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DOING DEALS IN A TIME OF CHANGING TECHNOLOGIES

Contracting Principles for Changing Technologies, Platforms, Structures: Autonomous, Robotics or Whatever Comes Next

Morgan Lewis Automotive Hour

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With US and global experience in mergers and acquisitions, **Robert W. Dickey** helps both public and private companies close domestic and cross-border deals. He also advises clients on issues that arise in joint ventures, strategic alliances, and investment transactions. Although he focuses his practice on representing companies in the media and technology industries, Rob also counsels strategic and financial clients in many economic sectors.

Rob represents a variety of clients, including a leading international educational company, a global high-tech engineering corporation, as well as one of the largest US media outlets. In addition to his M&A work, he also advises clients on corporate governance and compliance matters.

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Edward J. Hansen brings more than 20 years of experience representing clients in technology transactions that involve significant business change. From the early stages of deals, Ed works closely with clients and their advisers on whole deal advice, often before a request for proposal is sent, and continues his support throughout the engagement's life cycle.

Ed employs a highly collaborative approach in counseling clients that are executing technology-enabled programs that require substantial supplier/customer interdependence, such as information technology outsourcing, business process outsourcing, and complex system integration not only for newly sourced deals, but also for troubleshooting and realigning problematic deals and sourcing distressed processes.

What we hope to accomplish today

A Threshold Issue: Complexity

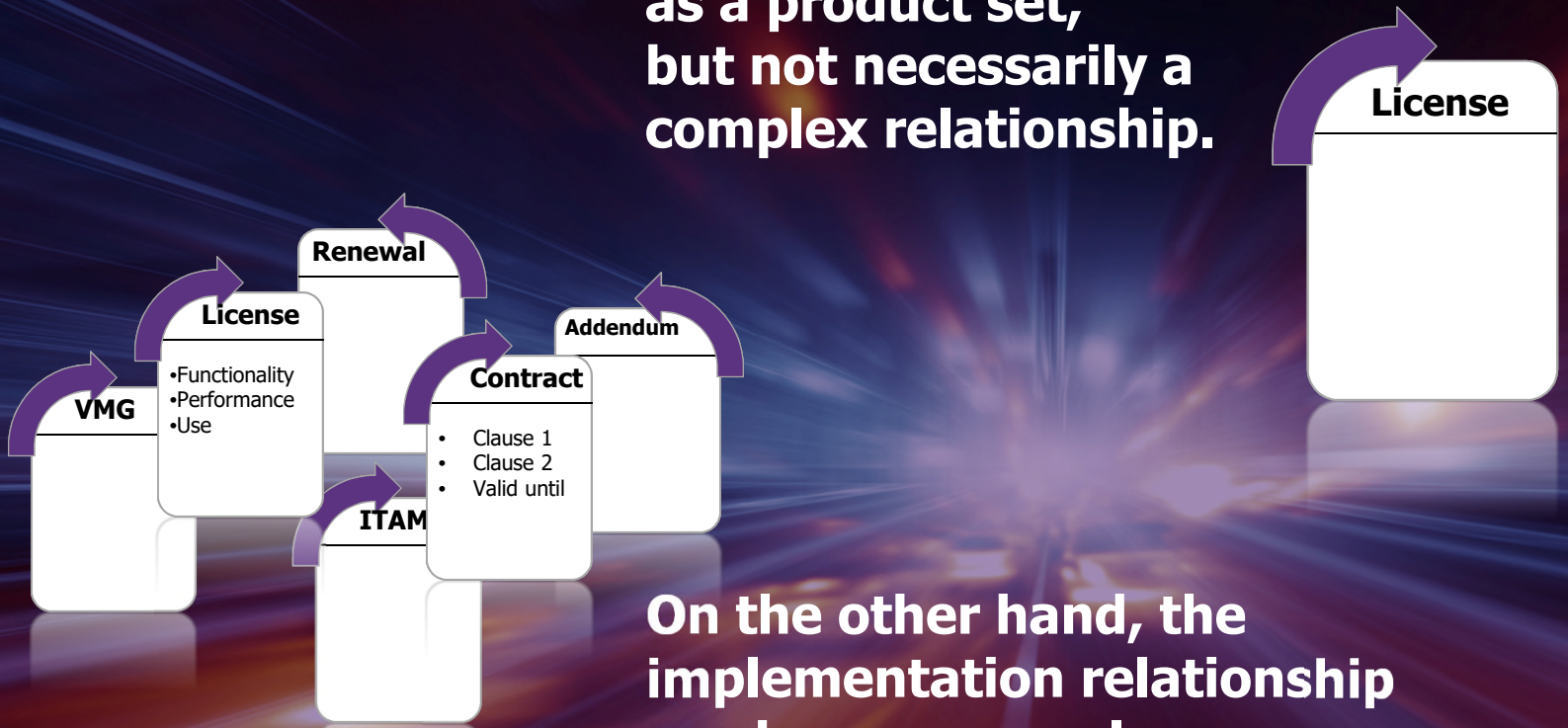
Relates to the complexity of the relationship, not the product	
Complete, Simple, or Commodity	• For our purposes, defined only by how the product can be contracted • Completely describable in a contract • Supplier agnostic • Inverse relationship between price and value
Complex	• Parties are very interdependent • Neither can be truly successful without the input, support and cooperation of the other • Economic rents may be involved • The relationship between price and value may not be inverse

