Making Transitional Service Agreements Work
Leading Practices for Sellers

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Executive Summary

During a carve-out or divestiture, the majority of the seller’s focus is on the purchase and sale agreement (PSA) and valuation considerations. However, after a deal’s legal close, there is one area that is often an afterthought but where tangible value is created or destroyed: The transitional service agreement (TSA). These contracts compel the seller to provide corporate functions from the legal close of the deal until the new company or buyer transitions to its own support solutions. While TSAs may appear administrative in nature, in Accenture’s experience they often have strategic consequences for both buyer and seller. Not paying sufficient attention to TSAs increases the risk that players will leave value on the table.

Accenture has identified six leading practices for sellers:

1. Think about getting out, before getting in: Define the business strategy for where you want to be after the divestiture and how quickly you need to get there.

2. Focus on TSAs early: Launch TSA efforts early to enable effective negotiations and ensure you have the time required to test post-close governance.

3. Dedicate a work stream: Establish a dedicated work stream to manage the large number of complex tasks and interactions related to a TSA.

4. Minimize stranded costs: Document the true costs of services, ensure accurate cost pass-through, and wind-down costs in concert with the establishment of stand-alone solutions.

5. Tightly manage negotiations: Set a clear negotiation timeline and ensure a robust negotiation framework, ideally in parallel with PSA negotiations.

6. Implement robust “post-close” service governance policies: Invest in appropriate post-close governance policies and dispute-escalation process and assign dedicated managers to monitor the provision of TSA-related services and the contract’s “wind-down.”
TSAs: Unassuming but Essential

Divestitures generate little of the buzz or financial market hype enjoyed by mergers and acquisitions (M&As), yet they represent roughly one-third of all M&A activity by volume. Getting divestitures right requires the seller to maximize the value captured from the deal while simultaneously minimizing the turmoil, operational disruption and employee uncertainty that can accompany a carve-out and divestiture transaction process. One critical tool companies use to achieve both goals is the relatively unassuming TSA.

A TSA is a contract between the two parties in a divestiture that provides essential services in a variety of functional areas for the business in transition following its legal separation from the seller. These services might include finance and accounting, human resources (HR), information technology (IT) and procurement. The objective is to ensure business continuity while the new company ("NewCo") establishes its own internal capabilities or to transition these services to a third party vendor. A TSA allows potential buyers to focus their efforts during the relatively tight "close window" period on post-close planning rather than on the operational risks and Day 1 issues. It also enables the parent company to transition smoothly to post-divestiture operations. Poorly articulated and conceived TSAs can leave value on the table, result in stranded costs and divert top management’s focus from core business activities.
Companies typically employ TSAs in situations where the divested entity needs time to replace corporate functions and capabilities that the parent company had previously provided. TSAs specify the scope, duration, costs, terms and conditions, affected parties and quality metrics that define the services. A typical TSA process involves five distinct stages:

**FIGURE 1.** Five stages of the typical TSA process

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<th>Set TSA Strategy</th>
<th>Baseline Assessment</th>
<th>Sizing</th>
<th>Agreement</th>
<th>Wind Down</th>
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A typical TSA process involves five distinct stages:

**Set the TSA strategy:** When defining the boundaries between the parent company and the NewCo, the seller establishes principles regarding what services it is willing and able to provide to the business post-close and how long it will provide them.

**Make a baseline assessment:** In conducting seller due diligence, the parent company must identify the services and service levels it currently provides to the NewCo, define the cost of those services, assess the selling company’s ability to continue to provide services at the current levels and determine the potential value a buyer could find in providing these services.

**Size the need for services:** Building on the business strategy and baseline to establish the right TSA parameters, the seller defines the scope of the required divestiture services, identifies associated costs, develops relevant schedules and establishes the contractual framework that it believes best accommodates the desired TSA characteristics.

**Shape an agreement:** Both parties carefully manage the review and negotiation process, refine the contract, and carry the TSA to signature.

**TSA wind down:** The seller establishes guidelines and governance policies prior to the closing of the deal. Once that event occurs and the TSA takes effect, the parent company monitors the progress of stand-alone solutions and manages service delivery and invoicing. It also helps manage costs and drives service wind down as the NewCo brings its own solutions up to speed.

