

Delaware Rulings on Ambiguity, Materiality and Damages in M&A Indemnification Provisions Highlight the Importance of Careful Drafting

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Delaware courts are frequently called upon to interpret indemnification provisions linked to representations and warranties, which serve as potential remedies for losses, dictating when and how one party must make whole the other. Transaction parties often heavily negotiate indemnification provisions because they are valuable mechanisms for allocating risks and transaction costs.

Three recent Delaware opinions underscore the importance of (i) defining the scope of indemnification to avoid ambiguity, (ii) signaling when compliance with a provision is material and (iii) determining how to calculate damages.

Ambiguity in Scope

In *LGM Holdings*,¹ the Delaware Supreme Court reversed a Superior Court decision, ruling that a post-merger letter agreement addressing the scope of indemnification was ambiguous. In the merger agreement for a \$35 million pharmaceutical business, the sellers represented material compliance with law. But after closing, the U.S. Food and Drug Administration and the Department of Justice investigated the business, including for pre-closing conduct. To address potential losses and claims, the sellers and buyers entered into a letter agreement, which included a \$6 million indemnification cap.

After submitting notice of an indemnification claim, the buyers sued for \$6 million plus over \$35 million, arguing that the agreement only capped losses arising from the investigations, not fraudulent inducement damages, and that they would not have bought the business had they known about the sellers' alleged pre-closing fraud. On a motion to dismiss, the trial court agreed with the sellers that the \$6 million cap broadly applied to all claims, and the fraudulent inducement claim fell within that cap and was thus waived.

The Supreme Court disagreed, finding that the letter agreement was ambiguous because both parties offered reasonable interpretations of it. To the buyers, they were entitled to seek \$6 million plus over \$35 million because the cap applied only to post-closing conduct and the fraudulent inducement claim arose from pre-closing conduct. To the sellers, the cap fixed the maximum recovery, and the buyers could not circumvent it by "disguising an indemnification claim as a separate action for fraud[.]"² The Supreme Court remanded the case, permitting discovery.

Conditions Precedent

In *Thompson Street*, the Delaware Supreme Court held that a condition precedent in the indemnification notice requirements created a forfeiture and remanded the case back to the Court of Chancery to determine whether the notice requirements were material and, if material, created a disproportionate forfeiture.

Several parties entered into a merger agreement stating that the buyer "shall have no right to [indemnification] ... unless [the buyer] notifies [the seller] in writing

¹ *LGM Holdings. LLC v. Schurder*, --- A.3d ---, 2025 WL 1162999 (Del. Apr. 22, 2025).

² *Id.* at *7.

of such Claim[.]”³ Further, the indemnification notice needed to: (1) describe the claim with “reasonable specificity,” include copies of “material written evidence ... and indicate the estimated amount[.]” and (2) be submitted before a certain date.⁴ The Supreme Court defined these requirements as the “Notice Requirements.”⁵

The parties also entered into an escrow agreement that created an indemnity escrow fund with instructions for disbursing the fund. Thereafter, Sonova, the buyer, filed an indemnification notice for alleged damages arising out of the seller’s failure to comply with applicable law governing certain company billing practices. In response, Thompson Street, acting as the seller’s representative, filed this action, alleging that Sonova failed to comply with the indemnification-related notice requirements under the merger agreement. On a motion to dismiss, the Court of Chancery held that the notice was valid under the escrow agreement.

On appeal, the Supreme Court reversed and determined that it was reasonably conceivable that the buyer’s notice was improper because the buyer failed to meet the Notice Requirements under the merger agreement. Interpreting the Notice Requirements, the court further concluded that “[c]ombining the ‘shall have no right to recover’ language with the word ‘unless’ ... unambiguously create[s] a condition precedent that provides for a forfeiture.”⁶ The court also noted that, if Sonova’s notice was improper, Sonova could not recover from the indemnity fund because “[t]he Indemnity Escrow Fund shall be

[Sonova’s] sole and exclusive source of recovery for Damages under this Agreement[.]”⁷

Next, the court stated that, “on this record[.]” it could not resolve whether the occurrence of the condition was a material part of the exchange, which Thompson Street argued that it was, and whether the nonoccurrence of the condition would cause a disproportionate forfeiture.⁸ Therefore, the Supreme Court remanded this case back to the trial court to develop the record on the materiality and forfeiture issues. The court offered the following guidance to the trial court: (1) Consider the factors listed in Restatement (Second) of Contracts § 241 when assessing materiality, and (2) if the trial court determines that the Notice Requirements are not material, then consider the proportionality prong of Restatement (Second) of Contracts § 229.

