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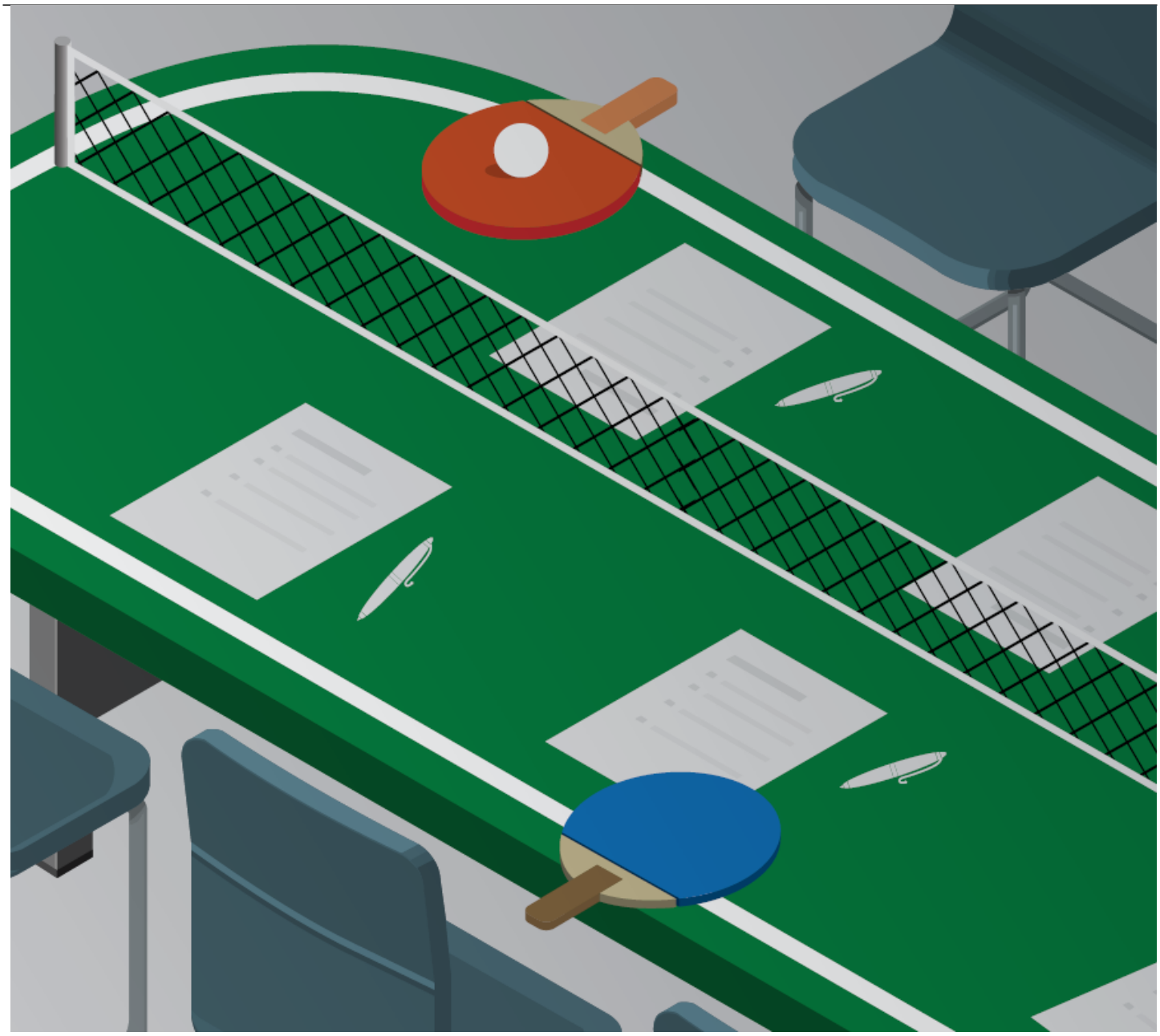
