

As M&A Rises, Dealmakers Grapple With Earnout Risks and Rewards

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As mergers and acquisitions are expected to rise in 2026, the use of earnout provisions to “seal the deal” on complicated transactions continues to be a focal point of both dealmakers and the M&A legal community.

Many view earnout provisions as an invitation to litigate, and the use of them forces courts to become the arbiter of deciding between the buyer’s post-closing business interests and the contractual expectations of the seller.

Earnout provisions are often used to bridge the gap between a buyer and a seller when the parties are unable to finalize a concrete purchase price for a transaction for various reasons. Although the specific mechanics vary, an earnout provision typically provides the seller with the opportunity to participate financially in the post-closing success of a transaction, providing the seller with a percentage of the profits or revenue of a product or target post-closing.

Originally, earnout provisions were common in the life sciences space when the post-closing value of the asset was typically unpredictable due to many post-closing variables, such as regulatory approval, clinical trials, and net sales. However, over the years, earnouts have become prevalent in all types of M&A transactions.

According to a recent [report](#) by SRS Acquiom, earnout provisions are currently included in 22% of non-life sciences for M&A transactions. Although this figure is down from its 2023 high of 33%, earnout provisions are still included in more than 1 in 5 non-life sciences transactions.

In concept, an earnout provision makes sense. Conceivably, the earnout should align the interests of a buyer and a seller in maximizing the post-closing profitability of transactions. However, in reality, the buyer’s and seller’s interests often diverge post-closing. Buyers must consider their overall business operations when deciding how to operate post-closing, whereas sellers’ goals are often aimed at maximizing their post-closing profits. Given these competing interests, it’s often left to the courts to balance the post-closing business interests of the buyer with the pre-closing expectations of the seller.

Balancing Efforts and Intent

These competing goals and the courts’ attempt to balance them are playing out before the Delaware Supreme Court in the [Fortis v. Johnson & Johnson](#) case, which was argued on Oct. 15. In that case, Johnson & Johnson [spent](#) \$3.4 billion to acquire Auris, a company that created a

surgical robot product known as “iPlatform.” Under the parties’ agreement, Johnson & Johnson was required to use “commercially reasonable efforts” similar to what Johnson & Johnson had used for other “priority medical products” in achieving regulatory milestones for iPlatform.

At the underlying trial, the Delaware Court of Chancery found that Johnson & Johnson breached the earnout provision and failed to operate in good faith and fair dealing by launching both iPlatform and “Verb,” another surgical robot product, ultimately combining the two product offerings.

However, in its appeal to the Supreme Court, Johnson & Johnson has argued that its actions were commercially reasonable and in the best interests of its business because the iPlatform robot was “plagued with technical challenges” and it became clear that iPlatform would never be viable in a “commercially reasonable timeline.”

Johnson & Johnson has further [argued](#) to the Delaware Supreme Court that the “commercially reasonable efforts” provision in the earnout, which included numerous factors outlined in the contract for Johnson & Johnson to consider, gave Johnson & Johnson the ability to “calibrate [its] efforts based on its own business judgment regarding potential profitability, competitiveness, and other factors.”

By contrast, Fortis, which sued Johnson & Johnson on behalf of Auris’s former stockholders, argued Johnson & Johnson could have negotiated more favorable terms into the contract that would have permitted Johnson & Johnson to abandon the regulatory milestones for “business reasons,” but failed to do so. Likewise, Fortis argued that launching iPlatform and Verb in a “head-to-head showdown” and, ultimately, abandoning iPlatform was a breach of the agreement. Further, Fortis argued that the supposed technical issues were “imminently solvable.”

As has become commonplace, it’s now up to the courts to decide whether Johnson & Johnson’s efforts were reasonable, even though those efforts would limit the earnout available to the sellers, and to determine the impact of an earnout provision. Consequently, the *Johnson & Johnson* case is simply another reminder that earnout provisions remain an invitation to litigation.

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