

CMS European M&A Study 2021

Thirteenth Edition

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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 5,000 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 categorised, 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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Introduction

Welcome to the annual CMS European M&A Study. I am delighted to have been appointed as the Head of the CMS Corporate/M&A Group working alongside Co-Head Stefan Brunnschweiler. Stefan has also stepped up to the role of managing partner of CMS Switzerland.

This edition of the CMS European M&A Study covers 408 deals on which CMS offices in Europe advised in 2020. It identifies for the 13th consecutive year the key market trends and standards in legal documentation arising from the M&A transactions on which we have advised and compares these against those from the last decade. It is therefore an important and useful guide for all dealmakers. The size of the deal sample (now over 5,000 deals since 2007) and range of countries involved means that it remains a unique and valuable resource for M&A practitioners across Europe.

Last year was clearly an extraordinary one. In terms of deal-making we saw that the drop-off experienced in the early stages of the COVID-19 pandemic fell away with a solid and at times spectacular recovery in the second half of the year. Apart from the inevitable impact on deals which were delayed or did not proceed as a result, the Study indicates that the pandemic is also likely to have affected certain deal terms. It remains to be seen if this trend will continue over the longer term.

We remain cautiously positive about future deal activity in Europe. Many deal makers have adapted their processes to the 'new normal' and continue working on transactions without meeting in person. The development and roll out of numerous vaccines, a tentative return to international travel and life slowly returning to normal should encourage corporates and sponsors to look hopefully towards the future. The strength of the equity capital markets and the resilience of private equity, reportedly with 'dry powder' of more than USD 17tr, also indicates that there should be an increase in transaction volumes.

Looking forward to 2021, the area we expect to give rise to increasing focus will be the applicability and uncertainty surrounding the differing FDI regimes across Europe and beyond. The impact on M&A transactions as the regimes evolve and governments pay greater attention to investors will be substantial.

We are delighted with the continued positive feedback we have received from clients and others as to the output from this annual report and trust that this remains the same for this year's Study. We hope the CMS European M&A Study proves a valuable resource to assist you all in preparing for any contemplated transaction and serves to ensure the overall process is efficient and effective.



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CMS European M&A Study 2021

The CMS European M&A Study 2021 ('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 both non-listed public and private companies in Europe for the fourteen-year period 2007–2020. Of the 5,017 CMS transactions we analysed, 408 relate to 2020 and 3,849 relate to the period 2010–2019.

In analysing the 2020 market, we report on current market standards on risk allocation in M&A deals, comparing 2020 against 2019 and the previous ten-year average for 2010–2019. 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 2020 with that of 2019 and/or the ten-year period 2010–2019.
- **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

This Study covers 408 share and asset deals on which CMS throughout Europe advised during 2020. Unsurprisingly for a year blighted by the COVID-19 pandemic this volume represents a small decline in the number of deals we covered for 2019. We found that the pandemic led to delays, the renegotiation of key terms (including in certain cases in respect of transactions closed in prior years involving earn-outs) and, in some cases, transactions did not proceed but perhaps the disruption to the M&A market was not as severe as might have been anticipated in early April 2020.

The results of this year's survey indicate a return to more 'buyer-friendly' positions on certain deal points. This may be a result of a more risk-averse environment prevailing due to the pandemic. For example, we found that liability caps increased and limitation periods were longer and the application of *de minimis* and basket clauses flattened out. There were also fewer locked box deals and, although earn-outs did not increase in use, earn-out periods were longer. It will be interesting to see if all or any of these trends continue to apply in future years as the pandemic hopefully subsides.

Highlights

- The effect of the COVID-19 pandemic was felt primarily in the early part of the first lockdown when many deals went on hold, during which time the parties analysed what impact the pandemic was having on target businesses. Although some transactions remained on hold or were aborted, many deals did come back and successfully close albeit some with changed purchase prices or modification to key deal terms.
- In many cases the delay or failure in a transaction arose from caution from the relevant financiers. Where this did not apply, very few transactions were terminated by reference to the application of a 'material adverse change' clause. In only a few cases did the threat of the application of such a 'MAC' clause result in adjustments to the purchase price, the basis for payment or the renegotiation of earn-out provisions.
- More 'buyer-friendly' provisions applied in 2020, likely in response to the COVID-19 pandemic. For example, the level of the liability caps applying to transactions increased significantly in 2020. There were fewer deals where the cap was less than 50% of the purchase price and we saw many more deals where the liability cap was equal to the purchase price. That said, nearly half of deals featuring W&I insurance still have caps of less than 10% of the purchase price.
- Other signals of a more 'buyer-friendly' environment are as follows: The use of locked box transactions declined slightly. *De minimis* and basket provisions flattened out so that they apply in just under three-quarters of the transactions covered. Earn-out periods were longer. Limitation periods settled at around 18 to 24 months, although there was an increase in periods of more than 24 months.
- Overall, the use of W&I insurance in European transactions dropped off slightly in 2020 compared to 2019, significantly so in the UK, although it remains relatively prevalent on larger transactions. We suspect this drop in use will not be a continuing medium to long term trend as W&I insurance brokers report that enquiry levels at the end of 2020 were significantly high.
- As regards security for warranty claims, the decline in the use of escrow accounts and a corresponding increase in more straightforward price retentions has continued. This may be driven by a desire to avoid the cost and complexity of an escrow arrangement or may mark a change in market sentiment.
- We saw a modest increase in the use of legal technology tools, principally for document automation, but this still represents a minority of deals when adopted. Although we anticipate such use will continue to grow there remains some way to go before it is of universal application.

Key conclusions

2020 results at a glance

CMS Trend Index

	2010–2019	2019	2020
DEALS WITH PURCHASE PRICE ADJUSTMENT	45%	45%	44%
DEALS WITH A LOCKED BOX (WHERE NO PURCHASE PRICE ADJUSTMENT)	48%	56%	51%
EARN-OUTS	19%	21%	21%
— SHORT EARN-OUTS (12 MONTHS OR LESS)	24%	23%	24%
— LONG EARN-OUTS (36 MONTHS OR MORE)	22%	17%	26%
— EBIT/EBITDA-BASED EARN-OUTS	41%	39%	46%
— TURNOVER-BASED EARN-OUTS	32%	40%	31%
<i>DE MINIMIS</i>	70%*	73%	74%
BASKET	66%	66%	68%
— LOWER BASKET (LESS THAN 1% OF PRICE)	57%*	62%	58%
— HIGHER BASKETS (MORE THAN 1.5% OF PRICE)	27%*	23%	25%
— FIRST DOLLAR RECOVERY	78%	80%	82%
LIABILITY CAPS			
— NO CAPS	14%	10%	12%
— LESS THAN 50% OF PRICE	55%	58%	49%
— LESS THAN 10% OF PRICE	13%	16%	16%
LIMITATION PERIODS			
— 12–18 MONTHS	33%	33%	30%
— 12–24 MONTHS	65%	69%	66%
— MORE THAN 24 MONTHS	22%	19%	23%
SECURITY FOR WARRANTY CLAIMS	32%	33%	29%
— RETENTION FROM PRICE	29%	31%	32%
— ESCROW ACCOUNT	58%	54%	48%
MAC CLAUSE	15%	16%	15%
ARBITRATION CLAUSE	33%	34%	32%
— APPLICABILITY OF INTERNATIONAL RULES RATHER THAN NATIONAL RULES	41%	42%	33%

* Data only available for 2019 (2011–2019)

Purchase price adjustments –

In 2020 there was a small decline in the use of purchase price adjustment clauses in M&A agreements (44% compared with 45% for 2019). This seems to reflect a levelling off in the application of such provisions over the last three years and reflects a decrease from the high of 49% in 2015. This may suggest that parties to M&A transactions are seeking more certainty as to the amount of the purchase price when signing the transaction documentation.

Locked box – As with PPA provisions there was a slight decrease in the use of locked box arrangements for non-PPA transactions (51% in 2020 compared with 56% in 2019). However, the overall upward trend for the application of a locked box continues, particularly when compared against the average usage of 48% for the period 2010–2019.

Earn-outs – With the impact of the COVID-19 pandemic we were anticipating some increase in the use of earn-outs, however our statistics show overall there was little change, at 21% of deals. The position remains above the average level over the last decade but earn-outs remain less popular than is the case in the US. Perhaps 2021 will see the increase we expect as deals originated and negotiated during the pandemic are transacted.

Warranty & Indemnity insurance –

The year-on-year rise in popularity of W&I insurance dropped off in 2020 by 2% (down to 17%) and most significantly so in the UK. Even so, it remains the case that on almost half of CMS' large transactions (EUR 100m and more), W&I insurance was used.

De minimis – This year’s Study shows a flattening of the number of European transactions which include a *de minimis* clause at 74%, representing a continuation of the trend over the last three years. It also represents a slight increase to the percentage in 2019 at 73%. We continue to think this demonstrates that a *de minimis* is the predominant market norm across most European jurisdictions.

Baskets – There was a slight increase in the application of baskets in European transactions at 68% for 2020 compared with 66% for 2019, which broadly represents the average for the years since 2017. This level may reflect the use of W&I insurance, where the basket may not be as relevant if 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 (returning to the more recent average of 74% compared to 68%).

Liability caps – In 2020 we saw many more deals with liability caps equal to the purchase price. We also saw a big decrease in the number of deals with a liability cap of less than 50% of the purchase price, down to 49% from highs of 60% in 2017 and 58% in each of 2015, 2016, 2018 and 2019. The amounts of those caps are however subject to significant variation depending on deal size and, most significantly, to whether W&I insurance cover applies to the transaction. For example, 51% of transactions with W&I insurance have caps of less than 10% of the purchase price as compared with just 10% of deals without W&I insurance.

Limitation periods – Buyers were able to achieve longer limitation periods in 2020, marking a shift to more ‘buyer-friendly’ positions in this area. This is demonstrated by the growth in use of longer (24 months or more) limitation periods (23% of deals – up 4%) and a corresponding 4% reduction in the number of shorter periods (18 months or less). This seems to have been a development both generally and also significantly on medium sized and large deals, where in previous years limitation periods had tended to be shorter.

Security for warranty claims – With more ‘buyer-friendly’ deal terms elsewhere, it is perhaps surprising that there was a fall in the use of security in 2020; down 4% to 29% of deals. Whilst escrow accounts remained the most popular form of security, their popularity continued to fall in 2020 – down to 48% compared to 54% in 2019 and below the ten-year average of 2010–2019 (58%). There was a corresponding increase in simple retentions/holdbacks from the purchase price with parties perhaps preferring to avoid the complexity and cost of establishing an escrow account.

MAC clauses – Any anticipated increase in deals involving MAC clauses as a consequence of the pandemic did not occur as the percentage of deals involving a MAC fell 1% to 15%, a figure consistent with the previous ten-year average.

Arbitration – In 2020 arbitration was used as the dispute resolution mechanism in 32% of deals, marking a 2% decrease compared to 2019. This is however generally consistent with its long-term popularity over the course of the previous ten years (2010–2019), where the average is 34%. Arbitration was less popular in certain regions (UK, France and Benelux) than others (CEE, German-speaking and Southern European countries) albeit over the past decade the popularity of arbitration has remained relatively stable within each such region.

Tax – Tax indemnities were agreed in 61% of deals in 2020. Whilst this is slightly higher than the ten-year average (59%) it does seem to reflect a levelling off in the application of such indemnifications over the past years and reflects a slight decrease from the high of 64% in 2014.



Deal drivers

Main deal drivers 2020

ENTRY INTO NEW MARKETS	45%
ACQUISITION OF KNOW-HOW (WITHOUT ACQUI-HIRE TRANSACTIONS)	17%
ACQUISITION OF A TEAM OF EMPLOYEES (I.E. ACQUI-HIRE TRANSACTIONS)	14%
ACQUISITION OF A COMPETITOR	22%
ACQUISITION OF A SUPPLIER	6%
DIGITALISATION	2%
OTHER	24%

Main deal drivers 2018–2020

	2018–2019	2019	2020
ENTRY INTO NEW MARKETS	45%	46%	45%
ACQUISITION OF KNOW-HOW (WITHOUT ACQUI-HIRE TRANSACTIONS)	22%	25%	17%
ACQUISITION OF A TEAM OF EMPLOYEES (I.E. ACQUI-HIRE TRANSACTIONS)	15%	16%	14%
ACQUISITION OF A COMPETITOR	24%	20%	22%
ACQUISITION OF A SUPPLIER	6%	3%	6%
DIGITALISATION	2%	1%	2%
OTHER	23%	25%	24%

This year's study again sought to identify the main deal drivers for each relevant transaction. We found a broadly consistent result to previous years with most deals seeing a buyer wishing to enter a new market, which will often be the case for PE-backed purchasers.

The details for 2020 were as follows:

- 45% of the deals covered represented the entry into a new market by the purchaser
- 31% of all deals were either the acquisition of know-how or acqui-hire transactions
- 22% of the deals were the acquisition of a competitor.

The proportion of new entry and know-how/acqui-hire transactions appears to have levelled off, after having seen a significant increase from 2018 (32% and 23% respectively). It remains of note that a consistent 24% of our deals had other unknown drivers, again demonstrating the variety of underlying reasons for entering into M&A transactions.



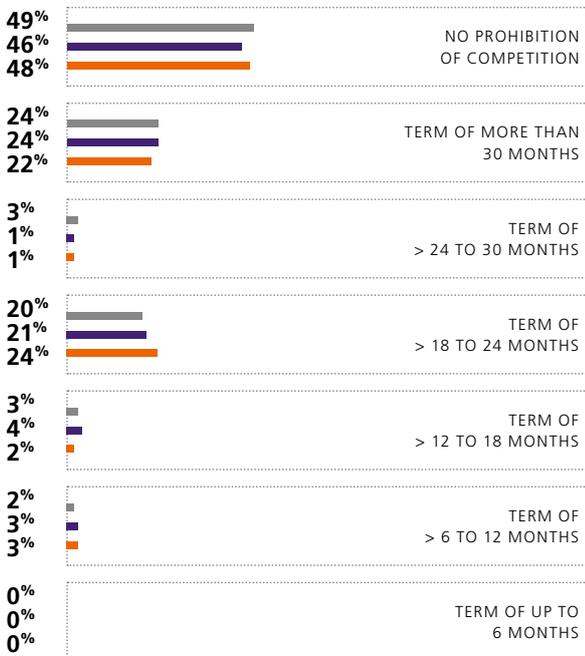
Non-compete provisions

Non-compete clauses which restrict the post-completion activities of the seller seek to ensure the buyer receives the full 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 issues. This is demonstrated from the Study's finding that the duration of non-compete clauses has remained very static over the period with the most

common restrictive periods being for either two years or for more than 30 months. There was a significant increase in the application of more than 30 months in the Benelux countries (up to 72%), in France (up to 59%) and the German-speaking countries (up to 65%), whereas in the UK there was a significant decline in their use (down to 45% of all deals).

Non-compete

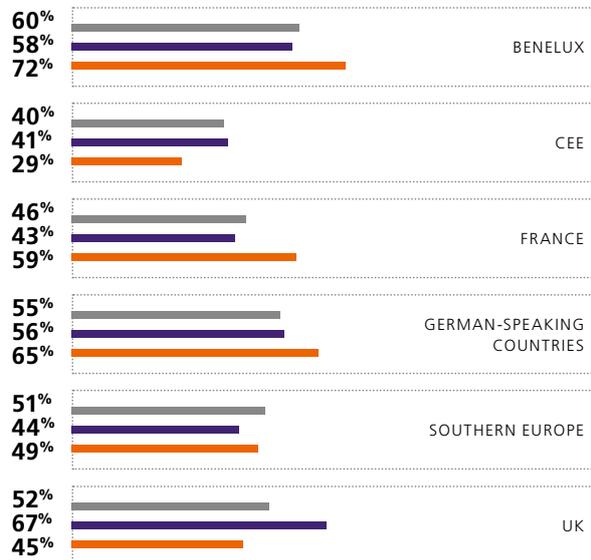
Duration of non-compete clauses 2010–2020



● 2010–2019 ● 2019 ● 2020
100% = all evaluated transactions

Non-compete

Deals containing a non-compete clause and term of more than 30 months 2010–2020



● 2010–2019 ● 2019 ● 2020
100% = all evaluated transactions

Warranty coverage

In this year's Study we repeated our enquiries as to the nature of the warranty cover included in the transaction agreements. As with last year, 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 about 75% or more of all agreements on which we have advised. Specific warranties about the target's profitability and its pensions position are however much less usual (50%) and very few agreements only contain title and capacity warranties (7%).

Warranties/Limitations of liability

Warranties Used 2020

ONLY TITLE AND CAPACITY WARRANTIES	7%
WARRANTIES REGARDING THE TARGET'S FINANCIAL STATEMENTS	77%
COMPLIANCE WARRANTY	79%
OPERATIONAL WARRANTIES	74%
WARRANTIES WITH REGARD TO CONDUCT OF BUSINESS	74%
WARRANTIES WITH REGARD TO PENSION SCHEMES	50%
WARRANTY REGARDING THE TARGET'S FINANCIAL SITUATION	47%

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

CMS European/US risk allocation comparison

In the years CMS has produced this Study, the difference in US and European M&A market practice has been consistent. Up until 2020, Europe probably would be regarded as having more 'seller-friendly' provisions whereas in the US, on the same topics, more 'buyer-friendly' positions are common. Overall, despite the COVID-19 pandemic having triggered some shift in favour of the buyer in Europe, the same differences remain.

One point to note, however, is that the Study has always used the data and analysis for US deals from the most recent ABA study which, for this year, remains the report looking at deals signed in 2018 and Q1 2019 and so does not cover the period impacted by the pandemic. Therefore, whilst this section continues to compare the available data, this year we have sense checked the US position with our contacts in the M&A community in America, who have alerted us to the SRS Acquiom M&A Deal Terms Study, which we may adopt in future years as it appears to be published annually.

- Market practice in Europe relating to purchase price adjustments (PPAs) has remained consistently in the 44–45% range for the past three years. This is a noticeable difference to US deals where a PPA features in almost all deals (95%).
- Working capital adjustments are the most frequently used component of a PPA in the US (92% of the deals involving a PPA); however, European deals in 2020 continue to demonstrate a greater variety on the components of a PPA with cash and debt only adjustments continuing to be most popular ahead of working capital (48% to 38%), although often both cash/debt and working capital adjustments are used.
- The frequency of earn-outs has remained largely the same over the past years. They feature more often in the US (27%) than in Europe (21%). We had anticipated that given the COVID-19 pandemic, earn-outs would have gained in popularity, but the data indicates there was little change.
- In European earn-outs, EBIT/EBITDA has again become significantly the most popular metric on which to determine the earn-out (up to 46% from 39% and nearly 61% on deals with a value of between EUR 25m and 100m). In the US it is also the most popular metric but only marginally ahead of turnover (31% to 29%).
- A *de minimis* financial limitation is seen in almost three-quarters of deals in Europe (74%, up 1% from 2019), but it remains less common in the US (only used in 39% of deals). Given the prevalence of 'excess only' baskets in the US it may be considered that the requirement for an additional financial limitation is not as necessary.
- The existence of a basket financial limitation occurs in almost all deals in the US (97%), compared to 68% on European deals (an increase of 2% since last year). 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 2020 such a feature occurred just 18% of the time on European deals involving a basket. In contrast, in Europe we more consistently experience 'first dollar' baskets (once the threshold is met, the buyer can recover from the first dollar of damage), although there can be significant differences between European regions (e.g. in 2020, in the UK 99% of baskets operate from the 'first dollar' whilst in the Southern European countries 'excess only' baskets jumped in use to 68%).
- How often have you heard a lawyer confidently state that a basket of 1% of the price is 'market practice'? It happens a lot. But the data would suggest otherwise. In the US, whilst 97% of deals that were analysed involved a basket of 1% or less this was made up of 63% at 0.5% or less and 34% between 0.5% and 1%. In Europe there is even greater variety, 27% at 0.5% or less and 31% between 0.5% and 1% of the purchase price. Significantly in Europe 17% of deals involved a basket of 2% or higher whereas in the US the equivalent percentage was 0%.
- 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 39% of European deals (this is a 4% reduction from 2019's figures). We are informed that many deals in the US are now being structured so that sellers do not have any liability for breaches of non-fundamental warranties (as is often the case on European deals involving W&I insurance). In the past, sellers would be responsible for 50% of the retention amount under the RWI insurance.



- A MAC clause is almost always a feature on a US deal (97%). It is far less common in European deals (only 15%).
- 83% of US deals involve some form of security for claims whether that be in the form of a cash escrow, a holdback or set-off from earn-out. This may be set at an amount between 7 to 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, the existence of forms of security for warranty claims reduced by 4% in 2020 to 29% of deals and tends to be a technique that is reserved for specific issues identified during the deal rather than featuring as a matter of course. In Europe, escrow accounts rarely operate as the exclusive recourse to satisfy claims.
- There has been an explosion of popularity in W&I insurance in the US and, as a result (so we are informed) the liability caps and baskets are becoming more seller favourable. The last ABA Study reported that over half of the deals analysed involved W&I insurance (or RWI insurance as it is known in the US) and anecdotally we understand that may have increased in 2020. The equivalent figure demonstrated by CMS deals throughout Europe shrunk 2% this year to 17%.

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

"Similar to Europe, the US market faced a reduction in deal flow but saw an earlier recovery and a surge in enquiries for W&I insurance over October, November and December 2020. To illustrate the surge, one of the leading carriers in the US reported a record December where they bound over 125 W&I insurance policies. The claims volumes experienced in the US market have resulted in an upward adjustment of over 15% to premium rates and also an increased focus on certain aspects of risk where claim trends have been seen. The pricing increase appears to have had minimal impact to interest and our data is showing regular increases in enquiry volumes."

The table below sets out a quick reference 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	15%	97%
SECURITY FOR CLAIMS	29%	83%
W&I INSURANCE USED	17%	52%

CMS deal size analysis

The Study divides deals into 'small', 'medium' and 'large' as below and highlights differences in deal terms between them.

- Deals with values of up to EUR 25m are the smaller deals;
- Deals with values of between EUR 25m and EUR 100m we call medium sized deals; and
- Deals with values over EUR 100m are the large deals.

The chart below shows the highlights for 2020.

