Tech Lite

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EMI Schemes For Tech Businesses

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Welcome to Myerson Tech Lite...

Carla Murray, commercial partner and leading woman in tech, introduces this edition of Tech Lite in a video, which is available for you to watch here.

At Myerson we have the experience and expertise to provide advice to those working within the IT, IP and Data Protection industries and in this issue our experts look at:

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Exiting IT

When considering a new IT project a business will usually be focused on choosing the right solution for their business and ensuring that it is implemented satisfactorily. Often contracts dealing with implementation, licensing and support/maintenance are not in place before the project starts and in some cases not before the solution goes live. There is a tendency for attention to be focused on agreeing the right commercial terms and ensuring that adequate contractual protections are in place for life of the contract.

But what happens when the agreement terminates or expires? This can be of key importance, and major issues can arise at the end of the life of the solution if what happens on exit has not been properly addressed at the time of negotiating the contract.

Termination

Termination rights tend to be a focal point of contractual negotiations, however what many businesses fail to give either equal or appropriate consideration to is:

- how reliant will the business be on the new solution in years to come?
- what will the business do when the arrangement terminates?

There is little point in negotiating termination rights if in practice the solution will come to an abrupt end, leaving the business unable to operate.

Similarly, if a business has stored vast amounts of key business information within a proprietary solution but is unable to extract that data in a usable format in order to migrate to a new solution, then, it may find itself at the mercy of the legacy solution provider. This could mean having to pay unknown or disproportionate fees for assistance with migration, a time when the legacy solution provider may have little interest in preserving the commercial relationship.

It is therefore crucial to customers for appropriate exit obligations to be put in place to ensure that an orderly termination and migration from the solution can be achieved. Realistically, this means that obligations relating to exit must be addressed within the initial contract negotiations or it is unlikely that there will be sufficient commercial impetus or leverage to ensure that binding obligations are put in place.

Exit obligations

Exiting an IT solution is often approached by ensuring that there are appropriate assistance and transitional services obligations in place within the contract. It will need to be considered whether hosting obligations should continue following the end of the contract, at least until the customer has had the opportunity to migrate its data away. It may also be necessary for the customer to have a licence to continue to use the solution, perhaps on a limited basis, for a period

post-termination. If this is to be the case then some level of support may also be necessary. If any assets have been transferred to the supplier as part of an outsourcing arrangement then these will also need to be transferred back to the customer at the end of the relationship. The fees for such services should also be documented to ensure that there is no sting in the tail of the contract for the customer.

An obligation should be placed on the supplier to prepare an exit plan, which will address each of the exit obligations to facilitate the transition to the new supplier, including the detail of how these will be implemented and the governance of the process. The supplier should be put under an obligation to keep the exit plan under review and ensure that it remains up to date.

Escrow

An additional approach that merits consideration is requiring the software involved in the solution to be placed in escrow. This means that a copy of the source code of the software (and, ideally, every release of the software) is held by a third party to be released to the customer if certain trigger events occur, such as insolvency of the supplier or termination for the supplier's breach of the agreement. This has the advantage that if a trigger event occurs the customer will be able to continue to use and support the software.

However, in practice, caution needs to be exercised before too much reliance is placed on an escrow arrangement by a customer. Many customers will lack the expertise to be able to use the software meaningfully and it may be costly (if it is possible) to procure a third party who is able to step into the original supplier's shoes to maintain and support the software. If the solution is hosted, the customer will need to ensure that it is able to obtain its data (which will not be part of the escrow arrangement) and that it has the infrastructure to be able to operate the solution. Lack of such infrastructure is often the catalyst for having outsourced the hosting of the solution in the first place.

Transfer of employees

When an arrangement terminates and the service provider is replaced or the service provision is taken in-house, then in some circumstances this will mean that certain employees of the current service provider will transfer to the new provider or to the client.

This will happen automatically under the Transfer of Undertakings (Protection of Employment) Regulations 2006 (commonly referred to as TUPE), if the change in provider (or move in-house) constitutes a "service provision change" under TUPE.

