

506 Effectively Integrating Acquired Businesses into the Legal Environment

Gary Friedman

Senior Vice President & General Counsel
Agouron Pharmaceuticals, Inc.

Johanna Rogers

Director, Global Plans & Operations
EDS Legal Affairs

Andrew A. Shayer

Counsel, Printing & Communications Papers
International Paper Company

Faculty Biographies

Gary Friedman

Gary Friedman is senior vice president and general counsel of Agouron Pharmaceuticals, Inc. in La Jolla, California.

Mr. Friedman worked for several San Diego-based law firms prior to cofounding Friedman, Jay and Cramer, APC (FJC). During the next 10 years, while practicing law at FJC, he was instrumental in cofounding two major publicly held corporations, Pace Membership Warehouse, Inc., which was sold to K-Mart in 1989, and Agouron Pharmaceuticals, Inc., which is now a subsidiary of Pfizer Inc.

Mr. Friedman has been active in a number of professional and civic organizations. He is a past chair of the San Diego County Bar Association Taxation Section and vice chair of the Executive Committee for the California State Bar Association Taxation Section. He is also a member of the San Diego Regional Chamber of Commerce, BIOCOM, ACCA, and the San Diego Dialogue. He has lectured widely, including for the USC Tax Institute, and is published in numerous journals, including the *Journal of Taxation*.

After receiving his JD from the University of California Boalt Hall School of Law, Mr. Friedman completed the requirements for a Masters of Business from the University of California, Berkeley.

Johanna Rogers

Director, Global Plans & Operations
EDS Legal Affairs

Andrew A. Shayer

Counsel, Printing & Communications Papers
International Paper Company

Gary Friedman**Issues Affecting Integration of Legal Functions of Acquired Businesses****ACCA's 2001 Annual Meeting, October 2001**

As mergers and acquisitions have blossomed around the world, Acquired Company's Legal functions are being integrated into existing legal support systems.

The Acquiring Company's Legal Departments are often required to provide legal advice in new areas and perform risk management. Sometimes the new business comes with its own in-house counsel, sometimes it does not. These seasoned experts will discuss integration issues and the kinds of management and reporting procedures and policies being used to integrate legal functions.

ISSUE: WHAT IS THE GOING FORWARD STRUCTURE AND THE AUTHORITY OF THE LEGAL DEPARTMENT OF THE ACQUIRED COMPANY?

NOTE: The friendly or hostile nature and the rationale of the merger will have a major impact on this issue.

Is the prior stand-alone performance of functions a post-merger option? Can the Acquired Company's Legal Department continue with its prior legal environment, except for the sourcing of certain functions from the Acquiring Company or from outside resources?

NOTE: A stand-alone legal operation will still need significant knowledge transfer about how the legal operating rules of the Acquiring Company are to be followed.

Will the Acquired Company's Legal Department be required to report up to the Acquiring Company's legal managers who will be responsible for all legal functions with duplicate legal positions being eliminated?

Will there be an interviewing of all employees to determine who will fill the remaining positions?

How will the performance criteria be established and interviews conducted?

Will the Acquired Company's former General Counsel report to line position or to General Counsel of Acquiring Company? What will be the dotted-line-reporting relationship?

How will outside counsel be engaged?

ISSUE: WHAT IS THE GOING FORWARD STRUCTURE AND THE AUTHORITY OF THE LEGAL DEPARTMENT OF THE ACQUIRED COMPANY?

COMPANY BUSINESS OBJECTIVE: THE GOING FORWARD STRUCTURE OF THE ACQUIRED COMPANY'S LEGAL DEPARTMENT MUST BE ALIGNED WITH HOW THE ACQUIRING COMPANY'S LEGAL FUNCTIONS ARE TO BE PERFORMED

Will best practices be discussed during the integration process?

COMPANY BUSINESS OBJECTIVE: MINIMAL DISRUPTION IN PROVIDING LEGAL SERVICES TO GOING FORWARD CLIENTS

ACQUIRED LEGAL DEPARTMENT OBJECTIVE: GAIN A "SEAT" AT THE TABLE FOR MEMBERS OF THE ACQUIRED LEGAL DEPARTMENT

NOTE: Problems of keeping a stand-alone environment in the Legal Department include:

- n Legal Department will not be invited into legal management system
- n Legal Department will not be invited to meetings where major legal projects are assigned
- n Legal Department may not be recognized as a legitimate advisor with authorized power to make final decisions

NOTE: Specific communication from top management can overcome certain of these problems.

ISSUE: HOW WILL THE EMPLOYEES OF THE ACQUIRED COMPANY'S LEGAL DEPARTMENT RECEIVE INFORMATION ON HOW THE ACQUIRING COMPANY'S LEGAL FUNCTION IS CARRIED OUT, AND ON THE BACKGROUND OF ITS LEGAL STAFF?

Soft public information sources will permit collection of data on personnel.

Post-merger briefings provide for significant exchange of information on, not only backgrounds of staff, but on legal capabilities in various functions.

How does the Acquiring Company want the legal function to be accomplished, including specific issues such as HR, IP, licensing, contracting, litigation, and regulatory?

Does the corporate approval process at the Acquiring Company mandate changes in operating styles of Acquired Company's Legal Department?

ISSUE: HOW CAN WE COMMUNICATE THE CAPACITIES OF THE EXISTING LEGAL STAFF TO THE GENERAL COUNSEL, LEGAL STAFF AND MANAGEMENT OF THE ACQUIRING COMPANY?

Different levels of communication are permissible as the merger process moves forward.

Determine what communication is appropriate at pre-merger due diligence sessions/after signing of merger agreement/day 1 post-merger/beyond day 1 post-merger.

NOTE: Business, anti-trust and other legal limitations limit disclosure of information at certain points in the merger process.

NOTE: Acquiring Company's Legal Department review and analysis of Acquired Company's legal documents and structure will have a major affect on attitudes about whether the members of Acquired Company's Legal Department should be retained.

Care should be taken in preparation of organizational chart and resumes to be provided to Acquiring Company's General Counsel during first contact meeting, meetings with other legal managers of Acquiring Company and managers of Acquiring Company.

NOTE: Introduction package should include description of functions and successes performed by each of the members of the Legal Department.

ISSUE: HOW WILL THE EMPLOYEES OF THE ACQUIRED LEGAL DEPARTMENT FIT INTO THE EXISTING STRUCTURE OF THE ACQUIRING COMPANY WITH REGARD TO:

The right level of responsibilities

The proper titles

The level of compensation

Do the compensation packages of the two Companies differ in material ways, such as:

- n Availability of bonus versus majority of compensation included in base pay
- n Availability of options

NOTE: Many of the compensation issues may not be resolved at the outset of the merger.