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

- Purchase price adjustments (PPAs) appear more frequently on large deals (53%) and medium sized deals (54%) and the percentages for each have increased whilst the use of PPAs on smaller deals

dropped to 39%. This would appear consistent with our expectation that given the turbulence the COVID-19 pandemic has caused in the economy, buyers will want greater ability to check the correct price is being paid.

- There has been a corresponding, and expected, drop in the popularity of locked box structures for both large deals (85% to 52%) and medium sized deals (less significantly to 60%) which is likely due to a lack of buyer confidence in locked box balance sheets prepared as at a date prior to the period affected by the pandemic and thus a lack of confidence in balance sheets reflecting a true and fair view of the target's financial situation after the start of the pandemic.
- Continuing the trend from prior years, earn-outs are rare on larger deals (only 13%). There was, however, a pronounced change in the duration of those earn-outs in 2020. 75% of the earn-outs on large deals were of a period between 6 to 24 months and we saw a corresponding fall in the number of longer earn-out periods (from 38% to 25%).

2020 results at a glance

Deal size comparison

	< EUR 25M	EUR 25M – 100M	> EUR 100M
PURCHASE PRICE ADJUSTMENT (PPA)	39%	54%	53%
LOCKED BOX (NO PPA)	48%	60%	52%
EARN-OUTS	20%	27%	13%
SHORT EARN-OUTS (12 MONTHS OR LESS)	23%	21%	50%
LONG EARN-OUTS (MORE THAN 36 MONTHS)	21%	36%	25%
EBIT/EBITDA-BASED EARN-OUTS	40%	61%	33%
TURNOVER-BASED EARN-OUTS	36%	25%	17%
LIABILITY CAP (LESS THAN 10% OF PRICE)	10%	29%	26%
LIABILITY CAP (LESS THAN 25% OF PRICE)	28%	48%	39%
W&I INSURANCE USAGE	8%	29%	48%
LIMITATION PERIOD (OF MORE THAN 24 MONTHS)	23%	24%	18%
SECURITY FOR WARRANTY CLAIMS	29%	31%	27%
ESCROW ACCOUNT (IF SECURITY FOR WARRANTY CLAIMS IS AGREED)	45%	56%	42%
MAC CLAUSE	13%	22%	13%
ARBITRATION	25%	47%	36%
TAX INDEMNITY CLAUSE	58%	68%	60%



- There has been a change in respect of earn-out metrics across all deal sizes with EBIT/EBITDA returning to being the most popular criterion on which earn-outs were calculated – particularly on the medium sized deals (at 61%).
 - Whilst the Study continues to point towards medium sized and large deals having lower liability caps (in percentage terms) it is significant that in 2020 purchase price caps on medium sized and large deals rose in their use (to 31%), reflecting perhaps a shift to a buyer’s market on this most key financial limitation.
 - The popularity of W&I insurance appeared to level off in 2020 with the percentage levels across smaller deals, medium sized and large transactions broadly equivalent to those seen in 2019. It is still used frequently on large deals.
 - Whilst time limitation periods to bring warranty claims tend to be shorter for larger transactions, the frequency of longer limitation periods (e.g. more than 24 months) for medium sized and large deals in 2020 is significantly higher than the average over the past decade – again highlighting a switch to a more ‘buyer-friendly’ market on this point.
 - Across all deals the overall frequency of security constructs remained broadly the same in 2020; however, there were differences across deal sizes with the popularity of security dropping from 34% on both the smaller (to 29%) and medium sized (to 31%), deals whilst there was an increase on the large deals (increasing to 27% from 24%). There was a significant fall in the use of escrow accounts on the large deals (down to 42% of deals involving security from 63%).
- Our conclusions from this data include the following:
- The modest growth in use of PPAs, longer earn-out periods and drop in locked box structures on larger deals suggests that the desire to fix the price at closing has been overtaken by the parties’ wish for pricing structures which enable them to revisit the position after closing – a likely outcome of the pandemic.
 - In terms of risk allocation, there also appears to have been a shift to ‘buyer-friendly’ terms in respect of liability caps, security and limitation periods on the more significant sized transactions.
 - With fewer deals overall and arguably more smaller deals in value terms in the market, there has been a levelling off in the surge of W&I insurance although its frequency of use remains broadly equivalent in terms of deal sizes to prior years (i.e. significant usage on large deals).

CMS European regional differences

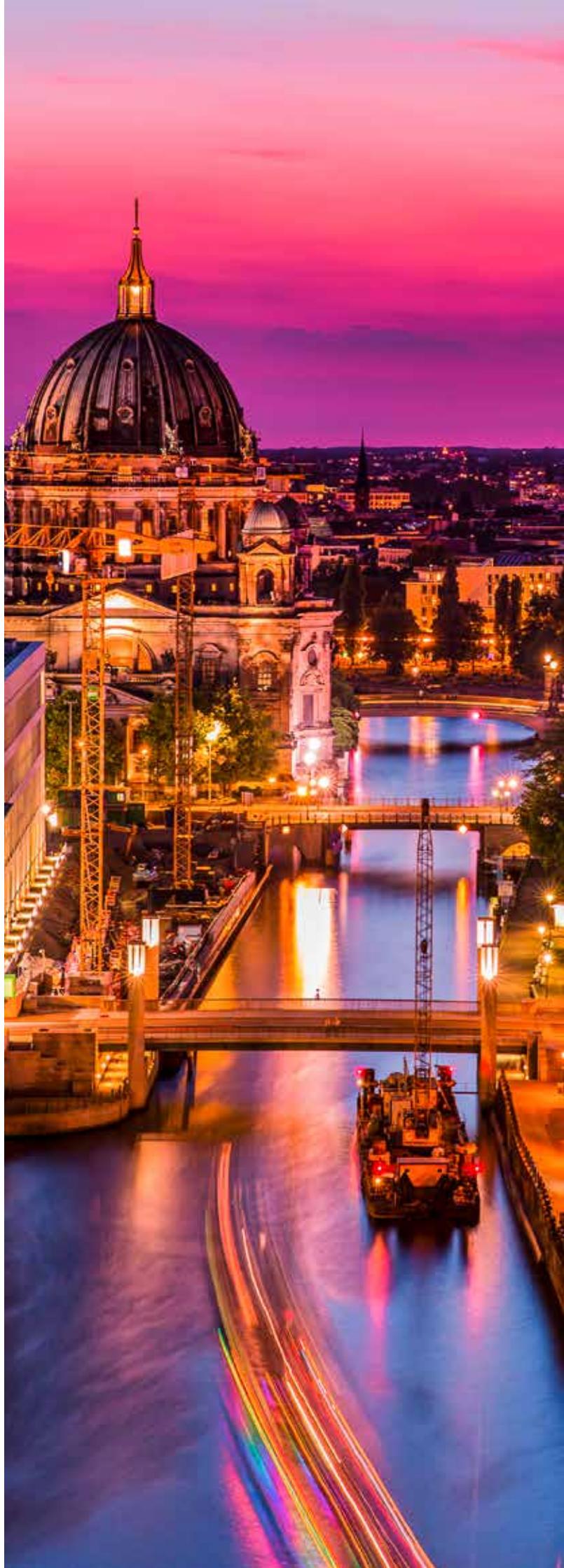
We continue to see marked differences in market practice on certain deal metrics between the European regions:

- France and the Benelux countries have the fewest deals with a purchase price adjustment.
- Locked boxes and earn outs have dropped off significantly in the UK but not in other European countries.
- A 'first dollar' basket is relatively uncommon in the Southern European countries and France.
- CEE and the Southern European countries have significantly higher liability caps particularly in comparison to France and the German-speaking countries.
- The take-up of W&I insurance cover remains low in France, Benelux and the Southern European countries and has dropped off significantly in the UK.
- Limitation periods for warranty claims are much longer in CEE, France and the Southern European countries.
- Data room disclosure has limited application in France and the Southern European countries but is accepted by buyers the majority of the time in Benelux, CEE, the German-speaking countries and the UK.
- Escrow accounts are rarely used in the UK and the German-speaking countries but are relatively popular in the Benelux countries.
- The use of MAC clauses has dropped off in the UK and the Benelux countries but remains high in the CEE and Southern European countries.

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

In Benelux:

- PPA provisions decreased: there was a significant decline in the application of PPA clauses in the Benelux countries with only 34% of transactions including a PPA compared with 53% in 2019 and behind the European average of 44% of such transactions.
- Data room disclosure: there was a big increase in the acceptance of general disclosure of the data room for transactions in the Benelux countries with this concept applying in 69% of such transactions compared with 53% in 2019.



In CEE:

- Earn-outs more frequently used: there was a large increase in the use of earn-outs in the CEE in 2020 with 20% of transactions including such a provision compared with 8% in 2019 and more in line with the European average of 21% for earn-out transactions.
- Liability caps have increased: in 2020 67% of transactions in the CEE countries had a liability cap of more than 50% of the purchase price, which was a big increase from the previous year at 47% and is some way ahead of the European average of 36%.
- Limitation periods are longer in the CEE region: in 2020 49% of CEE transactions had a warranty limitation period of more than 24 months, which was an increase from the previous year of 36% compared with the average of 23% of all European transactions with such long warranty periods.
- Arbitration clauses remain common in CEE: in 2020 70% of CEE deals included an arbitration clause and this is some way ahead of the European average where only 32% of relevant deals include such a clause.

In German-speaking countries:

- First dollar baskets: the use of first dollar basket provisions in German-speaking transactions rose in 2020 to 84% of such deals from 69% in 2019, which is somewhat consistent with the European average of 82% for last year.
- Data room disclosure: there was a big increase in the acceptance of general disclosure in the data room for transactions in the German-speaking countries with this concept applying in 67% of such transactions compared with 54% in 2019.
- Escrow accounts: there was a decline in the use of escrow accounts as security for warranty claims for transactions in the German-speaking countries, with such provisions only applying in 11% of transactions, a drop from 20% in 2019.

In France:

- PPAs are least applied in France: the application of PPA provisions for French transactions remains lower than the European average at 36% for 2020 although this is an increase from the previous year but less than the European average of 44% for the same period.
- Earn-outs more frequently used: there was an increase in the use of earn-outs in France in 2020 with 14% of transactions including such a provision compared with 8% in 2019, but still less than the European average of 21% for earn-out transactions.

- Liability caps have decreased: in 2020 only 24% of transactions in France had a liability cap of more than 50% of the purchase price, which was a big drop from the previous year at 49% and is below the European average of 36%.
- Limitation periods are longer in France: in 2020 53% of French transactions had a warranty limitation period of more than 24 months, which was itself an increase from the previous year at 31% and compared with the European average of only 23% for such warranty periods.

In Southern Europe:

- *De minimis* provisions have increased: in 2020 58% of transactions in Southern Europe included a *de minimis* as compared to 40% in 2019 and the average of 48% for the period 2010–2019, but behind the average of 74% for the whole of Europe.
- Basket provisions have increased: in 2020 some 50% of transactions in Southern Europe included a basket, a big increase from 33% in 2019 but when included only 32% were 'first dollar' baskets compared to 69% in the respect of the previous year.
- Liability caps have increased: in 2020 76% of transactions in the Southern European countries had a liability cap of more than 50% of the purchase price, which was a big increase from the previous year at 56% and is some way ahead of the European average of 36%.

In the United Kingdom:

- Locked box use declines: for UK transactions in 2020 without a PPA a locked box structure was applied in only 30% of those transactions, which was a significant decline from the previous year's level of 61%.
- W&I insurance decreased in the UK: in 2020 27% of all reported transactions had some element of W&I cover, which was a decrease from 37% in 2019 but is still ahead of the other European regions, which range from 5% to 20% 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 a massive 99% of transactions in 2020, which is some way ahead of the equivalent European average of 80%.
- Escrow accounts: there was a decline in the use of escrow accounts as security for warranty claims for transactions in the UK with such provisions only applying in 11% of transactions, a drop from 17% in 2019.



Key messages

This Study covers more than 400 deals on which the CMS offices in Europe advised in 2020. This volume is marginally behind the number of deals covered for 2019 and to some extent is a statement of the resilience of the M&A market notwithstanding the concerns associated with the COVID-19 pandemic.

We remain cautiously positive about future deal activity in Europe. The development and roll out of numerous vaccines, a tentative return to international travel and life slowly returning to normal should encourage corporates and sponsors to look hopefully towards the future. The strength of the equity capital markets and private equity indicates that there should be an up-tick in transaction volumes.

This unique and valuable report, particularly given the size of the deal sample (over 5,000 deals since 2007) 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.

We found the COVID-19 pandemic initially led to delays, the renegotiation of key terms and, in some cases, transactions did not proceed. The Study also indicates more 'buyer-friendly' provisions applied in certain areas. This may be as a result of a more risk-averse environment prevailing. For example, we found that liability caps increased and limitation periods were longer. It will be interesting to see if these trends continue to apply in future years.

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.

The Study demonstrates some new market trends. The application of W&I insurance to European transactions dropped off slightly in 2020, significantly so in the UK. We saw many more deals where the liability cap was equal to the purchase price. The use of purchase price adjustment clauses and locked box transactions declined. *De minimis* and basket provisions flattened out. Limitation periods have settled at around 18 to 24 months, although there was an increase in periods of greater than 24 months.



Purchase price adjustment (PPA)/Locked box

Purchase price adjustment (PPA) clauses in M&A agreements are designed to ensure the correct amount is finally payable by the buyer for the target business. Adjustment can be by reference in its simplest form to the target company's debt-free/cash-free position at completion or to its working capital or overall net asset position at completion. The final purchase price therefore reflects the actual debt/cash, working capital or net asset position at completion.

PPA provisions may result in uncertainty as to the final purchase price at the time of signing. Several months or even years may elapse before the price is agreed or determined. Some parties may regard this as unhelpful or impractical and therefore include a locked box clause to avoid any requirement to adjust the price after completion. The seller thereby merely warrants the accuracy of an agreed balance sheet and covenants that there are no leakage payments (e.g. dividends and management charges) from the target.

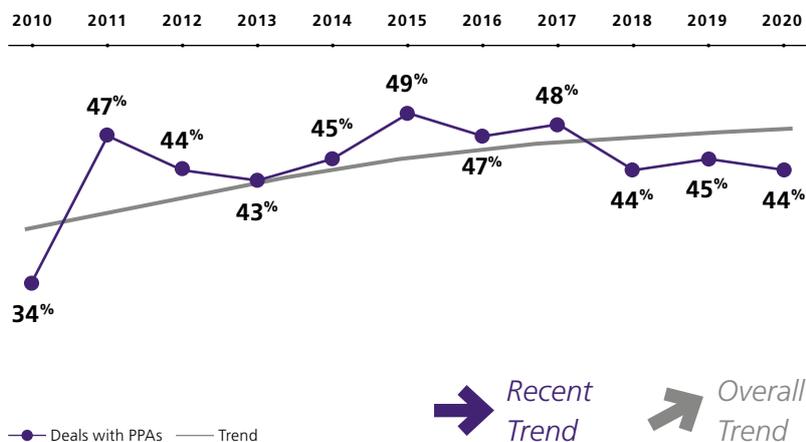
General Overview

In 2020 there was a small decline in the use of purchase price adjustment clauses in M&A agreements (44% compared with 45% for 2019). This seems to reflect a levelling off in the application of such provisions over the last three years and reflects a decrease from the high of 49% in 2015. This may suggest that parties to M&A transactions are seeking 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 (51% in 2020 compared with 56% in 2019). However, the overall upward trend for the application of a locked box continues, particularly when compared against the average usage of 48% for the period 2010–2019.

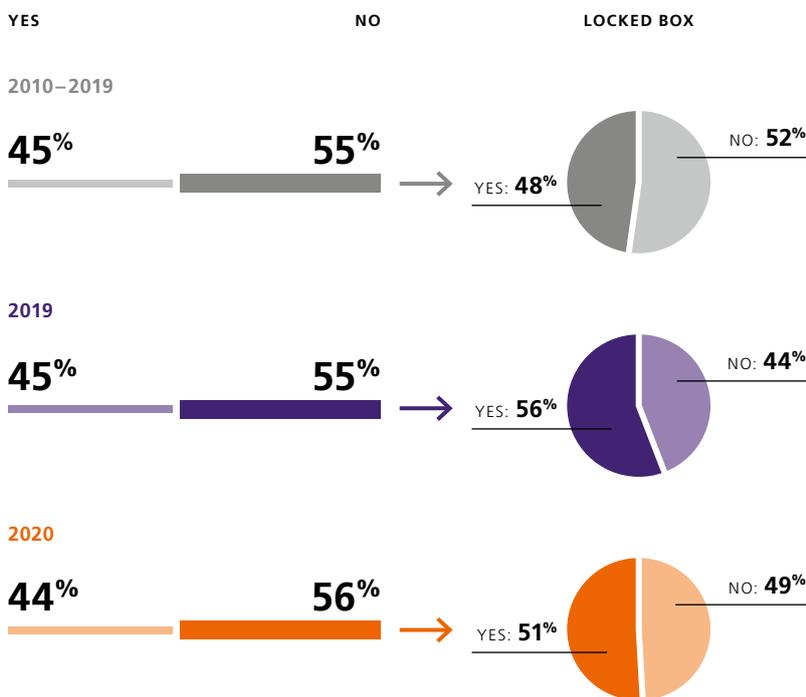
PPA ratio 2020

44% →

CMS Trend Index



Purchase Price Adjustment 2010–2020



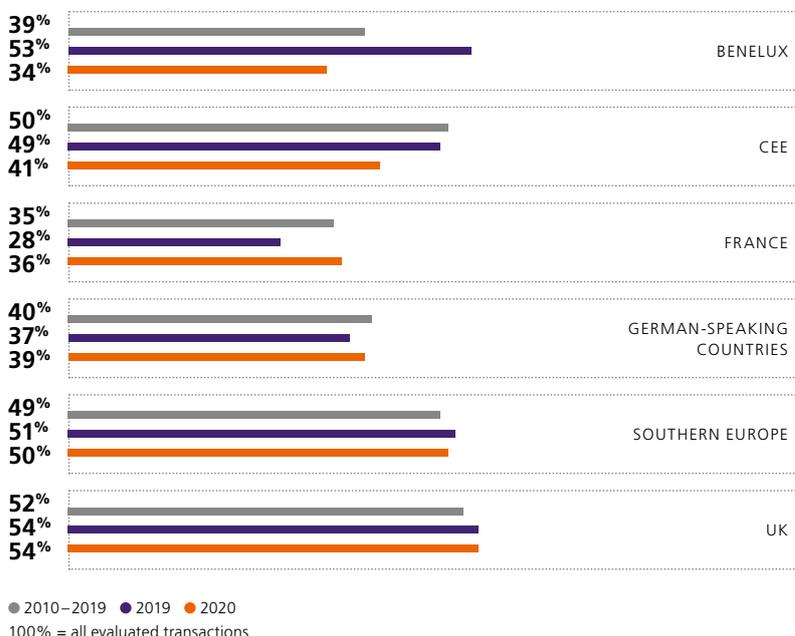
100% = all evaluated transactions

Specific Issues

Regional Differences

The use of PPAs continues to vary across the European jurisdictions. The UK remains the region with the highest application, at 54% of transactions, well ahead of the Benelux countries, France and the German-speaking countries at 34%, 36% and 39% respectively. The other regions (CEE: 41% and the Southern European countries: 50%) fall between the two. The application of PPA clauses across Europe over the period from 2010 to 2020 has however remained broadly consistent.

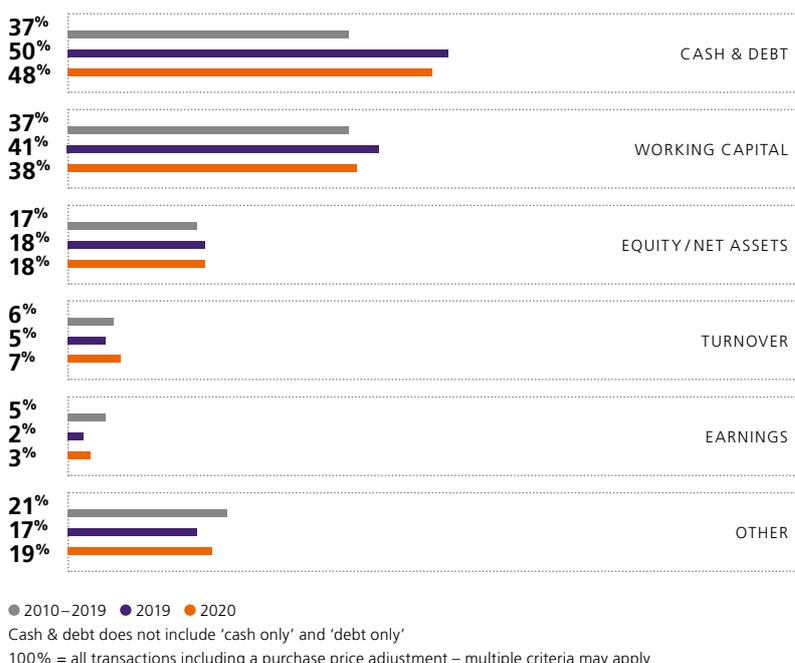
Time Trend Europe



Net Debt/Working Capital Adjustments

The application of cash/debt as the adjustment factor in a PPA transaction decreased slightly in 2020 from 50% to 48% of those deals, albeit still a significant uplift on the 37% rate for the period 2010-2019. The use of working capital as the determinant of the final purchase price declined from 41% for 2019 to 38% for 2020, although this is broadly in line with the 2010-2019 percentage of 37%. Net cash and working capital remain the predominant elements in calculating PPAs.

Chosen Criteria



Sector Differences

We have analysed the sector breakdown in relation to the use of PPA and locked box mechanisms. The average application of locked boxes in 51% of non-PPA transactions broadly applied across all the sectors except for the higher proportion applied in Banking & Finance, Hotels & Leisure and Energy & Climate Change transactions (at 75%, 63% and 61% respectively). There was a very sharp decline in respect of transactions in the Life Sciences sector at 35% (from 76% in 2019). The use of locked boxes in the Real Estate sector remains relatively low at 29%, which 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.

