

# ACC Hot Topics Making Waves in M&A: Navigating RWI and Earnouts

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Presented by:  
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# Team



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## Overview of RWI

- Used in M&A to protect against covered losses arising due to the seller's breach of certain of its representations and warranties in the transaction agreement.
- Insurance company assumes post-closing indemnity risk traditionally borne by the seller.

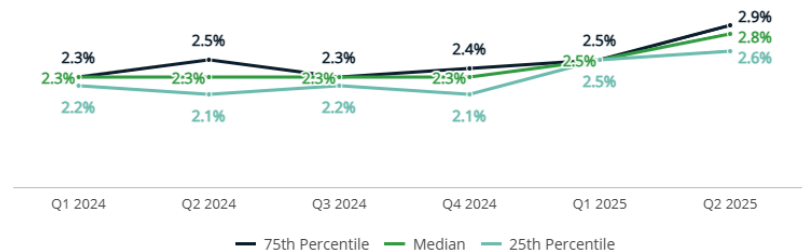
## Key Benefits of RWI

- Allows the seller to provide the buyer a greater set of representations and warranties than it otherwise would be willing to provide.
- Allows the seller to realize sales proceeds immediately by reducing the amount placed in an indemnification escrow.
- Allows the buyer to obtain its desired level of indemnification coverage without having to negotiate substantial indemnity from the seller.

## RWI Policy Terms

- *Duration of Policy:* Typically, three years for general representations and six years for fundamental and tax representations.
- *Cost:* Generally, 2.25 – 3% of limits purchased.
- *Deductible:* Generally, 0.5% – 1% of enterprise value.
- *Time to Procure:* Assuming all diligence materials are available, generally 1 – 2 weeks.

RWI Rate-on-Line Trend



## Current RWI Trends

- New market entrants have led to more competitive pricing and fewer broad exclusions from coverage.
- Streamlined underwriting process, with shorter underwriting calls and fewer supplemental requests post-call.
- RWI coverage has expanded to accommodate smaller deals.

## Coverage under RWI

### *Covered Claims*

- Breaches of representations and warranties not known as of signing and/or closing.
- Pre-closing tax liabilities.
- Fraud (so long as insurer maintains subrogation rights).

### *Excluded Claims*

- Known breaches of representations and warranties as of signing and/or closing.
- Interim breaches between signing and closing.
- Covenant breaches.
- Generally, defined benefit and retirement plan underfunding liability, use of NOLs, purchase price adjustments and transfer pricing matters.

