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M&A ACADEMY

**Bridging the Gap with Transition Services
Agreements**

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Overview

Transition services agreements (“TSAs”) are an important part of many M&A transactions. Parties typically enter into a TSA when a buyer purchases a business unit, operating subsidiary or other division of an enterprise, but the seller or its affiliates retain assets, personnel or third party relationships that are needed to operate the acquired business post-closing. Occasionally, the transferred business retains such items and the parties enter into a TSA pursuant to which the seller or its affiliates receive the services.

Depending upon the complexity of the TSA and the importance of the services being provided, TSAs can range from short form services agreements for back office administration, with set fees and no formal performance standards, to comprehensive and complicated services agreements with defined scopes and service levels, variable fee arrangements and detailed data security and privacy provisions.

Regardless of the complexity of the TSA, it will inevitably include sophisticated issues and the parties will likely be required to operate under its terms for a significant period of time post-closing.

Thus, it is important to consider TSA-related issues as early in the transaction process as possible. Additionally, it is important to involve not only the appropriate members of both the buyer’s and the seller’s commercial teams in the negotiation of a TSA, but also to involve members of the legal teams with experience in drafting and negotiating services agreements.

M&A Deal Considerations

- TSAs are important because they establish the framework for the relationship between a buyer and a seller post-closing.
- They also, however, form the basis of how a buyer acquires all of the assets and services necessary to operate a business post-closing.
- Thus, when evaluating a TSA, parties should also think about how the TSA fits in the context of the M&A transaction as a whole.
 - Additional value
 - Strategic vs. financial buyers
 - Timing for drafting and negotiating
 - Impact on future transactions
 - Offsets against other obligations
 - Third party consents

Scope of Services

- A clearly defined strategy for how the post-closing company will operate, both immediately following closing and on a more long-term basis, will help determine the scope of the TSA.
- Examples of services include:
 - Management support
 - HR, finance and legal administrative support
 - Facilities use and support
 - Procurement and third party vendor management support
 - IT separation and operational services (either directly or through a third party)
 - Day to day business services until operations are separated

Scope of Services (Cont'd)

A common dynamic in TSA negotiations is one side's desire to detail each of the services to be provided so it is clear what the parties' expectations are and to what fees apply versus the other party's desire to remain high level and flexible.

- In many TSAs, the parties wish to allow the scope of the TSA to remain flexible without the need for formal amendment, as the needs of the service recipient may change post-closing.
- In addition, a buyer may prefer flexibility because it may not be certain about the scope of all services that will be required.
- In other situations, such as where critical operations may be impacted, a party may want the TSA to contain detailed and specific day-to-day requirements.

The level of detail may also vary depending upon what is in the scope of services.

- For example, general back office assistance tends to be described at a higher level, while IT hosting and operations tends to be more detailed.

Performance Standards

A seller is not usually in the business of providing the services covered by a TSA to others and may not agree to assume the same level of liability for performance as a true third party provider.

- Typically a seller will agree that services will be provided in a manner consistent with the seller's historical standards and with the same standard of care as is currently used by the seller.
- The parties may agree that it is appropriate for certain services to be provided in accordance with detailed performance metrics, such as:
 - Hours during which services (such as help desks) will be provided
 - Reports to be delivered in connection with financial and accounting services

Performance Standards (Cont'd)

Consequences of failure to comply with stated performance standards include:

- Seller may be obligated to pay for replacement services.
- Seller (or its third party provider) may be liable for service levels credits or other “penalties.”
- Buyer can terminate the TSA with respect to the deficient services.

TSA Administration

- Specific individuals at seller and buyer organizations are often designated as service coordinators.
- These coordinators can efficiently address issues relating to TSA performance.

Third Party Assets and Providers

Services covered by a TSA can be provided by third party providers.

- The TSA should contain provisions permitting a seller to continue to utilize the third party to perform the services.
- The TSA can also allow the seller to hire new third party providers, if necessary.

The consent of a third party provider for provision of services to the buyer may be necessary.

- The cost of obtaining consents is negotiable.
- Consent issues often arise if IT services are being provided under the TSA.

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Please email Erik Scott at **erik.scott@morganlewis.com** if you have any questions.

Be Proactive – What Can You Put into Your Service Contracts Now?

