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CMS European M&A Study 2020

Twelfth Edition

Disclaimer

The results of the Study, the contents of this report and the conclusions which they present do not necessarily reflect the views of any member of CMS, the lawyers or the support staff who assisted with their preparation. Over 4,600 M&A transactions are evaluated in the Study and this report, the vast majority of which were negotiated. There were many differences between the underlying agreements we analysed. In order to compare the results, individual provisions were categorized a process which required a degree of subjective judgment. Although certain trends can be deduced from the Study and this report, each transaction has individual features which are not recorded in the Study or this report and to which no reference is made. As a result, the conclusions presented in the Study and this report may be subject to important qualifications that are not expressly articulated in them.

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M&A 2019

Our annual CMS European M&A Study 2020 aims to be an important resource for all dealmakers looking to navigate the increasingly difficult and challenging investment climate. For the 12th consecutive year, we are here to help them succeed in any M&A process, by identifying and tackling the complexities in practice in the fragmented European transaction market.

This year's Study analyses the key market trends in legal documentation in 466 deals, all of which were advised on by CMS offices in Europe throughout 2019. Despite the slowdown in the European M&A market in 2019, CMS still managed to increase the number of deals for the third consecutive year advising on more deals than any other law firm in Europe.

Over the 12 years of the Study, it became clear that both buyers and sellers have become increasingly sophisticated and demanding. It is therefore even more important for deal participants and their advisers to prepare carefully and rigorously in advance of any transaction.

This trend chimes with the market analysis in our latest European M&A Outlook, revealing that an uncertain geopolitical and macroeconomic backdrop has prompted buyers and sellers to take a more pragmatic approach to deal-making. While executives were less optimistic about the prospects for M&A over the next 12 months, their focus is on streamlining their organisations, buying the highest quality technology and IP assets that fulfil key strategic objectives, coupled with favouring deals in fast-growing sectors with upside potential but sufficient cushion on downside risks.

I trust the CMS European M&A Study 2020 will be a useful guide for those considering transactions this year, to ensure more efficient and effective deal processes. The size of the deal sample and range of countries involved means that it's a uniquely valuable and rich resource for all M&A practitioners across Europe.

If you have any feedback or questions, we would love to hear from you.



Stefan Brunnschweiler
Head of the CMS
Corporate/M&A Group

CMS European M&A Study 2020

The CMS European M&A Study 2020 ('the Study') provides insight into the legal provisions of merger & acquisition (M&A) agreements, makes comparisons across Europe and with the US, and identifies market trends. CMS analysed private M&A agreements relating to non-listed public and private companies in Europe for the thirteen-year period 2007–2019. Of the 4,609 CMS transactions we have analysed since 2007, 466 relate to 2019 and 3,383 relate to the period 2010–2018.

In analysing the 2019 market, we report on current market standards on risk allocation in M&A deals, comparing 2019 against 2018 and the previous nine-year average for 2010–2018. The special features of this Study are as follows:

- **CMS Trend Index** – we provide a CMS Trend Index to illustrate a current fact or trend for the particular feature reported on, comparing the position in 2019 with that of 2018 and/or the nine-year period 2010–2018.
- **CMS European/US risk allocation comparison** – we provide a headline analysis of the differing risk allocation on standard issues in European and US M&A.
- **CMS European regional differences** – we highlight certain issues which are particular to one or more of the six European regions covered.
- **CMS deal size analysis** – we analysed our data against three different deal values: firstly, deals up to EUR 25m; secondly, deals in a value range of EUR 25m to EUR 100m; and thirdly, deals exceeding EUR 100m.



Executive summary

The Study covers 466 share and asset deals on which CMS in Europe advised in 2019. This represents a small increase on the number of deals we covered for 2018. It has been widely reported that European M&A was affected by political and economic uncertainty with overall deal volumes down on previous years. As will be seen from the Study, the uncertain M&A market has not significantly affected the basis on which key deal metrics were agreed.

The Study demonstrates the continuation of existing market trends across Europe, particularly 'seller-friendly' provisions and Warranty & Indemnity insurance (W&I) as a replacement for or an addition to warranty coverage by sellers. We continue to see marked differences to the US approach to risk allocation, which is generally more favourable to buyers. Otherwise market practice has remained broadly unchanged over the last five years, particularly as regards provisions for purchase price adjustments, the application of locked box structures, liability caps, earn-outs and security for claims.

Highlights

- The significant increase in the use of W&I insurance, particularly in the UK and on larger transactions, has continued, which means that sale and purchase agreements appear to be even more 'seller-friendly' as the equivalent buyer protection is now provided by the insurer under the W&I insurance policy.
- The gradual decline in the use of purchase price adjustment clauses and the upward trend in locked box transactions demonstrate a continuing requirement for sellers, and possibly buyers, to seek certainty as to the amount of the purchase price when signing the transaction documents.
- The use of *de minimis* and basket provisions has flattened out so that such provisions apply in just under three-quarters of the transactions covered. Limitation periods have settled at around 18 to 24 months in duration, most likely reflecting W&I market practice.
- Liability caps are increasingly determined by deal size. The purchase price is most likely to be the overall cap for a smaller transaction and for a larger transaction it is most likely to be significantly less than the purchase price, often just 10% to 25% of the purchase price.
- Stark differences in approach and in market practice between the US and Europe continue to apply. Over the 13 years covered by the Study, the use of 'seller-friendly' risk allocation techniques increased across all territories throughout Europe, whereas the US remained a more 'buyer-friendly' market.
- Legal technology tools, such as artificial intelligence, document automation and for project management, were used in numerous of the reviewed transactions. Where this was the case, it was reported that this generally led to cost savings, so it seems likely their use will continue to grow in future.

Key conclusions

2019 results at a glance

CMS Trend Index

	2010–2018	2018	2019
DEALS WITH PURCHASE PRICE ADJUSTMENT	45%	44%	45%
DEALS WITH A LOCKED BOX (WHERE NO PURCHASE PRICE ADJUSTMENT)	46%	59%	56%
EARN-OUTS	18%	23%	21%
— SHORT EARN-OUTS (12 MONTHS OR LESS)	24%	20%	23%
— LONG EARN-OUTS (36 MONTHS OR MORE)	22%	23%	17%
— EBIT/EBITDA-BASED EARN-OUTS	41%	39%	39%
— TURNOVER-BASED EARN-OUTS	31%	33%	40%
<i>DE MINIMIS</i>	67%	74%	73%
BASKET	66%	68%	66%
— LOWER BASKET (LESS THAN 1% OF PRICE)	56%*	64%	62%
— HIGHER BASKETS (MORE THAN 1.5% OF PRICE)	27%*	19%	23%
— FIRST DOLLAR RECOVERY	78%	84%	80%
LIABILITY CAPS			
— NO CAPS	14%	11%	10%
— LESS THAN 50% OF PRICE	54%	58%	58%
— LESS THAN 10% OF PRICE	13%	18%	16%
LIMITATION PERIODS			
— 12–18 MONTHS	33%	29%	33%
— 12–24 MONTHS	64%	66%	69%
— MORE THAN 24 MONTHS	22%	24%	19%
SECURITY FOR WARRANTY CLAIMS	32%	31%	33%
— RETENTION FROM PRICE	28%	27%	31%
— ESCROW ACCOUNT	59%	58%	54%
MAC CLAUSE	14%	14%	16%
ARBITRATION CLAUSE	34%	33%	34%
— APPLICABILITY OF INTERNATIONAL RULES RATHER THAN NATIONAL RULES	41%	43%	42%

* Data only available for 2011–2018

Purchase price adjustments – In 2019 the recent trend of a gradual decline in the use of purchase price adjustment clauses in M&A agreements continued. There was a slight increase in the number of deals with a PPA in 2019 compared to the previous year but this was still significantly behind the average level for the prior three years. We think this reflects a continuing requirement for sellers, and possibly buyers, to seek certainty as to the amount of the purchase price when signing the transaction documents.

Locked box – Although there was a slight decrease in 2019 in the use of locked box arrangements for non-PPA transactions, the overall upward trend for the use of locked box provisions continues, particularly when compared against the average usage for the period 2010–2018. We think this demonstrates further confirmation that parties wish for as much certainty as possible as to the final purchase price at the time of entering into the relevant agreements.

Earn-outs – There was a small decrease overall in the frequency of earn-outs in 2019 (down by 2% to 21%), although this percentage still remains higher than the average of 18% for the period 2010–2018. Earn-out periods were generally shorter, sometimes just 12 months. Turnover overtook EBITDA/EBIT as the most popular financial metric on which to base an earn-out. Earn-outs remain most popular on Life Sciences & Healthcare and Technology, Media & Communications transactions but 2019 saw a notable increase in their usage in Hotels & Leisure deals.

Warranty & Indemnity insurance – The year-on-year rise in popularity of W&I insurance continued – up by 2% to 19% of all deals and now almost half of the deals worth more than EUR 100m involve a W&I insurance policy. The UK remains the most popular of the territories covered by the Study for W&I insurance at 37%. Real Estate & Construction remains the most popular sector for W&I insurance. As a result, sale and purchase agreements appear to be even more ‘seller-friendly’ as the equivalent buyer protection is now provided by the insurer under the W&I policy.

De minimis – This year’s Study indicates a continuation of the trend showing that approximately three-quarters of European transactions include a *de minimis* clause. In 2019 the number of deals with such a provision levelled off and this was broadly in line with the previous two years’ percentages. We think this demonstrates that a *de minimis* is now an agreed market norm across most European jurisdictions.

Baskets – There was a further slight decline in the application of baskets and a significant decline from the highs in 2015 and 2016. We suspect that this decline is linked to the increase in the use of W&I insurance, particularly in the UK, which means that a basket is no longer required as a protection for the seller as the equivalent liability is assumed by the W&I insurer. There is a strong correlation between the application of the basket and *de minimis* provisions although the recent trend is that a *de minimis* applies to a greater extent than a basket, again likely to be reflective of the W&I trend.

Liability caps – The trend in the application of liability caps for amounts of less than the purchase price has now broadly settled, with the same level of transactions with a cap of less than 50% of the purchase price applying over the last five years. The amounts of those caps are, however, subject to significant variation depending on deal size and, most significantly, on whether W&I insurance cover applies to the transaction. For example, a massive 45% of W&I transactions have caps of less than 10% of the purchase price as compared with just 10% of non-W&I deals. Clearly, the impact of W&I is now a significant factor in determining the overall level of the liability cap.

Limitation periods – We saw significant differences in approach in relation to the length of limitation periods for different deal sizes. However, the overall trend for all deals is towards more seller-friendly and shorter limitation periods with only 19% (down from 24%) of all deals in 2019 with a limitation period of longer than 24 months. Limitation periods of 12 to 24 months remain at a comparable level to previous years (69% of deals in 2019 compared with 66% in 2018 and 69% in 2017). That said, we did find that for deals of more than EUR 100m there were slightly more deals with warranty limitation periods of longer than 24 months.

Security for warranty claims – In 2019, 33% of deals contained security for warranty claims, a slight increase from 2018 (31%). Despite this small increase we consider that the seller-friendly trend of recent years has continued as sellers avoid having to provide security, a trend likely to have been encouraged by the greater use of W&I insurance – meaning that the buyer has less need for direct recourse to the seller in the first place. Where the parties agreed to use security for warranty claims, escrow accounts are still the most commonly used type of security, although their use has declined.

MAC clauses – In 2019, MAC clauses were used in 16% of the deals. This is a slight increase both when compared with 2018 (14%) and with the previous nine-year average (14%). The continuing high success rate of sellers in resisting MAC clauses generally demonstrates their strong commercial position, especially in auction processes.

Arbitration – In 2019, arbitration was used as the dispute resolution mechanism in 34% of deals, marking a steady increase compared to recent previous years (2018: 33%; 2017: 29%; 2016: 25%). The current popularity of arbitration has been consistent over the course of the previous nine years (2010–2018), where the use of arbitration averages 34%. The overall trend shows that arbitration is less popular in certain regions (UK, France and Benelux) than others (CEE, German-speaking and Southern European countries).

Tax – Tax indemnification, whereby the buyer is held harmless by the seller for pre-closing tax risks associated with the target, were agreed in a significant majority of 62% of the deals in 2019, which represents a slight increase compared with 2018 (61%) and the nine-year average (58%).



Deal drivers

Main deal drivers 2019

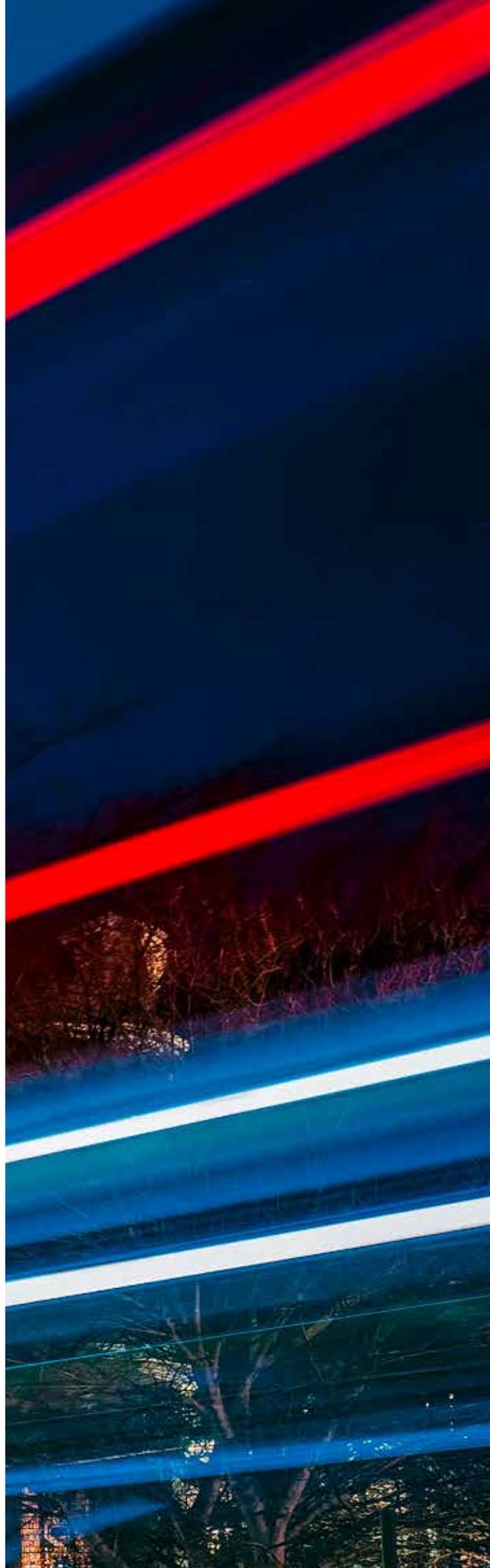
ENTRY INTO NEW MARKETS	46%
ACQUISITION OF KNOW-HOW (WITHOUT ACQUI-HIRE TRANSACTIONS)	25%
ACQUISITION OF A TEAM OF EMPLOYEES (I.E. ACQUI-HIRE TRANSACTIONS)	16%
ACQUISITION OF A COMPETITOR	20%
ACQUISITION OF A SUPPLIER	3%
DIGITALISATION	1%
OTHER	25%

The 2019 Study once again sought to identify the main deal drivers associated with each transaction covered. For these purposes it is worth noting that sellers and buyers broadly comprise either strategic or financial investors and it is therefore most likely that the main reason or driver for any deal will be derived from the aspirations of the buyer in respect of the target business.

As such we found:

- 46% of the deals covered represented the entry into a new market by the buyer;
- 41% of all deals involved either the acquisition of know-how or acqui-hire transactions;
- 20% of the deals involved the acquisition of a competitor.

It is interesting to note that the proportion of new entry and know-how/acqui-hire transactions both increased over the levels reported for 2018 (32% and 23% respectively). Despite this development, we would not yet be willing to suggest that this demonstrates any particular or unique insight into any change in deal drivers generally in the European M&A market. This is particularly demonstrated by the fact that more than 25% of our deals had other drivers.



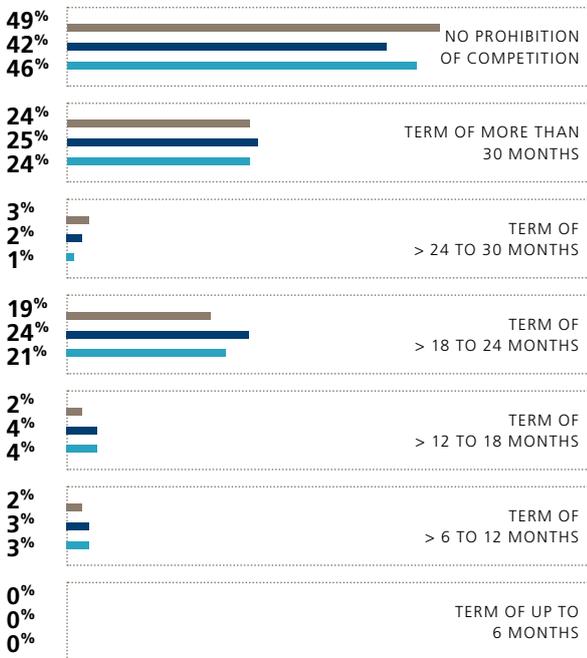
Non-compete provisions

Non-compete provisions restricting the activities of the seller after completion are often included in M&A agreements as a protection for the buyer and to ensure it receives the full amount of the goodwill and value inherent in the acquired business. In most European jurisdictions, the time period for which a non-compete can be legitimately enforced against a seller is limited by anti-trust rules and public policy considerations. This is demonstrated by the Study's

finding that the duration of non-compete clauses has remained very static over the 2010–2019 period, with the most common restrictive periods being either two years or more than 30 months. The longer non-compete provisions apply principally in the Benelux countries and the Southern European region although they are otherwise relatively equally distributed. It is noteworthy that nearly half of all transactions did not include a non-compete provision at all.

Non-compete

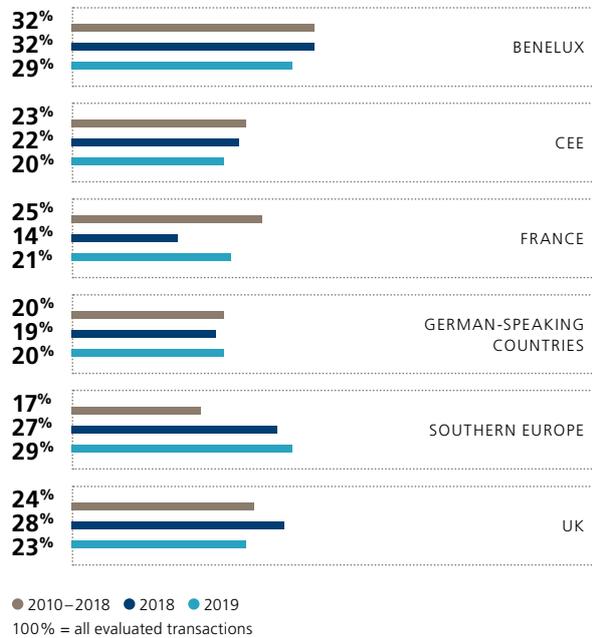
Duration of non-compete clauses 2010–2019



● 2010–2018 ● 2018 ● 2019
100% = all evaluated transactions

Non-compete

Deals containing a non-compete clause and term of more than 30 months 2010–2019



Warranty coverage

In this year's Study we also investigated in further detail the nature of the warranty cover included in the transaction agreements reviewed. As might well be anticipated, we found that warranties regarding the target's most recent financial statements, post balance sheet conduct of business, compliance and operations are very common and apply in up to 80% of the agreements on which we advised. Having said that, specific warranties about the target's financial situation and its pensions position are significantly less common.

Warranties/Limitations of liability

Warranties Used 2019

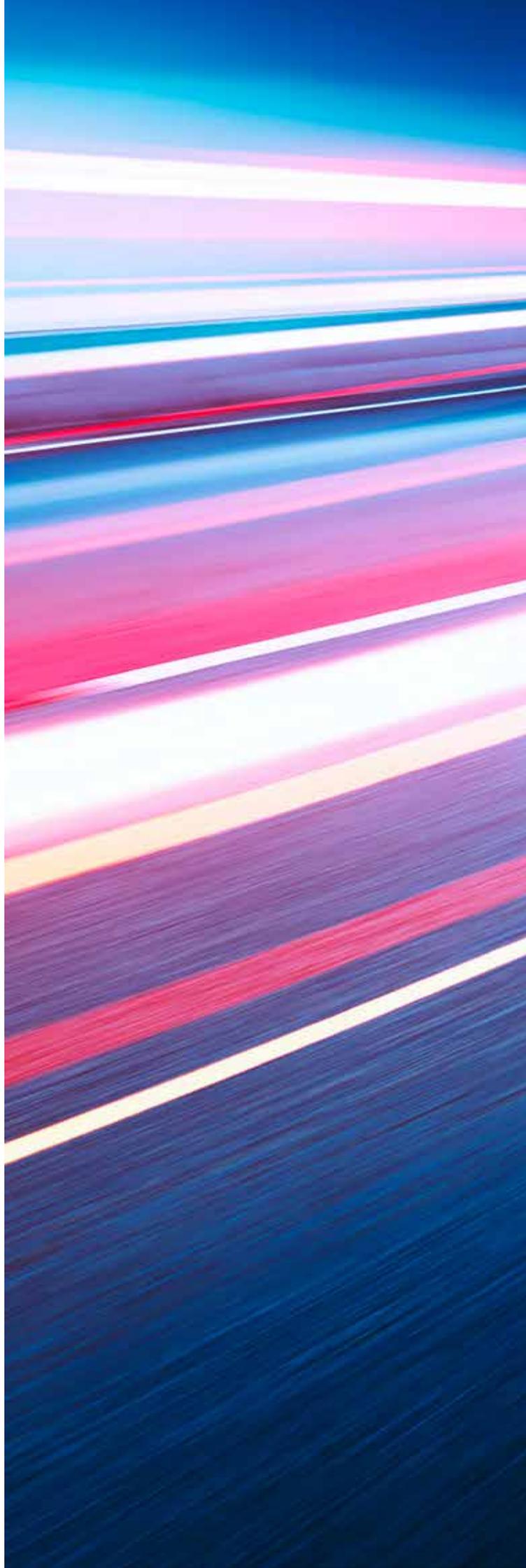
ONLY TITLE AND CAPACITY WARRANTIES	6%
WARRANTIES REGARDING THE TARGET'S FINANCIAL STATEMENTS	80%
COMPLIANCE WARRANTY	77%
OPERATIONAL WARRANTIES	75%
WARRANTIES WITH REGARD TO CONDUCT OF BUSINESS	72%
WARRANTIES WITH REGARD TO PENSION SCHEMES	50%
WARRANTY REGARDING THE TARGET'S FINANCIAL SITUATION	44%

100% = all evaluated transactions with warranties included in the agreement
Multiple warranties may apply

CMS European/US risk allocation comparison

In this section we consider what are often quite stark differences in approach and in market practice between the US and Europe when carrying out M&A deals. Since 2010, when CMS started producing the Study, the use of 'seller-friendly' risk allocation techniques has increased in Europe whereas the US has remained a more buyer-friendly market. The data below usefully highlights some of these differences.