Does the Acquired Company have a severance program, which encourages people to leave?

**ISSUE: WHO ARE THE ONGOING CLIENTS
OF THE ACQUIRED COMPANY'S LEGAL DEPARTMENT?**

NOTE: Loyalties to old managers are often hard to change.

**ISSUE: HOW CAN THE EMPLOYEES OF THE ACQUIRED COMPANY'S
LEGAL FUNCTION EARN THE TRUST OF THE ACQUIRING COMPANY
THAT THEIR SKILLS AND MOTIVES SUPPORT THE GOALS OF THE
ACQUIRING COMPANY GOING FORWARD?**

**ISSUE: HOW WILL THE INTEGRATION OF THE ACQUIRED COMPANY
AFFECT ALL OF THE ABOVE ISSUES?**

Will the Acquired Company be fully integrated or operate as a stand-alone operation?

If the functions of the Acquired Company are removed to the Acquiring Company and the previous clients of the Legal Department are eliminated, will there be a need for the legal capacities present in the Acquired Company?

Differences often arise in the desires of senior management of the Acquiring Company to preserve the best aspects of the Acquired Company versus the line management of the Acquiring Company's desire to fully integrate and control the functions of the Acquired Company?

MERGER, EVEN IF EXCITING CAUSES A SENSE OF LOSS

Feelings of loss occur on the announcement of:

- n The deal
- n Organizational structure
- n Relocation
- n New boss
- n Loss of compensation and benefits

Operating styles of two companies may be different:

- n Differences may be perceived or real
- n Real differences may involve issues affecting:
 - n Personnel
 - n Communication
 - n Decision-making
 - n Employee development
 - n Organizational structure
 - n Performance management
 - n Process orientation
 - n Resource allocation
 - n Success criteria
 - n Work environment

Merger causes:

- n Uncertainty and ambiguity
- n Deterioration of trust
- n Self preservation
- n Communication problems
- n Drop in productivity
- n Less team play
- n Power struggles
- n Low morale
- n Weak commitment
- n Bailouts

Each stage of integration process may trigger:**Stage 1. Shock and Numbness****Stage 2. Suffering****Stage 3. Resolution****Typical attitudes of each stage:****Shock and Numbness**

- n This will go away
- n I can just keep on doing my work like I have been

Suffering

- n This is bad for my career
- n I can't make a difference

Resolution

- n Change is here to stay
- n I need to change as the organization changes
- n How can I fit into the new order?

Managers can help employees get through each stage:**Stage 1. Shock and numbness**

- n Get everything out into the open
- n Be realistic
- n Be patient
- n Be non-defensive

Stage 2. Suffering

- n Listen
- n Spend more time with people
- n Keep people involved

Stage 3. Resolution

- n Don't rush recovery
- n Expect setbacks
- n Different people will take longer times to recover
- n Continue teambuilding
- n Manage

You will be more comfortable during times of change if you show:

- n Flexibility
- n Innovation
- n Risk tolerance
- n Stress tolerance

Methods exist for increasing your tolerance levels in problematic situations.**MERGER PRESSURE POINTS****Communications:**

- n More questions than answers
- n Rumor mills
- n New information routes
- n Confusion over whom to include
- n Less willing to commit to decisions

Behaviors required:

- n Over communicate
- n Tell the full truth (good, bad and ugly)
- n Don't tell when you don't know
- n Tell why, how and what
- n Check for understanding
- n Ask for feedback

Productivity:

- n Loss of focus lowers productivity

Behaviors required:

- n Reprioritize
- n Focus short-term goals
- n Exploit instability to get goals accomplished
- n Cope, adapt, exploit, create
- n Don't go back to status quo; instead, look for ways to deal with new environment

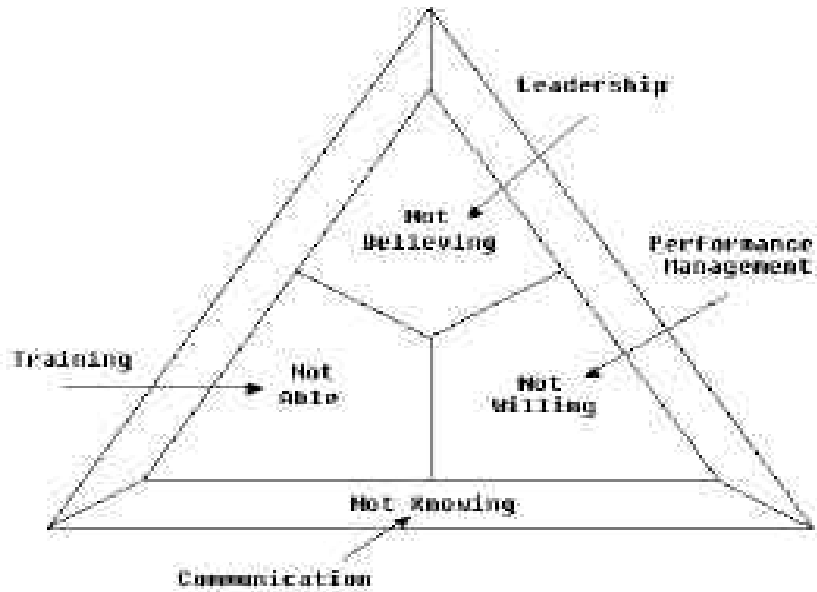
Resistance:

- n Misperception of merger situation
- n Low tolerance for ambiguity
- n New standards of performance
- n Can't see benefits
- n Stand to lose more than they gain
- n Displaced feelings
- n Believe change is wrong or bad

Behaviors required:

- n Identify source of resistance
- n Analyze types of questions employees are asking

RESISTANCE DYNAMICS



Managers should act based on the type of resistance problem the employee is experiencing:

- n If resistance comes from "**Not Knowing**" explain reasons for change and provide sense of direction
- n If resistance comes from "**Not Able**" provide training, communicate events to be dealt with to build their confidence
- n If resistance comes from "**Not Willing**" create a supportive environment, set clear standards of performance, alter reward system to support change
- n If resistance comes from "**Not Believing**" explain reasons for merger, give leadership and exhibit managerial courage to stand up for your own beliefs

COST OF LOST TALENT IS HIGH

- n Higher salary for replacement persons
- n Placement fees
- n Recruitment costs
- n Time involved in selection process
- n Time spent orienting and training
- n Loss Productivity
- n Relocation
- n Loss of knowledge and experience of departing employee, delay in goals satisfaction, delay in projects, knowledge transfer, impact on moral of organization