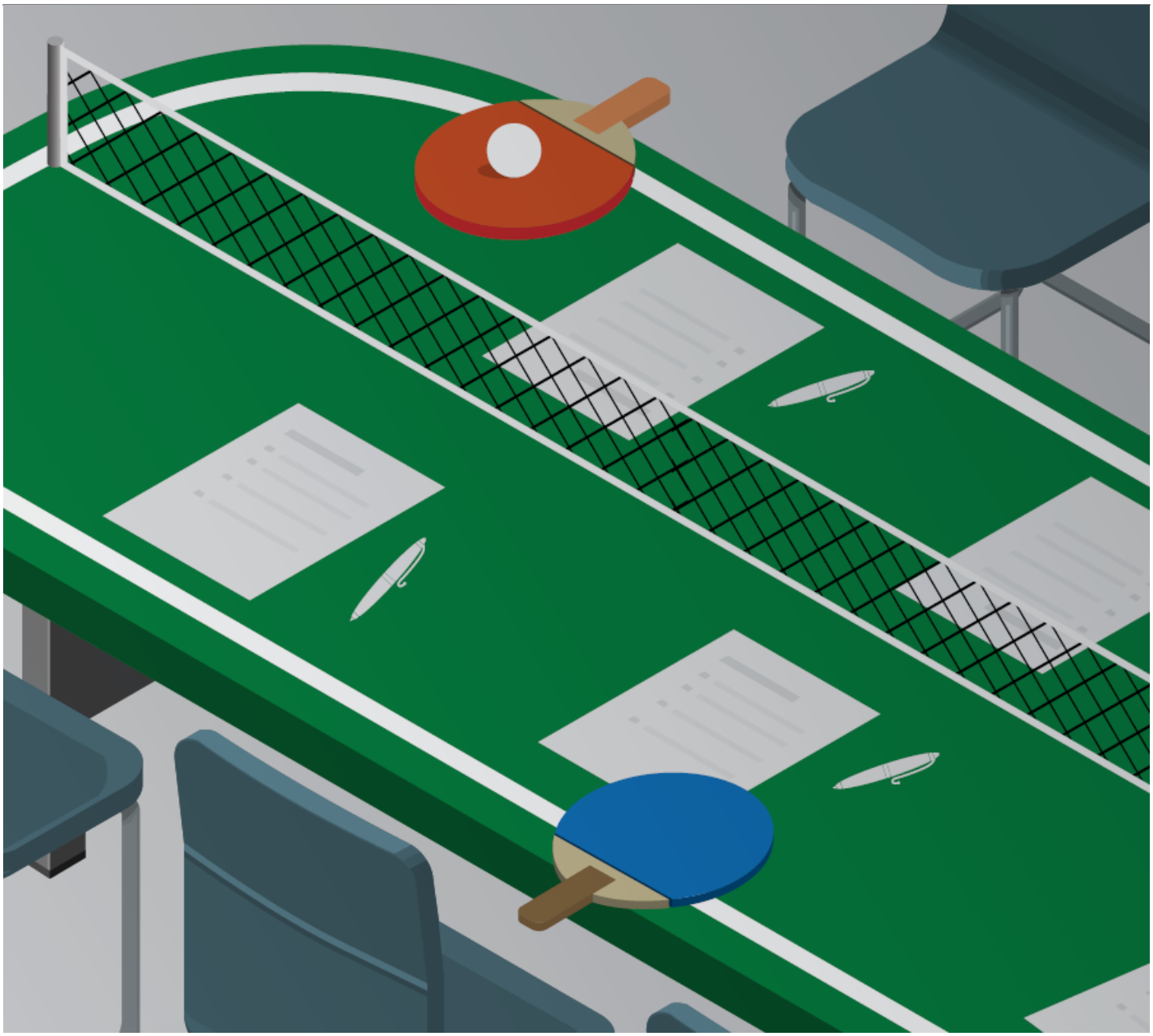
Tools for Efficiently Engaging and Closing Business Transactions

