NAVIGATING MERGERS AND ACQUISITIONS: THE SCIENCE AND ART OF TRANSITION SERVICE AGREEMENTS

The complex world of health care mergers and acquisitions ("M&A") involves intricate processes that require effective integration of systems and services to maximize value. A Transition Services Agreement ("TSA") is a contractual agreement that can play a crucial role in ensuring a smooth transition post-acquisition. The purpose of a TSA is two-fold: (1) to ensure the continued delivery of essential steady-state services post close; and (2) to provide for the orderly transfer of data and operational control of the IT systems.

A TSA generally outlines the services that the seller will provide to the buyer for a specified period post-closing. The services typically include IT support, human resources, finance, revenue cycle and administrative and operational functions. A TSA should be clear as to the services to be provided, the fees to be paid for each service, the duration of each service and the process and project management mechanisms to be used by the parties to ensure buyer success.

PREPARING FOR A TSA

When preparing for an M&A transaction, both the seller and buyer need to thoroughly understand their respective organizations and the objectives of the transaction. When negotiating a TSA, it is crucial for key stakeholders from both sides to be involved in the discussions, including legal, technical, business and clinical leadership. Having an experienced M&A advisor can be beneficial for the buyer to ensure that all necessary services are identified and adequately described.

In preparation for the transaction, the buyer must have a well-defined perspective or strategic plan for what it wants to do with the acquisition. Considerations should include the future state of human resources, finance, supply chain, procurement, revenue cycle, clinical and information technology that aligns with how the organization functions. Each department needs to identify the applications, services, capabilities and data requirements that will support the acquisition. This knowledge will be critical when negotiating the TSA.

The seller has valuable knowledge of the existing people, processes, technologies and culture that needs to be aligned with the buyer's strategic plan. To ensure a smooth transition, the parties must determine which services and applications are needed and able to be provided, as well as what cannot be provided. The parties should prepare a simple one-page conceptual document that outlines a summary of the TSA services, and including the intent of the services can be beneficial as it will serve as guiding principles to ground all parties during the negotiations. The initial draft of the TSA should include the services, costs and duration of each service to use as a starting point for discussions.

Data and business records are among the most critical components of any M&A integration, and the TSA most likely will need to address data extraction services and associated fees. The form of the transaction, the privacy data structures of the seller and early deal commitments related to the transfer of business records can create significant challenges with respect to data ownership. The type of M&A transaction, whether it is a membership substitution, asset purchase or another form, will determine the volume of data required, the relevant time periods and the systems involved. Extracting data from the seller's existing systems and converting it into the buyer's target system is typically the most prolonged and challenging activity during the TSA period. For a hospital, there could be hundreds of systems that necessitate some degree of data extraction.

Other operational components that can be critical include billing and collecting for pre-closing accounts receivable, access to the seller's supply chain, use of licenses, payroll and other functions that the buyer may not be ready to implement when the closing occurs. All of these components need to be carefully considered during this process, although the IT-related services are usually the most complex.

DRAFTING AND NEGOTIATING A TSA

Negotiating a TSA requires a collaborative approach and a focus on mutual benefits and realistic transition expectations. Both parties need to negotiate in good faith and should aim for a fair agreement that supports the buyer's integration efforts while compensating the seller for its services. It is important to remember that after closing, the TSA is the primary agreement that defines how both parties will be operating together for the duration of the TSA, which could be months or years. After execution, it's most likely that any change to the TSA requires

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both parties to agree, and contractual changes could increase fees.

TSA Key Components include:

