

Time Back on the Clock: Delaware Court of Chancery Equitably Extends Earnout Period to Remedy Buyer's Breach

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In *Fortis Advisors LLC v. Krafton, Inc.*, the Delaware Court of Chancery recently held after trial that an acquiror breached an equity purchase agreement by terminating key employees without valid “cause” and seizing operational control of the acquired company in an effort to avoid a nine-figure earnout obligation. The court granted specific performance, reinstating the company’s CEO and equitably extending the earnout testing period by 258 days to account for the wrongful ouster. The decision could have significant implications for the structuring and enforcement of earnout provisions, “for cause” termination protections, and operational control rights in acquisition agreements.

Background

South Korean gaming conglomerate Krafton, Inc. acquired Unknown Worlds Entertainment, developer of the *Subnautica* video game franchise, in October 2021 for \$500 million upfront plus up to \$250 million in contingent earnout payments tied to revenue performance through a defined testing period ending December 31, 2025. The equity purchase agreement (EPA) guaranteed that three “key employees,” co-founders Charlie Cleveland (Cleveland) and Max McGuire (McGuire), and CEO Ted Gill (Gill), would retain operational control of the studio during the earnout period and could only be terminated “for cause.” The EPA defined “cause” narrowly to include a felony conviction, an “intentional act of fraud or dishonest[y],” “a willful act or omission . . . that constitutes gross misconduct,” or “an intentional, wrongful disclosure of trade secrets or confidential information.”

Over time, Cleveland and McGuire transitioned into reduced roles and agreed to reduced salaries. Their transitions were communicated to Krafton’s senior personnel. Gill continued as CEO overseeing studio operations and the development of *Subnautica 2*. By spring 2025, as *Subnautica 2* neared its planned early access launch, Krafton’s internal financial projections showed that a successful release would generate between \$191.8 million and \$242.2 million in earnout payments. Krafton’s CEO, who had personally led the acquisition, became concerned that the payout would damage his reputation and consulted an AI chatbot for strategies to avoid the obligation. Krafton formed an internal task force, internally called Project X, to either negotiate a reduction of the earnout or execute a corporate takeover of the studio.

On July 1, 2025, Krafton terminated all three key employees, citing a single reason: their “intention to proceed with a premature release of *Subnautica 2*.” Krafton then locked the studio out of its Steam publishing platform, blocked the game’s release, and replaced the key employees with Krafton representatives. Fortis Advisors LLC, as

shareholder representative for Unknown Worlds' former stockholders, sued for breach of the EPA and sought specific performance.

The Court's Analysis of 'Cause'

The court found that Krafton failed to establish that the key employees were terminated for "cause" as defined in the EPA. At trial, Krafton abandoned its original stated reason for the terminations (the "premature release" justification) and instead advanced two alternative theories: (1) that Cleveland and McGuire's role transitions constituted "intentional acts of dishonesty" because they concealed their reduced involvement from Krafton, and (2) that the key employees' downloading of company files to personal devices in the weeks before their terminations was independently terminable misconduct. The court rejected both theories.

On the role transitions, the court held that these were "transparent maneuvers rather than deliberate acts of deception." The court found that Cleveland and McGuire openly communicated their evolving roles to Krafton's senior personnel over a period of years, that Krafton processed their voluntary salary reductions through its own HR systems, and that Krafton's assigned studio liaison witnessed the transitions firsthand. The court construed the EPA's "intentional act of dishonesty" language to require a specific intent to deceive, not merely a deliberate act that happened to result in a breach, distinguishing *Hexion Specialty Chemicals, Inc. v. Huntsman Corp.*, which addressed the distinct phrase "knowing and intentional breach."

As to the data downloads, the court found that the key employees' actions were "protective measures, lacking the requisite intent to deceive." The employees downloaded company files in anticipation of a hostile corporate takeover, kept the data confidential, and promptly returned it upon request. The court noted that the employees had access rights to the materials under the company's bylaws and that the EPA itself permitted use of confidential information to monitor their rights under the agreement.

