Advisory

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Delware Clarifies Impact of Common Merger Structure on Contractual Anti-Assignment Clauses

In a long-awaited decision, the Delaware Court of Chancery recently held in *Meso Scale Diagnostics v. Roche Diagnostics* [1] that the acquisition of a company by reverse triangular merger does not result in an assignment (whether by operation of law or otherwise) of the target company's agreements. Thus, the Court put to rest the uncertainty that it created two years ago in the same case.

REVERSE TRIANGULAR MERGERS

A reverse triangular merger is a common form of merger in which the acquirer creates a wholly-owned subsidiary that then merges into the acquisition target. As a result, the target entity remains intact, while the "merger subsidiary" ceases to exist. The net effect is the same as a stock sale of the target, but with the advantage that a merger does not require action by all target stockholders as in a stock sale – a majority vote is typically sufficient. The reverse triangular merger is often used because of its relative simplicity and its ability to allow acquiring companies to obtain control of the target's non-assignable contracts... or so everyone thought until April 2011.

TRANSACTION BACKGROUND... AND UNCERTAINTY

In 2007, Roche Diagnostics GmbH acquired BioVeris Corp. through a reverse triangular merger. BioVeris had previously licensed certain intellectual property from Meso Scale under an agreement that contained the following anti-assignment language:

"Neither this Agreement nor any of the rights, interests or obligations under [it] shall be assigned, in whole or in part, by operation of law or otherwise by any of the parties without the prior written consent of the other parties . . ."

In 2010, Meso Scale filed a complaint against Roche alleging that Roche's acquisition of BioVeris caused a *de facto* assignment of BioVeris' intellectual property rights, and that, as a result of the above prohibition on assignment, a breach of contract occurred when BioVeris merged into the Roche merger subsidiary. Roche moved to dismiss the complaint.

In a surprise April 2011 ruling, the Delaware Court of Chancery denied Roche's motion to dismiss. The Court's opinion injected uncertainty into the realm of Delaware corporate law by indicating that, for purposes of interpreting an anti-assignment clause, there may be circumstances in which a reverse triangular merger should be considered an assignment "by operation of law." [2]

ORDER IS RESTORED

In its motion for summary judgment, Roche analogized reverse triangular mergers to transactions in which all target company shares are acquired. In both transactions, Roche argued, the target company remains intact and continues to own its assets. Accordingly, BioVeris did not assign any of its assets at the time of the merger. As Roche made clear, Delaware courts have long held

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that the stock sale of a company does not violate anti-assignment provisions that do not expressly prohibit a change of control.

Drawing upon Delaware case law regarding forward triangular mergers, Meso Scale countered that the BioVeris reverse triangular merger constituted an assignment "by operation of law," urging the Court to embrace an unreported 1991 decision by the U.S. District Court for the Northern District of California, *SQL Solutions v. Oracle Corp.* [3] *SQL Solutions* also involved a reverse triangular merger and anti-assignment language in the target company's inbound license agreement. The SQL Solutions court found, in that case, that the third-party licensor would have been "adversely impacted" because the acquiring company was one of the licensor's direct competitors. The court suggested that third-party consents should be obtained even in the reverse triangular merger context, especially when the intellectual property licensed to the target company is an essential part of its business.

The Delaware Court of Chancery granted Roche's motion for summary judgment, concluding that Section 259 of the Delaware General Corporation Law supported Roche's position that a reverse triangular merger does not result in an assignment by operation of law or otherwise. [4] Specifically, the Court held that "mergers do not result in an assignment by operation of law of assets that began as property of the surviving entity and continued to be such after the merger."

In response to Meso Scale's argument that the merger constituted a *de facto* assignment, the Court held that, under Delaware's doctrine of "legal significance," the fact that a forward triangular merger would have triggered the plaintiff's consent rights did not have any bearing on the reverse triangular merger at issue.

The Court also found that the parties did not intend for the negotiated language to require third-party consent upon a change of control, since "the vast majority of commentary discussing reverse triangular mergers indicates that a reverse triangular merger does not constitute an assignment by operation of law as to the surviving entity."

Finally, the Court rejected the approach suggested by *SQL Solutions*, stating simply that such an approach conflicted with Delaware's jurisprudence regarding stock acquisitions, as well as Section 259.

IMPLICATIONS

The Court's ruling confirms that, under Delaware law, reverse triangular mergers do not result in the assignment, by operation of law or otherwise, of agreements held by a target company. The decision offers comfort to practitioners and would-be acquirers that regularly engage in M&A transactions governed by Delaware law that they can structure deals in a manner that ensures that consents will not be required with respect to target company agreements that do not contain language expressly prohibiting a change of control.

The decision also highlights the fact that it is limited to transactions and agreements governed by Delaware law. There is still uncertainty as to the risks associated with contractual anti-assignment clauses in certain jurisdictions. As a result, it would be prudent in situations where Delaware is not the governing law (and there is ambiguity in the applicable jurisdiction) to obtain all third-party consents to the assignment of material agreements.

Finally, the decision also serves as a reminder to practitioners to include clear consent and assignment language when drafting licenses and other agreements to avoid a court having to infer the intent of the parties after the fact. The *Meso Scale* court specifically noted that the plaintiffs "could have negotiated for a change of control provision" but failed to do so.

[1] *Meso Scale Diagnostics, LLC v. Roche Diagnostics GmbH*, No. 5589-VCP (Del. Ch. Feb. 22, 2013).

[2] Reading the factual allegations in Meso Scale's favor (as all courts must at the motion to dismiss stage), the Court found that Meso Scale had alleged sufficient facts to withstand Roche's motion to dismiss. Meso Scale alleged that, within months of the merger, all of BioVeris' employees were laid off, its Maryland facility was shut down and it was slated to cease all production. The Court found that these circumstances created a plausible argument "that 'by operation of law' was intended to cover mergers that effectively operated like an assignment, even if it might not apply to mergers merely involving changes of control."

[3] *SQL Solutions v. Oracle Corp.*, 1991 WL 626458 (N.D. Cal. Dec. 18, 1991).

[4] Section 259 provides that: "When any merger or consolidation shall have become effective under this chapter, for all purposes of the laws of this State the separate existence of all the constituent corporations, or of all such constituent corporations except the one into which the other or others of such constituent corporations have been merged, as the case may be, shall cease and the constituent corporations shall become a new corporation, or be merged into 1 of such corporations . . . the rights, privileges, powers and franchises of each of said corporations, and all property, real, personal and mixed, and all debts due to any of said constituent corporations on whatever account . . . shall be vested in the corporation surviving or resulting from such merger or consolidation; and all property, rights, privileges, powers and franchises, and all and every other interest shall be thereafter as effectually the property of the surviving or resulting corporation as they were of the several and respective constituent corporations."