Commercial and Contracts

Skills and Professional Development





CHEAT SHEET

- ***The bottom line***. To increase efficiency, in-house counsel must fully understand the bottom line of each issue to prepare for how the acceptance or rejection of each proposition affects the negotiation.
- ***Act to leverage***. Business and legal teams should meet regularly to discuss each party's real and perceived leverage in a potential transaction and act accordingly.
- ***Cards on the table***. To ensure agreement with terms that are vitally important to your company, it is imperative that in-house counsel submit these concerns during introductory discussions.
- ***Eyes on the prize***. In-house counsel should monitor the market to remain competitive throughout the negotiations process, and adjust given strategies to capitalize on industry fluctuations.

Successfully engaging strategic partners, customers, or suppliers and subsequently closing the transaction is an art. It requires a balance between being upfront about key facts — those that are nearly immutable and go to the core of who you are as a partner, supplier, or customer — while emphasizing your strengths and, therefore, the reasons why the other party should accept the core challenges of doing business with you. As in-house counsel, we often work alongside our business teams to close multiple transactions, often all happening at once. So with our knowledge of how transactions typically go, we can and should bring efficiency to the process by encouraging our internal business clients to use competent negotiation practices and tools. The essence of negotiation efficiency is understanding your ask and bottom line, and all other options in between, while simultaneously considering how each issue's acceptance or rejection affects whether or not you will accept or reject related issues.

Meet Sam (of Seller Company) and Bethany (of Buyer Company). Bethany is the founder and general counsel of Buyer Co. Buyer Co is building and distributing, under its own brand, a virtual reality headset. Buyer Co is one of the top three largest distributors of virtual reality headsets and, therefore, has its pick of component suppliers. Buyer Co controls the design, and therefore, the component suppliers of the headsets. Sam works for Seller Co, one of many small hardware suppliers whose components may be built into a virtual reality headset. Seller Co is the designer and manufacturer of Component X, and Sam would like to convince Bethany that she should use Component X because of its superior quality and the value-add of the integration of its technology into her headset.

Understand and behave according to the leverage of the respective parties.

Before discussing specific business and legal terms with their counterparts, the business and legal teams should have an internal discussion about each party's real and perceived leverage in a potential transaction. Often times, parties adopt egos commensurate with their companies' cache or market share. Failing to acknowledge your team's position relative to its counterparts, particularly if you are the underdog, can frustrate your potential business partner and, worse, communicate to him or her that your team just "doesn't get it." Specifically, your team's leverage should inform and dictate: (1) the tone of emails, verbal communications, and the revisions and margin comments in any agreements or documents exchanged, (2) the length, format, style, and readability of any proposed agreements, and (3) the speed with which you respond to requests for follow-up either through written or live clarification. In sum, if your team is the underdog, and they need the business relationship for strategic reasons, particularly more so than their counterpart needs them, then as their in-house counsel, you may want to advise them that they will get farther if they are fairly "easy to do business with."

For example, if Seller Co and Buyer Co are looking to build a strategic commercial relationship because Seller Co can provide a higher end version of a component that may be of interest Bethany, given her buy-side position, she will likely decide whose "base" agreement they will use and lead the engagement. If it is more convenient for Bethany's team to use their own agreement because she and the team often execute this type of transaction and have a standard agreement, Bethany will likely send over the first draft and either subtly or clearly state that she does not expect too many revisions. This subtle hint can come in the form of a PDF version. Alternatively, she may state in a

cover email to the agreement: “Please do not mark up this agreement. Instead, let me know if there are certain issues on which you’d like further clarification.” She may send an e-signature link, signaling that she rarely negotiates the form, many recipients acquiesce, and she expects nothing less this time.

When Sam responds to Bethany’s email, savvy in-house counsel should advise that if he chooses to return revisions, (1) he should consider returning minimal revisions, responding to her language, and not replacing it with his own just because he prefers to use familiar language, and (2) any proposed revisions should be material, not his idiosyncratic language and style preferences. “Material” here should be a fairly high bar, meaning the revision alters the risk profile of the agreement. Sam should also consider including explanatory comments alongside his revisions in the document margins, using the “insert comment” function, instead of just revising language with no explanation. In-house counsel can add significant value in this situation by encouraging Sam to demonstrate, via his margin comments, that he is open to feedback and continued conversation and, most importantly, that he is asking for well-reasoned revisions, not just being stubborn or lazy.

It is also our role as in-house counsel to help Sam understand what is a reasonable request and what is not. From a drafting and relationship perspective, if you get this wrong, you risk spending valuable resources removing your preferred terms when you actually have more leverage. Alternatively, you run the risk of including unreasonable or aggressive terms when you have less to offer in return. For example, if Sam asks Bethany to provide broad, nonmarket indemnification protection in a supplier agreement in which Seller Co supplies and licenses the hardware and enabling software of Component X, he may risk killing the deal. If Bethany wishes to continue the relationship, just to show him who’s on top, she may threaten to walk away, go silent for a long period of time, reply with even more rejections and counter-proposals, or all of the above. When in doubt, in-house counsel should encourage the business team to follow the relationship owner’s lead; such owner is in the best position to understand each party’s respective position.

Gain alignment with the right people on “non-market” deal-breakers early in the conversation.