What to Make of Complexity

- The contract is an extremely important element of any technology deal
- A great contract is important, but it will not save a sub-optimal business deal
- Make sure the deal is right, and then make sure that deal is reflected in the contract
- Because in a complex contract incomplete contract economics apply, pricing models need to be flexible
- The contract *process* should be an integral part of getting the deal right

Licensing and Implementing Technology are Different Contractual Exercises

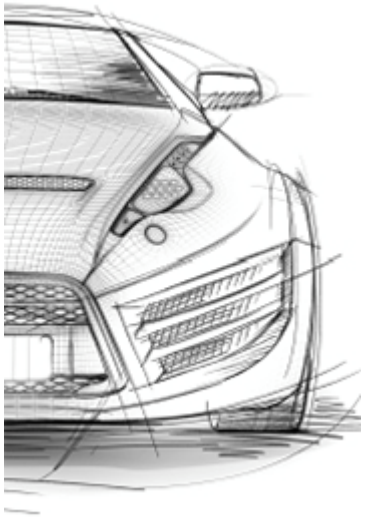
Technology can be complex as a product set, but not necessarily a complex relationship.



On the other hand, the implementation relationship can be very complex.

Contractual Complexity Hinges on the Nature of the Parties, Not the Product

Technology by Itself May Not Have the Attributes of a Complex Relationship



Attribute	Complete Contract?
Functionality	Yes
Performance	Yes
Lower Price = More Value	Yes
Technology Prescribed	Yes
Use Prescribed	Yes
Customer Input Not Required	Yes

Key Takeaway

- New technology is an example of a complex product
- Buying the technology may be very sophisticated and require deep industry knowledge

But

- Once defined, the resultant contract is not "complex" by our definition
- That does not mean that it is trivial or easy
- The contract to buy or license the technology may be very sophisticated

Why is The Implementation Relationship Complex?

Example 1: Internal Systems Integration (technology that changes how you work)

