

Attorney Explains Transition Services Agreements

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What is a Transition Services Agreement (TSA)?

A TSA is a limited term outsourcing or servicing agreement, generally between a Purchaser and a Seller, with the purpose of providing a smooth transition without stoppages or interruptions while the Purchaser is trying to integrate the purchased business into its operations. These agreements are generally entered into as part of an acquisition of a business or business unit and at the request of the Purchaser.

In smaller, owner-operated, turnkey transactions this type of agreement is often referred to as a Training and Transition Agreement. The focus of this article is on Transition Services Agreements.

Why a TSA?

Large diverse companies are often comprised of a number of self-sufficient business divisions or units that have established processes and systems attributed to them. When one of these divisions or business units are sold to another, less diverse, company, or spun off to a newly created company, the other acquiring company may not have the systems and processes in place to operate the acquired business and will need to rely on the Seller to continue to provide these processes and systems. This is typically for a short period until the Purchaser has set up its own processes and systems in-house or found a replacement third party provider.

Some common types of services needing transition are:

- manufacturing
- purchasing/procurement
- information technologies
- accounting/human resources/billing and collections
- logistics management (e.g. warehousing and distribution, transportation)
- warranty claims/insurance claims and management of these claims

Purchaser vs. Seller

As you can imagine, the Purchaser and the Seller have different goals in negotiating the terms of a TSA.

The Purchaser will generally want:

- a longer term TSA with ability to unilaterally end the TSA on short notice
- an open-ended undefined end date, or an option to extend the term of the TSA in its sole discretion
- a flat fee for all services (less than FMV) or for the services to be included in the overall transaction purchase price
- a robust TSA, broad in scope, with:
 - maximum service levels for the best price
 - a detailed list of services
- maximum knowledge/information transfer during transition and access to the Seller's:
 - technologies
 - systems (IT)
 - industrial design and intellectual property
- disclosure of and access to third party service providers/sub-contractors used by the Seller to provide the services
- a restriction on the Seller's ability to outsource the services provided under the TSA
- broad and strict indemnity provisions for failure to provide transition services:
 - no cap on liability exposure
 - a right of set-off of indemnifiable losses against purchase price
- broad inclusions for services inadvertently not described in the TSA

As a Purchaser it is in your best interests to become independent of the Seller for these transitional services as soon as possible but not too soon such that the transition of the business is not conducted as smoothly as possible. Often there are savings associated with this independence and the Seller will want to structure the TSA in such a way that it will

become inefficient and/or inconvenient for you to stay hitched to the Seller for any longer than necessary.

The Seller will generally want:

- a quick separation from the Purchaser – goal is to keep the term as short as possible, with punitive provisions for extensions or as the term grows longer
- a TSA that is narrow in scope, with:
 - minimal ongoing commitments
 - excluded services enumerated in detail
- minimal distractions, stoppages or interruptions from its own operations that it is retaining
- minimal knowledge/information transfer during transition with limited access to:
 - technologies
 - systems (IT)
 - industrial design and intellectual property
- protection of its intellectual property or industrial design, confidentiality and non-disclosure provisions
- protection of existing relationships with third party service providers and sub-contractors used by the Seller
- narrowly drafted indemnity provisions for failure to provide transition services:
 - caps/limits on liability to the Purchaser
 - exclusion of certain types of damages
 - no right of set-off against the purchase price
- a link in timing of the termination of the TSA and the termination of existing employees with notice periods to avoid exorbitant severance costs

As a Seller if you anticipate that transition services will be requested by a Purchaser, then you should consider in advance what services are you comfortable providing to the Purchaser and begin to prepare a “menu” of these services prior to receiving an offer – because after an offer is placed you may not want to (or be able to) allocate the time and resources to do this. You will also want to make sure that whatever is offered by you is accurately described and priced in such a manner that you can live with the inconvenience

that comes with it. You will also want to structure your TSA in such a manner that you discourage the Purchaser from continuing to want you to provide these services on a long term basis.

Don't Underestimate the Importance of a Good TSA

Given that TSAs are short term contracts (3-6 months), the details of these agreements sometimes get overlooked in the bigger picture of a transaction – either because of lack of time to allocate to this part of the transaction or a reluctance of the Purchaser to spend more money on legal fees to negotiate the terms of the TSA – which negotiation can be quite time consuming. With that said, however, a poorly drafted TSA can be very detrimental and interruptive to the businesses of both the Purchaser and the Seller. A poorly drafted TSA can lead to misunderstandings, service interruptions, and ultimately litigation – all of which are a poor use of post-closing resources. As with any contract in an M&A transaction, it is best to engage the services of experienced M&A, tax and legal advisors. Your business broker, accountant, and M&A lawyer each play an integral role in seeing your transaction through smoothly and successfully.

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