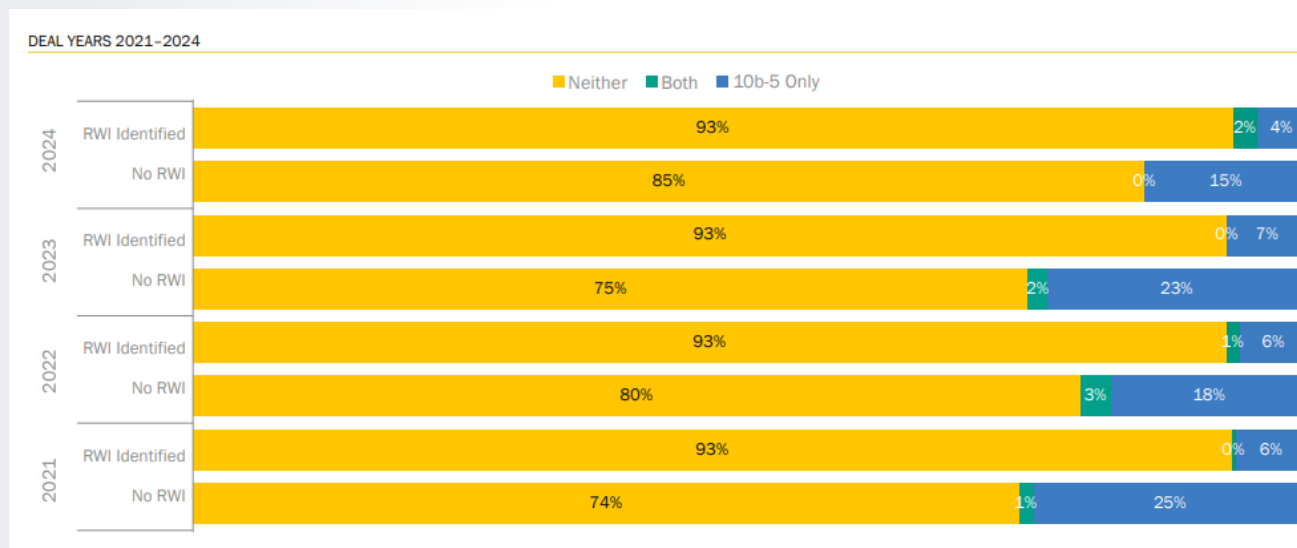
## Underwriting Process for RWI

- Engage representations and warranties insurance broker.
- Broker solicits bids from insurers with proposed pricing and expected scope of coverage and assists in evaluation and comparison of bids received.
- Once insurer is selected, diligence materials are provided to insurer, and insurer conducts underwriting call to probe.
- Insurer conducts follow-up due diligence and negotiates exclusions to coverage based on risks identified.
- Broker and legal counsel review policy and negotiate provisions with insurer.
- Policy is bound, either upon the signing of the transaction or the closing of the transaction.
- If signing and closing are not simultaneous and policy was bound at the signing, then there is a bring down call where the buyer reaffirms no knowledge of any breaches of the representations and warranties.



# Impact of RWI on M&A Deal Terms: Inclusion of 10b-5 and Full Disclosure Representations

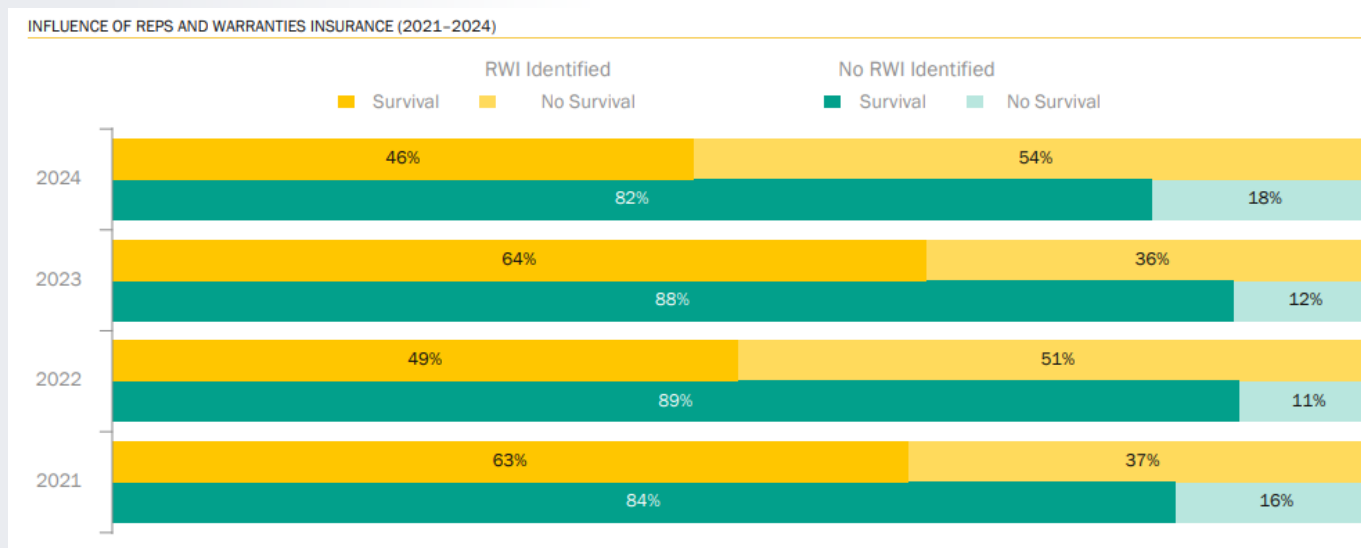
- Deals with RWI are less likely to have “10b-5” and “full disclosure” representations than deals without RWI.



Source: SRS Acquiom 2025 M&A Deal Terms Study

# Impact of RWI on M&A Deal Terms: Survival of Seller's Representations

- Deals with RWI are more likely to be structured as “no survival” (“walk-away”) deals than deals without RWI.

