

# 2024 Survey of Trends and Key Components of CVRs in Life Sciences Public M&A Deals

By Sally Wagner Partin, Sharon Flanagan, Hannah Brown, and Tong Tong

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As we look back on the first three quarters of 2024, there have been a number of significant life sciences M&A deals, including in emerging sectors like antibody-drug conjugates, CAR T-cell therapy, GLP-1s and novel autoimmune candidates. Of the 10 life sciences transactions year to date in 2024 with an equity value of over \$2 billion, seven were in the biopharma industry, two were acquisitions of medical device companies and one was an acquisition of a CDMO.

While the life sciences sector is constantly evolving, one important deal term that continues to hold significant relevance is the use of contingent value rights (“CVRs”), the public company analog to the earnout, in public M&A transactions. CVRs continue to be a valuable tool for bridging valuation gaps between buyers and sellers, particularly in an industry where future success is often contingent on uncertain events such as clinical trial outcomes, regulatory approvals and product commercialization.

In 2023, upon first publishing this article and survey, we observed a notable increase in the use of CVRs in life sciences M&A deals in the period from 2020 to 2023. The use of CVRs in life sciences deals has persisted into 2024, although with some signs of decreasing use, potentially indicating a narrowing of the valuation gap or a decrease in the number of sellers who financially must sell as reflected in the reduction in life sciences M&A activity generally in 2024.<sup>1</sup> In 2023, there were a total of 53 life sciences deals announced, of which 20 (or 38%) included a CVR. In the first three quarters of 2024, there have been only 27 life sciences deals announced, of which six (or 22%) included a CVR. If the pace set in the first three quarters of 2024 continues through the fourth quarter of 2024, approximately 36 life sciences M&A transactions would be announced in 2024, down 32% from 2023; similarly in the first three quarters of 2023, 39 life sciences deals were announced, reflecting a decrease of 31% in life sciences deal activity in the first nine months of 2024 as compared to the same period in 2023. Even though life sciences M&A and CVR usage is down from 2023, CVRs were still found in nearly one quarter of life sciences transactions in 2024 and, in our experience, discussed as a possible deal term in many more. There are also a number of repeat players in the life sciences industry using CVRs, such as AstraZeneca, with three acquisitions involving CVRs in the past 12 months, demonstrating a familiarity and continued comfort with the practice.

This article updates CVR deal statistics and trends from our article in the [May – June 2023 issue](#) of *Deal Lawyers*, reviewing all recent life sciences deals, including the 19 new transactions that used CVRs from May 2023 to September 2024 and presenting new trends and additional surveyed topics.

<sup>1</sup> This article examines all announced (even if later withdrawn or still pending) public transactions in the life sciences and health care industry from January 1, 2019 through September 30, 2024 providing CVRs as a specific form of consideration according to Deal Point Data (the “2019-2024 CVRs”). For purposes of determining transactions in the life sciences and health care industry, transactions were sorted by Deal Point Data’s “healthcare” industry sector, which includes pharmaceuticals, medical devices and equipment and health care services, among others. This article refers to all such transactions as “life sciences” transactions. Since 2019, there have been only four acquisitions using CVRs that were not in life sciences transactions, and those CVRs are not included in the statistics presented in this article unless otherwise indicated. All data in this article, including statistics on deal frequency, have been determined from Deal Point Data unless otherwise cited and is from the 2019-2024 CVRs dataset unless otherwise indicated. Deal Point Data provides coverage for only select deals with non-U.S. targets and/or deal equity values below \$100 million and covers all deals with U.S.-headquartered public targets with a deal equity value above \$100 million. Percentages calculated have been rounded to the nearest whole number, which rounding results in certain statistics not summing to 100%.

## Executive Summary and Key Updates for 2024:

- CVRs are the public M&A analog to earnouts used in private deals. They can be price-driven (e.g., providing CVR holders a payment if the average market price of the issuer's equity security is less than a pre-set target price) or event-driven (e.g., providing CVR holders a payment if certain regulatory milestones are achieved).
- CVRs are more common in life sciences transactions than in other industries. Of the 1,172 public deals announced across all industries since 2019, only 50 (or 4%) included CVRs; however, of those deals, 92% were in the life sciences industry.
- CVRs remain prevalent, with approximately 22% of life sciences transactions in the first three quarters of 2024 including the use of a CVR; however, both life sciences M&A activity in 2024 and the usage of CVRs are significantly down from 2023. In the first three quarters of 2024, nearly one in four announced life sciences transactions included a CVR, as compared to approximately one in three deals using a CVR in the first three quarters of 2023.
- Examining only biopharma deals (i.e., excluding transactions involving health care services and medical equipment and devices) the use of CVRs is even more concentrated, with approximately 29% of public transactions in this sector using CVRs as compared to approximately 23% of all public life sciences deals announced since 2019.<sup>2</sup>
- The use of CVRs remains generally more concentrated in relatively smaller public M&A transactions in the life sciences industry. Approximately 74% of all life sciences deals using CVRs announced since 2019 were deals with an equity value of under \$1 billion, and 50% of all life sciences deals using CVRs were deals with an equity value of under \$500 million.
- All the CVRs in life sciences transactions announced since 2019 had event-driven milestones, and the strong majority of CVR payments were tied to regulatory approval milestones or sales milestones.
- CVR terms are standardized within the life sciences sector, featuring nontransferable, cash-settled CVRs. Since 2019, all but two life sciences transactions involving CVRs provided for CVR consideration to be paid exclusively in cash. Of the CVRs included in life sciences transactions announced since 2019, only one CVR was transferable. The benefit of having a non-transferable CVR is that CVRs are generally not considered securities if they are non-transferable. As a result, there is no requirement for SEC registration and the associated regulatory burdens.
- CVRs typically have fewer milestones than those seen in private company deals, with approximately 87% of the CVRs in life sciences transactions announced since 2019 providing for only one or two milestones.
- Negotiations around the efforts required by buyers to achieve CVR milestones remain a focal point, highlighted by recent high-profile litigation addressing whether buyers have breached their post-closing diligence requirements. A majority of CVRs continue to include an objective standard (i.e., the efforts that a reasonable or a similarly sized company would expend on a similar program) and a majority of larger pharma company buyers include a subjective standard (i.e., the efforts that the buyer expends on its own internally developed programs).