Many companies add obligations in their contracts that:

- require the third party providers to provide services to a divested entity for a period of time
- allow a divested entity to use third party assets that are the subject of a license or lease for a period of time
- allow a seller to use the third party assets or services to provide services to a buyer for a period of time

Data Protection and Security

It is important for a seller and a buyer to understand the types of data that will be used or generated in connection with a TSA. The parties should ensure that the TSA has appropriate data safeguard provisions and includes an allocation of responsibilities if there is a data breach.

- The parties need to understand whether there will be personally identifiable information, health-related information or other sensitive or confidential information used in connection with the services being performed.
- If so, consider implementing appropriate safeguards for the service provider, service recipient and their respective employees and contractors, including technical access controls, export controls, HR/personnel controls and strong non-use and nondisclosure covenants.
- Carefully worded warranties and indemnification obligations should be considered in the event there is a data breach.

Payment

Fees for TSA services are generally set on a per service basis.

- This allows for flexibility in terminating or extending the term for the provision of specific services.
- The TSA should address responsibility for payment of sales taxes (if any) on services.

A TSA may provide that the buyer is directly responsible for certain out-of-pocket expenses and third party provider charges.

Service fees are invoiced by the seller, typically on a monthly basis.

- The TSA should set out payment terms and may include late fees and interest payments.
- Depending on the length of the term of the TSA, the TSA may provide for the buyer to pay any increased costs of providing services during the term.

Terms and Termination

A TSA provides a stated term for each service.

A buyer can often terminate any individual service early, upon notice.

- Generally, the seller will not object to early termination of services.

A TSA can provide for extension of the term for services.

- Usually extension will require agreement of the parties.
- Consider if fee adjustments are appropriate.

Termination of the TSA in its entirety by either a buyer or a seller is based on the occurrence of material events, such as a material breach of agreement, including non-payment of invoices when due, or bankruptcy-related events.

Wind Down/Exit

The seller can be obligated to provide support to migrate services to the buyer's internal organization or its third party providers.

The cost of migration assistance should be taken into account in the TSA fees or separately addressed.

Business Continuity

A TSA should outline a contingency plan if there are major service continuity issues.

- It is common for TSAs to contain arbitration clauses or clauses requiring the parties to bring a lawsuit if there are major service continuity issues, however, a service recipient may not want to invest the time and resources needed to comply with these traditional dispute resolution options for anything but the most egregious failures.
- Consider including escalation clauses that allow for internal representatives of the service provider and service recipient to settle continuity issues amicably.
- The parties should consider whether there is any need for enhanced business continuity or disaster recovery plans.

Representations and Warranties

TSA representations and warranties by a seller are usually limited to a statement that provision of services is consistent with historical practice.

Seller typically disclaims warranties as to merchantability or fitness for a particular purpose or for non-infringement of third party intellectual property.

Liability

Limitations on liability are customary provisions in a TSA.

- Representations as to quality and quantity of services are usually limited to historical practices.
- An express disclaimer of liability for consequential and punitive damages, loss of revenue or income or diminution in value is customary.
- The buyer should consider the implications of this type of disclaimer if its business may be significantly disrupted by a failure to provide service. Considerations include (i) alternative methods of obtaining necessary services, (ii) negotiating specific damage provisions for identified material service failures and (iii) availability of insurance protection for service failures.
- Liability is often limited to damages caused only by gross negligence or willful misconduct of the seller.
- The seller may negotiate for a stated dollar amount as a cap for its liability under the TSA.

Force Majeure provisions are typically included in a TSA.

- The seller is excused from its obligations to provide services during a force majeure event.
- Force Majeure events are acts beyond the seller's reasonable control, such as acts of God, disasters, strikes, power interruptions or government actions.
- The seller may be obligated to use commercially reasonable efforts to eliminate the force majeure event.

Compliance and Audit

It is important to understand the service recipient's review and audit needs, including whether it needs additional review and audit rights of any third party contractors used by the service provider to perform services under the TSA.

While general audit rights are common in TSAs, the service recipient should consider whether specific audit rights are necessary to comply with internal policy, regulatory requirements and/or contractual requirements.

Other Key Provisions for Consideration

- Confidentiality
- Separate Reporting and Data Segregation
- IP Rights
- Use of Names and Trademarks
- Non-Solicitation of Employees
- Dispute Resolution

Wrap Up

A TSA can be complex and time consuming to negotiate. The services provided under a TSA are often critical to the success of an acquisition for a buyer.

