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# Corporate Governance Group

# Client Alert

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## DELAWARE COURT REJECTS SELLERS' ATTEMPT TO RECOVER COSTS OF DEFENDING AGAINST BUYER'S INDEMNITY CLAIM

*Court explains that quality of buyer's due diligence is irrelevant to determining whether sellers breached their representations and warranties*

In *Hudson's Bay Co. Luxembourg, S.A.R.L. v. JZ LLC*<sup>1</sup>, the Delaware Superior Court recently was faced with an attempt by two sellers to recover costs incurred defending against a buyer's indemnity claim. Buyer had sought indemnification relating to alleged breaches of representations and warranties made by sellers in the purchase agreement. Sellers based their claim on the alleged breach by buyer of its representation in the purchase agreement that it received "adequate access" during the due diligence phase. The Court rejected sellers' claim, ruling that buyer's representation about its access during due diligence "makes clear" that it was "entitled to rely" on sellers' "explicit representations and warranties regardless of anything that occurred during the due diligence phase."

### **Background**

On April 25, 2008, Hudson's Bay Company Luxembourg, S.A.R.L. ("HBCL") entered into an agreement with two LLCs (together, "Sellers") to purchase their interests in True North Retail Investments I, Inc., the then-parent company of Hudson's Bay Company (the "Company"), "one of Canada's largest retailers." The purchase price was approximately \$202 million. As is customary, Sellers agreed to indemnify HBCL for breaches of certain representations and warranties made by them in the purchase agreement.

Some time after the July 2008 closing, HBCL sent a claim notice to Sellers that "identify four specific breaches of representations in the Purchase Agreement, and sought indemnification based solely for breaches of these four identified

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<sup>1</sup> C.A. No. 10C-12-107-JRJ CCLD (Del. Sup. Ct. July 26, 2011).

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representations and warranties.” The claim notice contained, among other things, a seemingly gratuitous – but as it turned out problematic – statement that HBCL had been given only limited access to the Company’s management during the due diligence phase of the transaction. Sellers refused to indemnify HBCL for the alleged breaches, forcing HBCL to seek relief from the Delaware Superior Court. Sellers not only continued to reject HBCL’s claim in this proceeding, but asserted a counterclaim seeking indemnification of all costs and expenses incurred in their defense of HBCL’s claim, arguing that HBCL’s statement in its claim notice relating to the due diligence process conflicted with its representation in the purchase agreement that it had “adequate access” during the due diligence process.

HBCL moved to dismiss this counterclaim, arguing that Sellers wrongfully alleged that the claim notice sought indemnification for deficiencies in the due diligence process rather than for the four specifically identified breaches. In support of its motion, HBCL argued that “requiring a party to pay the other party’s costs of defending a claim for breach of contractual representations and warranties ... would ‘undermine and render meaningless the representations and warranties that HBCL bargained for and received in the Purchase Agreement.’”

### *The Court’s Analysis*

The Court began by explaining that in evaluating HBCL’s motion, it had to decide whether HBCL was seeking indemnification for losses based *solely* on the breach of explicit representations and warranties in the purchase agreement or, as Sellers contended, from shortcomings in the due diligence process. In the Court’s view, “it is evident from the Claim Notice and the well pleaded allegations in the Complaint that HBCL seeks indemnification for ‘Covered Losses’ based solely on [Sellers’] breach of explicit representations and warranties in the Purchase Agreement. None of those specifically identified representations and warranties involve the due diligence process.” Moreover, the Court emphasized, “[i]t is well settled under Delaware law that the extent or quality of the buyer’s due diligence is not relevant to the determination of whether the seller breached its representations and warranties ... .”

In further support of its ruling, the Court noted that HBCL’s representation “that it had ‘adequate access’ during the due diligence period” was not inconsistent with the statements contained in the claim notice. Not only does “[t]hat statement not support a reasonable inference that HBCL breached the due diligence representation,” but “[r]ather, it highlights HBCL’s need to rely on [Sellers’] explicit representations and warranties given the lack of full access during due diligence.”<sup>2</sup>

### *Conclusion*

The Delaware Superior Court’s decision in *Hudson’s Bay* should be of comfort to M&A practitioners. While Sellers’ attempt to use HBCL’s “adequate access” representation as a shield against an indemnity claim based on Sellers’ alleged breaches of representations and warranties was certainly clever, it would be the rare buyer indeed who intended such a result. Nevertheless, there are two important takeaways from the decision. First, M&A purchase agreements should clearly provide – if the parties so intend – that no investigation on the part of buyer in any way limits seller’s representations and warranties. And, second, indemnity claim notices should be precisely worded so as to avoid any unnecessary language that could be construed to undercut an otherwise valid indemnity claim.

<sup>2</sup> The Court also found that Sellers’ counterclaim failed “to plead a cognizable injury resulting from the alleged breach of the due diligence representation.”

Please feel free to discuss any aspect of this Client Alert with your regular Milbank contacts or with any of the members of our Corporate Governance Group, whose names and contact information are provided below.

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