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<sup>2</sup> For purposes of determining transactions in the biopharma industry, transactions were sorted by Deal Point Data's "biotechnology" and "pharmaceuticals" target industry subcategories.

- Based on the 2019-2024 CVRs, the median potential value of a CVR, as compared to the non-contingent value a shareholder will receive in a deal, is approximately 21%. The majority of CVR agreements provide for a maximum payout within a range of 1% to 25% of the upfront non-contingent value to a shareholder.
- The majority of diligence definitions specifically provide that a buyer may not take the milestone payments themselves into consideration (70%), while approximately 27% are silent and 3% specifically note that a buyer may take the milestone payments into consideration.
- Approximately 27% of deals with defined efforts standards include specific language that a buyer's efforts must be sustained, while approximately 24% include language that specifically states that a buyer may, in fact, exercise different levels of efforts at different times based on the then-prevailing conditions and prospects of the CVR product.
- The majority of the life sciences CVR agreements since 2019 that set expiration dates for milestone achievement required that the milestones must be achieved within five years or less; a significant percentage provide for periods of achievement of over five but under 10 years; and only two CVR agreements provide for a period of achievement of more than 10 years.

As we continue to monitor the evolving landscape of life sciences M&A, it is clear that CVRs remain an important component in deal structuring, especially during economic times that continue to be uncertain.<sup>3</sup> It remains to be seen whether the CVR, which gained popularity during recent uncertain economic times, will have staying power as a useful tool even as the economy stabilizes, given the industry's growing familiarity and comfort with the practice.

## Background

CVRs, the public company analog to the earnout, were first introduced in the late 1980s and are still used today to provide additional value to public company shareholders in a transaction. CVRs can help bridge the valuation gaps in public M&A transactions, which can be especially significant in times of economic uncertainty. Despite their complexity, CVRs retain their appeal because they can be structured and customized to meet the circumstances of a particular transaction, providing a flexible tool that can offer a solution for a host of unknowns and risks associated with the future performance of a target company. While these valuation issues can occur for deals in any industry, CVRs may be more attractive in life sciences transactions because target companies already face high beta outcomes that depend on uncertain future events like clinical trial results, regulatory approvals and successful product commercialization. Furthermore, sellers in the private life sciences industry are already accustomed to partial payment in "bio bucks" — where earnouts, or milestones, are common practice.<sup>4</sup> While CVRs in public deals are less common than earnouts in private deals, largely due to the complexity of CVRs, they remain a potentially valuable tool under the right circumstances.

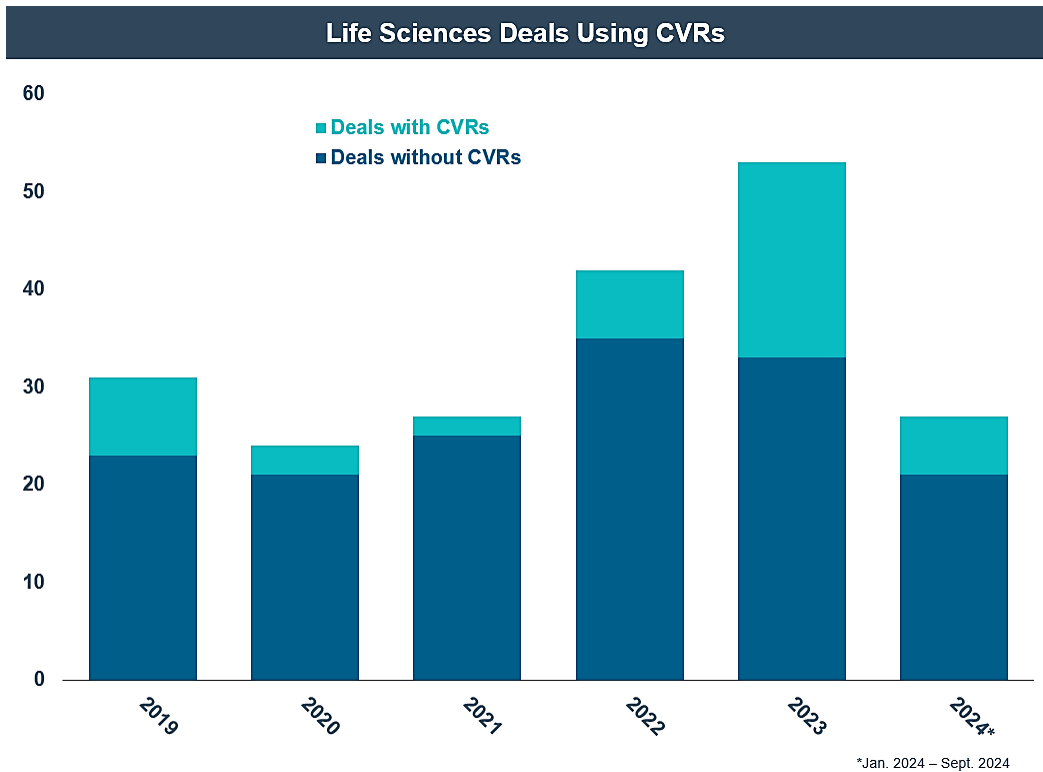
Recent uses of CVRs in public deals have been concentrated in the life sciences industry. Of the 1,172 public deals announced across all industries from January 1, 2019 through September 30, 2024, only 50 (or approximately 4%) included CVRs; however, of those deals, 92% were in the life sciences industry. In fact, in the last five years, there have only been four deals using CVRs outside of life sciences transactions (with the last one occurring in July 2022). In earlier periods, CVRs were less common across all industries, including in life sciences. In the five-year period from January 1, 2014 through December 31, 2018, there were only 25 deals that

<sup>3</sup> For example, according to Ernst & Young LLP's 2024 Beyond Borders: Biotechnology Report, in 2023, 56% of biotechs had two or less years of cash needed for further operation. Persistent inflation, higher-for-longer interest rates and escalation of geopolitical risks all heighten market volatility and make fundraising for biotechs difficult. In these situations where funding is hard to obtain, life sciences companies may need to look for M&A exits to continue to grow their programs.

<sup>4</sup> According to SRS Acquiom's 2023 Life Sciences M&A Study, the most recent SRS Life Sciences study as of the date of this article, earnouts have historically been included in 86% of biotech/pharmaceuticals transactions, 71% of medical device transactions, and 49% of diagnostics and research technologies transactions.

included CVRs (or approximately 2% of all announced public deals), 68% of which were in the life sciences industry. See Table 1.

