

DELAWARE BUSINESS COURT INSIDER

Recent Earnout Decisions by Delaware Courts Provide Implied Covenant Lessons

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In three recent decisions, the Delaware courts have addressed claims by sellers against buyers for breach of the implied covenant of good faith and fair dealing in the context of an earnout dispute. In the first decision, the Delaware Supreme Court reversed in relevant part the Delaware Court of Chancery's post-trial decision, finding that the trial court erred in holding that the buyer had an implied obligation to pursue an alternative approval process to achieve a regulatory earnout after a regulatory change rendered the particular form of regulatory approval specified in the parties' merger agreement unobtainable. In the latter two decisions, the Delaware Superior Court denied pre-trial motions by buyers seeking dismissal of, or summary judgment on, implied covenant claims, finding that the sellers had alleged adequate facts or presented sufficient evidence indicating that the buyers may have breached the implied covenant by apparently taking economically detrimental actions in bad faith to avoid collecting customer payments or to reduce revenues for the purpose of avoiding the earnout.

Below, we discuss the pertinent aspects of the decisions as they relate to the implied covenant.

'Johnson & Johnson v. Fortis Advisors'

In *Johnson & Johnson v. Fortis Advisors*, — A.3d —, 2026 WL 89452 (Del. Jan. 12, 2026), the Dela-



Courtesy photos

Christopher N. Kelly, left, and Heather S. Townsend, right, with Potter Anderson & Corroon.

ware Supreme Court, sitting en banc, reversed the Court of Chancery's post-trial finding that Johnson & Johnson breached the implied covenant.

As the Supreme Court explained in its decision, Johnson & Johnson acquired Auris Health, Inc. (Auris), a medical robotics company, through a merger agreement for an upfront cash payment and potential earnouts tied to regulatory (and sales performance) milestones related to Auris' primary products, including its iPlatform device. Johnson & Johnson agreed in the merger agreement to use "commercially reasonable efforts" to achieve the regulatory milestones. The regulatory milestones were specifically tied to an FDA process known as 510(k) clearance. Prior to exe-

cutting the merger agreement, in light of the FDA publicly indicating its plan to “modernize” the 510(k) process, Auris sought assurance from the FDA that iPlatform would qualify for the 510(k) pathway; despite the FDA indicating that 510(k) clearance was uncertain, the regulatory milestones in the merger agreement were expressly tied to 510(k) approval. After closing, the FDA informed the parties that iPlatform would not be eligible for the 510(k) approval process. Johnson & Johnson treated the regulatory shift “as excusing its obligations to achieve the earnouts.”

Following trial, the Court of Chancery held that there was a “gap” in the merger agreement regarding alternative approval pathways, that such gap was filled by the implied covenant, and that the covenant required Johnson & Johnson to use commercially reasonable efforts to achieve the pertinent regulatory milestone through an alternative regulatory process once the 510(k) process was no longer available. The court found that Johnson & Johnson’s “decision to halt development appeared unreasonable and contrary to the deal’s purpose,” and breached the implied covenant.

The Supreme Court reversed the trial court’s implied covenant ruling, holding that there was no gap to be filled because the merger agreement did not speak in general terms about regulatory approval, but instead specifically required 510(k) approval. Despite alternative regulatory processes, and notwithstanding the parties acknowledging different possible regulatory scenarios in other provisions of the merger agreement, the parties “chose to explicitly tie every regulatory milestone” to the 510(k) process.

Further, the Supreme Court noted that the FDA’s change in the 510(k) process “although believed to be unlikely, was not unforeseeable at the time of contracting.” Not only were both parties experienced with the 510(k) process and could have foreseen the change, both parties were on notice when the FDA announced its “modernization” plan. Auris even sought feedback about iPlatform from the FDA, in response to which the FDA

gave a cautionary response about its eligibility for the 510(k) process. In light of these facts, the Supreme Court concluded that a “sophisticated medical device company and acquiror could reasonably foresee the risk” of the change in approval process.

Because the risk that the 510(k) process may not be available for iPlatform was “both foreseeable and addressed in the parties’ agreement,” there was no gap to be filled by the implied covenant, nor was there any room for discretion that could otherwise implicate the implied covenant. Therefore, the court held that Johnson & Johnson had no implied obligation to pursue a different FDA pathway once the 510(k) pathway was no longer available.

The Supreme Court also reversed the associated damages award relating to the pertinent milestone, holding that the award could not stand because once the 510(k) process was unavailable, that milestone’s “express condition could not be satisfied as written.”

‘Monica v. Delta Data Software’

In *Monica v. Delta Data Software*, 2026 WL 370756 (Del. Super. Feb. 10, 2026), the Delaware Superior Court declined to dismiss the sellers’ implied covenant claim against the purchaser, Delta Data Software, Inc. (Delta Data).

According to the court’s decision, the plaintiff sellers alleged that Delta Data breached the implied covenant by undermining the collection of a payment from a customer in order to avoid triggering its earnout obligation. Under the parties’ purchase agreement, plaintiffs were entitled to an earnout if a certain annual recurring revenue threshold was met; pertinently, revenues would be counted toward the ARR threshold for new contracts for which an initial payment had been received by a certain date. After closing, Delta Data acquired a new customer whose initial payment was not received until after the cutoff date for inclusion of the associated contract revenue in the ARR calculation. Under the

express terms of the purchase agreement, the revenue from the new customer would not have counted toward the ARR threshold.

