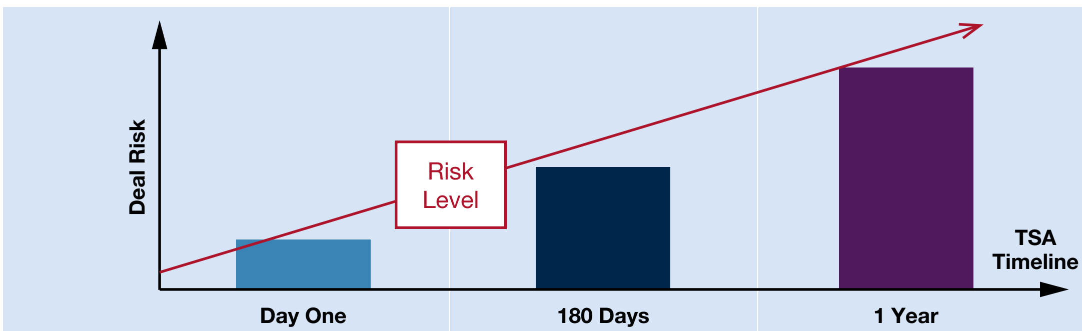
PROTECT DEAL VALUE WITH EFFECTIVE TRANSITION SERVICE AGREEMENTS

Go Beyond a Description of Services to Define Key TSA Elements

A well-developed TSA is like an insurance policy – it limits your exposure to risk.

Transition services agreement (TSA) development is a core aspect of M&A execution when the asset(s) or entity to be acquired shares common infrastructure (e.g., people, processes, technology or assets) with other parts of the seller's business that will not be included in the deal. In these cases, a TSA is developed to outline the buyer's and seller's obligations regarding the shared infrastructure after the deal is closed. Despite its risk to overall deal value, this agreement is not always given appropriate attention. Worse, it can be viewed as an additional negotiation to be "won" or "lost."

OVER TIME, A POORLY DEFINED TSA CAN ADD RISK TO DEAL EXECUTION



	Day One	180 Days	1 Year
Business Environment Factors	• Recent colleagues sharing space and services • Verbal agreement on delivery • "We will figure it out"	• Rising list of issues • Increased competitive interactions • New employees in positions requiring services (not part of TSA development) • Erosion of trust	• Critical issues unanswered or under-communicated • Contentious competitive interactions • New employees in leadership roles • Loss of trust and civility
Impact	• Business as usual • Low impact	• Resentment over priority of services • Inefficient business practices reduce profitability	• Damage to business reputation (affects future deals, public perception, etc) • Potential litigation

While TSAs vary in length, content and structure, there are some common truths to keep in mind before engaging in the development of a TSA.

1. The seller's infrastructure was likely developed to specifically support their own "internal" business operations. Providing support services to "external" parties with defined service levels is generally not something that the seller contemplated when the infrastructure was originally developed.

2. The seller's information systems, business processes and support personnel are not typically organized in a fashion that can be easily separated into component parts under a TSA. It is common in many cases for the buyer to have to take "all or none" of a seller's support services due to the integration of the seller's infrastructure with other parts of their business.

3. Sellers can generally only provide the service levels under a TSA that existed just prior to the transaction to a buyer. Adjusting services levels up or down to meet a buyer's specific needs may not be possible.

In addition to tackling the challenge to clearly define services, having a disciplined approach to five key elements of a TSA (below) will increase the odds of a smooth transition and improve the participation of key stakeholder groups.

GOVERNANCE — ISSUE RESOLUTION — PRICING — SERVICE LEVEL AGREEMENTS — REPORTING

These elements will also guard against deal value leakage from customer or employee attrition, supply interruption or increased cost of delivery. A well-developed TSA is like an insurance policy – it limits your exposure to risk.

Element #1 – Governance

Governance is the manner by which the legal document will be executed. Put plainly, it is the process of defining who, on both sides of the deal, is in charge. It is critical to have an escalation path defined before execution of a contract to ensure issues are resolved quickly.