- There was little change in 2019 in market practice in Europe relating to purchase price adjustments (remaining steady at 45%) but this is a notable difference to US deals, where a purchase price adjustment features in almost all deals (95%, marking a 9% increase from the previous ABA study (which analysed US private M&A deals for 2016 and H1 2017)).
- Working capital adjustments continue to be the most frequently used component of a purchase price adjustment in the US, featuring in 92% of the deals involving a PPA; in Europe there is a greater variety to the components of a PPA, with working capital adjustments this year again being less common than cash and debt only adjustments (50% to 41%).
- The frequency of earn-outs remained largely the same over the past year. They feature more often in the US (27%) than in Europe (21%). Both the US and Europe experienced a very marginal reduction in the frequency of earn-outs in the last year, perhaps indicating a desire to fix the purchase price at closing.
- A *de minimis* financial limitation is seen in almost three-quarters of deals in Europe (73%, down by 1% from 2018), but it remains less common in the US (only used in 39% of deals but up by 4% from the previous ABA study). Given the prevalence of 'excess only' baskets in the US it may be considered that the requirement for an additional financial limitation, such as a *de minimis*, is not as necessary.
- The existence of a basket financial limitation occurs in almost all deals in the US (97%), compared to 66% on European deals. These percentages were broadly the same in 2019. The basis for recovery is also often very different. In the US, 74% of baskets operate as 'excess only' baskets or as a deductible (where recovery is only permitted above the relevant threshold), but in 2019 such a feature occurred just 20% of the time on European deals involving a basket. In contrast, 'first dollar' baskets are more relevant in Europe (once the threshold is met, the buyer can recover from the 'first dollar')



of damage), namely 80% of the time, compared with 23% of the time in the US.

- Many M&A advisers will confidently assert that it is 'market practice' to include a basket amount that is equivalent to 1% of the purchase price but our statistics indicate that market practice is not so certain. In the US, 97% of deals that were analysed involved a basket of 1% or less. In Europe there is greater variety, with a total of 62% at less than 1%. Significantly in Europe 19% of deals involved a basket of 2% or higher, whereas in the US the equivalent figure was 0%.
- Whilst most deals in the US and Europe will feature a liability cap for the seller, as previously reported in the Study, lower liability caps are more popular in the US, with 95% of US deals having liability caps of 25% of the purchase price or less compared with only 43% of European deals (however, this is a 5% increase when compared with the figures for 2018).
- A MAC clause is almost always a feature on a US deal (97%). It is far less common in European deals (only 16%).

The table below provides a quick overview of the differences described above:

Europe/US differences

	EUROPE	US
PURCHASE PRICE ADJUSTMENT	45%	95%
WORKING CAPITAL ADJUSTMENT	41%	92%
EARN-OUT DEALS	21%	27%
DE MINIMIS	73%	39%
BASKET	66%	97%
BASKET THRESHOLD (1% OR LESS)	62%	97%
'EXCESS ONLY' RECOVERY (BASKET)	20%	74%
'FIRST DOLLAR' RECOVERY (BASKET)	80%	23%
SUB-25% LIABILITY CAPS	43%	95%
MAC CLAUSES	16%	97%

Some other interesting differing features between US and European M&A practice are worth exploring:

83% of US deals involved some form of security for claims in 2018/2019, whether that be in the form of a cash escrow, a holdback or set-off from earn-out. An escrow or holdback may be set at an amount between 7% and

15% of the purchase price (39% of deals with an escrow) and may well also be the buyer's sole recourse (and the seller's liability cap) on a deal for matters other than fundamental warranties, tax and special indemnities. On European deals, whilst the existence of forms of security for warranty claims increased again in 2019 to 33% of deals, it still tends to be a technique which buyers need specifically to justify by reference to issues identified in diligence rather than featuring as a matter of course, and as such escrow accounts rarely operate as the exclusive recourse to satisfy claims and are of varied levels.

The ABA study that analysed US private M&A deals for 2016 and H1 2017 reported on the use of W&I insurance (or RWI insurance as it is known in the US) for the first time and noted that 29% of deals contemplated the use of W&I insurance. In the latest study for 2018 and Q1 2019, that level had increased to 52%. The equivalent figure demonstrated by CMS deals throughout Europe has risen to 19%, although the figure is 37% in the UK alone. This is now an even larger difference than in the previous Study and demonstrates the rapid emergence of W&I insurance in the US.

Brian Hendry, Head of Mergers & Acquisitions at W&I insurance broker Paragon, notes that:

"The US market continues to expand rapidly and while there has been slight softening of rates, due to the already broad policy coverage we are experiencing minimal changes to the terms and conditions. The US market has evolved in a materially different way to the European markets. There is a more streamlined underwriting approach and a risk-based analysis as opposed to the greater legal focus that there is in Europe. Due to the growing expansion of US providers outside of North America, their underwriting style is increasingly being adopted in Europe and elsewhere.

We are however hearing that there is significant claims activity from past years and as these positions develop, we expect to see them influencing coverage, capacity and underwriting process."

A final example of a distinction between buyer-friendly US custom and more seller-friendly positions in Europe relates to restrictive covenants. It is not unusual in the US to see restrictive covenants (non-competition undertakings for instance) with a duration of five years. Periods of this length are not likely to be enforceable in Europe (where in some territories separate consideration is needed to justify a non-compete undertaking by the seller) and three years tends to be the maximum, with periods of 18 to 24 months more normal.

CMS deal size analysis

We found that depending on the size of the deal, certain of the risk allocation metrics differ and the parties' attitude towards risk is impacted by the amount of the purchase price.

Therefore, in the Study we have divided our deals into those which we term 'small', 'medium' and 'large' as below and highlighted particular differences between them.

- Those deals with values of up to EUR 25m are referred to as the smaller deals;
- those deals with values of between EUR 25m and EUR 100m are referred to as medium-size deals; and
- those deals with values over EUR 100m are referred to as large deals.

The table below shows the highlights for 2019.

Deal size comparison

The bullet points below identify (i) some changes since last year and (ii) the main differences, in each case, when comparing the large deals with the small and medium-size deals.

- Consistent with 2018, purchase price adjustments (PPAs) appear more frequently on large deals (51%) than the smaller deals (42%) and there is little disparity between the large deals and medium-size deals (roughly 50/50).
- Where there is no PPA, the use of locked box mechanisms remains very frequent on the large deals, increasing to 85% from 60% in 2018 but decreasing to 48% from 53% for the smaller deals, thereby marking a reversal of 2018's trend for smaller transactions.
- Continuing the trend from prior years, earn-outs are rare on large deals (only 13%). Where an earn-out forms part of a deal, the earn-out period tends to be notably longer in large deals – namely 38% being longer than three years and 0% being less than 12 months.

2019 results at a glance

Deal size comparison

	< EUR 25M	EUR 25M – 100M	> EUR 100M
PURCHASE PRICE ADJUSTMENT (PPA)	42%	50%	51%
LOCKED BOX (NO PPA)	48%	63%	85%
EARN-OUTS	22%	24%	13%
SHORT EARN-OUTS (12 MONTHS OR LESS)	29%	16%	0%
LONG EARN-OUTS (MORE THAN 36 MONTHS)	13%	20%	38%
EBIT/EBITDA-BASED EARN-OUTS	43%	39%	22%
TURNOVER-BASED EARN-OUTS	43%	39%	22%
LIABILITY CAP (LESS THAN 10% OF PRICE)	10%	22%	29%
LIABILITY CAP (LESS THAN 25% OF PRICE)	27%	58%	54%
W&I INSURANCE USAGE	7%	28%	49%
LIMITATION PERIOD (OF MORE THAN 24 MONTHS)	25%	32%	21%
SECURITY FOR WARRANTY CLAIMS	34%	34%	24%
ESCROW ACCOUNT (IF SECURITY FOR WARRANTY CLAIMS IS AGREED)	49%	59%	63%
MAC CLAUSE	14%	20%	19%
ARBITRATION	26%	43%	47%
TAX INDEMNITY CLAUSE	58%	69%	63%



- There has been a change in respect of earn-out metrics. In 2018, EBIT/EBITDA was the most popular criterion on which earn-outs were calculated on both large deals and the smaller deals but in 2019, for deals with values up to EUR 100m, the use of turnover and EBIT/EBITDA is equally popular at 41%, whilst for large deals over EUR 100m their popularity is likewise the same at 22%, but 'other' criteria are much more common.
 - The Study confirms that the liability cap for a smaller transaction is most likely to be the purchase price and the liability cap for a large transaction is most likely to be significantly less than the purchase price. For example, 30% of smaller deals were capped at the purchase price and 29% of large transactions were capped at less than 10% of the purchase price. For the medium-size deals, a significant 36% were capped at 10% to 25% of the purchase price.
 - The popularity of W&I insurance for large transactions continues to rise (to almost 50% in 2019), whilst for smaller deals it remains less common (less than 10% in 2019).
 - Whilst time limitation periods to bring warranty claims remain shorter for large transactions, the frequency of longer limitation periods (e.g. more than 24 months) again increased in 2019 to 21% compared to 10% in 2018.
 - Escrow/retention accounts are more popular on large transactions and the popularity of security for warranty claims on large deals rose by 3% to 24% in 2019 but remains well down on previous years.
- Our conclusions from this data include the following:
- On large deals, parties want certainty as to the purchase price and this lends itself to (i) the use of locked box discipline and (ii) the lack of earn-outs. The data demonstrates this as there were few earn-outs on large deals in 2019 and a very high percentage which applied a locked box mechanism.
 - In terms of risk allocation, the data suggests lower liability caps on large deals and perhaps other more seller-friendly limitation provisions (e.g. shorter limitation periods). However, in real money terms the financial caps remain significant (although lower in value percentage terms).
 - The seller also appears to be able to offload warranty exposure by pre-packaging a buyer's W&I policy which again increased in popularity and was used on almost 50% of large deals.
 - On the large deals, the buyers continue to focus on issues that go to value. So, we suspect buyers may be focussed on MAC clauses and meaningful security for claims (e.g. in the form of an escrow) or a W&I insurance policy to protect against the significant items which materially erode value.

CMS European regional differences

We continue to see marked differences in market practice on certain deal metrics between the European regions. The UK has the highest proportion of W&I insurance, which means lower liability caps and shorter limitation periods for those deals. France and the German-speaking countries have the fewest deals with a purchase price adjustment. Data room disclosure has limited application in the Southern European region. Limitation periods are longest in CEE and France and liability caps are lowest in the German-speaking countries and in the Benelux region.

The Study demonstrates the following specific differences in market practice throughout the relevant areas within the European region as follows:

In Benelux:

- Locked boxes were unusual: there has been a significant decrease in the use of locked box structures, with only 28% of transactions without a PPA using this structure, which is some way behind the European average of 56% of such transactions.
- Liability caps are relatively low: in 2019, just 24% of reported transactions had a liability cap of more than 50% of the purchase price as compared with the overall European average of 42% of such deals.

In CEE:

- Earn-outs were infrequently used: in 2019, only 8% of transactions included such a provision, which was a drop from 14% in 2018 and significantly less than the European average of 21% for earn-out transactions.
- Limitation periods are longer in the CEE region: in 2019, 36% of CEE transactions had a warranty limitation period of more than 24 months, which compares with the average of only 19% of all European transactions with such long warranty periods.
- MAC clauses are relatively common: in 2019, 38% of CEE deals with a gap between signing and completion included a MAC clause (an increase from 31% in 2018) and this is some way ahead of the European average, where only 16% of relevant deals include a MAC clause.

In German-speaking countries:

- PPAs remain unpopular: although the use of purchase price adjustments in Germanic transactions rose in 2019 to 37% of such deals from 31% in 2018, it is to be noted that this remains well below the European average of 45% application of PPAs for last year.
- Liability caps are relatively low: in 2019, just 29% of reported transactions had a liability cap of more than 50% of the purchase price as compared with the overall European average of 42% of such deals.

In France:

- PPAs are least applied in France: the application of PPA provisions for French transactions remains much lower than the European average at 28% for 2019, which is a reduction from the previous year and behind the local average of 36% for the period 2010–2018.
- Earn-outs were infrequently used: in 2019, only 8% of transactions included such a provision which was a drop from 19% in 2018 and this is significantly less than the European average of 21% for earn-out transactions.
- Basket provisions are relatively unusual: in 2019, only 55% of transactions in France included a basket and only 62% were 'first dollar' baskets compared to the European average of 80%.
- Limitation periods are longer in France: in 2019, 31% of French transactions had a warranty limitation period of more than 24 months, which compares with the European average of only 18% for such warranty periods.

In Southern Europe:

- Locked boxes were unusual: there has been a significant decrease in the use of locked box structures, with only 36% of transactions without a PPA using this structure, which is some way behind the European average of 56% of such transactions.
- *De minimis* provisions are relatively unusual: in 2019, only 40% of transactions in Southern Europe included a *de minimis* provision, which is indicative of a general decline in their use as compared to the average of 49% for the period 2010–2018 and 73% for the whole of Europe.
- Basket provisions are also relatively unusual: in 2019, only 33% of transactions in Southern Europe included a basket and when included only 69% were 'first dollar' baskets compared to the average of 80% 'first dollar' baskets for the whole of Europe.

- No data room disclosure: the concept of disclosure in the data room appears to have limited application in the Southern European region, with only 27% of transactions reflecting such a provision compared with more than 50% for Benelux, CEE, Germanic and UK deals.

In the United Kingdom:

- W&I insurance is very prevalent: in 2019, 37% of all reported transactions had some element of W&I cover which was itself an increase from 32% in 2018 and some way ahead of the other European regions, which range from 5% to 18% in application.
- ‘First dollar’ baskets are standard: the UK continues to lead Europe in relation to the use of ‘first dollar’ basket clauses, applying them in 91% of transactions in 2019, which is some way ahead of the equivalent European average of 80%.

CMS European regional differences in relation to W&I insurance

Adrian Furlonge, founding partner of specialist M&A insurance broker Hemsley Wynne Furlonge LLP commented on the regional differences in Europe in the W&I insurance market:

“Increased client demand for policies across Europe has led to many insurers and brokers moving out of the traditional insurance hubs. There are established market presences in Denmark, Germany, Finland, France, Italy, Norway, Netherlands, Poland, Spain and Sweden. Interestingly while this has led to local language and local law capabilities for clients, the result of a “globalised” Europe from a W&I perspective has led to policies as a whole becoming more similar so that historic inconsistencies in underwriting criteria, coverage and pricing have, to a large extent, been ironed out.”

This view is supported by the CMS data. The overall year-on-year growth in W&I insurance was demonstrated in each of CEE, France, the German-speaking countries and the UK. In the UK, a significant 37% of all transactions were covered by W&I insurance. After double digit growth in 2018, Benelux suffered a marked fall in the number of policies purchased from 19% in 2018 to 8% in 2019, back to a level consistent with the historic average for this region (2010–2018).





Key messages

This Study covers 466 deals on which the CMS offices in Europe advised in 2019, which is an increase on the number of deals covered for 2018. This was achieved notwithstanding the geopolitical and economic uncertainty associated with the M&A market. CMS was ranked at number one in the volume-based league tables of legal advisers for European deals in 2019.

As has been widely reported, there were fewer mega deals, less investment by mainstream corporates and a fall in foreign inbound acquisition into Europe. Future deal activity in Europe, particularly as a result of smaller scale divestments and bolt-ons, may be driven by the need to stay ahead of the competition, for instance acquiring new technologies and intellectual property.

This unique and valuable Study, particularly given the size of the deal sample and range of countries involved, means that it is an important guide for all European dealmakers and is designed to provide useful guidance as to the variations in practice and other complexities associated with the European transactional market and assist increasingly sophisticated market participants to achieve a successful result for any M&A process.

In 2019, we have seen the continuation of existing market trends across Europe, particularly 'seller-friendly' provisions in M&A agreements and the prevalence of Warranty & Indemnity insurance as a replacement for or an addition to warranty coverage by sellers. As premiums have decreased, the W&I market has become more accessible and, particularly for larger deals, the seller is now able to off-load liability to the W&I insurer.

The Study, however, does indicate that in many respects market practice on a number of important deal metrics has remained broadly unchanged over the last five years, particularly with regard to purchase price adjustments, locked box structures, liability caps, earn-outs and security for claims.

The data used in the Study is not publicly available and is based on privately negotiated transactions in which CMS acted as an advisor to either the buyer or the seller. CMS is one of the few legal service providers with the capability to provide a European study of this kind due to its presence and market penetration in a wide range of jurisdictions across Europe.



Purchase price adjustment (PPA)/Locked box

Purchase price adjustment (PPA) clauses in M&A agreements are designed to ensure the correct purchase price is payable by the buyer for the target business. This can be by reference in its simplest form to the debt-free/cash-free position at completion or by reference to either the working capital or overall net asset position of the business at completion. Therefore, the purchase price is finally determined dependent on the closing position in relation to assumed debt/cash, working capital or net assets.

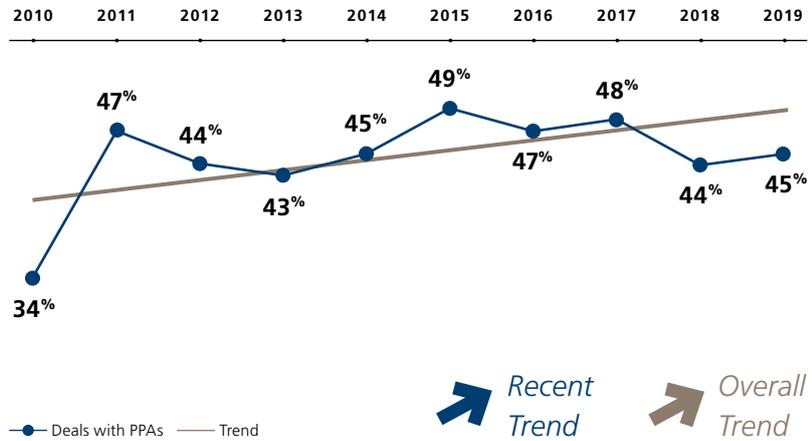
PPA provisions can mean there is uncertainty as to the final purchase price when the transaction agreements are signed. It can then take several months or even years to finally determine the price. This is often felt to be unattractive, so the parties include a locked box clause in the relevant agreement to avoid any requirement to adjust the price after completion. The seller warrants the accuracy of a fixed pre-closing balance sheet and covenants that there are no leakage payments (e.g. dividends and management charges) by the target to the seller.

General Overview

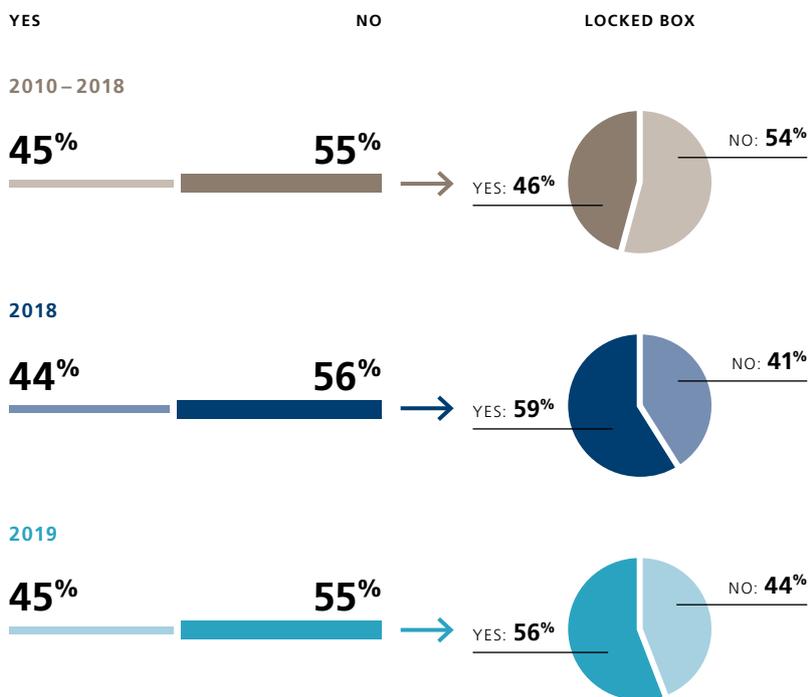
In 2019, we saw a continuation of the recent trend of a gradual decline in the use of purchase price adjustment clauses in M&A agreements. Although the number of deals with a PPA in 2019 was a slight increase over the previous year (45% for 2019 compared with 44% for 2018), the prior three years were significantly in excess of this level. These results seem to suggest that there is a continuing desire by parties to M&A transactions to seek more certainty as to the amount of the purchase price when signing the transaction documentation. This is also reflected in the slight decrease in the use of locked box arrangements for non-PPA transactions (56% in 2019 compared with 59% in 2018). However, the overall upward trend for the application of a locked box continues, particularly when compared against the average usage of 46% for the period between 2010 and 2018.

PPA ratio 2019
45% ➔

CMS Trend Index



Purchase Price Adjustment 2010–2019



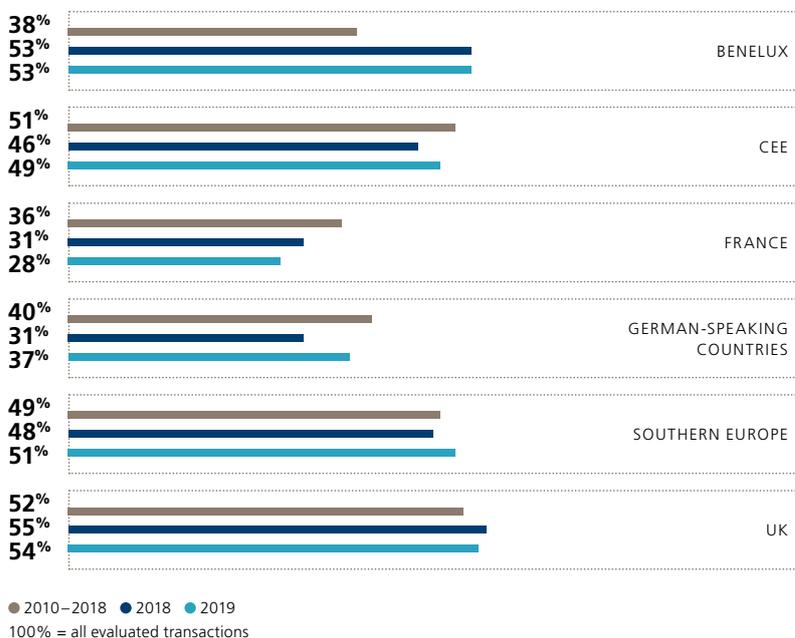
100% = all evaluated transactions

Specific Issues

Regional Differences

As always, there are significant differences between the European regions as to the use of PPAs. The UK remains the region with the highest application, at 54% of transactions, well ahead of France and the German-speaking countries on 28% and 37% respectively. The other regions (Benelux: 53%, CEE: 49% and the Southern European countries: 51%) fall between the two, albeit marginally more in line with the results for the UK. Of interest is that there appears to have been little change in the spread of application of PPA clauses across Europe over the period from 2010–2019.

