Indemnification Consternation: Delaware Supreme Court Questions the Materiality of Claim Notice Requirements

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Introduction

On April 28, 2025, the Supreme Court of Delaware issued a ruling in *Thompson Street Capital Partners IV, L.P. v. Sonova Unites States Hearing Instruments, LLC*,[1] clarifying how Delaware courts should interpret and enforce indemnification claim notice requirements. The case involves a relatively routine post-closing dispute concerning the timeliness and sufficiency of detail provided in an indemnification claim notice submitted by the buyer to the seller in a merger and acquisition (M&A) transaction.

In line with its typical contractarian slant, the Supreme Court spent much of its time focusing on the express language of the notice requirements spelled out in the definitive acquisition agreement, a merger agreement, ultimately finding that such language constituted a clear condition precedent, which, if not met, could result in forfeiture of the ability to recover in respect of the underlying indemnification claims. However, the Supreme Court made a striking, precedent-setting distinction, adding that a party's noncompliance with such a condition precedent may potentially be excused to avoid forfeiture "if the timing and specificity requirements were not material to the agreement and the noncompliance would result in a disproportionate forfeiture."[2] The Supreme Court summed up the tension at hand in arriving at such a conclusion, noting, "Delaware is a contractarian state, but our common law abhors forfeiture."[3]

The decision in *Thompson Street* generated much pause among M&A practitioners, as they contemplate the various bargained-for deadlines, survival periods, and content requirements typically included in acquisition agreements, and whether they would be considered sufficiently material under the relevant facts and circumstances if put to the test in a Delaware court applying the rubric outlined by the Supreme Court. Notably, the Supreme Court remanded the case to the Delaware Court of Chancery for further development of the facts relating to these materiality and disproportionate forfeiture concepts, so it is yet unclear what the final result will be, and how specifically that will impact practitioners' approach to drafting around these concepts in their transaction documents. In the meantime, parties and their advisors should consider enhancing their contracts to expressly state the material nature of survival periods, as well as notice deadlines and content requirements, as key, negotiated provisions upon which the parties have expressly relied in determining to enter into and consummate their M&A transaction.

Background and Facts

[1] Thompson St. Cap. Partners IV, L.P. v. Sonova U.S. Hearing Instruments, LLC, ---A.3d ---, No. 166, 2025 WL 1213667 (Del. Apr. 28, 2025).
[2] *Sonova*, 2025 WL 1213667, at *2.
[3] *Id*.

On January 13, 2022, Sonova United States Hearing Instruments, LLC (Sonova) acquired several audiology practices operated by certain subsidiaries of Alpaca Group Holdings, LLC, a portfolio company of Thompson Street Capital Partners IV, L.P. (Thompson Street), pursuant to the terms of an Agreement and Plan of Merger (the Merger Agreement), the primary transaction document governing the acquisition. The parties also entered into an Escrow Agreement (the Escrow Agreement) in connection with the transactions, which taken together with the indemnification provisions of the Merger Agreement, governed the process by which Sonova could submit claims to recover in respect of losses arising from inaccuracies in the representations and warranties provided to Sonova in the Merger Agreement.

Pursuant to the Merger Agreement and the Escrow Agreement, the parties established an Escrow Fund to be split into two separate accounts: a US$750,000 "Adjustment Escrow" which was released in late 2022 following the parties' resolution of certain financial issues in connection with a customary post-closing purchase price adjustment process, and a US$7,750,000 "Indemnity Escrow" that would be available to satisfy indemnification claims that might arise post-closing and the availability of which ended up being the subject of the dispute at hand.[4] The court also highlighted that the parties expressly agreed that these escrowed funds would serve as Sonova's sole recourse for recovery of any alleged damages under the Merger Agreement,[5] an increasingly common approach in private M&A transactions.

