Information Technology Lawyers: Adding Value In Corporate Transactions

By Barbara Lippett

Transaction teams involved in buying or selling a business, or part of it, need to fully understand the value and complexity of the information technology assets that form part of the deal. Technology transfer issues are commonly overlooked in the purchase, sale or restructuring of a business. This article explains why it makes good business and legal sense to include in the transaction team a technology lawyer who understands the business and the role that technology plays in it.

Technology Considerations Of The Transaction

A number of critical technology-related issues must be resolved early in the transaction process to help ensure the success of the transaction, minimize each party's risks and reduce technology transfer costs. At a minimum, each question set out below should, ideally, be settled before the parties begin negotiating the purchase and sale, but in any event, before the agreement is signed by the parties.

Which IT assets are being transferred? One of the first steps in a transaction involving significant IT assets is to determine which IT assets are to form part of the purchased assets. IT assets include not only hardware, software and equipment, but also data, databases, websites and all license, support, outsourcing and application service provider (ASP) agreements related to those assets and the operation of the business. Intellectual property and all related agreements may also form part of the IT assets being transferred.

Once the IT assets have been identified, they should be listed on a purchased-assets schedule or an excluded-assets schedule. The completeness of these lists is critical since the vendor makes representations and warranties with respect to title, ownership, completeness, non-infringement and sufficiency of the assets.

It is not uncommon for these schedules to include, mistakenly or not, IT assets that are needed by the vendor to operate the remaining business or that are used by the vendor's parent company or other related business divisions. Such IT assets may be so integral to the operations of the remaining business that they cannot be easily or cost-effectively separated from the target business. It is also not uncommon for the purchaser to discover (often late in the transaction process) that software, hardware, data or service arrangements needed to operate the target business are not being transferred because they were not on the purchased-assets schedule.

Unexpected problems that arise late in the transaction process can be resolved, but at a cost to at least one of the parties. For example, if a software application is *not* listed on the excluded-assets schedule, the vendor may have to negotiate a license back from the purchaser to use the software application after the sale. On the other hand, if an IT asset is not listed on the purchased-assets schedule, and the vendor elects not to transfer it (and is not in breach of its representations and warranties in doing so), the purchaser may have to negotiate a bridge or interim license for the continued use of the IT asset until it can acquire or develop the technology itself.

Who uses the IT assets? The next important step is to identify whether the technology is used exclusively by the business being sold or whether it is shared with various business affiliates or a parent company. If the technology assets are dedicated solely to the target business, the transition process will be much easier than if the IT assets were shared. Dividing up a company's IT assets upon a sale is often neither easy nor cost-effective.

Unless the transaction team allocates sufficient time to meet with those individuals who are most familiar with the company's information technology, IT assets may be incorrectly identified as shared or dedicated. If the vendor has agreed to sell IT assets that it mistakenly identified as dedicated to the target business, it may find itself negotiating a license back from the purchaser, at a cost, for the continued use of the IT asset. If assets are shared but are critical to the operations of the target business, the parties will have to agree on whether shared assets form part of the deal. If shared assets are not being transferred, the purchaser may want to adjust the purchase price to reflect the additional costs it will incur to acquire the necessary technology. Whether or not shared assets are being transferred, a detailed transition plan will be required.

Who supplies the technology? Often IT assets and services are provided by third parties through contractual arrangements with the parent company or a related company, not with the target business. After a sale or corporate restructuring, the technology provided by a third party may not be available to the purchaser – at least, not in the form it was provided before the sale. The transaction team should determine whether the technology is provided by the target business itself, is outsourced, is provided through an ASP arrangement or is provided by another entity within the corporate family.

If the purchaser determines that third-party technology is required to operate the target business, the parties must determine how the technology will be provided after the sale. For example, will the third-party provider permit a service bureau arrangement, and if so, at what cost and for how long?