RE-RECRUITMENT GUIDELINES

- n Operate from the premise that everyone is considering other employment
- n Identify your key people (rank on scale)
 - n Re-recruit your key people
- n Make target person feel special, not taken for granted
- n Keep communication lines open and active
- n Try to give individual key role, special assignment that makes it clear that he or she is a highly valued individual
- n Understand what motivates your people individually and as part of your team
- n Consider giving a raise, title or "stay" bonus, more control on project
- n Don't assume people are planning to stick with you just because they're not talking about leaving
- n Be willing to be unfair
- n Determine motivator that manager can use in retention process

BEST PRACTICES FOR LEADERS

- n Start managing the transition when the deal is announced
- n Protect productivity
- n Control amount of destabilization
- n Be realistic about cultural differences
- n Manage the turnover
- n Conduct necessary soft due diligence
- n Set your priorities carefully
- n Be bold
- n Put dollar signs on decisions
- n Offer "Quick Impact" training on merger management
- n Give your workforce a proper merger orientation
- n Take care of the "me" issues
- n Give yourself permission to make some mistakes
- n Keep focus on clients
- n Make everyone responsible for merger success

BEST PRACTICES FOR MANAGERS

- n Engineer some early wins
- n Communicate
- n Manage expectations
- n Provide leadership vs. politics
- n Be willing to be unfair
- n Re-recruit your key people
- n Exploit instability

Fire Up Commitment:

- n Be passionate in your job commitment
- n Provide a strong sense of purpose
- n Engineer and honor achievements
- n Delegate power to every person
- n Make your people feel needed
- n Assign generous responsibility for results
- n Be intolerant of weak commitment
- n Aim employees toward work they love
- n Prove you're committed to your people

BEST EMPLOYEE PRACTICES

- n Control attitude
- n Be tolerant of management mistakes
- n Expect change, be a change agent
- n Don't blame merger for all the bad things
- n Get to know the other company
- n Use merger as growth opportunity
- n Keep a sense of humor
- n Keep doing your job
- n Don't panic or act like a victim
- n Try harder
- n Don't play it safe
- n Take risks
- n Keep standards

Merger Integration: Lessons Learned from the Trenches

By Andrew A. Shayer

In a period of four years, International Paper acquired by merger Federal Paper, Union Camp Corporation, and Champion International Corporation. I was in-house counsel for one of the companies International Paper was acquiring, and now that I am in-house counsel for International Paper, I have had a chance to see how postacquisition integration can play out on a daily basis. To give you some idea of the overall scale, before these transactions, International Paper had sales totaling \$17 billion. Federal had sales of \$3.5 billion in the year before its acquisition by International Paper, Union Camp had sales of \$4.5 billion, and Champion had sales of \$6 billion. Today, International Paper enjoys total revenues of \$26 billion. Our company is now an amalgam of people from all four companies, and nearly everyone has a lesson to share about the complex process of the integration. If you've never been through the integration phase of mergers and acquisitions, our lessons learned may help save you some time on the learning curve.

The transaction may be legally complete at the closing, but the real benefits often cannot materialize until a successful integration has occurred. Management must make decisions quickly on a huge range of issues. Regardless of the business you're in or the size of the acquisition, management will have some common expectations of in-house attorneys. The premise of this article is that the in-house lawyer must be more than a resource. You need to do your homework, and you should be prepared to step out of the traditional role to maximize your contribution and the success of the integration.

To contribute to a successful integration, counsel should take the following steps:

- n Understand the business.
- n Know the targets that clients are expected to deliver to shareholders, such as efficiencies and synergies.
- n Understand the acquired company's businesses and practices.
- n Carry out postmerger due diligence.

- n Make clients aware of the trouble areas.
- n Monitor integration activities and move quickly to solve problems.
- n Follow up and execute.

This article will explore, based on our experiences, what is involved in each of these steps and how their prompt and effective execution will contribute to the benefits realized. We've found that the period of time immediately after the merger or acquisition can be chaotic, especially with people moving to and from positions. You will need a plan, and if you've never been through the exercise, you may not realize that you should have had a plan or what the plan should have contained until it's too late. You will need to do your homework long before the integration process begins. You will need a foundation in the business, as well as the trust and confidence of your business clients. And once the process does begin, you will need to maintain a focussed, structured, and sustained effort. The preclosing due diligence, to the extent a meaningful due diligence will have been carried out, will just scratch the surface and at best will give you a place to start.

UNDERSTAND THE BUSINESS

To fully appreciate the tactical importance of issues as they arise, to prioritize, and to know how best to resolve or address the issues, counsel need to understand the business. Over time, of course, you can pick up what you need to know about the business by being inquisitive, knowing your business clients, and absorbing available written material on the business. But merger and acquisition situations often accelerate the schedule for needing to know various aspects of the business. To be the most help to your client in a merger integration, you will need to research and understand the following aspects of the business:

- n Products.
- n Customers: who they are and what they do.
- n Value perceived by customers in their relationship with you as a supplier: why they buy from you and not from another company.

- n Challenges faced by customers today and in the future.
- n Challenges faced by your business and industry.
- n Strategies developed to face these challenges.

NAIL DOWN EXPECTATIONS

Like knowing your business, it is helpful to understand what the parties expect and what has been promised to shareholders by combining the two organizations. The important assets to be leveraged and exploited could include people, technology, facilities, or any number of operational or product efficiencies. Depending on the final goals, the strategy for the business and consequently the integration process may vary significantly. It is crucial to identify the strategies to achieve the targeted goals so that all related legal issues can be visited at the earliest opportunity. For example, it may be that manufacturing will be rationalized, meaning that facilities will be closed and that not all customers can be served. On the other hand, the objective may be to expand operations, meaning that as many customers as possible must be retained.

KNOW THE ACQUIRED COMPANY'S BUSINESS

For the same reasons, you need to know about the acquired company's business the same elements that you need to know about your own company's businesses. Especially in the early stages, before you have access to the acquired company, one of the best sources of this information is your own sales and marketing group. Out of competitive necessity, they will know a good bit about their competition, including products, strengths, weaknesses, and reputation. Another source is the various strategic documents prepared for senior management's evaluation of the acquisition, as well as the strategic planning documents of the acquired company.

For reasons that will be more fully developed below, it is critical to understand how the acquired business is organized in order to understand the internal and external relationships that affect the business. Organizations evolve differently, and each organization has some unique way

to get things done. The larger the business or company, the more complex the web may be for getting things done. Often, there are significant differences in organizational structures that must be recognized.