The period of time these services are delivered is between Legal Close (“Day 1”) and the point at which the divested business is self-sufficient and therefore no longer requires the services.

**FIGURE 2.** Illustrative example of transition from initial situation to Day 1

**Initial Situation**

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<th>NewCo</th>
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**Legal Day One**

**Services provided by corporate and support functions**

**Transition services agreements**
Embracing Six TSA Leading Practices

Accenture has supported numerous companies in their efforts to define, negotiate, operationalize and establish governance policies for TSAs. In our experience, sellers should follow six leading practices to help ensure that their TSAs enable them to work to capture the most deal value possible while minimizing business disruptions.

1. Think about getting out, before getting in.

Sellers should determine an overarching divestiture strategy that articulates where they want to be after the divestiture and how quickly they need to get there. The best way to clearly document and articulate the divestiture strategy is to create and widely circulate transactional principles. This step compels the seller to address strategic questions such as:

- Which services must remain in-house to support the core business? These could include a particular business capability that requires specialized key talent or specific legally protected Intellectual property (IP).
- Which transitional services might a prospective NewCo buyer need versus which ones it would really value?
- Is the seller in a position to offer such services to the buyer, and if so, for how long?
- Does the seller have clear line-of-sight into the security of its systems during the term of the TSA?

Answering these questions helps enable sellers to determine the scope of the transitional services they will provide to the NewCo and the information they may want to include in the confidential information memorandum (CIM) and other business marketing materials. It also helps to ensure that the seller has clearly thought through how it will get out of the TSA before getting into it.

Ensuring that the TSA provides the right services will have an impact on the pool of bidders and on the confidence with which they make bids, which will in turn affect deal value. For example, Accenture recently helped one global oil company divest its refining assets, working with the organization to define clearly the future boundaries between the two organizations. This evaluation uncovered a number of services currently provided by the parent company but not captured as costs on the separating businesses’ books, such as retail franchise contract administration and legal fees. Because the seller clearly articulated its post-closing service position, buyers fully understood the support requirements that came along with the refinery purchase. This knowledge enabled them to bid with confidence.

Additionally, setting a clear direction can help the seller to ensure that it does not unwittingly extend transitional services that provide little value to the acquirer but instead cause the seller undo stress, additional costs and limited post-close flexibility related to right-sizing its support functions. For example, Accenture supported a spin-off that faced the risk of takeover shortly after the legal close. Knowing this—and that the costly transitional services would offer little value to the acquirer—the parent company crafted a TSA that stipulated service cessation in the event of a change of the NewCo’s control. While the takeover never materialized, the parent company’s well-informed strategy served as powerful insurance against any obligation to continue to provide low-value ongoing services to a third party at considerable effort and expense.

2. Focus on TSAs early.

The TSA process can be extremely complex. Many sellers only begin work on TSAs during the period between the deal’s signing and its close. However, launching TSA planning as an early imperative helps ensure that sellers can negotiate PSAs and TSAs simultaneously and prepare for post-close activities in advance.

Starting early allows companies to negotiate TSAs in conjunction with PSAs. For example, in a recent financial services transaction that Accenture supported, the seller completed the definition and design of the TSA structure and its costs early in the deal process, enabling it to use the contract as a negotiation lever. By adapting pricing and service level agreements (SLAs) to the specifics of the deal, the TSA provided strong incentives to both parties to complete the transaction on time.

The best way to identify, scope and adequately price TSAs begins with business process mapping. Early in the process, this will include an examination of the critical business capabilities required to help ensure operational continuity. Best practices suggest a three prong process:

1. Map the affected business processes
2. Develop the business capabilities needed to perform a given process
3. Uncover any gaps in the NewCo’s capabilities in these areas.

Starting early also gives managers ample time to operationalize the service agreement and to establish and test post-close governance policies. This can greatly
enhance the ability of managers in both camps to identify and resolve emerging difficulties before problems escalate into expensive post-close disputes. Accenture recently helped a global oil company to scope and structure a variety of cross-functional TSAs. The company was divesting its entire downstream business portfolio through two asset sales and an initial public offering (IPO), and each transaction had a unique deal structure. The TSAs were a critical bridge that provided the time and space the NewCo needed to build business capabilities across a number of functions that weren’t originally indigenous to the business. Accenture helped the firm successfully scope, price and negotiate the TSAs while structuring an appropriate governance model to manage, invoice and seamlessly navigate service and delivery issues. The TSAs also worked with the company’s external counsel to codify a blended application-and infrastructure-based IT TSA that provided a creative way for the seller to develop a cloud-based environment that it ultimately handed over to the buyer. This solution significantly reduced the uncertainties in the legal close by helping to eliminate any operational continuity risk on Day 1, thus making possible a clean TSA exit process.

