

Strengthening Indemnification and Release Provisions after Cigna v. Audax

Overview

The Delaware Court of Chancery recently added a new level of complexity to private merger transactions when it held in *Cigna Health and Life Insurance Company v. Audax Health Solutions Inc.*, that:

- Broad releases 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
- Post-closing indemnification obligations requiring direct payment from a non-consenting stockholder that may have required repayment of the stockholder's entire pro rata portion of the merger consideration and were indefinite in duration were unenforceable in violation of Section 251 of the Delaware General Corporation Law (the "DGCL").

The plaintiff also challenged the appointment of the shareholder representative in the transaction, but the court did not issue a ruling on this point.

These mechanisms are common in private transactions, but practitioners may need to update practice to enhance their enforceability in light of this decision. We suggest some options below.

For a more in depth analysis into the court's reasoning in this case, please click [here](#).

Possible Solutions

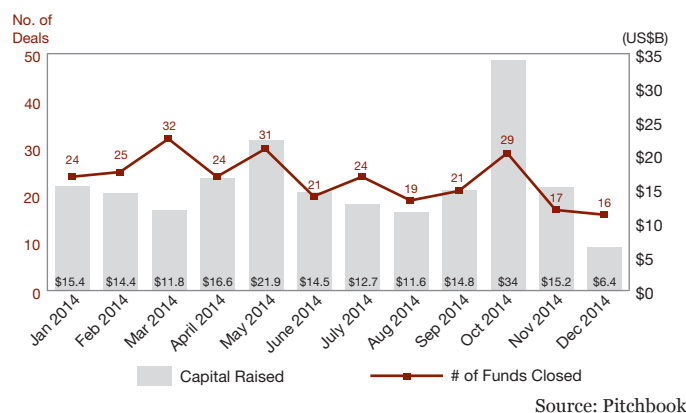
The best method to address the issues raised by the *Cigna* decision is to structure an investment in an entity that may be sold in such a way as to avoid the issues from the outset. Private equity sponsors could consider the following:

- Use an alternative entity form (e.g., limited liability company, limited liability partnership or limited partnership) to hold the business that is or will be sold. This avoids the application of DGCL Section 251 entirely since transactions involving those entities are governed by other provisions of the Delaware Code.
- Require all owners to agree to customary drag-along provisions that they will approve the same terms and sign the same documents (including releases, indemnification and shareholder representative provisions, etc.) as the "dragging" shareholder does in a sale.

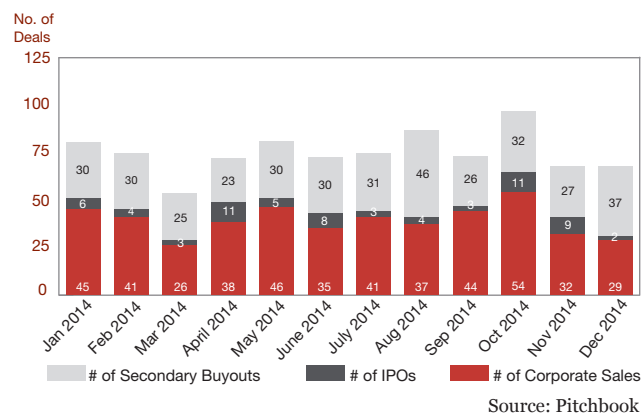
If the foregoing options are not available, other alternatives include the following:

- Obtain separate support agreements from sellers where possible and including the release, indemnification and shareholder

U.S. Private Equity Fundraising



U.S. Sponsor-Backed Exits By Number

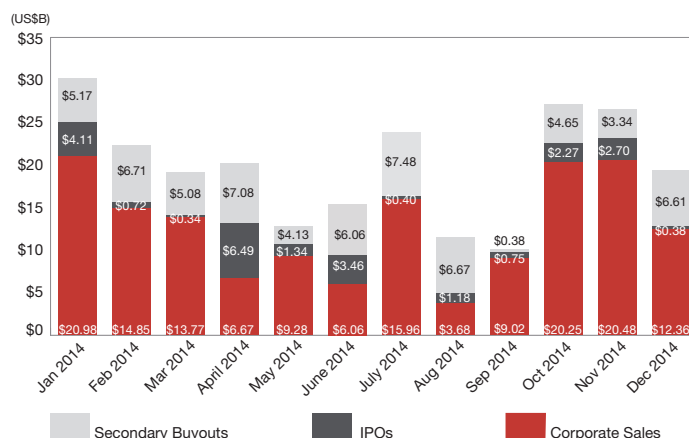


representative provisions in these agreements instead of only in the merger agreement. The indemnification obligation of the parties signing the support agreement could be drafted to increase in the event there are non-releasing parties.

- Refer in the merger agreement to the release and indemnification obligations so that they are more closely associated with and considered part of the overall exchange of consideration in the transaction. Similarly, the letter of transmittal, which should include the stockholder representation, release and indemnification obligations, should also be referenced in the merger agreement and attached as an exhibit to the merger agreement.
- Limit the indemnification obligation to a maximum of three years and/or cap the indemnification obligation to an amount less than the entire merger consideration.
- Establish consideration for the release of funds, for example, by making the releases mutual as between buyer and seller.

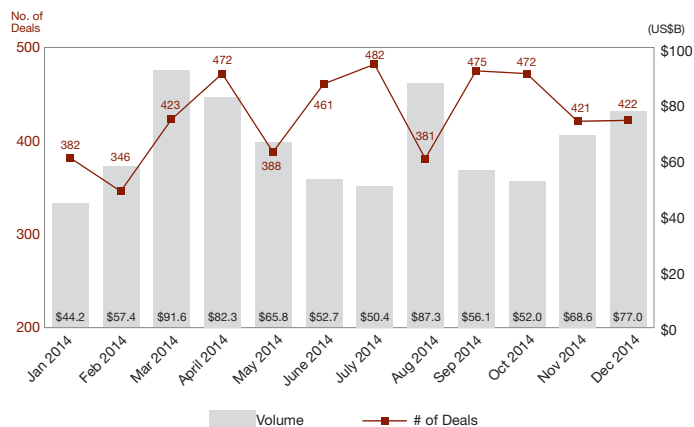
For a copy of the *Cigna* decision, please click [here](#).

U.S. Sponsor-Backed Exits By Dollar Volume



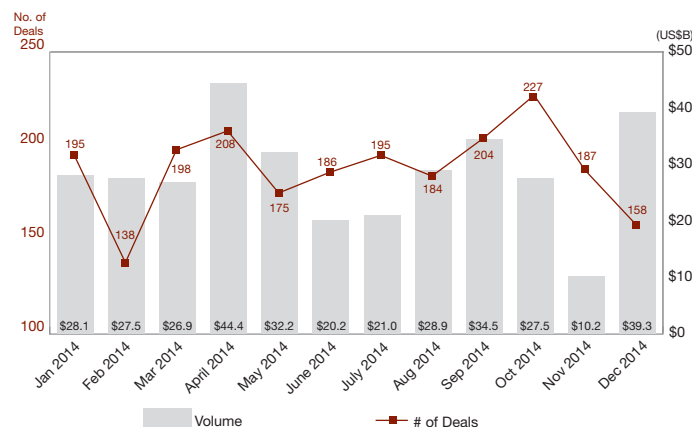
Source: Pitchbook

Global Sponsor-Related M&A Activity



Source: Dealogic

U.S. Sponsor-Related M&A Activity



Source: Dealogic

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