If your team seeks agreement on important, but non-market or unfamiliar (to the other party) terms that, if not met, would cause you to walk away from the negotiations, it is prudent to advise them to bring those up in the introductory, high-level discussions. Specifically, if: (1) the economics of the deal do not allow you to take on certain risks that your counterpart reasonably expects you would, and/or (2) you are working with a startup or a party that is unfamiliar with the business models within your industry, you will reduce the amount of wasted resources and frustration if you explain your business model to your counterpart’s senior legal and business teams early on in the relationship. That means discussing it, maybe not during the first kick-off meeting, but within the first two or three meetings.

For example, Seller Co’s designers and engineers may not work alongside patent attorneys that can mitigate the likelihood that its products do not infringe patents where Buyer Co operates, imports, exports, makes, and distributes its virtual reality headsets. Depending on the relevant jurisdictions and IP environments, the absence of such patent experts at Seller Co creates greater risk of an IP infringement claim. Given the unpredictability of patent infringement claims in multiple jurisdictions, Seller Co’s bottom line cannot handle these potential lawsuits. Buyer Co, however, should not be expected to bear the risk because Buyer Co is not the designer or manufacturer of Component X. Nonetheless, if Sam’s position is that Seller Co cannot take on responsibility for certain IP risk, he

should be as transparent as possible, communicating this to Bethany very early in their discussions, well before the term sheet phase. Early transparency is powerful because it fosters trust when one party is trying to convince the other that he or she is not being unreasonable in his or her position. It also saves both parties from wasting time if they are able to quickly decide that they cannot satisfactorily allocate the risk and accept each other's terms.

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In preparation for this conversation with Bethany, Sam's in-house counsel may need to help him distinguish between moral and economic arguments, the latter of which are difficult to dispute. It's hard to dispute Sam saying: "Given the low margins on component parts, this business is not profitable for me if I take on IP risk." Such a statement is likely more accepted than: "Even though I'm the creator of the IP, you should take on the risks of the IP." There is a strong so-called moral argument against the latter statement, and such a statement may create frustration and make Sam appear unreasonable and nearly ridiculous to Bethany. In contrast, the former statement opens the door to the parties discussing Buyer Co potentially paying more for Component X in exchange for Sam's agreement to take on the IP risk. If they get to this point in the discussions, Sam will need to decide whether the potential IP litigation would demolish the higher profit margins or not. Sam's in-house counsel can add value here and conduct diligence on the relevant IP environments, coaxing Sam to ask Bethany: "In what jurisdictions do you plan to operate?" Sam could then subsequently research litigation environments, sophistication of the courts, maturity of the patent systems, and recent regulatory and litigation trends. Armed with this knowledge, Sam can make a well-informed decision, even if it means actually hiring patent attorneys to work alongside the creators of the IP in Component X. If Sam hires patent attorneys, but only agrees to take on IP risk at a higher price, with this open dialogue, Bethany can decide how much she wants to do business with Sam and, if still interested, how her approach to the transaction will change. If she does not agree to pay Sam a higher price for Component X, but instead decides to take on the IP risk and continue discussions with him, Bethany now needs to consider developing her own IP hedging strategy and accruing an IP litigation reserve on her balance sheet.

During all of the give and take in the negotiations, the parties must not forget those deal-breaker terms that are paramount to continued business operations or the value and use of their product. For example, if Buyer Co is hired to stitch together virtual reality content for a movie studio or online media platform, Bethany would want to ensure that she does not agree to injunction terms within any dispute resolution clauses, allowing the other party to force Buyer Co to stop producing or distributing certain content. Similarly, if Buyer Co licenses a Software as a Service (SaaS) product to its customers that is required to enable the headset's hardware, Bethany may need to require each end user to license back its user data so that Buyer Co can anonymize, aggregate, and analyze the data in order to improve the software. Given the essential need for such a cross-license, if Bethany is negotiating with individual or enterprise customers, as opposed to the thousands of B2C users, in which case she would just need to include such terms in the end user license agreement (EULA), she should not mention this cross-license for the first time in a draft agreement. Instead, Bethany should make this clear in her initial conversations.

Of course, all of these upfront negotiations are only as useful as the people at the negotiating table. Far too often, teams go through months of negotiations and then learn that all of their "wins" still

need to be approved by a higher authority. Sometimes, it's a negotiation strategy, but other times, this issue is the result of the team's failure to ask who the ultimate decisionmakers are. Either way, Bethany needs to ensure that Sam does not have to answer to another person within his company and vice versa.