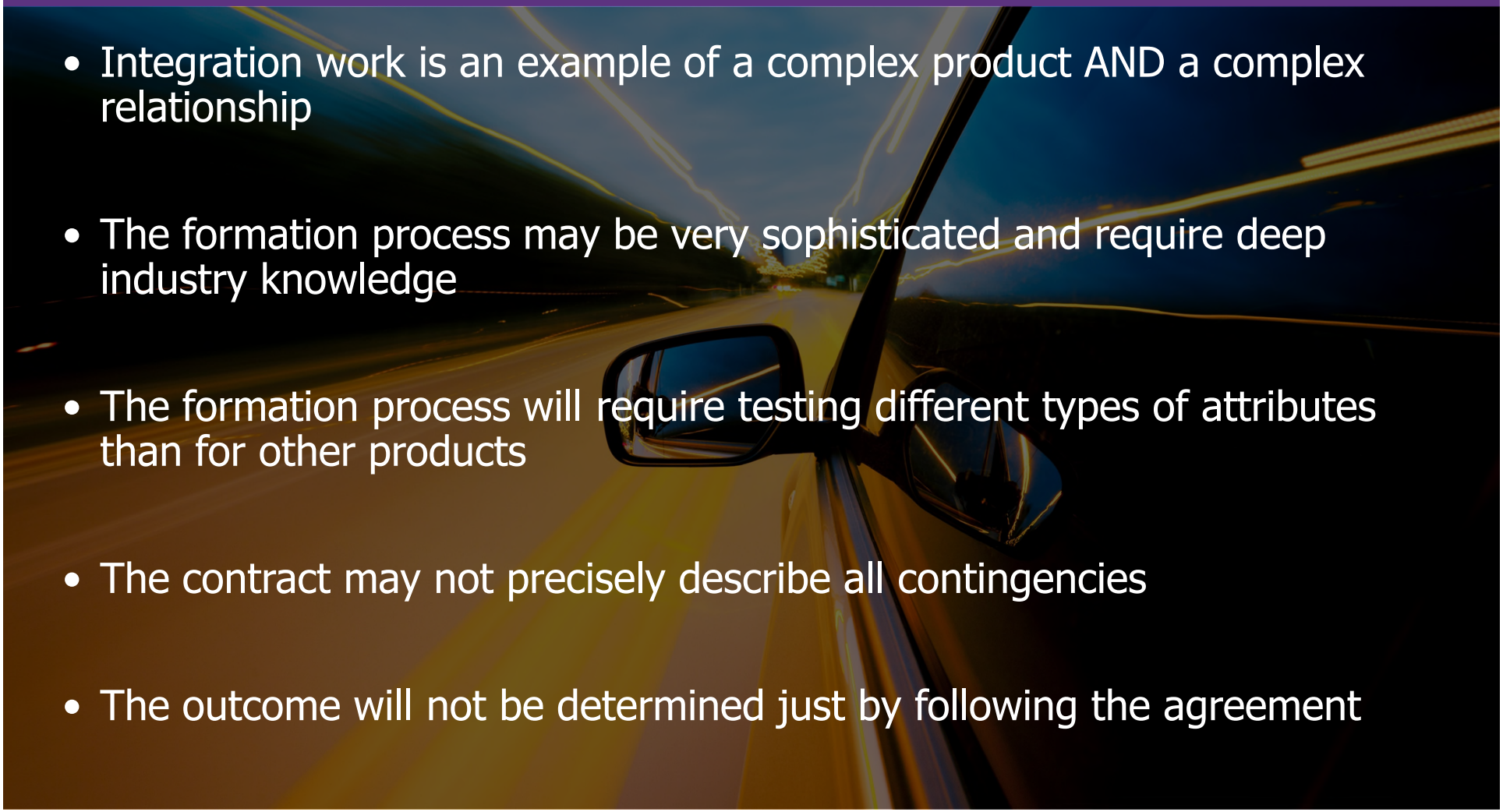
Skill	Sample Complexity
Domain Skills	• Understand base functionality and how to apply to business • Architect to allow scaling and to align with business • Moving business requirements, to functional specs, to technical specs • Strong business analytics required
People Skills	• May have to act as change agent; integral part of OCM program • Facilitation experience and effectiveness
Vertical Experience	• Supplement for scarce resources • Street Credibility – been there, done that • Required for certain aspects of design work
• Requires a high level of interaction • Neither party can be successful without the other's cooperation	

Why is The Implementation Relationship Complex?