Damages Calculation

In a post-trial opinion for *In re Dura Medic Holdings*, the Court of Chancery awarded damages upon finding that the sellers of a medical supply company breached two representations: one related to client contracts and one related to compliance with law.⁹ After closing, the buyers discovered that the sellers had not properly disclosed that one contract was terminated and another limited in scope and that three additional audits into the company’s billing practices were ongoing. The buyers delivered an indemnification notice of over \$16.5 million and sued.

On damages for the client contracts breach, the court found that, while the merger agreement expressly permitted damages based on “a multiple of earnings, revenue or other metric[.]” the agreement

³ *Thompson Street Cap. P’rs IV, L.P. v. Sonova United States Hearing Instruments*, --- A.3d ---, 2025 WL 1213667, at *2 (Del. Apr. 28, 2025) (italics and bold omitted).

⁴ *Id.*

⁵ *Id.*

⁶ *Id.* at *13, 15.

⁷ *Id.* at *13.

⁸ *Id.* at *20.

⁹ *In re Dura Medic Holdings, Inc. Consol. Litig.*, 333 A.3d 227, 236 (Del. Ch. Feb. 20, 2025).

neither required them nor clarified when they would be appropriate, such as by linking them to specific representations. That the loss of key contracts “resulted in recurring declines in revenue”¹⁰ persuaded the court, however, that employing a multiple was an appropriate remedy. Because the agreement also did not include a formula for calculating damages, the court invoked the common law rule that expectation damages can employ a multiple where the price for the business was determined with a market approach using a multiple. Therefore, the court derived damages by multiplying the lost revenue by the same multiple that the buyers used when calculating the merger price. The award totaled over \$2.8 million.

¹⁰ *Id.* at 260.

On damages for the compliance-with-law breach, the court did not apply a multiple; rather, it pruned the buyer’s claim of over \$546,000. In the court’s view, requests related to “unexpected cash flow problems” and an abandoned acquisition that was actually caused by other factors were “too attenuated to recover.”¹¹ Disavowing any “pretense of precision,”¹² the court instead granted a \$100,000 award for fees that were more directly incurred by the buyer, such as consultant charges to address the audits and overhaul the billing system.

¹¹ *Id.* at 261.

¹² *Id.* at 263.

Key Points

- Each case featured allegations of noncompliance with law, an area fraught with the potential for loss. Although devoting more attention to drafting compliance provisions may increase costs and time to close, the added certainty may be worth the price to avoid litigation. Additionally, sellers need to take steps to ensure that their companies are in compliance with the law to limit the possibility of litigation.
- If a post-merger agreement modifies indemnification provisions, the parties should assess how fraudulent inducement and other claims may interact in order to avoid ambiguity in their modifications.
- Contracting parties need to carefully draft the notice requirements for indemnification: (1) to create a condition that is material to the exchange under the Restatement (Second) of Contracts § 241 factors, or (2) if the condition is immaterial to the exchange, the parties should avoid drafting a notice provision that would cause a disproportionate forfeiture under Restatement (Second) of Contracts § 229.
- For representations regarding key contracts, it may be sensible to specify the multiple or liquidated damages that would apply in the event of breach rather than risk expending resources to prove such a remedy with expert testimony at trial.
- The Supreme Court reversed and remanded in *LGM Holdings* and *Thompson Street*, allowing discovery and highlighting that a record of the parties’ negotiations may prove decisive at trial to establish contract meaning and materiality.

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