

Key Considerations in Negotiating Transition Services Agreements

Contributed by [Darcy Down](#), [Adam Aft](#) and [Asama L. Itseumah](#), Baker McKenzie

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Blackrock's recently released [2024 Private Markets Outlook](#) predicts that corporate carve-out activity will increase in 2024, as companies look to divest non-core or underperforming business lines and acquirers look to benefit from untapped value-creation potential. Those companies that will either acquire or sell through carve-out transactions in the coming year to meet their strategic needs should consider the importance of Transition Services Agreements (TSA).

TSAs are important to both parties because they ensure that critical functions are maintained in the transition period following the closing of the carve-out transaction. This is particularly true amid a concurrent increase in regulatory scrutiny of carve-out and other M&A transactions, where continued operation of the target business in compliance with local laws and regulations is crucial for all parties involved.

This article examines key considerations for both parties when entering into a TSA. In examining these key considerations, this article seeks to provide a baseline understanding of how these considerations impact the TSA planning, negotiation and implementation process in a carve-out transaction while also providing the common perspectives of the acquirer and the seller when approaching these key issues.

What Is a TSA?

A TSA is an agreement between the acquirer and the seller of the target business, requiring either the acquirer, the seller, or both parties to provide services to the other as a result of the acquisition of the target business. In the most common TSA scenario, the acquirer purchases less than all of the seller's businesses—a so called "carve-out transaction"—but the acquired business relies on the business retained by the seller for certain critical functions—e.g., back office services like accounting or human resources. In order to avoid or minimize disruption to the target business while the acquirer works to set up its own infrastructure to support the target business in these critical functions, the seller will agree to provide the target business with the same services the target business relied on the seller to provide prior to the acquisition.

In some instances, the target business may include critical functions that the seller needs to operate its remaining business after the closing of the acquisition. In this situation, the acquirer would provide transition services to the seller in order to minimize disruptions to the seller's remaining business—a "Reverse TSA." Finally, in some scenarios, the acquirer and the seller will provide services to each other in order to ensure the smooth operation of both the target business and the seller's remaining business.

It is important for the parties to determine whether the provision of services will be unilateral or bilateral prior to preparing an initial draft of the TSA. A bilateral TSA will require a more balanced first draft of the agreement as any onerous conditions that a party seeks impose on the other will prompt a request for reciprocal treatment.

Key Considerations

Scope of Services

It is vital that the parties come to an understanding of what services need to be included within the scope of the TSA. Typically, TSAs cover corporate- or back-office- type services that are provided by a company to its various businesses and are not allocated to a single business line. Some of these include finance, accounting, legal, human resources—e.g., payroll and employment benefits—, tax functions, IT functions, and shared space arrangements.

However, the transition services could be more substantial and, in some cases, involve the seller operating the target business on behalf of the acquirer during the transition period. These kinds of full scale services are typically required when regulatory or contractual requirements prohibit the acquirer from immediately operating the target business on its own.

As part of identifying the services to be included within the scope of the TSA, the following should be considered:

- **Identity of Service Provider.** Are the services currently self-provided by the seller or are they outsourced? Are any of the products or services currently provided to the seller by a third party—e.g., subcontracting—and can the service provider identified in the TSA subcontract the provision of the products or services? Services that are self-provided are more straight forward as no third party approvals will be needed in order for the seller to provide the services. However, outsourced services —e.g., SaaS or cloud providers—generally require the consent of the third party provider in order for the seller to provide the acquirer with access to the outsourced services.

- **Service Mapping.** In addition to identifying the nature of services required, the parties should map out which levels—e.g., entity level, system level, or individual level—within the target business the services are required. This will allow the parties to define with greater specificity the scope of the transition services required.

- **Jurisdictions Involved.** The parties should determine what jurisdictions are involved in providing and receiving the services. For cross-border transactions, localized TSAs may be required for tax or other reasons, the acquirer may need to acquire certain local permits or authorizations in order to receive the services, and the manner in which the services are provided may be subject to local regulations—e.g. data transfers.