Example 2: Taking New Technology To Market With a Partner

Skill	Sample Complexity
Domain Skills	• Understand base functionality and how to apply to market • Design business model to allow scaling and to align with business • Balancing what's possible with what's smart • Strong business analytics required
People Skills	• May have to act as an external change agent • Joint marketing can be tricky to align properly • Developing the right relationships is critical
Vertical Experience	• Supplement for scarce resources • Street Credibility – been there, done that • Required for business modeling, etc.
• Requires a high level of interaction • Neither party can be successful without the other's cooperation • Assuming good technology, the business model will be critical to success	

Key Takeaways



- Integration work is an example of a complex product AND a complex relationship
- The formation process may be very sophisticated and require deep industry knowledge
- The formation process will require testing different types of attributes than for other products
- The contract may not precisely describe all contingencies
- The outcome will not be determined just by following the agreement

Applying Complexity to the Contract

Attribute	Complexity Applied
Enforceable by law	• Interactive nature can create gaps in the responsibility chain • May be difficult to sue because of evidentiary complexity • Cost (in money and inconvenience) may be prohibitive
Requires mutual assent	• Allows parties to understand their obligations without duress • Procurement process can skew this (maybe not legally, but certainly practically)
Remedies are damages, consequential damages, and specific performance	• Terms may be largely market driven • May not want specific performance if the relationship is bad • Will not collect damages if you don't want to sue • Still an avoidance value