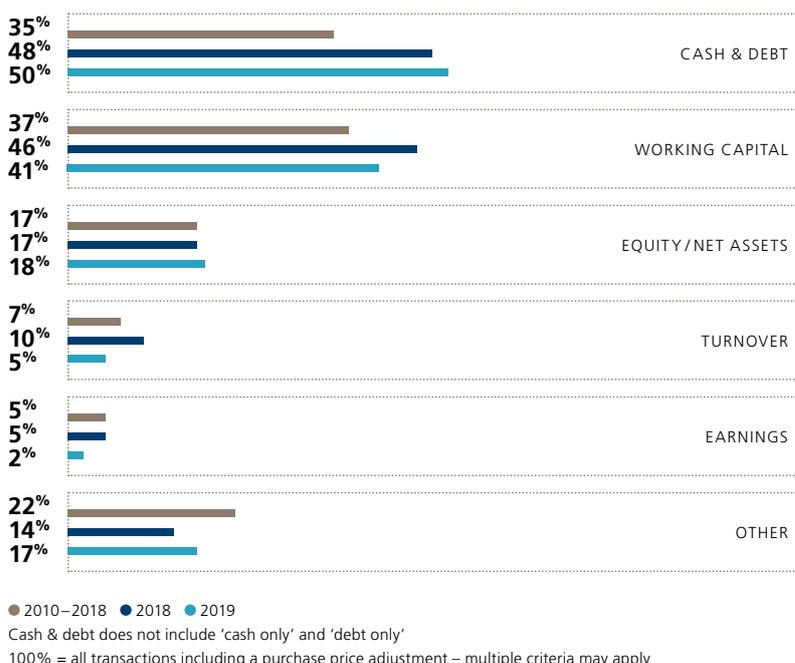
Time Trend Europe



Net Debt/Working Capital Adjustments

The increased use of cash/debt as the adjustment factor in a PPA transaction has continued, with those balance sheet line items being applied in 50% of such deals, which is a big increase on 35% for the period 2010–2018. At the same time the use of working capital as the determinant of the final purchase price declined (41% for 2019 compared with 46% for 2018), although this is broadly in line with the nine-year average of 37% for 2010–2018. Net cash and working capital remain the predominant elements in calculating PPAs, although we are unable to identify any cogent reason why there is such a disparity in the cash/debt adjustment (50%) compared with a working capital adjustment (41%) as traditionally these elements are often complementary and applied together.

Chosen Criteria



Sector Differences

As in previous years, we analysed the sector breakdown in relation to the use of locked box mechanisms. The overall average of 56% of non-PPA transactions broadly applied across all of the sectors except for the higher proportion in Life Sciences & Healthcare and Industry transactions (at 76% and 69% respectively). There was however a sharp decline in respect of transactions in the Hotels & Leisure sector at 29%. The use of locked boxes in the Real Estate & Construction sector remains relatively low at 39% and this is consistent with the purchase price in such transactions being determined by reference to a fixed valuation rather than against a balance sheet with a number of moving parts. It may be that the same principle applies, particularly as regards hotel valuations.

Frequency of Locked Box Mechanism

SECTOR	2010 – 2018	2018	2019
BANKING & FINANCE	47%	65%	48%
HOTELS & LEISURE	46%	57%	29%
ENERGY & CLIMATE CHANGE	41%	57%	67%
CONSUMER PRODUCTS	57%	79%	57%
TECHNOLOGY, MEDIA & COMMUNICATIONS	50%	58%	53%
INFRASTRUCTURE & PROJECTS	27%	33%	50%
LIFE SCIENCES & HEALTHCARE	52%	56%	76%
REAL ESTATE & CONSTRUCTION	31%	34%	39%
INDUSTRY	52%	64%	69%
BUSINESS (OTHER SERVICES)	47%	63%	50%
CMS AVERAGE	47%	59%	56%

100% = transactions with no purchase price adjustment mechanism

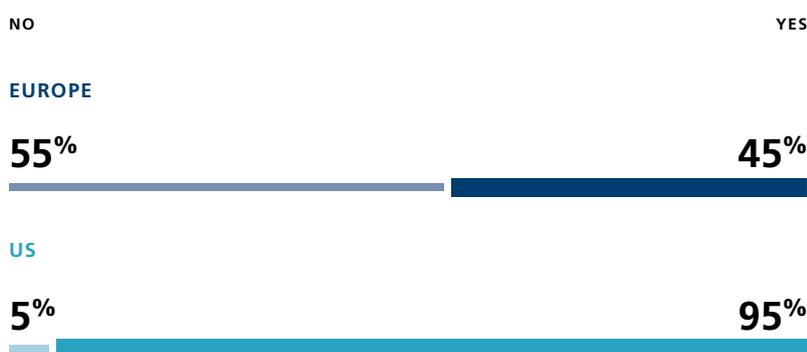
Locked box usage
in the Life Sciences
& Healthcare sector

76% ➔

European/US Differences

The massive disparity between the US and European markets in relation to the application of PPAs continues to apply. The vast majority of US deals will include some form of PPA (usually with working capital as the adjusting factor). The most recent figures suggest that 95% of US deals include a PPA compared with 45% of our European deals, and 95% is an increase on the previously reported figure of 86%. This most likely demonstrates a mixture of the US acceptance of a PPA as standard in the market combined with the more buyer-friendly environment there, where the opportunity to calculate the price based on a closing balance sheet is preferred.

Purchase Price Adjustment Europe/US

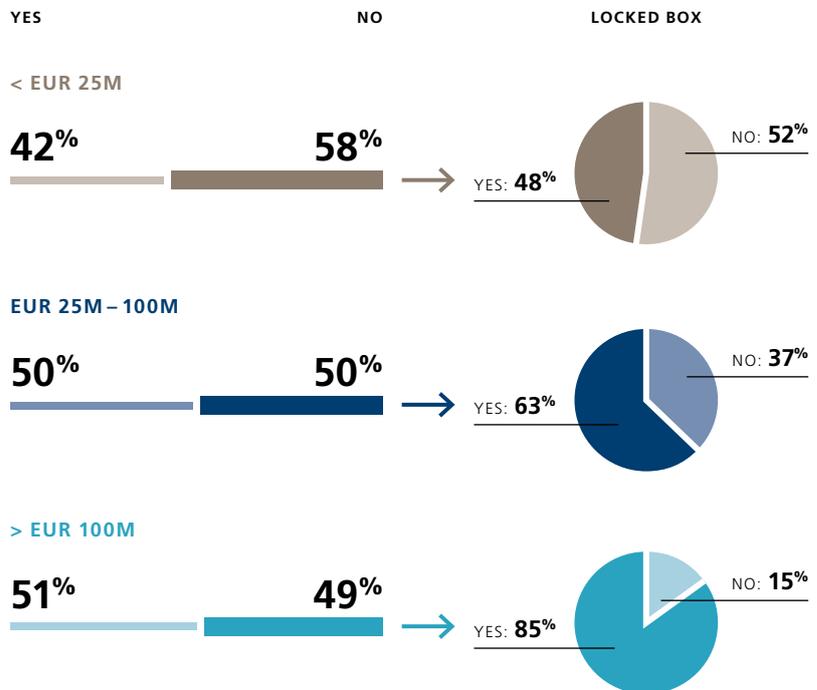


100% = all evaluated transactions

Analysis by Deal Size

There remains little difference in the use of PPA provisions by deal size. For small deals (below EUR 25m), 42% had a PPA, for medium-size deals (between EUR 25m and 100m), 50% had a PPA and for large transactions (purchase price in excess of EUR 100m), 51% had a PPA. The big disparity in 2019 concerned the use of locked box structures for the other transactions with no PPA provisions, where there was a significant increase to 85% in respect of deal sizes above EUR 100m (compared with 64% in 2018). The use of locked boxes in smaller non-PPA transactions remained at similar levels to previous years (48% for deals less than EUR 25m and 63% for deals between EUR 25m and 100m).

Purchase Price Adjustment 2019



100% = all evaluated transactions

100% = transactions with no purchase price adjustment mechanism

(deals containing purchase price adjustment and locked box at the same time are not included)



Earn-out

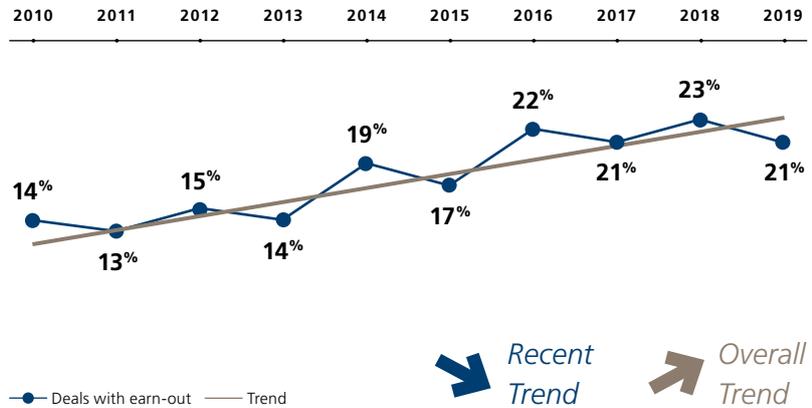
An earn-out mechanism in a purchase agreement most commonly provides for additional consideration to be payable by the buyer after completion, usually dependent upon the performance of the acquired business during an agreed earn-out period. In such circumstances the benefits and risks of the target business post-acquisition are shared between the seller and buyer. Sellers will potentially see the purchase price increased but must remain engaged in the business to secure increased value. The buyer benefits by linking the final overall purchase price both to historic performance and also how the business operates under its ownership.

General Overview

After the high point for earn-out arrangements in 2018, this year saw a small decrease (by 2%) in their frequency to 21% of all deals. This figure still highlights how overall from 2010–2019 there has been continued growth in the use of earn-outs in Europe (from a low point of 13% in 2011), although they are still far less popular than in the US.

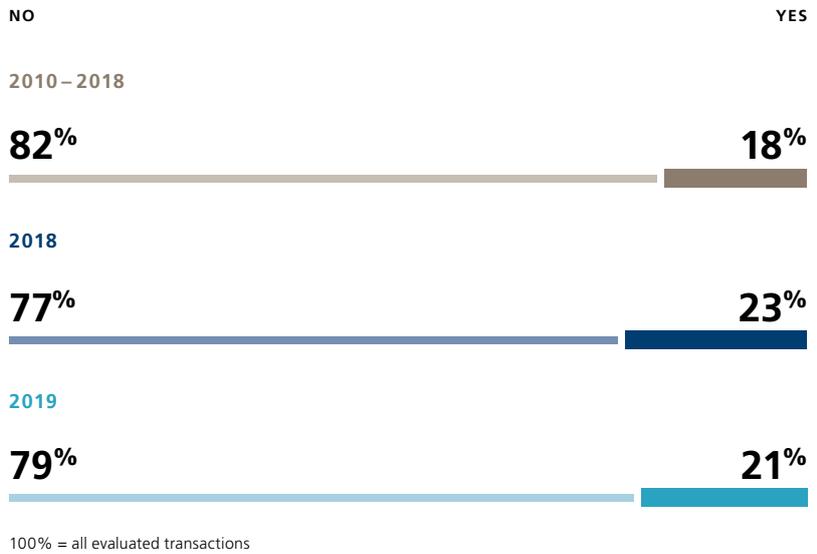
Earn-out popularity 2019 

CMS Trend Index



 Recent Trend  Overall Trend

Earn-out 2010–2019



Specific Issues

Sector Differences

Life Sciences & Healthcare remains the most popular sector for earn-outs at 41% of such deals, topping the table ahead of Technology, Media & Communications (down to 29%, a notable drop of 11%). This overall trend demonstrates that earn-outs are most applied in sectors that are innovative and creative, frequently involving individual owner managers. The most marked differences from prior years are the increase in earn-outs in the Hotels & Leisure sector (rising from 11% to 27%) and the fall in the Consumer Products sector (10% from 24%).

Life Sciences & Healthcare again tops earn-out table

Earn-out Determination

In 2019, for the first-time turnover was the most common criterion for determining the amount of an earn-out, rising from 33% for 2018 to 40% – significantly higher than the nine-year average of 31% for 2010–2018. Whilst EBITDA/EBIT has fallen 1% behind, it too remains a popular metric at 39%, the same figure as in 2018. We anticipate the rise in popularity in the use of turnover to determine the amount of an earn-out reflects the view that turnover is a more easily verifiable metric whilst EBITDA can be open to different accounting interpretations.

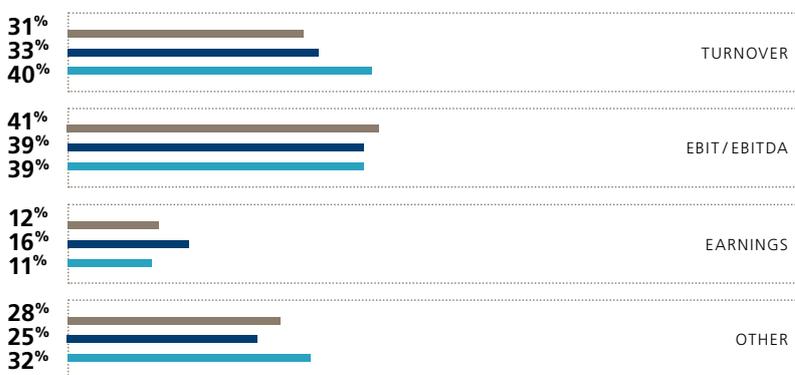
Turnover now most popular earn-out measure

Frequency of Earn-out Mechanism

SECTOR	2010 – 2018	2018	2019
BANKING & FINANCE	14%	7%	14%
HOTELS & LEISURE	9%	11%	27%
ENERGY & CLIMATE CHANGE	15%	11%	16%
CONSUMER PRODUCTS	18%	24%	10%
TECHNOLOGY, MEDIA & COMMUNICATIONS	25%	40%	29%
INFRASTRUCTURE & PROJECTS	7%	25%	22%
LIFE SCIENCES & HEALTHCARE	29%	43%	41%
REAL ESTATE & CONSTRUCTION	12%	19%	10%
INDUSTRY	17%	22%	19%
BUSINESS (OTHER SERVICES)	22%	18%	26%
CMS AVERAGE	18%	23%	21%

100% = all evaluated transactions of the respective industry

Time Trend



● 2010–2018 ● 2018 ● 2019

100% = all transactions including an earn-out clause – multiple criteria may apply

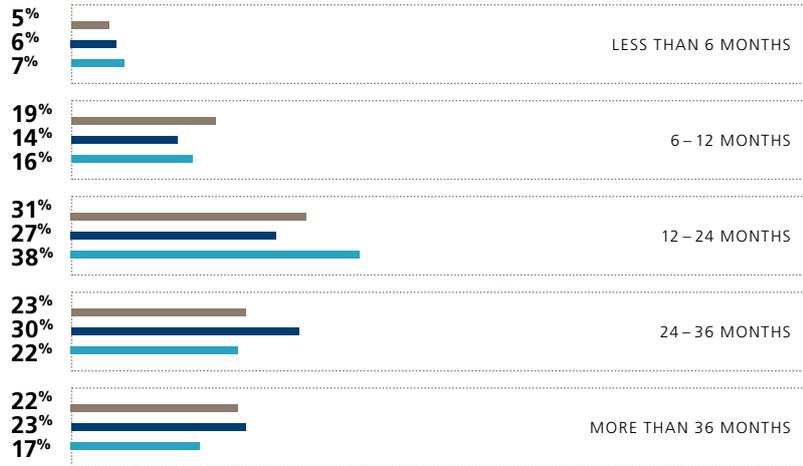
Turnover-based earn-outs

40% ➔

Earn-out Duration

Consistent with the overall trend from 2010–2018, earn-out time periods of 12 to 24 months were most common in 2019 (38% of deals involving an earn-out). This had historically been the case, but in 2018, for the first time, longer periods (24 to 36 months) topped the table. In 2019, overall longer earn-outs were less popular. This shift can be described as being consistent with ‘seller-friendly’ deal characteristics, with the overall purchase price being ascertained more quickly and giving both parties certainty.

Duration of Time Periods Relevant for Assessment of Earn-out



● 2010–2018 ● 2018 ● 2019
100% = all transactions including an earn-out clause

Earn-out periods of 12 to 24 months again the most popular

Earn-out duration →

Earn-out periods of 12 to 24 months

38% ↗

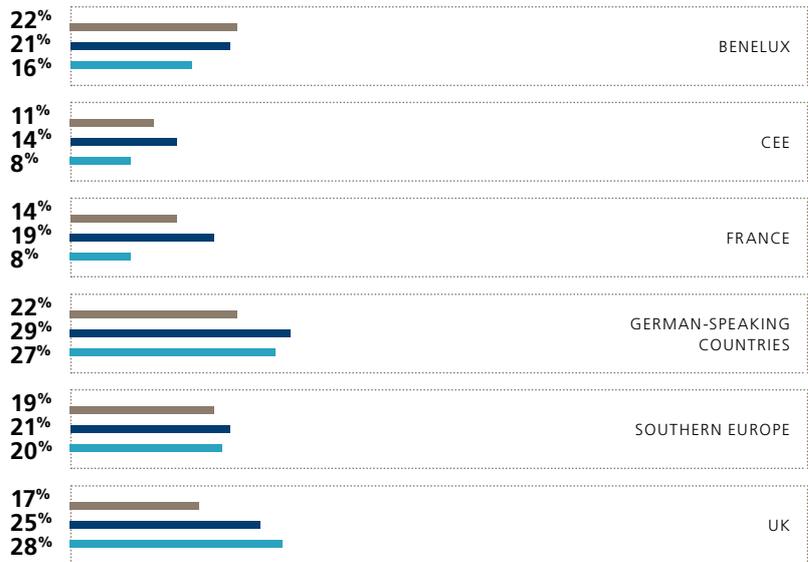


Regional Differences

The overall percentage of 21% of transactions involving an earn-out component derives from analysis across all the CMS European territories, but there continue to be interesting regional differences. In every one of the regions covered by the Study there was a drop in popularity in earn-outs, except in the UK, which saw a 3% increase to 28% of all analysed transactions. The notable increase in earn-outs in France in 2018 was not repeated. Whilst there was a small decrease in popularity in the German-speaking countries, earn-outs here are still more common than the European average and the 2010–2018 trend.

*Regional variation
in use of earn-outs*

Time Trend Europe

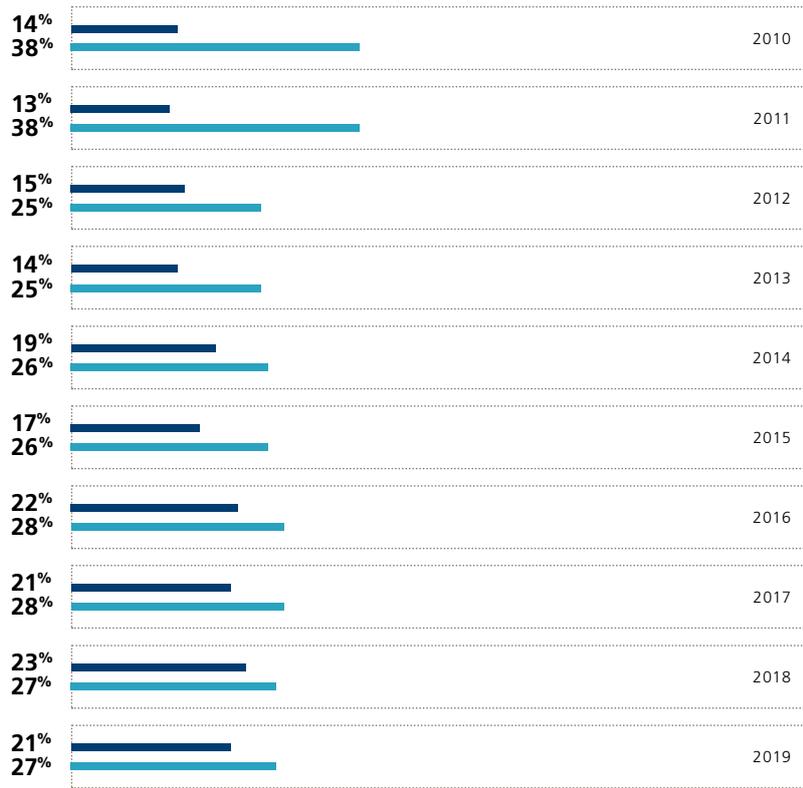


● 2010–2018 ● 2018 ● 2019
100% = all evaluated transactions



Consistent with all other years covered by the Study (2010–2019), earn-outs remain and have always been more popular in the US than in Europe. This was most clearly shown in 2010, when in Europe only 14% of deals involved an earn-out compared to 38% in the US. Over time there has been an upward trend in Europe whilst the popularity of earn-outs in the US has levelled off (between 25% and 28%). There is also a difference between Europe and the US with regard to the criteria used to determine an earn-out, with turnover/revenue having now become slightly more popular than EBIT/EBITDA in Europe, whilst the latter overtook turnover/revenue as the most frequently seen criterion in 2018/2019 in the US.

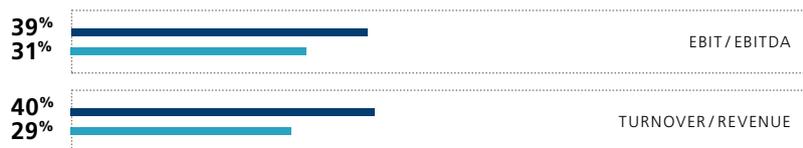
Earn-out Europe/US



● Europe ● US
100% = all evaluated transactions

Earn-out Europe/US

Earn-out criteria



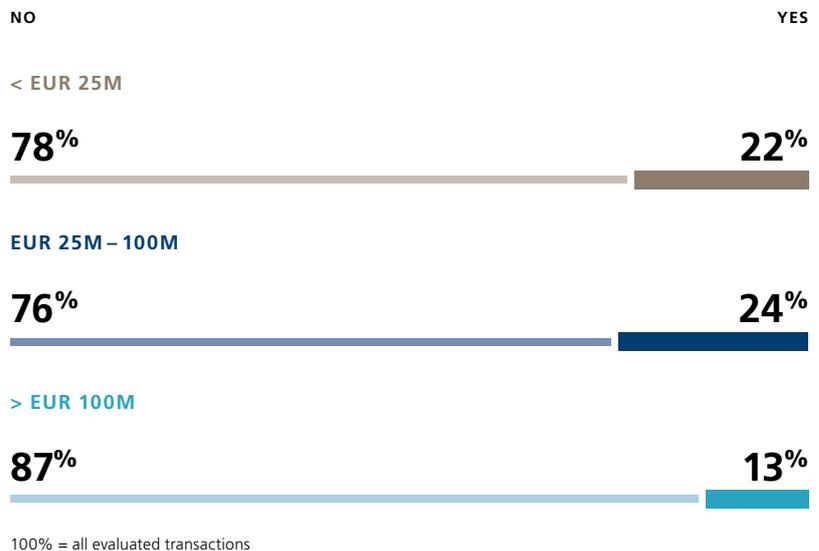
● Europe ● US
100% = all evaluated transactions with an earn-out mechanism

Analysis by Deal Size

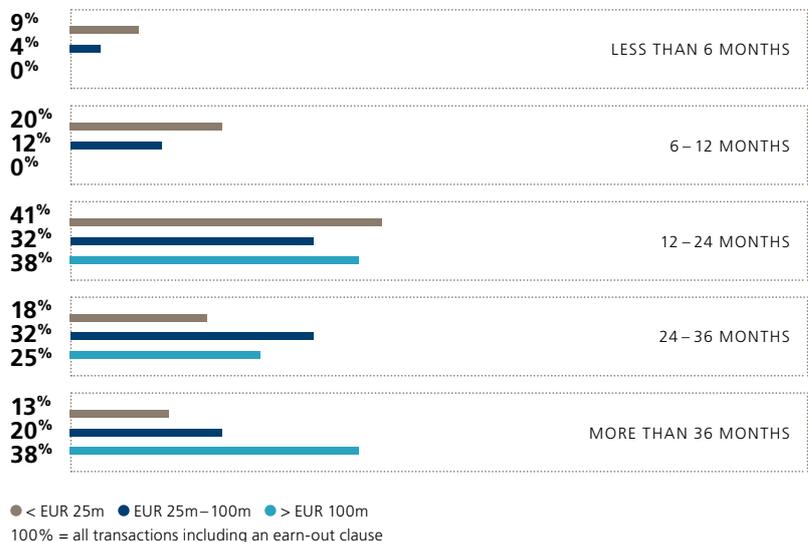
As in previous years, earn-out provisions were most frequently seen on lower value deals. In 2019, for deals with a value of under EUR 100m, earn-outs were used approximately 22% of the time as compared to only 13% on EUR 100m plus deals. This does however represent a 5% increase in the use of earn-outs on EUR 100m plus deals. This difference may reflect both the fact that deals involving founder shareholder exits and other management disposals fall in the sub-EUR 100m range and also that, as noted above, the parties tend to seek a fixed price at the time of closing in larger deals.