- **Resources Required and Set-Up Costs.** The parties should determine whether there are any specific resources—e.g., facilities, employees, custom tooling—that are required to provide or receive the services, the associated set-up costs for such resources, and who will bear such costs, if any.

In light of the foregoing considerations, the parties generally look to be as specific as possible in describing the types of services to be included within the scope of the TSA. However, the seller may attempt to limit the overall scope of transition services to specific, enumerated services listed in the TSA's service schedules, while the acquirer may want the right to include additional services to the scope of the TSA on an ad hoc basis.

Acquirers typically seek this ability to include additional services because, at the time of the closing of the transaction, the acquirer may not have a full understanding of what services it needs the seller to provide and may need some time with the business to fully determine its service needs. Beginning the transition planning process as early as possible in the acquisition process will allow adequate time for the parties to flesh out the transition services and reduce this tension when negotiating the scope of the TSA services and implementing the transition post-closing.

Duration of Services

Both parties typically want the TSA to end as soon as possible, with the seller no longer wanting to divert attention from its core businesses in order to service the target business and the acquirer wanting to take full control of the business for which it just paid. However, acquirers will typically push for a longer TSA period in order to ensure that it has support for the target business for as long as is necessary, while the seller will push for a shorter TSA period in order to cut-off its obligations to the acquirer as soon as possible—typically in the form of a covenant by the acquirer in the TSA to endeavor to be self-sufficient with respect to the services as soon as possible—in addition to any specific service terms.

These opposing positions usually result in the parties negotiating specific service periods for specific services with some services carrying on longer than others. In some instances, the acquirer will have a one-time right to extend the service period for certain services if the acquirer can provide evidence to the seller that it requires services for a longer period based on a negotiated standard—e.g., good faith basis.

Cost of Services

What is the commercial model for the TSA—e.g., cost plus? Will there be any markup on the TSA services? This is often a key commercial point in TSA negotiations.

The seller, who typically does not provide these services to unaffiliated third parties, will want to be paid for the time it is taking away from its primary business, while the acquirer, who just paid a substantial sum for the target business, will be reluctant to pay any more for the transition services. Parties come up with various solutions to this issue.

The services may be provided at cost to the seller, meaning that any out of pocket costs incurred by the seller—not including the time spent by the seller's employees—will be borne by the acquirer. Alternatively, the parties may use a "costs plus" mechanism, or the time spent by the seller's internal employees may be charged to the acquirer after a certain threshold—e.g., the acquirer is billed hourly after exceeding 100 personnel hours.

In addition to determining the basic cost model for the TSA, the parties should also address the following questions in the agreement:

- (1) The method for paying invoices—e.g., via permitted set-offs;

- (2) How much time the acquirer has to make the payment;

- (3) Whether payments are incurred based on the passage of time or upon the successful completion of transition services, the latter being more favorable to the acquirer;

- (4) Whether ratchets apply to the TSA fees after an initial period; and

- (5) For cross-border transactions, the currency for service charges and, if applicable, exchange rate protocol and local invoicing procedures.

Data, Data Privacy & Data Security

Access to, and continued processing of, data is one of the most important aspects of TSA services—i.e., the applications being supported under a TSA matter, but what really matters is the data in those applications. An initial threshold question is what is the nature of the data—e.g., is it personal data,

data protected by trade secret, data that is competitively sensitive, data restricted by trade or sanctions laws, etc.? After identifying the nature of the data, the parties are able to plan around managing ongoing protection and compliance issues related to such data.

One area that routinely needs to be addressed in the TSA context with respect to data is personal data privacy compliance. Data protection laws govern the parties access to, use of, and processing of personal data, and it is important to first establish each party's role with respect to the personal data that is exchanged as part of the TSA.

The service provider will generally be considered a "processor" under data protection laws, while the party receiving the services will generally be considered a "controller," although there are certain services—e.g., regulatory submissions under certain TSA models—where both parties may be considered "controllers." Data protection laws prescribe the types of terms that must be put in place between controllers and processors, which include—among others—restrictions on the processor's use of personal data, commitments to the principles of data minimization and "least access," and cooperation between the controller and processor.

