

## HBMA Holdings LLC v. LSF9 Stardust Holdings

### Delaware Law Update

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*Application of a survival clause as a contractual statute of limitations to indemnification claims on an earn-out agreement.*

In *HBMA Holdings LLC v. LSF9 Stardust Holdings LLC, C.A. 12806-VCMR* (Del. Ch. Dec. 8, 2017), the Delaware Court of Chancery dismissed a seller's claim for indemnification for breach of covenant on an earn-out agreement on the basis that indemnification was not specifically mentioned in the notice of arbitration. The Court of Chancery applied a survival clause as a contractual statute of limitations to bar litigation of disputes that the arbitrator ruled outside its own subject matter jurisdiction as a matter of substantive arbitrability. As a practical matter, *HBMA Holdings* stands for the proposition that as a matter of claim preservation, all potential disputes should be listed in an arbitration demand even if not arbitrable.

The seller sold the buyer a suite of building supply companies for \$1.4 billion, subject to an earn-out agreement worth up to \$100 million. Disputes over the accounting calculation of the earn-out payment were subject to binding arbitration by an international accounting firm. The accountant could determine that some objections were outside the defined scope of an accounting calculation, leaving such objections unresolved and subject to litigation as indemnification claims. But a general survival clause in the sale contract required any such indemnification litigation to be noticed by June 2016.

The seller alleged that the buyer deflated the EBITDA of the sold business and subsequently sabotaged the seller's efforts to calculate the earn-out by refusing to share documents. The seller filed a notice of dispute to trigger arbitration of the earn-out calculation. However, the notice did not expressly raise any non-arbitrable indemnification claims. The buyer disputed the arbitrator's subject matter jurisdiction to calculate EBITDA, based upon the narrow language of the arbitration clause. The seller sued to compel arbitration and subsequently amended its complaint to include a demand for indemnification of any non-arbitrable claims. The buyer moved to dismiss the arbitration demand on the basis that the narrow arbitration clause did not confer arbitration jurisdiction of the particular dispute and moved to dismiss the indemnification claims as time-barred based on the contractual survival clause.

The court first applied the familiar *Willie Gary* test of substantive arbitrability to determine (a) the arbitration clause was "narrow" and (b) the calculation of EBITDA nonetheless fit within the narrow subject matter jurisdiction conferred on arbitration. Walking through the contract, the court determined that the calculation of

EBITDA was incorporated by reference into defined terms within the arbitration clause. Therefore, the seller's claim to compel arbitration was proper.

Next, the court analyzed the seller's right to litigate any disputes that the arbitrator determined were outside the scope of its own subject matter jurisdiction. The contract limited any litigation to indemnification claims only. The seller had demanded arbitration by filing a notice of dispute, which challenged the buyer's calculation of the earn-out payment. However, that notice did not mention any indemnification claim or any other non-arbitrable dispute. The seller raised indemnification only during briefing on the motion to dismiss, long after the expiration of the contractual survival clause. The court ruled that the seller's notice of arbitration did not preserve the right to litigate non-arbitrable claims, and therefore the survival clause applied to time-bar all possible contract litigation. The court thus dismissed the contract claims for failure to state a claim.

*HBMA* presents a cautionary tale to commercial litigators. Delaware will enforce a contractual survival clause on its plain terms. A party which first notices arbitration with a view that any subsequent disputes can be handled by later litigation should state that reasoning expressly within its initial notice of dispute. Failure to do so can leave a party dissatisfied with arbitrator rulings on substantive arbitrability without any litigation remedy.