

2023 Trends for Technology Transactions

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Announcer

Welcome to Mayer Brown's Tech Talks Podcast. Each podcast is designed to provide insights on legal issues relating to Technology & IP Transactions, and keep you up to date on the latest trends in growth & innovation, digital transformation, IP & data monetization and operational improvement by drawing on the perspectives of practitioners who have executed technology and IP transactions around the world. You can subscribe to the show on all major podcasting platforms. We hope you enjoy the program.

Julian Dibbell:

Hello and welcome to Tech Talks. Our topic today is "2023 Trends for Technology Transactions." This episode begins our fourth season of Tech Talks, our podcast on data, digital, outsourcing and software transactions.

I'm your host, Julian Dibbell. I am a senior associate in Mayer Brown's Technology & IP Transactions practice, and I'm joined today by quite a few of my colleagues from our Technology & IP Transactions practice. We have today Marina Aronchik, Paul Chandler, Joe Pennell, Brad Peterson, Mark Prinsley, Linda Rhodes, Oliver Yaros and Scott Young.

We have brought this team together today for a look ahead at the year to come. This is something we like to do each year at about this time on the podcast, but right now feels like a particularly important time to pause and take stock. As 2023 begins, we are at the end of many years of fast and frothy innovation in the tech space, with a great deal of new complexity in both products and business models. We are now facing a downturn, with prominent companies across the economy announcing layoffs and other cost-cutting measures. In the fourth quarter of 2022, we saw greater focus on technology deals that rationalize and reduce spend and drive revenue. Of course, those types of deals have always been a mainstay of the podcast and our practice, but based on the kind of year 2023 is shaping up to be, we expect that the push for profitability is going to be stronger than we've seen in a long time. And that, in turn, is going to drive companies toward more complex deals—structurally complex, of course, but also complex in the sense of leveraging technologies that raise a lot of subtle, and in some cases, untested issues such as AI or open-source software. So I want to turn now to our dream team here for their thoughts on what to watch for as these broader trends play out.

Brad, I want to ask you first about cost-saving deals. This is when we are looking to drive profitability. This tends to be where companies turn first to save costs, reduce costs and implement deals that do that. What are we seeing on that front?

Brad Peterson:

Julian, we are seeing more focus on outsourcing and digital transformation deals. Outsourcing was born as a cost-cutting strategy, and got a tremendous boost both in the early-2000s recession and the great recession. Digital transformation, which is in essence reducing cost by removing manual processes, has long been the reason for core systems projects.

We are now in a downturn with a tight labor market. As a result, our clients' executive management is both more focused on cost cutting and less constrained by reputational concerns about outsourcing. Also, the opportunity to cut costs has grown because of dramatic advances in business service technologies like those we'll be discussing today, including digital platforms, Cloud, AI and open source.

Not surprisingly, we're now seeing deals in every part of businesses, from back-office information technology, finance and accounting, human resources to customer-facing work such as product engineering and contact centers.

Julian Dibbell:

And how is all of this affecting outsourcing and transformation deals?

Brad Peterson:

Julian, we are seeing timelines accelerating, so the contracting process is becoming more central. Our clients are using both collaboration and competition with suppliers to drive to closure.

Substantively, we are seeing more focus on securing strong commitments to perform necessary services at necessary levels of performance and compliance for a firm price. It's not just about price, though. Our clients are focusing more on optimizing overall cost. That overall cost includes the cost of taking on new risks. At this point, the continuing global supply chain problems, the Ukraine war, inflation and other factors have made our clients much more aware of risk. Similarly, our clients are focusing on value provided.

Finally, one of the most exciting elements that I've seen is digital transformation through outsourcing. In a digital transformation through outsourcing deal, the provider agrees to take over an internal business function and automate it in ways that will continue delivering value after the deal has ended. They do that using bots, SaaS solutions, artificial intelligence and other approaches. There are new risks and there are new complexities in those arrangements, but they hold the promise of delivering tremendous overall cost savings. And we see suppliers in those deals committing to 30% to 50% cost savings.

