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The Best Laid M&A Plans? How A Dispute Over Ownership of Critical IP May Threaten eBay's Sale of Skype

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News reports in recent weeks have revealed how disputes over the ownership of certain critical IP may derail eBay's \$1.9 billion deal to sell a stake in the well-known internet communications company Skype. In the latest development companies owned by the founders of Skype filed additional lawsuits last week against eBay and its future investors. At the heart of the dispute is the peer-to-peer technology called "global index" ("GI") that is critical to Skype's success. Somewhat surprisingly, the GI technology, which was developed by Skype's founders, Janus Friis and Niklas Zennstrom, is not owned by eBay or Skype. Rather it is owned by Joltid Ltd., a company controlled by Friis and Zennstrom. When it initially purchased Skype, eBay attempted to purchase Joltid as well but Friis and Zennstrom refused to sell, wanting instead to retain the intellectual property rights in GI. They also refused to sell or directly license the GI source code to eBay. eBay therefore purchased Skype subject to a license agreement for the GI code between Skype and Joltid. That decision appears to be coming back to haunt eBay. According to Friis and Zennstrom, the license agreement granted Skype the right to use an executable-only form of the GI code, known as the object code, which is un-editable. Skype did not obtain any rights or license to the source code of the GI software. This arrangement worked so long as Friis and Zennstrom remained with Skype because they were authorized to use and tinker with the GI source code. However after their departure in 2007, Friis and Zennstrom began challenging eBay's use of the GI technology, claiming that Skype (at that point owned by eBay) obtained unauthorized versions of the GI source code and breached the terms of its licensing agreement by continuing to modify and create derivatives of the source code. In March of this year, Skype filed a claim in a U.K. court asking for declaratory relief and a finding that it is lawfully accessing, in possession of, using and modifying the GI code in accordance with the terms of the agreement. Joltid disagreed, terminated the license agreement and filed defenses and counterclaims against Skype alleging that Skype had repudiated the license agreement, infringed upon Joltid's copyright, and misused confidential information. The case is scheduled for trial in June 2010. A few weeks ago, Friis and Zennstrom opened another front in the dispute by filing a lawsuit in Northern California U.S. District Court against eBay that also names the investors as defendants. These investors

include private-equity firm Silver Lake, venture-capital firms Index Ventures and Andreessen Horowitz and the Canada Pension Plan Investment Board. The suit claims that the investors were aware of Skype's copyright violations during negotiations of the deal and seeks an injunction on Skype's use of the GI technology in addition to damages and profits that Skype has made while using the technology in breach of its license. Such damages are allegedly "amassing at a rate of more than \$75 million daily". The pair also filed another lawsuit shortly after which alleges that new software being developed by Skype incorporated confidential information that was misappropriated by a former executive at one of Friis and Zennstrom's companies who recently joined Index Ventures, part of the investor group paying \$1.9 billion for Skype. With the benefit of hindsight, many have wondered why eBay would have paid \$2.6 billion for Skype without better securing rights to its underlying technology in a manner that would not be interrupted. While the precise reasons eBay structured the deal in this manner may not be clear, the opportunities it missed to protect itself are apparent. First, by allowing Joltid to retain rights to the GI code, eBay's use of the code was subject to the restrictions and limitations that Joltid and Friis and Zennstrom placed on such use as set forth in the license agreement. Additionally, without obtaining rights to the source code, eBay was at the mercy of Friis and Zennstrom, the two individuals who understood how the GI code functioned. While eBay likely felt that having Friis and Zennstrom on its payroll would mitigate any concerns, perhaps additional thought should have been given to what would transpire if and when Friis and Zennstrom were no longer affiliated with eBay. eBay also apparently did not acquire sufficiently clear rights to develop derivatives and modifications of the GI technology. Therefore, any next generation versions of the GI technology that eBay wished to develop would have been subject to the restrictions of the original license agreement, including the rights that Joltid, Friis and Zennstrom had in the technology and source code. While the intrigue and tangled nature of this dispute are in many ways unique, the lesson is clear: the treatment of IP rights in an M&A transaction involves consideration of multiple factors, contingencies and interests. Careful and deliberate analysis of possible future scenarios—however likely or unlikely—is necessary to avoid losing the competitive advantage that is one of the foundations of the underlying transaction.

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