Frequency of Locked Box Mechanism

SECTOR	2010 – 2019	2019	2020
BANKING & FINANCE	47%	48%	75%
HOTELS & LEISURE	45%	29%	63%
ENERGY & CLIMATE CHANGE	44%	67%	61%
CONSUMER PRODUCTS	57%	57%	55%
TECHNOLOGY, MEDIA & COMMUNICATIONS	50%	53%	48%
INFRASTRUCTURE & PROJECTS	29%	50%	33%
LIFE SCIENCES & HEALTHCARE	55%	76%	35%
REAL ESTATE	32%	39%	29%
INDUSTRY	54%	69%	56%
BUSINESS (OTHER SERVICES)	47%	50%	41%
CMS AVERAGE	48%	56%	51%

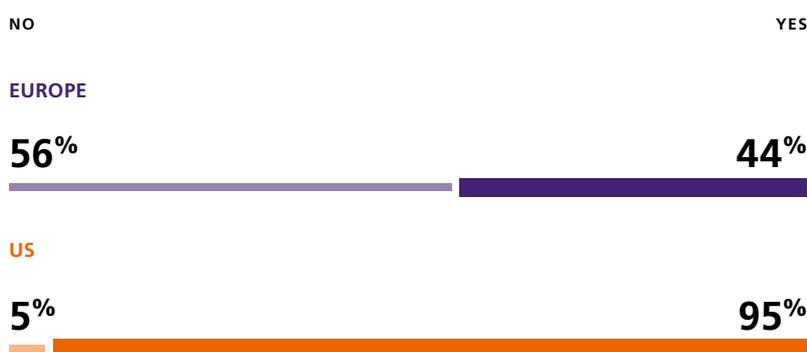
100% = transactions with no purchase price adjustment mechanism



European/US Differences

The very significant disparity between the US and European markets in relation to the application of PPAs continues to apply. Most 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 44% of our European deals. It seems likely that the US regards a PPA as standard in the market. In European deals there seems to be more scope for negotiation as to the preferred approach to PPA provisions.

Purchase Price Adjustment Europe/US

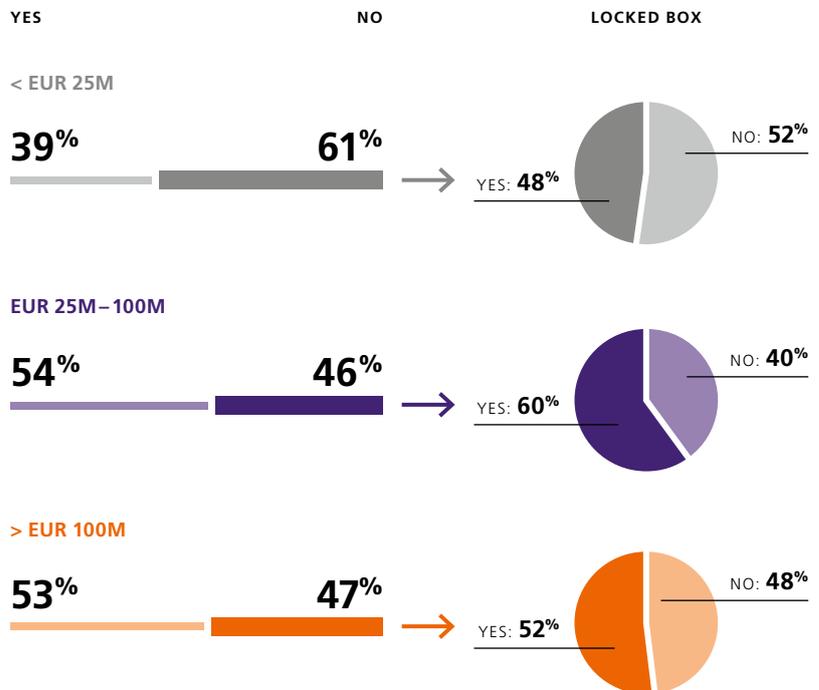


100% = all evaluated transactions

Analysis by Deal Size

For deal sizes under EUR 25m, just 39% had a PPA whereas for those deals with a consideration between EUR 25m and 100m, 54% had a PPA and for those transactions with a purchase price in excess of EUR 100m, 53% had a PPA. For the other transactions with no PPA provisions, for deal sizes under EUR 25m, 48% applied a locked box, for those deals with a consideration between EUR 25m and 100m, 60% had a locked box and for those transactions with a purchase price in excess of EUR 100m, 52% utilised a locked box structure. The latter represents a significant decrease from 85% in 2019. The use of locked boxes in smaller non-PPA transactions remained at similar levels to previous years.

Purchase Price Adjustment 2020



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

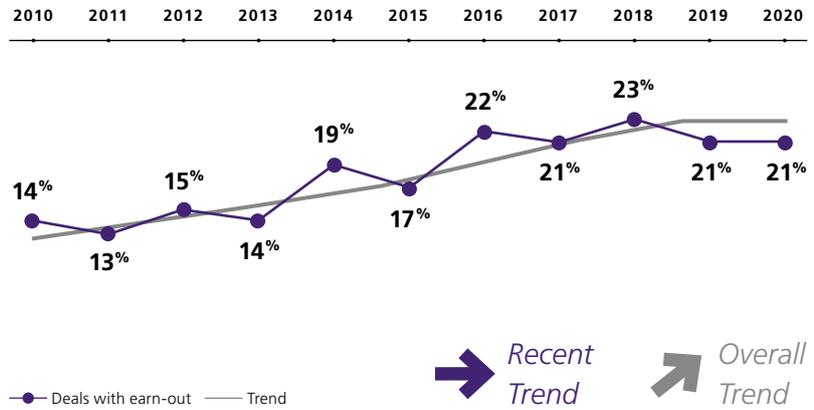
Earn-outs typically provide for additional consideration to be payable by the buyer after completion of the transaction, usually by reference to the post-completion performance of the acquired business. In such circumstances the benefits and risks of the target business post-acquisition are shared between the seller and buyer. Sellers potentially receive a higher overall price but must remain engaged by the business and wait to secure increased value. The buyer benefits by linking its final overall purchase price both by reference to historic performance and how the business operates under its ownership. It may also get to link payment to the continued engagement of key sellers.

General Overview

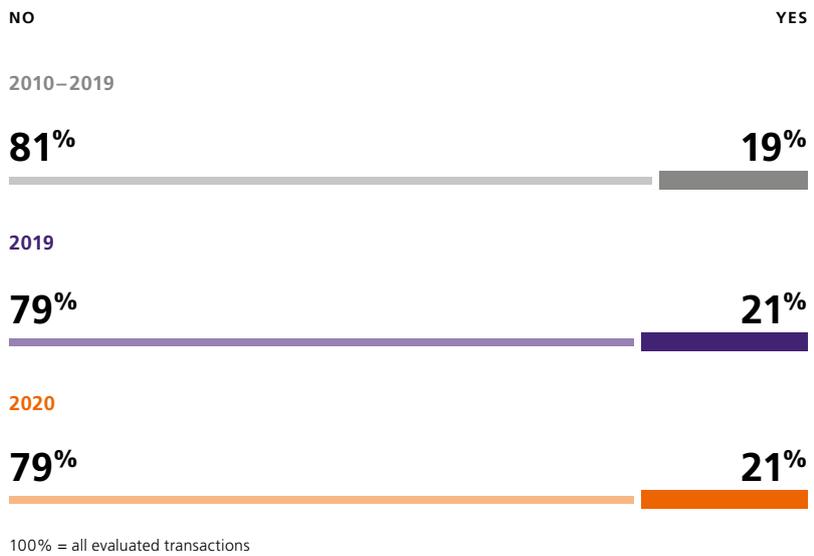
With the impact of the COVID-19 pandemic we were anticipating a marked increase in the use of earn-outs, however our statistics show overall there was no change in how frequently earn-outs were used; they featured in 21% of deals. This position remains above the trend over the last decade and earn-outs in Europe are still less popular than in the US. Perhaps 2021 will see the increase we expect as deals originated and negotiated during the pandemic are transacted. In addition, the COVID-19 pandemic saw occasions where earn-out arrangements documented in previous years were revisited this year as parties considered whether to disregard or smooth over the impact the pandemic would have on an acquired business's financial performance in its measurement period.

Earn-out popularity →

CMS Trend Index



Earn-out 2010–2020



Specific Issues

Sector Differences

Life Sciences continues to be the most popular sector for earn-outs at 43% of those deals topping the table from the trio of Technology, Media & Communications, Banking & Finance and Infrastructure & Projects – each at 25%. Whilst we did not see the overall surge in earn-outs we might have anticipated, 2020 saw certain sectors demonstrating notable high points for their use (i.e. higher than the trend for the last ten years), including Banking & Finance, Energy & Climate Change, Consumer Products, Infrastructure & Projects and even Real Estate, which does support the view that buyers may use earn-out mechanisms to alleviate concerns about paying too high a price during a volatile economic climate.

Earn-out Determination

In 2020, EBIT/EBITDA returned as the most common metric on which to determine an earn-out (up 7% from 2019 to 46%) whilst each of the other measures has fallen in popularity to a level below its ten-year average.

EBIT/EBITDA-based
earn-outs

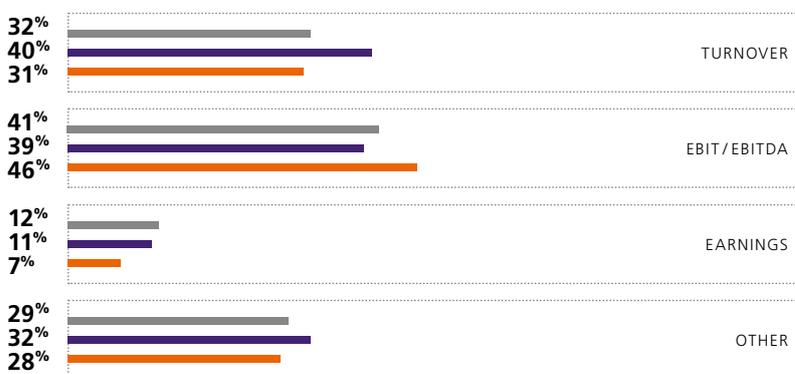
46% ↗

Frequency of Earn-out Mechanism

SECTOR	2010 – 2019	2019	2020
BANKING & FINANCE	14%	14%	25%
HOTELS & LEISURE	10%	27%	10%
ENERGY & CLIMATE CHANGE	15%	16%	18%
CONSUMER PRODUCTS	17%	10%	22%
TECHNOLOGY, MEDIA & COMMUNICATIONS	25%	29%	25%
INFRASTRUCTURE & PROJECTS	8%	22%	25%
LIFE SCIENCES & HEALTHCARE	30%	41%	43%
REAL ESTATE	11%	10%	20%
INDUSTRY	18%	19%	11%
BUSINESS (OTHER SERVICES)	23%	26%	21%
CMS AVERAGE	18%	21%	21%

100% = all evaluated transactions of the respective industry

Time Trend



● 2010-2019 ● 2019 ● 2020

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

Earn-out Duration

2020 saw an increase in longer earn-out periods – with a 9% rise to 26% in earn-out periods of more than 36 months and a modest 2% increase in earn-out periods of between 24 and 36 months. This marks a shift away from the conventional trend we have seen over 2010–2019 of earn-outs being measured over 12 to 24 months. With much of 2020 and 2021 impacted by the COVID-19 pandemic, it is understandable that parties will want a longer earn-out period to apply to smooth out the extraordinary effect the pandemic is having to all business’s finances.

Duration of Time Periods Relevant for Assessment of Earn-out



● 2010–2019 ● 2019 ● 2020
100% = all transactions including an earn-out clause

Earn-out periods of more than 36 months

26% ➔

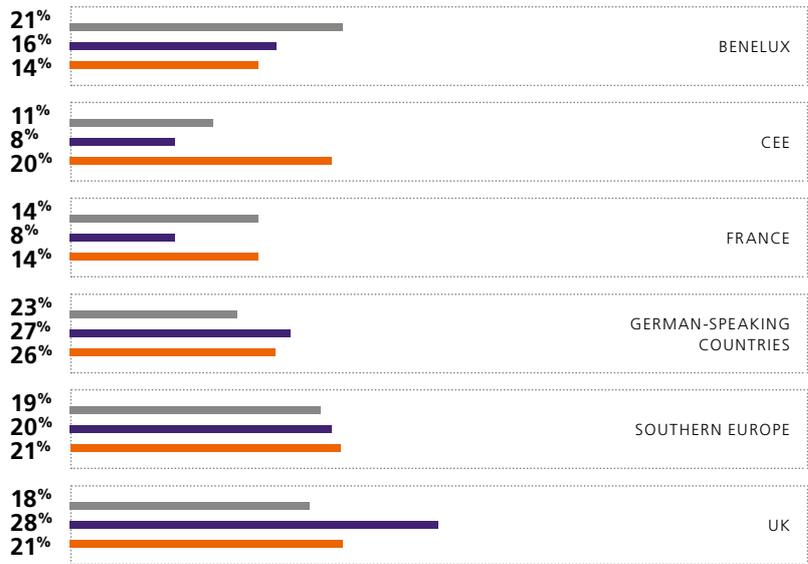
Earn-out duration ➔



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. The UK experienced a 7% fall in the use of earn-outs (falling from 28% to 21%) whereas in both France and CEE there were fairly significant increases (by 6% and 12% respectively).

Time Trend Europe

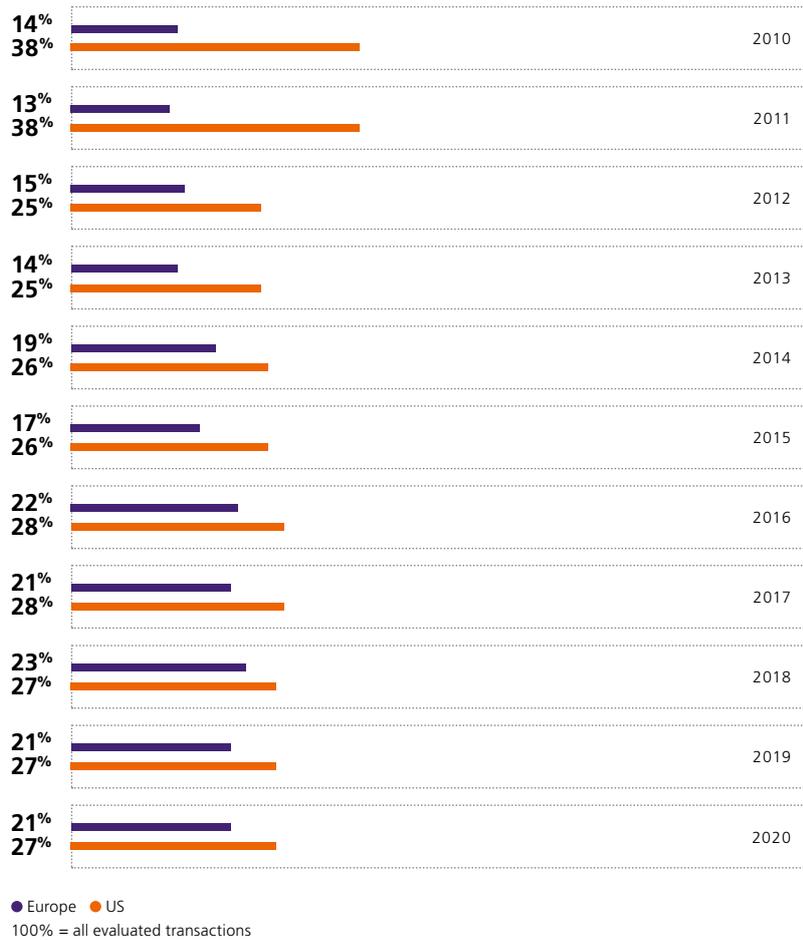


● 2010-2019 ● 2019 ● 2020
100% = all evaluated transactions



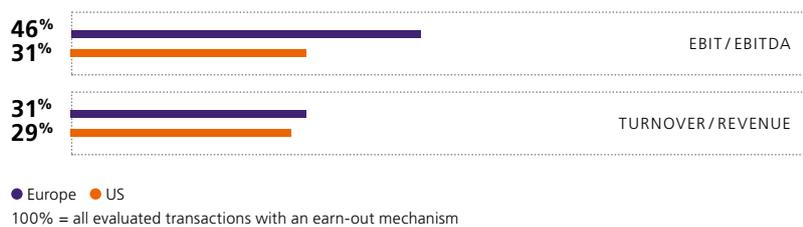
Consistent with all other years covered by the Study (2010–2020), earn-outs remain and have always been more popular in the US than in Europe. This was most clearly shown in 2010 where in Europe only 14% of deals involved an earn-out compared to 38% in the US. Over time there has been an upward trend in Europe whilst popularity in the US has levelled off (between 25%–28%). In Europe EBIT/EBITDA returned as being the most common metric on which to determine an earn-out (up 7% from 2019 to 46%). It is also the most popular criterion in the US, although in the last ABA study there was only a modest difference between EBIT/EBITDA and turnover.

Earn-out Europe/US



Earn-out Europe/US

Earn-out criteria

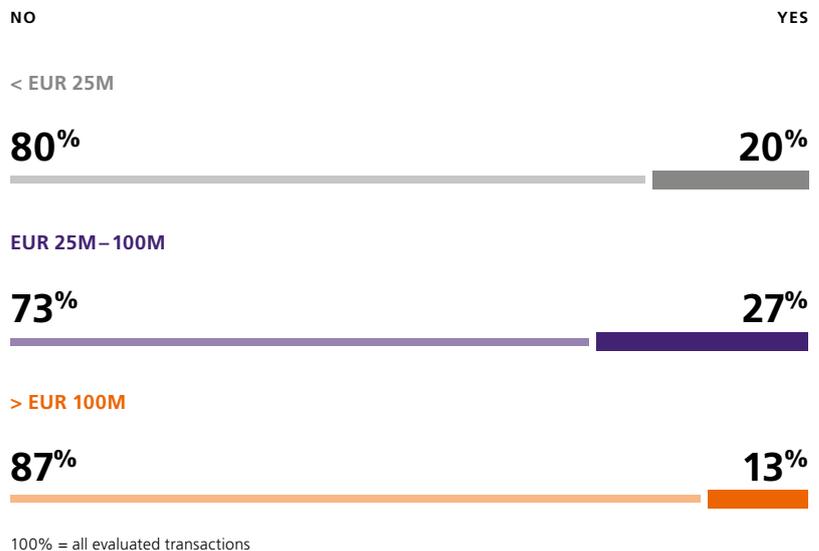


Analysis by Deal Size

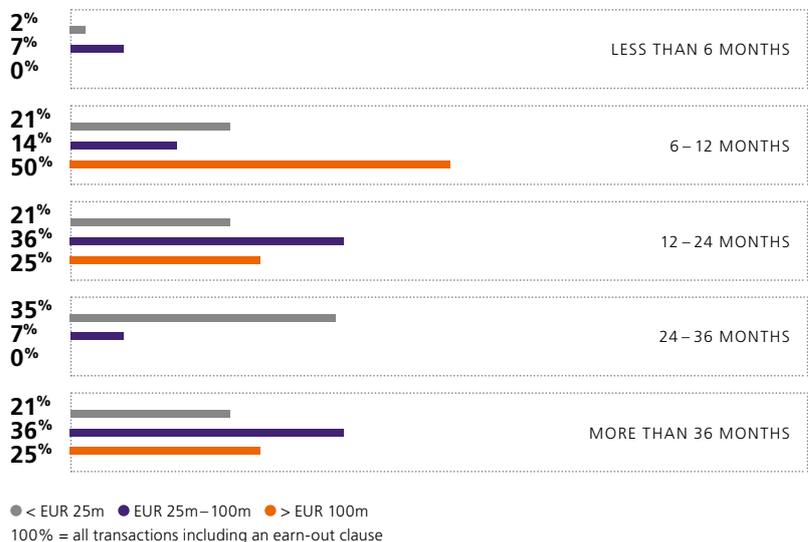
As in previous years, earn-out provisions were most frequently seen on lower value deals. In 2020, there was a small increase to 27% in the use of earn-outs on the medium size transactions (EUR 25m to EUR 100m) whilst the equivalent figure remained the same for deals of EUR 100m plus at 13%. This difference reflects the fact that deals involving founder shareholder exits and other management disposals, where earn-outs tend to be most common, fall in the sub-EUR 100m range and also that, as noted elsewhere in the Study, in large deals the parties tend to fix the price at the time of closing.

2020 saw great variety in the length of earn-outs at different deal sizes. Whilst overall in 2020 the trend appears to be towards longer earn-out periods, this year we also noticed a huge spike in 6 to 12 month earn-outs on large deals (50% of deals of more than EUR 100m with earn-outs), although it must be recognised, as stated above, that the number of earn-outs on these deals was relatively small.

Earn-out 2020



Duration of Time Periods Relevant for Assessment of Earn-out





De minimis

Many M&A agreements provide that individual warranty claims below an agreed minimum amount are excluded (such minimum amount being the *de minimis*). If a claim is less than the *de minimis* then the claim is automatically excluded. The seller is thereby 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.

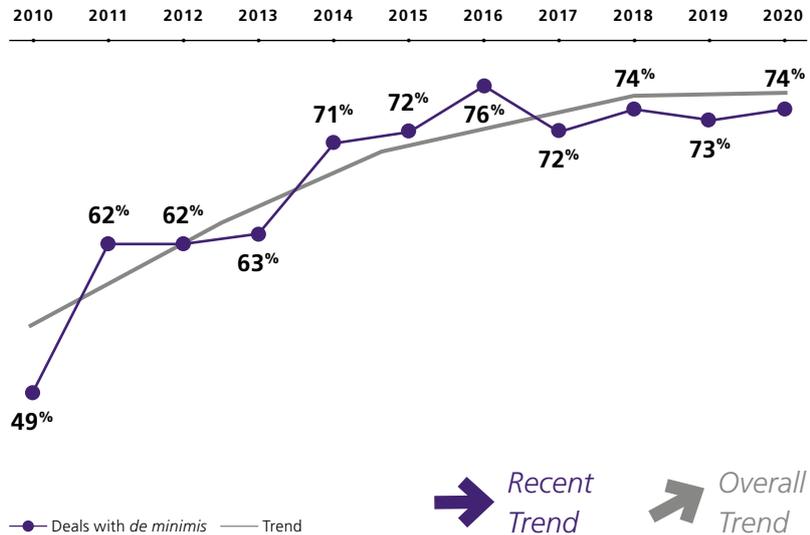
General Overview

This year's study shows a flattening of the number of European transactions which include a *de minimis* clause at 74%, representing a continuation of the trend over the last three years. It also represents a slight increase over the percentage in 2019 at 73%. We continue to think this demonstrates that a *de minimis* is the predominant market norm across most European jurisdictions.