Julian Dibbell:

Ok, so generally what Brad has been describing here is transformational efforts focused on the back-office operations of a business. You do a lot of work in deals looking to transform the more customer-facing elements, what we call "platform deals." What are you seeing in terms of platform deals? What have you been seeing in 2022 and what do you expect to see as we kick off 2023?

Joe Pennell:

Thanks, Julian. We have been seeing tremendous growth in customer-facing, revenue-generating platform deals, and we fully expect that trend to continue in 2023. So, as you alluded to, these are deals

where companies are using one or more technology platforms to directly sell products and services to their end customers. These platform deals are driven by both the need to cut costs that Brad focused on, and to drive revenue and build scalable, digital business models, and many of our clients see them as the future of their enterprises. One of our non-tech clients even reorganized itself in 2022 to make platforms one of its three core business units.

Historically, most of these deals involved companies licensing white-labeled SaaS platforms to offer products to end customers in a digital and lower-cost way. An example would be a casino licensing mobile and web-based platforms to provide online gaming to their customers.

We are now seeing more complex platform deals. For example, major financial institutions are using APIs to directly integrate banking products and services into the platforms of fintechs, ERP providers and retailers. The platform provider improves its customer experience by offering frictionless, embedded solutions, and the financial institution can quickly acquire new customers at a very low cost.

Julian Dibbell:

How are these platform deals different from the outsourcing and digital transformation deals that Brad was discussing earlier?

Joe Pennell:

Good question. The customer-facing nature of any platform deal changes the contracting parties' incentives in a lot of interesting ways as compared to a traditional, back-office services contract.

So for example, both parties may be seeking to maximize platform revenue, rather than one party trying to minimize charges that are payable to the other party.

The direct customer interface also increases the risk of performance failures and the importance of clear exit rights, amongst other issues.

Even more issues and questions arise in the more complex platform relationships we are seeing now, where customers – where *companies* – are creating overlapping relationships with the same customers.

What if a party's existing customer wants to receive the other party's products via the platform, but the existing customer does not meet the other party's customer eligibility criteria, including in relation to ESG policies? How can each party use customer data, including for marketing additional products and services to joint customers? Which party gets to retain the customer relationship when the contract terminates?

These are just a few of the complex questions that companies need to think through, but the potential benefits of these transactions are enormous.

Julian Dibbell:

Another example of the new complexity of data, digital outsourcing and software contracting is the multi-layer reality of technology solutions. Linda, what are you seeing in terms of multi-layer technology deals?

Linda Rhodes:

Thank you, Julian, and hello everyone. As we heard Brad discuss, we are seeing more focus on outsourcing and digital transformation deals, and Joe discussed the tremendous growth in the use of technology platforms. The technology in market conditions discussed by Brad and Joe are helping to drive the prevalence and complexity of multi-layer deals in an effort to further achieve cost savings and to allow for more efficient, revenue-generating and/or innovative technology solutions.

Today, technology providers frequently host their technology solutions on hyper-scaler-provided environments or platforms, and use a multitude of hyper-scalers and other upper-tier providers to host, store and process data and/or provide functionality for their solutions. The use of hyper-scalers, in particular, enhances the ability of the technology provider to scale based upon demand. Similarly, as you heard Joe discuss, customers often contract with technology providers for solutions that support the customers' services to their end clients. Clearly, the line between the "provider" and "customer" becomes blurred as each party serves in multiple roles, but the bottom line is that, in any particular negotiation between parties, each party is negotiating in the context of its other related contractual commitments.

Julian Dibbell:

Okay. So, what should clients be thinking about as they structure their technology deals in 2023?