Table 1

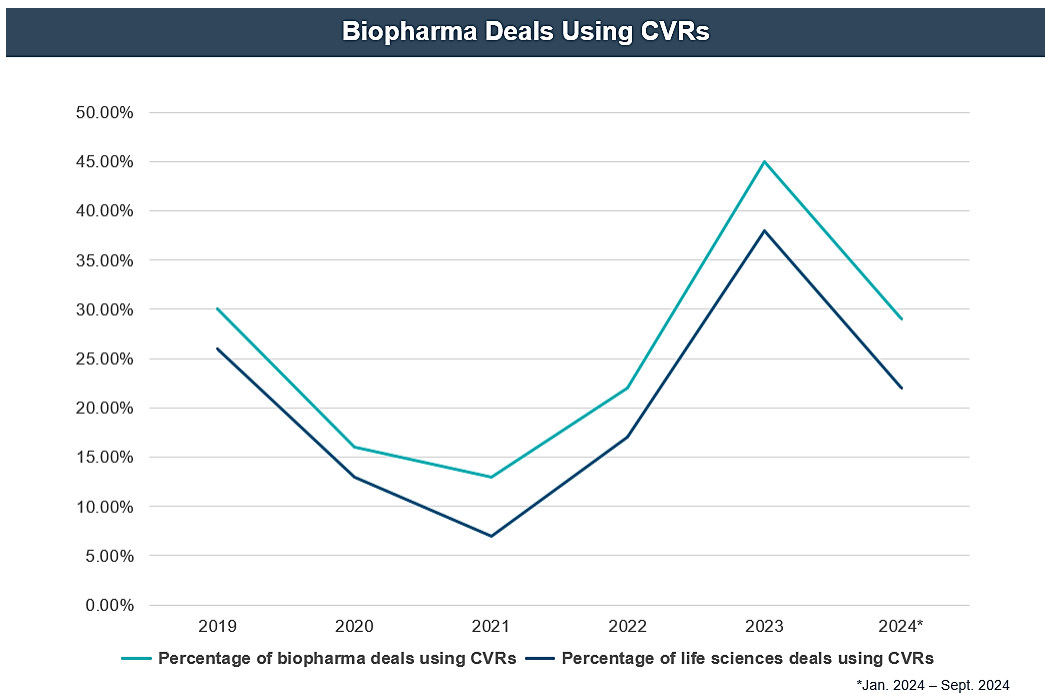


CVRs are more common in public company life sciences transactions than one might expect — they were included in approximately 23% of the 204 public M&A deals in the life sciences industry announced from January 1, 2019 through September 30, 2024. Over the last three years, CVRs have been particularly common. In 2022, there were 42 life sciences deals announced, of which seven (or 17%) included a CVR, and in 2023, there were 53 total life sciences deals announced, of which 20 (or 38%) included a CVR. However, to date in 2024, life sciences transactions are down generally, and the use of CVRs is down from its peak in 2023. In the first three quarters of 2024, there have been 27 life sciences deals announced, of which six (or 22%) included a CVR.

Removing healthcare services and medical equipment and device transactions from the dataset, the use of CVRs is even more concentrated. Examining only transactions in the biopharma industry announced since 2019, approximately 29% of public transactions in this sector included CVRs, whereas during the same period, approximately 23% of public transactions in the life sciences industry in general included CVRs. Only two medical device transactions used CVRs in the same period, and the last healthcare service transaction to use a CVR was in 2013. This may be because public healthcare service and medical device and equipment companies are less likely to be pre-revenue as compared to biopharma target companies, so their futures are not as tied to uncertain events which may result in less of a valuation gap.<sup>5</sup> See Table 2.

<sup>5</sup> This is consistent with SRS Acquiom's 2023 Life Science M&A Study for private company deals, reporting that from mid-2021 through mid-2023, 91% of biopharma deals included milestones, while only 59% of device deals and 47% of diagnosis/research deals in the same period included milestones.

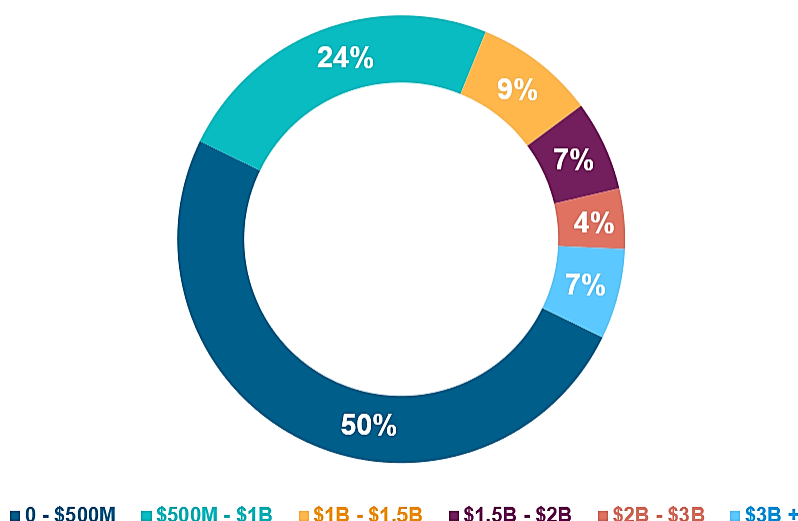
Table 2



The use of CVRs is also much more concentrated in relatively smaller public M&A transactions in the life sciences industry. Approximately 36% of all public life sciences M&A deals announced since 2019 that had an equity value of less than \$500 million used CVRs, and approximately 31% of all public life sciences M&A deals announced in the same period that had an equity value of \$500 million to \$1 billion used CVRs. Further, approximately 74% of all life sciences deals using CVRs were deals with an equity value of under \$1 billion, and 50% of all life sciences deals using CVRs were deals with an equity value of under \$500 million. A possible reason for this CVR concentration in lower equity value transactions may be that the valuation of those target companies is particularly tied to uncertain future events such as clinical trial results, regulatory approvals and successful commercialization. Table 3 on page 6 allocates each CVR announced in the period to the size of the deal in which it was used (based on equity value).