Economics vs. Financials

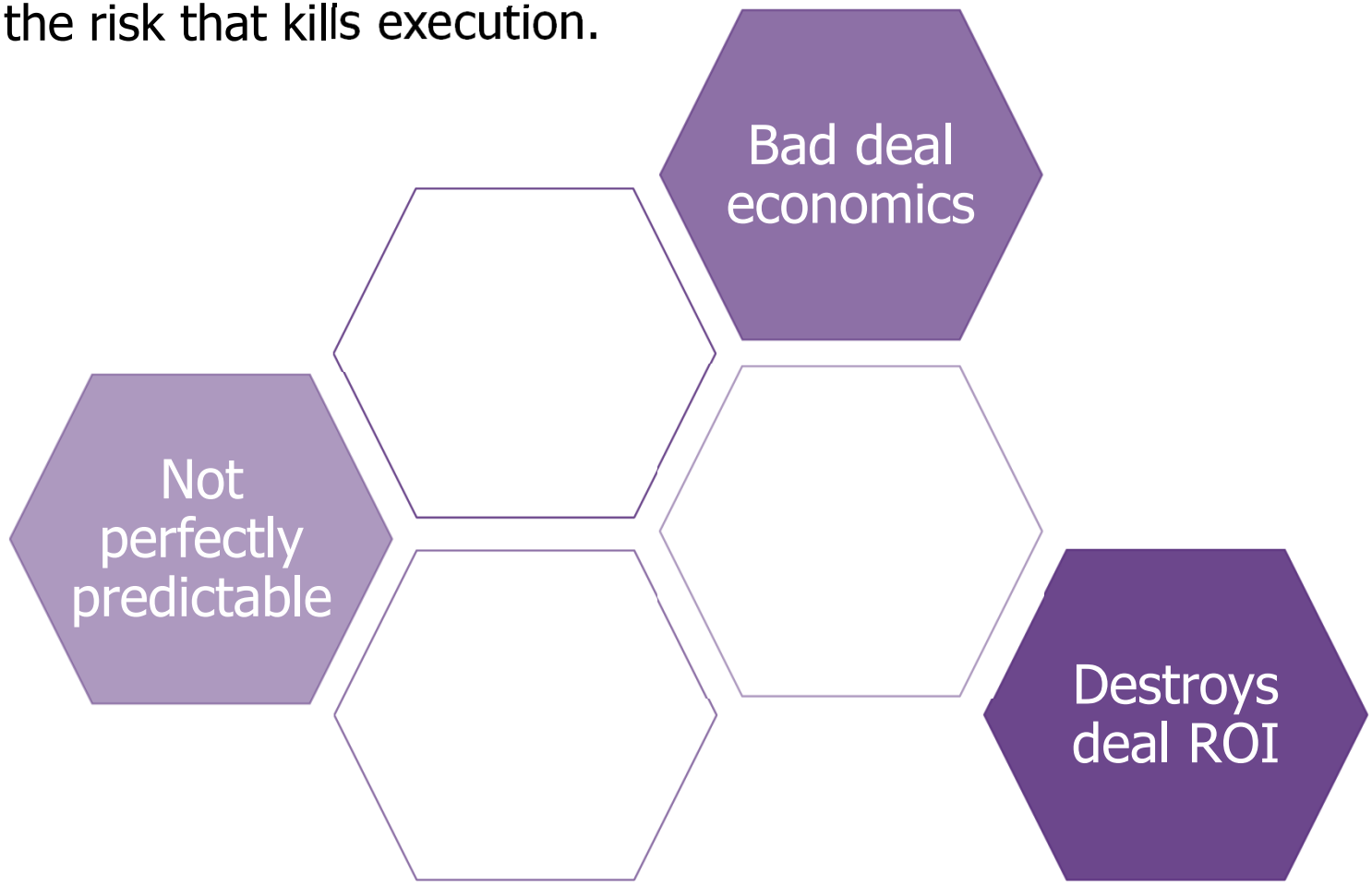
Risk

Structural or Static Risk

Static Risk is within our comfort zone.

Execution or Dynamic Risk

This is the risk that kills execution.



Dynamic Risk Factors

Factor	Potential outcomes
Choosing the wrong person to partner with	Cultural or capability mismatches resulting in over-reliance on a contract
Inappropriate timing of buy process	Poor partner match; Ill-defined deal; Poor transitions
Failed or Incomplete Software Implementation	Lack of functionality, automation, creation of costly workarounds, failure to realize business case
Failed Transition	Cost of delay, wasted resources, customer impact
Insufficient Change Management	Poor operational alignment, employee attrition, failure to achieve buy-in to solution
Inappropriate pricing	Too high or too low; Use a pricing model and a rate card to stay aligned.
Over-leveraged buy process	Over-commitment from Vendor leading to a death spiral early in the deal.
Misaligned SLA's	Increased probability of a hostile environment which will drive up transaction costs.

Risk: Allocation or Mitigation?

Risk Allocation…

- Shifts risk to the other party.
- Not a great strategy for complex deals.
- Is largely market driven.

Risk Mitigation…

- Lowers the amount of overall risk.
- Offers better results for both parties.

Some Relevant Terms (Examples)

Risk Allocation	Risk Mitigation
Limitation of Liabilities	Objectives
Indemnities	Service Levels
Compliance with Laws	Pricing Model
Privacy/Data Protection	Certain Personnel Provisions
Certain IP Provisions	Staffing Plan
Certain Warranties	Certain Warranties
Others?	Others?

Looking for Outcomes

Driver	Select Terms or Schedules Impacted
Scalability at a fixed and known level of price and service quality	• Pricing model based on transaction-level resource units with no or very high upper limit for SLA relief • Where solution is mixed FTE/RPA, consider technology mix in whether pricing remains constant
No loss of institutional knowledge when workers leave	IP; Transition/Transformation/Production Run best practices
Reduced training and other costs associated with employee turnover capability	Fee Schedule; SLA Schedule
Reduced risk of theft or misuse of information by Service Provider Personnel	Data protection; Security
Potential increase in employee morale (less repetitive tasks, etc.)	Employee engagement SLA; customer satisfaction
Detailed Data Capture and improved analytics	SOW
Better compliance (decreased human factor)	MSA/SOW

Strategic Contracting

Attribute	Implication
Puts the DEAL first	Emphasis on execution, not just terms
Concentrates on ROI	Looks at overall investment (including up front costs), including soft costs, to maximize return on investment
Minimizes Low Value Negotiations	Moves the focus to business-driven, ROI impacting terms
Tests Relationship Attributes	• Avoids the RFP prisoner's dilemma • Recognizes that contracts based on relationships succeed where relationships based on contracts fail
Recognizes Incomplete Contract Economics	Focuses on deal economics
Product Flexibility	• Structure flexibility or substitution whenever possible; leverage tokens or burn down when forecasting is questionable

Strategic Contracting

Attribute	Implications
Contract as conduit for business	Design the contract to put a stake in the ground for the business
Sales and contract cycles combined	• Use the contracting cycle to make the sales cycle more productive • Use problem solvers to your advantage
Negotiate the substantive contract outside the contract	Most efficient way to negotiate a complex contract is not getting bogged down in contract language
Defines and describes relationships	The relationship is key. If the relationship is betrayed, the non-betraying party should be made whole