The same is true for the types of terms that must be put in place between two independent controllers, although these terms are less prescriptive. As such, the parties must determine their roles with respect to the personal data being exchanged pursuant to the TSAs and execute privacy terms that reflect these roles.

In addition, data security will be an important issue in the TSA given that data protection laws focus on data security. The parties will need alignment about data security given potential access to each other's systems, and general vigilance from a cybersecurity perspective is especially important when there is a transformative transaction, such as a carve-out, where there is higher risk for cyber-attacks.

Personnel

Another important consideration in TSAs is the personnel implementing the services. In most situations, the employees providing the services to the target business remain employees of the seller. However, in some instances, the personnel necessary to facilitate the provision of the transition services transfer with the target business as part of the acquisition.

If the personnel providing the transition services remain with the seller, the parties may want to specify how much of the relevant personnel's time is allocated to the provision of transition services. The parties may also consider if there are any retention payments contemplated for personnel providing the services and, if so, who pays. The acquirer may also want to require background checks for any personnel providing TSA services. If personnel providing the transition services transfer with the target business such personnel may require access to the seller's databases to provide the transition services, giving rise to the data protection and data security considerations identified above.

It is important to consult with your employment counsel on personnel arrangements to ensure that any personnel arrangements—e.g., secondment, leasing, rebadging—are structured appropriately and in compliance with local law requirements.

Other than the personnel who will be responsible for providing the transition services, the parties to the TSA should include a model for governance of the TSA. One model is to have a service manager for each individual service, while a simpler approach is to have one manager for each party. The manager—usually called a TSA representative—is responsible for overseeing and managing delivery of the transition services, including all requirements, procedures, and processes specified in the TSA service schedules. In order to facilitate the continuous dialogue that is necessitated by the TSA relationship, the parties typically agree to predetermined review meetings between the TSA representatives for each party in order to discuss issues relating to the provision of the transition services.

The TSA representatives can be a vital tool in the TSA relationship as the parties may choose to delegate the authority to resolve certain disputes, like invoicing issues or service completion determinations, to the respective TSA representatives without the need for costly litigation. To the extent the TSA representatives are unable to agree on a disputed matter, the parties can agree on escalation procedures to the executives of the respective parties.

Service Standards & Liability

No discussion of commercial relationships can be complete without mentioning standards of performance and liabilities. However, TSAs are different from other third-party commercial arrangements between a service provider and a customer in that, in most instances, sellers who are service providers under a TSA are not in the business of providing the subject services to third parties as part of their usual business dealings.

In light of this, sellers will typically push for the services to be provided on an as-is where is basis with no promises as to the standard of performance of the services. Acquirers on the other hand will push for the seller to provide the services based on a specified standard.

For example, a seller may covenant to provide the services to the acquirer using substantially the same degree of care as provided to the target business during a determined lookback period. If the seller is in the business of providing the same services to its customers, then the acquirer would push for a service standard that is the same level as the seller provides to its customers during a determined lookback period. Finally, if there are already written

service standards related to the transition services, the acquirer would push for the TSA to include reference to those standards as the baseline for seller's performance.

With service standards come opportunities to satisfy or fail to satisfy such standards. Therefore, sellers attempt to limit their liability associated with the provision of the services by either disclaiming all liability in connection with the services or by attempting to cap any potential liability to the acquirer to amounts actually received by the seller under the TSA. Sellers, with frequency, will also push for the acquirer to indemnify the seller for any losses it may sustain as a result of the acquirer's bad acts.

Conclusion

Although there are a myriad of issues for the parties to consider when planning, negotiating and implementing a TSA, the biggest takeaway for the parties is to talk early and talk often. As early as possible in the transaction process, the parties should discuss the TSA work stream and the key considerations mentioned above surrounding the TSA work stream. TSAs are vital to the success of a carve-out transaction and take a lot of time and multi-functional resources to prepare, but, despite this, are often last in time on the status agenda. If discussions start early and often, and each of the key considerations discussed above receives due attention from the right decisionmakers, the TSA planning, negotiation and implementation process will be more efficient, ensure continued operation of the target business in compliance with local laws and regulations and safeguard the overall carve-out transaction value for both parties.