

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.



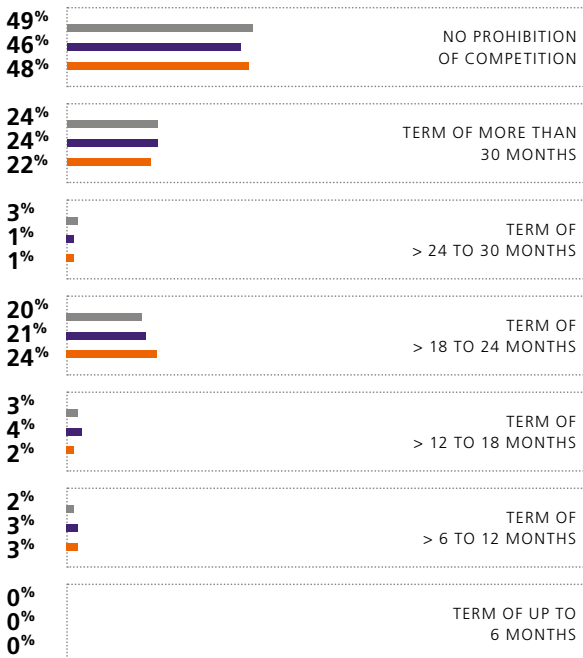
Non-compete provisions

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

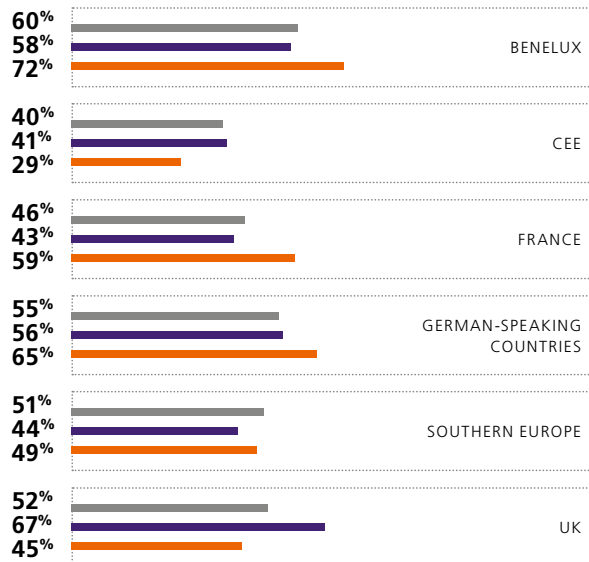
Duration of non-compete clauses 2010–2020



● 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.