There were no short earn-out periods (i.e. less than 12 months) on the large deals, but in 2019 there was a greater range of such periods. Whereas in 2018 all earn-out periods on EUR 100m plus deals were 24 months or more, in 2019 the earn-out periods were of 12 to 24 months on 38% of earn-out deals – reflecting the previously mentioned trend towards parties wanting to finalise a fixed price earlier after closing.

Earn-out 2019



Duration of Time Periods Relevant for Assessment of Earn-out





De minimis

Many M&A agreements exclude individual warranty claims below an agreed minimum amount (i.e. the *de minimis*). If such a claim is less than this amount, then the claim is automatically excluded. As a result, the seller is protected from potential liability for very small or frivolous claims. The *de minimis* may not be appropriate for deals with full W&I insurance cover as this is reflected in the W&I insurance policy itself.

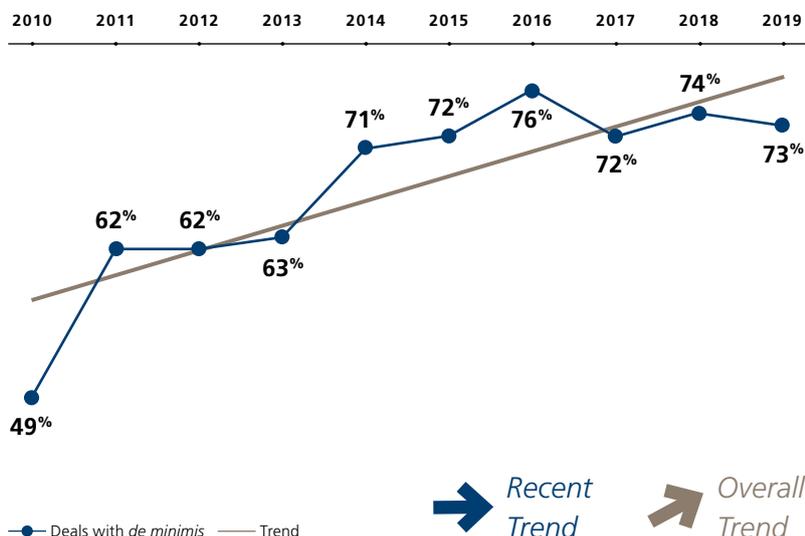
General Overview

This year's Study indicates a continuation of the trend showing that approximately three-quarters of European transactions include a *de minimis* clause. In 2019, the number of deals with such a provision levelled off at 73% and this was broadly in line with the previous two years, percentages of 72% and 74% respectively. We think this demonstrates that a *de minimis* is now a market norm across most European jurisdictions.

De minimis ratio 2019

73% →

CMS Trend Index

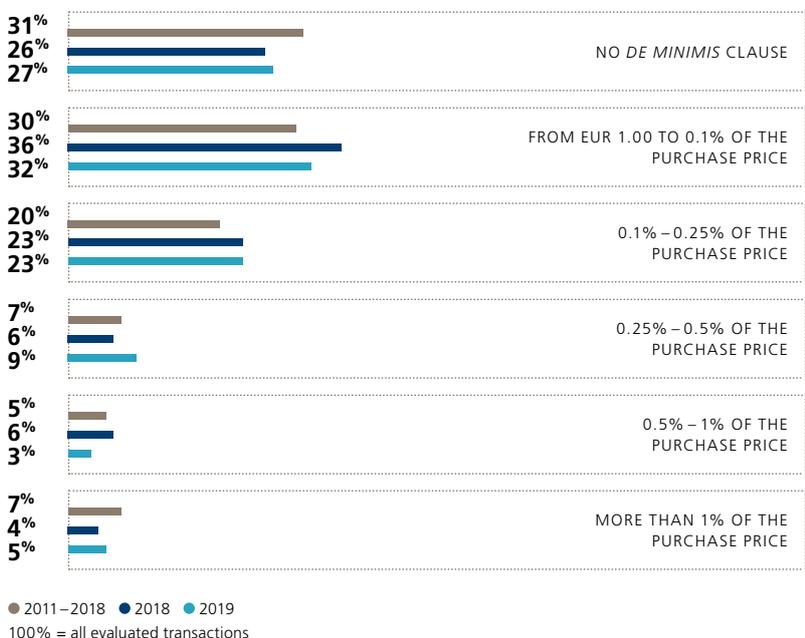


It continues to be the case that most transactions (55%) have a *de minimis* of somewhere up to 0.25% of the purchase price, although in 2019 there was a slight decrease in the application of a *de minimis* of less than 0.1% of the purchase price (from 36% to 32%) and a corresponding increase in the use of a *de minimis* of 0.25% to 0.5% of the purchase price (from 6% to 9%). We think this demonstrates the extent to which the amount, rather than the principle, of a *de minimis* is often heavily negotiated.

De minimis < 0.1% of purchase price

32%

De Minimis Levels 2011–2019

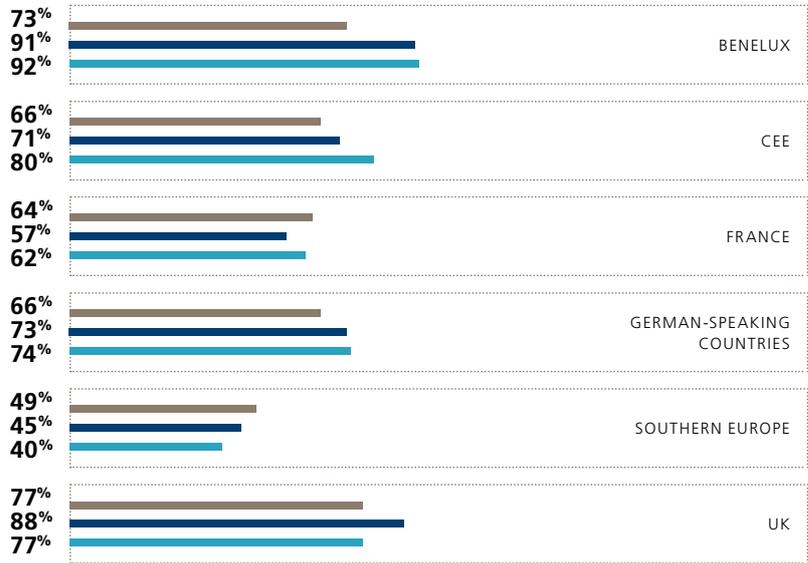


Specific Issues

Regional Differences

The variation in the application of *de minimis* clauses across the regions remains. The countries of Southern Europe only applied such clauses in 40% of their transactions, which compares with 92% for Benelux transactions. In the UK, the application decreased from 88% to 77% to reflect the European average, broadly matched at 74% in the German-speaking countries, with both being some way behind the 80% for the CEE countries. This indicates there is clearly no overall market standard for a *de minimis* amount across Europe with the finally agreed amounts in each European jurisdiction subject to a potentially different result.

Time Trend Europe



● 2010-2018 ● 2018 ● 2019
100% = all evaluated transactions



Basket

As a further protection for sellers, many M&A agreements have a basket provision which prevents claims from being made if or to the extent the total amount claimed in respect of all warranties is less than an agreed amount. This amount is often agreed by reference to a percentage of the purchase price. The basket will either protect against warranty claims up to the agreed amount (i.e. 'first dollar') or for claims once the amount claimed exceeds that agreed amount (i.e. 'excess only'). The relevant amount is usually different depending on the type of basket selected by the parties. For deals with full W&I insurance cover, a basket provision is usually not required as this is reflected in the W&I insurance policy itself.

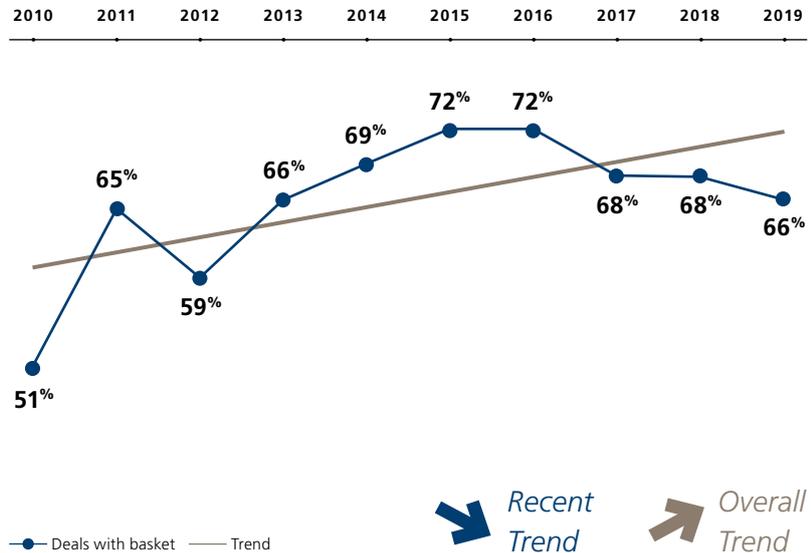
General Overview

There was a further slight decline in the application of baskets in European transactions at 66% for 2019 compared with 68% for 2018, and a significant decline from the highs of 72% in 2015 and 2016. We suspect this decline is linked to the increase in the use of W&I insurance, particularly in the UK, which means that the basket is no longer required as protection for the seller as the equivalent liability is assumed by the W&I insurer. The correlation between the application of a basket and a *de minimis* provision continues to apply, although the recent trend is that a *de minimis* applies to a greater extent than a basket (76% vs. 72% in 2016 to 73% vs. 66% in 2019), which is again likely to be reflective of the W&I trend.

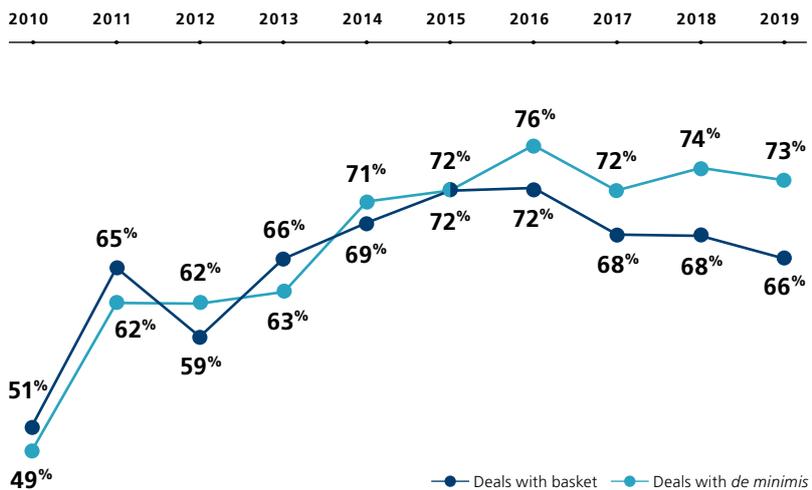
Basket ratio 2019

66% ➔

CMS Trend Index



Comparison: Existence of De Minimis and Basket



Specific Issues

Size of Baskets

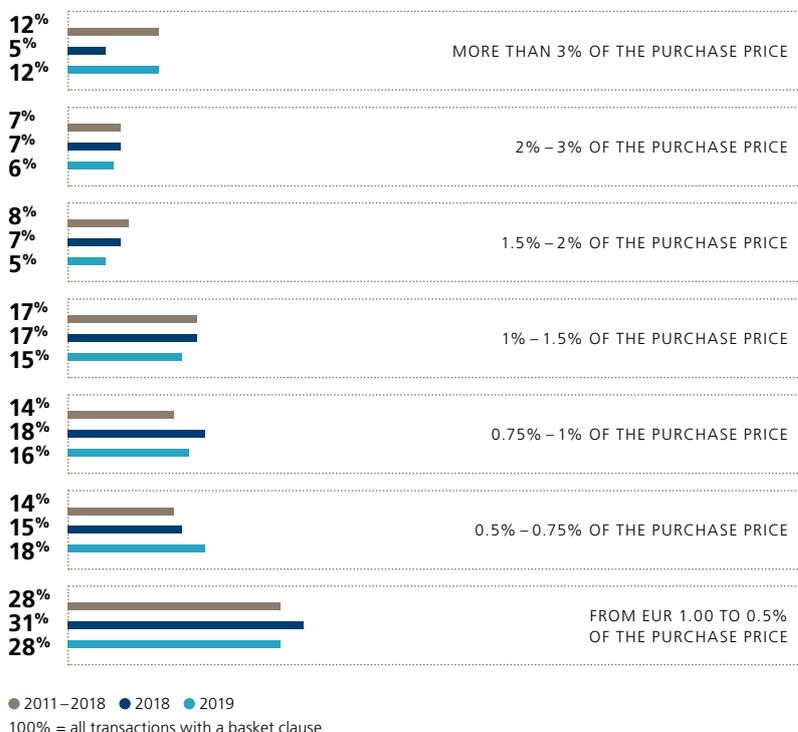
As indicated, most baskets in European transactions are of the 'first dollar' type and this structure generally guides the size of the basket, i.e. a 'first dollar' basket will generally be larger than an 'excess only' basket. For 2019, the split in respect of baskets equal in value to up to 1% of the purchase price for 62% of transactions and the remaining 38% at more than 1% of the purchase price remains consistent with the position for 2018. This indicates that the negotiation parameters for basket sizes have remained broadly consistent at around the mark of 1% of the purchase price, although we did note a significant spike in the application of a basket at more than 3% of the purchase price, but this constitutes a return to market norms for the period 2010–2018.

Size of basket →

Impact of W&I Insurance

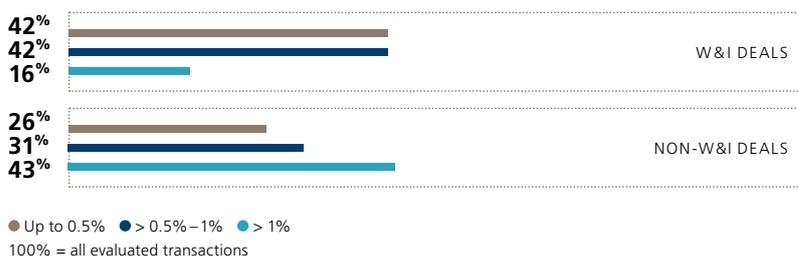
In the UK, the use of basket provisions dropped from 80% in 2018 to 68% in 2019, which is indicative of the overall decline across Europe generally. We think this reflects the greater use of W&I insurance in the UK market, where we have seen an increase in its application to 37% of transactions compared with 32% for 2018 and 20% for the period 2010–2018. With regard to Europe overall, only 16% of W&I deals have a basket of more than 1% of the purchase price as compared to 43% for non-W&I deals. In the absence of W&I protection, sellers are seeking, and in many cases obtaining, relatively high levels of basket protection and where W&I applies the lower basket levels reflect that the seller has passed on this risk to the W&I insurer.

Time Trend



Basket Thresholds for 2019

W&I deals + non-W&I deals

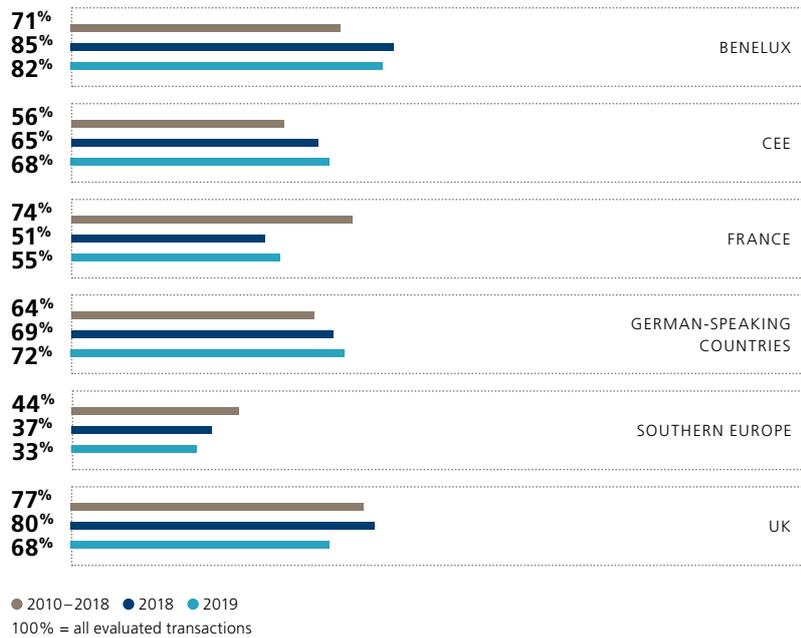


Regional Differences

The average application of baskets in European transactions at 66% for 2019 is reflected in most territories covered (i.e. the UK, the German-speaking countries and the CEE region). We continue to see that in Southern European countries there is relatively little appetite to apply a basket and the decline in usage to 33% is reflective of the recent trend in those countries. We assume this is a particular aspect of transactions in this region and reflects the differences in market norms which often apply throughout Europe. Similarly, the contrast between the UK in the application of a 'first dollar' basket in 91% of basket transactions compares with the relatively lower levels of 62% in France and 69% in the German-speaking and Southern European countries and the consequential greater application of 'excess only' baskets in those countries.

Time Trend Europe

Basket application

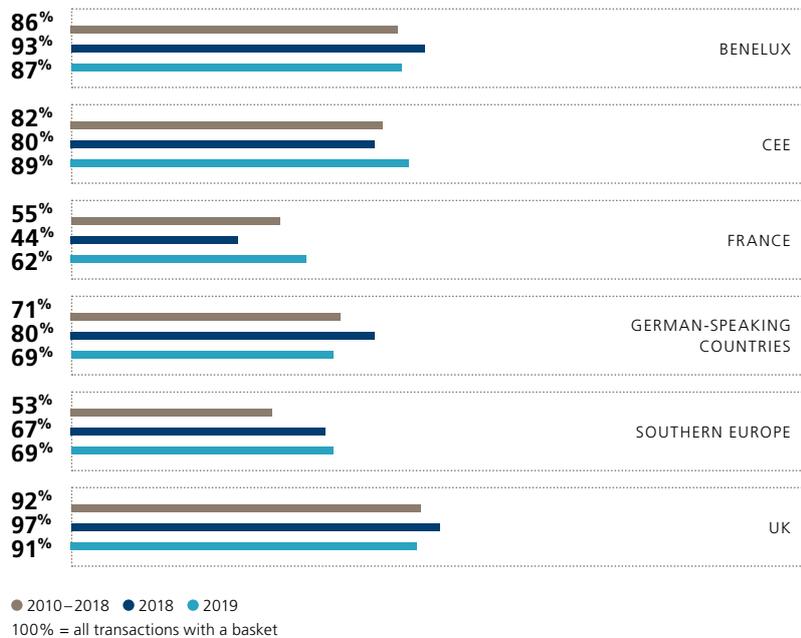


'First dollar' recovery

80%

Time Trend Europe

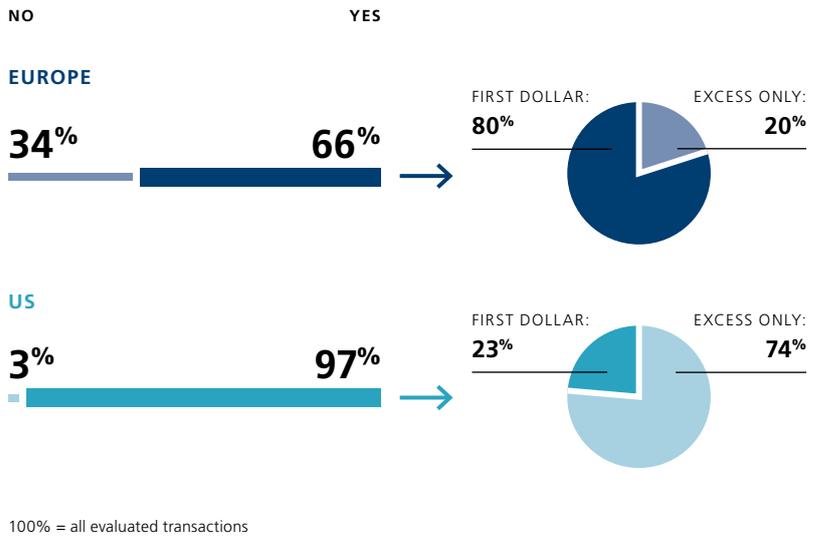
First dollar



European/US Differences

As in previous years, the US market continues to apply baskets in nearly all transactions (97%), which compares markedly, once again, with their much lower application across Europe (66%). The lower range is unlikely to be explained solely by the use of W&I insurance, as this is equally available in the US, so we think this simply demonstrates differences in market norms. With respect to those transactions to which a basket applies, the prevalence of 'excess only' baskets in the US market continues at 74% compared with the European equivalent of just 20%. For the reasons identified above, this gives rise to a disparity in the amount of the basket, with just 3% of US transactions applying a basket of more than 1% of the purchase price as compared with 38% for European transactions.

Frequency of Baskets



Thresholds Europe/US





Liability caps

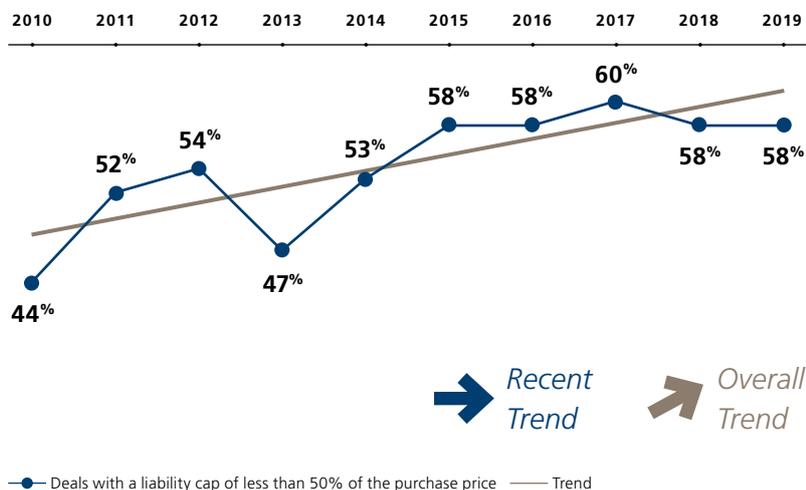
Sellers will generally seek certainty that their liability in respect of warranty claims will not exceed a pre-agreed amount. Traditionally this amount has been equal to the purchase price as the seller would expect not to return to the buyer any more than it has been paid for the target business. Over the years of this Study we have seen there can be a lot of debate between the parties as to the level of a liability cap. We have seen that this varies significantly from deal to deal by reference to the purchase price, particularly for larger deals. For deals with full W&I insurance cover, the liability cap is often a nominal amount.

General Overview

The trend in the application of liability caps for amounts of less than the purchase price has now broadly settled, with a continuing level of 58% of transactions with a cap of less than 50% of the purchase price applying in 2019 and also in 2015, 2016 and 2018. The amounts of those caps are, however, subject to significant variation depending on deal size and, most significantly, on whether W&I insurance cover applies to the transaction. For example, a massive 45% of W&I transactions have caps of less than 10% of the purchase price as compared with just 10% of deals without W&I. Clearly, the impact of W&I is now a significant factor in determining the overall level of the liability cap for sellers.

