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10 M&A Trends Gleaned from the 2020 – 2021 ABA Deal Points Study

January 5, 2022

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The American Bar Association (ABA) 2020 – 2021 Private Target Mergers & Acquisitions Deal Points Study^[1] analyzed publicly available acquisition agreements for 123 transactions executed and/or completed in 2020 and the first quarter of 2021. The deals analyzed ranged in size from \$30 million to \$750 million.

Below is a list of trends which began, continued, accelerated, or were halted in 2020 and early 2021:

1. **Earnouts declined slightly in popularity.** Earnouts appeared in only 20% of post-pandemic transactions, the lowest percentage in the past decade by 5-8%. Earnouts are typically structured to favor the acquirer, eliminating some of the risk that a target's business will slow post-closing. Sellers often agree to earn outs when they believe a buyer is undervaluing their company. In 2021 we saw sellers willing to agree to earn outs where a buyer was not as confident that 2020-2021 results were sustainable or that federal stimulus funds caused an artificial bump in revenue. On a related note, there was a sharp increase in the number of deals where the earnout payment accelerated if the buyer changed ownership.
2. **“Material Adverse Effect” was defined to exclude effects of the pandemic.** Although it wasn't measured in previous years, the Deal Points study revealed that 67% of transactions carved out the effects of the pandemic (and/or governmental responses to the pandemic) from the definition of a “material adverse effect.” This was accompanied by an increase (to 95%) in carve-outs for “changes in law,” which would include governmental responses to the pandemic such as social distancing requirements, mandatory shut downs, and other public health responses.

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3. **Continued decline in “10b-5” and full disclosure representations.** Buyers prefer what is known as a “10b-5” representation, that, simply put, no statement made by seller contains any untrue statement or omits any material fact necessary to make any statement “not misleading.” The full disclosure representation is similar to the 10b-5 representation but is limited to disclosure of any fact that may materially adversely affect the seller’s business. In 2020-2021, sellers were increasingly successful in limiting the inclusion of 10b-5 representations and qualifying full disclosure representations to the seller’s knowledge.
4. **Covenant to operate in the ordinary course qualified by an “efforts” standard.** Almost 100% of separate sign and close transactions since 2014 have included a post-signing pre-closing covenant to operate the business in the ordinary course. However, only about 15% of deals on average over the past decade have qualified the covenant by an “efforts” standard—meaning the seller doesn’t *absolutely* need to operate in the ordinary course in the intervening period, but rather that the seller only needs to use reasonable best efforts or commercially reasonable efforts to maintain or preserve the business. In 2020 – 2021, 40% of these covenants were qualified by an “efforts” standard.
5. **Shortening of survival periods.** Eighteen (18) months used to be the generally expected survival period for most representations and warranties to allow the buyer to get through a full audit cycle. In 2020 – 2021, 43% of deals included only a 12-month survival period and 33% expressly provided no survival period.
6. **Limitation on damages.** Agreements in 2020 – 2021 limited damages across the board more than in 2018 – 2019. Incidental damages, punitive damages, consequential damages, lost profits, and damages based on a multiple were expressly excluded at a higher rate than in 2018 – 2019.
7. **Decreased use of alternative dispute resolution provisions.** At its height in 2008, more than a third of agreements included alternative dispute resolution provisions. From 2010 to 2018-2019, ADR provisions continued to appear in about 15% of all agreements. In 2020-2021 this percentage was cut in half, with only 7% of agreements including ADR provisions.
8. **Increased use of #MeToo representations.** The so-called #MeToo representation specifies that there have been no allegations of sexual harassment or misconduct against the seller’s management. When they first appeared in 2018-2019 they were in only 13% of Deal Points’ agreements, but in 2020-2021 they appeared in 37% of the agreements analyzed.
9. **Sandbagging clauses continue to lose favor.** Sandbagging clauses and benefit-of-the-bargain clauses reached their peak in the 2006 Deal Points study, appearing in 50% of the analyzed transactions, and have hovered between 35%-42% since then. In 2020-2021, they dropped to only 29% of transactions, with the majority of transactions remaining silent as to sandbagging altogether.
10. **Caps, baskets, escrows, and holdbacks decline.** Not only did the use of caps and baskets decline but the size of the caps and baskets relative to the transaction value also declined. Furthermore, the number of deals with no escrow or holdback jumped to 37% in 2020-21 from only about 15% in 2018-2019. As the number of deals with representation and warranty insurance (RWI) increased, the size of the escrow

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or holdback decreased precipitously.

The 2020-2021 transaction season presented corporate departments across the United States with many disruptive factors: the increased use of RWI, a presidential election, several rounds of tax proposals and PPP funding, and the COVID-19 pandemic. Overall, although the pandemic initially halted many transactions, 2020 still put many transactional attorneys into overdrive—not only in the number but also in the speed with which the parties wanted to close. Anecdotally, transactions closed in about half the time they did in years previous—a sign not only of the available capital on the market but also the pressures of significant tax changes and the uncertainty caused by the pandemic.

Some of the trends we've witnessed in 2020-2021 included an increased attention to the pricing of the transaction and heavier reliance on quality of earnings reports. While many buyers feared that success realized by a target during the pandemic would be short-lived, many sellers believed their numbers were strong enough to support a better purchase price, and we saw quite a few sellers walk away from closings to find a better price. The increased use of RWI is also changing the dynamic of negotiations and diligence, and we expect to see that trend continue as RWI policies become more available for smaller transactions.

Pullman & Comley's Mergers and Acquisitions practice shepherded an unprecedented number of transactions from start to close in 2020-2021 and looks forward to another busy year in 2022.

[1] The Deal Points Study is a Project of the M&A Market Trends Subcommittee of the Mergers & Acquisitions Committee, part of the Business Law Section of the American Bar Association.

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