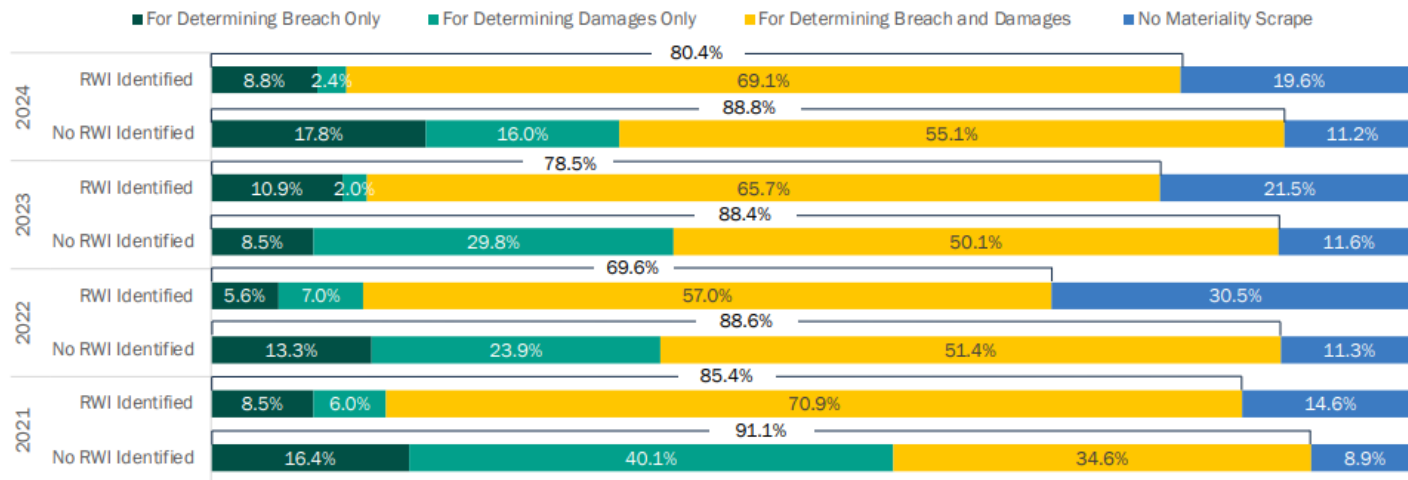


Source: SRS Acquiom 2025 M&A Deal Terms Study

# Impact of RWI on M&A Deal Terms: Inclusion of Materiality Scrape

- Deals with RWI are more likely to include a materiality scrape than deals without RWI (with most insurance policies defaulting to a double materiality scrape).

MATERIALITY SCRAPE INCLUDED AND DETAILS (2021–2024)

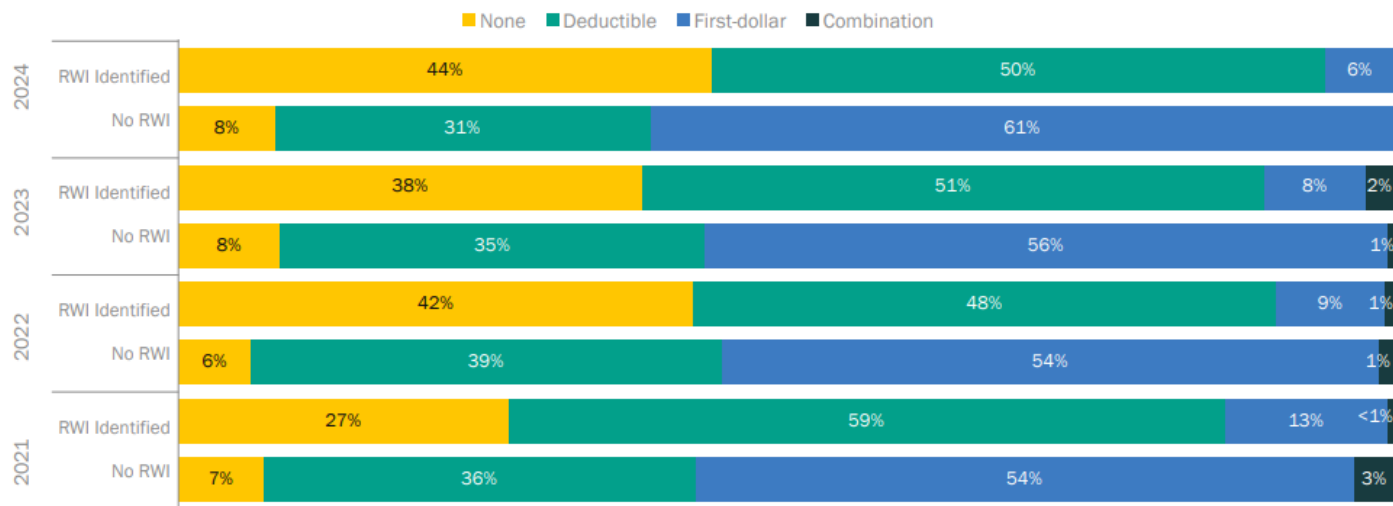


Source: SRS Acquiom 2025 M&A Deal Terms Study

## Impact of RWI on M&A Deal Terms: Baskets

- Deals with RWI are more likely to have no deductible or a true deductible (as opposed to a tipping basket) than deals without RWI due to retention under insurance policy.

