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## Delaware Court of Chancery Refuses to Enforce Merger-Related Obligations Against Non-Consenting Stockholder

In *Cigna Health and Life Insurance Company v. Audax Health Solutions, Inc.*, the Delaware Court of Chancery (i) held that a broad release of claims found only in a letter of transmittal that a stockholder was required to execute to receive merger consideration was unenforceable for lack of consideration, and (ii) refused to enforce the portion of a post-closing indemnification obligation requiring direct payment from a non-consenting stockholder that was indefinite in duration and potentially required repayment of the stockholder's entire pro rata portion of the merger consideration.

### BACKGROUND

In February 2014, Audax Health Solutions, Inc. ("Audax") entered into a merger agreement whereby it would be acquired by Optum Services, Inc., through its wholly owned subsidiary (the "Buyer"). The merger was approved by the written consent of 66.9% of Audax's stockholders. The merger agreement conditioned receipt of the merger consideration on the surrender of shares and the execution of a letter of transmittal that required the executing stockholder to be bound by certain obligations including:

- *A broad release of all claims that the executing stockholder "ever had or now has" against the Buyer or its affiliates, subject to certain limited exceptions (the "Release Obligation").* The Release Obligation was not provided for in the merger agreement itself.
- *An agreement to indemnify the Buyer post-closing for certain breaches of Audax's representations and warranties up to the full pro rata amount of merger consideration that an executing stockholder received (the "Indemnification Obligation").* Most of Audax's representations and warranties terminated within thirty-six months after the closing of the merger. Some representations and warranties (and those portions of the Indemnification Obligation), however, survived indefinitely. The Indemnification Obligation was included in the merger agreement, in addition to the letter of transmittal.

At the time of the merger, Cigna Health and Life Insurance Company ("Cigna") was a preferred stockholder of Audax. Cigna did not vote in favor of the merger, did not execute a support agreement, and did not execute a letter of transmittal. In response, Cigna was denied payment of the merger consideration. Cigna sued Audax, the Buyer, and the stockholder representative to obtain declaratory relief. Cigna argued that the Release Obligation and the Indemnification Obligation violated the Delaware General Corporation Law (the "DGCL") and were unenforceable.

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**ANALYSIS**

In considering Cigna's motion for judgment on the pleadings, the Court held that:

- *The Release Obligation, found only in the letter of transmittal, was unenforceable because it was not supported by consideration.* Under Section 251 of the DGCL, Cigna's shares were cancelled immediately upon consummation of the merger, and Cigna was entitled to receive the merger consideration upon surrender of its cancelled certificates. Because the Release Obligation was not contained in the merger agreement, it was a new, post-closing obligation. Because no new consideration was provided to Cigna beyond the merger consideration to which it was already entitled, the Release Obligation was unsupported by independent consideration and thus unenforceable. The Court specifically rejected the defendants' "bundle of rights" argument that the merger consideration consisted of each of the obligations in the letter of transmittal, including the Release Obligation, in addition to cash because wholesale adoption of that position would allow buyers to impose limitless additional provisions on stockholders as conditions precedent to payment of the merger consideration.
- *To the extent that it was not subject to any monetary cap and not limited in duration, the Indemnification Obligation violated Section 251 of the DGCL and was thus void and unenforceable against Cigna.* Under Section 251, the merger agreement must quantify the merger consideration shareholders are to receive. The portion of the Indemnification Obligation that was indefinite in duration prevented such quantification because Cigna remained potentially liable to the Buyer for the entirety of Cigna's merger consideration. The value of the merger consideration was thus "unknowable." The Court explained that a stockholder could contractually agree to the indefinite duration portion of the Indemnification Obligation, such as in a support agreement, but a non-consenting stockholder like Cigna could not have such an obligation "foisted" on it. Further, although Section 251 specifically contemplated some adjustments to purchase price, the Court stated that non-escrow, post-closing adjustments potentially requiring stockholders to repay a portion of the merger consideration (as opposed to those operating against a portion of the merger consideration escrowed to satisfy post-closing indemnification claims) had an "uncertain" status under Delaware law. The Court stated that its opinion expressly did not concern escrow agreements. The Court further explained that its holding was limited to the specific facts and circumstances presented in this case and should not be viewed as a broad statement on the general validity of such post-closing price adjustments. The opinion thus leaves for future determination whether such post-closing price adjustments are permissible if limited in duration or as to only a portion of the merger consideration.

In addition to the Release Obligation and the Indemnification Obligation, the instruments also included an agreement appointing a stockholder representative who was specifically empowered to take all actions specified or contemplated by the merger agreement, including defending and settling any indemnification

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claims asserted by the Buyer. The Court, however, did not decide Cigna's challenge to this agreement, explaining that the briefing was insufficient to permit the Court to decide the issue.

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This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Questions concerning issues addressed in this memorandum should be directed to:

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