Plaintiffs, however, alleged that Delta Data acted with intent to avoid paying the earnout, first issuing an invoice that required payment before the ARR cutoff date, then telling the customer it would void the invoice and that the customer need not pay until after the ARR cutoff date.

In ruling on defendant's motion to dismiss, the Superior Court held that the purchase agreement contained a "gap" to fill because it was "silent" on how Delta Data was required to act "when it comes to collection of payments," noting, for instance, that the agreement did not include an "efforts" clause obligating the buyer to use any level of effort to collect payments in a timely fashion.

The court determined that plaintiffs had asserted well-pleaded allegations of a breach of the implied covenant because Delta Data allegedly took affirmative acts for the specific purpose of undermining the earnout. The court held it was reasonable for plaintiffs to expect that "at least" Delta Data "would not take affirmative acts to avoid receiving customer payments by the ARR cutoff date." The plaintiffs' allegations that Delta Data had issued an invoice requiring payment before the ARR cutoff date, but then voided the invoice and told the customer it need not pay during the earnout period, reasonably suggested affirmative conduct to avoid the earnout.

The court relied on *Winshall v. Viacom International*, 55 A.3d 629 (Del. Ch. 2011), *aff'd*, 76 A.3d 808 (Del. 2013), which explained that there was a "critical difference" between failing to take an opportunity and "purposefully push[ing] revenues out of the earn-out period." See *Delta Data*, 2026 WL 370756, at *8 (quoting *Winshall*, 55 A.3d at 638)). The court explained that Delta Data's alleged deliberate postponement of an initial customer payment to outside the earnout period well-pleaded a breach of the implied covenant under *Winshall*. The court distinguished a

buyer's inaction from a buyer's affirmative acts to undermine an earnout, (citing *Limitless Coffee v. Mott's*, 2024 WL 4233900, at *3-4 (Del. Super. Sept. 19, 2024)). The court stated that the "plaintiffs were reasonable to expect at least that Delta Data would refrain from affirmatively acting to avoid" receiving customer payments by the earnout cutoff date. Where the purchase agreement did not "expressly address the matter of how [Delta Data] must conduct itself regarding collection of payments," the court concluded that the implied covenant could fill that gap at the pleading stage. The court noted, though, that "with the benefit of a record, the defendant will have a chance to offer its own version of the facts" later in the case.

'Jiggy Puzzles v. Steelhead Acquisition EE'

In *Jiggy Puzzles v. Steelhead Acquisition EE*, 2026 WL 465112 (Del. Super. Feb. 18, 2026), the Delaware Superior Court declined to grant summary judgment in favor of the buyer on an implied covenant claim in an earnout dispute, concluding that the seller had presented evidence suggesting the buyer acted in bad faith as the business was on the verge of triggering the earnout to prevent it from doing so.

As the court explained in its opinion, defendant Steelhead Acquisition EE, Inc. (Steelhead) purchased substantially all of Jiggy Puzzles, LLC's (Jiggy) assets through an asset purchase agreement. In that agreement, Steelhead agreed to pay Jiggy an upfront cash payment at closing as well as potential earnout payments if certain revenue thresholds were met. After the business failed to meet the earnout revenue thresholds, Jiggy alleged that Steelhead acted in bad faith to lower Jiggy's revenues and avoid the earnout. Steelhead moved for summary judgment on Jiggy's implied covenant claim.

The Superior Court clarified that "the implied covenant applies even when a party to a contract is granted unfettered discretion. The court noted that the purchase agreement contained

no efforts clause requiring Steelhead to operate Jiggy in a particular way post-closing, and thus Steelhead had the discretion to operate Jiggy “as it saw fit.” Despite such broad discretion, however, the Superior Court explained that Steelhead could still breach the implied covenant if it acted “in bad faith to ensure that Jiggy wouldn’t qualify for an earnout payment.”

The Superior Court held that plaintiff had developed sufficient record evidence suggestive of bad faith to avoid summary judgment against it. This evidence included communications indicating that Steelhead’s senior leadership planned to make “game time decisions if the [contingency] triggers are too close,” and “predicted—based on Steelhead’s own internal plan—that Jiggy would miss the earnouts.” According to the court, Jiggy also had presented evidence indicating that Steelhead cut nearly all of Jiggy’s marketing spend during the peak holiday season and “one of Jiggy’s most profitable periods,” deprioritized Jiggy’s Amazon channel, destroyed thousands of Jiggy units, “rejected large brand-building opportunities that Jiggy had already secured, refused to sell certain new products, and missed large purchase order deadlines.”

As a result, the court denied the buyer’s summary judgment motion on the seller’s implied covenant claim, holding that a jury could find that Steelhead “concocted an internal plan to lower Jiggy’s revenues to eschew paying an earnout payment and then followed through with that plan.” The court emphasized that decisions that reduced revenues or diminished profits alone would not constitute a breach of the implied covenant in the absence of bad-faith intent to avoid the earnout. The court, however, declined to weigh evidence at the summary judgment stage; instead, the court stated that defendants could present evidence defending their business decisions at trial.