CARRY OUT YOUR POSTTRANSACTION DUE DILIGENCE

Many mergers of public companies involve little, if any, preclosing due diligence for a variety of reasons, including unsolicited bids. In cooperation with your business clients, you will still need to carry out due diligence as you work your way through the integration process. You will certainly need to understand what effects the merger will have on the many relationships the business has, and you'll have to handle the routine tasks of clearing contract contingencies, getting consents for assignments, and so forth. For purposes of the actual integration of the businesses, however, you will need to conduct due diligence in far greater detail and continue it as revised business strategies begin to develop. In this respect, your due diligence will go on well after the actual closing.

One of the most important areas for due diligence in merger integration is that of third party relationships. You'll need to start by having a complete list of all the relationships the acquired company has with third parties. Third parties include customers, suppliers, service providers, and joint enterprise partners. This aspect of due diligence work is where your knowledge of the acquired company's organization becomes important. Some companies may be organized such that the manufacturing organization is independent from the sales and marketing organization. Others combine these functions within one organization or division. Gaps develop when there are differences in functional alignment.

For example, one of the business units that International Paper acquired as part of a larger company handled its own exports and had responsibility for the associated business infrastructure, including profits and losses. Within the acquired company, exports were handled by a separate organization. Because their export organization handled exports for all businesses, there were distribution agreements that dealt with products from several different businesses.

And now, the model we have been moving toward is to have geographic centers of operation, meaning that the existing organization in a geographic region would have responsibility for sales of all products from outside the region. There are probably dozens of possible permutations. Resolving these different approaches in the two companies has required considerable research, sorting, and regrouping.

Similar merger integration issues could arise relative to almost any functional area, including research and development, overseas operations, intellectual property licenses, purchases, and joint ventures. Any cross-functional agreement could present similar issues, especially if communication is inadequate. Effective communication on such issues often requires broadening perspective and helping those concerned to gain an appreciation of the importance to other businesses or groups within the organizations. Consequently, unless you make the effort to facilitate the communication, you may not learn about the agreement until after you could have more effectively dealt with it.

Consistent with this general reasoning, it is important to understand how the various staff groups within the acquired company support their organization. For example, purchasing can be dealt with in any of a number of ways. Purchases can be managed at the corporate level, at the business unit level, by the individual manufacturing facility, or in any combination of the above. Different attorneys may independently support each function, similar to the way International Paper has organized its attorneys. So unless you actively seek such information, it is conceivable that you may not know about certain contractual relationships. For example, if the manufacturing organization dictates new purchasing practices that are inconsistent with the rest of the organization, you may have a breach of agreement to manage that might not have occurred if you had had all the information you needed earlier on.

In your due diligence, look for the following cross-functional agreements:

- n License agreements.
- n Joint development projects.
- n Contract services.
- n Purchasing.

n Bundled sales agreements.

After you have assembled a complete list of relationships, what should you do with it? For the most important relationships, you will have a file of some kind with miscellaneous documentation and a written agreement. The purpose, scope, and intent of the agreement may appear unambiguous, but what you see in writing may not reflect the true state of the relationship. Immediately after the merger, you will have access to resources and people that may not be available later. Use those resources to find out whether the written agreement is missing something important. Perhaps, for example, there may have been a significant capital expenditure made based on verbal assurances that the relationship would not be terminated. Also, keep in mind that there may be undercurrents that will inevitably lead to conflicting points of view that will need to be reconciled. Perhaps, the best example is an overseas joint venture. There may be a comprehensive shareholders agreement that specifies in great detail the rights and obligations of each party and how every decision is to be made. If you rely solely on the agreement, you may still breach the spirit of the relationship as it has evolved, and you may be painfully dependent on the good will of your joint venture partner for the achievement of your objectives. To give the best possible advice, you should have all the facts available.

Your assessment needs to include not only what is provided for in writing but also what isn't. As you flesh out the substance of each of these relationships, the potential issues will become apparent in light of what you know about your business, the acquired company's business, and the objectives of the merger. With enough good information about the relationships, you can begin thinking about potential solutions and communicate your concerns and suggestions in time to avoid potential problems.

MAKE YOUR CLIENTS AWARE OF THE POTENTIAL RISKS

It's easy to suggest that counsel be involved in every decision and know all that's going on. The process will move quickly, however, and you will probably be unable to review and evaluate every decision that needs to be made. So right up front, at the absolute earliest stages, make your

clients aware of the potential risks so that they can spot the red flags and help you get the job done right. You won't always be able to counsel in advance, but you can encourage your business clients to bring you the facts of a particular situation before making a decision. What follows are some observations and lessons learned in some of the potential trouble areas and suggestions on how you could avoid them.

Customer Reaction

International Paper is now the biggest forest products company in the world. We had customers that were buying a significant portion of their product requirements from International Paper and a significant portion from one or more of the acquired companies. Many of these customers like having many suppliers to keep us all on our toes. If you anticipate sentiments like these, you can develop some alternatives that will give the customer assurances that they won't be hurt by keeping all their business with you. The assurances that you will need to make will depend on the nature of the business. Usually, price will be important. You can suggest several mechanisms that your business clients can discuss with customers, including most favored nation, price protection, market index pricing, service guarantees, and so forth. Your clients will sell the "value proposition," but you may need to structure the relationship in such a way that the customers do not feel as if they're giving up too much to get what's being offered.

Protecting Intellectual Property

Before the merger and during the integration, there will be a vast amount of change, particularly for the acquired company. One of the areas of immediate exposure is attrition, especially when people take their experience and know-how to a competitor.

Here is an example that is probably illustrative of a number of points. Suppose that the acquired company employs an engineer coordinating development work under a joint development agreement project with a key supplier. This particular engineer resigns shortly after the closing. Let's say that this agreement is not one of the agreements that ever found its way to your desk, perhaps because the technology group supports a number of businesses. Eventually, you or your business clients find out about the project. The development agreement includes a

time limited exclusivity arrangement. Most of the time has now passed. You also learn that the engineer coordinating the work has gone to a competitor to start a similar development program. These sorts of experiences can make you think long and hard about how you would have done things differently.

We have a standard practice in such cases when an employee leaves the company to join a competitor. We write a letter to the employee, with a copy to the prospective employer, reminding the employee of the agreement that the employee had signed and the employee's general obligations to protect our trade secret information. We further identify the specific projects, programs, or other specific information to which the employee has been privy. The practice has paid unquantified, but significant dividends as evidenced by the responses we often receive. You may want to adopt a similar system.