Linda Rhodes:

Be mindful of the context in which you are negotiating your technology contracts. Carefully consider each of the technology provider's and the customer's contractual commitments up and down the chain and the extent to which there are differences in those contractual commitments. To further complicate matters, in some cases – for example, in the case of a contract between the technology provider and an upper-tier hyper-scaler – the contract may already have been negotiated and executed, with little to no ability for the technology provider to change the hyper-scaler contract terms. In other cases – for example, in the case of a contract between the customer and its end client – the contract may or may not have been finalized, but even if the contract has not been finalized, there could still be customary industry terms that the customer knows will need to be maintained and difficult to negotiate around in its end-user contract.

In determining how to deal with the complexity of multi-layer contracting, the technology provider and the customer will need to consider which party is in the best position to close contractual gaps or, if not close those gaps, to mitigate the risks associated with the gaps and what workarounds can be implemented to reduce the risk to both parties.

Julian Dibbell:

Scott, in your practice you've worked with a lot of the technology providers themselves, particularly in the SaaS space and the adjacent. What are you seeing there in terms of the pursuit of revenue generation?

Scott Young:

Thanks, Julian. It's great to be here with everybody today. Julian, I think your introduction was really spot-on. This really is an interesting time for tech companies. We're certainly seeing a lot of these types of companies preparing for the worst. You've got companies like Salesforce, Amazon, Google and several others that are cutting workers in unprecedented numbers. That just means these tech companies across

the board are seeing and forecasting a reduced demand for their products and services this year. So, it is an interesting time. But at the same time, these companies are still going to be under a lot of pressure to maintain and even grow their revenue despite these economic conditions.

So with that pressure, I'm really seeing this as a buyers' market. There will be good deals to be had. Customers are seeing an increase in their leverage like they have never seen before. You're going to see SaaS providers. These other tech companies are going to be willing to make concessions they wouldn't even have made just six months ago, which is very interesting. It's a great time to be a customer.

Julian Dibbell:

And regarding the technologies themselves, what should tech companies be doing or thinking about given these changing economic conditions?

Scott Young:

If you are a tech company, you should be thinking about a few things. First of all, if you are a tech provider, you are going to want to take a close look at your form contract to make sure that that contract, and the whole contracting process, doesn't unnecessarily hinder your sales. In many cases, these companies should be taking a close look at those templates, updating them and streamlining them so that they're more efficient, while at the same time protecting that technology provider. I suggest that if a tech company would invest a little bit now in making a more efficient template, that's going to pay dividends down the road and really help their cost of customer acquisition. The second thing I would say is that legal counsel for these companies really need to be prepared to have some difficult conversations. They are going to be under tremendous pressure and their clients are going to be under pressure to make unprecedented, and sometimes even unwise, concessions. Given that pressure, these companies will need to be smart about their contract negotiations so they don't subject their businesses, or their IP in particular (intellectual property), to unnecessarily high levels of risk for any given sale.

Julian Dibbell:

Thanks, Scott. Marina, I know you've had a busy year end, especially because you and I were working on an AI deal together that was particularly interesting. Do you want to talk about that and other lessons learned?

Marina Aronchik:

Yes, and Happy New Year everyone! It is so nice to be here with all of you. So, my end of 2022 involved negotiating a large cloud ERP deal and, as you just mentioned Julian, an M&A deal where we focused on the target's AI offerings. I think these projects are really consistent with what we expect to see in 2023. For cloud ERP deals, there will be new deals and renegotiations of existing deals, largely in an effort to reduce costs for on-prem systems and also to advance digital transformation to drive revenue. Interestingly, in the world of ERP, these often "commercial" renegotiations are inextricably linked with complex legal issues, like those involving indirect use, or additional terms covering new features and new services, like AI.

And speaking of AI, I expect AI deals or AI deal features to continue to gain momentum in 2023.

Julian Dibbell:

Right, there's a lot of talk about AI right now. And in these deals, it's critical to understand the components of the AI solution. Are there new issues emerging that lawyers working on these deals should be considering?

