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Insights

THE CARVE-OUT DEAL: WHAT SPONSORS NEED TO KNOW

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There is a growing consensus that 2026 is shaping up to be the year of the carve-out. A confluence of market and regulatory pressures has created a significant pipeline of non-core division disposals. For mid-market sponsors, this represents one of the most compelling deal opportunities in the current cycle, but one that differs in important respects from a conventional acquisition, and has the potential to reward those who approach it with the right preparation.

Several factors explain why balance sheet simplification has returned to the top of the corporate agenda including:

- higher cost of capital is forcing boards to redeploy resources toward core operations;
- divesting non-core divisions to allow repayment of debt with proceeds;
- activist investors are increasingly targeting diversified groups for break-up; and
- the growing burden of ESG and regulatory reporting is making complex group structures harder to justify.

The result is a wave of disposals that is predominantly strategic rather than distressed. Sellers are typically sophisticated corporates acting on a considered portfolio strategy, but may be operating under imposed timelines that leave limited room for separation planning. This urgency means that some targets will have been well advanced in their standalone readiness by the corporate seller, while others will be little more than identified as the business unit for sale. Each of these variables shapes the legal and structural challenges that follow, and this article sets out the key legal issues that sponsors should focus on when evaluating and executing a carve-out transaction.

WHAT MAKES A CARVE-OUT DIFFERENT

In a conventional share sale, the buyer acquires a legal entity with its own assets and liabilities. In a carve-out, the target business does not exist as a standalone entity. It is being separated from a larger group, often having been integrated into that group's systems and infrastructure over many years. The legal work is therefore not just about ascertaining what assets and liabilities are to be transferred, it is about spotting what is missing from the transferring business to allow it to operate

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independently. This is particularly acute for sponsors, who unlike trade buyers cannot absorb a carved-out business into existing operations: the business must be capable of operating independently from day one. That additional complexity narrows the competitive field and can support more attractive entry valuations, but sponsors should plan for longer transaction timelines and higher transaction costs, and resource the deal accordingly from the outset.

ASSESSING THE TRANSACTION PERIMETER

The most important legal task in any carve-out is defining the transaction perimeter: the precise boundary of what assets, liabilities, operations, contracts and employees are being acquired and transferred as part of the transaction. This has several dimensions:

- **Contracts.** Many of the target's commercial contracts will have been entered into by the seller's group rather than the business unit itself. Transferring those contracts requires novation or assignment. In broad terms, an *assignment* transfers rights under a contract, with obligations remaining with the assignor, and the counterparty's consent is often not required. *A novation*, by contrast, transfers both rights and obligations, effectively replacing the original contract and releasing the original party from liability. In a carve-out of any scale, the volume of contracts requiring review can be substantial, and AI-assisted contract review tools are increasingly being deployed to accelerate the identification of change of control, consent and assignment provisions across large portfolios. Identifying which contracts are material and where consent may be required as a condition to the transaction is a critical early task.

- **Employees.** In a carve-out, where the seller is transferring assets, employees that are assigned to the transferring business will transfer automatically under TUPE regulations, which also may require consultation obligations. Identifying who is genuinely shared with the retained group, and how these employees should be treated requires careful analysis and needs to be factored into any timetable.

- **Intellectual property.** Carve-out businesses frequently rely on IP such as brand names, software and data which is owned by the wider group. IP should ideally be assigned to the target, but if a licence is the only option, its scope, duration, exclusivity and termination provisions need to be negotiated with great care.

- **Property.** The carved-out business will need premises from which to operate, and in many cases it will currently occupy space held under leases in the name of the seller or another group entity. Where the business is to remain in its existing premises, the relevant leasehold interest will need to be assigned or a new lease or underlease granted. Most commercial leases contain restrictions on assignment and require the prior written consent of the landlord (not to be unreasonably withheld), and the landlord may impose conditions such as guarantees or rent deposit requirements. Where assignment is not achievable within the transaction timetable, the parties may need to agree interim occupation arrangements under

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a separate licence to occupy. Sponsors should assess the property position early, as landlord consent processes can be protracted and may affect the completion timetable.