BASKET TYPE DISTRIBUTION, DEALS 2021–2024



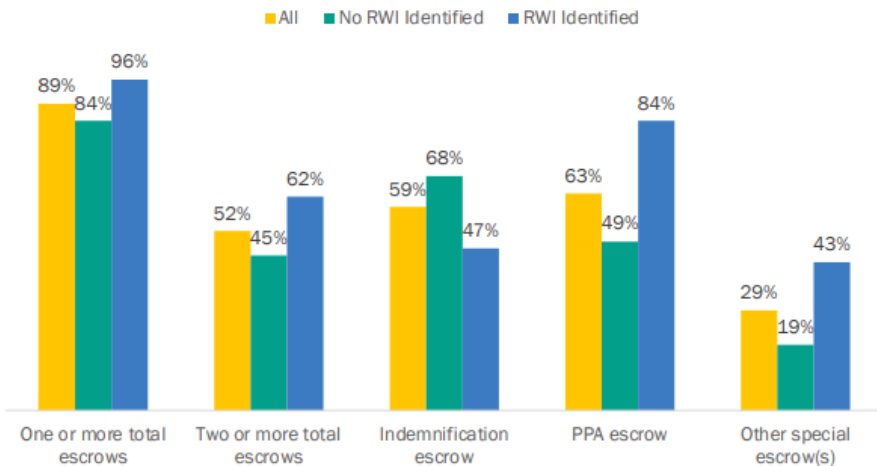
Source: SRS Acquiom 2025 M&A Deal Terms Study

# Impact of RWI on M&A Deal Terms: Deal Escrows

- RWI impacts the number and size of deal escrows.

Subset: 2024 deals

PERCENTAGE OF ALL DEALS THAT INCLUDE AN ESCROW, BY CATEGORY



\* Includes holdbacks

Subset: 2024 deals with an indemnification escrow

AGGREGATE SIZE OF ALL ESCROWS AS A PERCENTAGE OF TRANSACTION VALUE

	Average	Median
All deals	10.25%	10.0%
No RWI Identified	13.2%	11.3%
RWI Identified	4.1%	2.1%

Subset: 2024 deals with an indemnification escrow

SIZE OF GENERAL INDEMNIFICATION ESCROWS AS A PERCENTAGE OF TRANSACTION VALUE

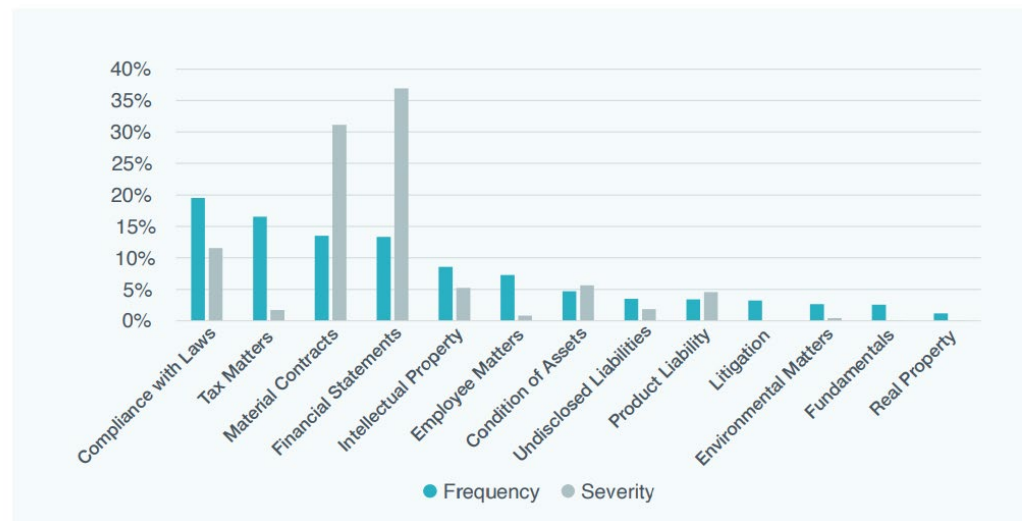
	Average	Median
All deals	7.8%	9.0%
No RWI Identified	10.9%	10.0%
RWI Identified	1.4%	0.35%

Source: SRS Acquiom 2025 M&A Deal Terms Study

## RWI Claims Trends: Types of Claims

- Financial statements, material contracts and compliance with laws breaches remain the top drivers of loss in RWI claims.

