IN THE COURTS

Delaware Courts Interpret Survival Clauses Relating to Contractual Representations

By Kevin R. Shannon and Berton W. Ashman, Jr.

The Delaware Court of Chancery has issued two recent decisions—*GRT, Inc. v. Marathon GFT Technology, Ltd.* and *ENI Holdings, LLC v. KBR Group Holdings, LLC*—holding contract indemnification claims to be time-barred because the litigation was not commenced before the representations at issue terminated.[1] The decisions, which interpreted indemnification and survival provisions similar to those found in many merger or stock/asset purchase agreements, are significant for both deal lawyers and litigators. Among other things, in contrast to some prior cases, the court held that it was not sufficient to provide "written notice" of a claim prior to the termination date. Rather, based on the contract provisions at issue, the court held that a party must commence litigation prior to the termination date of the representations at issue or the claim will be barred.

For deal lawyers, *GRT* and *ENI Holdings* make clear that Delaware courts will respect and enforce the allocation of risk reflected in the parties' agreement, including any shortening of the otherwise applicable limitations period. More importantly, the cases suggest that, absent clear language to the contrary, the court will interpret provisions relating to the termination of representations as the cut-off for filing any claims. Accordingly, it is important that parties attempt to negotiate representations that survive for a sufficient period of time to allow them to discover potential claims, comply with any contractually-mandated dispute resolution procedures, and commence litigation. Alternatively, if the parties intend that they need only provide written notice of a claim prior to the termination date for the representations, the agreement should expressly so state.

For litigators, it is important to recognize that, based on the decisions in *GRT* and *ENI Holdings*, courts may be more likely to determine that providing written notice of a claim prior to the termination date is insufficient to preserve a claim—even when the agreement requires such notice and further requires that the parties engage in certain dispute resolution procedures before commencing litigation. As a result, parties may have a limited period of time to discover, investigate, and file claims in litigation. It is therefore important that parties promptly investigate whether any claims exist because such claims otherwise might not be discovered until after they are time-barred.

GRT, Inc. v. Marathon GTF Technology Ltd.

As Chancellor Strine of the Court of Chancery has stated,

> the shortening of statutes of limitations by contract is viewed by Delaware courts as an acceptable and easily understood contractual choice because it does not contradict any statutory requirement, and is consistent with the premise of statutory limitations

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> periods, namely, to encourage parties to bring claims with promptness ….[2]

One convention interpreted to accomplish this purpose is the inclusion of a survival clause stating that representations and warranties survive only through a specified "termination" date.[3]

In *GRT*, Marathon GTF Technology and GRT, Inc. were parties to a securities purchase agreement pursuant to which Marathon agreed to build an experimental testing facility for GRT to conduct research on certain new technologies. Marathon represented in the agreement that the facility, which was not expected to be completed until after the contract's closing, would be reasonably designed to meet certain objectives, and the contract permitted GRT to inspect the facility following its completion to ensure it was designed as represented.

In the event the facility did not meet the contractual requirements, the agreement provided for a somewhat unique three-part remedial scheme. First, GRT had to "sue and prove" that Marathon had breached the design representations.[4] Second, if a breach was established, the agreement required Marathon to remedy that breach by modifying the facility's deficient design. Third, if Marathon failed to cure the deficiency, GRT could bring suit for Marathon's separate breach of its remedial obligations and seek specific performance. The three-step scheme provided GRT with its "sole and exclusive remedy" for breach of the design representations.[5]

The contract also provided that the design representations would survive for a period of one year after the contract's closing date and thereafter terminate "together with any associated right to indemnification" or other contractual remedies.[6] The court held that this survival clause required that any claims for breach of the design representations be brought before the expiration of the one-year period, opining that "the lifespan of that remedy expressly terminated along with the Design Representations at the end of the Survival Period."[7] Because GRT did not file the litigation until after that period had expired, the court dismissed the claims as time-barred.