Distributors, Agents, and Franchisees

One of the first priorities in realizing synergies and efficiencies is terminating redundant services. Although you may have agreements that indicate that you have certain rights to terminate such agreements, many states and many countries may have laws that limit those rights notwithstanding what an agreement may provide. The first step is to put your business clients on notice before the process begins. Later, simple and subtle changes to strategy may alleviate expensive problems. For example, let's suppose that you and the target enterprise have a separate, single distributor in a particular jurisdiction for similar competing products. One option is to terminate one of the distributors. Or perhaps, there is an opportunity to split the product line in some rational way that eliminates the need to terminate one distributor. There may be a benefit to the business, as well, because the remaining distributor could have difficulty adjusting to increased volume. Also, the long-term benefits may outweigh the short-term expense savings of termination. The issues associated with rationalizing service providers, including distributors and agents, may not be generally known to your clients. Many may be familiar with such laws, but some may not expect that distribution of a commodity may be protected by state franchise laws. If there have been stable long-term agreements, there may not have been a need to address such issues at any time in recent experience. If you've done your due diligence, you will know

what sales arrangements the target organization has, whom you need to talk to obtain any additional details, and what legal implications may be at play, and you'll have had a chance to develop some options.

Joint Ventures and Strategic Alliances

Joint enterprise relationships are often among the most challenging and deserve extra attention. Consider the effects to your existing relationships, as well as those of the target enterprise. Any agreements covering these relationships, such as shareholder agreements, may contain an enormous amount of detail. As previously stated, however, there may have been significant and important changes that may not have been documented. For example, obligations and procedures may have found their way into a shareholders agreement that might be impractical or may simply not have been enforced or followed for any number of reasons. In effect, the rules may have changed, but you won't find those changes in the agreement. Therefore, you will need to have an appreciation for the cultural and relationship issues, as well as the status quo that the parties have become comfortable with.

MOVE QUICKLY TO SOLVE PROBLEMS

Inevitably, there will be disagreements or conflicts that need to be resolved. Consider the following suggestions to minimize and solve such problems.

Ask your business clients to review their tentative decision with an enterprise partner before sending a formal notice. Despite your having reviewed files and having talked to internal contacts, there may be unanticipated or underappreciated facts or circumstances. This review may be a good way to flush out issues while you could still help your clients avert some calamity.

To the extent that you've inherited disputes from the target organization, the combined businesses may present new opportunities for resolution, whether it's diffusing personality conflicts or finding a new solution based on the combined resources. The opportunities may take a bit of effort to find. If, for example, you've inherited a significant customer dispute with the acquired company, there may be something new that you can offer. Sometimes, it's obvious, and

sometimes it's not, especially if it's a customer that's new to the organization. If you can, take the time to participate in a meeting with the new customer. As often applies to disputes, try to move quickly before damages mount or relationships sour.

You may get some advance warning regarding the transaction, but once parties have reached a decision, there may not be a lot of time before you'll get bogged down with all of the issues that always need to be dealt with. Don't wait too long. Seek out and read whatever you can get your hands on. Search the internet and look at periodicals, Wall Street analyses, SEC filings, and so forth. Talk to your business clients. What do they do well or not so well? What reputation do they have? At the same time, you can tell them why you are interested and the extent to which you will all need to be prepared for the next steps.

SEE THE PROCESS THROUGH

Keep Track of Developments

There may be a subtle evolution that takes place during the actual integration. What may have been clear to all at the early stages may begin to blur as your business clients learn more about the acquired company and its business. Now that you've got a list as long as your arm of the things that you need to do, you need to keep doing the things on that list to stay in step with what your clients are doing. New people will be coming on board, and people familiar with the operations and issues will be leaving. Under these circumstances, this step takes effort. Get out your list periodically, and make sure that nothing is falling through the cracks.

Follow Up

Identifying issues and communicating recommendations on resolutions are not going to be enough. Perhaps you've done your job, but the premise is that doing more is necessary and appropriate. In the example above describing the neglected joint development project, what if you had seen the file and had put the appropriate people on notice? Personnel changes can take place without notice. Be prepared to support and even educate people filling a position in a business that may be new for them. Given all that will be going on, organizational changes,

personnel changes, and all the work, it is so easy for important matters to fall between the cracks. Even the law department is not immune to such distractions. Our general counsel, William B. Lytton, has been on both sides of an acquisition, and now, so have many of our colleagues. Having been through the uncertainty, they are more sensitive to the people issues and the importance of making people comfortable and therefore productive as quickly as possible.

The process can be derailed anywhere along the line. You need to be out front, and you need to be the anchor. So you must follow up. You or your client may identify an issue, and you may discuss options and agree on a course of action. You may provide the necessary documentation to support the course of action, such as a contract amendment or a notice letter. Under normal circumstances, you've fulfilled your obligation. Given all that goes on in a merger, all of the issues, and all of the organizational changes, someone should be tracking the resolution of these issues. It is a role best assumed by counsel, but it takes a concerted effort to track and follow up on the resolution of so many issues.

Pitch in on Execution

If you have trouble facilitating action or finding the right person at the right time, you should be prepared to take the initiative and take the appropriate action as necessary to address the issues and problems. For example, you can always call your counterpart in-house counsel. Whether a customer or a supplier, these relationships are important to develop in any event. If there is an issue or a concern to be addressed, calling your counterpart may be a good way for you to take the initiative, if necessary.

Cleaning Up

Ultimately, the objective will be to prosper. A number of relationships will be redefined. You are in a good position to help structure these changes to maximize the benefit for all involved.

CONCLUSION

The business world is different now from the way it was years ago. Business consolidation will continue. By most accounts, mergers and acquisitions will involve some number of sleep-less nights and concern for lots of people, but they are mechanisms that enable organizations to accomplish what cannot be accomplished by any other means. The synergies or efficiencies derived from such transactions have helped to fuel the growth of our economy and have yielded shareholders enormous value. Many mergers and acquisitions have been successful, but many have not. As business changes, so must the role of the business lawyer. As in-house counsel, you have a unique perspective and background, and given the traditional role of the in-house lawyer in the transaction, you have access to all the resources and information to make a real difference. You can't sit back and react to problems as they arise. You are in house to do more.

Andrew A. Shayer is counsel, Printing and Communications Papers, International Paper Company, in Memphis, TN. With an undergraduate degree in engineering, he began his legal career as environmental counsel with Union Camp Corporation, broadened his scope to include the business side, and worked on, among other things, joint ventures and acquisitions. He joined International Paper through International Paper's acquisition of Union Camp. He would like to thank his colleagues, especially Laura Powers and Ted Niederriter, for their comments and suggestions for this article.