On August 25, 2023, one business day before the August 29, 2023 deadline for submitting indemnification claims, Sonova delivered an indemnification claim notice (the Claim Notice) to Thompson Street and the third-party escrow agent (the Escrow Agent), alleging certain improper billing practices that led to Sonova incurring certain as-yet-unquantified damages.[6]

Weeks later, on September 11, 2023, Thompson Street filed a complaint in the Delaware Court of Chancery, seeking declaratory judgment and a mandatory injunction regarding the Claim Notice and release of all of the escrowed funds. In particular, Thompson Street sought an order declaring that the Claim Notice did not meet the notice requirements contained in the Merger Agreement, and a mandatory injunction requiring that Sonova execute a "Joint Written Instruction" letter directing the Escrow Agent release to Thompson Street the entirety of the Indemnity Escrow. Sonova moved to dismiss the complaint, arguing in pertinent part that Thompson's Street's complaint failed to claim that Sonova's Claim Notice did not comply with the requirements set forth in the Merger Agreement.[7]

The Court of Chancery reviewed the Claim Notice against the notice provisions in the Escrow Agreement, which in describing the content requirements as "specify[ing] in reasonable detail the nature and dollar amount of the [claims]" did not require the same level of specificity as the Merger Agreement, and in particular did not require delivery of any supporting

[4] *Id.* at *6.
[5] *Id.* at *4.
[6] *Id.* at *8.
[7] *Id.* at *9-10.

documentation.[8] On March 25, 2024, the Court of Chancery issued a letter opinion (Letter Opinion), holding that Sonova's Claim Notice was valid for the purpose of preventing the release of the Indemnity Escrow and granting Sonova's motion to dismiss.[9]

Supreme Court's Review on Appeal

Following the Court of Chancery's Letter Opinion, Thompson Street filed an appeal with the Supreme Court of Delaware on February 19, 2025. In issuing its opinion reversing the Court of Chancery and remanding the case for further development, the Supreme Court held that the Merger Agreement and Escrow Agreement are integrated and thus must be read together, meaning that Sonova was required to comply with the relevant notice provisions in both agreements.[10] As such, the Supreme Court focused almost entirely on the Merger Agreement's more specific notice requirements for the submission of indemnification claims, contained in Section 9.3.2 and entitled "Claim Procedures", which provided that:

> [a]ny claim by a Purchaser Indemnified Party on account of Damages under this Article IX (a "**Claim**"), including those resulting from the assertion of a claim by any Person who is not a Party to this Agreement (a "**Third-Party Claim**"), will be asserted by giving the Members' Representative reasonably prompt written notice thereof, but in any event not later than 30 days after the Purchaser Indemnified Party becomes actually aware of such Claim, provided that no delay on the part of the Purchaser Indemnified Party in notifying the Members Representative will relieve the Merger Parties from any obligation under this Article IX, except to the extent such delay actually and materially prejudices the Merger Party. Such notice by the Purchaser Indemnified Party will describe the Claim in *reasonable detail*, will include the justification for the demand under this Agreement with *reasonable specificity*, will *include copies of all available material written evidence thereof*, and will *indicate the estimated amount*, if reasonably practicable, of Damages that has been or may be sustained by the Purchaser Indemnified Party. **The Purchaser Indemnified Parties *shall have no right to recover any amounts pursuant to Section 9.2 unless the Purchaser notifies the Members' Representative in writing of such Claim pursuant to Section 9.3* on or before the Survival Date.**[11]

Thompson Street argued that Sonova's Claim Notice failed to provide the requisite detail, specificity, and documentation supporting its claim, thus not complying with the express terms of the Merger Agreement governing notices of indemnification claims, and that as such Sonova was precluded from pursuing its indemnification claim because no adequate claim notice was timely tendered (i.e., in advance of the August 29, 2023 deadline).

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[8] *Id.* at *7.
[9] *Id.* at *12.
[10] *Id.* at *5-6.
[11] *Id.* at *32-33.

The Supreme Court in essence sided with Thompson Street on this front, "read[ing] Section 9.3.2 of the Merger Agreement as unambiguously creating a condition precedent that provides for a forfeiture."[12] The Supreme Court emphasized the final sentence of Section 9.3.2 of the Merger Agreement, shown in bold above, as the operative language creating said condition precedent, through the "[combination of] the 'shall have no right to recover' language [and] the word 'unless.'"[13]

We recommend M&A practitioners take note, ensuring that similar conditions precedent are clearly and expressly described. Otherwise, forfeiture may not be read into the parties' agreement, which may not align with their intentions. Additionally, the Supreme Court's analysis highlights the importance of ensuring that similar provisions in multiple M&A transaction documents should align with one another, so as to avoid ambiguity and provide the parties with a clear roadmap towards compliance with, for example, content requirements for indemnification notices. However, as described below, even express "condition precedent" language outlining a forfeiture of rights for failure to comply with deadlines or content requirements may still be insufficient to ensure that conditions precedent based on deadlines and content requirements are given effect.