3. **Dedicate a separate work stream to manage the TSA process.**

Developing a successful TSA involves a wide variety of tasks and stakeholders. A dedicated work stream can provide standardization and agility, which allows the many stakeholders—the business operations, deal teams, buyers, legal advisers and separation design teams—to focus on the specific tasks they must manage throughout the process.

A dedicated work stream accelerates the TSA process by using standardized approaches. Accenture recently assisted an Asia-Pacific client where the management team initially chose to develop the TSA using an ad-hoc, function-by-function approach. Unfortunately, this caused wide disparities to emerge across various functions that would have resulted in wasted work and lost time. To put the process back on track, Accenture helped to implement a separate work stream for TSA activities managed by the deal program office. By imposing more stringent oversight measures, the company rapidly synchronized the approach and standardized the quality of the TSA documentation, allowing the program to proceed quickly.

Dedicated work streams also give companies the flexibility to re-scope their TSAs during negotiations or because of unavoidable changes caused by external factors. Take one firm’s recent divestiture of its share in a joint venture in the financial services sector, where events caused a change in the TSA’s scope very late in the deal process. As the negotiations developed, it became clear the seller would have to offer a number of new products during the period the TSA was in effect. By establishing a dedicated team that understood the TSA development process, including its risks and issues, the seller could rapidly scope and develop the contracts, enabling the deal to continue within its original timeframe.

4. **Minimize stranded costs.**

Stranded costs occur when a seller cannot easily recalibrate its current cost structure while providing support services to the divested business. For example, a divested business unit might leave behind buildings, land, mineral rights, machinery and other capital and infrastructure investments that the seller will have trouble right-sizing. Alternatively, the seller’s company-wide support functions can suddenly become too large when the subsidiary unit leaves the fold.

Sellers should manage stranded costs from three angles.

- **During baselining efforts (see sidebar),** sellers should make sure that they capture all costs associated with providing services and that they understand the changes needed to segment activities more cleanly after Day 1. Actions include identifying easy-to-capture costs such as dedicated employees, but should also address less clear-cut situations as well. One example of the latter might involve accounting for employees who spend perhaps 20 to 30 percent of their time serving the divested business.
- **During negotiations,** sellers should strive for TSA contract language that helps ensure accurate cost pass-through and gives them the flexibility to change pricing if the cost of providing services changes. Additionally, sellers should negotiate an early termination notification period that allows sufficient time for them to handle stranded costs before the service agreement ends. Finally, in order to provide an incentive to the buyer to end the TSAs and to compensate the seller for the burden of providing the contracted services, sellers should negotiate step-change price increases for any optional extensions that the buyer may have the right to request.
• Post-close, the seller must maintain close contact with subsidiary managers to monitor the pace of the transitional activities. By closely monitoring the NewCo’s progress in developing its new services solution, the seller can make appropriate changes to its business to take care of stranded costs in parallel.

One Accenture client in the media and entertainment industry protected itself from stranded costs by negotiating TSA contract inclusions that provided full cost pass-through and advanced notification of cost variances greater than ten percent. It also secured minimum termination notice periods that gave it sufficient time to deal with costs prior to early service termination. Managers in the parent company maintained close communication with the NewCo throughout the transition, ensuring that they had adequate time to manage their costs efficiently in line with the TSA’s projected wind-down.

5. Tightly manage negotiations.
Arriving at a final TSA agreement usually involves several rounds of negotiation. Regulatory issues can complicate the process, which can make finding common ground among parties increasingly difficult as the TSA start date approaches and both sides become acutely aware of their responsibilities. Successful negotiations begin with a common understanding of the timeline and disciplined adherence to an established negotiation framework that provides negotiation details and lists who needs to be involved.