Figure 8: Aon Data: Frequency and Percentage of Total Loss Paid by Primary Type of Breach

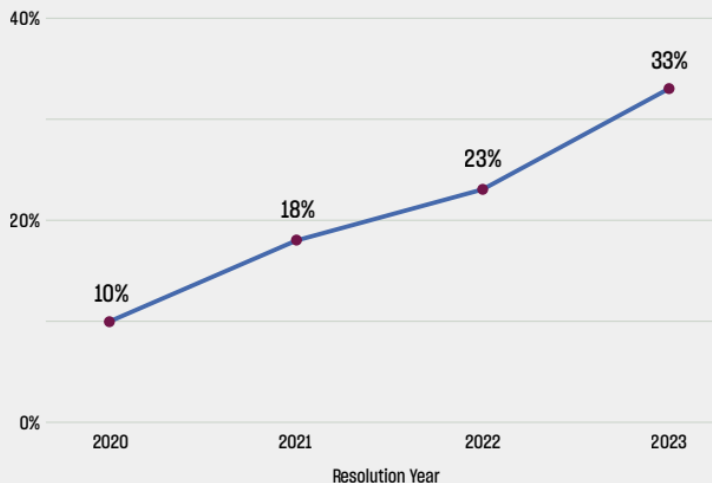


Source: Aon 2025 Transaction Solutions Global Claims Study

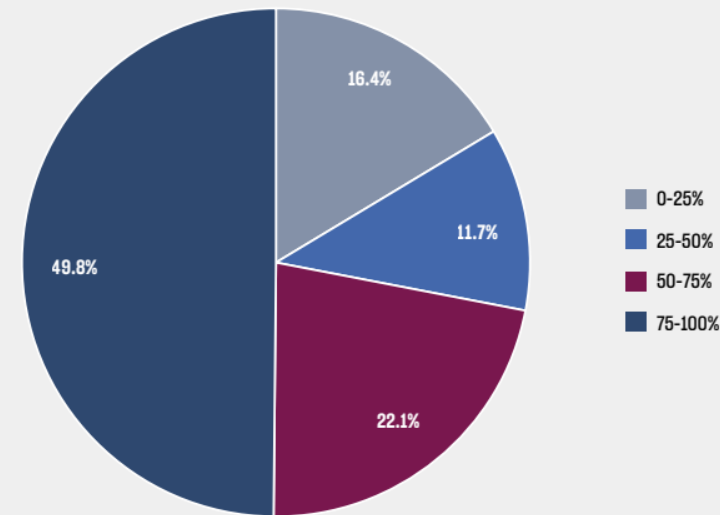
## RWI Claims Trends: Severity of Claims

- Although the claim frequency has remained somewhat steady, the severity of claims has increased.

**FIGURE 1: PERCENTAGE OF CLAIM PAYMENTS \$10M+**



**FIGURE 2: LOSS PAID AS PERCENTAGE OF POLICY LIMIT**

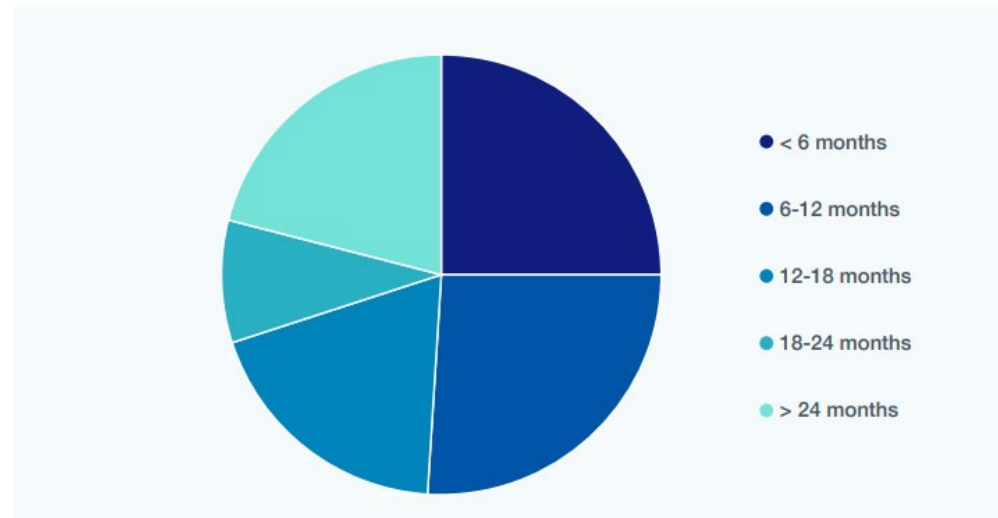


Source: Euclid 2024 Global Representations & Warranties Insurance Claims Study

## RWI Claims Trends: Timing of Claims

- Overall, nearly half of claims are coming in more than 12 months post-closing.

