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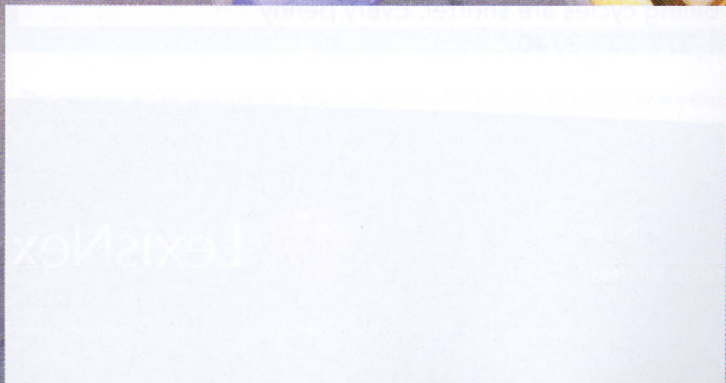
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Planning for Life after the Closing

The Impact of Information Technology and Outsourcing

By Christopher C. Cain and Karl A. Hochkammer

In the sale of a business, the buyer, seller, and their respective counsel often pay too little attention to the impact of information technology (IT) and outsourcing on the business pre-closing and post-closing. That is unfortunate because IT and outsourcing drive many financial and operational functions of the modern business.

Understanding and addressing these functions will have a significant operational and financial impact on the ability of the parties to realize the synergies expected from the deal. In this regard, there are two critical IT and outsourcing components of any business sale that should be considered: (1) planning the post-closing transition of the business from the seller's IT infrastructure and business processes to the buyer's IT infrastructure and business processes and (2) documenting that plan in a comprehensive transition services agreement.

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The benefits of addressing these components are significant for all parties—for the seller, a better understanding of the cost to it of the transition, both from a financial and a human/capital requirements perspective, and a definitive timeline to be “done” with the business; for the buyer, the same understanding of the cost of the transition but also a clearer integration strategy and path to realizing the expected synergies that drove it to do the deal in the first place. Attorneys knowledgeable about these IT and outsourcing issues can help their clients plan for and document the parties' post-closing needs and goals.

Focus on the “Backbone”

In the sale of a business, each party typically has some idea of its operational goals after the closing, but spends little to no time in due diligence fully examining the operational “backbone” of the business. The backbone of a business typically includes a patchwork of contracts for IT systems, software licenses, hardware and software maintenance and support, and a host of outsourcing service contracts for critical business functions and operations.

Focusing on this backbone early in the transaction process helps identify opportunities, potential pitfalls, and issues that will arise after the deal closes so they can be addressed before the closing. The perspectives of the buyer

and seller are different, but areas of overlap exist. The seller wants a clean break with the divested business, both financially and operationally. The buyer also wants a clean break from the seller so it can get on with running the new business. Neither side can achieve its goals without working through and documenting how they need to help each other get there.

This is where a transition services agreement should come into play, right at the start of due diligence, but it is often an afterthought addressed in the waning moments before the closing. The result of this last-minute cursory attention is often a vague, poorly drafted, and incompletely thought-out transition services agreement. Even worse, the transition services agreement is often drafted entirely by the businesspeople, with little or no oversight or review by counsel. This can be a mistake because a thorough transition services agreement dictates the basic approach to the eventual integration of the acquired business into the buyer's operations and defines how and when the seller will support and then eventually cease supporting the divested business.

The authors have witnessed firsthand the perils of not paying early enough and sufficient attention to the backbone and, by extension, the transition services agreement. In one case, where we represented the buyer, the

seller had agreed early on to support the computers of the divested business for a period of years, only to later discover that its licenses for the software did not permit it to do so. This discovery forced the seller, at the last minute, to have to renegotiate with its existing vendors when time was running out and it had little negotiating leverage. Similarly, we have seen deals where the buyer finds out too late (because of inaccurate or incomplete information from the seller) that certain services it was counting on receiving from the seller were more expensive than planned because of licensing restrictions or other contractual restrictions. Each of those situations resulted in last-minute disagreements, hasty negotiations with each other and third parties, and unanticipated delays and costs.

Plan for Post-Closing

Proper planning for post-closing transition and integration of IT and outsourcing involves at least three steps: (1) due diligence planning and

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analysis, (2) understanding what services seller can offer buyer and how they are impacted by the seller's agreements with third parties who may need to provide some of the services, and (3) considering how the buyer will eventually move from the transition services and proceed toward post-transition integration, which integration often requires the buyer to leverage its existing outsourcing relationships or create new ones.

Plan in Due Diligence. Many necessary questions are not asked or addressed until it is too late for counsel to be proactive in helping clients

identify and head off issues—putting the parties into a reactive position. Reactive actions cost more than proactive ones, resulting in increased transaction costs, unexpected resource requirements and sometimes situations where the seller has to pay for services or goods it no longer receives.

Instead, start examining these issues in the early stages of a business sale. Both parties should conduct an internal due diligence program to understand their respective existing operations so that they can assess the impact of the transaction on their respective third-party relationships and understand the scope of a transition services agreement. In other words, the seller needs to know what services it can provide and how much it will cost to do so. The buyer also should use the due diligence process as the first step in developing its integration strategy and identifying opportunities to achieve operational efficiencies and cost savings (including implementing new, or leveraging existing, outsourcing relationships) as it weans itself from the seller-provided transition services.