To manage the seller’s risk of ongoing service provision and stranded costs, the negotiation process should include formal approval of the TSA wind-down schedule. While it may be difficult ultimately to agree on and codify the exact wind-down schedules for each TSA, with the right planning, organizations can make it happen. As a rule, establishing general principles early on can help companies to formulate exact wind-down timelines. Additionally, where appropriate, the TSA should include contractual incentives to encourage the divested business unit to meet standalone support requirements. The seller could specify a price increase if the NewCo requires a service extension, or include non-renewal provisions for service extensions beyond a specified date.

6. Implement robust "post-close" service governance policies.
Executing a seamless service delivery and wind-down schedule requires a solid governance structure, thoughtful change management and a transactional mindset. As with any significant contract, changes to the terms of the agreement can leave either organization exposed to operational or financial risks. Consequently, agreements must spell out clear change and dispute resolution processes.

Typical contract terms and conditions include:
• Service performance
• Third Party Consents—Third Party Agreements
• Pricing & payment terms
• Warranties & obligations
• Term & termination
• Transfer/migration of services
• Liability
• Contract management
• Intellectual Property Rights (IPR)
• Data protection & confidentiality
• Force Majeure
• Use of sub-contractors for service provision
• Audit rights
• Service change rights
• Service Governance and dispute resolution

Typical schedule contents include:
• Scope and service descriptions
• Costs and specific payment terms
• Service levels
• Service providers and receivers (i.e., the managers who are responsible and accountable)
• Service run time/wind-down
• Wind-down plan (i.e., transfer to NewCo or third party provider)
• Buyer service dependency
Additionally, the NewCo and seller teams will naturally spend less time together after the deal has closed, severing the previously established informal communication networks. As a result, organizations must replace informal communications with deliberate interactions, such as a periodic schedule of meetings between key managers on both sides of the deal.

In particularly complex environments, Accenture recommends that when managing service delivery and wind-down, both sides create a central point of accountability to monitor all charges, verify appropriate service levels, track milestones and make necessary adjustments. Additionally, each functional manager must carefully track the transitional services under his or her purview. Ideally, oversight should involve the same experts who constructed and negotiated the agreement because they will have detailed knowledge of the end-to-end services the contracts document.

Despite dealing with a complex set of TSAs and reverse TSAs, an Accenture client recently applied these governance approaches and subsequently enjoyed a smooth transition that concluded on time and within budget. Management teams established monthly meetings and regular reporting schedules before the TSA went into effect, and executives remained engaged and informed until all transitional services concluded. Managers tracked divestiture milestones closely and both sides used the same functional experts who wrote the TSA to lead transition efforts. Keeping close tabs on costs, service levels and timelines made an easy separation possible.
Why Forging Strong TSAs Makes Sense

Leaders might find it tempting to view TSA development as an afterthought to a divestment decision, especially if they believe the process is administrative and adds little real value. Doing so would be a mistake. We recommend that the seller set a clear direction and start TSA due diligence to determine the scope, pricing and duration of services and other related provisions early in the divestiture process. A dedicated work stream can help companies manage the large number of complex tasks and interactions involved, and a tight TSA negotiation process can help prevent surprises that could stall negotiations as the divestiture date draws near. Robust post-close governance can help sellers avoid unnecessary difficulties and keep wind-down activities on schedule and under budget. Following these six leading practices can help sellers extract the greatest deal value while minimizing costs and disruptions. Given the stakes, it makes sense to invest the effort and time required to get TSAs right.
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End Notes

1 Source: Accenture Research, Thomson Reuters. Divestiture volume measured as the sum of split-offs, spin-offs, equity carve-outs, two-step spin-offs, and divestitures (loss of majority control).

2 “Carve-out” refers to the overall process of separating a division, business unit or business/support functions from the parent company and, depending on the strategic intent of the carve-out, setting it up as independent legal entity. In most cases, the carve-out process runs in parallel to a divestiture transaction process.

3 Reverse transitional service agreements apply when the parent requires services from the carved-out and divested business.

4 This is key in order for the seller to avoid any liability (e.g., service credits) in relation to issues with the services being provided that have arisen as a result of the buyer failing to meet its end of the bargain (e.g., failing to provide data to the service provider).
About Accenture

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