to securities transactions, Laura represents issuers and underwriters in public and private offerings of debt and equity securities (both initial public offerings and offerings of seasoned, public companies), including guidance on federal and state securities law compliance. She also advises issuers in connection with the securities law aspects of employee benefit plans and dividend reinvestment plans.

Other transactional matters in which Laura represents corporate clients include acquisitions and dispositions of assets or stock, restructurings (such as holding company formation) and going-private transactions. She also advises investors in leveraged buyout transactions, and represents financial institutions that take equity positions in companies. Laura advises clients on shareholder rights plans and anti-takeover protection provisions.

In addition to her governance and transactional practice, Laura counsels clients on day-to-day corporate questions. She drafts and reviews contracts and other corporate documentation, prepares terms and conditions of sale, provides guidance on limited liability company and other limited liability entity issues, and assists clients with various regulatory issues. Laura was named an *Illinois Super Lawyer* for Business/Corporate in 2006 and 2008.

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Ryan earned his LLM with a concentration in international finance from Harvard Law School, where he served as an editor of the *Harvard Business Law Review*. He earned his JD with honors from the Ateneo de Manila Law School, where he served as captain of the World Champion team in the 45th Philip C. Jessup International Law Moot Court Competition, and his BA, with honors, in Economics from the Ateneo de Manila University. Ryan was previously an associate in the capital markets group of another global law firm in New York and, prior to that, was a corporate associate in a regional law firm headquartered in Singapore.

Ryan is recognized as a “Rising Star” for Capital Markets: Debt and Capital Markets: Equity in the United States by IFLR1000 2019.

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