Table 3

**CVR Prevalence Relative to Life Sciences Deal Size (Jan. 2019 – Sept. 2024)**



## Fundamentals of CVRs

**CVR Agreements.** CVRs are typically incorporated into standalone agreements attached as an exhibit to the merger agreement, unlike private company earnouts that are generally included in the acquisition agreement itself. The CVR agreement is entered into between the buyer and a rights agent who acts as the representative of the CVR holders and oversees their rights under the CVR agreement.

**Price-Protection and Event-Driven CVRs.** CVRs are typically structured in one of two ways:

- **Price-Protection CVRs.** CVRs can be used as a form of price protection to provide target company shareholders some downside protection when a portion of the merger consideration will be paid in a buyer's public company stock. Price-protection CVRs are used to guarantee that a certain stock value is paid even if the buyer's stock fails to perform to specified levels post-closing, and are typically settled in cash or additional shares of buyer stock. While the price-protection CVR gained significant recognition in a few notable public takeover contests in the early 1990s, only one publicly-announced M&A transaction announced since 2019 provided for a traditional price-protection CVR and it was not a life sciences transaction.
- **Event-Driven CVRs.** Alternatively, and as more commonly used today, CVRs can be structured as payments owed upon the achievement of certain milestones or the occurrence of specific triggering events after closing (*i.e.*, "event-driven" CVRs). Similar to private company earnouts, event-driven CVRs are bespoke for each transaction and have significant variation between deals. A CVR may have only one milestone (for example, based on a regulatory approval, achievement of a product development stage or future CVR product<sup>6</sup> sales) or may provide for multiple milestones paid incrementally upon the achievement of each milestone or paid in a single payment only if all milestones have been achieved.

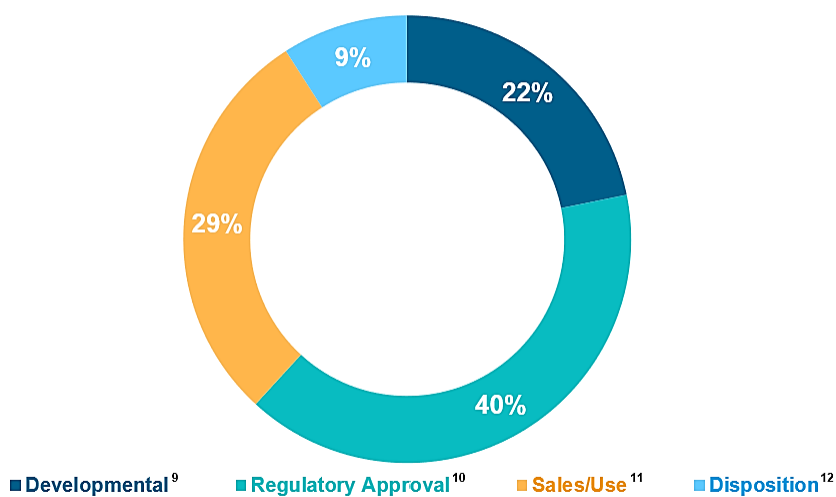
<sup>6</sup> CVR agreements with event-driven milestones generally include a product definition to isolate the acquired products which trigger the milestones.

Event-driven CVRs can also be used as a form of risk-shifting when the value of a target is reliant upon certain positive future events, such as the resolution of pending disputes against the target.<sup>7</sup>

In recent years, there have also been a few event-driven life sciences CVRs that provide for the sharing of proceeds from a monetization event (*i.e.*, generally a sale or licensing) of the target company's CVR products following the closing of the acquisition. This structure has been used most often for distressed companies, with some proposed in unsuccessful hostile takeover attempts. This structure contemplates that a target company would be taken private for some small upfront amount of consideration and the former shareholders of the target would share significantly in any post-closing monetization event of the target or its CVR products. Some of these "Hail Mary" CVR transactions were entered into following a robust but unsuccessful sale process, being viewed by the target board as a better alternative to a liquidating distribution to shareholders, since the CVR transaction provides shareholders with the opportunity to share in any future proceeds resulting from a buyer's monetization of target assets. See Table 4.

**Table 4**<sup>8 9 10 11 12</sup>

**Event Milestones in Life Sciences CVR Agreements (Jan. 2019 – Sept. 2024)<sup>8</sup>**



<sup>7</sup> For example, one non-life sciences transaction provided for CVRs to be paid in the event "a certain ongoing dispute" between the seller and "certain unrelated third-parties has not been resolved, and the proceeds, if any, from the resolution of the dispute have not been paid out" to the seller's shareholders prior to the completion of the merger.

<sup>8</sup> Based on review of the 2019-2024 CVRs, excluding one transaction that was withdrawn before the CVR terms relevant to this chart were disclosed. Certain CVR agreements use more than one event milestone type. CVR agreements using multiple milestones of the same type were only counted once.

<sup>9</sup> Developmental milestones included, for example, regulatory submissions, including investigational new drug applications or new drug applications, and successful initiation or results of clinical trials.

<sup>10</sup> Regulatory approval milestones included, for example, approval by the U.S. Food and Drug Administration, the European Medicines Agency or another international regulatory authority of a drug or device.

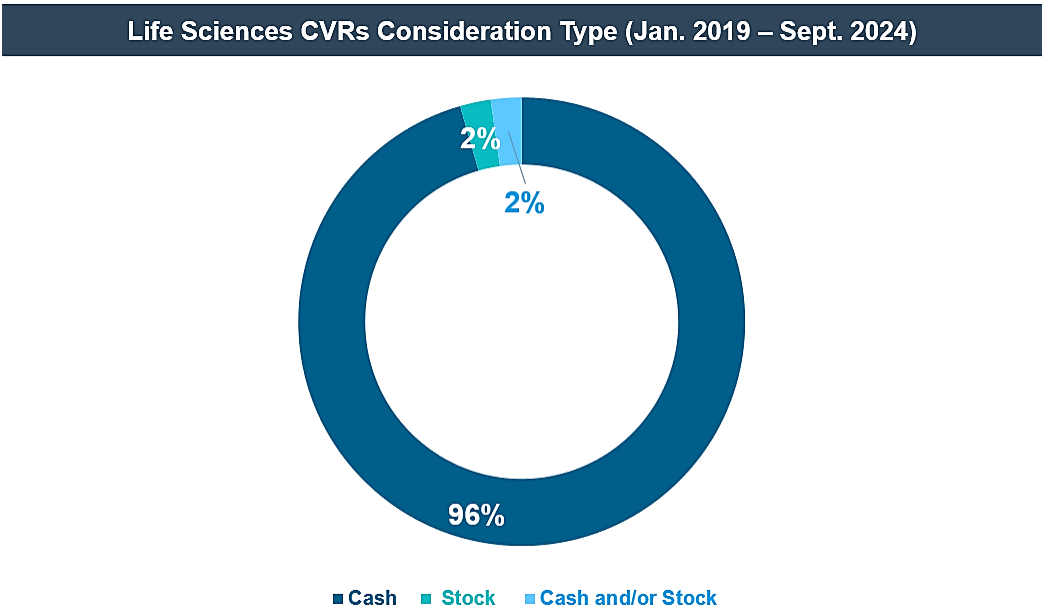
<sup>11</sup> Sales milestones included, for example, first commercial sale and net sales milestones. Use milestones included, for example, milestones based on the numbers of issued prescriptions or treatment visits.