There is a tendency to spend a lot of time writing and scoping the services within a TSA and then expecting everyone involved to "act professionally" to avoid any issues. The problem is, while there are relatively few people involved in the development of a TSA, there can be many involved in the execution. The further down the line the responsibility for a specific activity resides, the less likely that person will understand the "spirit" of the agreement (to close quickly without affecting deal value for either side) and the more likely they will be concerned with their personal sphere of work.

First, the team should define governance roles at both the functional and enterprise level. For each role, “both sides of the deal” should be represented. For example, there should be an overall TSA lead within the buyer’s organization and an overall TSA lead within the seller’s organization. If there is an IT TSA lead on the buyer side, there should also be one on the seller side.

Second, the team must identify the right people to fill each TSA leadership role. These individuals must have the ability to rapidly make decisions within their functional area (or for the entire company if acting as the overall TSA lead), be highly-regarded throughout the organization as someone who can informally navigate and address issues and have a demonstrated ability to work outside of the organization (e.g., with a counterpart, new supplier, new customer etc.) in a constructive manner.

CASE IN POINT

A private equity client agreed to purchase substantial assets from an Exploration and Production (E&P) company and stand up a new company to manage those assets. The problem? The client didn’t have any of the infrastructure necessary to run an E&P company.

The A&M team quickly assessed the required infrastructure and developed timing to stand-up the new company. It was very clear that the seller would be required to provide transition services for a substantial period of time in order for the deal to close. The team built detailed descriptions of those services but also made sure to be very specific in the contractual language around which seller resources would support each function (i.e. governance) and built SLAs around each functional activity. These details allowed the deal to close as planned while mitigating operational risk.

Element #2 – Issue Resolution

Issue resolution is the process by which issues are resolved including communication methods, escalation paths and service level agreements (SLAs) around timeliness. Issues that linger often get bigger, more complicated and drive animosity among team members.

The more complex the merger, the greater the list of issues will be in the first week after close. If allowed to fester over a long period of time with no solution or transparent resolution path, these issues can quickly drain any excitement that may be associated with a deal. But when resolved quickly, clearly and consistently, issues actually present an opportunity to demonstrate the commitment of the integration team to realizing merger success and set the proper tone to prioritize integration activities.

An issue resolution process should be explicitly defined in the TSA. Issues should be prioritized based upon their effect on the core business. Highest priority is given to those issues that affect the delivery of a product or service.

Element #3 – Pricing

Pricing is the cost of the services provided by one party to the other and can be a sensitive issue for both sides of the deal. Failure to properly price services can erode deal value and lead to resentment or execution issues due to perceived inequality.

Sellers are generally concerned with underpricing their services which could reduce the incentive for the buyer to transition at a fast pace or negatively affect seller financial goals. Buyers, on the other hand, are leery of overpaying for services, potentially destroying deal value while subsidizing another company's back office.

Generally, the key to ensuring smooth pricing discussions is simplicity. Sellers should leverage reporting of the actual cost of resources required to deliver services. A pricing model that takes more than a few sentences to describe will drive unnecessary activity on a non-core issue. Teams should be focused on running the business, NOT on a complex algorithm to precisely compute pricing. An additional best practice is to develop the various cost elements so they can wind down independently (e.g., by region, activity levels, etc.).

