

Corporate Finance/M&A - USA

Delaware Court of Chancery strikes down claims provisions in private merger

Contributed by [Ropes & Gray LLP](#)

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Introduction

In *Cigna Health and Life Insurance Company v Audax Health Solutions, Inc* (CA No 9405-VCP (Del Ch November 26 2014)) the Delaware Court of Chancery granted a plaintiff stockholder a partial victory in its attempt to invalidate portions of the merger agreement. The court held that a general release obligation was not supported by adequate consideration because it was contained solely in the letter of transmittal and that the stockholder's indemnification obligations were not defined with sufficient clarity to satisfy the Delaware law governing statutory mergers.

Facts

Optum Services, Inc, a health insurance company and subsidiary of UnitedHealth Group Inc, agreed to acquire Audax Health Solutions, Inc, a privately held health technology company which develops health and lifestyle tracking applications for insurance companies. The plaintiff, Cigna Health and Life Insurance Co, a subsidiary of Cigna Corporation and also a health insurance company, was a preferred stockholder of Audax before the merger. A majority of Audax's board of directors and 66.9% of Audax's stockholders approved the merger via written consent and it was ultimately consummated in February 2014. However, Cigna did not consent to the merger.

Cigna objected to the merger agreement's requirement that in order to receive the merger consideration, each stockholder must agree to:

- release all claims against the surviving company;
- indemnify the surviving company for breaches of representations and warranties; and
- appoint a designated stockholder representative.

Decision

After the merger's consummation, Cigna brought suit to obtain its merger consideration (\$46 million) and alleged that each of these three conditions were invalid. In its opinion the Court of Chancery struck down the general release obligation and limited the indemnification obligation.

The court invalidated the general release obligation on the grounds that it was not in the merger agreement itself, but rather imposed solely in the letter of transmittal that would accompany stockholders' shares when exchanged for cash. Because Cigna would receive no benefit from submitting a letter of transmittal beyond what it was already entitled to receive under the merger agreement, the court ruled that the letter of transmittal was not a valid contract supported by consideration and that the general release obligation was therefore not binding.

Instead it held that the indemnification obligation was invalid because it violated Section 251 of the Delaware General Corporate Law. Section 251(b) requires that a merger agreement must set out the manner in which post-purchase price adjustments may affect the parties. The court held that the indemnification obligation was not defined with sufficient clarity to satisfy Section 251(b), because the stockholders' liability under the indemnification of the merger agreement in this case could extend up to the full amount of the merger consideration and certain "fundamental" representations and warranties would survive for an unlimited time. As a result, the court found that the merger agreement failed to state the "cash, property, [or] rights" which stockholders would receive, as required by Section 251(b)(5).

With respect to the appointment of the stockholder representative, the court observed that "the propriety of stockholder representatives under the DGCL [Delaware General Corporate Law] is the subject of active and ongoing debate", but it declined to rule in favour of Cigna on the technical grounds that it had not provided enough factual or legal support in its briefing to invalidate the

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stockholder representative appointment.

Comment

Although the court stressed that it was not opining on escrow agreements or post-closing purchase price adjustments generally, and that its decision is limited to the facts of this case, *Cigna Health* provides a reminder that:

- the requirements of statutory mergers set out in Section 251 will be strictly construed;
- any material terms that are to be included in the letter of transmittal must be incorporated into the merger agreement and disclosed in connection with solicitation of votes for stockholder adoption;
- it is important to focus on the mechanical details in structuring post-closing remedies in private merger agreement transactions, including how to structure and word post-closing indemnification obligations through escrow or other mechanics; and
- to the extent that parties want to impose upon stockholders direct release or indemnification obligations, they may need to negotiate for such stockholders to enter into agreements (either by signing the merger agreement or providing standalone support or indemnification agreements as a condition to either signing or closing) to implement such arrangements effectively.

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