TRANSITIONAL SERVICES

A transitional services agreement (TSA) governs the services the seller will continue to provide to the target after completion, covering functions such as IT systems, payroll, finance and facilities that the buyer cannot replicate on day one. Without a well-drafted TSA, a buyer can find itself in possession of a business that is legally separated from the seller but operationally dependent on it in ways that are not adequately documented or costed.

Key negotiating points include:

- **Service scope.** Each service must be described with sufficient precision that both parties know what is, and what is not, included.
- **Duration and exit.** TSA periods typically run six to eighteen months. The TSA should include a clear exit plan with milestones and exit assistance obligations on the seller.
- **Pricing.** Services are typically priced at cost or cost-plus. Buyers should ensure pricing is locked and that there is a mechanism for auditing the seller's cost base.
- **Stranded costs.** Certain group-level overheads such as central IT infrastructure, head office costs and shared service functions that were previously allocated in part to the target will remain with the seller. Sellers will frequently seek to recover these costs from the buyer. Sponsors should resist this: stranded costs are a consequence of the seller's retained group structure and do not form part of the standalone cost base of the acquired business.

REGULATORY, ANTITRUST AND W&I

Regulatory. Licences and authorisations under which the business currently operates are often held at group level and do not automatically transfer. Identifying what is required to obtain standalone permissions, and how long that will take, needs to be undertaken early on. Regulatory timelines can be long and unpredictable, and failure to obtain a necessary permission before completion can delay or derail a transaction.

Antitrust. Where a transaction meets the applicable filing thresholds, gun-jumping risks are heightened in carve-outs because separation planning necessarily involves close operational collaboration between buyer and seller before merger clearance is obtained. Gun-jumping occurs where a party crosses the line from planning to exercising control before closing, and can trigger intervention by competition and other regulatory authorities.

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W&I insurance. Underwriters approach carve-outs with particular caution. A key issue is financial information: unlike a standalone company with a track record of audited accounts, a carved-out business will not have its own historic financials. Standalone accounts will need to be prepared and approved in advance of the transaction, requiring the exchange of financial information with the appointed accountants, all of which must be factored into the transaction timetable. Warranty packages are typically narrower, historic liabilities arising during group ownership are often excluded, and the accuracy of pro forma standalone financial information is difficult to warrant with confidence. Losses arising from the structuring of the separation itself, including perimeter definition, asset allocation and transitional arrangements, also generally fall outside the scope of W&I coverage. Sponsors should not assume that the coverage available will be equivalent to a conventional acquisition, and specific indemnities for known separation risks are more commonly needed.

PRACTICAL CHECKLIST

- Has the perimeter been defined precisely before heads of terms are agreed?
- Is standalone financial information and pro forma accounts being prepared for the target?
- Has the consideration mechanic (and payment of agreed price) been understood and agreed?
- Have material contracts been reviewed for change of control and assignment restrictions, with a plan for those that cannot transfer without consent?
- Which employees will transfer automatically and how will shared employees be handled?
- Has IP ownership been mapped and has a decision been made on assignment versus licence for each material asset?
- Have shared databases and data migration requirements been identified, with a plan for separating and transferring key data in compliance with GDPR and applicable data protection requirements?
- Has the TSA negotiation been prioritised and resourced appropriately, including operational advisers who understand the seller's systems and cost base?
- Have regulatory requirements been identified and is there a clear timeline for standalone permissions?
- Has the property position been assessed, including whether leasehold interests require assignment and whether landlord consent is needed, and has sufficient time been built into the timetable for that process?
- Has the W&I broker been engaged early to understand any coverage limitations?

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CONCLUSION

Carve-out transactions offer sponsors access to businesses with genuine standalone potential at valuations that can be attractive. The sponsors who succeed are those who resource the transaction appropriately, engage specialist advisers early, and treat the separation plan, not just the purchase agreement, as a core deliverable. In a market where carve-out volume is increasing, the ability to execute these transactions well is becoming a genuine competitive advantage.

RELATED CAPABILITIES

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