Moore and Khan in Dallas Bar Association Headnotes: The Importance of Earn-outs & the Delaware Courts' Interpretation

By Ethan Moore | February 28, 2025

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The earn-out is a common practice within the mergers and acquisitions field and can bridge valuation gaps of the target company between the parties, among other benefits. Haynes Boone Associates Ethan Moore and Zan Khan authored an article for the Dallas Bar Association's *Headnotes* explaining the importance of this practice.

Read an excerpt below:

What is an Earn-Out?

A common practice in an M&A transaction is to defer payment of part of the purchase price to a point in time after closing via a mechanism called an earn-out. An earn-out is used for various reasons, including but not limited to bridging valuation gaps of the target company between the parties, apportioning risks between the parties, or aligning the economic interests of both parties to work towards the continued success of the target company post-closing. In an earn-out, part of the purchase price becomes contingent on achieving certain milestones post-closing. The metrics are either financial (e.g., EBITDA or net income) or non-financial (e.g., retention of key employees for a certain amount of time or regulatory approval) in nature.

The earn-out payment may be structured as a fixed or variable amount. Fixed earn-out payments adopt an all-or-nothing approach. Variable earn-out payments can be scaled to a percentage of the amount the company's performance exceeds or falls short of the earn-out target, or scaled according to actual company performance.

Given that the buyer typically is in control of the target company's operations post-closing, it is essential for the seller to receive the appropriate assurance that the buyer is committed to the continued success of the target company. While there are numerous ways that earn-outs can be drafted, each earn-out can often be broken down into one of two types of obligations bestowed onto the buyer—an "inward-facing" efforts obligation and an "outward-facing" efforts obligation.

Read the full article in the Dallas Bar Association's *Headnotes* March edition on page 26.

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