Seller's Transition Abilities. The seller is often faced with the difficult task of carving the business being sold out of its existing operations. The seller often discovers that its underlying contracts with third parties do not provide for the required degree of flexibility or fail to address the issues that arise when the seller is required to support the divested business for a period of time after the deal closes.

Examples of issues that frequently arise include the following:

- Can the seller use its existing software systems to support a third party without the need to obtain consent from the licensor?
- What consents are required, how much are the consent fees, and who is going to pay them?
- How should the seller address issues of confidentiality when its employees may be providing certain critical functions for the divested business after closing (i.e., purchasing activities, legal support, finance

and accounting services, and human resource administration services)?

- Where services are subject to service levels, should the same service levels be applied to the services received by the divested entity?
- After the business is sold, will there be an impact to the price of the services or goods (e.g., will the volume of services fall below a minimum revenue commitment)?
- How will the parties address changes to items provided by the seller that the buyer required to meet changing needs?

The specific process and functions to be provided under transition services agreements will be provided either by the seller itself or by one or more third-party service providers, or both. For those shared IT and business process services that are provided by the seller internally, counsel and the client should work together to ensure that existing business processes are thoroughly mapped to the business users and to develop transition services requirements, including appropriate service level agreements and providing for continuity of business operations after the sale. Where those services are provided by third parties, negotiations may be necessary to modify, assign, terminate, or exit those agreements.

As part of the standard due diligence process, the seller identifies material third-party contracts relating to the business to be sold. However, in many instances, the seller does not think to inquire about third-party services provided to the seller's business operations as a whole. Examples of these types of agreements include enterprise software license agreements and the related support and maintenance and information technology and business processing outsourcing agreements.

Technology agreements may permit the divested business to receive the benefits of the services to be provided but if so, usually only for some limited period of time, often for no more than 12 months. These same agreements often impose requirements and restrictions on the ability of the divested business to enjoy

the benefit of these services, each of which should be addressed in a transition services agreement. In addition, software license agreements often require the licensor's consent to the divested business continuing to use the software and such consents often cost a significant amount of money. The seller needs to identify and understand these items so that it can develop a proposal for the buyer and the buyer needs to understand the nature of the services that are available and the associated costs.

A good understanding of the contractual limitations on the seller's ability to support the divested business is critical to deciding what services can be offered, the terms that are applicable to those services, and how long the services are to be provided. This concern directly relates to the duration of the transition services and whether the acquired business can be easily folded into the buyer's existing IT infrastructure.

Buyer's Integration Needs. The issues the buyer faces and the questions it needs to ask typically are mirror images of the questions and considerations discussed previously for the seller. However, from the buyer's point of view, those questions and considerations may have a slightly different focus, such as the following:

- What, if any, transition services are needed from the seller after the deal closes to ensure that the acquired business continues to operate in the ordinary course until the new operations are integrated into the buyer's existing operations, how much will they cost, and how long will they last?
- Does it make sense to include the acquired business within the scope of the buyer's existing outsourcing and third-party technology agreements, if at all possible?
- Are there opportunities for the buyer to use new outsourcing contracts or third-party technology agreements to realize cost saving opportunities and synergies as part of the overall integration plan?

As part of the buyer's due diligence activities, it is important that it ask the

seller to identify all of the functions that the business will no longer receive from the seller after the closing. Such questions should include the following:

- What services and functions does the seller itself provide to the divested business?
- What services and functions does the seller provide to the divested business through third parties?
- How much do these third-party services cost and how are the contractual relationships structured?
- What third-party consents are required to provide the services, who obtains them, and who pays for them?
- How will the parties address intellectual property issues?
- What obligations and liabilities associated with the post-closing support of the divested business need to be transferred or shared?
- How will the parties address additional or new capital investments that may be required in the seller's systems and operations to support the divested business?
- How will the economics be structured for the transition services?
- How do the parties plan to address requests for new services?
- How will the parties structure their contractual governance processes?

By way of illustration, if a buyer only needs transition services for a few months, or the buyer can easily add volume or new sites to its existing agreements, or if the required services are not critical to the day-to-day operation of the acquired business, then the seller's ability or inability to provide some or all of the required services is less material. However, if the buyer requires transition services for a significant period of time or cannot easily add the acquired business to its existing agreements, then the buyer needs to understand all of the limitations on the seller's ability to provide the services. For example, the seller's IT outsourcing agreements may limit the seller's ability to provide help desk services to a divested business to a period of no more than six months. The buyer needs to be aware of this limitation so that it can start to put an

alternative solution in place as soon as possible, either by working with the seller to modify the outsourcing agreement or by finding a new service provider itself.

Understanding both parties' respective obligations and needs related to moving the divested business away from the seller's transition service offering and into the buyer's organization is therefore critical. Where these types of issues are identified and planned for early on in the transaction process, the parties will be prepared to address them and can allocate the appropriate resources to the

Identify all of the functions that the business will no longer receive from the seller after the closing.

issues. This attention in turn makes it easier to ensure that the transition services agreement will meet the needs of the acquired business and will be consistent with what the seller is permitted to do under its existing agreements.

Conclusion

It can be difficult to achieve all of the post-closing expectations of the parties in the sale of a business. However, with careful attention to the IT and outsourcing needs and anticipated requirements of both parties, each party will be in a better position to achieve its goals. Transition services agreements should not be an afterthought, but rather should be the seller's last operational interaction with the divested business and the buyer's initial stepping stone toward successfully integrating the business into its existing operations. **BLI**