Two-Pronged Test for Excusing Forfeiture From Noncompliance With a Condition Precedent

After considering the "condition precedent" question, the Supreme Court then moved to address whether Sonova's forfeiture for noncompliance could be excused, which the Supreme Court indicated involves a two-pronged analysis of materiality and disproportionate forfeiture.[14]

The Court relied on Section 229 of the Restatement (Second) of Contracts (the Restatement) for this analysis, which provides that "[t]o the extent that the non-occurrence of a condition would cause disproportionate forfeiture, a court may excuse the non-occurrence of that condition unless its occurrence was a material part of the agreed exchange."[15] Specifically, those two prongs are: "(1) whether the occurrence of the condition was a material part of the agreed exchange, and (2) a proportionality analysis that balances the risk to be protected with the amount to be forfeited."[16] The Supreme Court noted that that application of the second prong will only occur if the first prong is satisfied. That is, a condition precedent must not be material in order to even consider excusing forfeiture for noncompliance. And conversely, if a condition precedent is found to be material, then there is no need to move to the proportionality analysis and forfeiture will be allowed to occur.

The Supreme Court provided additional guidance to the Court of Chancery on each prong, drawing again from the Restatement and its application by other courts. On materiality, the Supreme Court cited a 1994 decision by the Superior Court of Pennsylvania, *Acme Mkts.,*

[12] *Id.* at *29.
[13] *Id.* at *33.
[14] *Id.* at *45.
[15] *Id.* at *45 (citing Restatement (Second) of Contracts § 229).
[16] *Id*.

Inc. v. Fed. Armored Express, Inc., which held that materiality "rests to a large extent on the analysis of the requirement's purpose, [but] it also involves a consideration of the negotiations of the parties along with all other circumstances relevant to the formation of the contract or the requirement itself[.]"[17] The Supreme Court also outlined a number of factors noted in the Restatement and relevant to the materiality inquiry, including the extent to which the injured party will be deprived of the benefit that it reasonably expected, whether the injured party can be adequately compensated, the extent to which the party failing to perform will suffer forfeiture, the likelihood that party will cure its failure, and whether the breach comports with standards of good faith and fair dealing.[18] The Supreme Court adds that this is a flexible rule, application of which "is within the sound discretion of the court."[19]

For now, at least, the Supreme Court's decision in *Thompson Street* will remain open for interpretation as to how, upon further development of the facts, the Delaware Court of Chancery might have ruled as to the questions of materiality (and, if applicable, disproportionate forfeiture). On July 17, 2025, Thompson Street and Sonova stipulated and agreed to dismissal with prejudice, thus concluding the litigation at hand.[20]

It may well be the case that most M&A practitioners consider indemnification provisions, including survival periods and associated claim deadlines, as well as content requirements for claim notices, to constitute a material aspect of the agreed exchange between parties to an M&A transaction. As to the point regarding claim deadlines, many acquisition agreements in M&A transactions contain provisions, sometimes dismissed as "boilerplate" language, stating that time is of the essence with respect to all time periods and dates set forth therein (or some similar formulation). Particularly, given the Supreme Court's focus not just on the timeliness—or lack thereof—of Sonova's Claim Notice, but also the substantive content of that Claim Notice, it is not clear that such a provision would have made a difference in its analysis. In light of the Supreme Court's decision in *Thompson Street*, drafters would be well-cautioned to consider stating that those deadlines and notice content requirements not only constitute conditions precedent for tendering an adjudicable indemnification claim, but also that the parties' agreement that those conditions precedent were a material aspect of their broader agreement and willingness to enter into and consummate their M&A transaction, i.e., a "material part of the agreed exchange."[21]

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[17] *Id.* at *40-41 (citing Acme Mkts., Inc. v. Fed. Armored Express, Inc., 648 A.2d 1218, 1220 (Pa. Super. Ct. 1994)).
[18] *Id.* at *24 (citing Restatement (Second) of Contracts § 229).
[19] *Id*.
[20] Thompson St. Cap. Partners IV, L.P. v. Sonova U.S. Hearing Instruments, LLC, C.A. No. 2023-0922-PRW, Docket Entry # 99048130 (Del. Ch. July 17, 2025).
[21] *Id.*

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