CASE IN POINT

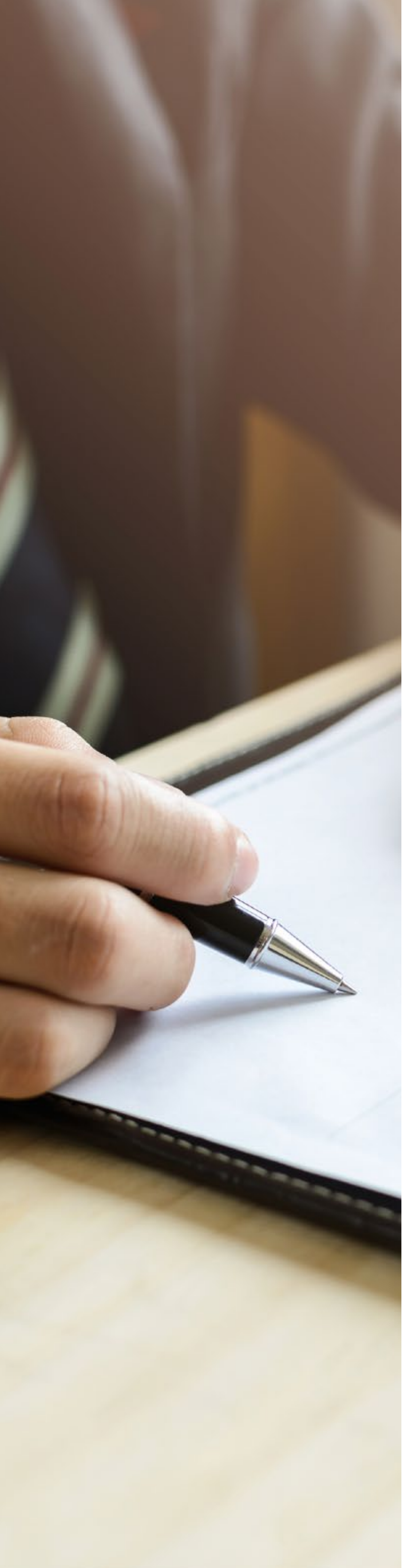
One of our teams was supporting the divestment of a property and casualty portfolio for a large insurance client. It was a very complex deal with multiple functions requiring transition services. The A&M team was asked to review a draft of the TSA to develop a risk mitigation plan, develop a compliance approach, and manage the TSA through transition / exit.

By engaging early in the process, the team was able to bundle services and fees in a simple, easy to describe pricing structure. They also defined a regular schedule for TSA leadership to meet, review TSA performance and agree on actions. These risk mitigation activities allowed the integration team to focus on a rapid transition / exit from the TSA with less concern that the core functional activities would be an issue.

Element #4 – Service Level Agreements

Service levels are the measurements or expectations around the quality and timeliness of the delivery of TSA services. Realistic service level measurements allow key leaders to have productive conversations about the execution of the TSA.

Some examples of SLAs in the various functional areas are response time for an IT service request, timeline to prepare financial period close documents or invoice delivery timing. These measures should follow the SMART model; they should be Specific, Measurable, Attainable (and agreed upon), Realistic and Timely.



If SMART service levels already exist for a given TSA service, consider leveraging them. Doing so will save time and costs while also emphasizing a collaborative approach between the buyer and seller.

By defining specific, measureable SLAs by function, the deal teams ensure that conversations about delivery will be fact based and lessen the emotion that accompanies change of this magnitude.

Element #5 – Reporting

Reporting on TSA execution includes defining the structure, forum and cadence for how information will be shared regarding performance against the TSA. Defining this beforehand sets a process for review of the quality of TSA delivery, eliminating ad-hoc meetings and confusion.

The structure of a TSA status report should be simple to digest and easy to reproduce. Reports should include both quantitative and qualitative elements. The forum defines how the reporting will be reviewed, who will review it and where. It is generally advisable to set up a meeting that brings key people together to review status on a periodic basis. By getting those meetings on the calendar early, integration teams can ensure that minor problems don't turn into major ones.

Recap

TSAs are developed to mitigate the natural conflict created between a corporate development team looking to close a deal as quickly as possible and a management team focused on business continuity. The optimal result when developing a TSA is to produce the shortest time to close without affecting the deal value or core business.

Above and beyond a detailed description of services, a TSA should include five key elements to reduce the risk of deal value erosion over time:

1. **Governance.** Clearly define who is in charge so issues can be resolved swiftly and decisively.
2. **Issue Resolution.** Layout how issues will be captured, reviewed, prioritized and resolved.
3. **Pricing.** Keep pricing models simple and base pricing on actual resource costs to deliver services.
4. **Service Levels.** SMART SLAs help remove unproductive emotion from conversations regarding performance against the TSA.
5. **Reporting.** Design a digestible status report, and establish the forum / cadence by which it will be reviewed ahead of time.

The optimal result when developing a TSA is to produce the shortest time to close without affecting the deal value or core business.

Attention to these elements will increase the odds of a smooth transition, improve the participation of key stakeholder groups and mitigate the risk of deal value leakage from customer or employee attrition, supply interruption or increased cost of delivery.

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