Figure 10: Aon Data: Time from Closing to Notice (Policies Where Coverage for the General Representations Has Expired)



Source: Aon 2025 Transaction Solutions Global Claims Study

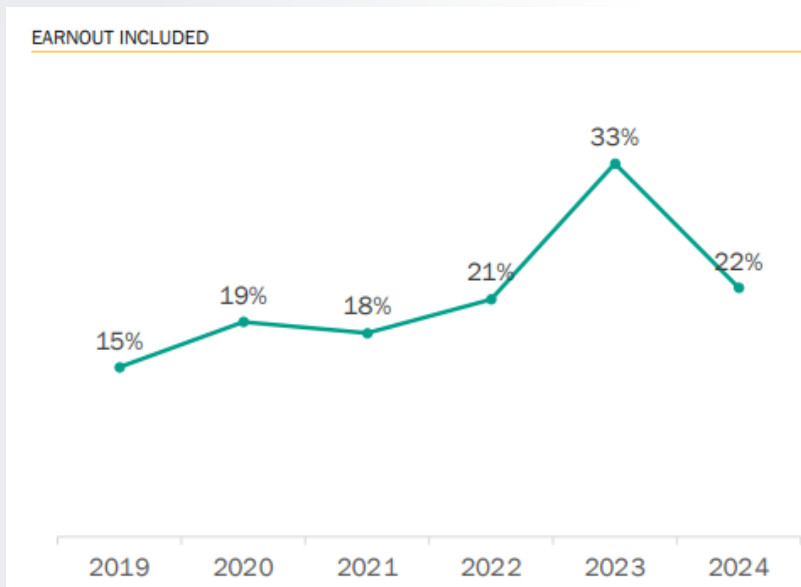


## Overview of Earnouts in M&A Deals

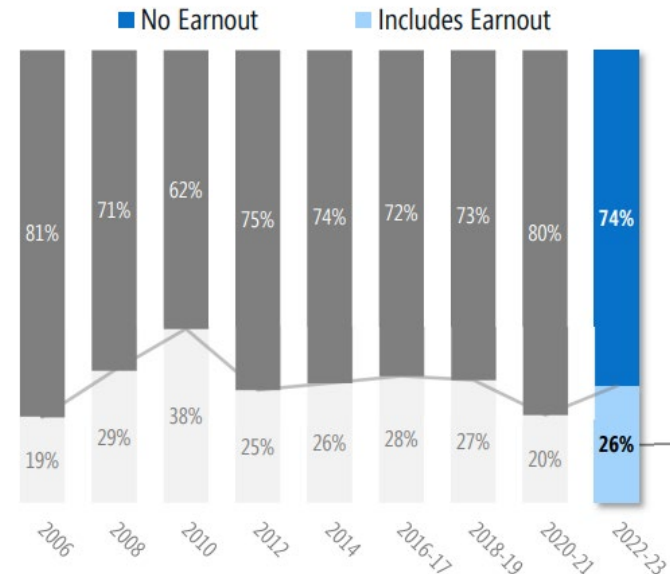
- An earnout is contingent purchase consideration that the seller can earn based on the post-closing performance of the business.
- Earnout is primarily used to:
  - Bridge valuation gaps.
  - Address uncertainty or volatility in the target's revenue, earnings or growth prospects.
  - Incentivize performance and align post-closing interests.
  - Reduce the upfront consideration and provide the buyer with downside protection post-closing.

## Frequency of Earnouts

- Earnout usage remains high, although there has been a notable decrease since earnout usage peaked in 2023.