Who owns the IT asset? Determining who owns the IT asset is fundamental to the success of a transaction. The vendor must fully understand what it has rights to and what it is permitted to sell free and clear. Is the technology proprietary to the target business – that is, was it developed in house or otherwise acquired by the company? If developed in house, was it by independent contractors or employees? Did the independent contractors assign to the vendor all their intellectual property rights in the technology? Is the technology licensed from third parties? If so, who is the licensee – the parent or the target business? No vendor wants to discover that it has mistakenly agreed to transfer a valuable piece of software that is actually licensed by the parent company, not the business being sold. If the vendor's parent company licenses mission-critical IT assets for use by several of its subsidiaries, it is unlikely that it will agree to transfer such IT assets. Therefore, the parties will need to determine who will pay the cost of acquiring the additional technology that will be transferred to the purchaser as part of the transaction.

What post-closing obligations will the parties have? The parties need to agree on whether there will be any post-closing obligations on either of the parties, and if so, how long these post-closing obligations will continue. For example, if it is discovered that the target business does not own mission-critical technology, and the vendor has made representations and warranties as to title, the parties may agree to obtain the necessary rights to sell or use the technology after the transaction has closed. The parties need to agree in advance on what steps will be taken if the necessary rights are not obtained and which party will bear the financial cost of acquiring the new technology. Each party may bear some cost (legal and otherwise) in fulfilling post-closing obligations if IT assets cannot be fully transferred as part of the transaction. However, each party's goal should be to reduce these costs and, if possible, eliminate surprises that would necessitate unpredicted post-closing undertakings.

Adding Value

Why do IT assets typically not receive appropriate attention from the transaction team? Corporate lawyers may not have sufficient knowledge to identify and resolve the unique technology-related issues that arise in corporate transactions. They may be reluctant to discuss with technical personnel subject matter that they do not fully understand.

Few corporate lawyers would undertake a corporate/commercial transaction without seeking the assistance of, for example, a lawyer with expertise in tax, environmental or competition law. Given the complex corporate structures of, and the integral role that technology plays in, business organizations and the delivery of services, a technology lawyer who is familiar with technology and the various means of acquiring rights in technology can add value to the deal. This lawyer can form a bridge between the technical personnel and the transaction team. The bridge is essential for the smooth transfer of IT assets. The technology lawyer can explain the legal requirements to the technical personnel while gathering valuable information to be used in drafting and negotiating the transaction documents. A technology lawyer can assist the client in identifying the "right" people to speak with and the "right" questions to ask, propose creative solutions to minimize a party's risks and help reduce the costs of closing the deal.

Critical Success Factors

The following factors are critical to the successful transfer of IT assets in corporate transactions:

1. *Make your technology lawyer an integral part of the deal team.* Bringing in the technology lawyer to implement a deal that has already been settled is not an effective use of the technology lawyer's time or the client's dollars. A technology lawyer should be an integral part of the deal team, and adds value to the corporate transaction – from negotiating the letter of intent, through conducting due diligence, to negotiating the purchase and sale agreement and fulfilling the post-closing undertakings.

2. *Conduct thorough due diligence.* Both the vendor and the purchaser should agree on which IT assets will be included in the transaction. The vendor should also determine what its rights are in the IT assets and whether any third-party consents are required. It should obtain this information before it agrees to warranties and indemnities relating to the IT assets. To fully understand which IT assets are required to operate the target business, the parties should allow sufficient time to meet with the IT experts and to investigate which IT assets are being transferred (see "Which IT assets are being transferred?" above).

3. *Negotiate a transition services agreement.* Even in share transactions, some services and IT assets provided by a third party may not continue after the target business is sold. Early in the transaction process, the parties need to prepare a transition services agreement. Technical personnel of each party should, with the assistance of technology lawyers, identify which IT assets will be required by the vendor after closing, how they will be provided, how long they will be needed, whether or not third-party consents will be required to continue providing the services and which party will bear the cost of the transition services.

4. *Negotiate a deal you can live with.* It is critical to clearly define post-closing obligations agreed to by each of the parties and for each party to be aware of these. In particular, the vendor should know how long its obligations relating to the transferred IT assets will last. The vendor may be surprised to discover that the transaction documents provide for post-closing obligations to go on indefinitely – for example, securing consents, transferring purchased assets, or acquiring new assets to be transferred as part of the purchased assets.

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