<sup>12</sup> Disposition milestones entitled the former shareholders of the target to share in the proceeds from dispositions or sales of the target or percentages of futures net proceeds from any license or disposition of the target's CVR products following the closing.

CVR agreements for public deals also generally provide for fewer milestones that are less complex in nature as compared to private company deals,<sup>13</sup> with approximately 87% of the 2019-2024 CVRs providing for only one or two milestones.<sup>14</sup>

CVRs May Be Settled in Cash, Stock or a Mix. CVRs can be paid out either in cash, buyer stock or a mix of both. Typically, the form of consideration is fixed at the signing of the merger agreement, but the CVR agreement may also provide that a buyer or a CVR holder may elect the form of payment as between cash and stock or a mix at the time the rights become due. Since 2019, all but two life sciences transactions involving CVRs provided for CVR consideration to be paid exclusively in cash. See Table 5.

**Table 5**



Valuation of CVRs. The average potential value of a CVR in life sciences deals was approximately 71% of the non-contingent upfront value a shareholder will receive in a deal and the median potential value of a CVR was approximately 21% of the non-contingent upfront value.<sup>15</sup> The general trend was for the maximum payout available under the CVR agreement to represent a range between 1% to 25% of the upfront non-contingent value to a shareholder in cash or stock — however, some high-value outliers exist which greatly affected the average potential payout. For example, two CVRs provided that if the maximum payouts were made, between 200% and 230% of potential additional value could be achieved under the CVR as compared to the non-contingent upfront merger consideration; another transaction provided for CVR payments of approximately 634% of the upfront merger consideration; and a fourth transaction provided for CVR payments of approximately 748% of the upfront merger consideration. Excluding these four outlier transactions, the average maximum payout available under the 2019-2024 CVRs represented approximately 27% of the upfront non-contingent value to a shareholder in cash or stock and the median maximum payout was approximately 18% of the upfront non-contingent value.

<sup>13</sup> For example, SRS Acquiom's 2023 Life Sciences M&A Study reports that the mean number of milestone events for private biopharma deals from mid-2021 through mid-2023 was 7.7.

<sup>14</sup> Based on review of the 2019-2024 CVRs, excluding one transaction that was withdrawn before the relevant CVR terms were disclosed.

<sup>15</sup> Based on review of the 2019-2024 CVRs, assuming all milestones are met so as to lead to the maximum payout possible without any discount for risk or time value of money and valuing a buyer's stock at the time of signing based on the value of the buyer's shares as defined in the merger agreement. Excluded from this analysis were six transactions with uncertain CVR values (e.g., disposition CVRs, CVRs entitling holders to percentages of future net sales and one transaction where the guaranteed consideration included shares in a new spin-off entity) and one transaction that was withdrawn before the relevant CVR terms were disclosed.

CVRs as Tradable Securities Requiring Registration. As buyers consider whether to include a CVR in an acquisition, they frequently consider that one of the downsides of CVRs is that they may impose regulatory requirements upon the buyer. If a CVR is considered a “security” under U.S. federal securities laws, this may require the issuance of the CVRs to be registered under the U.S. Securities Act of 1933. This would also require the CVRs to be registered under the U.S. Securities Exchange Act of 1934, which in turn would lead to reporting obligations for the buyer under that statute as long as the CVRs are outstanding. These reporting obligations can be of particular concern to non-U.S. or private buyers that may not otherwise be required to comply with U.S. federal securities law reporting obligations.

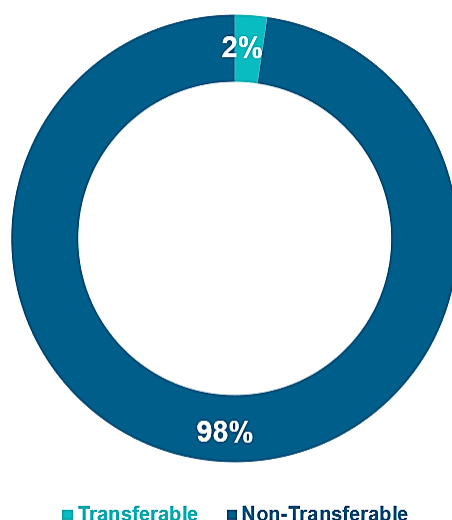
The SEC has provided a five-factor test for determining if a CVR is a contractual right, rather than a security.<sup>16</sup> Under this test, the SEC will typically conclude the CVR is not a security if all of the following five factors are met:

1. The rights are an integral part of the consideration to be received in the merger;
2. The holders of the rights have no rights common to shareholders such as voting and dividend rights;
3. The rights bear no stated rate of interest;
4. The rights are not assignable or transferable except by operation of law; and
5. The rights are not represented by any form of certificate or instrument.<sup>17</sup>

The SEC places particular emphasis on whether a CVR is transferable. If a CVR is not transferable, it generally can be structured so that it is not considered a “security.”

**Table 6<sup>18</sup>**

**Life Sciences CVR Transferability (Jan. 2019 – Sept. 2024)<sup>18</sup>**



<sup>16</sup> See Minnesota Mining and Manufacturing Co., SEC No-Action Letter, 1988 WL 234978 (Oct. 13, 1988).

<sup>17</sup> These are the five factors most commonly considered by the SEC when determining whether a CVR is a security, but some no-action letters have also included additional factors in support of a CVR being a contractual right and not a security.

<sup>18</sup> Based on review of the 2019-2024 CVRs, excluding three transactions that were withdrawn before the CVR terms relevant to this chart were disclosed.