How to effectively engage and close a transaction

- Act according to your leverage.
- Get the right people to agree to deal-breaker terms up front.
- Agree on the big picture before you begin to draw the details, allowing no exception.
- Keep your pulse on the competition and your attractiveness in the market throughout discussions.

Move to detailed negotiations only once higher-level issues are closed, and agree that reopening one issue reopens all issues.

Getting aligned and feeling security around agreed upon deal-breakers often proves to be more difficult than many expect. Suddenly changing your business priorities, hiding the ball as a negotiation strategy, and allowing external factors or incompetant team members to affect negotiations may cause misalignment and deal fragility. Even with these difficulties, each team should ultimately remain flexible, and, with the help of in-house counsel, keep a thorough terms matrix so that the team can keep track of the risk profile of the transaction. Such matrix should outline detailed connections like: "If we give on Item A, then we need to push harder to increase protection with respect to Item C." In addition to creating a terms matrix, your team can benefit from a tiered approach to issue-spotting and terms alignment. Even though you want to appear flexible and natural in your discussions, you may find it helpful to draft and work through a survey-style document of your agreed upon terms, only giving your counterpart (or yourself) specific answer choices.

To begin, start discussions with very high-level questions, and ask tiered, gradually broader questions only once you've gotten past the preceding tier. Tier 1 should include binary questions, typically that can only be answered "yes"/"no" or "Party A"/"Party B" or "Option A"/"Option B." Tier 1 questions should also include those issues that get to the bottom line economics of the transaction. For technology companies, especially, intellectual property is very often at the top of that list. For example, if Buyer Co wishes to engage Designer Co, a well-known design house, to jointly design a virtual reality headset, prudent in-house counsel will instruct Designer Co's team to ask Bethany upfront:

- "Do you want to form a new company that we will govern together, or do you wish to create a commercial collaboration?"
- "Do you own any relevant IP to contribute to the collaboration?"
- "Do you wish to jointly own any jointly developed IP, or do you prefer to own and license the IP back to me, as needed?"
- "Can each of us maintain rights to the derivative works created from our respective contributed IP?"

Revisiting the discussions between Sam and Bethany, given Seller Co's conservative capitalization, Sam may want to ask Bethany:

- "Do you agree to take on all risk and liability related to the IP of the final product, or would you rather pay me more in order to do it?"
- "Will you indemnify me against any losses incurred that are a result of any third party infringement claims, or do you expect that I indemnify you?"

Similarly, if Bethany needs to use enterprise customers' data in order to improve her SaaS product, she should ask potential enterprise customers during Tier 1 discussions, "Will you share anonymized data with us?"

After agreeing on what you've designated as Tier 1 issues, move to Tier 2 multiple choice or checkbox questions. If Bethany is purchasing Component X from Seller Co, after settling the IP issues, she may consider asking Sam the following multiple-choice questions:

"For which types of failures are you willing to offer a warranty on Component X: A. Workmanship, B. Workmanship and Design, or C. Workmanship and Materials?"

For licensing discussions between Bethany and Sam, Bethany may switch to checkbox questions. If Sam needs to license software that enables his components to work, Bethany may ask:

"What type of license do you wish to grant, choosing all answers that apply:

A: A1 – Worldwide or A2 – United States only or A3 – Americas or A4– China,
B: B1 – Exclusive or B2 – Non-exclusive,
C: C1 – Revocable or C2 – Perpetual,
D: D1 – Sub-licensable or D2 – Not sub-licensable or D3 – Sublicensable to affiliates, or
E: E1 – Percentage Royalties or E2 – Royalty-free?"

Finally, after Tier 2 items are closed, move to Tier 3. Tier 3 is for open-ended and "Other" answers. While moving through the tiers, it is paramount that the teams communicate upfront to their counterparts regarding the significance of closing each issue and, subsequently, closing a tier. Specifically, each team will want to make it clear that agreement on an issue is contingent upon the continuity of all previous agreements made up to that point. In other words, when Sam agrees to a price for Component X, it is contingent upon whether or not he or Bethany is taking on IP risk. If Sam passes the IP risk to Bethany, Sam may charge a lesser price. However, if Bethany agrees to take on this IP risk during initial, Tier 1, discussions, but then changes her position based on a changing patent litigation environment or the advice of a newly hired patent attorney, for example, she should expect that Sam's price, a Tier 1 issue, is now open for renegotiation, as it's directly matrixed to his IP exposure. These types of surprises happen more often than one may think, but in-house counsel's goal should be to create strong disincentives for counterparts to attempt such a surprise in the middle or end of negotiations.