Explore information related to this topic.

ONLINE:

- n Antitrust Division of Department of Justice at www.usdoj.gov/atr/.
- n Federal Trade Commission, Antitrust/Competition, at www.ftc.gov/ftc/antitrust.htm.
- n Legal Issues and the Role of Outside Counsel in Mergers and Acquisitions (WMAACCA Chapter Program) at www.acca.com/protected/legres/program/wmacca/piper.html.
- n Sample Agreement and Plan of Reorganization for corporate merger at www.acca.com/protected/legres/agree/reorganization.html.



Gary Friedman

**Issues Affecting Integration of Legal Functions
of Acquired Businesses**

ACCA's 2001 Annual Meeting

October, 2001

Topic Summary

As mergers and acquisitions have blossomed around the world, Acquired Company's Legal functions are being integrated into existing legal support systems.

The Acquiring Company's Legal Departments are often required to provide legal advice in new areas and perform risk management. Sometimes the new business comes with its own in-house counsel, sometimes it does not. These seasoned experts will discuss integration issues and the kinds of management and reporting procedures and policies being used to integrate legal functions.

I-1

Issue: What Is The Going Forward Structure and The Authority of The Legal Department of The Acquired Company?

- **NOTE: The friendly or hostile nature and the rationale of the merger will have a major impact on this issue.**
- **Is the prior stand-alone performance of functions a post-merger option? Can the Acquired Company's Legal Department continue with its prior legal environment, except for the sourcing of certain functions from the Acquiring Company or from outside resources?**
- **NOTE: A stand-alone legal operation will still need significant knowledge transfer about how the legal operating rules of the Acquiring Company are to be followed.**

I-2

Issue: What Is The Going Forward Structure and The Authority of The Legal Department of The Acquired Company? (cont.)

- Will the Acquired Company's Legal Department be required to report up to the Acquiring Company's legal managers who will be responsible for all legal functions with duplicate legal positions being eliminated?
 - Will there be an interviewing of all employees to determine who will fill the remaining positions?
 - How will the performance criteria be established and interviews conducted?
- Will the Acquired Company's former General Counsel report to line position or to General Counsel of Acquiring Company? What will be the dotted-line-reporting relationship?
- How will outside counsel be engaged?

I-3

Issue: What Is The Going Forward Structure And The Authority Of The Legal Department Of The Acquired Company?

COMPANY BUSINESS OBJECTIVE: THE GOING FORWARD STRUCTURE OF THE ACQUIRED COMPANY'S LEGAL DEPARTMENT MUST BE ALIGNED WITH HOW THE ACQUIRING COMPANY'S LEGAL FUNCTIONS ARE TO BE PERFORMED

- Will best practices be discussed during the integration process?

COMPANY BUSINESS OBJECTIVE: MINIMAL DISRUPTION IN PROVIDING LEGAL SERVICES TO GOING FORWARD CLIENTS

I-4

Issue: What Is The Going Forward Structure And The Authority Of The Legal Department Of The Acquired Company? (cont.)

ACQUIRED LEGAL DEPARTMENT OBJECTIVE: GAIN A "SEAT" AT THE TABLE FOR MEMBERS OF THE ACQUIRED LEGAL DEPARTMENT

- **NOTE: problems of keeping a stand-alone environment in the legal department include:**
 - Legal department will not be invited into legal management system
 - Legal department will not be invited to meetings where major legal projects are assigned
 - Legal department may not be recognized as a legitimate advisor with authorized power to make final decisions
- **NOTE: specific communication from top management can overcome certain of these problems.**

I-5

Issue: How Will The Employees Of The Acquired Company's Legal Department Receive Information On How The Acquiring Company's Legal Function Is Carried Out, And On The Background Of Its Legal Staff?

- **Soft public information sources will permit collection of data on personnel.**
- **Post-merger briefings provide for significant exchange of information on, not only backgrounds of staff, but on legal capabilities in various functions.**
- **How does the Acquiring Company want the legal function to be accomplished, including specific issues such as HR, IP, licensing, contracting, litigation, and regulatory?**
- **Does the corporate approval process at the Acquiring Company mandate changes in operating styles of Acquired Company's Legal Department?**

I-6

Issue: How Can We Communicate The Capacities Of The Existing Legal Staff To The General Counsel, Legal Staff And Management Of The Acquiring Company?

- Different levels of communication are permissible as the merger process moves forward.
- Determine what communication is appropriate at pre-merger due diligence sessions/after signing of merger agreement/day 1 post-merger/beyond day 1 post-merger.
- NOTE: Business, anti-trust and other legal limitations limit disclosure of information at certain points in the merger process.
- NOTE: Acquiring Company's Legal Department review and analysis of Acquired Company's legal documents and structure will have a major affect on attitudes about whether the members of Acquired Company's Legal Department should be retained.

I-7

Issue: How Can We Communicate The Capacities Of The Existing Legal Staff To The General Counsel, Legal Staff And Management Of The Acquiring Company? (cont.)

- Care should be taken in preparation of organizational chart and resumes to be provided to Acquiring Company's General Counsel during first contact meeting, meetings with other legal managers of Acquiring Company and managers of Acquiring Company.
- NOTE: Introduction package should include description of functions and successes performed by each of the members of the Legal Department.

I-8

Issue: How Will The Employees Of The Acquired Legal Department Fit Into The Existing Structure Of The Acquiring Company With Regard To:

- The right level of responsibilities
- The proper titles
- The level of compensation
- Do the compensation packages of the two Companies differ in material ways, such as:
 - Availability of bonus versus majority of compensation included in base pay
 - Availability of options
- NOTE: Many of the compensation issues may not be resolved at the outset of the merger.
- Does the Acquired Company have a severance program, which encourages people to leave?

I-9

ISSUE: WHO ARE THE ONGOING CLIENTS OF THE ACQUIRED COMPANY'S LEGAL DEPARTMENT?

- NOTE: Loyalties to old managers are often hard to change.

I-10

ISSUE: HOW CAN THE EMPLOYEES OF THE ACQUIRED COMPANY'S LEGAL FUNCTION EARN THE TRUST OF THE ACQUIRING COMPANY THAT THEIR SKILLS AND MOTIVES SUPPORT THE GOALS OF THE ACQUIRING COMPANY GOING FORWARD?

It Takes Time

I-11

Issue: How Will The Integration Of The Acquired Company Affect All Of The Above Issues?