Former shareholders of a target company generally prefer CVRs that are transferable and registered on a stock exchange so that the holders are able to achieve liquidity by selling the CVR instead of holding the CVR for the entire milestone period.<sup>19</sup> However, the overwhelming majority of recent deals involving CVRs have been structured to provide that the CVRs are non-transferable, likely to avoid SEC registration requirements (and, to the extent applicable, stock exchange requirements), along with the costs and expenses of registration, listing and continued compliance. Another reason buyers may insist on non-transferable CVRs is because hedge funds and other market participants often become the holders of a significant percentage of transferable CVRs and may even hedge their CVR exposure with the buyer's stock, resulting in unnatural trading activity in a buyer's stock and undesired consolidation of holdings in CVRs and buyer's stock.

Given buyer concerns about SEC registration, recent agreements with CVRs have provided only for limited "permitted transfers" that are not considered to convert these CVRs from contractual rights into securities from an SEC perspective. These limited permitted transfers are generally transfers of CVRs: (a) upon death of a holder by will or intestacy; (b) pursuant to court order; (c) by operation of law (including by consolidation or merger) or without consideration in connection with dissolution, liquidation or termination of any corporate entity; or (d) in the case of CVRs held in book-entry or other similar nominee form, from a nominee to a beneficial owner.

### **Additional Specific CVR Terms in Life Sciences Transactions**

CVRs Are Typically Event-Driven, Cash-Settled and Non-Transferable. The life sciences industry has shown some standardization in the terms of CVRs — the strong majority of life sciences deals provided for event-driven, non-transferable and cash-settled CVRs. Since 2019, only one life sciences CVR provided for stock consideration, while one transaction provided for CVR consideration to be paid in cash and/or stock at the buyer's election, and one deal provided for transferable CVRs. Each of the CVRs in the remaining transactions announced since 2019 were cash-settled and non-transferable. The most recent use of a transferable CVR in a life sciences transaction was in 2019, and the transferable CVR was publicly registered to trade on the NYSE.<sup>20</sup>

### Post-Closing Efforts to Achieve the CVR Events.

#### *Subjective, Objective and Set Metrics Efforts*

CVR agreements are sophisticated documents that require structuring complex variables — this can present numerous issues both in the negotiation, and later, the implementation of these rights. When CVRs are event-driven, sellers and buyers will focus during negotiations on what efforts, if any, the buyer must expend post-closing to achieve the milestones that are the subject of the CVR. A seller may be concerned that a buyer will not devote sufficient resources for the acquired program post-closing or may prioritize an internal program over the acquired program, resulting in the nonachievement of the milestone. A buyer will be focused on maintaining autonomy over a company that it now owns. It will want the freedom to make decisions in the future without regard to the existence of these contingent payments. For example, a buyer may need the freedom to continue to pursue internal programs after the acquisition, even if those internal programs are potentially competitive with the acquired program.<sup>21</sup>

A buyer's efforts to achieve the milestones are typically found within the definition of "Commercially Reasonable Efforts" or "Diligent Efforts." The efforts that the buyer commits to expend may be articulated as a subjective standard, also referred to as an inward-looking standard (*i.e.*, the efforts that the buyer expends on its own internally developed programs or in-licensed products) or an objective standard, also referred to as an outward-looking standard (*i.e.*, the efforts that a reasonable company or similarly sized company would expend on a

<sup>19</sup> The listing of CVRs is governed by Nasdaq Listing Rule 5732 and by NYSE Listed Company Manual Section 703.18.

<sup>20</sup> Bristol-Myers Squibb Company's acquisition of Celgene Corporation, announced on January 3, 2019.

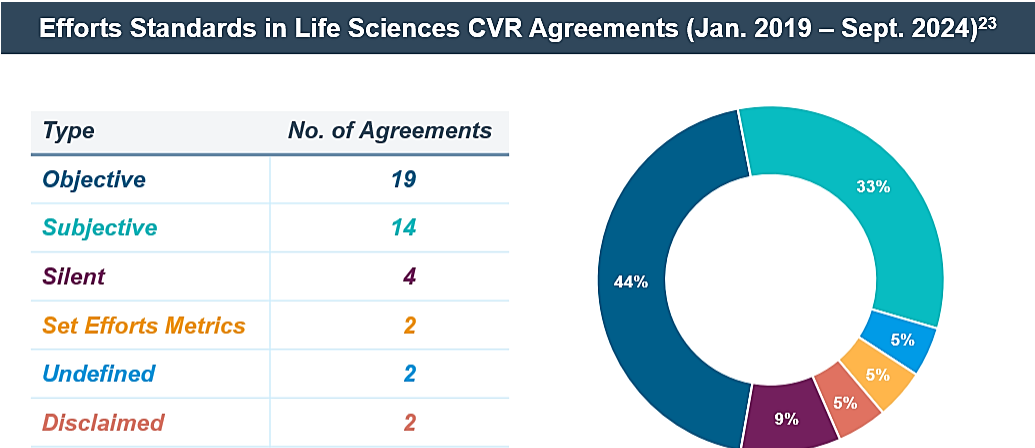
<sup>21</sup> One CVR agreement included, for example, "For clarity, the application of Commercially Reasonable Efforts will not necessarily require Parent to disadvantage any particular currently available competing products or products currently under development by Parent or any of its Affiliates or which may in the future enter development by Parent or any of its Affiliates, the success of which may reduce the prospects of achieving the relevant Milestone."

similar program). A majority of CVR agreements in the life sciences industry announced since 2019 provide for an objective standard, as shown in the next graphic. When CVRs are used in transactions with larger pharma company buyers, a subjective standard of efforts is more typically seen. Some CVR agreements specifically disclaim that the buyer will have to use any specified efforts to achieve the milestones.<sup>22</sup>

As an alternative to general defined efforts provisions, a CVR agreement may instead provide for specific funding requirements or a set sales strategy to be used to reach the milestones. In one transaction, for example, the CVR agreement provided for the achievement of three independent milestones: a clinical recommendation, regulatory approval and net sales targets. In that CVR agreement, the buyer agreed to expend not less than a specified amount toward the achievement of the clinical recommendation milestones and the regulatory approval milestone, while specifically reserving sole and absolute discretion over the development, marketing, commercialization and sales of the product tied to the net sales milestone. In a hybrid variation from a different transaction, the buyer agreed to use commercially reasonable efforts to achieve the milestones; however, the efforts covenant provided that if the buyer spent a specified dollar amount toward the development of the applicable CVR product, then the buyer would be conclusively deemed to have satisfied its efforts obligations (and it was acknowledged that buyer could still fulfill its diligence obligations even if it did not spend that amount on the development of the CVR product).

