**Transitional Services Agreements**

This element looks at the circumstances in which a transitional services agreement is needed in practice and what typical provisions might be included in one.

**Issues with sales by Group companies**

As we have seen throughout the knowledge stream, a corporate seller might choose to carve out one or part of its businesses or sell one of the subsidiaries from its group for many reasons. For example, for commercial reasons, such as the business is no longer seen as a core part of its overall business strategy or where it cannot keep up with the latest developments in the market in its current format; or financial reasons, where the business needs to raise finance to avoid the failure of either part or all of its business.

Group companies often rely on each other for services and support. Some groups are structured so that some group companies provide services to all subsidiaries within the group, or have a specific purpose (e.g., to employ all staff or to own the group’s real estate). Examples of group-wide centralised business operations or functions may include:

* HR/ payroll
* Finance and Accounts
* Inventory management
* IT / software systems
* Enterprise resource planning systems (e.g. to invoice clients and to pay suppliers)
* Legal/ Compliance

One of the issues which should be identified during the due diligence process is whether the target company or business can operate as an independent entity post-completion, In other words, how will the target operate post-completion when it is no longer part of the group.

In some cases, the target business or company may be highly dependent on the seller’s group (for systems, services or other support) a clean break on completion is not feasible. Even if the buyer already has the systems and resources to replicate the services, systems or support of the seller group, it is often not practicable for it to do so straightaway.

This interdependence potentially creates a level of cost and complexity which, if not managed correctly, can significantly impact the transaction, both in terms of timing but also the value of the deal. Indeed, for carve-out transactions (i.e., where an integrated business division is separated and sold to a third-party buyer), one of the biggest risks to the success of the transaction, is the failure to address interdependencies between the target business and the retained group.

**Transitional Services Agreements**

These issues are usually resolved by a **transitional services agreement (“TSA”).** This is an agreement between the relevant parties to provide services for a specified period following completion to facilitate the handover and to provide the target company or business with sufficient time to put alternative arrangements in place.

Notwithstanding the above, if there is an intra-group supply of goods or services to the target which is key to the target’s business – and which the buyer would like to continue post-completion – a separate supply or services agreement will be negotiated.

It may also be necessary to deal with any services provided by the target to the retained seller group – a reverse TSA – in addition to or instead of services provided to the target.

Early planning, and where appropriate involvement of specialist advisors, are key for successfully managing and implementing a TSA. The process of planning a TSA begins by identifying the services provided to the target by the seller’s group and those provided by the target to the retained seller group.

The buyer will need to identify which services they can replicate from completion and those they cannot. The seller will need to identify the costs of these services, which may not be readily available, depending upon the cost allocation of the services across the group.

**TSA - Buyer and Seller Considerations**

**Buyer considerations**

During due diligence the buyer should start identifying the services provided to the target by the seller’s group and those provided by the target to the retained seller group. The buyer will need to assess which services they can replicate from completion and those they cannot, how long it will take to secure a replacement, ease of integration etc.

Delays in this assessment may delay the transaction and/or minimise the buyer’s ability to negotiate the terms of the TSA.

**Seller considerations**

The seller need to identify what support can and should be provided, for how long and at what price. It is also important to understand interdependencies between TSA items. For example, does the target need to remain on the human resources information system to maintain payroll under the TSA?

A well-drafted TSA will clearly define the support the seller provides to the target post-completion, as well as the service levels and duration. This helps the seller to minimise the legal, operational and reputational risks of separating the target business from the seller’s remaining enterprise(s).

Price will be a key feature and early planning (e.g., identify the cost of providing the service) will facilitate negotiations.

**TSA – Key points to negotiate**

The key issues to consider when drafting a TSA include:

* Who requires the relevant services, the buyer or the seller and any subsidiaries.
* The services to be provided and their scope (as well as any excluded services).
* Service levels and standards.
* The charges for the services and related payment terms.
* The extent of the service provider’s liability.
* The period during which the services are to be provided (typically between 6 to 24 months), including any options to extend that period in respect of some or all of the services, as well as early termination rights.
* Arrangements to be made with third parties whose systems or resources are used in connection with the services, such as under software licences.

**Key TSA provisions: Sellers**

For a seller, the key aims in the TSA will be:

* Scope of Services – to be minimal services, with ideally no (or else minimal) service levels (and in any event, no greater than the services provided at the time of sale).
* Pricing - the ability to charge market rates for the services, if possible, and the ability to pass increases in the costs of providing services on to the buyer.
* Term - A shorter term for the services.
* Liability – In addition to usual limitation of liability provisions, no ongoing liability for the provision of the services once the term of the TSA has expired. Sellers may also wish to ensure a limitation period on potential liabilities that arise from warranties (if any) that would otherwise have ongoing liability (for example, no breach of third-party intellectual property rights) so that any liability is effectively limited.
* Termination - No obligation to provide the services if they are no longer required internally by the seller in its retained business/ group.
* Termination - An option to terminate provision of the services if the costs become prohibitive or provision of the services is otherwise unpalatable.

**Key TSA provisions: Buyers**

For a buyer, the key aims in the TSA will be:

* Scope of Services – to be sufficient to ease integration/ transition.
* A "missed services" clause, giving the ability to require the seller to provide, or procure, extra services for the acquired business later if some were not determinable at the time of the TSA’s commencement.
* Services levels and ideally of a commercial standard.
* Pricing – cost price for the services, or a low price where it is not easily determinable what the pricing metric of internal services would be.
* Further assistance (with the seller agreeing to work with the buyer on detailed transition plans and provide co-operation to facilitate integration).
* Term - A longer term for the services with the ability to extend if necessary (but with the ability to terminate with no penalty earlier than the end of the transition period if the buyer can itself provide, or procure elsewhere, the services for a lesser price).

**Summary**

* If a target business or company is part of a group of companies, it may well rely on group companies for certain business operations, services or support e.g., HR, IT, payroll etc. The buyer and seller are likely to have to enter into a TSA to facilitate a transition and maintain sufficient support for the target to continue to operate post-completion while the buyer integrates the target into the buyer’s business / group.
* The parties will need to consider matters such as the scope of the TSA, service levels, length of the TSA, the price paid for the services, third party consents and the limitation of liability.