CMS Trend Index

Liability caps (less than 50% of purchase price)



Liability cap less than purchase price

65% ➔

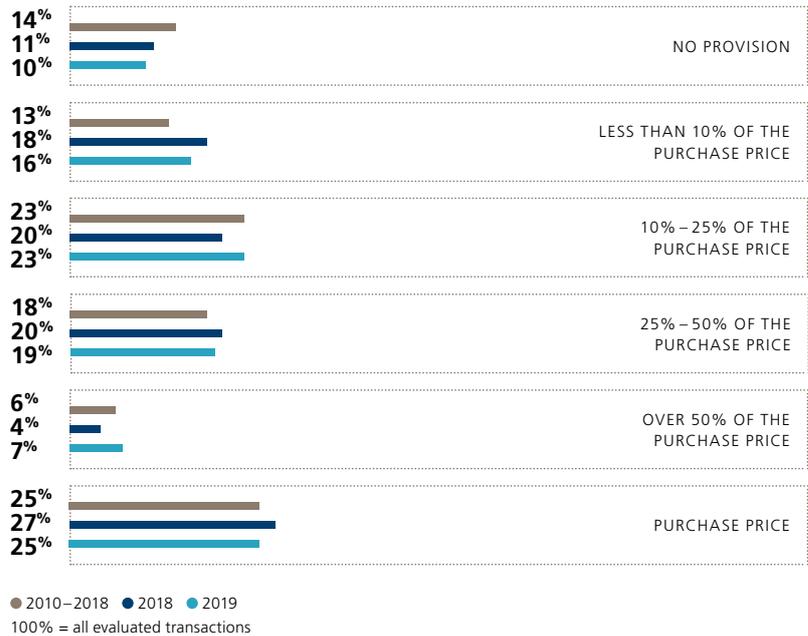
Liability Caps for 2019

W&I deals + non-W&I deals



This year's Study indicates that, as before, most deals (65%) have a liability cap of less than the purchase price. The largest proportion of such deals (23%) is, as in previous years, for a liability cap of between 10% and 25% of the purchase price. A not insignificant minority (10%) of European transactions do not have a liability cap at all but this seems to be a declining trend and the largest single proportion (25%) of transactions have a liability cap equal to the purchase price. There is a wide variety of agreed liability caps between these two levels, indicating the range of debate between sellers and buyers as to the most appropriate amount for a particular transaction.

Amount of Liability Cap



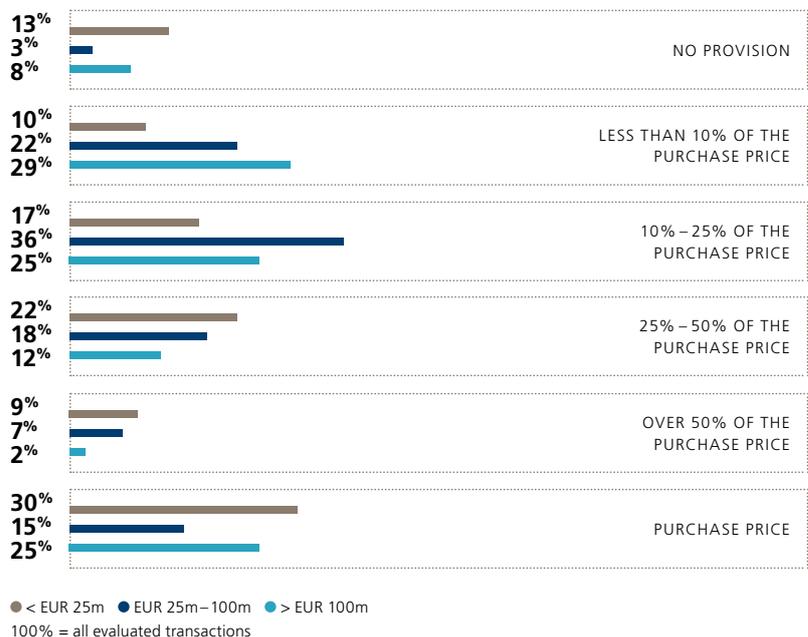
Deals without liability caps

10%

Analysis by Deal Size

The results of this year's Study seem to confirm the aphorism that the liability cap for a smaller transaction is most likely to be the purchase price and the liability cap for a larger transaction is most likely to be significantly less than the purchase price. For example, 30% of the smaller transactions were capped at the purchase price and 29% of the larger transactions were capped at less than 10% of the purchase price. For medium-size deals, a significant 36% were capped at between 10-25% of the purchase price. It would however be brave to suggest that these represent benchmark levels for liability caps, given the ranges indicated across all deal sizes.

Liability Caps

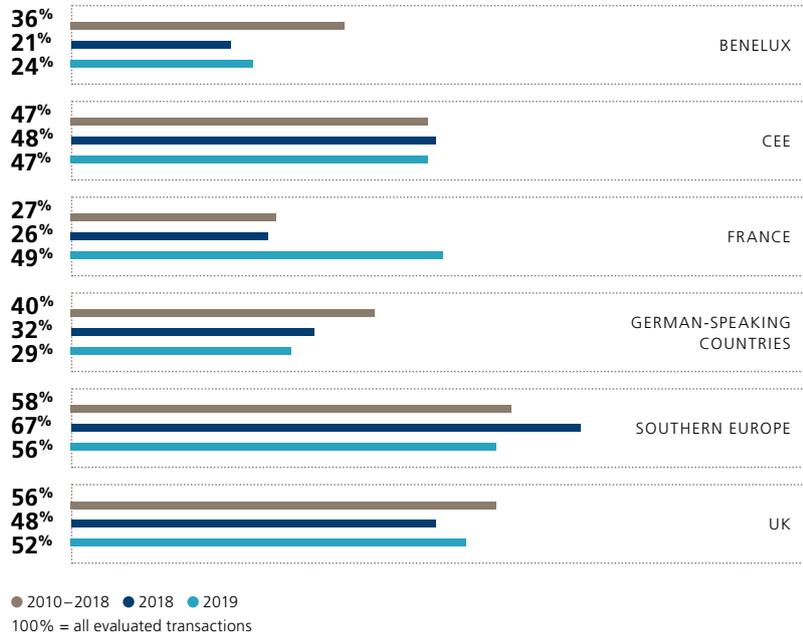


Specific Issues

Liability Caps (more than 50% of purchase price)

A liability cap of more than 50% of the purchase price applied in 42% of our European transactions and has done for the last five years. Notwithstanding the lack of movement of that average, there have been significant regional movements within that period. Over that period, the UK and CEE countries have remained broadly static and close to the average. We have however seen big swings for France, where nearly half of transactions have caps of more than 50% of the purchase price (up from 26% in 2018), and the opposite in German-speaking countries with a drop to 29% compared to 40% as the average for the period 2010–2018.

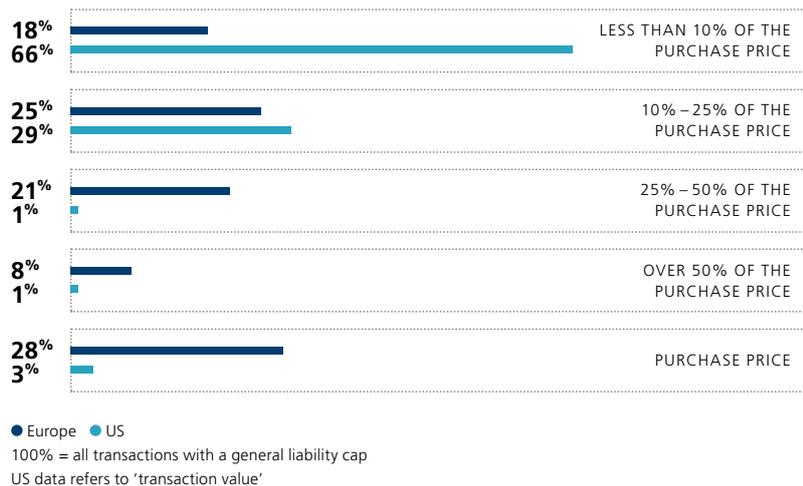
Time Trend Europe



European/US Differences

The US market has a more consistent and less varied range of liability caps in that the vast majority (95%) of deals there have a cap of 25% or less of the purchase price. Indeed, a massive 66% of US deals have a cap of less than 10% of the purchase price. This is another very significant difference to our European sample, where only 18% of European deals with a liability cap in 2019 had a cap of less than 10% of the purchase price and, as indicated above, many European deals (28%) have a liability cap equal to the purchase price as compared with just 3% of US deals. This is one area where the US market is more 'seller-friendly' than the European market.

Liability Caps



Sector Differences

As indicated above, 38% of all our European deals had caps of up to 25% of the purchase price and this average applied in most of the sectors covered. As with previous years, the exceptions were in the Life Sciences & Healthcare sector, where 50% of such transactions had caps at this level, which was joined in 2019 by the Real Estate & Construction sector at 53% overall. It is difficult otherwise to discern any particular sector anomalies, so we assume that deal size and geography, rather than sector, are the major determining factors in setting an agreed level for a liability cap.

Frequency of Liability Caps up to 25%

SECTOR	2010 – 2018	2018	2019
BANKING & FINANCE	30%	46%	29%
HOTELS & LEISURE	44%	50%	36%
ENERGY & CLIMATE CHANGE	25%	28%	34%
CONSUMER PRODUCTS	38%	43%	32%
TECHNOLOGY, MEDIA & COMMUNICATIONS	34%	34%	36%
INFRASTRUCTURE & PROJECTS	18%	67%	50%
LIFESCIENCES & HEALTHCARE	36%	24%	43%
REAL ESTATE & CONSTRUCTION	48%	41%	53%
INDUSTRY	42%	40%	43%
BUSINESS (OTHER SERVICES)	32%	40%	27%
CMS AVERAGE	36%	38%	38%

100% = all evaluated transactions of the respective industry



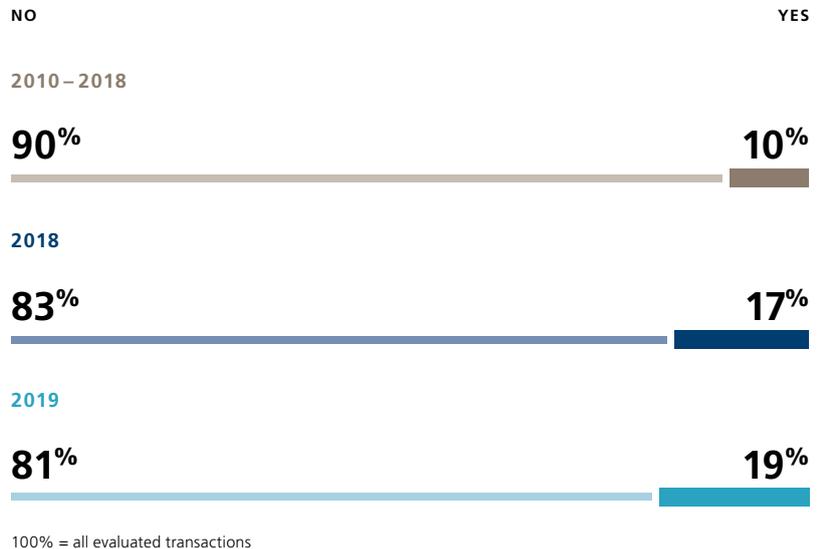


Warranty & Indemnity insurance

Warranty & Indemnity insurance (W&I insurance) has proved an elegant solution to problems where (i) there is no obvious warrantor to stand behind the warranties (e.g. private equity sellers) or (ii) there is an insufficient amount of coverage provided by the warrantors. Year-on-year the usage of W&I insurance continues to rise and 2019 was no different, with 19% of CMS transactions involving a W&I insurance policy. This is up by 2% from 2018 and 9% higher than the average over the period 2010–2018.

General Overview

Time Trend W&I Insurance



W&I insurance usage

19%

The market this year

Brian Hendry, Head of Mergers & Acquisitions at W&I insurance broker Paragon International Insurance Brokers, comments:

“On a global basis the M&A insurance market has continued to grow, with particular expansion across Europe. There are now in excess of 30 M&A insurance “providers” in Europe. As the market matures providers are starting to specialise in particular areas, either size of deal, location, sector or complexity, and there are now few transactions that are outside of market appetite. There is also a growing specialism in tax risks with experienced tax practitioners being hired to underwrite and broker tax risk.

Premiums and policy retention levels remain very competitive as the new providers compete for business, plus the policy terms are being expanded as “enhanced” cover positions are being more widely accepted, driven again by the competition for business.

The factors that currently make W&I insurance interesting are however leading to increasing claims activity, increasing costs of underwriting and reducing margins. This renewal season has seen a small withdrawal of capacity by certain insurance companies that give capacity to the “providers”. If the claims trends and margin squeeze continue, the macro impact across the product line could lead to a larger reduction in capacity, which in turn could lead to hardening of policy terms for 2021.”

Specific Issues

Analysis by Deal Size

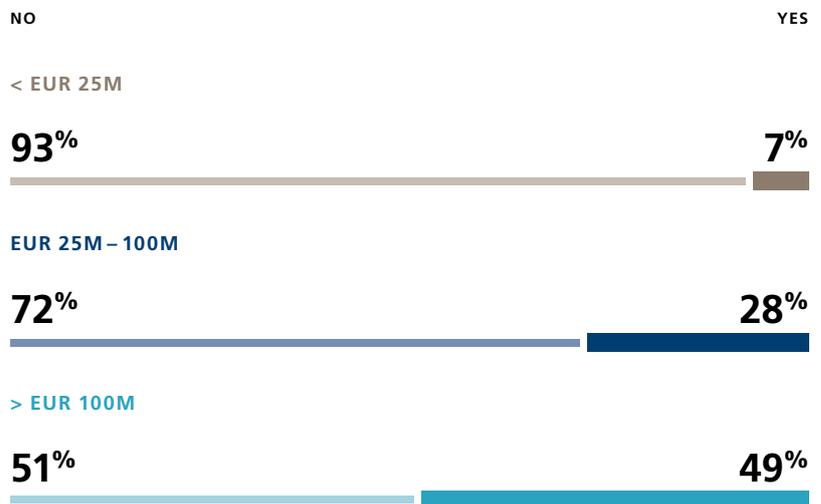
2019 continues the trend that the larger the deal value, the more likely W&I insurance will be used. W&I insurance was purchased on 49% of large deals, an increase of 11% from 2018, which is a significant jump. The percentages for medium-size deals and smaller deals have remained broadly static, at 28% and 7% respectively.

W&I insurance usage



W&I Insurance 2019

By purchase price (Europe-wide)



100% = all evaluated transactions

Sector Differences

Real Estate & Construction remains the most popular sector for W&I insurance (30% of CMS' Real Estate & Construction M&A deals in 2019) and enjoyed an 11% increase from the 19% low in 2018. 2019 saw a number of fluctuations in sector trends, with falls in popularity in Hotels & Leisure (6% from 15%) and Industry (10% in 2019 from 19% in 2018) and notable rises for the Energy, Technology, Media & Communications and Life Sciences & Healthcare sectors.

Frequency of W&I Insurance

SECTOR	2011 – 2018	2018	2019
BANKING & FINANCE	3%	3%	0%
HOTELS & LEISURE	14%	15%	6%
ENERGY & CLIMATE CHANGE	9%	8%	13%
CONSUMER PRODUCTS	11%	9%	7%
TECHNOLOGY, MEDIA & COMMUNICATIONS	11%	12%	18%
INFRASTRUCTURE & PROJECTS	1%	3%	2%
LIFE SCIENCES & HEALTHCARE	4%	3%	8%
REAL ESTATE & CONSTRUCTION	23%	19%	30%
INDUSTRY	13%	19%	10%
BUSINESS (OTHER SERVICES)	10%	9%	6%
CMS AVERAGE	10%	17%	19%

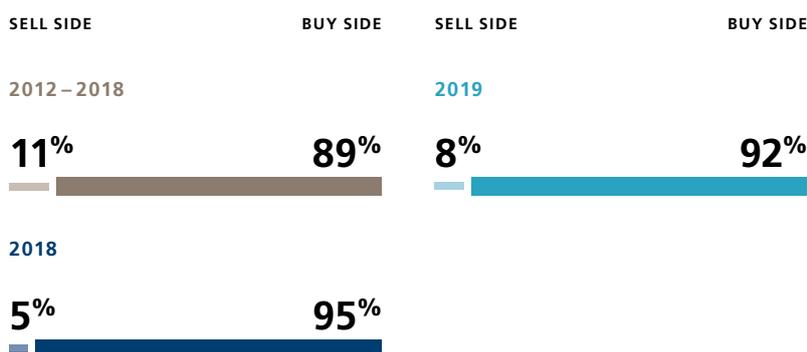
100% = all evaluated transactions of the respective industry

Type of Policy

It remains the case that if a W&I insurance policy is purchased it will most often be a buy-side policy (i.e. the buyer will be the insured party). In 2019, this was the case on 92% of the deals which involved W&I insurance; a 3% decrease from 2018 but still comfortably the most common. It is normally the buyer that will pay or fund the cost of the W&I insurance policy – 76% of the time in 2019. Deciding the payer of the W&I insurance premium is often a heavily negotiated item between the seller and the buyer.

W&I Insurance

By purchase price 2019



100% = deals in which W&I insurance was actually used

W&I Insurance

Who pays the premium



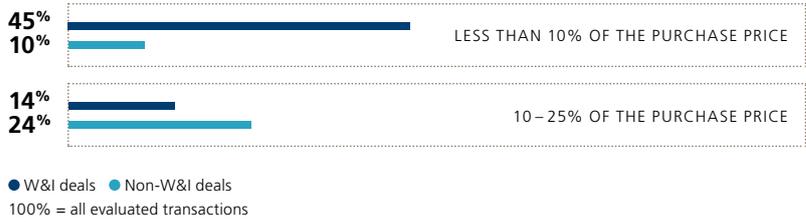
100% = all evaluated transactions

Liability Caps

It can be expected that where a deal involves W&I insurance it is more likely that the seller will be able to agree a lower liability cap in its negotiations with the buyer. This may be a nominal amount with the buyer able then to purchase a W&I insurance policy to top up its warranty coverage. In 2019, 45% of deals involving W&I insurance had liability caps that were less than 10% of the purchase price, compared to only 10% of non-W&I insured deals.

Liability Caps for 2019

W&I deals + non-W&I deals

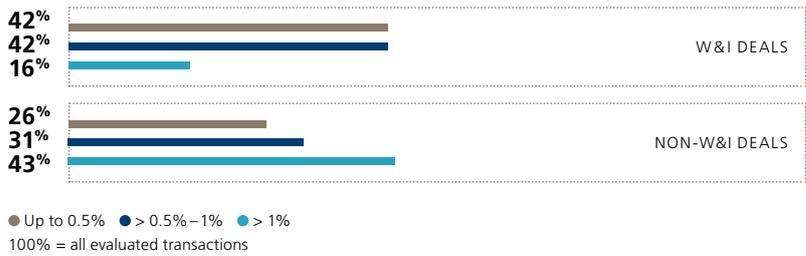


Baskets

If the W&I insurance policy has its own *de minimis* and basket which were negotiated with the underwriter (often determined by the amount of the premium for the policy), then it is right to debate whether there is a need for a basket and *de minimis* in the SPA. That said, the data for 2019 (consistent with 2018) shows that deals involving W&I insurance are likely to include baskets with a lower value than if insurance is not being used (as the seller will want the benefit of a greater financial hurdle for itself before being subject to claims).

Basket Thresholds for 2019

W&I deals + non-W&I deals

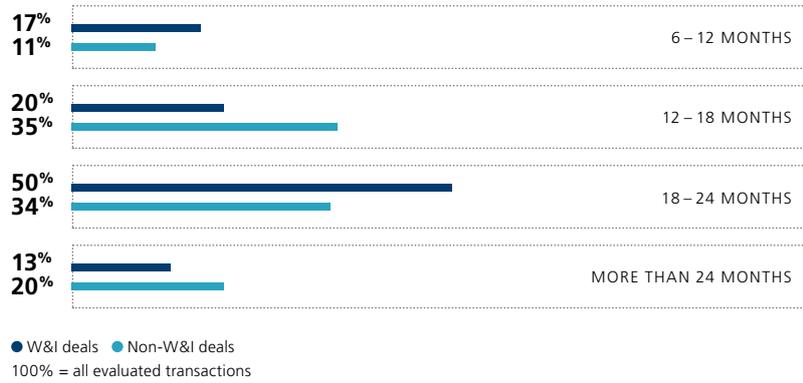


Limitation Periods

Usually the length of any W&I insurance policy period will match the equivalent time limitation period for bringing warranty claims in the SPA. However, it is possible to agree with the underwriter of the W&I policy to purchase a different (usually longer) period than is available in the SPA. The data for 2019 (similarly to 2018) shows that a time limitation period of between 18 to 24 months is even more common on W&I insurance deals than on those deals without insurance.

Limitation Period for Warranty Claims for 2019

W&I deals + non-W&I deals



Frequency of Claims under W&I Insurance Policies

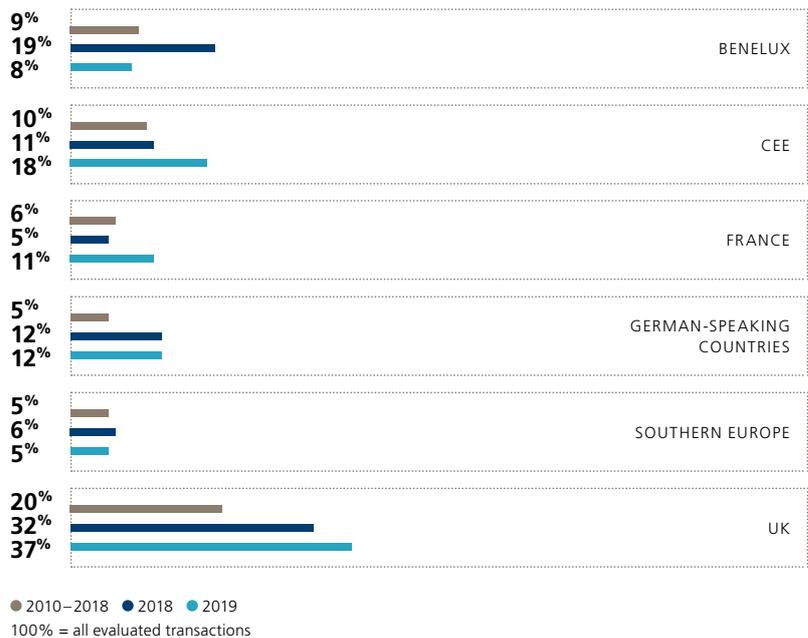
Many clients ask us how often we experience claims in relation to M&A deals and particularly those where W&I insurance is in place. Adrian Furlonge, founding partner of specialist M&A insurance broker Hemsley Wynne Furlonge LLP, notes:

“Over the last few years the frequency of claims has increased due to change in M&A practices and familiarity of the claims process by insureds. However while the number of claims has increased in line with the number of W&I insurance policies placed this year, there is no hard evidence to suggest that the frequency has changed. This is positive news for insurers and clients as increased claims activity would have put pressure on insurers to consider either providing inferior coverage or increasing their pricing. While pricing may well increase over the coming years with a general hardening of the insurance market, provided the volume of policies continues to grow in line with claims activity, the positive benefit for clients of a solid base of claims data leading to a better claims handling experience should be seen.”