The prevalence of efforts standards in life sciences CVR agreements is shown in Table 7.<sup>23</sup>

Table 7



*Restrictions on Buyer’s Bad Faith Acts*

As with any earnout negotiation, sellers will be looking for contractual commitments from buyers, and buyers will seek discretion as to required efforts to allow flexibility in making future business decisions. Sellers may attempt to seek further assurances as to the efforts buyer will use to achieve a milestone by specifically restricting acts in bad faith made for the purpose of avoiding the achievement of a milestone or making a milestone payment. While Delaware law provides that the implied covenants of good faith and fair dealing attach to every contract unless

<sup>22</sup> One CVR agreement included, for example, “Notwithstanding anything in this Agreement or elsewhere to the contrary, in no event shall Parent or any of its Affiliates be required to undertake any level of efforts, or employ any level of resources, to achieve either of the Milestones prior to the end of the respective Milestone Period.”

<sup>23</sup> Based on review of the 2019-2024 CVRs, excluding three transactions that were withdrawn before the CVR terms relevant to this chart were disclosed.

specifically disclaimed, a seller may seek to include an explicit prohibition against bad faith acts.<sup>24</sup> Specific prohibitions against bad faith actions or actions to avoid the achievement of milestones taken by buyers were found in approximately one-third of CVR agreements in the life sciences industry since 2019.<sup>25</sup> A similar number of CVR agreements included an affirmative statement that the buyer would use good faith in its efforts, sometimes in conjunction with the prohibitions discussed above.<sup>26</sup>

#### *Buyer Considerations in Commercially Reasonable Efforts*

As part of the negotiated efforts definition, the parties typically agree to a list of enumerated items that the buyer may take into consideration in the performance of its diligence obligations, with the following commonly included, among other items:

- Patent coverage;
- Manufacturing and supply chain considerations;
- Anticipated financial performance of the product;
- Competitiveness of alternative products;
- Regulatory structure and environment considerations;
- Safety, tolerability and efficacy of the product;
- Project costs and reimbursements; and
- Expected time to develop the product.

Whether a buyer may take the milestone payments into consideration in exercising its diligence toward the achievement of the milestone events, the majority of diligence definitions specifically provide that a buyer may not take the milestone payments themselves into consideration (70%), while 27% are silent and 3% specifically note that a buyer may take the milestone payments into consideration. See Table 8.<sup>27</sup>

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<sup>24</sup> The following is a common formulation of this prohibition: "Neither Parent nor any of its Affiliates shall act in bad faith for the purpose of avoiding achievement of the Milestone or the payment of the Milestone Payment Amounts."

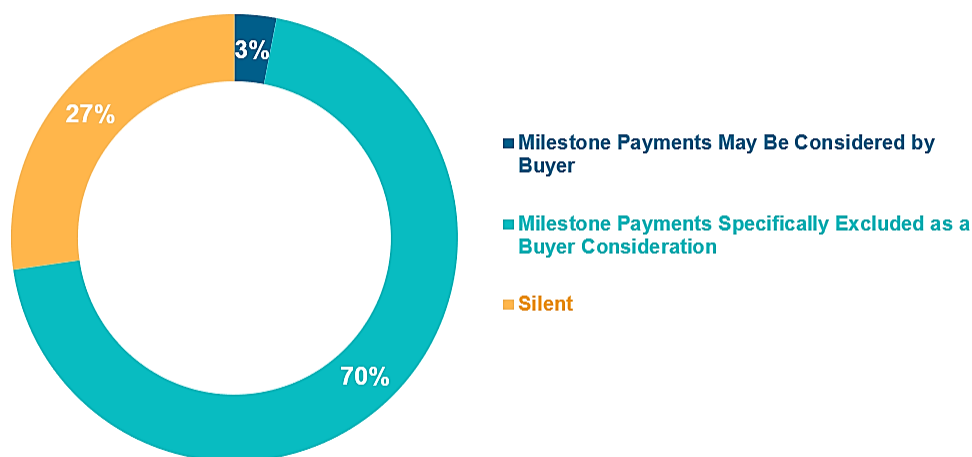
<sup>25</sup> Based on review of the 2019-2024 CVRs, excluding three transactions that were withdrawn before the relevant CVR terms were disclosed.

<sup>26</sup> The following is a common formulation of this acknowledgment: "(a) With respect to each Milestone, from the Effective Time until the earlier of (i) the applicable Milestone Outside Date and (ii) the achievement of such Milestone, Parent shall, and shall cause each other applicable Selling Entity to, act in good faith and use Commercially Reasonable Efforts to achieve such Milestone."

<sup>27</sup> Based on review of the 2019-2024 CVRs with defined effort standards.

Table 8

**Consideration of Milestone Payments in Subjective and Objective CRE Definitions  
(Jan. 2019 – Sept. 2024)<sup>27</sup>**



*Target Company Acknowledgments that Milestones May Never Be Achieved*

While a majority of CVRs include language that milestone payments cannot be taken into consideration by a buyer in its post-closing diligence efforts as noted above, a similar number of CVR agreements with defined efforts standards (*i.e.*, approximately two-thirds of those CVRs) include acknowledgments by the target company in the merger agreement that the milestones may never be achieved, even if the buyer diligently performs its efforts obligations.<sup>28</sup>

*Consistent and Inconsistent Efforts*

In a buyer's exercise of its efforts, it is often disputed post-closing whether efforts must be carried out in a consistent and sustained matter or if a buyer may pause or calibrate its efforts as it might do for other projects based on then-prevailing market conditions. While the expected positions of buyers and sellers on this point are easy to predict, the majority of efforts definitions are silent on this point. Approximately 27% of CVR agreements with defined efforts standards include specific language that a buyer's efforts must be sustained,<sup>29</sup> while a similar percentage of CVR agreements (approximately 24%) include language that specifically states that a buyer may, in fact, exercise different levels of efforts at different times based on the then-prevailing conditions and prospects of the CVR product.<sup>30</sup>

*Audit Rights/Buyer Reporting Obligations*

As in private company deals, audit rights for the CVR holders in transactions involving net sales milestones and reporting obligations of the buyer are also common in CVR agreements. The provisions governing the audit procedures will generally set out the period in which the audit must be requested, the process for selecting the

<sup>28</sup> The following is a common formulation of this acknowledgment: "For the avoidance of doubt, Commercially Reasonable Efforts will not mean that a party guarantees that it will actually achieve the Milestone, and a failure to achieve the Milestone may still be consistent with Commercially Reasonable Efforts."