It is important to address this possibility at the time of entering into the contract so that risks and responsibilities in relation to potential transfers at the end of the contract are allocated appropriately. From the client's point of view it will be important not to have to take on a large unexpected employment liability or for the service provider to have moved employees around so that the client ends up taking on the service provider's least desirable employees at the end of the contract. Issues such as these can be addressed by including appropriate contractual obligations at the time of entering into the contract.

Conclusion

The key to successfully exiting an IT solution is to consider what will be required from the outset and ensure this is addressed in the contract. Otherwise a business risks termination not actually being a realistic option to enforce compliance with the contract or, worse still, finds itself without any solution or assistance it requires to move on to a new solution. The whole life cycle of a solution needs to be contemplated from the start so that, even if it cannot be known when the solution will have reached its expiry date or what the replacement will be, the process can be smoothed as far as possible by having appropriate obligations provided for in the contract.

Mind Over Machine – Could and should AI make fully automated decisions?

Artificial Intelligence (AI) can bring automation, consistency, scalability and speed to a business, however do the benefits of automated decision making by AI outweigh the human factor? Or, does mind over machine matter, with human emotion and rationale still having a role to play?

What is automated decision-making?

The Information Commissioners Office (ICO) describes automated decision-making as "the process of making a decision by automated means without any human involvement and such decisions can be based on factual data, ... [and] digitally created profiles, or, inferred data".

Examples include:

- an online decision to award a loan; or
- an aptitude test used for recruitment which uses pre-programmed algorithms and criteria.

ICO Audit and Comment

Automated decisions and AI is something that is on the ICO's radar, as it continues to issue blogs on this subject and is actively seeking views on what auditing framework should be put in place to govern this.

In this rapidly developing area, the ICO has identified five specific risks businesses need to be aware of:

1. Can meaningful human reviews take place in non-solely automated AI systems?
2. Are the outputs of AI systems truly accurate, and can this be measured or tested?
3. Will known security risks be exacerbated by the AI?
4. Can the decisions of AI be explained?
5. Is AI susceptible to human biases and can it cause discrimination?

Ethical Questions

The underlying issue with the identified risks is an ethical dilemma. Difficulties can arise not only from the sources used to train the AI at the outset (potentially teaching the AI to be biased at the outset and therefore creating a "bias in bias out" scenario) but also where human intervention is required to analyse and assess the decision making process (which in itself would be subjective because of the human factor). It does raise the question whether AI automated decisions can ever be error or biased free? If not, how can they be challenged? Could further automation and AI be used to regulate the human regulators?

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The difficulty for both businesses and its customers is AI and automation are here to stay and therefore if random or spurious automated decisions are made these can not only impact a business but also its customers.

Risk versus reward

What if we can eradicate the potential for biases at the outset and enable AI to evolve in a balanced unbiased manner? Where does this leave human intervention? What will happen if businesses delegate too many decisions to algorithms, will this result in a loss of human ability to form innovative strategic choices? If businesses do not use the creative minds of their workforce, to evaluate plans, take creative risks and innovate, we lose this skill? The academic discussions around these aspects of automated decision making in business are vast, complex and unfortunately do not provide a clear answer.

What can businesses do?

Businesses should be alive to the benefits of AI and automated decision making but also approach the same with some caution. For most businesses, AI is a tool to assist its workforce and help with efficiencies, streamlining processes but is rarely a complete substitute for human involvement altogether.

Mind Over Machine? Not quite yet...

It's clear from the calls for AI regulation and 'policing', that for now, the human mind and its inner workings has not yet been surpassed by machine learning. How the use of AI in business will continue to develop is very much a 'watch this space' scenario over the coming weeks, months and years given the pace at which AI continues to develop.

Therefore, if you intend to implement AI to aid in making crucial business decisions, whether that's in your recruitment process, as part of your main service offering or otherwise, you need to ensure you have a robust comprehensive process for reviewing the same should you ever be challenged on the decision made

No Deal - No Data?

Many businesses in the UK and the EU are reliant on the free flow of personal data between the UK and the rest of the EU. This is especially true of any who trade or provide services across borders or who use data centres in other parts of the EU.

Since the EU granted the UK an extension to the process of leaving the EU, the basis of the UK's departure from the EU is unlikely to be known until some point in 2020, but a "no deal" Brexit remains one of the potential outcomes.

