



News & Types: Corporate, Finance & Acquisitions Update

# Navigating Earn-Outs in M&A Transactions

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Practices: Corporate, Finance & Acquisitions

During periods of economic uncertainty—including evolving regulatory schemes and supply chain disruption—earn-outs are increasingly used in private M&A transactions to bridge valuation gaps and allocate risk. While earn-out structures vary widely, some transactions utilize potential earn-out payments equal to 50% or more of the total purchase price.

Earn-outs typically defer a portion of the purchase price based on post-closing performance milestones, often tied to revenue or profitability. These payments can vary drastically depending on factors such as the percentage of total purchase price allocated to the payment, the type of performance metrics, the length and structure of the earn-out period, the applicable accounting standards, and any acceleration triggers that may exist.

While these provisions can be beneficial for both buyers and sellers, they remain highly deal-specific and are heavily negotiated—and they continue to be a frequent source of post-closing M&A disputes. Such disputes most commonly arise from ambiguous drafting or misaligned expectations regarding financial metrics, the accounting principles used to measure performance, and the degree of operational discretion retained by the buyer during the earn-out period. Sellers may expect the business to be operated to maximize earn-out payments, while buyers typically seek flexibility to integrate the target with their existing businesses and make strategic or cost-driven changes. Absent clear contractual standards, sellers may claim the buyer diverted revenue, shifted expenses, or otherwise acted in bad faith by managing the business in a manner that suppressed earn-out performance.

At the same time, insufficient reporting, access, and review rights can leave sellers without visibility into earn-out calculations, leading to challenges and mistrust. Unaddressed issues such as accounting changes, intercompany transactions, restructurings, or extraordinary events also increase the risk of disputes.

Courts look first at the plain language of the governing transaction documents, but also, where unclear, to extrinsic evidence of the parties' intent. This makes consistent documentation and negotiations critical. To reduce the risk of post-closing disputes, parties should implement practical drafting safeguards, such as clear definitions of financial metrics and accounting standards, express provisions governing the buyer's operational discretion and any efforts-based obligations, and detailed reporting, access, and review procedures. Well-structured dispute-resolution mechanisms, such as expert determination provisions with clearly defined scope and finality, can further reduce the cost and uncertainty associated with such disputes.

In short, both buyers and sellers should approach earn-outs with heightened care. Thoughtful drafting at the outset remains the most effective method to reduce post-closing disputes and uncertainty regarding the earn-out's structure, methodology or dispute-resolution procedures.

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