- **Scope of Services**: Clearly define and detail the services to be provided, including any limitations or exclusions. This ensures that both parties have a mutual understanding of their responsibilities. Collaboration with functional leaders is essential to identify all services required during the transition period, including IT, HR, finance, legal and other operational and administrative functions. Included should be processes defined for the buyer requesting additional ad hoc work from the seller.
- **Supported Applications**: Clearly define and detail the applications to be provided, including any limitations or exclusions. Seller's applications typically fall into three classifications: Excluded (not available to the buyer after the Transaction Effective Date), TSA Supported (available to the buyer for the entire TSA duration or a defined shorter period) and Not Supported (applications in use that the seller does not support). Information helpful for each application is where the application is hosted, who supports it and how maintenance is paid.
- **Duration (Term)**: Set realistic timeframes for each service with buyer options for extension periods, if feasible. Considerations include the seller's desire to exit as quickly as possible, and the buyer's integration plans and potential challenges. This time period can vary depending on the size and complexity of the integration, but a hospital integration typically takes 12-24 months.
- **Service Termination**: Establish clear and fair conditions for terminating individual services, the entire agreement or other specific circumstances. The termination provisions should include any penalties for early termination and the notice requirements for termination. This provides flexibility and protection for both parties.
- **Costs**: Negotiate a pricing model that is fair and reflects the value of the services provided, considering factors such as complexity, duration and resource requirements. The fee can be fixed, variable or a combination of both. The fee schedule should be structured to 1) incentivize the buyer to complete the transaction as fast as possible with fee reductions as the buyer assumes services; 2) fairly compensate the seller for the services; and 3) stipulate if and when inflationary increases will occur.
- **Service Levels**: Performance standards and metrics should be clearly outlined in the TSA to ensure high-quality service delivery. This can include response times, quality standards and service performance escalation procedures. Service levels should be similar to the support the seller was providing previously or similar to other seller locations, if applicable.

BEST PRACTICES FOR EFFECTIVELY MANAGING A TSA

Effective management of a TSA requires collaboration, communication and oversight. Here are some best practices:

- **Integration Management**: The key operational and technical leaders from both parties should establish a regular cadence of meetings to discuss the integration, coordinate activities and resolve any risks, issues or concerns. Progress reports should be published at an agreed frequency to both the seller's and buyer's leadership. To assist with this complex process, engaging an advisor can provide leadership with invaluable insights regarding the process and efficiencies, saving unnecessary costs down the road.
- **Summary of TSA**: After negotiations, a simple summary document of the agreed TSA services, supported applications, data ownership and timelines is beneficial as guiding principles to ground all parties during the integration phase.
- **Data Management**: For a TSA with critical IT elements, effective management of various artifacts such as documents, questionnaires, assessments, diagrams, policies and procedures is crucial. It is recommended to have a single central repository accessible by both parties and managed by a librarian. Certain sections of the repository should be protected and restricted to ensure the confidentiality and sensitivity of information, such as human resources and patient data. The librarian oversees the entire repository, while Data Custodians manage data for their specific service areas like finance, supply chain and revenue cycle. These resources help catalog and organize new data as it is provided and validate, if requested, information that has already been supplied.
- **Establish a Governance Structure**: Create a governance and dispute management framework that includes representatives from both the buyer and the seller, with defined escalation tiers to both senior executives. This team should oversee the execution of the TSA, address issues and ensure compliance with the agreement.
- **Monitor Performance**: Regularly monitor the performance of the services provided under the TSA. Use the established service levels

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and metrics to assess quality and address any deviations promptly.

- **Facilitate Knowledge Transfer**: When there will be significant turnover between the seller employees and the buyer employees, encourage knowledge transfer between the seller's and buyer's teams. This can include training sessions, documentation and shadowing opportunities to ensure a smooth handover of responsibilities.
- **Plan for Day One and Overall Transition**: Collaboratively create a comprehensive transition plan that details the steps and phases for integrating the acquired assets. This plan should include timelines, milestones, resources and contingency plans to address potential challenges. The buyer should be proactive, drive the process to completion and not wait for the seller to provide direction.
- **Financial Review**: Conduct regular financial reviews to ensure that TSA invoice fees and expenses reflect the TSA's contractual cost structure, and invoices are being paid on time. If there are issues, variances or unexpected charges, discuss in good faith in order to appropriately resolve.

PRACTICAL TAKEAWAYS

When a TSA is part of a transaction, a well-drafted and negotiated TSA is vital for a successful transition. It ensures continuity, minimizes disruptions and supports the buyer's integration efforts. By carefully considering the scope of services, costs, service levels, duration and termination conditions, both parties can achieve a smooth and efficient transition.

THE HALL RENDER ADVISORY SERVICES ADVANTAGE

Hall Render and Hall Render Advisory Services have the experience and depth of knowledge to be your one-stop legal and Information Technology advisor in M&A and TSA negotiations, bringing decades of experience to assist your organization. We can help your organization across all phases to realize the anticipated benefits of a deal, from expanded patient reach and service offerings to improved operational efficiencies and financial performance.

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