The Court Further Rejected Krafton's New Justifications for Termination

Beyond its substantive analysis of "cause," the court addressed Krafton's litigation strategy of advancing successive post hoc justifications for the terminations:

- **Mend-the-hold doctrine.** The court applied the mend-the-hold doctrine, under which a party that has asserted one ground for its contractual position cannot switch to a different, inconsistent justification during litigation. Krafton's initial termination letters cited only the key employees' intention to proceed with a "premature release." When that justification collapsed, Krafton pivoted to the role transitions and data downloads. The court found this shifting impermissible.
- **After-acquired evidence doctrine.** The court held that Krafton could not rely on the after-acquired evidence doctrine to retroactively justify the terminations based on facts discovered after the firing decision had already been made. The court observed that when an employer faces a contractual payout it wishes to avoid, it is heavily incentivized to search through an employee's history for any pretext to declare the termination was "for cause." The court stated that it would not permit a party to use the after-acquired evidence doctrine to fabricate "cause" where the evidence showed the termination decision was made for different reasons.

Remedies

The court enforced the EPA's express provision that irreparable harm would result from any breach and that the

nonbreaching party was entitled to specific performance, and ordered the following:

- The court ordered the reinstatement of Gill as CEO of Unknown Worlds with full operational authority, effective immediately. The court declined to reinstate Cleveland and McGuire, finding that restoring Gill alone was sufficient to vindicate the sellers' operational control rights under the EPA.
- **Injunction against interference.** The court enjoined Krafton from circumventing the EPA's operational control provision or impeding Gill's authority over the early access launch of *Subnautica 2*, and ordered Krafton to immediately restore Gill's access to the Steam publishing platform.
- **Board resolution declared ineffective.** The July 1, 2025, board resolution through which Krafton seized control of the studio was declared ineffective to the extent it infringed on Gill's operational control right.
- **Equitable extension of the earnout period.** The court equitably extended the earnout testing period by 258 days, the duration of Gill's wrongful ouster, moving the base deadline from December 31, 2025, to September 15, 2026, with Fortis retaining its contractual right to further extend the period to March 15, 2027.

The court acknowledged that Gill's reinstatement would create tension between the parties given "the obvious bad blood," but held that this did not excuse a material breach of contract or override the bargained-for performance obligations. The court reserved damages and the question of whether Krafton deliberately impaired the earnout for a second phase of the litigation.

Takeaways

This decision could have broad implications for acquirors, sellers, and practitioners involved in structuring and enforcing acquisition agreements with earnout and key employee provisions:

- **"For cause" definitions may be strictly construed.** Acquirors should not expect courts to apply "cause" definitions flexibly when the economic incentive to terminate is transparent. Where the EPA narrowly defines "cause," the court will likely hold the acquiror to those terms. Practitioners should draft "cause" definitions with precision, understanding that each prong, particularly concepts like "intentional act of dishonesty," will be parsed according to its plain meaning, and that "intentional" modifies the dishonesty itself, not merely the underlying act.
- **Post-hoc justifications for terminations face heightened scrutiny.** The court's application of the mend-the-hold and after-acquired evidence doctrines signals that acquirors who terminate key employees and then search for a justification after the fact, will be assessed with heightened scrutiny. The stated reason at the time of termination will anchor the court's analysis, and shifting to new theories during litigation may be foreclosed entirely. Termination letters should be drafted with care, as they may define the boundaries of the acquiror's litigation position.
- **Operational control provisions may be enforceable through specific performance.** Sellers who negotiate operational control rights during the earnout period generally can expect courts to enforce those rights in equity, including possible reinstatement, particularly where the EPA contains a specific performance clause and the factual findings support an improper interference with operational control provisions. The court's willingness to order reinstatement of a CEO, even over the acquiror's objection and amid significant interpersonal conflict, underscores that these provisions can have real teeth.
- **Courts could equitably extend earnout periods to remedy buyer misconduct.** Where an acquiror's breach shortens the effective earnout window, sellers may obtain an equitable extension to restore the time lost. This decision demonstrates that the court will calculate the extension with specificity, here, matching the 258-day period of the CEO's ouster, rather than relying on imprecise approximations. Acquirors should be aware that wrongful interference with an earnout does not merely create a damages claim but may extend the earnout obligation itself.
- **AI-generated strategies are discoverable and create evidentiary risk.** The acquiror's use of an AI chatbot to develop strategies for avoiding the earnout, and the subsequent deletion of those logs-featured prominently

in the court's factual findings. Parties should treat AI-generated content as they would any other business communication: subject to discovery, preservation obligations, and potential adverse inference.

- **Contractual specific performance clauses carry significant weight in Delaware.** The EPA's mutual agreement that breach would cause irreparable harm and that the parties would be entitled to specific performance materially influenced the court's remedy. Sellers should insist on these provisions, and acquirors should understand that agreeing to them creates meaningful exposure to equitable relief, including when warranted based upon the court's factual findings, forced reinstatement and injunctive relief, not merely monetary damages.

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