<sup>29</sup> A common formulation of this language is as follows: "the level of efforts required to carry out such task in a diligent and sustained manner without undue interruption, pause or delay."

<sup>30</sup> One example of the formulation of this concept reads: "Commercially Reasonable Efforts will be determined as of the applicable time of determination on an indication-by-indication (if needed) basis, and it is anticipated that the level of effort may be different for different indications and may change over time, reflecting changes in the status of the Product and the indications involved."

independent accountant that will review the records, limitations on the number of audits that may be conducted within a given period, and requirements for confidentiality arrangements.

Duration. CVR agreements provide for varying durations but, in our experience, CVRs are typically of a shorter duration than milestones seen in private company M&A transactions that often survive for many years post-closing. The strong majority of the CVR agreements for public life sciences transactions announced since 2019 provided for a specified time period for performance (*i.e.*, a date by which the milestones must be achieved) or expiration date (*i.e.*, a date upon which the milestones will expire if some or all of the milestones have not been achieved by that date). The majority of CVR agreements with an expiration date provided for an expiration date of five years or less; a significant percentage provided for an expiration date of over five but under 10 years; and only two CVR agreements since 2019 provided for expiration dates in excess of 10 years.<sup>31</sup>

Post-Closing Assignment by the Buyer. CVR agreements in life sciences transactions typically provide for the assignability of the CVR agreement by the buyer, and in cases where the milestones are tied to the development, regulatory approvals or sales of a specific product, the assignability of that CVR product by the buyer. Generally, the buyer may assign the CVR agreement so long as the assignee agrees in writing to be bound by the terms of the original CVR agreement — however, the buyer will often remain liable for performance by any assignee. A minority of CVR agreements allow the buyer to assign without ongoing obligations or liability if the assignee meets certain pre-established criteria, such as holding certain net assets or being a significant company in the buyer's industry.<sup>32</sup>

## **Other Considerations**

Tender Offer HSR Waiting Period Considerations. As M&A practitioners will recall, in the context of a cash tender offer, the Hart-Scott-Rodino Act provides for an accelerated 15-day waiting period, facilitating a faster closing of a tender offer transaction as compared to a one-step merger. However, if the consideration includes non-cash elements, such as a CVR, the benefit of this 15-day accelerated period is forfeited, resulting in the standard 30-day waiting period. Generally, tender offers are more prevalent than one-step mergers in the life sciences industry. For example, in the three years ended September 30, 2024, 498 transactions were announced across all industries, excluding life sciences transactions. Of those non-life sciences transactions, approximately 8% were structured as tender offers. In the same time period, of the 128 life sciences transactions announced, approximately 35% were structured as tender offers. Even with the full 30-day waiting period, tender offers will likely still be incrementally faster than a one-step merger agreement (and a significant portion of life sciences transactions with CVRs were structured as two-step transactions).

Litigation Risks. As with earnouts in private M&A transactions, CVRs create a real risk of post-closing litigation. Common disputes, highlighted by recent high visibility litigation addressing whether buyers have breached their post-closing efforts requirements, involve claims that the buyer failed to meet the efforts standards specified in the CVR agreement, leading to missed milestones and non-payment. Disputes are very common in milestones in private M&A, and in public M&A, the larger number of former shareholders of a public company target who may hold CVRs amplifies this risk.

Related to this risk of post-closing litigation, sellers have for quite some time insisted on non-reliance and “no other representations” language in definitive agreements to cut off the risk of allegations of extra-contractual fraud. Similarly, it is important and reasonable for a buyer to have reciprocal protections in deals using CVRs for the same reasons that sellers argue that their shareholders should receive this protection. Without these protections, there is risk that it will be alleged that a buyer made extra-contractual representations or warranties

<sup>31</sup> Based on review of the 2019-2024 CVRs, excluding one transaction where the expiration date was measured from a future date uncertain (*i.e.*, the date of first commercial sale) and excluding three transactions that were withdrawn before the relevant CVR terms were disclosed.

<sup>32</sup> For example, one CVR agreement permitted the buyer to be released from liability if the assignee was one of the top 30 pharmaceutical companies, determined on worldwide annual revenue, or a pharmaceutical or biotechnology company with a regulatory and scientific infrastructure comparable to that of buyer. Another allowed for the buyer to be released from liability if the assignee held net assets of at least \$350,000,000.

— for example, about the prospects of post-closing CVR products or the buyer's then-anticipated expectations for its post-closing efforts, further increasing buyer's litigation exposure. More buyers are recognizing this risk, and a majority of the transactions using CVRs announced in the last two years include these reciprocal provisions. However, many buyers are still omitting this important language, even in deals where they have agreed to provide the seller's shareholders the protection they are not securing for themselves.

Accounting Considerations. Another complexity that may dissuade buyers (in particular, public company buyers that have their own public financial disclosure requirements) from using CVRs, is that, as with all contingent consideration, buyers will also need to consider the accounting treatment of these contingent payments. Accounting Standards Codification 805 is the primary accounting standard governing the accounting for business combinations under U.S. GAAP and provides guidance on a wide range of accounting issues related to business combinations, including recognizing and measuring contingent consideration. Under ASC 805, a buyer typically must establish a liability account on its balance sheet for the outstanding CVRs that is marked to market on a quarterly basis.

## **Conclusion**

In today's M&A landscape, it remains common for buyers and sellers to have divergent views on the value of a target company — this divergence is amplified in the life sciences space because success in this industry is often dependent on the outcome of future events, making it difficult to accurately predict the value of a company over the long term. The use of CVRs in life sciences M&A transactions can provide a valuable mechanism for bridging these valuation gaps by tying future payments to specific events, such as developmental, regulatory or commercial milestones. However, implementing a CVR agreement is a complex process that requires careful consideration of a variety of factors, including the appropriate milestones and metrics, other key terms of the CVR and the potential risks and rewards for both buyers and sellers.

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