De minimis ratio 2020

74% →

CMS Trend Index

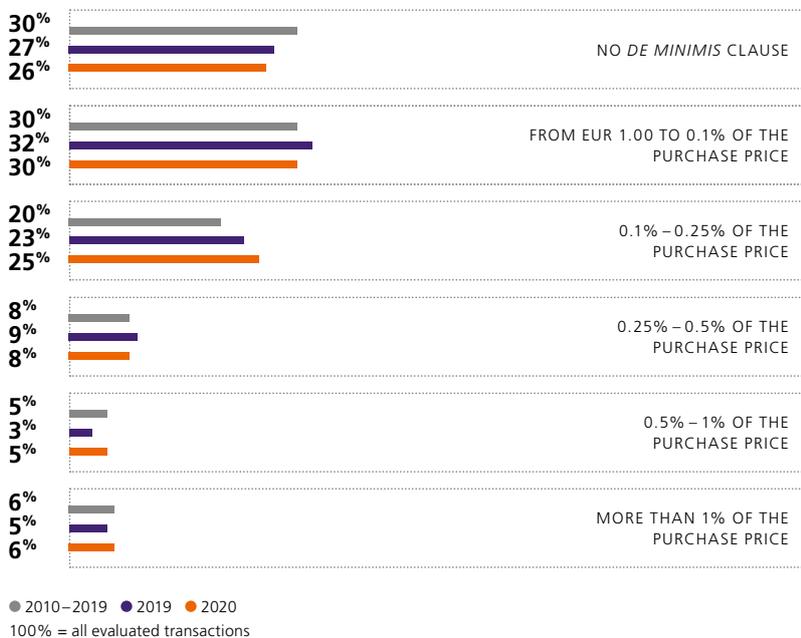


Most transactions (55%) have a *de minimis* at somewhere up to 0.25% of the purchase price. In 2020 there was a slight decrease in the application of a *de minimis* at less than 0.1% of the purchase price (from 32% to 30%) and a corresponding increase in the use of a *de minimis* at 0.1 to 0.25% of the purchase price (from 23% to 25%). 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

30%

De Minimis Levels 2011–2020



Specific Issues

Regional Differences

The application of *de minimis* clauses across Europe continues to vary although there appears to be some degree of convergence in 2020. The range varies from 91% for Benelux transactions to 58% for Southern European countries, although most regions applied such clauses in nearly three-quarters of all deals. In the UK, CEE, the German-speaking countries and France the percentages were 76%, 75%, 75% and 68% respectively. This seems to indicate an overall trend across all European deals.

Time Trend Europe



● 2010-2019 ● 2019 ● 2020
100% = all evaluated transactions





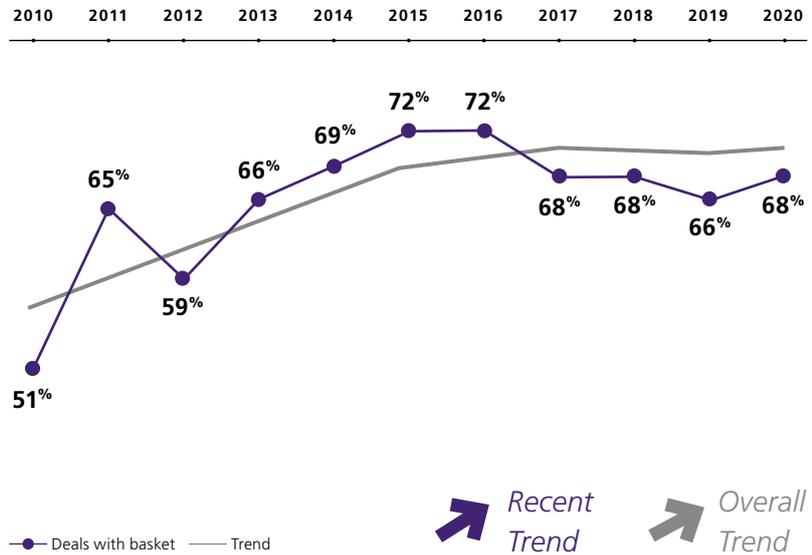
Basket

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 sellers 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'). 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 slight increase in the application of baskets in European transactions at 68% for 2020 compared with 66% for 2019, which broadly represents the average for the years since 2017. This level reflects the use of W&I insurance, particularly in the UK, where the basket may not be as relevant if 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 (returning to the more recent average of 74% vs 68%).

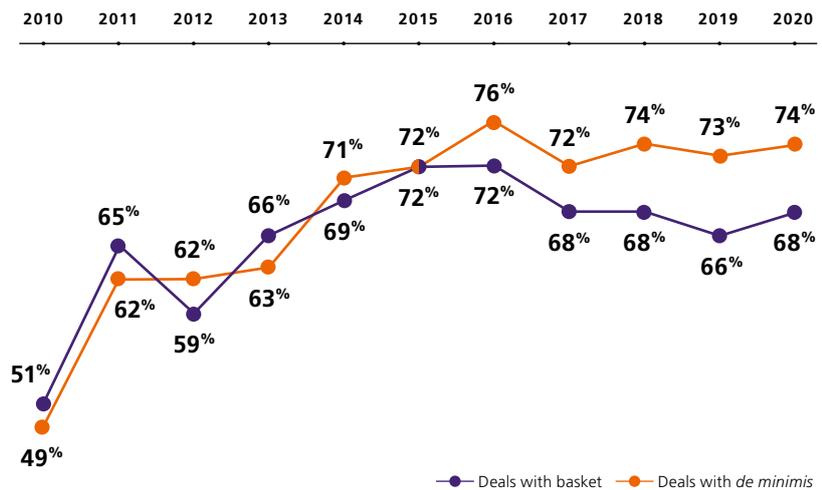
CMS Trend Index



Basket ratio 2020

68% ↗

Comparison: Existence of *De Minimis* and Basket



Specific Issues

Size of Baskets

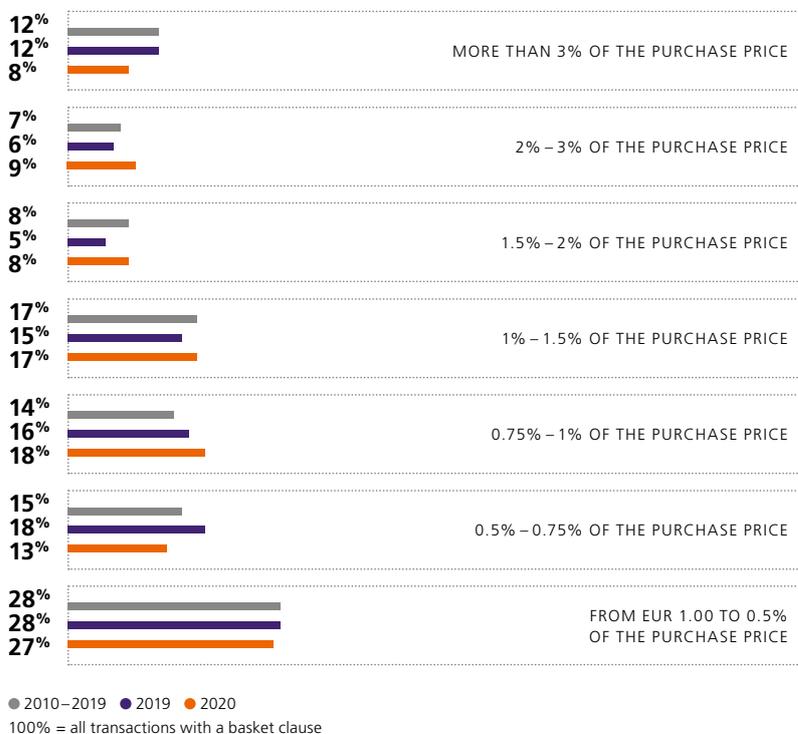
Most baskets in European transactions are of the 'first dollar' type. It is usually the case that a 'first dollar' basket is larger than an 'excess only' basket. In this connection most baskets in 2020 (58%) were equal in value to up to 1% of the purchase price and the remainder were at more than 1% of the purchase price. There was a year-on-year decrease in the percentage of baskets in the 0.5% to 0.75% range from 18% to 13% and a corresponding increase in the percentage of baskets in the 0.75% to 1% range at 18%. This indicates that basket sizes are possibly increasing in size albeit still consistently in the region of 1% of the purchase price. Interestingly, there was a significant drop-off in the application of a basket at more than 3% of the purchase price (down from 12% to 8%).

Size of basket →

Impact of W&I Insurance

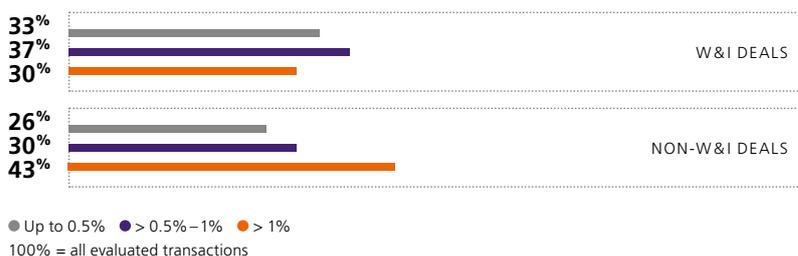
The comparative statistics relating to the use of basket provisions in relation to W&I and non-W&I deals demonstrates that there is scope for sellers to decrease the basket level significantly if W&I insurance applies. This is shown by the fact that 30% of W&I insurance deals have a basket of more than 1% of the purchase price as compared to 43% for non-W&I insurance deals. The differences are less marked where baskets are smaller. In the absence of W&I insurance protection it can be seen that 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 2020

W&I deals + non-W&I deals



Regional Differences

There is a relatively consistent application of baskets across European transactions. The Benelux and German-speaking countries continue to lead the field with 74% and 73% application, CEE and the UK are in the middle with 71% and 68% application, and France and the Southern European countries have increased to be nearer the overall average at 59% and 50% respectively. It seems that there is a greater degree of convergence across the territories in this respect. However, there are significant differences in the application of 'first dollar' baskets, with them applying in an extraordinary 99% of UK transactions as compared with levels of 50% and 32% in France and the Southern European countries and the consequential greater application of 'excess only' baskets in those countries. In the German-speaking countries there was a significant increase in the application of 'first dollar' baskets to 84% of all transactions there.

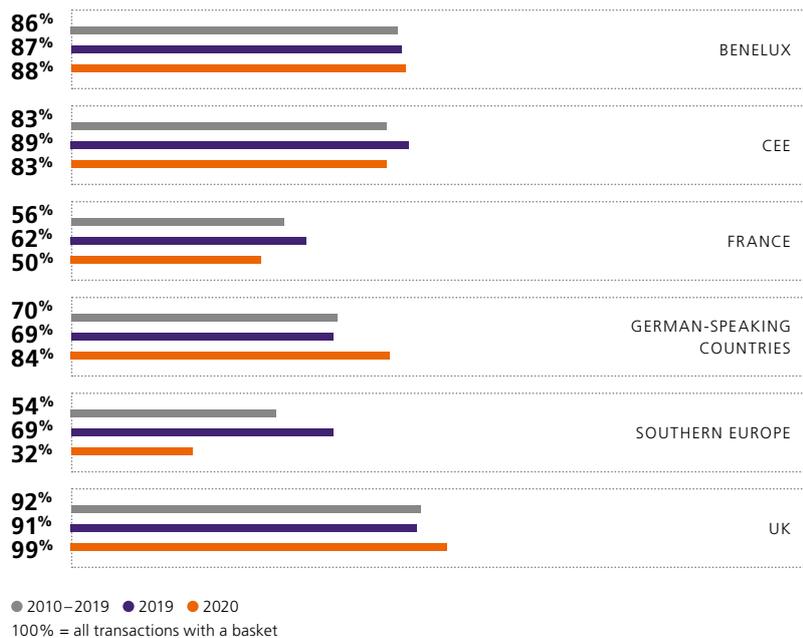
Time Trend Europe

Basket application



Time Trend Europe

First dollar



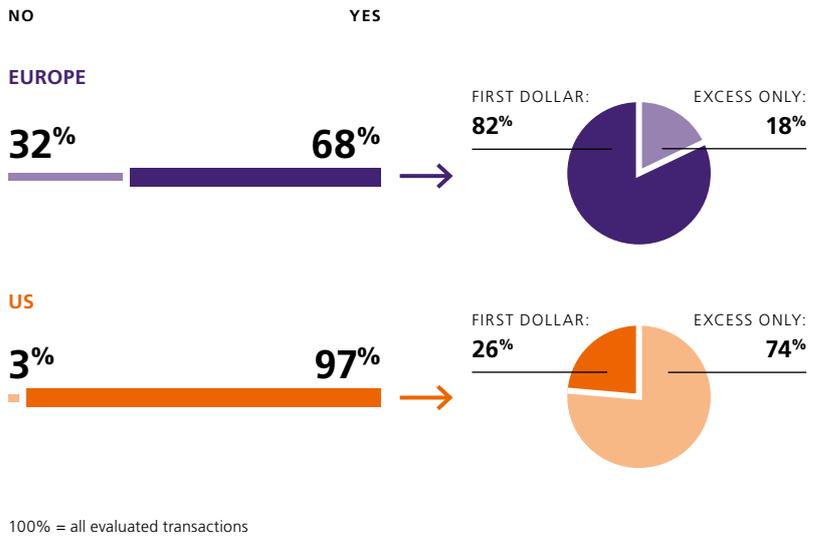
'First dollar' recovery

82% ➔

European/US Differences

We have previously noted that the US market applies a basket in nearly all transactions (97%). The differences are possibly explained by differing market practices particularly given the lower prevalence in France and the Southern European countries. The US market uses 'excess only' baskets in 74% of transactions whereas such baskets rarely apply in the European market with just 18% of deals covered. There is also 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 42% for European transactions.

Frequency of Baskets



Thresholds Europe/US





Liability caps

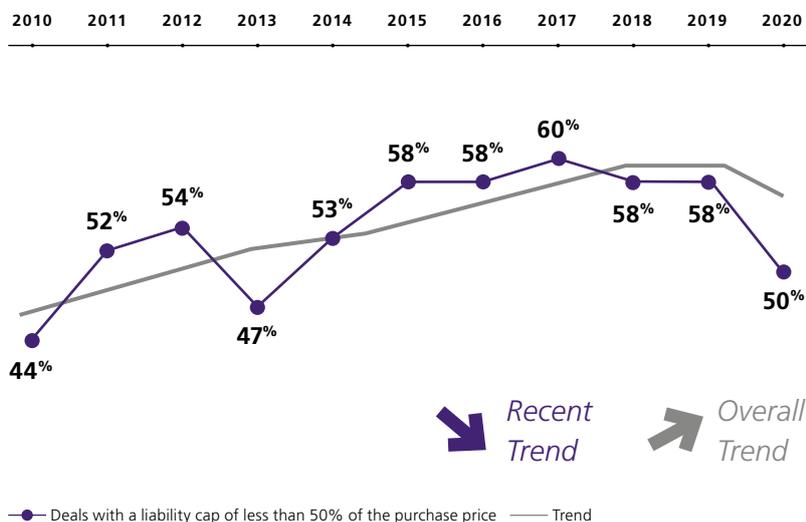
Sellers will generally seek certainty that their liability in respect of warranty claims will not exceed a pre-agreed amount. Traditionally this amount has been equal to the purchase price. This means the purchaser cannot recover any more than it has paid for the target business. There can be a lot of debate between the parties as to the level of a liability cap, which can vary 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

In 2020 we saw many more deals with liability caps equal to the purchase price. There was a big decrease in the number of deals with a liability cap of less than 50% of the purchase price, down to 50% from highs of 60% in 2017 and 58% in 2015, 2016, 2018 and 2019. The amounts of those caps are however subject to significant variation depending on deal size and, most significantly, to whether W&I insurance cover applies to the transaction. For example, 51% of transactions featuring W&I insurance have caps of less than 10% of the purchase price as compared with just 10% of deals without W&I insurance. The impact of W&I insurance is a significant factor in determining the overall level of the liability cap.

CMS Trend Index

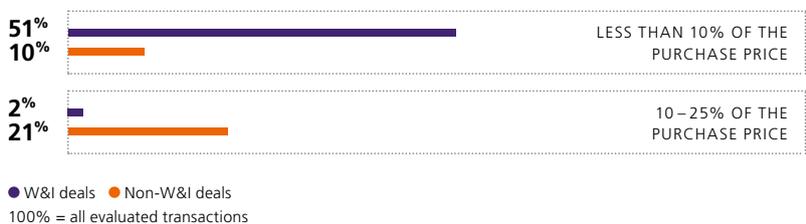
Liability caps (less than 50% of purchase price)



Liability Caps for 2020

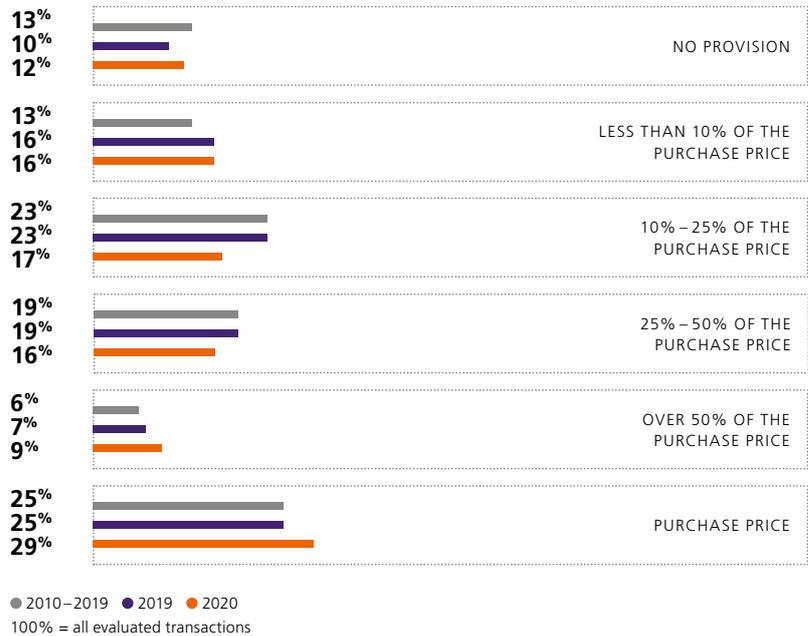
W&I deals + non-W&I deals

Liability cap less than 50% of purchase price
50% ➔



This year's survey indicates that a greater proportion of deals (i.e. 29%) have a liability cap equal to the purchase price, which is a significant increase over the previous years' average of 25%. There was a corresponding drop-off in caps equal to 10–25% and 25–50% of the purchase price, which have fallen to 17% and 16% respectively from highs of 23% and 19%. A not insignificant minority (12%) of European transactions do not have a liability cap at all. The overall trend in 2020 of higher levels of liability caps indicates that buyers are now winning the argument as to what is the appropriate level.

Amount of Liability Cap



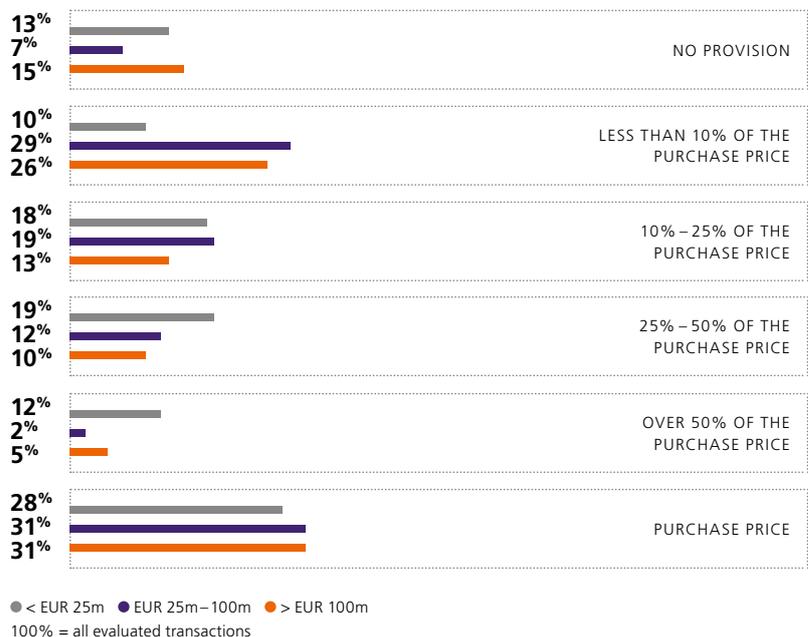
Deals without liability caps

12%

Analysis by Deal Size

The results of this year's survey indicate that the liability caps for larger transactions are increasing and fewer of these transactions have caps of less than the purchase price. For 31% of large and medium deals (i.e. EUR 25–100m and greater than EUR 100m) the purchase price is the agreed liability cap. In 2019 this percentage was 15% and 25% respectively, which is reflective of the overall result indicated above. For deals of more than EUR 100m in value the liability caps of 10–25% or 25–50% of the purchase price are relatively low at 13% and 10% of such transactions.

Amount of Liability Cap by Deal Size



Specific Issues

Regional Differences

A liability cap of more than 50% of the purchase price applied in 43% of our European transactions. However, there are big variations between countries with the range being 24% to 76%. In 2020 there were also significant regional movements in respect of CEE and the Southern European countries, where that liability cap applied to 67% and 76% of their transactions, representing a large increase from previous years at 47% and 56% respectively. This contrasts with a big drop in France where only 24% of transactions have a cap of more than 50% of the purchase price. Over that period the UK, German-speaking and Benelux countries have remained broadly static at 55%, 35% and 30%.