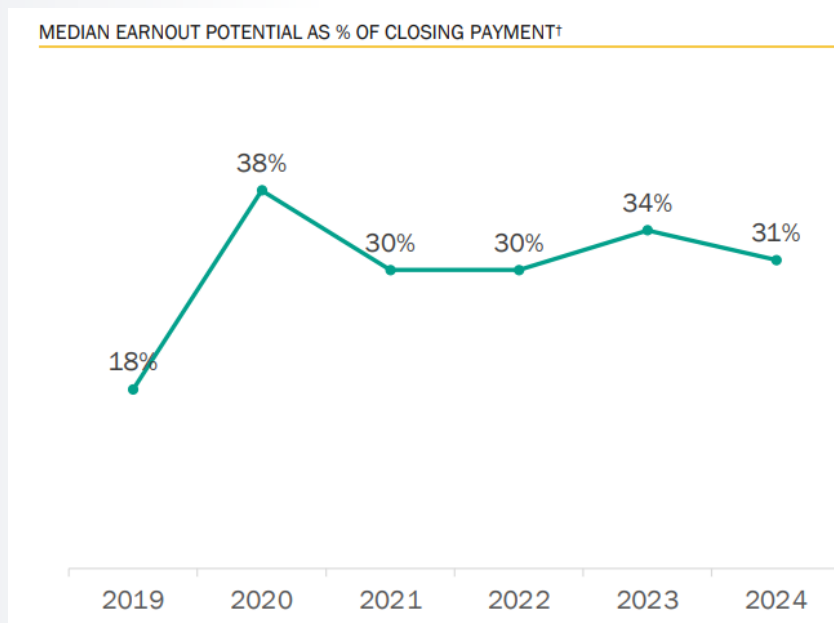
Source: SRS Acquiom 2025 M&A Deal Terms Study\*  
 \*Excludes Life Science Deals



Source: ABA 2023 Private Target Mergers & Acquisitions Deal Point Study\*  
 \*Includes Life Science Deals

## Size of Earnouts

- In recent years, earnout payments have become a significant portion of the consideration sellers are receiving.



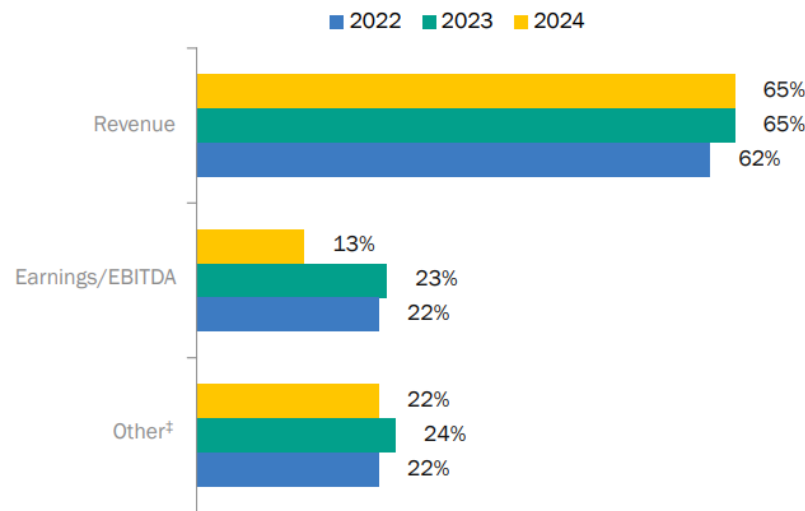
Source: SRS Acquiom 2025 M&A Deal Terms Study\*

\*Excludes Life Science Deals

## Other Earnout Considerations: Performance Metrics

- *Financial metrics:*
  - Revenue.
  - Earnings/EBITDA.
  - Net income.
- *Non-financial metrics:*
  - Success of clinical trials.
  - Patent issuance.
  - Receipt of regulatory approvals.
  - Number of customers.
  - Other business-specific milestones.