So, what will happen if the UK leaves the EU without a deal? Will data continue to flow freely or will it become instantly unlawful to transfer data?

The problem

If the UK leaves the EU without a deal then it is likely that the immediate effect in the majority of cases would be that personal data could not be lawfully transferred from the EEA (which is the area covered by EU data protection regulation) to the UK and there would be an instant disruption of data flows.

This is because the UK would become a "third country", i.e. a non-member of the EEA. For personal data to flow freely to a third country from the EEA the EU Commission needs to have made an "adequacy decision", which is a unilateral decision that would need to be made following a process which would scrutinise the adequacy of data protection regulation and enforcement in the UK.

There is no adequacy decision currently in place (as it is not necessary while the UK remains in the EU) and it would take some time for a decision to be made.
There is no guarantee that an adequacy decision would be granted in respect of the UK and, even if one is made in the future, it will be reviewed periodically and can be withdrawn by the Commission or overruled in the Court of Justice of the EU.

Conversely, the UK government has indicated that even if there is a no-deal Brexit it intends to recognise the EU's data protection regime as adequate, which would have the result that transfers of personal data could continue to be made from the UK to the EU.

What can businesses do?

So what can businesses do to ensure the free flow of personal data that is required in their business from the EU to the UK? Outside of an adequacy decision, personal data can be transferred to third countries where there are applicable standard contractual clauses in place or binding corporate rules.

Standard contractual clauses are sets of clauses that have been approved by the EU which enable transfers between controllers and processors or between controllers and controllers and can be used with third-party companies.

They can therefore be used to facilitate many commercial relationships and many large suppliers will already have these in place within their standard terms. However, the standard contractual clauses are in standard form and cannot be amended, meaning that they are not always appropriate to the situation. They must also be put in place for each controller-controller and controller-processor relationship and must be agreed to by both parties, so for businesses with complex data flows they may be very cumbersome to implement. Nonetheless, they may be the only immediate way post-Brexit to ensure that data can continue to be transferred.

Binding corporate rules are primarily for multinational groups of companies, who must apply to a data protection authority within the EEA to approve the rules, which will facilitate data transfers within the group. Implementing binding corporate rules can be a costly and lengthy process (potentially costing £250,000 and taking several years), so is unlikely to be a viable solution in the short term or for any but the largest companies.

Businesses would be well advised to undertake a review of their current data transfers and consider what cross-border data flows they are currently reliant upon. Business should prepare for the possibility of a no-deal Brexit. The most pragmatic solution for most businesses will be to implement standard contractual clauses where possible and particularly for key transfers of personal data, in order to ensure that data can continue to flow post-Brexit.

At Myerson our dedicated Brexit team analyse the potential impact of Brexit on UK businesses. For more information email lawyers@myerson.co.uk or call 0161 941 4000.

Driverless Cars - Are we there yet?

Whilst technology companies, vehicle manufacturers and Uber clamber to be at the forefront of the “driverless revolution”, the Law Commission is also putting into place the necessary measures to ensure a smooth transition into an environment where driverless vehicles could soon be the norm.

This year has seen a number of significant developments in driverless technology, with many businesses pinning their future prosperity on its implementation. Some of the most prominent developments include:

- Uber, in connection with its controversial $82bn flotation, has invested vast sums of money into its autonomous vehicle technology. The business recently raised $1bn for investment in its driverless technology research and has set up a designated corporate entity which is entirely dedicated to driverless technology. The “spin off” company is valued in the region of £7.3bn on its own and looks continued to grow as Uber seeks to streamline its business model with driverless cars;

- Uber does however face significant competition from other key players in the sector. Tesla is also making significant investments into driverless technology and is working on its own brand of “robotaxis” which Elon Musk has tentatively stated he expects to see on the roads by 2020 in a “full self-driving” form;

- Meanwhile, in New York and in Singapore, driverless busses are already being trialled, with the Singapore government aiming to implement the technology across the whole country by 2022;

Whilst technological advances can bring significant benefits, they can also pose challenges. There has been some backlash from public and regulatory authorities who have expressed concerns about issues with the technology around road safety and cybersecurity.

Whilst the general consensus is that automated technology will improve road safety, as 90% of all accidents arise from human error, it is acknowledged that safety and liability concerns are still significant.