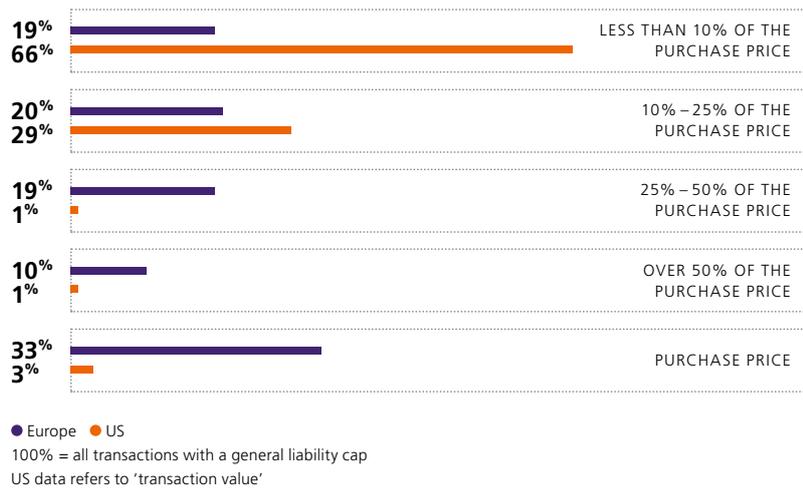
Time Trend Europe Liability Caps of more than 50%



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 19% of European deals in 2019 had a cap of less than 10% of the purchase price and, as indicated above, most European deals (i.e. 33%) have a liability cap equal to the purchase price as compared with just 3% of US deals.

Liability Caps



Sector Differences

As indicated above 34% 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. The exceptions were in the Consumer Products and Real Estate sectors, where 56% and 40% of such transactions had caps at this level. 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 arriving at an agreed level for a liability cap.

Frequency of Liability Caps up to 25%

SECTOR	2010 – 2019	2019	2020
BANKING & FINANCE	30%	29%	0%
HOTELS & LEISURE	43%	36%	22%
ENERGY & CLIMATE CHANGE	26%	34%	33%
CONSUMER PRODUCTS	37%	32%	56%
TECHNOLOGY, MEDIA & COMMUNICATIONS	35%	36%	31%
INFRASTRUCTURE & PROJECTS	20%	50%	25%
LIFESCIENCES & HEALTHCARE	37%	43%	38%
REAL ESTATE	49%	53%	40%
INDUSTRY	42%	43%	33%
BUSINESS (OTHER SERVICES)	31%	27%	36%
CMS AVERAGE	36%	38%	34%

100% = all evaluated transactions of the respective sector



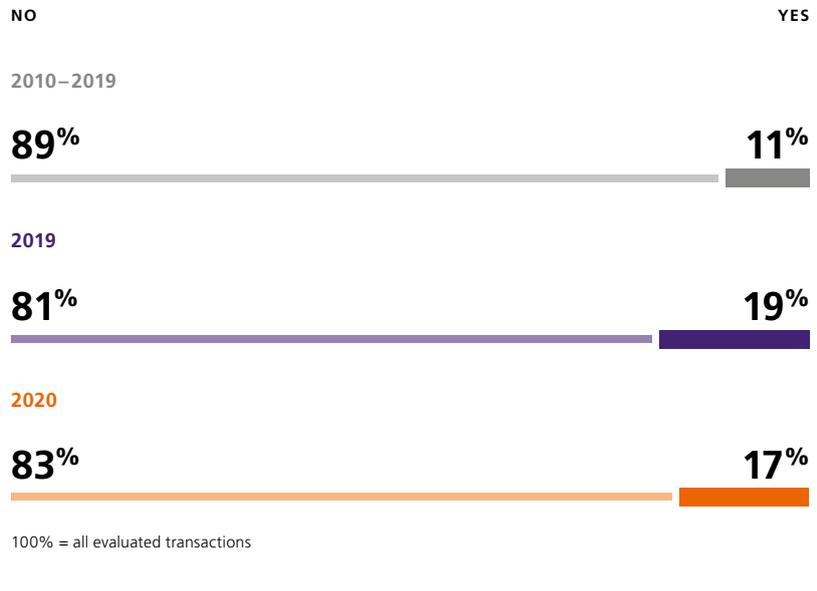


Warranty & Indemnity insurance

Warranty & Indemnity insurance (W&I insurance) continues to offer 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. 2020 did however see the end of the year-on-year rise in the usage of W&I insurance on CMS deals with the figures dropping 2% to it being used on 17% of deals across Europe. This does however remain comfortably higher than the average over the period 2010–2019 and W&I brokers report the amount of enquiries being received at the end of 2020 was significant, suggesting that a return to popularity can be anticipated in 2021.

General Overview

Time Trend W&I Insurance



W&I insurance usage

17% ↘

The market this year

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

“The European W&I insurance market was heavily impacted by the COVID-19 pandemic and the resulting deceleration in M&A activity. There was an understandable drop in deal flow from the end of Q1 through to the start of August but as confidence returned, enquiry levels for W&I insurance increased and the latest W&I insurance market data would suggest that there were similar enquiry volumes in FY20 as there were in FY19. Certainly Q4 and particularly November and December were as active as anyone can recall. There was an expectation that the distressed deals would come to the fore and that “synthetic” W&I insurance policies could be regularly deployed. Our experience, however, has been that distressed deals continue to be a challenge for the W&I insurance market as, to meet their risk assessment requirements, W&I insurance underwriters need good standards of disclosure, backed up with buyer due diligence that has looked into all areas of the target where warranty cover is needed.”

From a coverage and cost perspective, 2020 has been good for the buyer of W&I insurance as rates have softened and cover has broadened. This is partly down to increased entrants to the W&I insurance market and partly due to competition for deals over the period when deal volume was low. There remains the expectation that there will be a hardening of insurance premium rates in Europe over the next 12–24 months.”

Specific Issues

Analysis by Deal Size

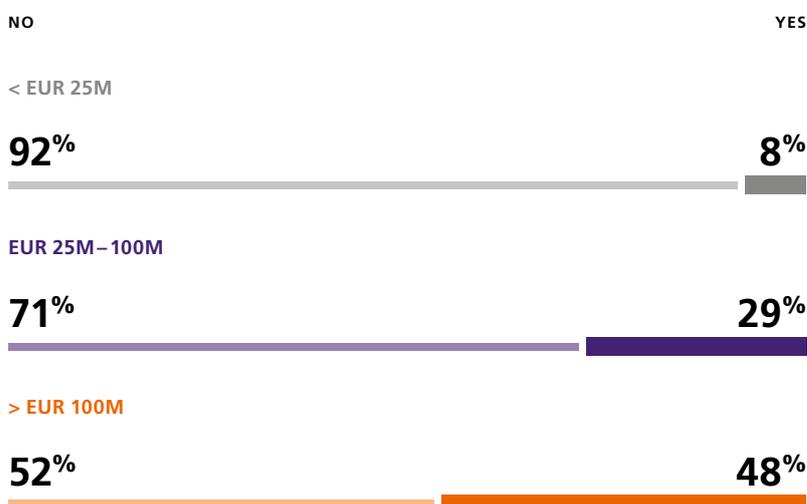
2020 continues the trend that the larger the deal value, the more likely W&I insurance will be used. W&I insurance was purchased on 48% of deals with a purchase price exceeding EUR 100m – broadly the same level as in the previous year. The figures for the mid-market deals (EUR 25m – EUR 100m) and the small deals (sub-EUR 25m) each increased by a single percentage point.

W&I insurance usage



W&I Insurance 2020

By purchase price (Europe-wide)



100% = all evaluated transactions

Sector Differences

Real Estate remains the most popular sector for W&I insurance (24% of CMS' Real Estate M&A deals in 2020), although there was a 6% fall in 2020. The notable rise of popularity in its use in the Energy & Climate Change sector continued again this year with an 11% spike to equal Real Estate at the top of the table with 24%. W&I insurance continues not to be popular in the Infrastructure & Projects sector and there was a big reduction in the frequency of its use in the Life Sciences sector.

Frequency of W&I Insurance

SECTOR	2011 – 2019	2019	2020
BANKING & FINANCE	2%	0%	4%
HOTELS & LEISURE	12%	6%	10%
ENERGY & CLIMATE CHANGE	10%	13%	24%
CONSUMER PRODUCTS	10%	7%	7%
TECHNOLOGY, MEDIA & COMMUNICATIONS	13%	18%	16%
INFRASTRUCTURE & PROJECTS	2%	2%	0%
LIFE SCIENCES & HEALTHCARE	5%	8%	1%
REAL ESTATE	25%	30%	24%
INDUSTRY	12%	10%	9%
BUSINESS (OTHER SERVICES)	9%	6%	4%
CMS AVERAGE	11%	19%	17%

100% = all evaluated transactions of the respective industry

Type of Policy

As in previous years, 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 2020 this was the case on 91% of the deals which involved W&I insurance; a 1% decrease from 2019 but still comfortably the most common. Despite sell-side policies being relatively infrequent, sellers are still participating in the market and may actually agree to pay some or all of the premium payable for the relevant policy. This year, however, saw a fall in the number of policies paid for by sellers (down 4% to 20%).

W&I Insurance

By purchase price 2020



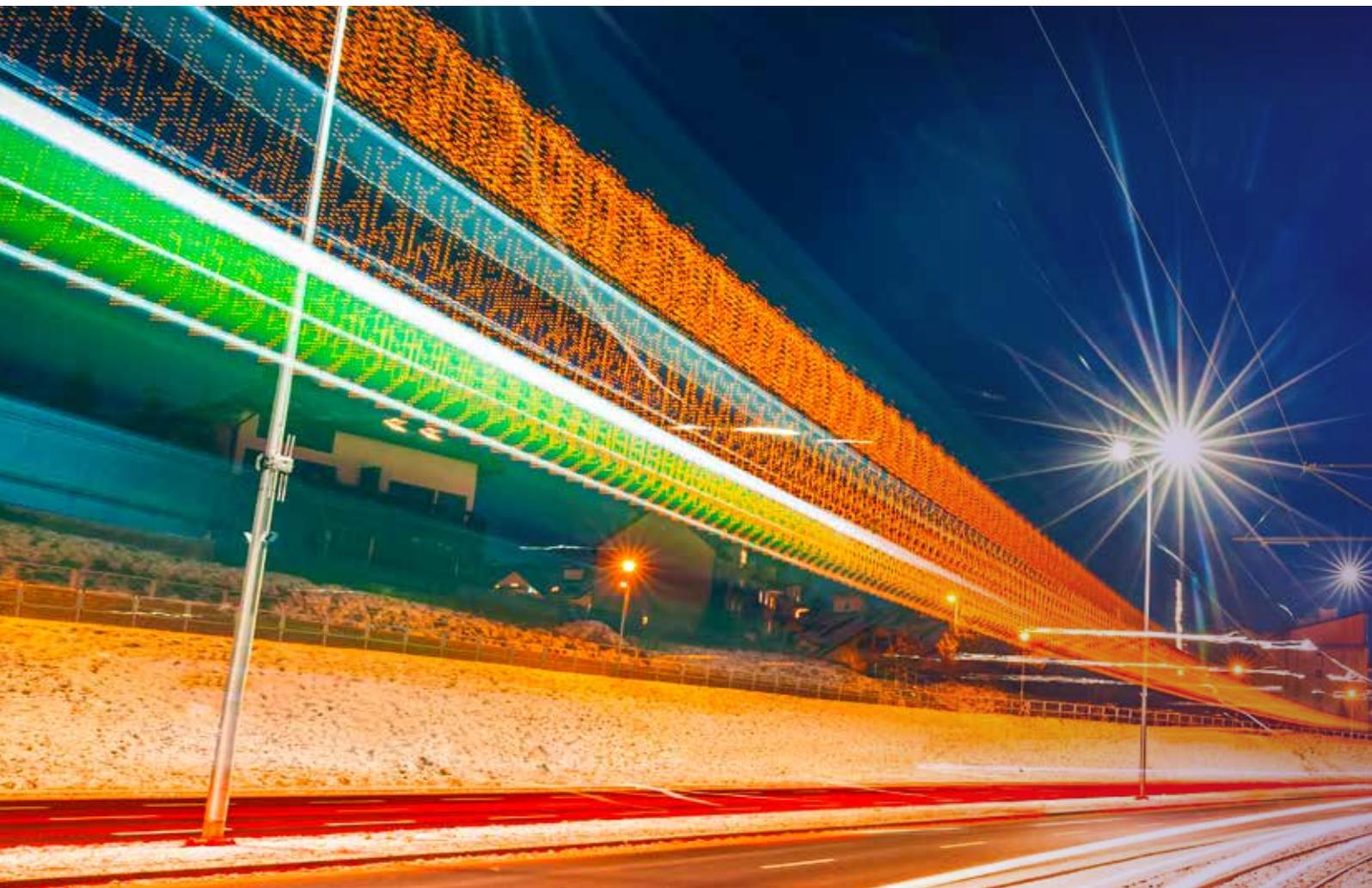
100% = deals in which W&I insurance was actually used

W&I Insurance

Who pays the premium



100% = all evaluated transactions

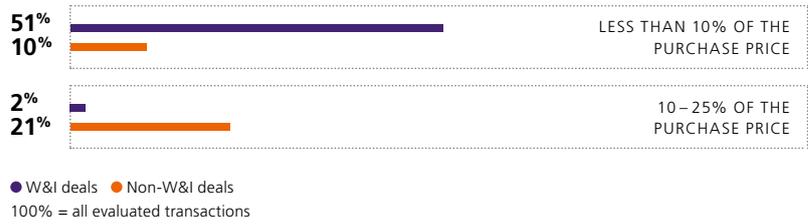


Liability Caps

Deals involving W&I insurance are more likely to see the seller being able to agree a lower liability cap in its negotiation with the buyer. This may be a nominal amount with the buyer able then to purchase a W&I insurance policy either to top up its warranty coverage or, as is common, its sole recourse. In 2020, 51% 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 2020

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 to purchase a different (usually longer) period than is available in the SPA. The data for 2020 (like in 2019) shows that a time limitation period of between 18 and 24 months is even more common on W&I insurance deals than on those deals without insurance. There was also a modest increase in 2020 in longer limitation periods (more than 24 months) featuring on W&I insured deals (up 7% to 20%).

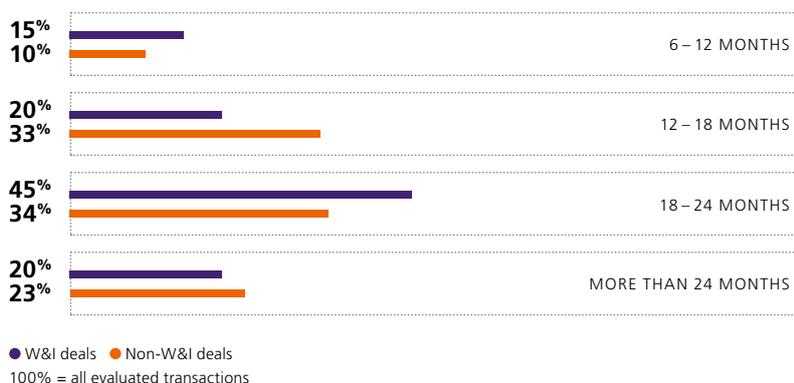
Frequency of Claims under W&I Insurance Policies

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. Recent reports issued by notable underwriters like AIG and Liberty indicate that they receive claims notifications on between 15–20% of W&I insurance policies, but do not go into much detail as to the extent of paid claims materialising from those notifications.

Adrian Furlonge, founding partner of specialist M&A Insurance Broker Hemsley Wynne Furlonge LLP, notes:

Limitation Period for Warranty Claims for 2020

W&I deals + non-W&I deals



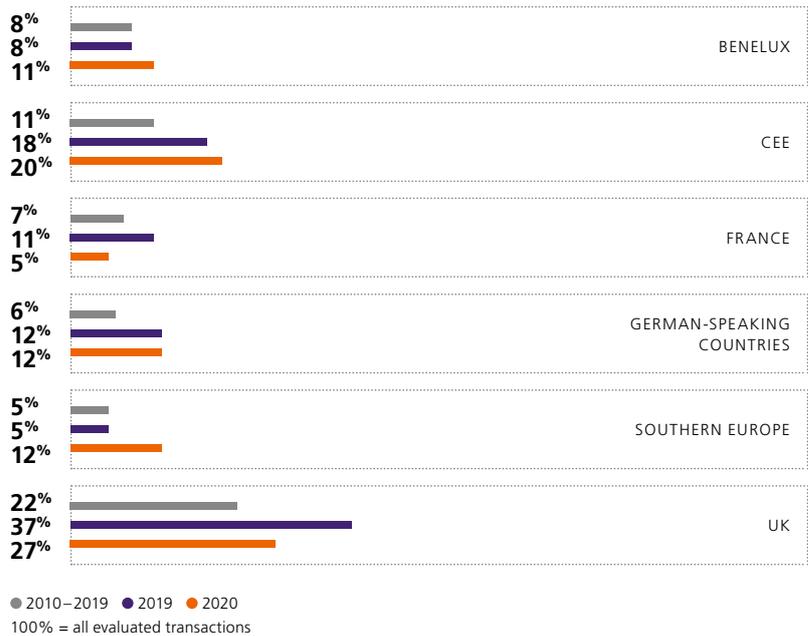
“Over the last few years the frequency of claims has increased due to change in M&A practices and familiarity of the claims process by insureds. This has been further exacerbated by the economic down turn caused by the COVID-19 pandemic – buyers are looking at ways to extract value from struggling businesses more than ever. HWF has seen more notifications during 2020 than any other period including some potential limit loss notifications and several notifications in traditionally “safe” sectors such as Real Estate and Renewable Energy. The impact of the claims increase is being felt in the market with most insurers indicating a need to increase pricing in the future to ensure profitable trading.”

Regional Differences

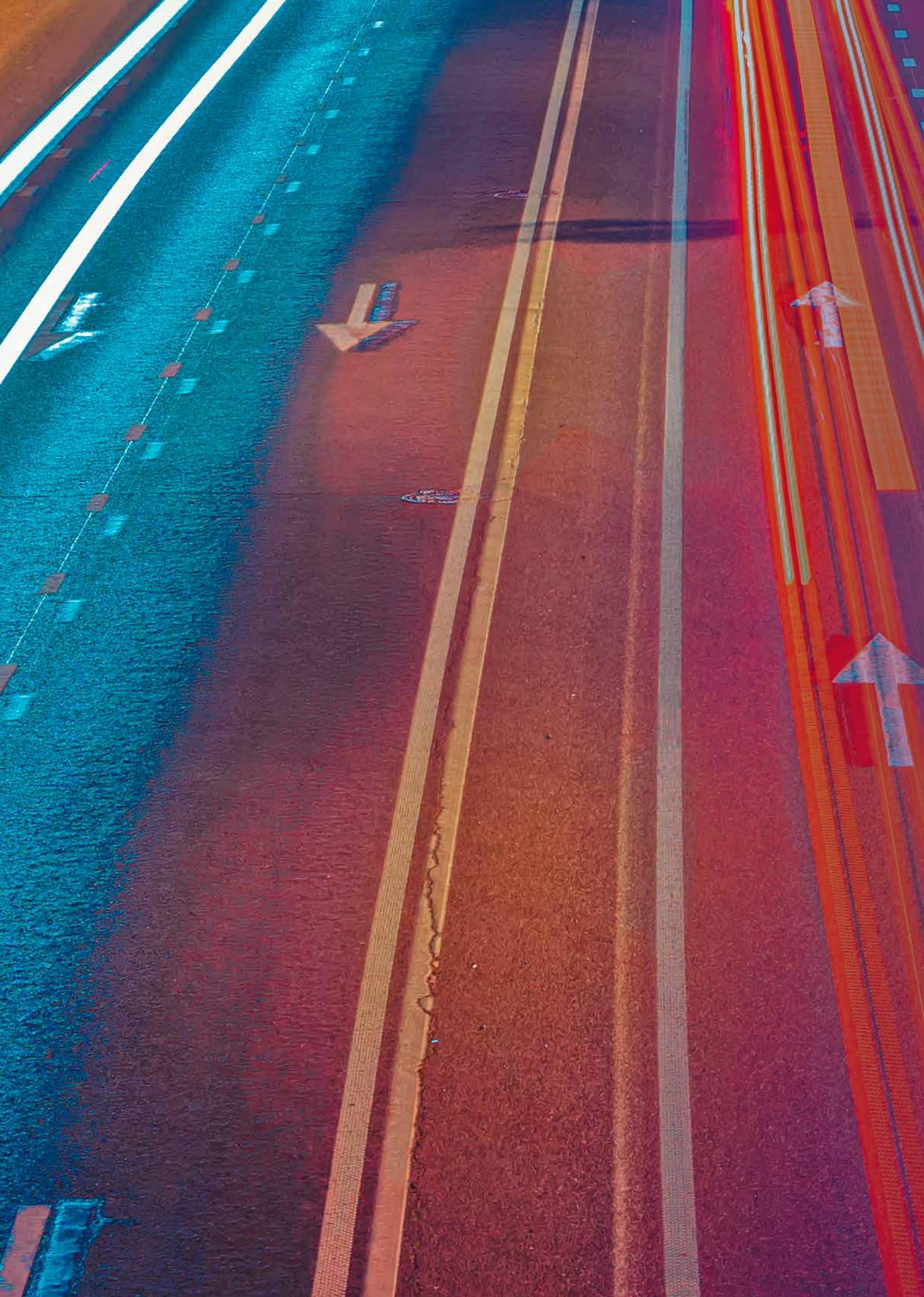
Regional disparity in popularity of W&I insurance shows up again in 2020. Whilst the UK remains the most popular market, at 27% of deals it experienced a 10% decline from 2019's high point. Whilst there was also a decline in its use in France, each of Benelux, CEE and the Southern Europe demonstrated small increases in frequency in 2020 whilst the position remained stable in the German-speaking countries.

Adrian Furlonge commented on the regional differences in Europe in the W&I insurance market:

Time Trend Europe



“Increased client demand for W&I insurance policies across Europe has led to many insurers and brokers moving out of the traditional insurance hubs and placing dedicated teams on the ground across Europe. As a result we are seeing an increase in understanding of local law and local M&A practice considerations being taken into account in W&I insurance policies where there was inflexibility previously. For example, UK practices like general disclosure of the data room and updating of disclosure for repeated warranties have often been mandated by insurers in other jurisdictions where this is not commonplace leading to disappointed clients. Equally W&I insurance policies mirroring local law measures of damages has sometimes been challenging. This has now changed so that W&I insurance policies can respond appropriately to local requirements. Conversely, this does also mean that clients should be aware that certain local market exclusions/diligence concerns may also apply in certain circumstances which do not apply in the UK, such as title to property in certain CEE countries, or specific tax liabilities like VATCLAT in Poland, RETT in Germany or WHT in Spain).”