EARNOUT METRICS†

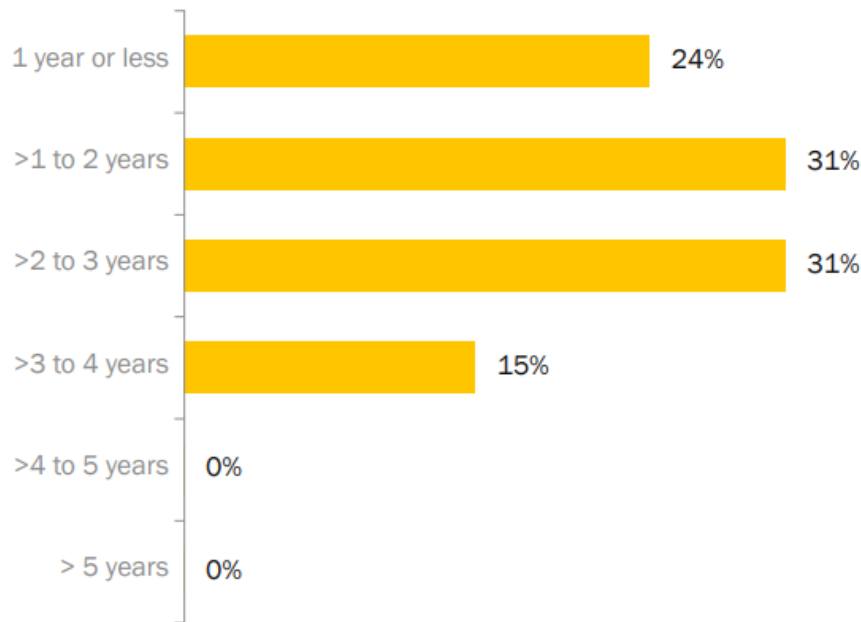


Source: SRS Acquiom 2025 M&A Deal Terms Study\*

\*Excludes Life Science Deals

## Other Earnout Considerations: Duration

EARNOUT LENGTH\* (2024 MEDIAN: 24 MONTHS)



Source: SRS Acquiom 2025 M&A Deal Terms Study\*

\*Excludes Life Science Deals

## Other Earnout Considerations: Payout Structure

- Calculating the earnout payment:
  - Fixed payment upon achievement of milestone (i.e., the seller receives all-or-nothing).
  - Agreed formula (e.g., percentage of EBITDA).
  - Combination of the above.
- Other considerations:
  - Catch-up rights.
  - Floors.
  - Caps.
  - Acceleration events (i.e., change of control, covenant breach, termination of employment).

## Earnout Claims Trends

- In SRS Acquiom's 2024 claim study, a majority of deals with an earnout due saw at least a partial payment, but only half of the maximum amount earned was paid.

### KEY POINTS



Deals in this dataset where some amount (partial or full) was paid out on the earnout



Percentage of aggregate maximum earnout potential paid to date

### ADDITIONAL DETAILS

**100** Number of deals with an earnout due in this dataset (excluding Life Sciences deals, "this dataset")

**\$9.6B** Aggregate transaction value of the deals in this dataset

**\$3.6B+** Aggregate potential earnout payments for deals in this dataset

**28%** Percent of deals in this dataset where sellers contested\* the earnout

**17%** Percentage of deals with a contested earnout where sellers were successful (payment amount increased)

**\$132M** Aggregate additional earnout payments as a result of renegotiations

**3%** Percentage of deals in this dataset where the earnout was disputed and resolved via litigation or arbitration to final judgment

\* At least in writing to the buyer; please note this dataset excludes pending earnouts, such as contested earnouts that are not yet resolved.

Source: SRS Acquiom 2024 M&A Claims Insights Report\*

\*Excludes Life Science Deals

## Common Causes of Earnout Disputes

- Ambiguous or poorly drafted earnout provisions.
- Differing interpretations of whether milestone was achieved.
- Accounting methodology.
- Post-closing management of the target.

“...an earnout often converts today’s disagreement over price into tomorrow’s litigation over the outcome”

*Aveta, Inc. v. Bengoa, 984 A 2d 126, 132 (Del. Ch. 2009).*



## **Drafting Earnouts to Mitigate Future Uncertainties: Use Clear and Unambiguous Language**

- Clearly define performance metrics, calculation methods, time periods and other relevant terms.
- Draft language with litigation in mind.
- Use objective milestones when possible.
- When a financial metric is used:
  - Utilize a metric that is less manipulable (revenue vs. EBITDA); and
  - Attach a sample calculation to the transaction agreement.

## Drafting Earnouts to Mitigate Future Uncertainties: Use Measurable Criteria to Define Buyer's Obligations

### *Seller Position*

- Require the buyer to run the business consistent with past practice and to maximize earnout.
- Require the buyer to maintain the target's business operations intact and standalone post-closing.
- Require financial statements to be prepared consistent with past practice.
- Require the buyer to provide specific financing and/or resources.
- Accelerate earnout upon a change in control, the buyer's covenant breach or a termination of employment.

### *Buyer Position*

- Provide that the buyer may operate the business post-closing in the buyer's discretion.
- Include express disclaimer of any fiduciary relationship or obligation to maximize earnout.
- Provide that the buyer may offset any indemnity payments against any earnout payments.

## **Drafting Earnouts to Mitigate Future Uncertainties: Specify Procedures for Determining Achievement of Earnout**

- Provide for earnout progress reports.
- Allow sufficient time for the seller to review earnout statement.
- Provide the seller with access to books and records after delivery of earnout statement.
- Require the parties to negotiate among themselves before engaging an independent accountant or arbitrator to resolve any dispute.
- If a dispute is to be referred to an independent accountant, then independent accountant should be designated as an expert and not as an arbitrator.

# Questions?



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