Marina Aronchik:

Exactly. Understanding the components of AI solution – the algorithm, model and data set – and related IT and IP intellectual property issues is now table stakes. Increasingly, we are seeing a divergence, a different prioritization, a different take on AI-related issues on an industry-by-industry basis. For example, audit firms, financial institutions and chemical companies will all focus on somewhat different sets of issues and have different concerns when it comes to AI. This is based in part on the use cases for AI (internal versus customer-facing), and the regulatory regime in which you operate (environmental and competition laws versus bank regulations or audit standards). Increasingly, we are also moving away from what I call "first-adopter concerns" to a more sophisticated evaluation of the history of the AI solution – how was the model created, how was it trained, what are the data sources contributing to the continued evolution, how will your production data be treated vis-à-vis training data for the tool, etc. Last but not least, we are starting to see AI-specific regulations, including in Europe, with a continued quest for safe and ethical or responsible AI.

Julian Dibbell:

Thanks, Marina. Paul, you and I just did an episode on potential pitfalls in negotiating deals involving open source, and I would recommend that to anyone who wants to understand the fundamentals on that issue. But, just looking ahead into the coming year, Paul, what are you seeing happening with open-source software?

Paul Chandler:

Happy New Year, everyone. Julian, as you mentioned, we begin 2023 with headlines of businesses laying off workers, decreased revenue projections and predictions of a major recession coming. And given that economic environment, I expect to see more companies view open source as an important tool for reducing costs, just as many others have in the past, while reaping the benefits of industry-accepted, open-source technology. This is a continued trend, as open source played a major role in virtually every development deal I worked on in 2022.

Beyond using open source to reduce costs, companies are reminded, on almost a daily basis, of hacker exploits taking advantage of security vulnerabilities in the software that the companies use. Open source is getting a lot of attention in this respect, particularly in companies' cybersecurity reviews, but also at the initial stage when companies are considering whether or not to approve using a given open-source package. And this, in turn, is driving and will continue to drive companies to focus on creating inventories of the open-source software that they use; that will, of course, help them know what to patch when security vulnerabilities become known.

And, speaking of cybersecurity, I think we are going to see more in the way of guidelines that are flowing from President Biden's executive order governing software bill of materials (so called "SBOMs"). And that

is going to lead to more SBOM and software supply chain issues in technology contracts, particularly those involving government procurement.

Finally, and I think this is *really interesting*, at the end of 2022, we saw Github, OpenAI and other companies sued because of Github's "Co-Pilot" tool. Now, Co-Pilot uses AI trained on a vast database of open-source code to generate code for developers. It's like an automated code development tool. The basis of the lawsuit is that Co-Pilot is illegal because it outputs swaths of open-source code without complying with any of the notice, attribution or other open-source license requirements that apply to the code that it is using to generate its output. Now, the outcome of this litigation may have a huge impact in how open source is used for AI. In fact, lawyers for the plaintiffs anticipate that if there is a finding that Co-Pilot is illegal, then this will lead to new legal approaches for using open source and AI, and they analogize that to just how Napster was found to be illegal in the early 2000s, and that could be seen as leading to the Spotify that we have today.

Julian Dibbell:

Okay, we'll watch for that. Of course, there's a lot of talk about AI and a lot of attention on AI. And I've heard, Oliver, that there are some important developments in Europe that we should be aware of.

Oliver Yaros:

Hello, Julian. Thanks very much and that's right. It wouldn't be a new year without new law from Europe to talk about. And as all previous speakers have mentioned, AI is definitely a hot topic on this side of the Atlantic as it is on your side of the Atlantic. I think there are a number of initiatives that are taking place in Europe to do with the use of AI, principally from the EU itself. We have the AI Act, which is close to being finalized and will probably be in force in 2024 or a little later in 2025. And that essentially requires organizations using AI systems in Europe to assess the risk that those AI systems have, and will require it to impose certain assessments depending on what risks those AI systems have. So AI systems that have unacceptable risks will be banned according to the legislation, and those that are high-risk or low-risk will have different requirements in terms of assessments that have to be conducted or information that has to be provided to users to make sure that their use is safeguarded.