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. 2020 marked a shift to a more 'buyer-friendly' market as we experienced an increase in longer limitation periods.

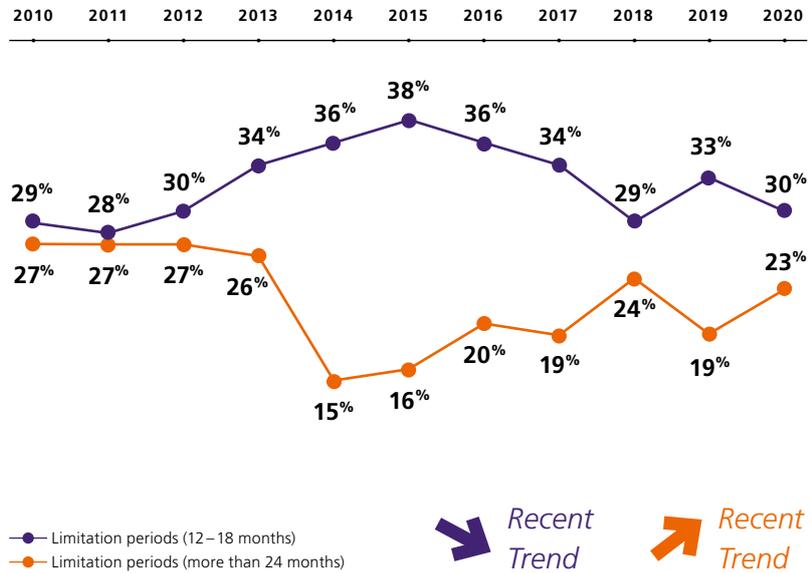
General Overview

2020 saw a trend towards the use of longer limitation periods, with time periods of more than 24 months being used in 23% of deals (compared to 19% in 2019). In contrast, shorter limitation periods (i.e. below 18 months) became less frequent, decreasing from 45% in 2019 to 41% in 2020.

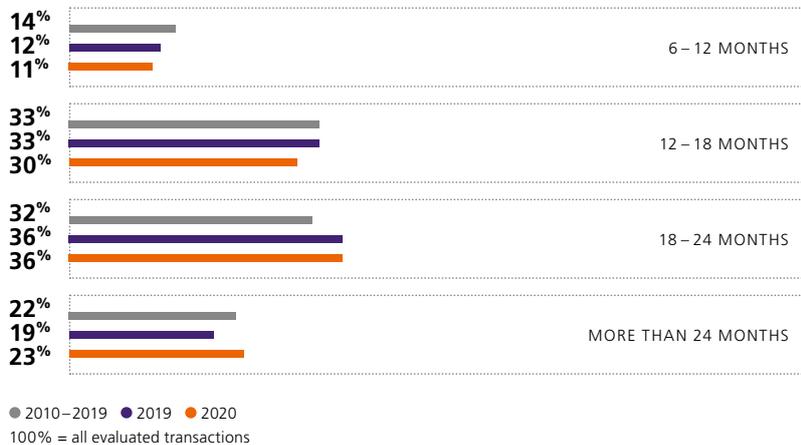
As regards deal size, in previous years limitation periods have tended to be shorter on large transactions, but this year the percentage of longer limitation periods (i.e. more than 24 months) for medium sized and large deals is significantly higher (23% and 24% respectively) than in 2019 (21% and 12% respectively). This highlights a switch to a more 'buyer-friendly' market on this point.

Limitation periods of 18 to 24 months remained constant at 36% of deals, which, however, still marks an increase compared to the ten-year average (2010–2019: 32%). Short limitation periods of less than 12 months were used in only 11% of the deals (2019: 12%). Limitation periods of 12 to 18 months were also less common in 2020 (30%) compared to 2019 (33%). Limitation periods of more than 24 months increased (23%) in comparison to 2019 (19%) to a level that is comparable with the ten-year average (2010–2019: 22%).

CMS Trend Index



Time Trend



Limitation periods < 18 months

41% ➔

Specific Issues

Regional Differences

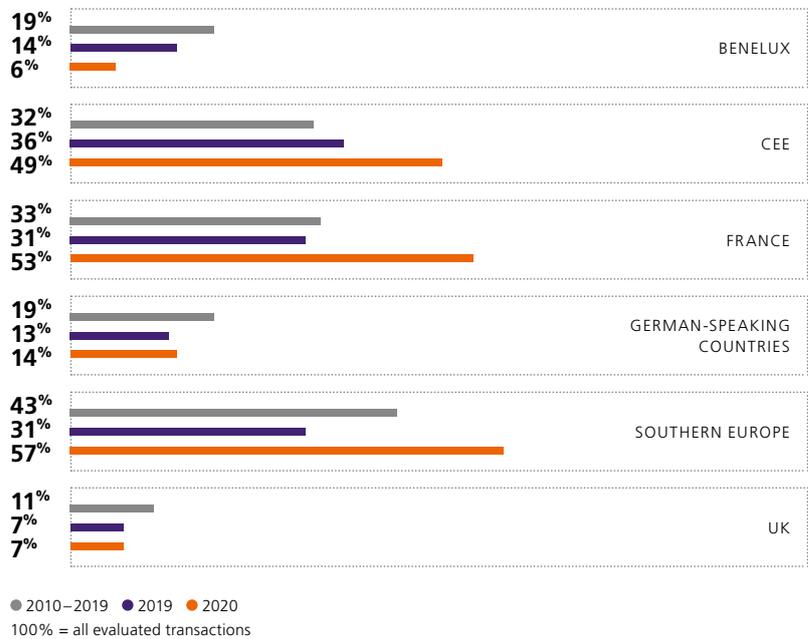
When comparing the position across the different regions in Europe, we noticed some significant differences. The Southern European countries (57%), France (53%) and CEE (49%) showed a notable increase in deals with longer limitation periods; other regions, especially Benelux, tend to use shorter limitation periods.

2020 saw a return in France and the Southern European countries to the more typical longer limitation periods highlighted in previous editions of the Study and a corresponding reduction in short limitation periods (between 6 and 12 months) from the high levels reported last year. The percentages are now more consistent with the ten-year average.

In CEE we saw huge variety: a significant increase (from 36% to 49%) in longer limitation periods of more than 24 months as well as in short limitation periods of 6 to 12 months (from 7% in 2019 to 18% in 2020). By contrast, the usage of limitation periods between 18 and 24 months dropped from 35% in 2019 to only 11% in 2020.

Time Trend Europe

More than 24 months



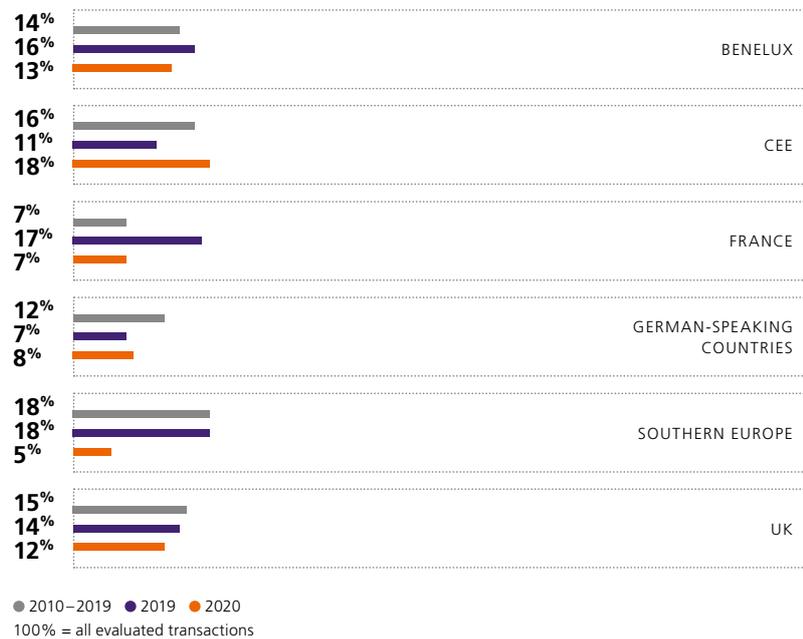
In Benelux the use of longer limitation periods dropped from 14% in 2019 to only 6% in 2020, while shorter limitation periods also decreased from 16% in 2019 to 13% in 2020. Limitation periods between 12 and 18 months became most typical (38% compared to 30% in 2019).

In the German-speaking countries the use of both short and long limitation periods remained broadly equivalent to the levels of 2019 but also experienced a reduction as compared to the ten-year average (19% for longer limitation periods and 12% for shorter periods). As with the Benelux countries, limitation periods of between 18 to 24 months were most common (43% compared to 37% in 2019).

In the UK, there was a slight decrease in the number of deals with shorter limitation periods (6 to 12 months).

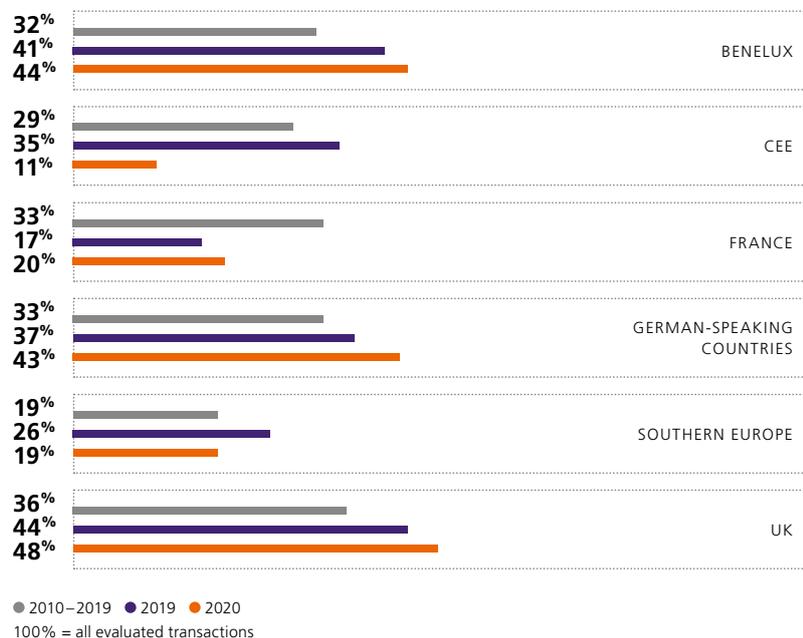
Time Trend Europe

6 to 12 months



Time Trend Europe

18 to 24 months



Sector Differences

Sector analysis demonstrates that in 2020, longer limitation periods (i.e. those exceeding 24 months) were most likely in the Hotels & Leisure and Energy sectors (37% and 26% of deals in those sectors, respectively).

The Infrastructure & Projects sector, which had seen longer limitation periods (i.e. those exceeding 24 months) in 2019 (29%), experienced a shift to shorter limitation periods in 2020 as the usage of longer limitation periods dropped completely (to 0%).

Limitation Periods (more than 24 months)

SECTOR	2010 – 2019	2019	2020
BANKING & FINANCE	17%	14%	7%
HOTELS & LEISURE	25%	27%	37%
ENERGY & CLIMATE CHANGE	20%	18%	26%
CONSUMER PRODUCTS	26%	33%	24%
TECHNOLOGY, MEDIA & COMMUNICATIONS	18%	12%	20%
INFRASTRUCTURE & PROJECTS	16%	29%	0%
LIFE SCIENCES & HEALTHCARE	23%	23%	26%
REAL ESTATE	27%	16%	22%
INDUSTRY	19%	18%	24%
BUSINESS (OTHER SERVICES)	25%	19%	16%
CMS AVERAGE	22%	19%	23%

100% = all evaluated transactions of the respective industry



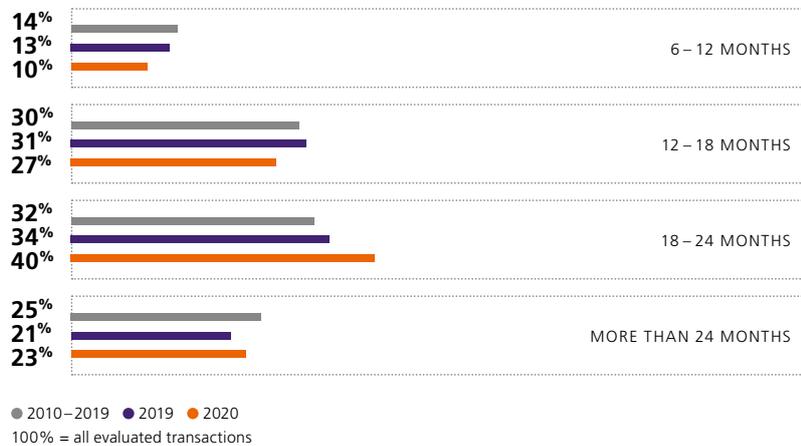
Analysis by Deal Size

Whilst time limitation periods to bring warranty claims tend to be shorter for larger transactions, the frequency of longer limitation periods (e.g. more than 24 months) for medium sized and large deals in 2020 is significantly higher than the average over the past decade – highlighting a switch to a more ‘buyer-friendly’ market on this point.

Limitation periods are more ‘buyer-friendly’ in transactions with a value below EUR 25m. 63% of small deals contained limitation periods exceeding 18 months in 2020.

Time Trend

By purchase price less than EUR 25m



*Limitation periods
> 24 months in deals
< EUR 25m*

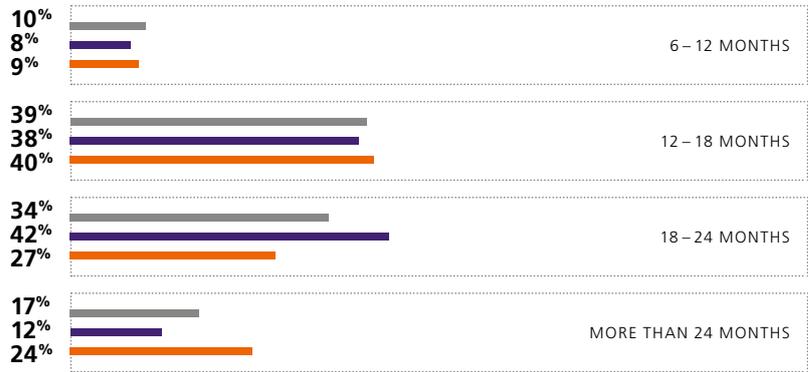
23% ➔

With regard to transactions with a value between EUR 25m and EUR 100m, sellers and buyers are most likely to agree on a limitation period between 12 and 18 months (40% in 2020).

In large transactions the parties mostly agreed on limitation periods between 12 and 24 months (65%).

Time Trend

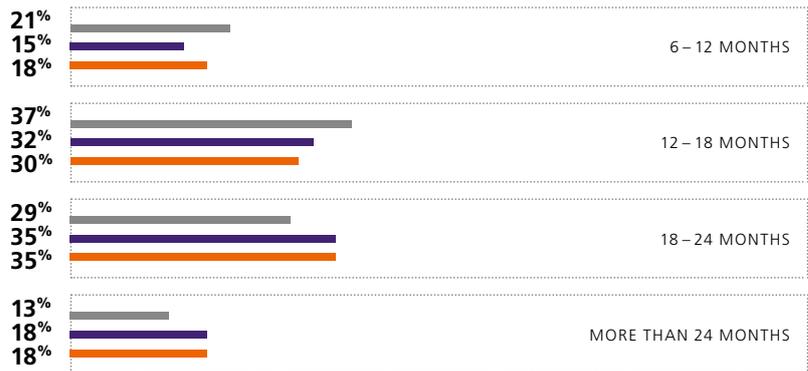
By purchase price EUR 25m – 100m



● 2010-2019 ● 2019 ● 2020
100% = all evaluated transactions

Time Trend

By purchase price more than EUR 100m



● 2010-2019 ● 2019 ● 2020
100% = all evaluated transactions



Security for warranty claims

Parties to M&A deals may agree to include a form of security for warranty claims in circumstances where the buyer has valid concerns about the seller's ability to stand behind the warranties given and satisfy any claims liabilities. The type and the amount of the security depends on many factors, such as the likelihood of a claim arising, the strength of the seller's covenant and the cost of establishing or obtaining the form of security.

General Overview

The number of deals involving security for warranty claims in 2020 fell by 4% to 29% as compared with 2019 (33%). The 'seller-friendly' trend of recent years continued as sellers were able to avoid having to give any security. Where the parties agreed a form of security for warranty claims, we noted the 'buyer-friendly' trend of using straightforward price retentions/holdbacks from the purchase price continued, with a fall in the use of escrow accounts. This may be driven by a desire to avoid the cost and complexity of establishing an escrow account (and increasingly law firms now are unwilling to act themselves as escrow agent) or may mark a change in market sentiment and be a sign of the decrease generally in the desire to use security for claims.

Sellers continue to avoid having to give security for warranty claims

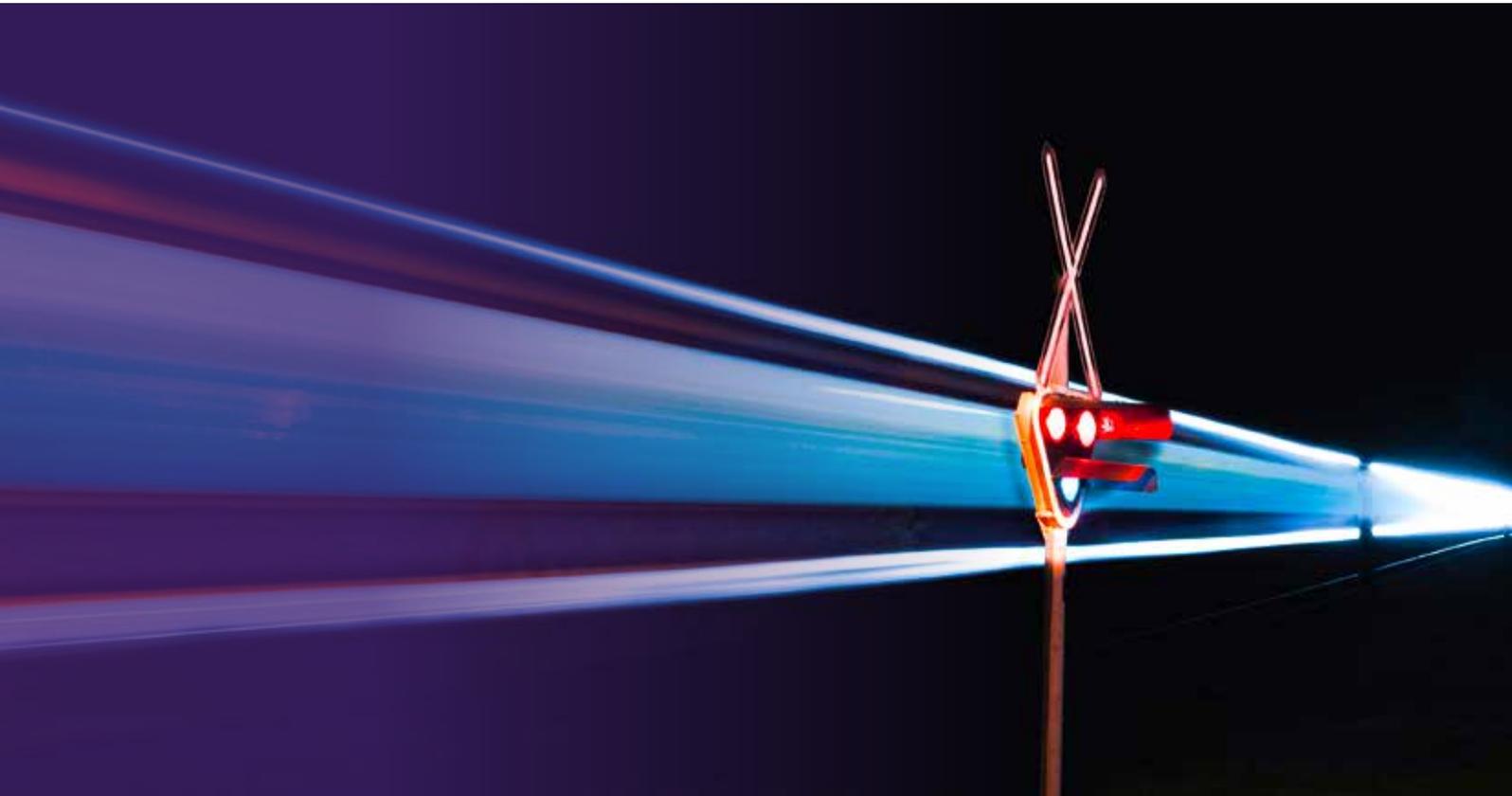
Time Trend



100% = all evaluated transactions

Frequency of security

29% ➔

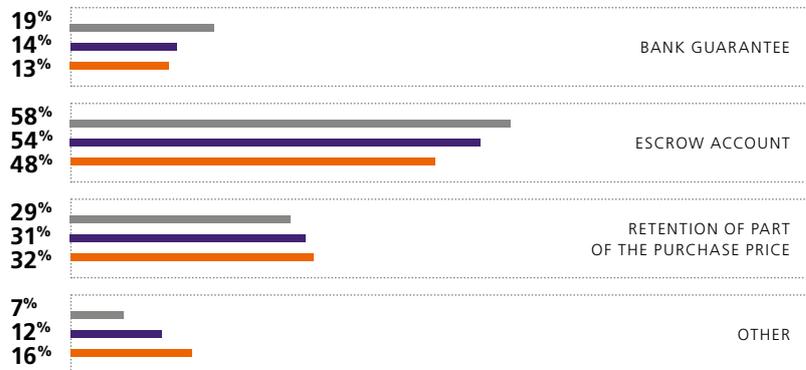


Specific Issues

Type of Security

Granting security for warranty claims by means of an escrow account was still the most popular type of security in 2020; despite this, escrows continued to feature on fewer deals in 2020 (48%) than in the past e.g. contrasted with 2019 (54%) and the ten-year average of 2010–2019 (58%). Whilst obtaining a bank guarantee slightly lost favour in 2020 (13%) when compared with 2019 (14%), retention of part of the purchase price and ‘other’ forms of security have become slightly more popular. Given that establishing an escrow account or obtaining a bank guarantee each are likely to involve increased expense and require additional negotiation, it is perhaps not surprising that parties are seeking cheaper and more straightforward mechanisms.