In so ruling, the court rejected GRT's argument that the survival clause was intended only to limit the time in which a breach of the representations might occur, rather than shorten the limitations period applicable to claims for any such breach.[8] As the court observed, under Delaware law, claims for breach of contractual representations and warranties accrue at closing—*i.e.*, the representations and warranties "are to be true and accurate when made"—and, therefore, any cause of action for breach of those representations accrues as of that date.[9] Interpreting the survival clause to extend the time in which breach might be deemed to occur, as GRT advocated, would in the court's view extend the date of accrual past the closing, and thus arguably operate also to extend the limitations period beyond the three-year period proscribed by statute, in contravention of Delaware law.[10]

ENI Holdings, LLC v. KBR Group Holdings, LLC

Although the court's analysis in *GRT* was instructive, the impact of the decision was subject to debate given the specific facts and unusual contract provisions at issue. The Court of Chancery's recent, subsequent decision in *ENI Holdings*, which addressed contract provisions that differed in several (arguably material) respects from those in *GRT*, suggests that the analysis in *GRT* may be interpreted broadly to require all claims be filed before the expiration of the survival period. The court in *ENI Holdings* relied heavily on *GRT* to conclude that claims filed after the termination of the representations were timed-barred—even though the agreement at issue appeared to require only that written notice of the claims be provided, and did not expressly require that litigation be commenced, before that date. This holding was

significant because some prior Delaware cases suggested that written notice under such circumstances could be sufficient,[11] and the primary treatise relied upon in *GRT* had noted that, when it comes to "whether the party seeking indemnification merely has to give notice of a claim before the end of the survival period … or whether a lawsuit must have been filed," notice was "the more common formulation."[12]

The dispute in *ENI Holdings* arose from KBR Group Holdings, LLC's December 2010 acquisition of Roberts & Shaefer Co. (R&S) from ENI Holdings, LLC pursuant to a stock purchase agreement (SPA). The acquisition price was subject to potential adjustments based on R&S's working capital at the time of closing and any rights to indemnification for breach of representations and warranties, with a portion of the purchase price escrowed to provide for these potential adjustments. Except for claims of fraud, the sole and exclusive remedy for all claims relating to KBR's acquisition of R&S would be indemnification, as set forth and governed by the SPA.

The SPA provided that, while certain "fundamental" and other representations would survive longer, all "non-fundamental" representations would survive until a specified termination date (Termination Date). The SPA also included the following provision requiring written notice of claims:

> In the event that an Indemnified Party determines that it has a claim for Damages against an Indemnifying Party … the Indemnified Party shall promptly, but in any event within five (5) Business Days of becoming aware of any facts or circumstances that would reasonably be expected to give rise to a claim for indemnification hereunder, give written notice thereof to the Indemnifying Party, specifying, to the extent then known by the Indemnified Party, the amount of such claim, the nature and basis of the alleged breach giving rise to such claim and all relevant facts and circumstances relating thereto ….[13]

If ENI timely disputed the liability asserted in the notice, the SPA required the parties to "engage in good faith negotiations aimed at resolution of the dispute" and, promptly following a final determination of the damages to which KBR is entitled—"whether determined in accordance with [the foregoing negotiations] or by a court"—ENI would be required to pay such damages.[14] The SPA provided for the release of escrowed funds to ENI on the Termination Date, with the exception of any amounts reserved for timely-noticed, but unresolved, indemnification claims.[15]

Alleging breach of various representations and warranties, including non-fundamental representations, KBR provided written notice of certain claims prior to the Termination Date and refused to allow for the release of escrowed funds.[16] ENI subsequently filed suit seeking to require KBR to authorize the release of the escrowed funds, and KBR counterclaimed for breach of representations and warranties, as well as fraud.[17] ENI moved to dismiss on the basis, in part, that certain of the counterclaims arose from non-fundamental representations that terminated prior to KBR's filing its counterclaims and, therefore, were time-barred under the SPA.