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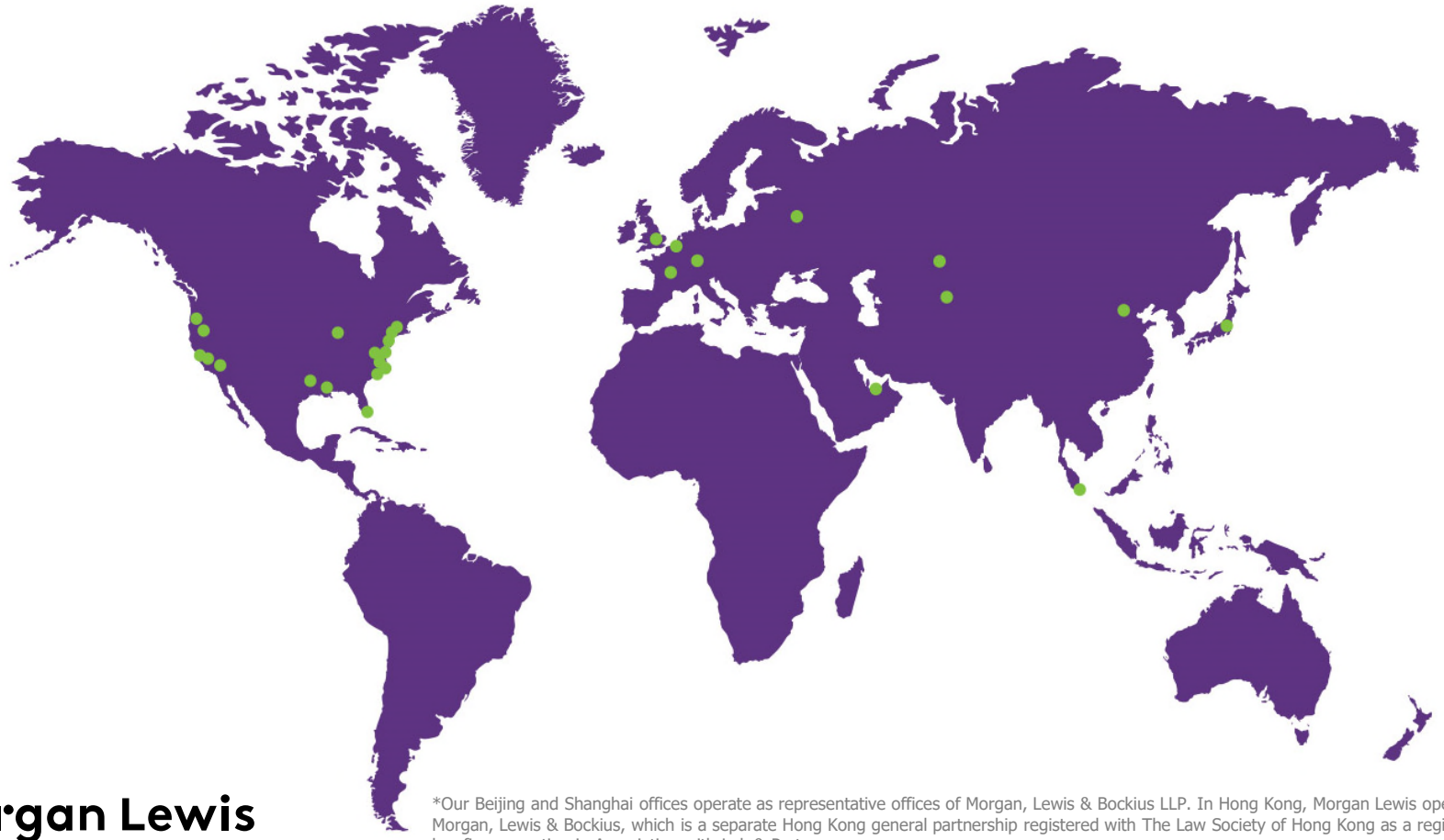

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