Doing a Deal from the Inside Out

Preparing for Transition Services Agreements

Third in a Series

By B. Scott Burton

The second article in this series discussed the importance of the seller's self-assessment process in preparing for a transaction as well as how to effectively collaborate with outside advisors and internal clients to maximize potential value and negotiation advantages in a transaction. There are few areas where these advantages are as immediate and crucial as in the case with transition services.

When a transaction involves the sale or purchase of a subsidiary or a division of a larger corporation (the target business), the buyer and the seller many times encounter a situation where services essential to the target business are provided not internally by the target business itself, but rather are provided as part of an enterprise-wide operation. Consequently, the sale of the target business does not include these operations, which likely are essential to the day-to-day operations of the target business. Most commonly, the buyer and the seller address this situation using a mutually agreed transition services agreement.

Scope of the Agreement

A transition services agreement is an agreement between the buyer and the seller under which the seller typically agrees to provide certain shared services to the buyer for a short or transition period following the closing of the primary transaction. An appropriately contemplated transition services agreement allows the transaction to proceed without the potential delay caused by a buyer securing those services on its own. Avoiding such a delay helps ensure a smooth transition to the buyer and its newly engaged employees and preserves the value of the enterprise just purchased. Since a well-conceived transition services agreement may be of crucial importance to the buyer, the wise seller will contemplate it in advance of the transaction negotiations.

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Transition services agreements commonly provide services related to information technology support, financial and accounting services, payroll/benefits/human resources support, litigation support and services, and sometimes shared facilities, insurance administration and customer service. While the typical transition services agreement covers more than one transition service, it is common for the different services to expire at varying times reflecting the conversion of such services to the buyer's platform.

Undertaking a Process Inventory

A seller can enhance the chances of a successful transition services agreement by identifying those services that likely would be subject to a transition services agreement. This inventory would occur during the seller's self-assessment or self-diligence process (discussed in the previous article in this series). With respect to the target business, the seller should undertake a process inventory to ascertain the shared services activities and how a potential buyer may handle each in the post-closing period. As to each identified item, the seller should determine in which of the following ways the activity will be handled:

- Included with the target business—the shared resource in question can be cleanly separated from the seller's operations and becomes included as part of the target business sold;
- Discontinued from the target business (the target business will be sold without the shared resource, leaving the buyer to make other arrangements post closing);
- Cloned, meaning a duplicate version of the shared resource is created and placed within the target business;
- Provided to the target business via a third-party contracting arrangement under which the contract(s) would presumably be part of the target business purchased by the buyer; or
- Provided to the target business for a limited duration under a mutually agreed transition services agreement.

When evaluating each of the possible activities that may be subject to a transition services arrangement, the seller should make certain that its provision of such services does not violate the terms of any other contracts under which the seller currently provides those services. For example, software and intellectual property contracts often contain restrictions on how the software or other property can be used and may prohibit the use for third-party services. Another complication often arises when the buyer is a competitor. Despite an exhaustive self-assessment process, the seller would not want to reveal (or may be prohibited from revealing) too much information about its businesses before the sale closes, potentially complicating the negotiation of transition services.

Internal and External Collaboration

The complications of assessing the potential provision or receipt of transition services necessitate excellent collaboration between internal and external resources. The expertise of lawyers who specialize in outsourcing can prove invaluable in sorting out the potential implications of transition services. The disciplines that are inherent in outsourcing transactions are extremely useful in the pre-transactions assessment of anticipated transaction services as well as the actual preparation and negotiation of transition services agreements. The engagement of such resources can be highly advantageous to both the buyer and the seller.

Dynamics and Intentions

Regarding the negotiation of transition services agreements, both sellers and buyers should be cognizant of the dynamics and intentions that may permeate the negotiations. The seller likely will wish to move on to other businesses without the distraction of the sold business. Likewise, the seller may be concerned with providing any services to a third party. After all, the seller is not in the business of providing such services to third parties. The seller also may be concerned with determining the price that is optimal for those services, as it does not want this "distraction" to negatively impact its financial results.

On the other hand, the buyer will want as much support from the seller as possible to facilitate any post-closing integration, prevent business interruption and otherwise realize the value of the purchased business without an immediate depletion following closing. In addition, the rapid timing of a transaction may prevent the buyer from having all of its shared services online from a third-party vendor prior to closing. If the timing of the transaction itself is not the reason for the delay, it may be due to restrictions on the types of information the buyer is allowed to give a third-party vendor under such circumstances. For instance, much of the information about the target business possessed by the buyer may be subject to nondisclosure restrictions. Finally, despite the buyer's due diligence, quite often the buyer is not in a position to truly assess the operational needs of the target business until it actually operates it.

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An Interative Process

The transition services agreement should detail the precise scope of services to be provided as well as the duration and pricing of those services. In addition, the parties should consider including alternative terms for services that go beyond the initial duration of the agreement and contemplate the appropriate rights and remedies of the parties during the transition period. It is important to note that the drafting and negotiation of a transition services agreement is an iterative process. Irrespective of the amount of diligence the seller does on itself and the buyer does on the target business, the agreement can only be finalized through the exchange of information from buyer and seller. Therefore, despite the general categories of issues that the parties may encounter, there is no cookie cutter approach to transition services agreements. From both a seller's and a buyer's perspective, the keys to a successful resolution of the provision and receipt of transition services are identifying such services (and the continued needs for them) in advance and working with subject matter experts both from within and outside the businesses.

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