- **Will the Acquired Company be fully integrated or operate as a stand-alone operation?**
- **If the functions of the Acquired Company are removed to the Acquiring Company and the previous clients of the Legal Department are eliminated, will there be a need for the legal capacities present in the Acquired Company?**
- **Differences often arise in the desires of senior management of the Acquiring Company to preserve the best aspects of the Acquired Company versus the line management of the Acquiring Company's desire to fully integrate and control the functions of the Acquired Company?**

I-12

Merger, Even If Exciting Causes A Sense Of Loss

Feelings of Loss Occur on the Announcement Of:

- **The Deal**
- **Organizational Structure**
- **Relocation**
- **New Boss**
- **Loss of Compensation and Benefits**

M-1

Merger, Even If Exciting Causes A Sense Of Loss (cont.)

Operating styles of two companies may be different:

- **Differences may be perceived or real**
- **Real differences may involve issues affecting:**
 - **Personnel**
 - **Communication**
 - **Decision-making**
 - **Employee development**
 - **Organizational structure**
 - **Performance management**
 - **Process orientation**
 - **Resource allocation**
 - **Success criteria**
 - **Work environment**

M-2

Merger Causes:

- **Uncertainty and ambiguity**
- **Deterioration of trust**
- **Self preservation**
- **Communication problems**
- **Drop in productivity**
- **Less team play**
- **Power struggles**
- **Low morale**
- **Weak commitment**
- **Bailouts**

M-3

Each Stage of Integration Process May Trigger:

- **Stage 1 Shock and Numbness**
- **Stage 2 Suffering**
- **Stage 3 Resolution**

M-4

Typical Attitudes of Each Stage:

- Shock and Numbness
 - This will go away
 - I can just keep on doing my work like I have been
- Suffering
 - This is bad for my career
 - I can't make a difference
- Resolution
 - Change is here to stay
 - I need to change as the organization changes
 - How can I fit into the new order?

M-5

Managers Can Help Employees Get Through Each Stage:

Stage 1. Shock and numbness

- Get everything out into the open
- Be realistic
- Be patient
- Be non-defensive

Stage 2. Suffering

- Listen
- Spend more time with people
- Keep people involved

Stage 3. Resolution

- Don't rush recovery
- Expect setbacks
- Different people will take longer times to recover
- Continue teambuilding
- Manage

M-6

Managers Can Help Employees Get Through Each Stage: (cont.)

You will be more comfortable during times of change if you show:

- Flexibility
- Innovation
- Risk tolerance
- Stress tolerance

Methods exist for increasing your tolerance levels in problematic situations.

M-7

Merger Pressure Points

Communications:

- More questions than answers
- Rumor mills
- New information routes
- Confusion over whom to include
- Less willing to commit to decisions

Behaviors required:

- Over communicate
- Tell the full truth (good, bad and ugly)
- Don't tell when you don't know
- Tell why, how and what
- Check for understanding
- Ask for feedback

M-8

Merger Pressure Points (cont.)

Productivity:

- **Loss of focus lowers productivity**

Behaviors required:

- **Reprioritize**
- **Focus short-term goals**
- **Exploit instability to get goals accomplished**
- **Cope, adapt, exploit, create**
- **Don't go back to status quo; instead, look for ways to deal with new environment**

M-9

Merger Pressure Points (cont.)

Resistance:

- **Misperception of merger situation**
- **Low tolerance for ambiguity**
- **New standards of performance**
- **Can't see benefits**
- **Stand to lose more than they gain**
- **Displaced feelings**
- **Believe change is wrong or bad**

Behaviors required:

- **Identify source of resistance**
- **Analyze types of questions employees are asking**

M-10

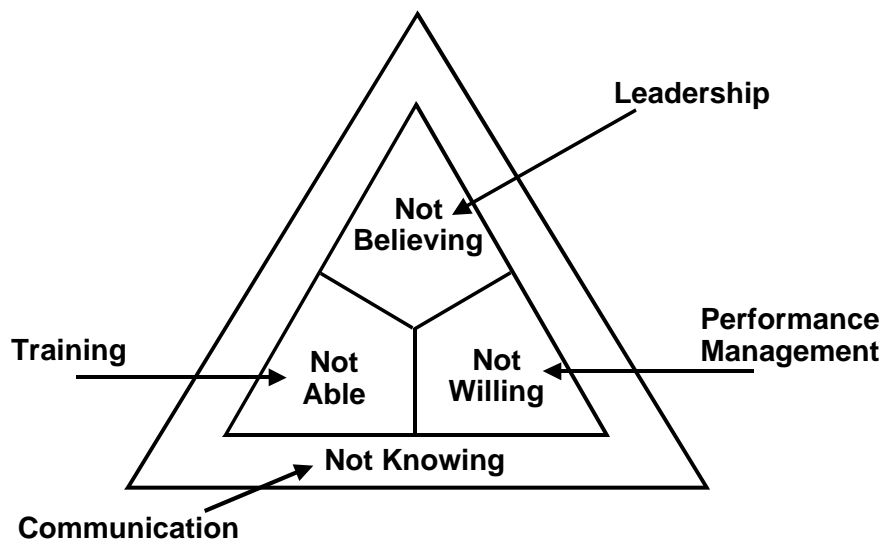
You Will Be More Comfortable During Times of Change If You Show:

- Flexibility
- Innovation
- Risk tolerance
- Stress tolerance

◆Methods exist for increasing your tolerance levels in problematic situations.

M-11

Resistance Dynamics



M-12

Managers Should Act Based on the Type of Resistance Problem the Employee Is Experiencing:

- If resistance comes from “Not Knowing” explain reasons for change and provide sense of direction
- If resistance comes from “Not Able” provide training, communicate events to be dealt with to build their confidence
- If resistance comes from “Not Willing” create a supportive environment, set clear standards of performance, alter reward system to support change
- If resistance comes from “Not Believing” explain reasons for merger, give leadership and exhibit managerial courage to stand up for your own beliefs

M-13

Cost Of Lost Talent Is High

- Higher salary for replacement persons
- Placement fees
- Recruitment costs
- Time involved in selection process
- Time spent orienting and training
- Loss Productivity
- Relocation
- Loss of knowledge and experience of departing employee, delay in goals satisfaction, delay in projects, knowledge transfer, impact on moral of organization

M-14

Re-Recruitment Guidelines

- Operate from the premise that everyone is considering other employment
- Identify your key people (rank on scale)
- Re-recruit your key people
- Make target person feel special, not taken for granted
- Keep communication lines open and active
- Be willing to be unfair
- Determine motivator that manager can use in retention process

M-15

Re-Recruitment Guidelines (cont.)