Regional Differences

The overall year-on-year growth in the use of W&I insurance was also demonstrated in CEE, France, the German-speaking countries and the UK. In the UK, a significant 37% of all transactions were covered by W&I insurance. After double-digit growth in 2018, Benelux suffered a marked fall in the number of policies purchased from 19% in 2018 to 8% in 2019, back to a level consistent with the historic average for this region (2010–2018).

Time Trend Europe





Limitation period for warranty claims

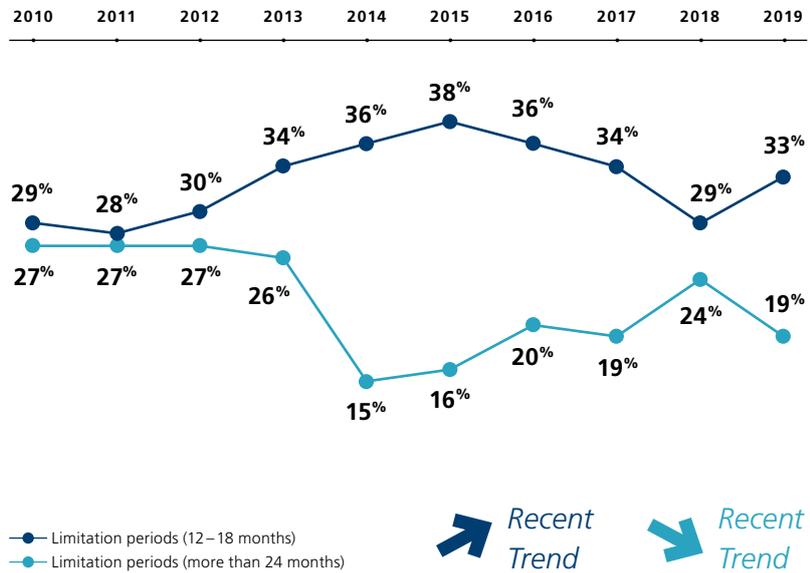
Sellers and buyers typically agree to reduce the statutory limitation period for warranty claims under a sale and purchase agreement by choosing shorter limitation periods. This is favourable to sellers because buyers have less time to bring warranty claims. Over the past six years (2014–2019), this has been a consistent trend.

General Overview

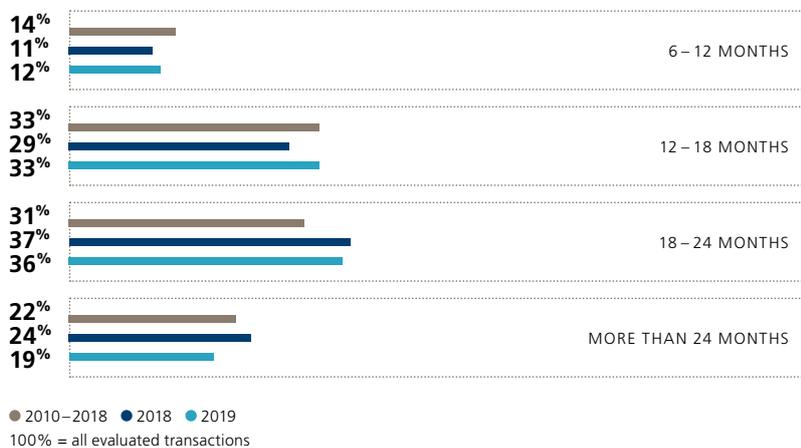
In 2019, there were opposing developments in relation to the duration of limitation periods. Whilst in small deals (below EUR 25m) the usage of longer limitation periods (more than 24 months) dropped from 32% in 2018 to 21%, we saw the complete opposite on medium-size and large deals. The large deals (EUR 100m plus) experienced a rise in longer limitation periods (18% of deals in 2019 compared with 10% of deals in 2018), and saw a corresponding decrease in deals with short limitation periods of 6 to 12 months (15% of deals in 2019 compared with 23% of deals in 2018). For the medium-size deals (EUR 25m to EUR 100m), we also noted a trend towards longer limitation periods, especially 18 to 24 months (42% of deals in 2019 compared with 36% in 2018).

Limitation periods of 12 to 24 months remain at a comparable level to previous years (69% of deals in 2019 compared with 66% in 2018 and 69% in 2017). Despite the stark differences in the periods for different deal sizes, we see a more seller-friendly trend towards shorter limitation periods in 2019: limitation periods of more than 24 months and between 18 to 24 months each decreased from the previous year, from 24% to 19% and from 37% to 36%, respectively.

CMS Trend Index



Time Trend



Specific Issues

Regional Differences

We noted contrasting positions when comparing the different regions analysed in the Study. In some regions we saw a decrease in deals with longer limitation periods, especially in CEE and Southern European countries; other regions, especially France, tended to use shorter limitation periods.

In prior years, French deals included longer limitation periods for warranty claims. This trend changed in 2019 as 17% of the French deals contained limitation periods of between 6 and 12 months compared to 0% in 2018. Correspondingly, the number of limitation periods of 18 to 24 months dropped sharply from 42% in 2018 to 17% in 2019.

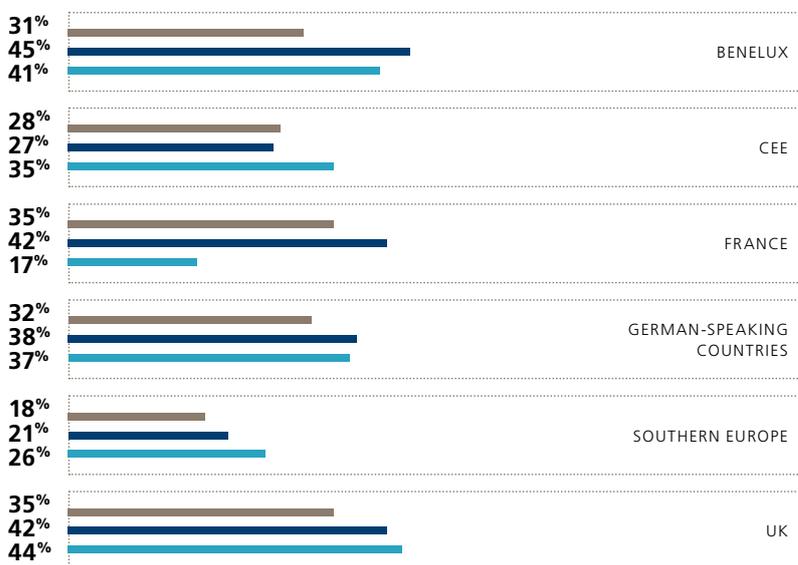
Previously the Southern European countries had a consistent trend towards long limitation periods (more than 24 months) (2018: 57% and 2010–2018: 45%); however, this figure dropped significantly to only 31% in 2019. Correspondingly, there was an increase in deals with shorter limitation periods (6 to 12 months) from 11% in 2018 to 18%.

Just as in France and the Southern European countries, Benelux experienced an increase in deals with short limitation periods (between 6 and 12 months), rising from 6% in 2018 to 16% in 2019.

In the UK, CEE and the German-speaking countries, there was a slight decrease in the number of deals with short limitation periods (6 to 12 months) for warranty claims.

Time Trend Europe

18 to 24 months



● 2010–2018 ● 2018 ● 2019
100% = all evaluated transactions

Sector Differences

Sector analysis demonstrates that in 2019, longer limitation periods (i.e. those exceeding 24 months) were most likely in the Consumer Products and Infrastructure & Projects sectors (33% and 29% of deals recorded in those sectors, respectively).

The Life Sciences & Healthcare sector, which saw longer limitation periods (i.e. exceeding 24 months) in 2018 (43%), chose short limitation periods in 2019 and the proportion of longer limitation periods dropped (from 42% to 23%).

Limitation Periods (more than 24 months)

SECTOR	2010 – 2018	2018	2019
BANKING & FINANCE	18%	19%	14%
HOTELS & LEISURE	25%	22%	27%
ENERGY & CLIMATE CHANGE	20%	31%	18%
CONSUMER PRODUCTS	25%	16%	33%
TECHNOLOGY, MEDIA & COMMUNICATIONS	19%	15%	12%
INFRASTRUCTURE & PROJECTS	15%	50%	29%
LIFE SCIENCES & HEALTHCARE	23%	42%	23%
REAL ESTATE & CONSTRUCTION	29%	31%	16%
INDUSTRY	19%	17%	18%
BUSINESS (OTHER SERVICES)	26%	23%	19%
CMS AVERAGE	22%	24%	19%

100% = all evaluated transactions of the respective industry

Longest limitation periods in the Consumer Products and Infrastructure & Projects sectors

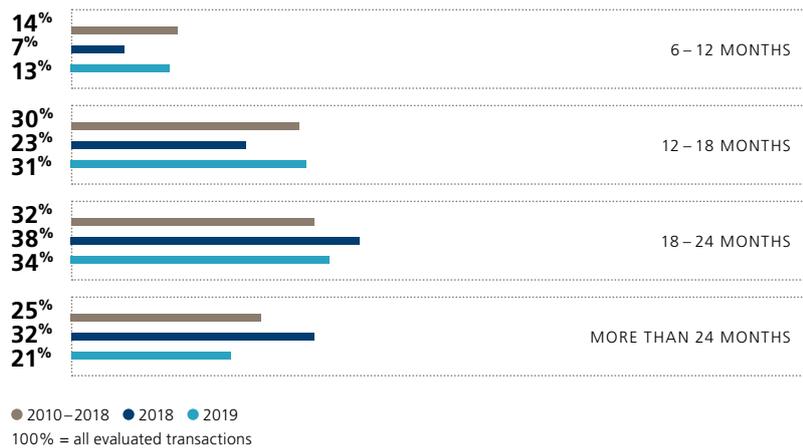
Analysis by Deal Size

Only 12% of deals with a value between EUR 25m and EUR 100m and 18% of EUR 100m plus deals contained limitation periods exceeding 24 months in 2019. In smaller deals with a value lower than EUR 25m, the number of deals with a longer limitation period (18–24 months and more than 24 months) decreased from 70% in 2018 to 55% in 2019.

In transactions with a value between EUR 25m and EUR 100m, sellers and buyers are most likely to agree on a limitation period of between 18 and 24 months (42% in 2019). Nonetheless, a limitation period of 12 to 18 months also remained popular in 2019 (38%).

Time Trend

By purchase price less than EUR 25m



Limitation periods > 24 months in deals < EUR 25m

21% ➔

Limitation periods of more than 24 months

Deals EUR 100m plus:

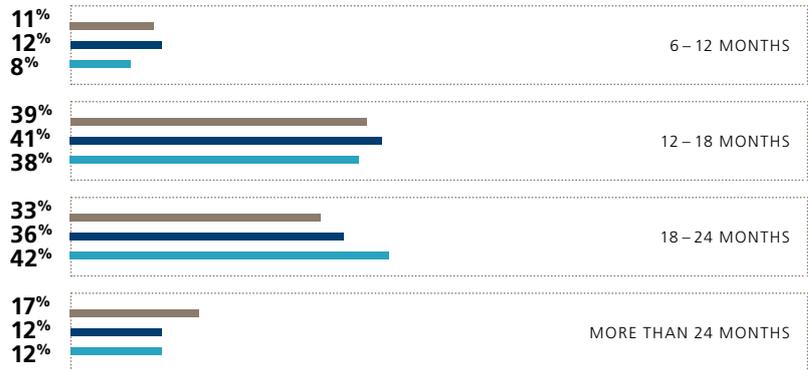
18% ↗

Deals EUR 25m to EUR 100m:

42% ↗

Time Trend

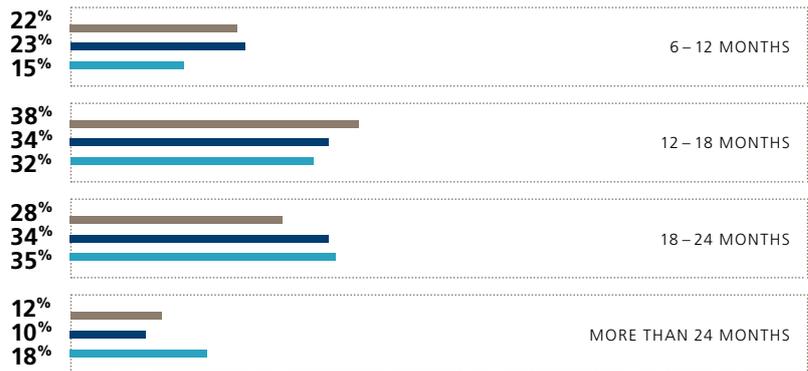
By purchase price EUR 25m – 100m



● 2010-2018 ● 2018 ● 2019
100% = all evaluated transactions

Time Trend

By purchase price more than EUR 100m



● 2010-2018 ● 2018 ● 2019
100% = all evaluated transactions

The bigger the deal the longer the limitation period



Security for warranty claims

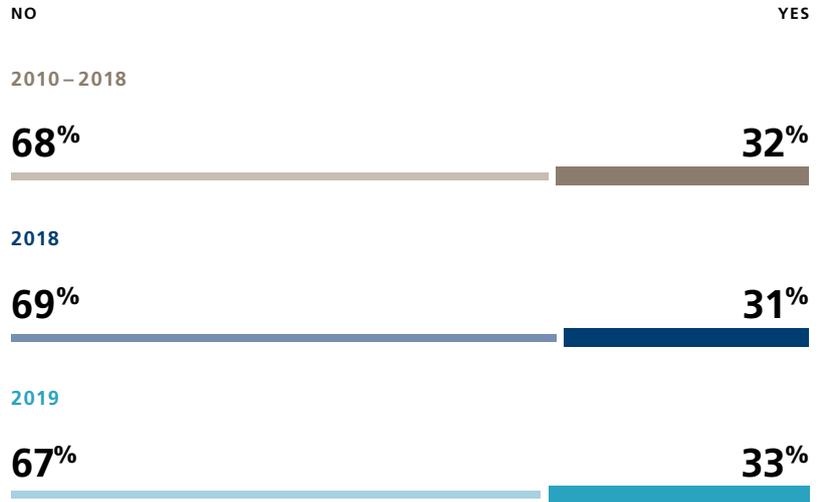
If a buyer has concerns about the covenant strength of a seller to stand behind the warranties given in a sale and purchase agreement, then the parties may often negotiate some form of security for warranty claims. The type and the value of the security depend on many factors, such as the likelihood of a warranty claim, the strength of the seller's covenant and the deal structure.

General Overview

In 2019, 33% of deals contained security for warranty claims, a slight increase over 2018 (31%). Despite this small increase, we consider that the seller-friendly trend of recent years has continued as sellers avoid having to provide security, a trend likely to have been encouraged by the greater use of W&I insurance meaning that the buyer has less need for direct recourse to the seller in the first place, thereby avoiding the need for security. Where the parties agreed to use security for warranty claims, we noted that escrow accounts are popular and consider this form of security to be favourable to sellers as the buyer will need to fund such escrow account (as opposed to a simple holdback).

Sellers still able to avoid giving security for warranty claims

Time Trend



100% = all evaluated transactions

Frequency of security

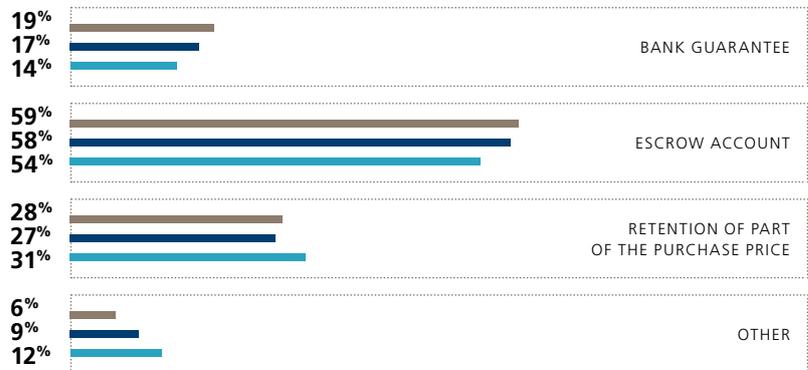
33% ↗

Specific Issues

Type of Security

In 2019, an escrow account was the most popular type of security for claims among sellers, even though it featured on fewer deals in 2019 (54%) compared to 2018 (58%) and the nine-year average of 2010–2018 (59%). Providing a bank guarantee also fell in popularity in 2019 (14%) when compared with 2018 (17%), whereas a retention of part of the purchase price and other forms of security for warranty claims were slightly more popular.

Time Trend



● 2010–2018 ● 2018 ● 2019
100% = transactions with safeguarding mechanism – more than one type of security possible

Escrow accounts

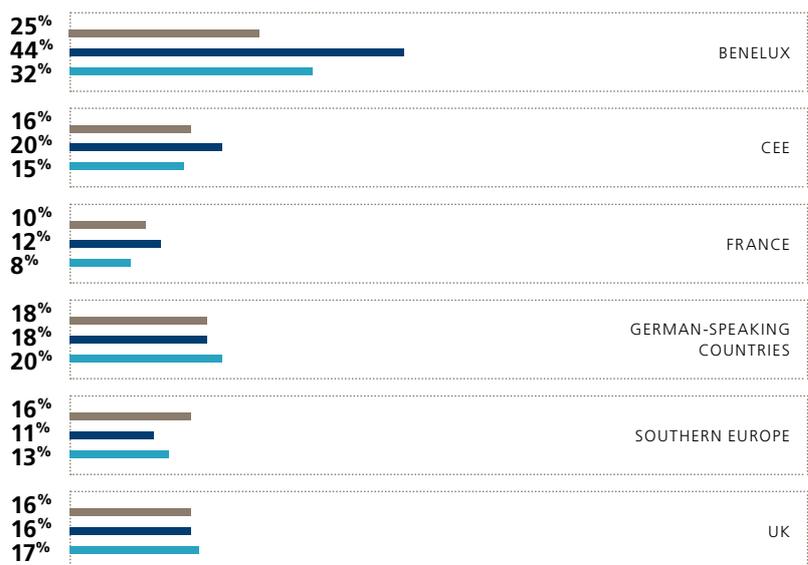
54% ➔

Escrow accounts are still the most commonly used type of security

Regional Differences

Escrow accounts are the most common type of security. The use of escrow accounts is especially popular in Benelux, featuring on 32% of deals including security. However, this is a much lower figure when compared with the figure for Benelux in 2018 (44%). Whilst the use of escrow accounts slightly increased in the UK, in the German-speaking and Southern European countries in 2019, we noted the opposite trend in France and CEE, where the use of escrow accounts dropped from 12% in 2018 to 8% in 2019 and from 20% in 2018 to 15% in 2019, respectively.

Time Trend Europe



● 2010–2018 ● 2018 ● 2019
100% = all evaluated transactions

Analysis by Deal Size

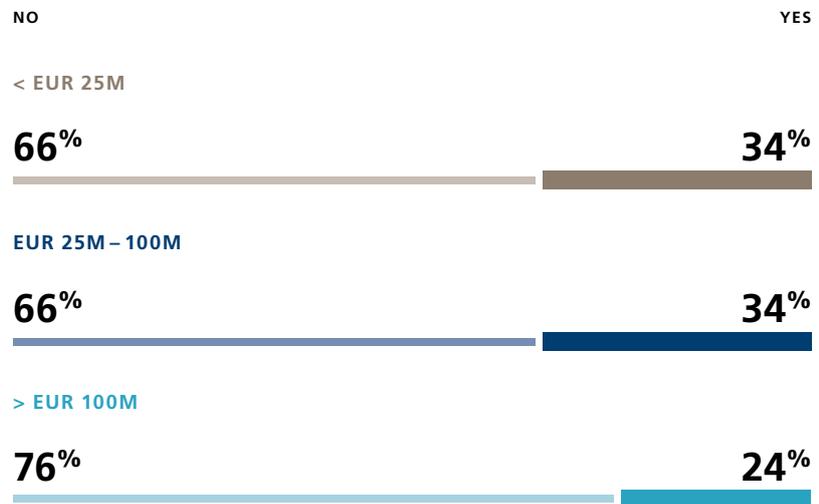
Parties agree on a form of security for warranty claims more often if the purchase price is below EUR 100m (34% in 2019). For large deals, a form of security was agreed only in 24% of the deals in 2019.

We saw that purchase price retention is more common (44%) in EUR 100m plus deals.

Escrow accounts are much preferred in large deals, being used in 63% of EUR 100m plus deals where a form of security for warranty claims was agreed.

Bank guarantees are slightly more commonly used in medium-size and large deals (13% for deals with a value below EUR 25m, 15% for deals with a value between EUR 25m and EUR 100m, 19% for EUR 100m plus deals).

Security for Warranty Claims 2019

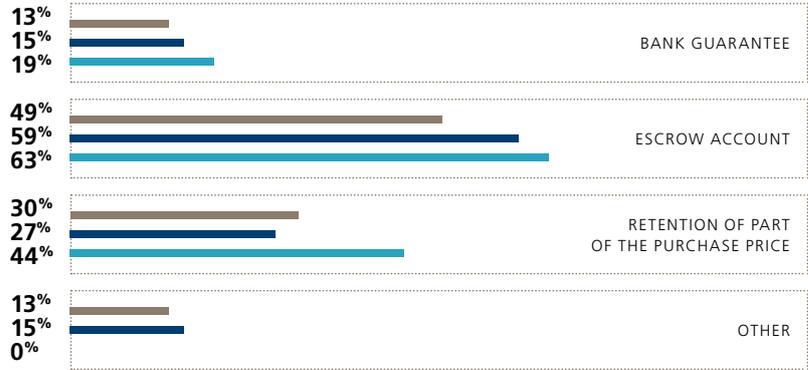


100% = all evaluated transactions

Escrow accounts most popular in large deals

Security for Warranty Claims

By purchase price 2019



● < EUR 25m ● EUR 25m-100m ● > EUR 100m

100% = transactions with safeguarding mechanism – more than one type of security possible



MAC clause

Material Adverse Change clauses (MAC clauses) allocate the risk of fundamental changes occurring between signing and closing. MAC clauses entitle the buyer to terminate the agreement if a specific event materialises before closing. Such events are expressly defined in the contract and often subject to extensive and detailed negotiations. The seller will usually seek to exclude specific unavoidable events from triggering the MAC clause so that the risk of any fundamental change is borne by the buyer.

General Overview

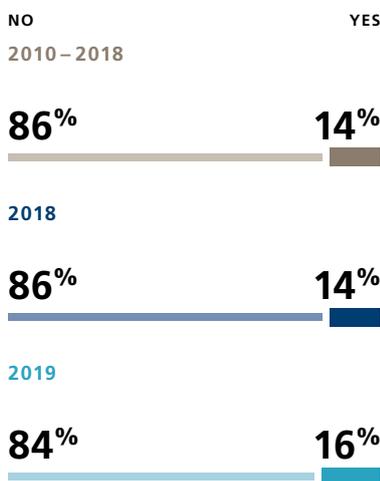
In 2019, MAC clauses were used in 16% of the deals. This is a slight increase both when compared with 2018 (14%) and with the previous nine-year average (14%). The continuing high success rate of sellers in resisting MAC clauses generally demonstrates their strong commercial position, especially in auction processes.

There are often carve-outs from the MAC clause, although it remains challenging for buyers to negotiate general carve-outs. Whilst exemptions on the basis of overall (22%) and sector-specific (17%) economic development, as well as exemptions in the event of force majeure (15%), decreased in 2019 by contrast with previous years, other types of exemptions gained significantly in popularity in 2019. This exemption applied in 46% of the deals (2018: 32% and 2010–2018: 31%).