Conclusion

It “seems all too common in disputes over earn-out payments” for sellers to assert implied

covenant claims. See *Fortis Advisors v. Dialog Semiconductor*, 2015 WL 401371, at *1 (Del. Ch. Jan. 30, 2015). Implied covenant claims, however, are rarely successful. Indeed, as the Supreme Court explained in *Johnson & Johnson*, “the implied covenant cannot be used to retrofit an earnout to match a disappointed seller’s expectations after-the-fact about how the buyer would pursue the earnout.” See *Johnson & Johnson*, --- A.3d ---, 2026 WL 89452, at *18 n.142. On the contrary, where a seller failed to secure sufficient contractual protections relating to the earnout “ex ante at the bargaining table,” the Delaware courts generally are reluctant to invoke the implied covenant to provide additional protections “ex post in the courtroom.”

The Supreme Court’s decision in *Johnson & Johnson* exemplifies such reluctance. Although the risk of a potential regulatory change was apparent, the seller failed to secure protections relating to such a change at the bargaining table. Rather, the contracting parties “anchored their milestones to a specific regulatory category.” The Supreme Court, therefore, determined that “there was no contractual gap for the implied covenant to fill” and there was “no room for discretion”—rather, the specific regulatory approval expressly agreed on by the parties was required. Invocation of the implied covenant, in the court’s view, would not vindicate the parties’ reasonable expectations, but rather would rewrite the parties’ expressly agreed regulatory milestone. Accordingly, the court refused to invoke the implied covenant so as to imply an obligation on the part of the buyer to pursue an alternative regulatory approval pathway when a regulatory change rendered unavailable the particular form of approval expressly agreed by the parties in the merger agreement.

Still, there may be room in an earnout dispute for operation of the implied covenant in narrow circumstances. The implied covenant can potentially operate in “two primary ways.” “The first is when a contract allocates discretionary

authority to one party over a central aspect of the contract,” the implied covenant requires that such discretion be used reasonably and in good faith. “The second” is when the covenant is “used to address unforeseen developments—contingencies neither anticipated nor resolved by the contract—that threaten the parties’ bargained-for economic expectations”; “when such an unanticipated development arises,” the implied covenant can be used “to fill in the spaces between the written words.” Where a seller can establish that the buyer “acted arbitrarily or unreasonably” in the context of an earnout to “frustrate the fruits of the bargain that the seller reasonably expected” at the time of contracting, the implied covenant may potentially be invoked in such circumstances. See *Nemec v. Shrader*, 991 A.2d 1120, 1126 (Del. 2010).

That was the case in *Delta Data* and *Jiggy Puzzles*. The purchase agreements did not contain express obligations governing how the buyer operated the acquired business post-closing. As the now-owner of the acquired company, the buyer in each case was permitted to operate the business as it chose (it should be noted that a buyer, having just made a considerable investment to acquire a business, generally has “powerful incentives” to see it succeed (*Airborne Health v. Squid Soap*, 984 A.2d 126, 147 (Del. Ch. 2009))). The buyers’ broad authority, however, did not permit them to take economically detrimental actions in bad faith with the intent to deprive the sellers of earnout payments. Although the courts took somewhat different approaches to their analysis, in each case, the court was presented with allegations or evidence of buyers apparently engaging in bad-faith conduct to postpone earnout-triggering revenue outside the measurement period or cease profitable activities as the business approached the earnout threshold, for the purpose of avoiding the earnout. In *Delta Data*, the court viewed the

purchase agreement as silent on the issue of how the buyer was required to act when collecting customer payments; it invoked the covenant as a gap-filler, implying an obligation on the part of the buyer to not take “deliberate action to push a customer payment outside of the earnout payment period” to avoid making an earnout payment to sellers. In *Jiggy Puzzles*, the court viewed the buyer as having “discretion to operate the acquired business as it saw fit;” it found sufficient evidence suggesting the buyer abused that discretion in bad faith by “concocting an internal plan to lower the acquired company’s revenues to eschew paying an earnout payment and then following through with that plan” when the business was close to the earnout trigger. Given the aforementioned allegations or evidence indicating to the Superior Court bad-faith conduct on the part of a buyer with the intent to deprive the seller of an earnout, the court in each case concluded that the seller’s implied covenant claim withstood the buyer’s pretrial dispositive motion.

In sum, sellers are best served bargaining for express contract terms to address potential developments or to govern the buyer’s post-closing conduct during the earnout period, rather than later attempting to resort to the implied covenant. As seen in *Johnson & Johnson*, the implied covenant cannot be used to rewrite express contract terms or to “rebalance economic interests after events that could have been anticipated, but were not.” However, as illustrated in the *Delta Data* and *Jiggy Puzzles* cases, where a seller can establish that the buyer exploited a contractual gap or abused its discretion by taking actions in bad faith with the intent of depriving the seller of the earnout, the covenant may potentially be invoked.

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