Time Trend



● 2010–2019 ● 2019 ● 2020

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

Escrow accounts

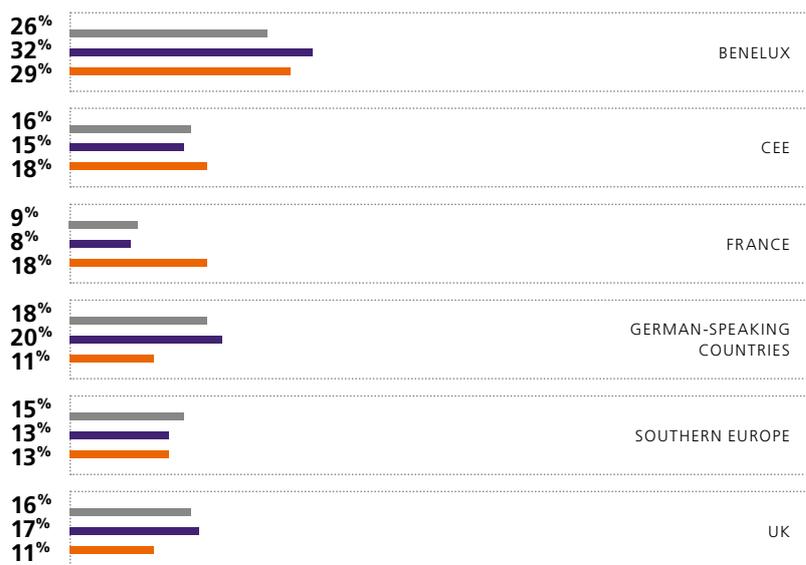
48% ➔

Escrow accounts still the most commonly used type of security but their popularity continues to fall

Regional Differences

The use of escrow accounts is still particularly popular in Benelux, with 29% of deals including this security. However, this is again a lower figure when compared with the figure for Benelux in 2019 (32%) and 2018 (44%). Whilst the use of escrow accounts dropped in the UK and in the German-speaking countries in 2020, we recorded the opposite trend in CEE, where the use of escrow accounts slightly increased from 15% in 2019 to 18% in 2020 and especially in France (from 8% in 2019 to 18% in 2020).

Time Trend Europe



● 2010–2019 ● 2019 ● 2020

100% = all evaluated transactions

Analysis by Deal Size

Parties agree on a security for warranty claims less often if the purchase price is above EUR 100m (27% in 2020). For small and medium sized deals, a security for warranty claims was agreed in 29% and 31% of the deals in 2020.

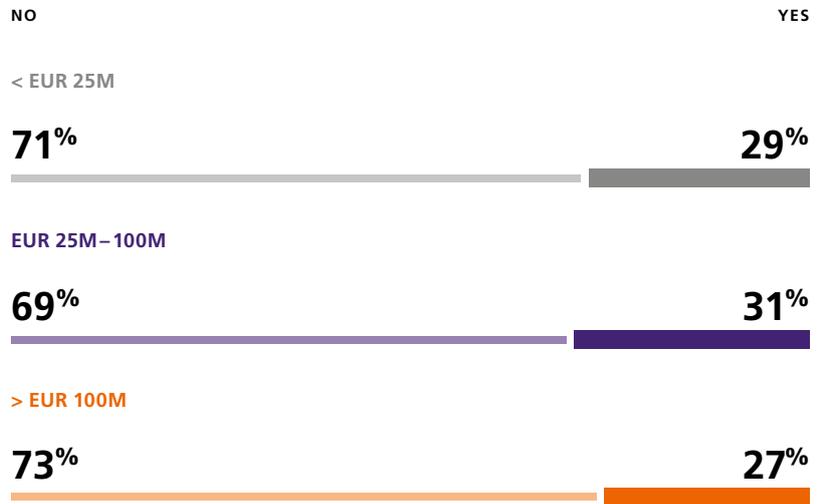
We saw that purchase price retention and escrow accounts are extensively used (both 42%) in large deals (above EUR 100m).

Escrow accounts are much preferred in medium sized deals, being used in 56% of such deals where security for warranty claims was agreed.

Bank guarantees are slightly more commonly used in medium sized deals (12% for deals with a value below EUR 25m, 13% for deals with a value between EUR 25m and EUR 100m, 8% for EUR 100m plus deals).

Escrow accounts most popular in large deals

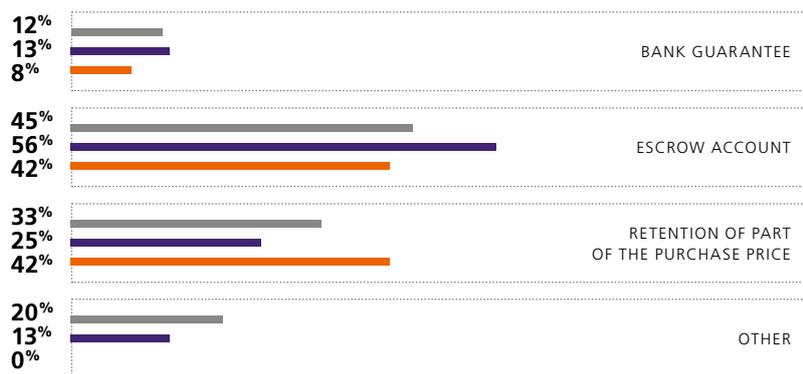
Security for Warranty Claims 2020



100% = all evaluated transactions

Security for Warranty Claims

By purchase price 2020

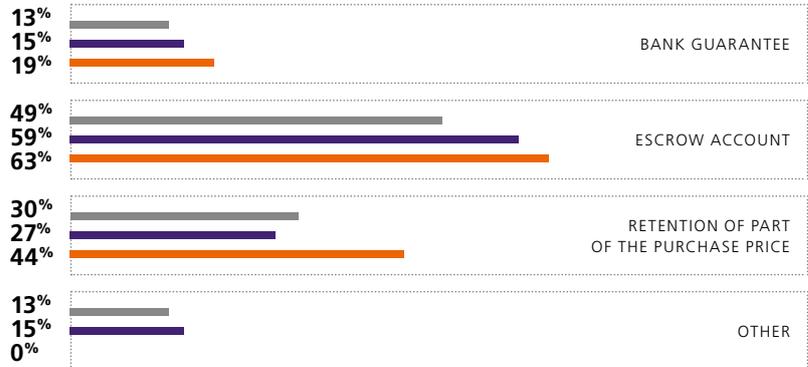


● < EUR 25m ● EUR 25m-100m ● > EUR 100m

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

Security for Warranty Claims

By purchase price 2019

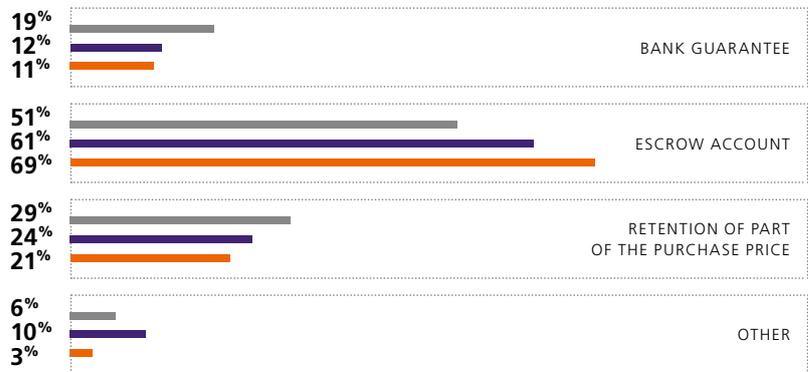


● < EUR 25m ● EUR 25m-100m ● > EUR 100m

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

Security for Warranty Claims

By purchase price 2010-2019



● < 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

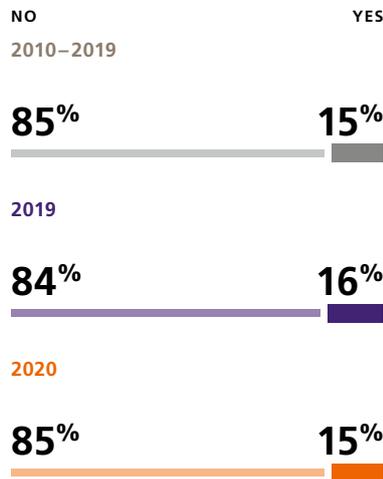
In 2020, MAC clauses were used in 15% of the deals, consistent with the previous ten-year average (15%). However, this is a slight decrease when compared with 2019 (16%). The continuing high success rate of sellers in resisting MAC clauses generally demonstrates their strong commercial position, especially in auction processes. Given the COVID-19 pandemic one could have expected an increase in usage of MAC clauses, as buyers may have argued that the volatility in the market justified their inclusion. However, it seems that on the whole sellers were able to continue to resist including MAC clauses, perhaps having conceded other 'buyer-friendly' points as part of the overall package.

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 (24%) and sector-specific (21%) economic development slightly gained in significance in 2020, exemptions in the event of force majeure (27%) were significantly more popular in 2020. We anticipate this is as a consequence of the COVID-19 pandemic and the desire of sellers to maximise deal certainty. Most lawyers would argue that a pandemic is some kind of force majeure (despite the economic impact) which could be the reason for a significant increase in use. By contrast, 'other' types of exemptions significantly lost popularity in 2020 (27%, 2019: 46%, 2010–2019: 33%).

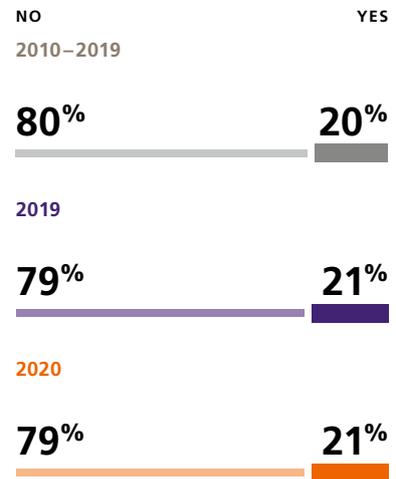
The frequency of Back-Door-MAC clauses in a transaction (i.e. a right of the buyer to rescind or terminate the SPA in the event that warranties given as of signing are not true and accurate after signing) remained stable in 2020 (21%).

Time Trend

MAC CLAUSES



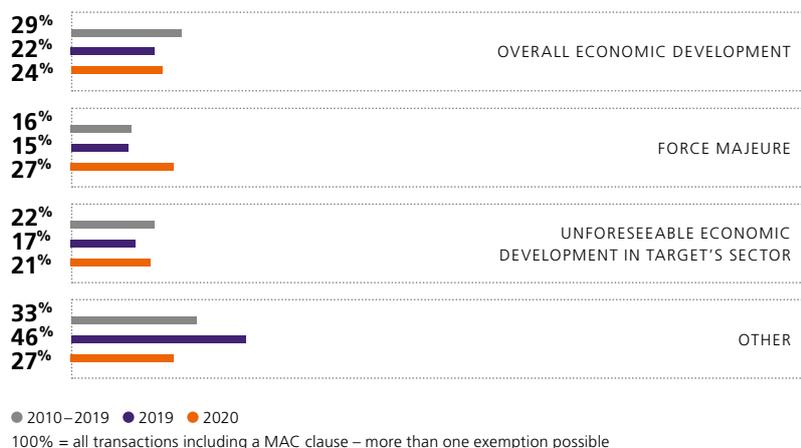
BACK-DOOR-MAC



100% = all evaluated transactions



Exemptions from Material Adverse Change



Specific Issues

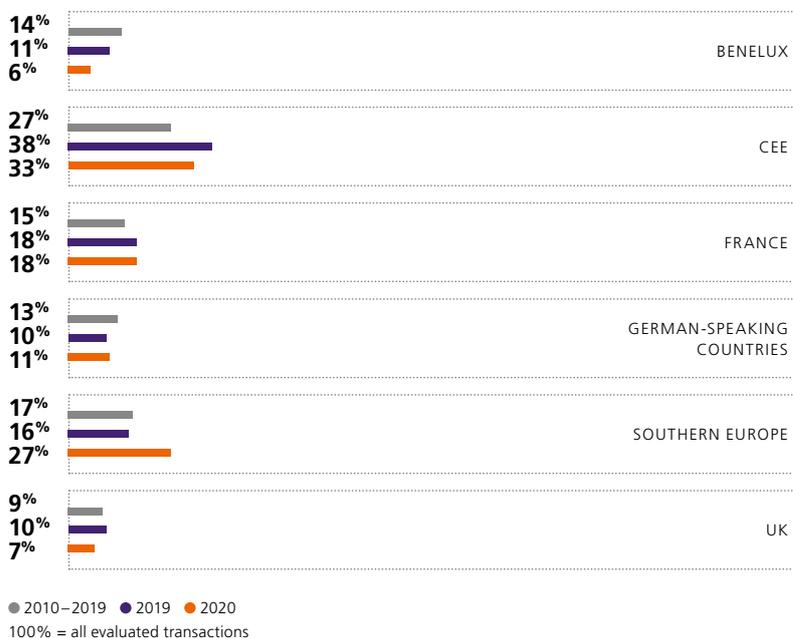
Regional Differences

The stark regional inconsistencies in the development of using MAC clauses remain as in previous years.

In comparison to 2019, MAC clause usage remained stable in France (18%) and broadly the same range in the German-speaking countries (10% in 2019 vs 11% in 2020). In Benelux there has been a continuous decline in MAC clause usage (2018: 18%, 2019: 11%, 2020: 6%). In CEE (from 38% to 33%) and in the UK (from 10% to 7%) MAC clauses lost popularity in 2020, which is contrary to the trend experienced in 2019. By contrast, in Southern European countries MAC clause usage increased significantly in 2020 (from 16% to 27%).

Southern European countries are experiencing a significant increase in MAC clause usage

MAC Clauses 2010–2020



Sector Differences

In 2020, MAC clauses were least frequently used in the Banking & Finance sector. The frequency of MAC clauses in this sector dropped significantly from 32% in 2019 to 6% in 2020. An opposite trend of increasing MAC clause usage can be observed especially in the Hotels & Leisure sector (plus 17%) and in the Real Estate sector (plus 8%). This might be caused by the COVID-19 pandemic, which has heavily impacted the Hotels & Leisure sector.

In the same period we saw only small changes in the Consumer Products sector (minus 8%) and in the Technology, Media & Communications sector (minus 6%).

Frequency of MAC Clauses

SECTOR	2010 – 2019	2019	2020
BANKING & FINANCE	21%	32%	6%
HOTELS & LEISURE	13%	13%	30%
ENERGY & CLIMATE CHANGE	14%	13%	14%
CONSUMER PRODUCTS	13%	24%	16%
TECHNOLOGY, MEDIA & COMMUNICATIONS	13%	15%	9%
INFRASTRUCTURE & PROJECTS	10%	22%	25%
LIFE SCIENCES & HEALTHCARE	17%	14%	17%
REAL ESTATE	15%	12%	20%
INDUSTRY	16%	17%	17%
BUSINESS (OTHER SERVICES)	14%	15%	14%
CMS AVERAGE	15%	16%	15%

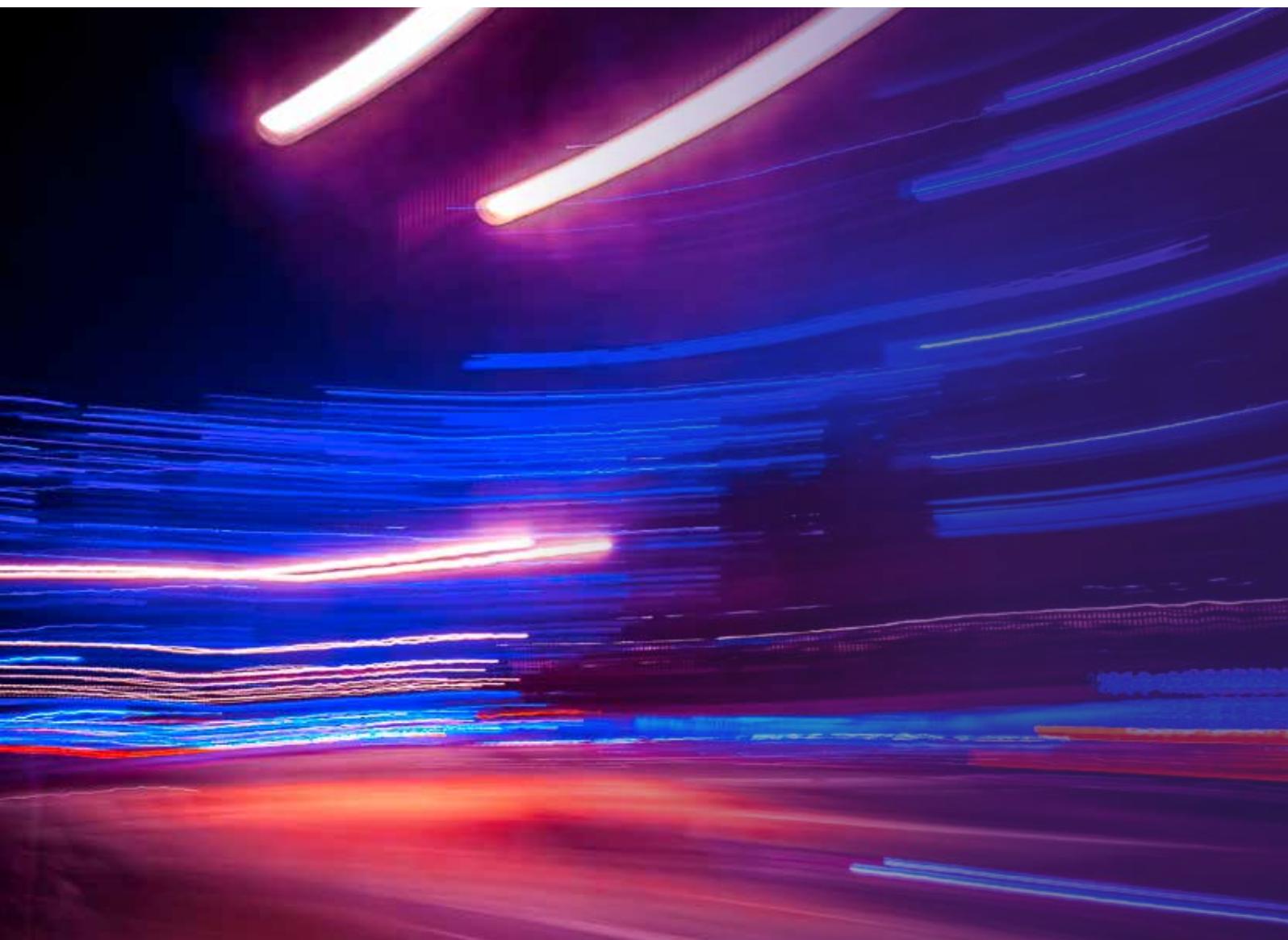
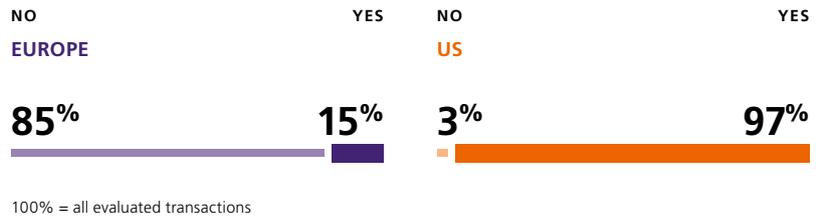
100% = all evaluated transactions of the respective industry

European/US Differences

In contrast to Europe, where only 15% of deals included MAC clauses in 2020, there were MAC clauses in 97% of US deals according to the most recent US statistics for 2018 and Q1 in 2019. This remarkable disparity is, on the one hand, explicable 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 (15%) and the US (97%)

MAC Clauses Europe/US 2020



Analysis by Deal Size

In 2020, we noted an opposing development in the usage of MAC clauses while looking at different deal sizes. We saw a slight decrease for small deals (from 14% in 2019 to 13% in 2020) and a significant decrease for large deals (from 19% to 13%). On the other hand, we noted a slight increase for medium sized deals (from 20% in 2019 to 22% in 2020), reflecting the trend of increasing MAC clause usage over the previous years (2010–2019: 17%).

Small deals less commonly include a MAC clause, presumably due to the lower financial risk of fundamental changes post-signing as contrasted to such risks in medium sized and large deals and also because the majority of smaller deals sign and close simultaneously given there is less regulatory oversight and few CPs. The drop in MAC clause usage in large deals in 2020 (from 19% to 13%) might be a unique event, although a comparable sudden drop occurred in 2018 (12%). This might be caused by the COVID-19 pandemic as particularly on large deals sellers will seek as much deal certainty as possible.

MAC clause usage more common in medium sized deals

MAC Clauses 2010–2020

By purchase price

< EUR 25M

NO YES
2010–2019

87% 13%

2019

86% 14%

2020

87% 13%

> EUR 100M

NO YES
2010–2019

82% 18%

2019

81% 19%

2020

87% 13%

EUR 25M–100M

NO YES
2010–2019

83% 17%

2019

80% 20%

2020

78% 22%

100% = all evaluated transactions



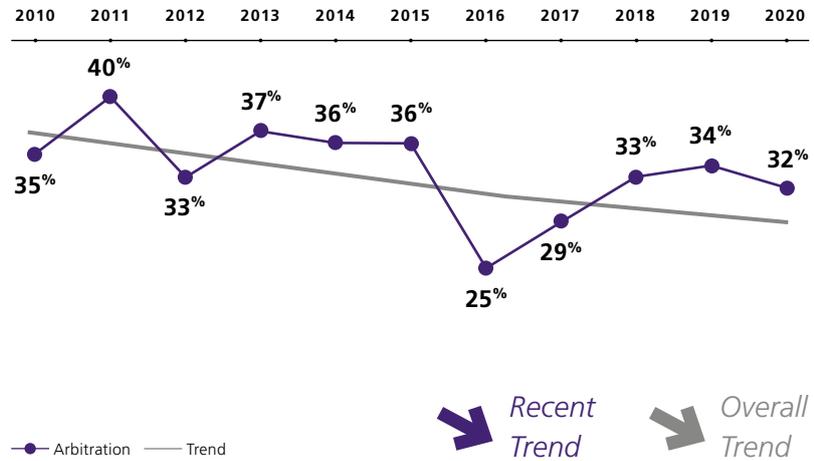
Arbitration

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 judgments 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 2020, arbitration was used as the dispute resolution mechanism in 32% of deals. This marks a slight decrease compared to 2019 (34%), following a steady increase in recent previous years (2018: 33%; 2017: 29%; 2016: 25%). The current popularity of arbitration as a dispute resolution mechanism is still nearly consistent with its long-term popularity over the course of the previous ten years (2010–2019), 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 ten years, the popularity of arbitration clauses has remained relatively stable within each categorised region.