Twinned with that are a number of measures from the EU in the form of directives to address the liability that organizations might have or incur as a result of using AI systems, which I think is quite interesting. And what these proposals are all about is trying to make it easier for individuals who suffered physical harm or suffered liability as a result of AI systems going wrong to claim liability or to claim damages back from those organizations that are deploying these AI systems. And the big area of concern that has been identified is often defective product claims or defective service claims that are all about wrongfulness, and how you prove that an AI system has gone wrong. How does an individual or service recipient prove that an AI system that has been given to them has gone wrong in a way that has affected them? That is obviously very hard to do, and these proposals from the EU are all about trying to make it a lot easier to prove that the system people who are deploying systems should be liable for the impact that those systems have.

So why is this important? It's important to individuals and organizations that are entering into transactions to procure or deploy AI systems in Europe – they need to be thinking quite carefully about whether those AI systems will be deployed in Europe in a successful way and what sort of requirements need to be met in order to do that. They should be detailing that in the relevant contract. What they should also be thinking about is the liability position that they might be taking in that contract, because organizations that are developing these systems may be putting liability for the use of those systems onto customers in situations where, actually, the customer might be taking on more liability under the new EU framework that might exist in the future than they might have anticipated.

Julian Dibbell:

Well that's a lot to keep an eye on for companies deploying AI solutions. Alright, thanks very much, Oliver. Well, finally – look, I said at the top of the episode that this feels like a moment for taking stock after a long run of blistering technological innovation. That innovation involved a lot of business activity, most of it productive, but I think what we are seeing now is the pace of things returned to something like normal, as a fair amount of that activity was perhaps misdirected, sometimes misconceived and in a few cases not really pursued in good faith. Mark Prinsley, I want to turn to you to ask, what are the lessons we have learned here?

Mark Prinsley:

Julian, you ask a very broad question. Certainly the last 12-18 months have seen a number of high-profile failures in what might be called tech-enabled businesses. In the US and Caribbean, there has been FTX; in Europe, there's Wirecard; and in the UK, there's Greensill. It is probably too early to draw conclusions from any of these failures. The stories have some way to run. However, a theme that seems to come out of all of them, in one way or another, is that the deployment of innovative technology is involved. There is a risk that appropriate due diligence is overlooked in the rush to get on the latest, greatest bandwagon.

As Warren Buffett noted, only when the tide goes out do you see who is swimming naked. When everything in the economy is going well, there is definitely a temptation to take a risk and be what you might describe as "proportionate" about the scope of due diligence around a tech investment in order to proceed speedily. The economic downturn means some of these projects are inevitably going to fail, as you say, and the lack of due diligence will be a factor in the risks investors and others have become exposed to.

We are certainly seeing a greater focus on legal due diligence in tech transactions. The skepticism, which is sometimes unhealthy, which comes with a lawyer's life and the background subject matter expertise and which tech lawyers come with, looks like bringing more activity in 2023. For new investments and procurement exercises, the tech lawyer can bring an overview of the state of maturity of the suppliers' solution. We can anticipate more work in setting up or reviewing, reporting and control mechanisms around the use of new technology solutions to help investors and others avoid being duped by the next convincing snake oil salesman.

Switching gears, but also an indication that we might be in different economic times, is the recent news that the UK government and Atos, the French technology contractor, have reached a settlement arising

from Atos's challenge to the award of a \$1 billion contract to Microsoft for a supercomputer system for the UK Meteorological Service. Atos appears to have alleged that the procurement process was not fully transparent. The parties have settled without admission of liability, and the UK government and the UK Met Office, which we call the UK Meteorological Service, have paid Atos \$29 million. We are also anticipating more involvement in big procurement processes in 2023 as that lesson strikes home both with purchases of solutions and vendors.

Julian Dibbell:

All right, thank you, Mark, and thank you all for the insights today. They're going to equip us well for the year to come.

Listeners, if you have any questions about today's episode or an idea for an episode you would like to hear about – anything related to data, digital outsourcing and software transactions in the law – please email us at techtransactions@mayerbrown.com. Thank you for listening.

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