

Delaware Supreme Court Clarifies Indemnification Notice Requirements in M&A Escrow Dispute

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The Delaware Supreme Court recently issued a significant decision in *Thompson Street Capital Partners IV, L.P. v. Sonova United States Hearing Instruments, LLC*, clarifying the importance of strict compliance with indemnification notice requirements in mergers and acquisitions (M&A) agreements. As a result of the decision, practitioners should consider stipulating in the relevant M&A agreement that the notice requirements are material to the parties' bargain.

Background

In 2022, Sonova United States Hearing Instruments, LLC (Sonova) acquired audiology practices from Alpaca Group Holdings, LLC, with Thompson Street Capital Partners (Thompson) acting as the members' representative for Alpaca's former members. The transaction was governed by a merger agreement and an escrow agreement. The merger agreement required Sonova to provide a written claim notice with specific details and supporting evidence by a certain deadline (survival date) to recover from the indemnity escrow fund. On August 25, 2023, Sonova submitted a claim notice one day before the escrow expiration, alleging improper billing practices but did not include supporting written evidence or a quantified damages amount. Thompson sued, arguing Sonova's notice was deficient and the escrow funds should be released. The Delaware Court of Chancery subsequently dismissed the complaint, focusing on the escrow agreement and finding Sonova's notice sufficient to prevent release of the escrow funds. Thompson appealed to the Delaware Supreme Court.

Analysis

On appeal, the Delaware Supreme Court found the merger agreement's notice requirements were controlling (rather than those in the escrow agreement) and that the merger agreement created a condition precedent, potentially triggering forfeiture of Sonova's indemnification rights if not met. However, according to the court, Delaware law may excuse noncompliance if the notice requirements were not material to the underlying agreement and enforcing them would cause a disproportionate forfeiture. The case was remanded to the Delaware Court of Chancery for further factual development on these points.

Takeaways

This court's decision highlights the critical need for precision in contract compliance and the potential consequences of overlooking detailed notice provisions in M&A transactions governed by Delaware law. Specifically:

- Parties to M&A agreements should strictly comply with notice requirements for indemnification claims, as failure may result in loss of recovery rights.
- Courts may excuse technical noncompliance if enforcing the condition would be disproportionate and the requirement was not material to the deal.
- When drafting or responding to indemnification claims, parties should document compliance with all contractual notice provisions and be prepared to show materiality and prejudice if a dispute arises.
- Alternatively, parties should consider stipulating to the materiality of all notice provisions in the underlying M&A agreement.

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