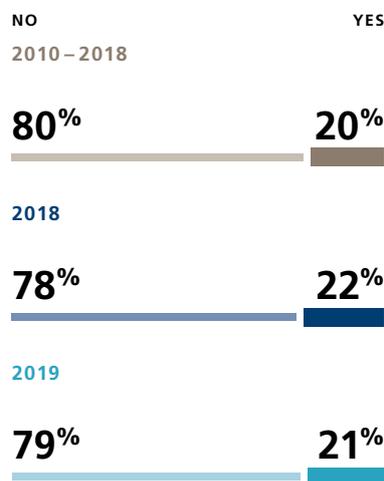
The frequency of Back-Door MAC clauses in a transaction (i.e. a right of the buyer to rescind or terminate the SPA in the event that warranties given as of signing are not true and accurate after signing) remained relatively stable in 2019, with 21% of the deals including such a clause when compared with 22% in 2018 and the nine-year average of 20% for 2010–2018.

Time Trend

MAC CLAUSES



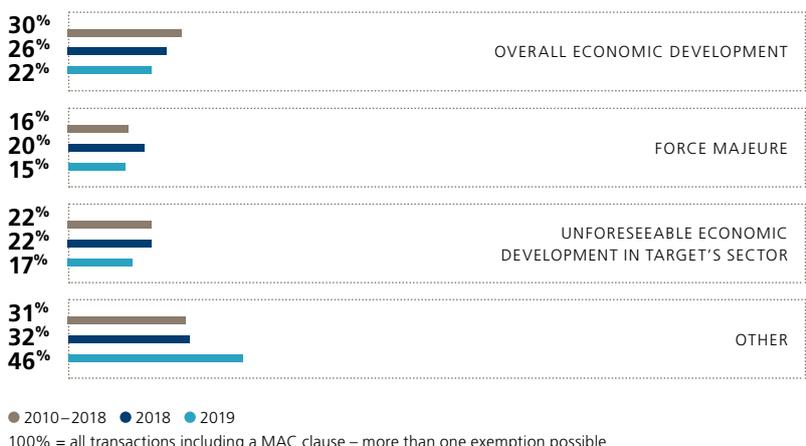
BACK-DOOR MAC



100% = all evaluated transactions



Exemptions from Material Adverse Change



Specific Issues

Regional Differences

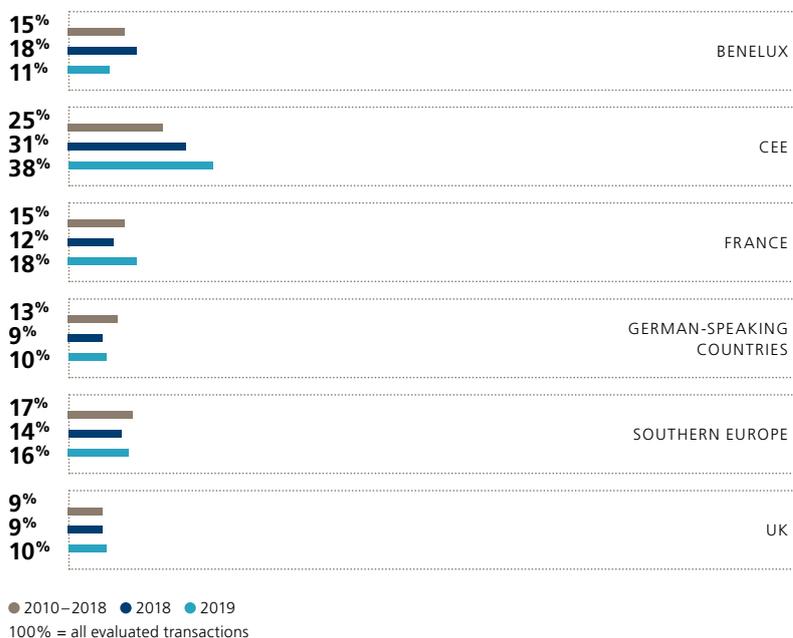
Significant regional inconsistencies in the use of MAC clauses remain.

In comparison to 2018, MAC clause usage in 2019 increased notably in CEE (from 31% to 38%) and in France (from 12% to 18%). MAC clause usage remained relatively stable in the Southern European countries (from 14% to 16%), in the German-speaking countries (from 9% to 10%) and in the UK (from 9% to 10%). In Benelux, meanwhile, we noted a stark decrease in MAC clause usage (from 18% in 2018 to 11% in 2019).

The increase in CEE reflects the overall trend of increasing MAC clause usage over the previous years when compared with the nine-year average of 25% for 2010–2018 and 31% in 2018.

CEE has experienced a steady increase in MAC clause usage over recent years

MAC Clauses 2010–2019



Sector Differences

In 2019, MAC clauses were most frequently used in the Financial Institutions (Finance and Insurance) sector (32%). The frequency of MAC clauses in the Infrastructure & Project Finance sector dropped significantly from 50% in 2018 to 22% in 2019. An opposite trend of increasing MAC clause usage can be observed especially in the Consumer Products sector (plus 16%), Industry sector (plus 8%) and Technology, Media & Communications sector (plus 7%). In the same period, we saw only slight changes in all other sectors.

Frequency of MAC Clauses

SECTOR	2010–2018	2018	2019
BANKING & FINANCE	20%	29%	32%
HOTELS & LEISURE	13%	14%	13%
ENERGY & CLIMATE CHANGE	14%	15%	13%
CONSUMER PRODUCTS	11%	8%	24%
TECHNOLOGY, MEDIA & COMMUNICATIONS	13%	8%	15%
INFRASTRUCTURE & PROJECTS	9%	50%	22%
LIFE SCIENCES & HEALTHCARE	17%	26%	14%
REAL ESTATE & CONSTRUCTION	15%	13%	12%
INDUSTRY	15%	9%	17%
BUSINESS (OTHER SERVICES)	13%	13%	15%
CMS AVERAGE	14%	14%	16%

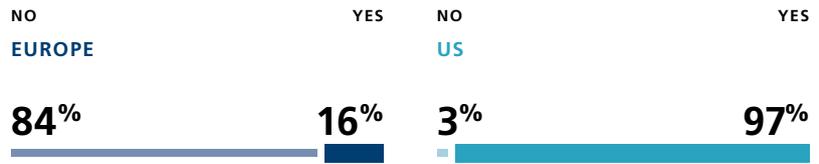
100% = all evaluated transactions of the respective industry

European/US Differences

In contrast to Europe, where only 16% of deals included MAC clauses in 2019, there were MAC clauses in 97% of US deals according to the most recent US ABA Report for 2018 and Q1 2019. This remarkable disparity can on the one hand be explained by sellers' higher success in demanding deal certainty on controlled auctions in Europe, and on the other hand by the greater number of transactions that sign and close simultaneously in certain European jurisdictions.

Remarkable disparity between Europe (16%) and the US (97%)

MAC Clauses Europe/US 2019



100% = all evaluated transactions



Analysis by Deal Size

In 2019, irrespective of the purchase price, transactions tended to have MAC clauses more often when compared with previous years. Whilst this trend may not seem as notable for small deals (increase from 13% in 2018 to 14% in 2019), the trend has been slightly more significant for medium-size deals (from 16% in 2018 to 20% in 2019) and for large deals (from 12% in 2018 to 19% in 2019). Small deals less commonly include a MAC clause presumably due to the lower financial risk of fundamental changes post-signing as contrasted with such risks in medium-size and large deals, and also because the majority of small deals sign and close simultaneously given there is less regulatory oversight and therefore fewer CPs. The drop in MAC clause usage in large deals in 2018 appears to have been a one-off as the figure in 2019 (19%) is more consistent with the long-term average for 2010–2018 (18%).

MAC clause usage more common in large deals

MAC Clauses 2010–2019

By purchase price

< EUR 25M

NO YES
2010–2018



2018



2019



EUR 25M – 100M

NO YES
2010–2018



2018



2019



> EUR 100M

NO YES
2010–2018



2018



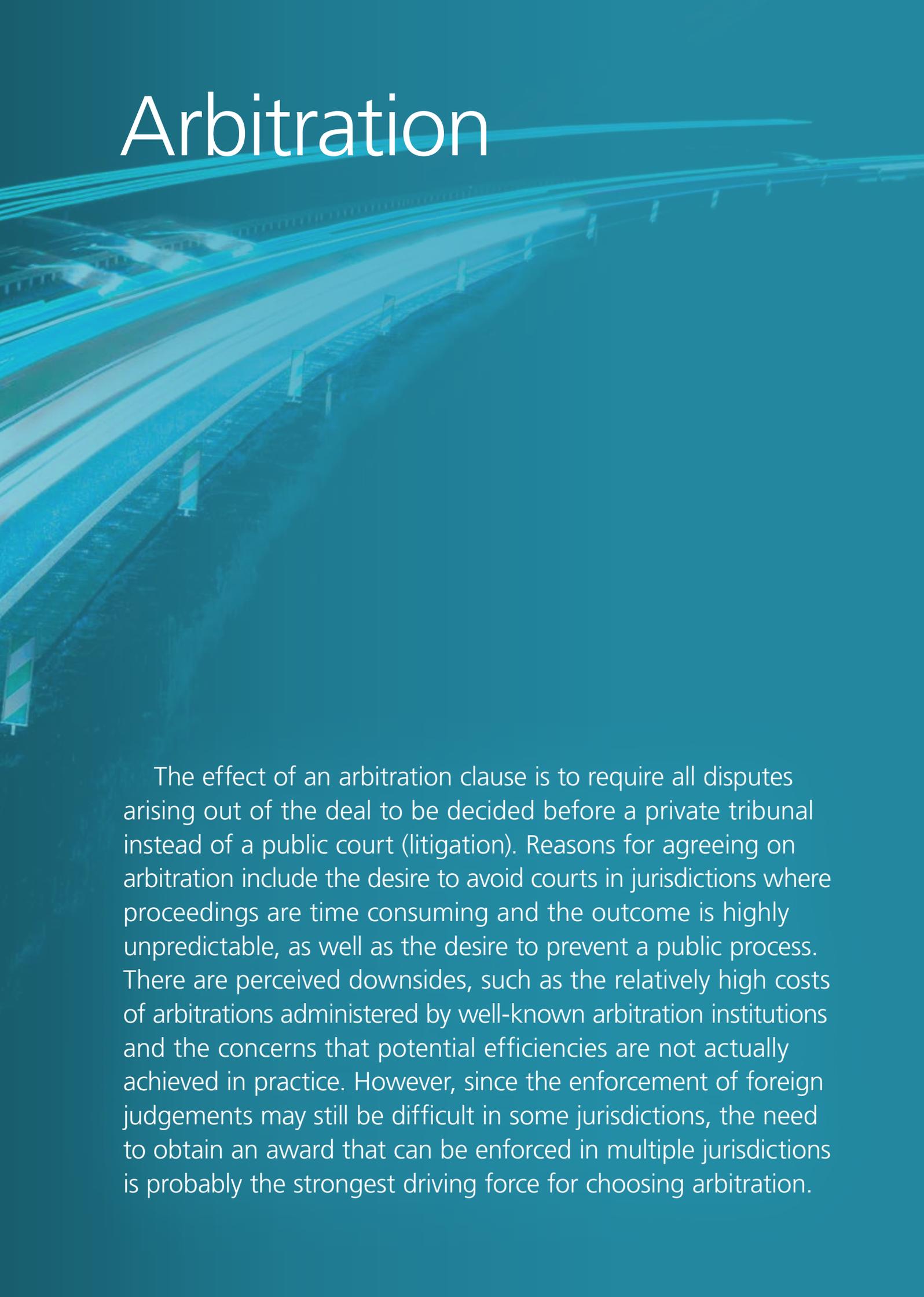
2019



100% = all evaluated transactions



Arbitration

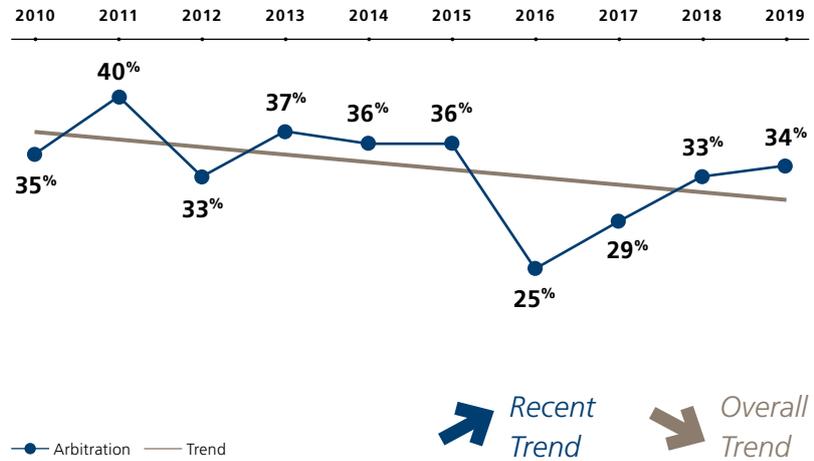


The effect of an arbitration clause is to require all disputes arising out of the deal to be decided before a private tribunal instead of a public court (litigation). Reasons for agreeing on arbitration include the desire to avoid courts in jurisdictions where proceedings are time consuming and the outcome is highly unpredictable, as well as the desire to prevent a public process. There are perceived downsides, such as the relatively high costs of arbitrations administered by well-known arbitration institutions and the concerns that potential efficiencies are not actually achieved in practice. However, since the enforcement of foreign judgements may still be difficult in some jurisdictions, the need to obtain an award that can be enforced in multiple jurisdictions is probably the strongest driving force for choosing arbitration.

General Overview

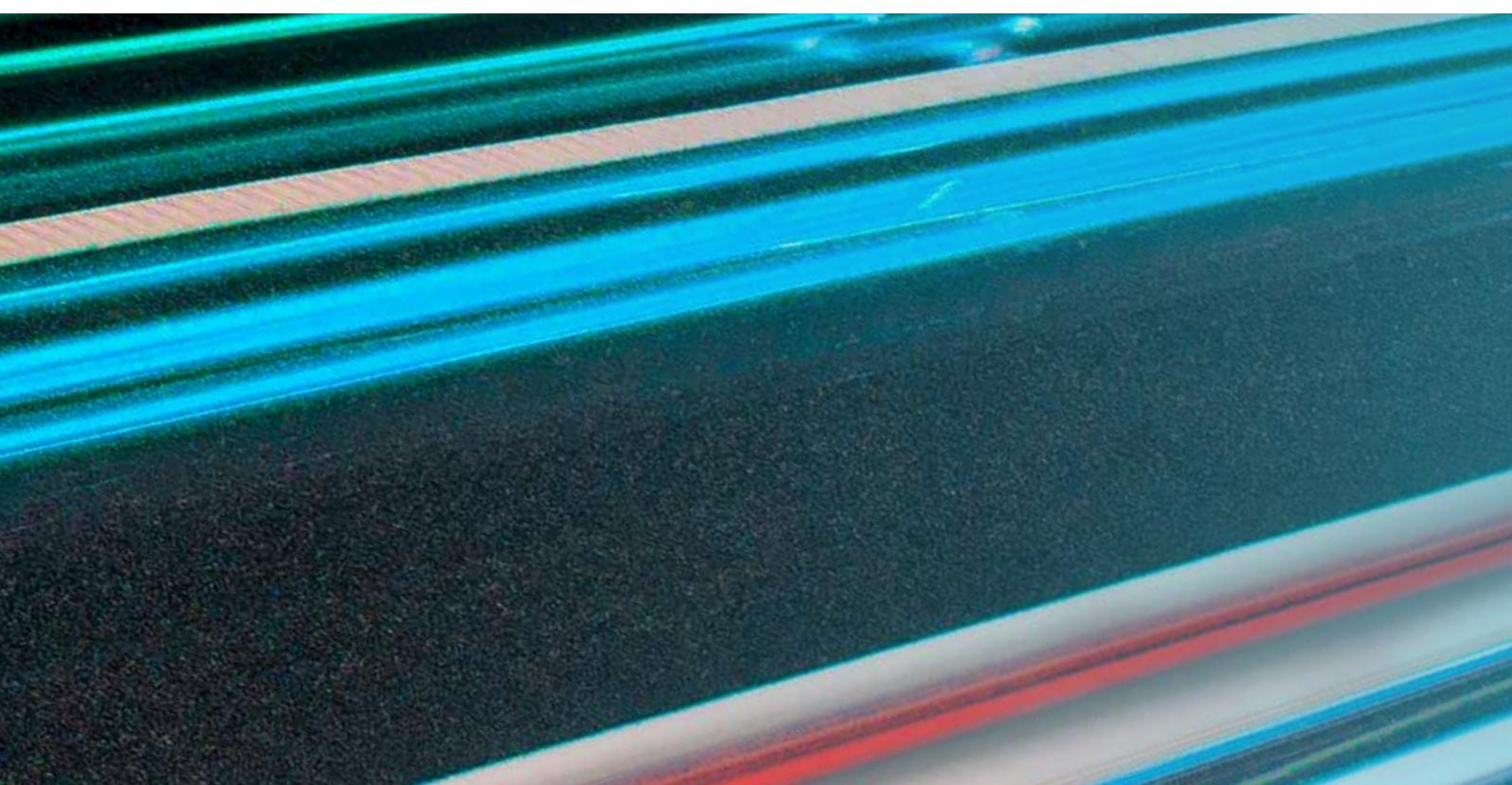
In 2019, arbitration was used as the dispute resolution mechanism in 34% of deals, marking a steady increase compared to recent previous years (2018: 33%; 2017: 29%; 2016: 25%). The current popularity of arbitration is consistent with its long-term popularity over the course of the previous nine years (2010–2018), where the use of arbitration averages 34%. The overall trend shows that arbitration is less popular in certain regions (UK, France and Benelux) than others (CEE, German-speaking and Southern European countries). In the previous nine years, the popularity of arbitration clauses has remained relatively stable within each categorised region.

CMS Trend Index



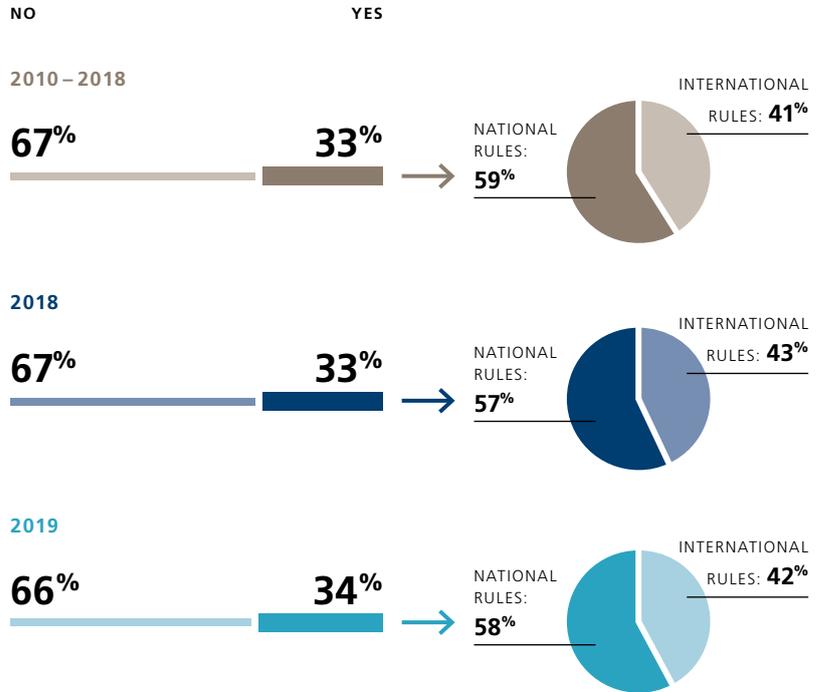
Arbitration clause ratio 2019

34% ➔



In 2019, the use of national rules to govern arbitration (58%) remained slightly more popular than the use of international rules when compared with 2018 (57%). Again, this is broadly consistent with the nine-year average of 59%.

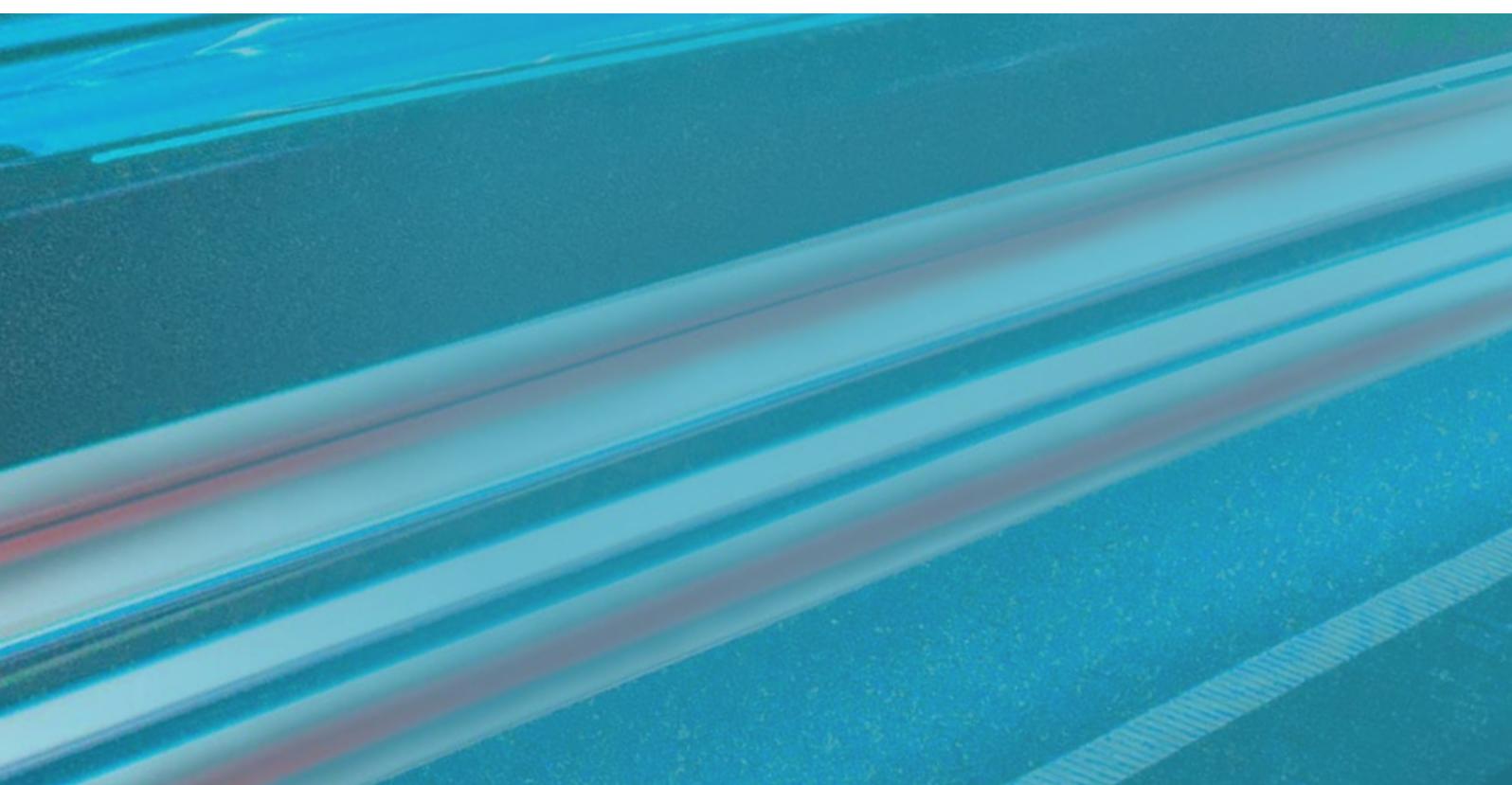
Time Trend



National rules

58% ➔

100% = all evaluated transactions



Specific Issues

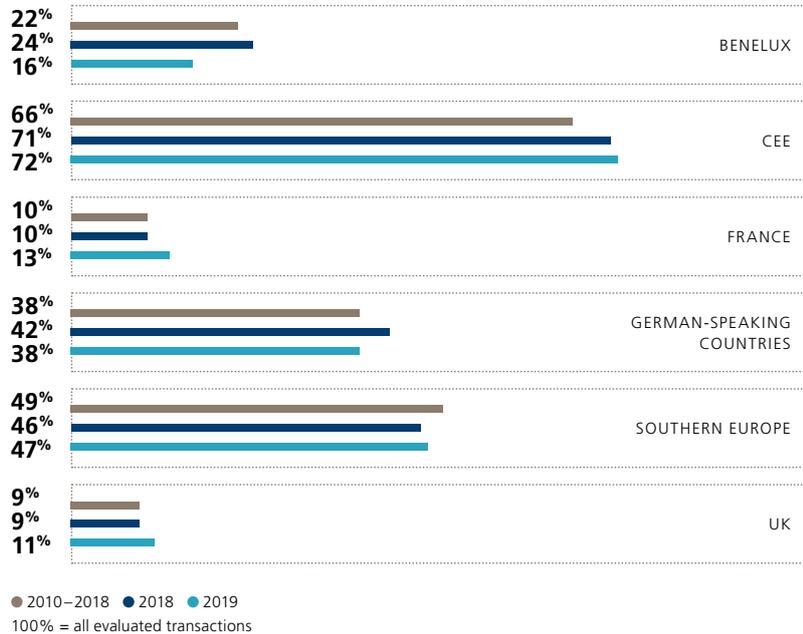
Regional Differences

In 2019, arbitration clauses remained relatively uncommon in the UK (11%) and in France (13%). Having said that, arbitration clauses gained slightly in popularity in both countries when compared with 2018 (9% in the UK and 10% in France) and with the nine-year average for 2010–2018 (9% in the UK and 10% in France).