KBR responded that the express terms of the SPA required only written notice of the claims, not filing of suit, prior to the Termination Date. Among other things, KBR contended that it could assert a claim for purposes of initiating the parties' dispute resolution procedures by providing written notice, as it had done, prior to the Termination Date, and that the SPA allowed the parties to resolve any such claims either through the negotiations prescribed by the contract or in court. KBR argued that this reading of the contract was consistent with provisions addressing the release of escrowed funds, noting that, "'so long as it initiated the claims process … by giving notice to ENI before the Termination Date,

ENI would not be entitled to the release of the Indemnity Escrow Account until KBR's claims were finally determined' either through inter-party negotiations or a competent court."[18]

Relying primarily on the reasoning in *GRT*, the court rejected KBR's position. In the court's words, it was "not a reasonable interpretation of the SPA that KBR can preserve a lawsuit based on an expired representation or warranty merely by providing notice before the applicable Termination Date."[19] Reading the SPA to allow KBR to provide notice before the Termination Date and file a complaint any time after that date, the court observed, "is neither how a statutory limitations period nor a contractual limitations period operates in Delaware."[20]

Practical Implications

Although the interpretation of a contract necessarily will depend on the specific language at issue, the recent decisions in *GRT* and *ENI Holdings* suggest that, absent unambiguous language to the contrary, Delaware courts likely will interpret termination dates with regard to representations as end-dates for the filing of related indemnification claims. Practitioners should consider these decisions when negotiating survival provisions, and when advising clients regarding the investigation and pursuit of potential indemnification claims.

Notes

1. *GRT, Inc. v. Marathon GFT Tech., Ltd.*, 2011 WL 2682898 (Del. Ch. July 11, 2011); *ENI Holdings, LLC v. KBR Group Holdings, LLC*, 2013 WL 6186326 (Del. Ch. Nov. 27, 2013).

2. 2011 WL 2682898, at *12 n.59. *See also id.* at *3 ("Delaware law does not have any bias against contractual clauses that shorten statutes of limitations because they do not violate the legislatively established statute of limitations, there are sound business reasons for such clauses, and our case law has long upheld such clauses as a proper exercise of the freedom of contract.").

3. *Id.*, at *3 (citing 2 Lou R. Kling & Eileen T. Nugent, Negotiated Acquisitions of Companies, Subsidiaries and Divisions § 15.02[2] n.45 (2011)).

4. *Id.*, at *2.

5. *Id.*, at *7.

6. *Id.*

7. *Id.*, at *4.

8. *Id.*, at *5-6.

9. *Id.*, at *6 (citing *CertainTeed Corp. v. Celotext Corp.*, 2005 WL 5757762, at *4 (Del. Ch. Jan. 24, 2005), 10 *Del. C.* § 8106).

10. *Id.*, at *3 Delaware, like many jurisdictions, does not permit the extension of a statute of limitations by contract. *See id.*, at *15. The court also rejected GRT's argument that parties seeking to shorten a limitations period must use "clear and explicit" language, as required in other jurisdictions such as California and New York. *Id.*, at *11.

11. *See, e.g.*, *Sterling Network Exch., LLC v. Digital Phoenix Van Buren, LLC*, 2008 WL 2582920, at *5 (Del. Super. Ct. Mar. 28, 2008) (claims deemed timely asserted where party provided written notice within the one-year period established by contract's survival clause); *Winshall v. Viacom Int'l, Inc.*, 2012 WL 6200271, at *8 (Del. Ch. Dec. 12, 2012) (suggesting claims would have survived if written notice had been provided prior to the termination date set forth in merger agreement).

12. Kling & Nugent, Negotiated Acquisitions § 15.02[2], at 15-22 (rev. 2012). The most recently revised version of the treatise, which includes a discussion of *GRT*, does not appear to include this comment. In any event, Kling and Nugent strongly caution drafters to be careful to make expressly clear that notice is sufficient to preserve a claim past a termination date, if that is the parties' intention, or else risk the interpretation applied, for instance, in *ENI Holdings*. *See id.* at 15-22.2 (rev. 2013).

13. *ENI Holdings*, 2013 WL 6186326, at *3 (quoting Section 6.08 of the SPA).

14. *Id.*

15. *Id.*, at *2 (quoting Section 6.13 of the SPA).

16. *Id.*, at *3.

17. *Id.*

18. *Id.*, at *10.

19. *Id.*

20. *Id.* (citing *GRT*, 2011 WL 2682898, at *9).