In an attempt to address some of these concerns, on 19 June 2019, the Law Commission published some initial responses to its ongoing three year "automated vehicle consultation". The consultation is the main initiative from the Law Commission which includes a comprehensive review of all existing laws and how driverless technology will impact on these.

The Law Commission's review concentrates on three main areas:

1. Safety issues and cybersecurity.
2. Changes to the rules of the road and protocols.
3. Liability issues in the event of accidents or other problems with the vehicles.

The main outcome from the recent publication is that, after consultation, the government will begin developing a "safety assurance scheme" to ensure the key concerns are adequately addressed before driverless technology is implemented. This will supplement and improve on the government's efforts, including the legislation it has already implemented (namely, the Automated and Electric Vehicle Act) which deals with civil liability for when things go wrong with driverless vehicles.

The Law Commission will continue to publish its results over the next 12-18 months, to coincide with and facilitate the government's stated aim to have driverless vehicle on UK roads by 2021.

In the meantime, the key players in the automotive and technology industries will no doubt continue to push the boundaries and invest heavily in what could be a "revolution" in the sector.

What Should Businesses Do?

Whilst the opportunities are exciting, businesses will need to be vigilant and ensure that they can meet the regulatory requirements and are up to date with these as they are published. In addition, it is crucial that businesses have in place robust protections over their intellectual property rights and the confidentiality of their trade secrets.

EMI Schemes: Tech Businesses and Key Employee Incentivisation

As any founder of a tech company will testify, it is crucial to keep key personnel incentivised and on board in order to scale up a tech business and prepare for an eventual exit.

Tech companies are often reliant on their key talent, whether these are developers, salespersons, managers or directors. As tech businesses often start out small and go through periods of quick growth, incentivisation schemes for employees can be crucial to ensure stability of the workforce during such periods.

So, how can a tech business go about incentivising its key employees and rewarding them for their efforts? And, how can this be done whilst also being mindful of cash flow, and without the need to spend heavily on bonuses, salary increases or other incentives?

Entreprise management Incentive

One of the most popular incentivisation tools is the Enterprise Management Incentive share option (or EMI Scheme), a government backed scheme aimed at UK companies.

An EMI Scheme is a tax efficient scheme which enables businesses to grant share options to their employees under which the employees can acquire share in the business at a later date.

EMI Schemes: The Benefits

EMI Schemes are intended to help companies retain valued employees and reward them for investing their time and skills in helping the company grow. EMI Schemes have many benefits, including:

- They are purposely designed to be tax efficient: There is no tax payable on the grant of option and the employee will typically pay capital gains tax when they sell their shares, rather than paying income tax;
- Entrepreneurs' relief: The employee may, subject to meeting the relevant criteria, also qualify for the 10% entrepreneurs' relief rate of tax;
- Flexibility: It is possible to create different classes of shares, introduce "growth" share concepts to preserve the present value of the business, incentivise with performance conditions for exercise, etc;

It should be noted that there are certain criteria which need to be satisfied for companies to qualify for EMI Schemes, including qualifying trades, gross asset and employee count limits. These are not unduly restrictive for most start-up or SME tech companies.

Exit driven schemes

Commonly, companies look to put EMI Schemes in place with a prospective exit in mind, whether the exit is imminent, or planned for 5 years to 10 years' time. EMI Options have a long-stop exercise date of 10 years, which typically gives businesses sufficient time to plan for an exit.

It is increasingly common for businesses to structure their EMI Schemes so that they are "exit-only" (i.e. they can only be exercised on a sale of the business). This is a great way for tech companies to lock in key talent until an exit event occurs, and then to reward those employees with a tax efficient payment at the time of the exit.

The other key benefit of an "exit only" option is that it avoids the company having minority shareholders and the issues this creates, including the need for more detailed constitutional documents.

Summary

EMI Schemes are a very powerful tool which tech companies can use to incentivise key staff, and we would strongly encourage any business operating in the tech sector to explore its potential benefits.

If you wish to discuss implementing an EMI scheme, or if you have any further queries, please contact a member of our corporate team, at lawyers@myerson.co.uk or call 0161 941 4000.

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