CMS Trend Index



Arbitration clause ratio 2020

32% ➔



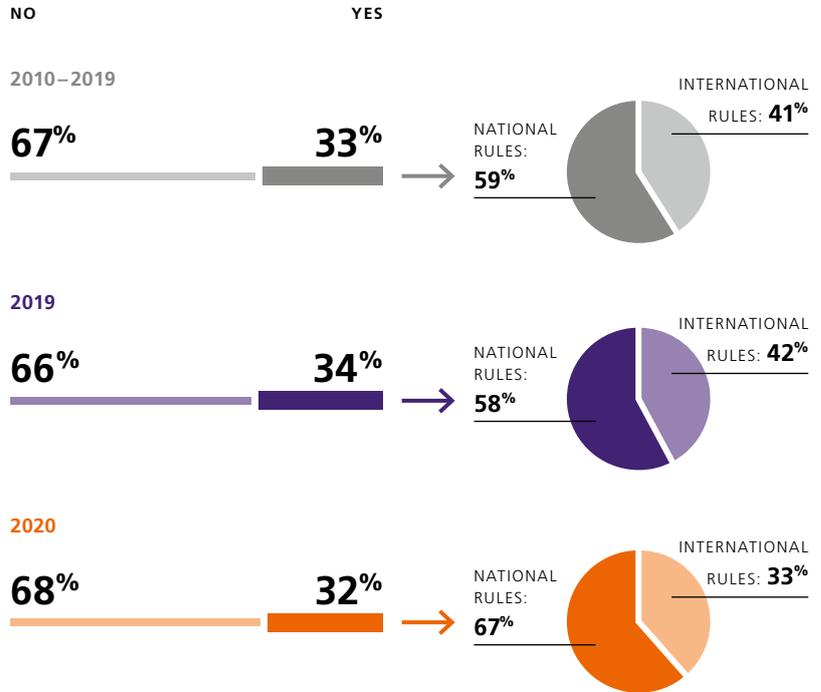
In 2020, the use of national rules to govern arbitration (67%) vastly extended its popularity over the use of international rules when compared with 2019 (58%), as well as when compared to the ten-year average of 59% (2010–2019). This might be caused by the impact of Brexit and a stronger focus on national interests. It will be interesting to see whether this will set a new trend or will level off as European states get accustomed to the new normal post the UK leaving the European Union.

Arbitration remains popular

National rules

67% ➔

Time Trend



100% = all evaluated transactions



Specific Issues

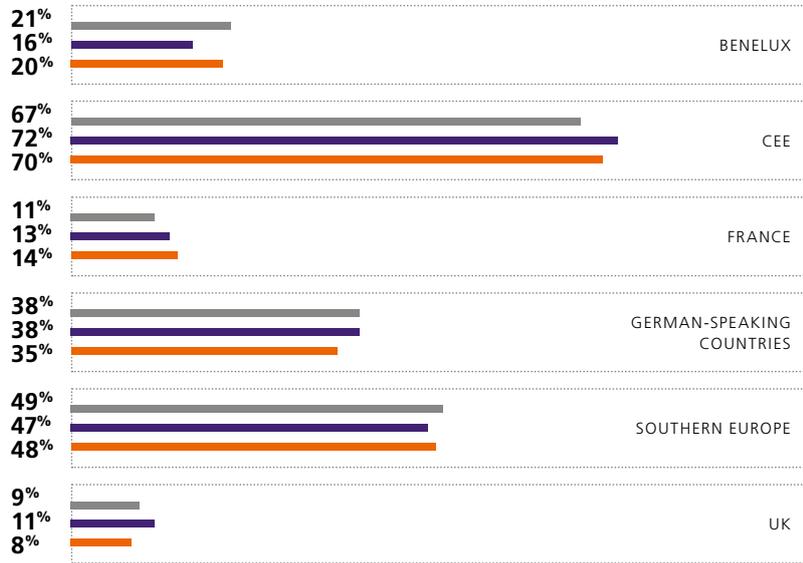
Regional Differences

In 2020, arbitration clauses remained relatively unpopular in the UK (8%, 2019: 11%, 2010–2019: 9%) and in France (14%). Despite this fact, arbitration clauses have gained slightly in popularity in France when compared with 2019 (13%) and with the ten-year average for 2010–2019 (11%).

In comparison to 2019, arbitration is slightly more popular in Benelux, featuring on 20% of deals in 2020 (16% in 2019). We saw an opposing development in the German-speaking countries, where an arbitration clause was included in 35% of deals in 2020 in contrast to 38% in 2019 and 42% in 2018.

On the other hand, arbitration remained a popular dispute resolution mechanism in CEE (70% in 2020 compared with 72% in 2019) and the Southern European countries (48% in 2020 compared with 47% in 2019).

Time Trend Europe



● 2010–2019 ● 2019 ● 2020
100% = all evaluated transactions

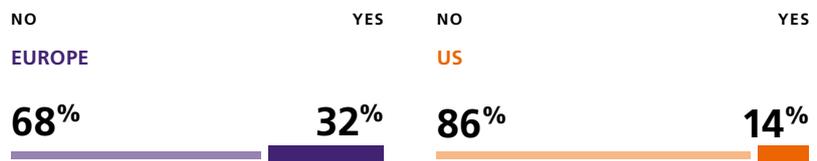
Arbitration still most commonly used in CEE

70%

European/US Differences

The use of arbitration is much more popular in Europe (32%) than in the US (14%).

Arbitration Clauses Europe/US



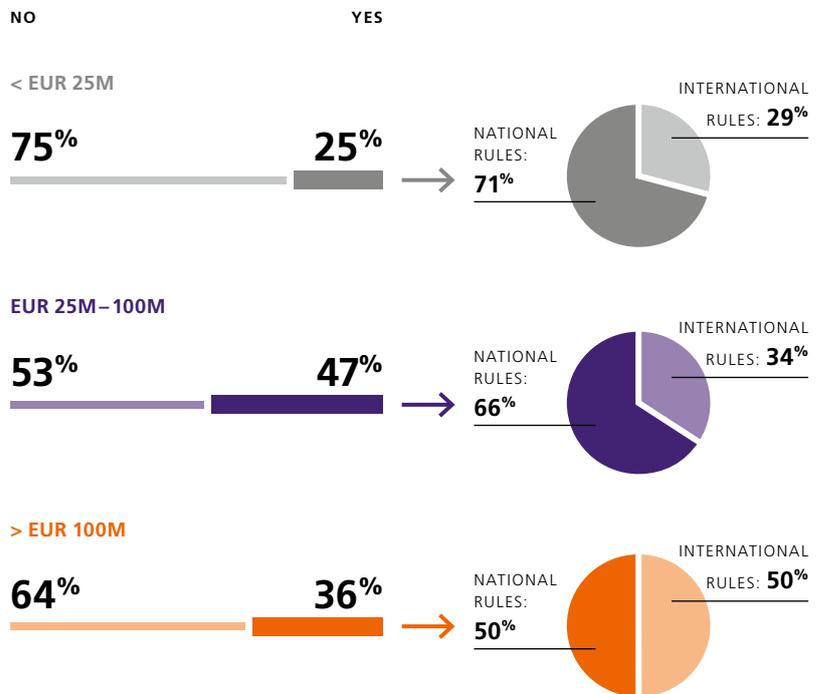
100% = all evaluated transactions

Analysis by Deal Size

Since 2016, the transaction value has been a determining factor for the use of arbitration as the dispute resolution mechanism. In 2020, a quarter of small deals (25%) contained an arbitration clause, whereas almost half (47%) of the medium sized deals (EUR 25m to EUR 100m) contained an arbitration clause. Contrary to 2019, we saw that usage of arbitration clauses appears less popular on large deals (EUR 100m plus) (36% in 2020 compared with 47% in 2019).

Whilst the application of international rules is frequently chosen for large deals (50% of EUR 100m plus deals), national rules are significantly more likely to be selected for small and medium sized transactions (71% of deals below EUR 25m and 66% of EUR 25m to EUR 100m deals).

By Purchase Price 2020



100% = all evaluated transactions

Transaction value is still the driving factor in 2020 as to whether to choose national rules of arbitration (rather than international rules)



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

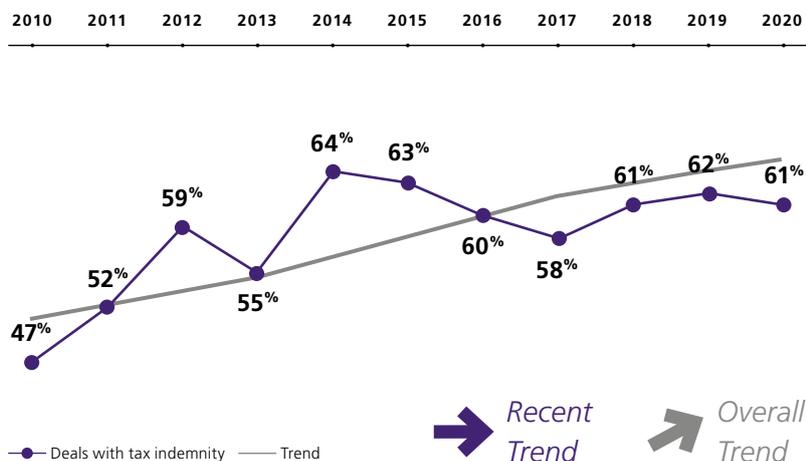
Tax indemnities were agreed in 61% of the deals in 2020. This seems to reflect a levelling off in the application of such indemnifications over the past years and reflects a slight decrease from the high of 64% in 2014. However, this is still a slight increase compared with the ten-year average (59%).

Tax indemnity 2020

61% →

CMS Trend Index

Tax indemnity agreed



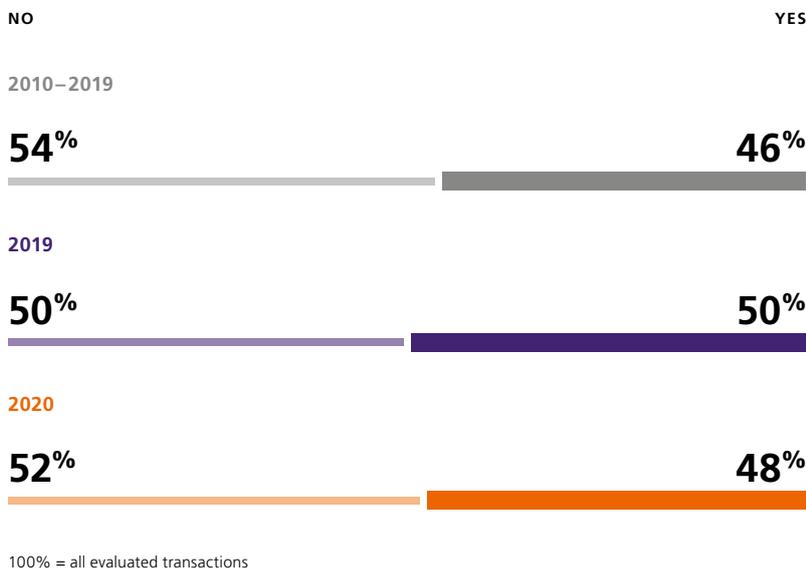
In 2020, nearly half of the deals (48%) contained a clause granting the seller the right to participate in a future tax audit. This reflects a slight decrease when compared with the previous year (2019: 50%). Despite this fact, participation rights slightly gained in popularity when compared with the ten-year average (2010–2019: 46%), with an even bigger increase compared to 2017 (31%) and 2018 (46%).

Sellers in nearly half of the deals able to negotiate a participation right in future tax audits

Seller's participation right

48% ↘

Participation Right in Future Tax Audit

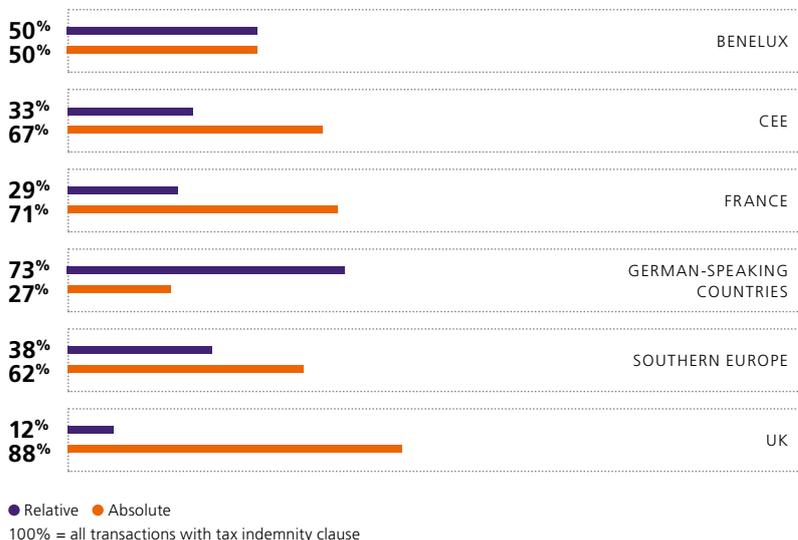


Specific Issues

Regional Differences

The strong regional differences in the use of absolute and relative limitation periods remain as in past years. While relative limitation periods continue to prevail in the German-speaking countries (2020: 73%, 2019: 75%), the opposite is the case in the UK, France and Southern European countries in recent years. Absolute limitation periods are still the norm in the UK (2020: 88%, 2019: 93%), France (2020: 71%, 2019: 78%) and Southern European countries (2020: 62%, 2019: 70%), even though the numbers for these countries are continuously decreasing. The use of either absolute or relative limitation periods tends to be almost universal within most regions, except in Benelux (2020: 50%) and in CEE (2020: 67%, 2019: 59%, 2018: 91%), where we observed greater variation in recent years. In Benelux we noted a stark decrease in the use of relative limitation periods (2019: 62%, 2018: 76%).

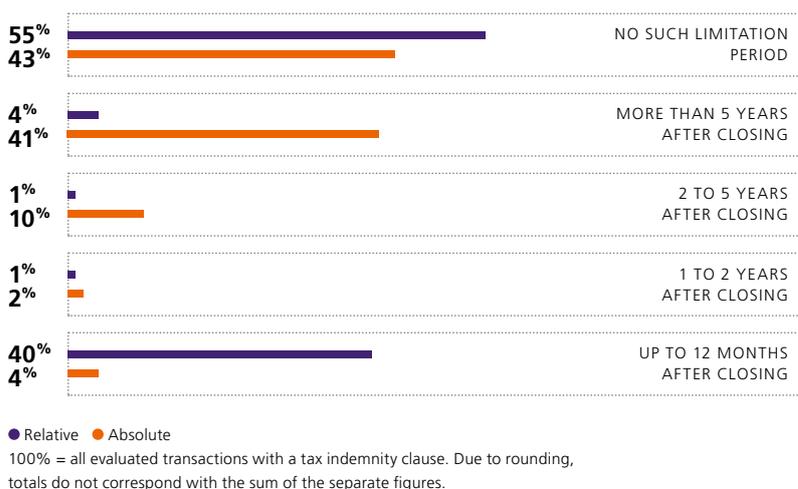
Absolute and Relative Limitation Period 2020



Type of Limitation Period

Parties who agree on an absolute limitation period tend to choose a period of more than five years after closing (2020: 41%, 2019: 43%). If the parties agree on a relative limitation period for tax indemnification, the vast majority choose a period of up to 12 months after the decision of the tax authority (2020: 40%, 2019: 35%).

Duration of Limitation Period

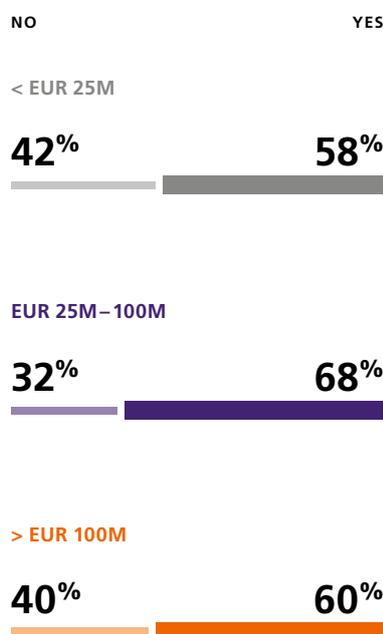


Analysis by Deal Size

Both in 2020 and in 2019, tax indemnifications were mainly agreed in medium sized deals (2020: 68%, 2019: 69%). In large deals (EUR 100m plus), tax indemnities were agreed slightly less often in 2020 (60%) when compared with 2019 (63%).

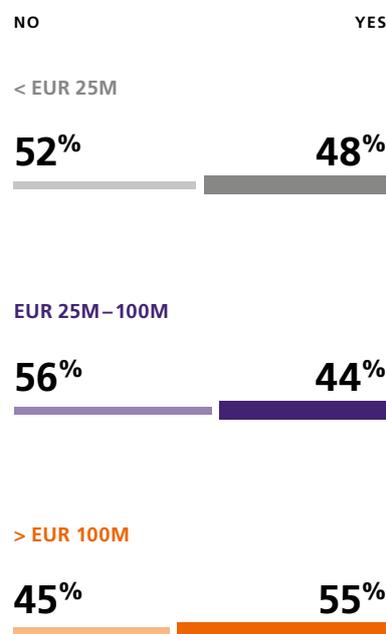
Our deal size analysis demonstrates that in large deals sellers were more frequently able to preserve a participation right in proceedings started by a tax authority (2020: 55%, 2019: 51%). In contrast, we noted a significant decline (2020: 44%, 2019: 56%) in the use of participation rights for medium sized deals (between EUR 25m and EUR 100m). It will be interesting to see in the next years if this has set a new trend. In 2020, the seller's right to participate in proceedings was agreed in 48% of small deals (below EUR 25m).

Tax Indemnity Agreed



100% = all evaluated transactions

Participation Right in Future Tax Audit



100% = all evaluated transactions with a tax indemnity clause

Tax indemnity

68% of deals
EUR 25m – 100m



60% of deals
> EUR 100m



Tax indemnities more common in medium sized transactions

Where to find CMS



Our latest CMS Corporate / M&A headline deals

AB Electrolux

Advised on the separation of the Professional Products business area from the rest of the Electrolux group worldwide.

Airbus

Advised Airbus on the divestment of PFW Aerospace, a key supplier in the aviation industry.

Authentic Brands

Advised on the acquisition of the Brooks Brothers group worldwide.

Discovery

Advised on taking over the TV channel TELE 5 and a long term content agreement with LEONINE.

EBRD

Advised on renewable energy investment in Ukraine.

HP

Advised on acquisition of GNA Biosolutions, a Bavarian biotechnology company that developed a coronavirus rapid test which is awaiting approval for use throughout Europe.

Aenova

Advised Aenova in the restructuring of its Italian affiliate and indebtedness.

Allianz

Advised on EUR 214m acquisition to expand Munich office portfolio and on EUR 500m joint venture with developer VGP.

Cosco

Advised Chinese container logistics giant COSCO on acquisition of Greek PEARL Group, a railway company mainly operating in Southern Europe.

DuPont

Advised DuPont Nutrition and Biosciences on investment in MRM Health.

Grupa Azoty Polyolefins

Advised on the Polimery Police investment project – the largest chemical investment in Poland and CEE with an estimated budget of USD 1.8bn.

InPost and Advent International

Advised InPost on its IPO on the Euronext Amsterdam Stock Exchange.

Manchester Airports Group

Advised on sale of assets at Manchester, Stansted and East Midlands airports.

News Corp UK & Ireland

Advised NewsCorp UK on the sale of Unruly Media, a global programmatic advertising group, to AIM quoted New York based adtech group Tremor International.

Oaktree Capital Management

Advised funds managed by Oaktree Capital Management, L.P. on the Dutch aspects of the sale of Kadans Science Partner (Kadans) to AXA Investment Managers – Real Assets.

RWE

Advised RWE, one of the world's leading renewable energy companies, on an agreement to sell a 49% stake in the Humber Gateway offshore wind farm to Greencoat, a UK-based investment company focusing on renewables projects, for a total cash consideration of GBP 648m.

Savills

Advised on acquisition of property and facilities management companies from OMEGA Immobilien Group.

Telefonica

Advised Telefonica on formation of fibre optic joint venture with Allianz Group.

Urban & Civic

Advised on the takeover of Urban & Civic plc by the Wellcome Trust.

Modine

Advised Modine on sale of the liquid-cooled portion of its automotive business to Dana Incorporated.

NH Hotels

Advised in relation to acquisition of operations of a portfolio of 8 hotels in Italy, Czech Republic, Hungary and France, in the context of the acquisition of the above portfolio by Covivio Hotels, as lead purchaser and property investor.

REWE

Advised REWE on investment in beverage delivery service Durst.

RWS Holdings

Advised AIM listed RWS Holdings plc on its recommended all share combination with SDL plc implemented by a court sanctioned scheme of arrangement.

Sequoia Economic Infrastructure Income Fund Limited

Advised on GBP 300m placing, open offer and offer for subscription and GBP 300m share issuance programme.

Transatlantic Reinsurance

Advised Transatlantic Reinsurance Company on corporate restructuring in Germany and France.

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
- 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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CMS shines in market turmoil

Notwithstanding the extraordinary market conditions of 2020, CMS continues to lead the Corporate/M&A market across a number of jurisdictions worldwide as recognised by top rankings from Bloomberg, Mergermarket and Thomson Reuters.

- #1** Germany, DACH, Austria
- #2** Europe, UK, Switzerland, Benelux

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

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