Compared with 2018, arbitration is less popular in Benelux, featuring on 16% of deals in 2019 (24% in 2018). We saw a similar trend in the German-speaking countries, where an arbitration clause was included in 38% of transactions in 2019 in contrast to 42% in 2018.

Arbitration remained popular in CEE (72% in 2019 compared with 71% in 2018) and the Southern European countries (47% in 2019 compared with 46% in 2018).

Time Trend Europe



Arbitration clause ratio in CEE

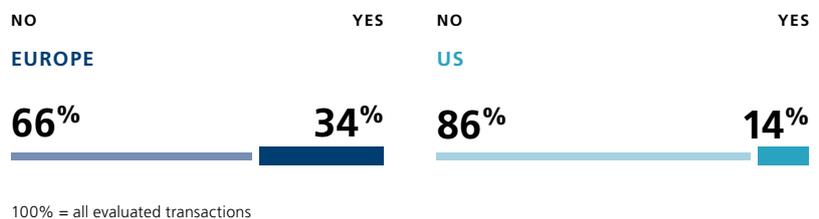
72% ➔

European/US Differences

The use of arbitration is much more popular in Europe (34%) than in the US (14%).

Compared to the US (14%), the use of arbitration is much more popular in Europe (34%)

Arbitration Clauses Europe/US



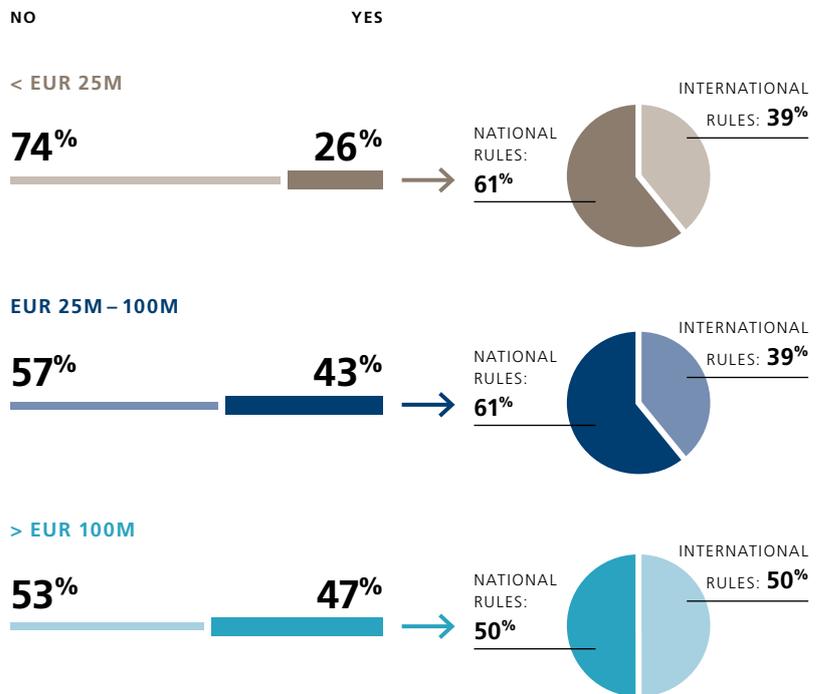
Analysis by Deal Size

In 2019, 26% of small deals contained an arbitration clause, whereas almost half (47%) of the EUR 100m plus deals contained an arbitration clause. Thus, we see that usage of arbitration clauses appears more popular on larger deals.

Whilst the application of international rules is frequently chosen for large deals (50% of EUR 100m plus deals), national rules are more likely to be selected for small and medium-size transactions (61% of EUR 25m deals and 61% of EUR 25m to EUR 100m deals).

Transaction value was still the driving factor in 2019 as to whether to choose national rules of arbitration (rather than international rules)

By Purchase Price 2019



100% = all evaluated transactions



Tax

The rationale behind a tax indemnification provision is that the buyer wants to be held harmless for pre-closing tax risks. Tax indemnities often include specific caps and time limitation periods. There are also different types of limitation periods for tax indemnity claims, namely 'absolute' limitation periods and 'relative' limitation periods. An 'absolute' limitation period bars tax claims by the buyer against the seller after a fixed date. A 'relative' limitation period is directly related to a decision by the relevant tax authority. In these cases, the limitation period (which is then usually very short) does not start until a relevant decision of a tax authority has been made.

General Overview

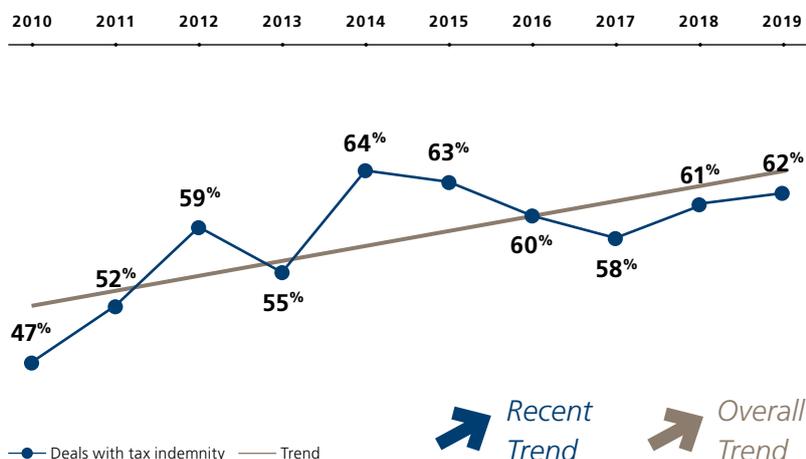
Tax indemnifications were agreed in 62% of the deals in 2019, which represents a slight increase compared with 2018 (61%) and the nine-year average (58%).

Tax indemnity 2019

62% ↗

CMS Trend Index

Tax indemnity agreed



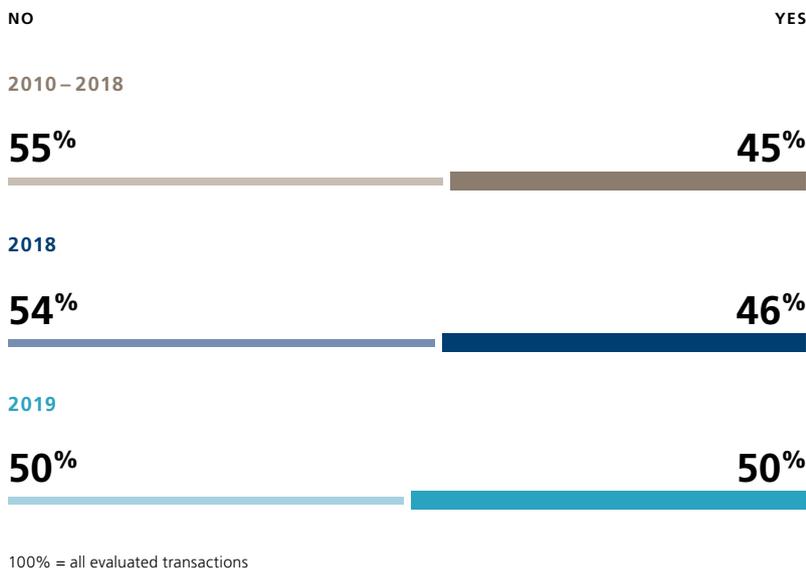
In 2019, half of the deals (50%) contained a clause granting the seller the right to participate in a future tax audit. This reflects an increase when compared with recent previous years (2017: 31% and 2018: 46%), as well as when compared with the nine-year average (2010–2018: 45%).

Sellers more often able to negotiate a participation right in future tax audits

Seller's participation right

50% ↗

Participation Right in Future Tax Audit

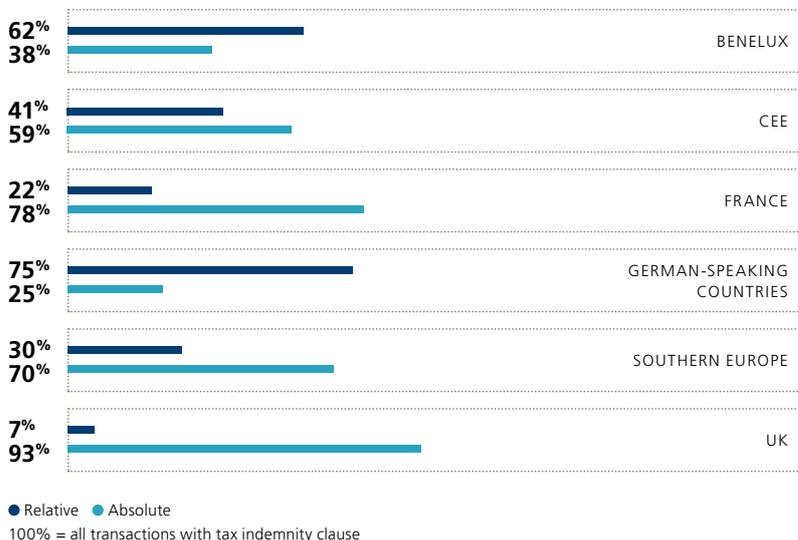


Specific Issues

Regional Differences

The clear regional differences in the use of absolute and relative limitation periods remain as in previous years. While relative limitation periods continue to prevail in the German-speaking countries (75%, 2018: 66%) and in Benelux (62%, 2018: 76), the opposite trend was seen in the UK, France, CEE and Southern Europe in 2019. Absolute limitation periods are the norm in the UK (93%, 2018: 94%), France (78%, 2018: 83%) and Southern Europe (70%, 2018: 76%). We note that the use of either absolute or relative limitation periods tends to be almost universal within each region, except in CEE, where we observed greater variation in 2019 (59%) than in 2018 (91%).

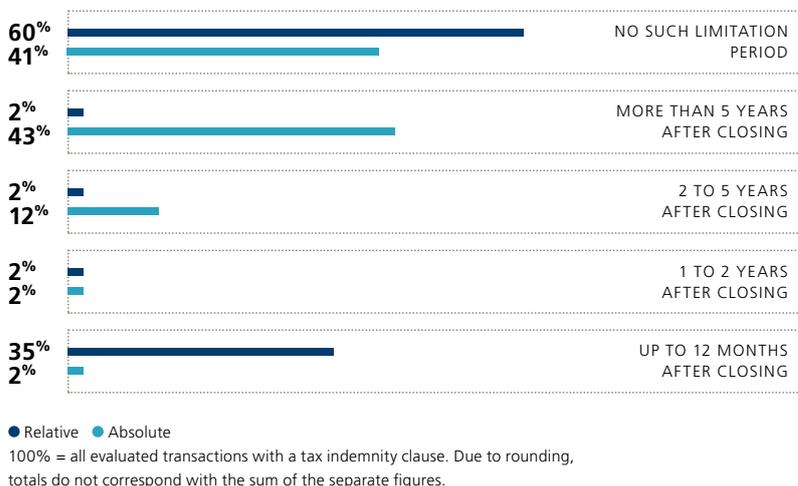
Absolute and Relative Limitation Period 2019



Type of Limitation Period

Parties who agree on an absolute limitation period tend to choose a time limitation period of more than five years after closing (2019: 43%). If the parties agree on a relative limitation period for tax indemnification, the majority choose a period of up to 12 months after the decision of the tax authority (2019: 35%).

Duration of Limitation Period



Analysis by Deal Size

In 2019, the parties agreed on tax indemnity in more deals than on a participation right in a future tax audit. Both in 2019 and in 2018, tax indemnifications were mainly agreed in medium-size deals (2019: 69% and 2018: 73%). In large deals (EUR 100m plus), tax indemnities were agreed on more frequently in 2019 (63%) when compared with 2018 (53%).

Our deal size analysis demonstrates that for medium-size deals (between EUR 25m and EUR 100m), sellers were able to preserve a participation right in proceedings started by a tax authority in 56% of deals (2018: 55%). In 2019, the seller's right to participate in proceedings was agreed on in 47% of small deals (below EUR 25m) and in 51% of large deals.

Tax indemnity

69% of deals
EUR 25m – 100m

63% of deals
> EUR 100m

Tax indemnities more common in medium-size transactions

Tax Indemnity Agreed

NO YES

< EUR 25M



EUR 25M – 100M



> EUR 100M



100% = all evaluated transactions

Participation Right in Future Tax Audit

NO YES

< EUR 25M



EUR 25M – 100M

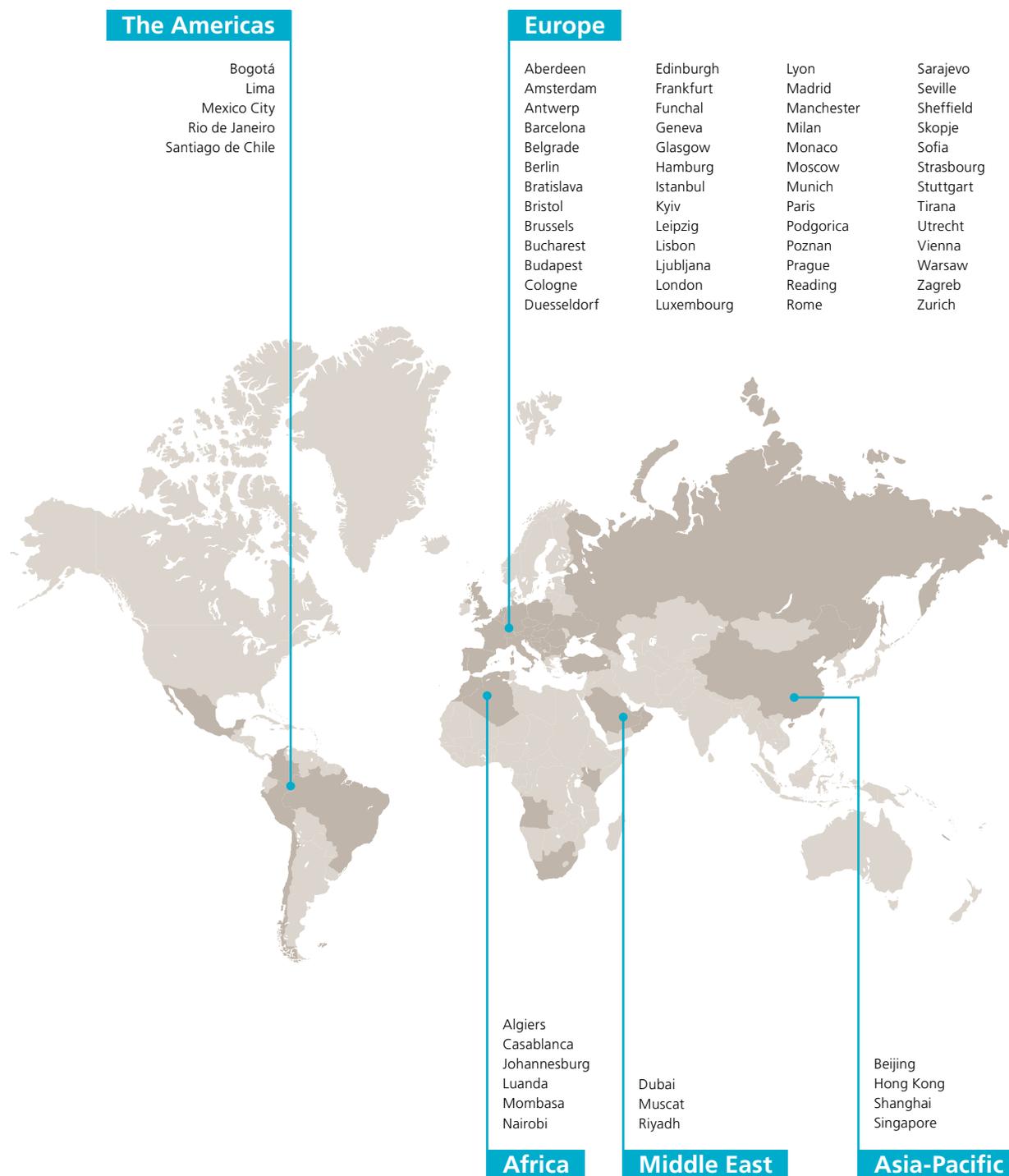


> EUR 100M



100% = all evaluated transactions with a tax indemnity clause

Where to find CMS



Our latest CMS Corporate / M&A headline deals

ABB

Advised ABB on the acquisition of all shares in Cassantec Ltd, a software company operating out of Zurich and Berlin.

Acciona

Advised Acciona on its EUR 912m acquisition of a further 10% stake in German company Nordex and the subsequent takeover bid.

Advent International

Advised Advent and its portfolio company Zentiva on the acquisition of Alvogen's CEE business.

Airbus Defence and Space

Advised on establishing a joint venture between Airbus Defence and Space and LM Industries Group (Local Motors, Inc.) to operate the microfactory called Neorizon.

ALPLA Holding

Advised Alpla Holdings on the 100% buyout of their JV partner, Zamil Group, from Zamil ALPLA, a platform comprising five factories across the UAE and KSA.

Banca Popolare di Vicenza

Advised Banca Popolare di Vicenza S.p.A. in the public bidding procedure under control of the Bank of Italy for the disposal of its subsidiary Immobiliare Stampa SC.p.A., owning an extensive portfolio of more than 200 real estate assets in six Italian regions and a platform for the provision of real estate services.

Blackstone

Advised Blackstone on the acquisition of a stake in US investment fund FRS Capital.

Colgate-Palmolive

Advised Colgate-Palmolive on its EUR 1.5bn acquisition of Laboratoires Filorga Cosmétiques.

Conzzeta

Advised Conzzeta on the sale of Schmid Rhyner Group.

CTS EVENTIM

Advised CTS EVENTIM on negotiations with FNAC DARTY on strategic ticketing partnership in France. Further, CMS advised CTS EVENTIM on all legal aspects of the acquisition of the majority stakes in Gadget Entertainment and wepromote.

Dentsu Aegis Network

Advised Dentsu Aegis Network on its acquisition of the entire share capital of B2B International Ltd.

EMS Group

Advised EMS Group on the sale of EMS-PATVAG.

Galliford Try

Advised Galliford Try on its GBP 1.1bn sale of its Linden Homes and Partnerships & Regeneration businesses to Bovis Homes.

Lone Star

Advised Lone Star on the acquisition of BASF's Construction Chemicals business for EUR 3.17bn.

OTP

Advised OTP on its strategic expansion in CEE by acquiring the local banking, financial leasing and insurance subsidiaries of Société Générale across six CEE jurisdictions.

Vattenfall

Advised Vattenfall on the acquisition of DELTA Energie from EQT.

Vivacom

Advised the sellers on the sale of Vivacom for EUR 1.2bn to United Group backed by its major shareholder, BC Partners.

Ei Group

Advised Ei Group on its GBP 3bn acquisition by Stonegate Pub Company Limited.

Eqitix and Kansai-led consortium

Advised Eqitix and Kansai-led consortium on its GBP 2bn acquisition of a 50% stake in Electricity North West.

Hermes Infrastructure

Advised Hermes Infrastructure on its EUR 900m acquisition of a 74% stake in the six shadow toll concessions in Spain from Iridium, a subsidiary of Spain-based ACS.

Mercedes-Benz Automobil AG

Advised Mercedes-Benz Automobil AG on all legal aspects of the acquisition of Austrian company "Wiesenthal Handel und Service GmbH", a total of six branch locations and the service and fleet management provider "Mo'Drive". Further, CMS advised Mercedes-Benz Automobil AG on the sale of locations in central Switzerland.

SNCF

Advised Transport Ferroviaire Holding (an affiliate of the logistic division of SNCF Group) on the acquisition of Railtraxx group, an independent Belgian railway group operating freight transport throughout Europe.

VINCI Energies

Advised VINCI Energies on the acquisition of 100% of Novabase Digital.

x+bricks and SCP Group

Advised the bidder consortium formed by x+bricks AG and SCP Group on the acquisition of real,- Group from Metro AG.

Methodology

The Study includes deals which were structured either as a share sale or an asset sale, including transactions where a seller held less than 100% of the target company's share capital, provided this represented the seller's entire shareholding in the target company. The Study also includes property transactions which involved the sale or acquisition of an operating enterprise such as a hotel, hospital, shopping centre or comparable business, and not merely a piece of land. Internal group transactions were not included in the Study. The data has been divided for comparative purposes into four European regions. The countries included in each of these regions are as follows:

- Benelux: Belgium, The Netherlands and Luxembourg
- Central and Eastern Europe (CEE): Bulgaria, Croatia, Czech Republic, Hungary, Poland, Romania, Serbia and Ukraine
- German-speaking countries: Austria, Germany and Switzerland
- Southern Europe: Italy, Spain and Portugal

France and the United Kingdom are presented as individual categories.

Transactions included in the Study cover the following sectors:

- Banking & Finance
- Hotels & Leisure
- Energy & Climate Change
- Consumer Products
- Technology, Media & Communications
- Infrastructure & Projects
- Life Sciences & Healthcare (pharmaceutical, medicinal and biotechnical products)
- Real Estate & Construction
- Industry
- Business (Other Services)

Comparative data from the US was derived from the "2018 and Q1 2019 Private Target Mergers & Acquisitions Deal Points Study" produced by the Mergers & Acquisitions Market Trends Subcommittee of the Mergers & Acquisitions Committee of the American Bar Association's Business Law Section. Due to rounding, some totals may not correspond with the sum of the separate figures.

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#1 Benelux, CEE, Europe, DACH, Germany, UK

#7 Global

Sources: Bloomberg, Mergermarket and Thomson Reuters, by deal count



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