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Delaware Court of Chancery Holds That Conditioning Merger Consideration on Execution of a Release Agreement Breaches the Certificate of Incorporation

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In *Chertok v. OnSolve, LLC*, the Delaware Court of Chancery held that a surviving corporation breached the target company's certificate of incorporation by conditioning payment of merger consideration on a common stockholder's execution of a release of claims. Although the claiming stockholder made a variety of arguments in support of a higher measure of damages, the court limited the stockholder's remedy to the per share merger consideration provided for in the merger agreement, plus interest. The decision provides further confirmation that buyers cannot require stockholders to sign a release post-closing as a condition to receive merger consideration unless that release is supported by independent consideration, but also limits the scope of a stockholder's remedy for breach.

Background

SWN Communications Inc. (the company) agreed to be acquired by OnSolve, LLC (OnSolve or the acquiror) in a cash merger for total consideration of $250 million. The merger agreement required stockholders to deliver several items before receiving payment, including an executed Joinder, Indemnification and Release Agreement (the Joinder Agreement). The Joinder Agreement was a 13-page document that included, among other things, a waiver of appraisal rights and a broad general release of all claims against the company and acquiror "from the beginning of time" through the effective date of the merger.

Douglas Chertok (Chertok), a common stockholder who did not consent to the merger, received an information statement that disclosed the merger's approval, provided certain financial information, and requested execution of the Joinder Agreement to receive the merger consideration, among other items. Chertok did not execute the Joinder Agreement and instead demanded appraisal. Within 60 days of the merger's effective date, Chertok timely withdrew his appraisal demand. The company did not pay Chertok his merger consideration. Instead, OnSolve insisted that Chertok could not receive payment unless he executed the Joinder Agreement and delivered the other required documents.

Nearly three years after the merger closed, Chertok delivered a letter to the company demanding payment of the merger consideration, unpaid dividends, and interest accruing from the deadline to file an appraisal action. Chertok also objected to OnSolve's request to deliver the executed Joinder Agreement and other required documents. Prior to receiving a response from the company, Chertok filed suit, asserting claims for breach of the certificate of incorporation and unjust enrichment in the alternative. After the complaint was filed, OnSolve tendered a check for Chertok's share of the merger consideration, but without interest. Chertok rejected the check, contending that the amount was insufficient and did not include interest.

Holding

The court held that OnSolve breached the certificate of incorporation. The Delaware Supreme Court has held that a corporation's certificate of incorporation is a "contract[] among a corporation's shareholders" and that "[i]t is elementary that [the Delaware General Corporation Law's] provisions are written into every corporate charter," including Section 262 of the DGCL. Under Section 262(e), a stockholder who has demanded appraisal but has not filed a petition within 120 days, or who timely withdraws the demand within 60 days of the effective date of the merger, is entitled to receive the merger consideration. As such, OnSolve was obligated to pay the merger consideration to Chertok after he timely withdrew the appraisal demand. The court further found that requiring a stockholder to execute a release lacking independent consideration as a prerequisite to receiving merger consideration breached the corporate contract.

As a remedy for that breach, the court limited the stockholder to the per-share merger price, plus interest. Chertok had argued that, because he did not consent to the merger, he was entitled to his proportionate share of the $250 million merger price without deductions for management bonuses, escrows, or transaction expenses. The court rejected this damages theory and explained that the merger agreement governed the calculation of per share consideration for all common stockholders. The certificate was consistent with this structure, requiring the company to satisfy preferred liquidation preferences and provide for payment of debts and liabilities before distributing remaining assets to common stockholders. Thus, the stockholder was not entitled to receive a higher per share amount than every other common stockholder. The court reasoned that accepting the stockholders' damages theory would create a perverse incentive for stockholders to demand appraisal and then withdraw the demand to obtain a better economic result than the negotiated deal.

That said, the court held that prejudgment interest was available as a matter of right. The court emphasized that it had no discretion to deny prejudgment interest to a prevailing contract plaintiff. The court, however, exercised its discretion to decide what rate of interest applied. Ultimately, the court awarded simple (not compound) interest at the legal rate of 6.75% and rejected plaintiff's request for compound interest of 8.625%. The court's holding was premised on Chertok's delays, including waiting nearly three years before demanding payment, pursuing overly broad and unproductive discovery, extended periods of inactivity (including retaining substitute counsel), and delaying post-trial briefing for five months. Under those circumstances, the court found that an award of simple interest, rather than compound interest was warranted.

Takeaways

- **Do not condition merger consideration on execution of a release without separate consideration.** A merger agreement provision requiring stockholders to execute a release of claims as a condition to receiving merger consideration is unenforceable absent independent consideration. If a release is desired, it should be supported by separate consideration or structured as a voluntary agreement rather than a mandatory prerequisite to payment. However, *Chertok* arguably supports conditioning the closing of a merger upon the receipt of a specified percentage or number of executed releases from stockholders as the buyer would not have closed without those releases. However, the decision makes clear that post-closing, a buyer may not condition payment of the merger consideration on the execution of such a release.[1]

- **Withdrawing an appraisal demand does not entitle a stockholder to more than the merger consideration.** A stockholder who demands appraisal and later withdraws that demand is entitled to the per share merger consideration as calculated under the merger agreement. The certificate of incorporation does not create a separate path to a higher payout. Buyers should be able to take comfort that a nonconsenting stockholder cannot use the appraisal withdrawal mechanism to circumvent negotiated deal economics.

- **Prejudgment interest is a matter of right for prevailing contract plaintiffs.** Buyers should be aware that prejudgment interest cannot be denied to a prevailing breach-of-contract plaintiff. However, the rate and compounding method remain within the court's equitable discretion. Plaintiff-driven delays in litigation can result in a reduced interest award.

- **Timely payment of the undisputed amount can avoid interest exposure.** The nearly three-year delay between the merger closing and Chertok's demand, combined with OnSolve's refusal to pay without the Joinder Agreement, generated significant interest exposure. Buyers should consider promptly paying the undisputed portion of merger consideration to stockholders, where appropriate.

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[1] Buyers should structure exchange agent mechanics so that standard mechanical deliveries (stock certificates, letters of transmittal, W-9s) are separated from any release-bearing joinder, ensuring that a non-signing stockholder's path to payment does not run through the release, which is a distinction the court arguably preserved in a footnote to the opinion.

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