This strict, tiered structure may seem extremely stale to some, yet severely obvious to others. While it may be a stale approach, what you will ultimately gain in efficiency makes up for any awkwardness or staleness. Further, if you don't keep a clear terms matrix, you may get lost in all of the related issues that need to be reopened. More casual negotiation styles may give the impression that all terms are fluid and open to renegotiation, leading your counterparts to continue to try and chip away at closed terms until both sides walk away in frustration, confusion, and exhaustion. Too often business teams

waste months and even years of time because they dug into Tier 2 and, worse, Tier 3 questions without agreeing on the deal-breaker Tier 1 issues. Or they allowed their counterpart to reopen a Tier 1 issue — one as important as who takes the IP risk — and did not immediately threaten to walk away in a move to demonstrate their strong opposition. Such failure often communicates lack of strategy, leverage, or both. Ultimately, months and millions of dollars of resources could be on the line.

> As in-house counsel for either party, take some time to listen to the market alongside the business. Sam's team should listen to Bethany's response to his arguments balancing quality and price. Bethany's team should listen to her customers and gauge what they prioritize.

Monitor the market and its appetite for your business model in order to remain competitive, and adjust your model or decide to pull out and recalibrate, as needed.

Finally, as in-house counsel, in order to gain the business team's trust, you must demonstrate your understanding of the business and appreciation of their goals and challenges. This includes your clients' specific business model, industry trends, and the relevant business, regulatory, and economic environment. In some industries and geographies, many of these factors will continue to change. For instance, because of growing technologies, your team and their competitors are trying out new business models in the market, and you're not sure how the market — your customers and/or end users — will respond. Consider Sam's options when he is designing and manufacturing Component X. He can try to compete based on price, assuming the market prefers a less expensive headset, or he can try to compete based on superior design and subcomponents, taking a gamble that Bethany will purchase his components because of their high-end quality and her ability to emphasize that to her receptive end customers. As in-house counsel for either party, take some time to listen to the market alongside the business. Sam's team should listen to Bethany's response to his arguments balancing quality and price. Bethany's team should listen to her customers and gauge what they prioritize. If Sam emphasizes the importance of higher quality components for a slightly higher price, and Bethany rebuts with the importance of her being able to sell her headsets at a competitive price, then Sam has his feedback. The takeaway could be that a lower price is more important than quality in certain geographies, among certain demographics, or with respect to certain commoditized products. It's worth encouraging your business teams to do an analysis of these issues and reconsider their model, from price to the commercial terms that affect the bottom line and risk profile of the transaction.

Three ways to discourage heavy revisions to an agreement

- Clearly state in a cover email that you will not accept a redlined agreement, but are open to high-level discussions;
- Send a locked, PDF version of the agreement; and,
- Send an e-signature link along with the agreement, signaling volume and cooperation.

Conclusion

In sum, closing a transaction requires self-awareness, skilled but honest communication, matrixed organization, and market awareness. Changes in the market may lead to changes in leverage and, therefore, require an adjusted negotiating approach, facilitating continued efficiency. As in-house counsel, we often have many transactions on our plates with limited resources, one of the most important ones being time. As such, we can increase efficiency and company productivity among our business development and strategic teams by sharing intradepartmental knowledge and tools learned after successfully completing previous transactions and, in some cases, watching other transactions fail.

Charlotte Lewis Jones

Senior Director, Lead Counsel, Global Strategic Partnerships

Flextronics

Charlotte Lewis Jones is senior director, lead counsel, global strategic partnerships at Flextronics,

located in San Jose, CA. In this role, she partners with and advises senior executives on diverse matters such as foreign direct investment, global regulatory risk and compliance, antitrust and critical dispute and litigation risk, deal structure and restructuring, labor force management, corporate formation and governance, global trademark and brand strategy, commercial and IP strategies, and the reconciliation of competing legal, revenue, and branding goals. She began her legal career with Skadden, Arps, Slate Meagher & Flom, and received her Bachelor of Arts in Economics from Yale University and her Juris Doctor from Columbia University School of Law.