Attention to the TSA early in the acquisition process will lead to a clearer and more thought out contractual arrangement that will be more effective in meeting the post-closing needs of the seller and the buyer.

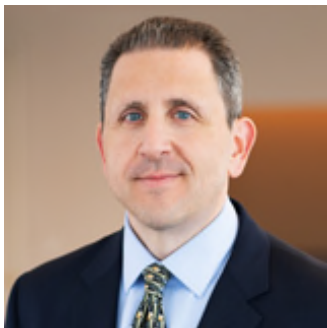
Key Takeaways from This Session

- While TSAs may not contain the same level of detail as a traditional services agreement, they need to be given serious consideration and reviewed by attorneys that are used to dealing with service agreements.
- The team working on the TSA needs to fully understand the scope of the services to properly assess the risks and ensure that the TSA fully addresses those risk.
- Security and data protection need to be treated seriously – similarly to how it would be in an outsourcing relationship.
- Seriously consider how the liability provisions actually work – what is really at risk and what are the actual potential damages.

QUESTIONS?

A long-exposure photograph of a highway at night, showing vibrant red and blue light trails from cars moving away from the viewer. The trails are dense and create a sense of motion and speed. The background is a dark, deep blue.

Biography



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Vito's practice focus is technology and outsourcing matters. Clients regularly turn to him to draft and negotiate domestic and international outsourcing service agreements for a variety of business processes, such as information technology, finance and accounting, human resources, and procurement. Within the realm of information technology, Vito drafts and negotiates agreements for software licensing, hardware purchases and leases, data licensing and subscriptions, website hosting and development, and other technology-related agreements, including system implementation, joint venture, and strategic alliance agreements.



Biography



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David advises and represents life sciences, healthcare, and technology companies in matters throughout the United States, Europe, and Asia. Working closely with clients to understand their businesses, David structures and negotiates deals to meet their objectives and find practical solutions to complex problems. David's clients range from biotechnology startups to global Fortune 100 pharmaceutical companies.

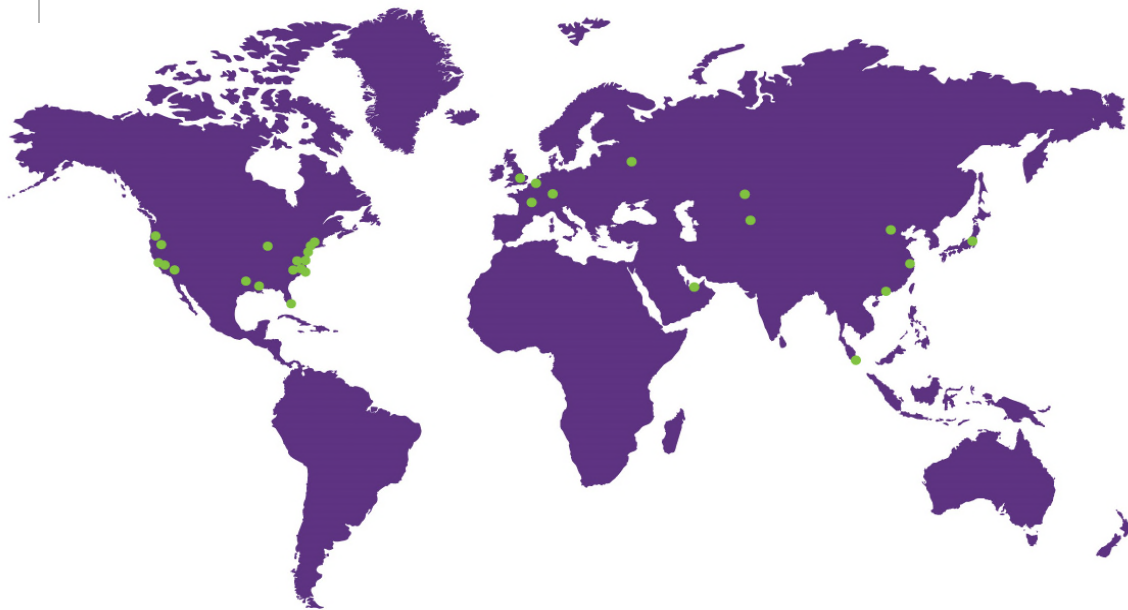


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