- Try to give individual key role, special assignment that makes it clear that he or she is a highly valued individual
- Understand what motivates your people individually and as part of your team
- Consider giving a raise, title or “stay” bonus, more control on project
- Don't assume people are planning to stick with you just because they're not talking about leaving

M-16

Best Practices For Leaders

- **Start managing the transition when the deal is announced**
- **Protect productivity**
- **Control amount of destabilization**
- **Be realistic about cultural differences**
- **Manage the turnover**
- **Conduct necessary soft due diligence**
- **Set your priorities carefully**

M-17

Best Practices For Leaders (cont.)

- **Be bold**
- **Put dollar signs on decisions**
- **Offer "Quick Impact" training on merger management**
- **Give your workforce a proper merger orientation**
- **Take care of the "me" issues**
- **Give yourself permission to make some mistakes**
- **Keep focus on clients**
- **Make everyone responsible for merger success**

M-18

Best Practices For Managers

- Engineer some early wins
- Communicate
- Manage expectations
- Provide leadership vs. politics
- Be willing to be unfair
- Re-recruit your key people
- Exploit instability

M-19

Fire Up Commitment:

- Be passionate in your job commitment
- Provide a strong sense of purpose
- Engineer and honor achievements
- Delegate power to every person
- Make your people feel needed
- Assign generous responsibility for results
- Be intolerant of weak commitment
- Aim employees toward work they love
- Prove you're committed to your people

M-20

Best Employee Practices

- Control attitude
- Be tolerant of management mistakes
- Expect change, be a change agent
- Don't blame merger for all the bad things
- Get to know the other company
- Use merger as growth opportunity
- Keep a sense of humor

M-21

Best Employee Practices (cont.)

- Keep doing your job
- Don't panic or act like a victim
- Try harder
- Don't play it safe
- Take risks
- Keep standards

M-22

Merger Knowledge Test - True or False?

1. Moving quickly to implement changes after a merger is reckless. It is too costly if it isn't right the first time.	T	F
2. Loss of productivity, low morale and lack of job commitment are characteristics only of a merger that has been poorly handled.	T	F
3. It is important for managers to do the "politically correct" thing during the integration period.	T	F
4. It's important for leaders to keep employees happy by focusing only on the positive aspects of the merger.	T	F
5. Cost should not be a consideration in planning a merger integration.	T	F

Q&A-1

Merger Knowledge Test - True or False? (cont.)

6. After a merger, management should keep the pressure off employees by temporarily relieving them of their duties.	T	F
7. When there is no employee resistance, you know the merger is being well managed.	T	F
8. Failure to attain a common culture will cause a merger to fail.	T	F
9. A "hands on" approach by managers will help to maintain productivity during a merger.	T	F

Q&A-2

Question 1: Moving Quickly to Implement Changes After a Merger Is Reckless. It Is Too Costly If It Isn't Right the First Time.

Answer: False

The longer you take to integrate, the closer you live to the edge. Mergers are a race against operating problems, competitors, employee complacency, and those resisting the merger. Procrastination is expensive, and you can't afford it.

The natural tendency is to study the situation, trying to craft the perfect plan. There are no perfect plans in a merger, only good and timely ones.

Speed is an advantage. It will disorient those clinging to the status quo and will stack the odds in your favor.

Q&A-3

Question 2: Loss of Productivity, Low Morale and Lack of Job Commitment Are Characteristics Only of a Merger That Has Been Poorly Handled.

Answer: FALSE

These are the predictable dynamics that typically come into play during any merger. They are simply signs that a merger is taking place.

Productivity drops because people can't get the answers they need. Employees waste hours thinking, talking, and worrying about the merger. People also move into holding patterns, deciding to take a play-it-safe stance. They are afraid of making mistakes.

Q&A-4

Question 2: Loss of Productivity, Low Morale and Lack of Job Commitment Are Characteristics Only of a Merger That Has Been Poorly Handled. (cont.)

Answer: FALSE

Employees become frustrated and quit trying. They burnout from trying to do a good job in what feels like hopeless circumstances. They feel out of control and some will seek other employment. They feel they will likely be terminated or demoted if they stay. Some leave for better opportunities, but some may have left even if the firm had not been acquired.

Do not interpret these dynamics as signs that the merger is being poorly executed. These pains are experienced by even the most successfully merged companies during their integration process.

Q&A-5

Question 3: It Is Important for Managers to Do the “Politically Correct” Thing During the Integration Period.

Answer: FALSE

Employees often tiptoe around the executives' egos to avoid ruffling any feathers. On the other hand, management goes overboard to avoid antagonizing the employees. This slows the process, and valuable time slips away. Mergers need strong leadership and demand management direction.

Q&A-6

Question 4: It Is Important for Leaders to Keep Employees Happy by Focusing Only on the Positive Aspects of the Merger.

Answer: FALSE

Managers need to present a balanced viewpoint to maintain credibility. Trying to push only good news wastes time and energy. Being realistic will help mentally prepare your employees for the work and strain that lies ahead.

Q&A-7

Question 5: Cost Should Not Be a Consideration in Planning a Merger Integration.

Answer: FALSE

A merger is a financial proposition, not a plan “to create positive feeling.”

The bottom line is in dollars and cents and you have to play the financial angles to achieve the big numbers.

Q&A-8

Question 6: After a merger, management should keep the pressure off employees by temporarily relieving them of their duties.

Answer: FALSE

This would be nice for the employees, but customers don't wait. They don't care if your company is going through the strain of a merger, it's not their problem. Your team will fall behind if there is a let up in productivity. The realistic approach is to expect extra work from employees during the merger.

Q&A-9

Question 7: When there is no employee resistance, you know the merger is being well managed.

Answer: FALSE

Resistance is normal and to be expected from some employees during a merger. What is important is to get it out in the open, so you can work to overcome it. Resistance isn't necessarily bad and the idea is to use the resistance to achieve positive results.

Q&A-10

Question 8: Failure to attain a common culture will cause a merger to fail.

Answer: FALSE

Forget about a common culture. Stay on course. State the facts, be specific. Quickly determine the key cultural differences between specific parts of your organization and communicate these findings to your employees. Be up front.

Q&A-11

Question 9: A “hands on” approach by managers will help to maintain productivity during a merger.

Answer: TRUE

Set priorities and keep your employees informed. Changes will occur on a minute-by-minute basis during a merger, and managers need to keep employees in the loop. This will prevent wasting time working on low priority projects.

Q&A-12