

Delaware Court of Chancery Confirms that a Reverse Triangular Merger Does Not Constitute an Assignment by Operation of Law

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On April 8, 2011, the Delaware Court of Chancery (“Court”) sent preliminary tremors through the M&A community when it denied a motion to dismiss a breach of contract claim in a case of first impression for the Court. In denying the motion to dismiss, the Court indicated a willingness to consider the possibility that a reverse triangular merger could, under Delaware law, constitute an assignment “by operation of law.” Practitioners had long believed that reverse triangular mergers did not operate as assignments “by operation of law” in Delaware. In a grant of summary judgment issued on February 23, 2013, Vice Chancellor Parsons restored that belief when the Court held that a reverse triangular merger is not an assignment by operation of law.

What is a Reverse Triangular Merger?

A buyer acquires a target company by forming a subsidiary to merge with and into a target company in a reverse triangular merger. The target company assumes all of the merger subsidiary’s assets, rights and liabilities by operation of law, and the merger subsidiary ceases to exist as a separate entity while the target company survives the merger and becomes a subsidiary of the buyer.

Impact of Transaction Structure on Target’s Contracts

During the due diligence phase of any acquisition transaction, business and legal teams will analyze the target’s contracts to determine what, if any, consents are needed to consummate the transaction. As many contracts contain ambiguous anti-assignment provisions (e.g., requiring consent for assignments “by operation of law or otherwise”), it is critical to know whether the structure of the proposed transaction would trigger an assignment “by operation of law.” For example, Delaware law views transactions structured as forward mergers to result in an assignment of the target company’s assets by operation of law and views transactions structured as stock acquisitions not to result in such an assignment. While no Delaware court had previously addressed the treatment of a reverse triangular merger, practitioners and legal commentators have viewed reverse triangular mergers as analogous to stock acquisitions in not constituting an assignment by operation of law as to the surviving entity.



Meso Scale vs. Roche

In 2007, BioVeris Corp. (“BioVeris”) was acquired by Roche Diagnostics GmbH (“Roche”) as a means for Roche to acquire BioVeris’s intellectual property rights. Under the terms of these intellectual property rights, the consent of Meso Scale was required to assign such rights “by operation of law or otherwise.” The transaction was structured as a reverse triangular merger with Roche forming an acquisition subsidiary to merge with and into BioVeris, as the surviving corporation.

In 2010, Meso Scale filed a complaint with the Court alleging, among other things, that Roche’s 2007 acquisition of BioVeris, without the consent of Meso Scale, resulted in a breach of BioVeris’s intellectual property rights because the acquisition constituted an assignment of BioVeris’s intellectual property rights by operation of law.

In its recent decision granting summary judgment in favor of Roche, the Court relied heavily on an examination of the intent of the parties when drafting the anti-assignment provision at issue, and how they may have been informed by statutory, juridical and practical precedent. For the reasons set forth below, the Court did not find Meso Scale’s arguments to be persuasive nor Meso Scale’s interpretation of the anti-assignment provision to be reasonable.

The Court began its analysis by stating that “[g]enerally, 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.” It found that Section 259(a) of the Delaware General Corporation Law and case law precedent support the proposition that it is the non-surviving corporation’s rights and obligations that are transferred to the surviving corporation by operation of law and that the “surviving corporation would not have effected any assignment.” Vice Chancellor Parsons also considered that the leading commentators and the “vast majority of commentary” do not consider reverse triangular mergers to constitute an assignment by operation of law.

Additionally, the Court was not persuaded by Meso Scale’s claim that Roche’s acquisition was essentially nothing more than an assignment of BioVeris’s intellectual property rights to Roche. The Court noted that Meso Scale’s claim ignores Delaware’s longstanding doctrine of independent legal significance which, the Court wrote, has been applied in situations where deals were structured so as to avoid consent rights. That doctrine holds that the “mere fact that the result of actions taken under one section may be the same as the result of action taken under another section does not require that the legality of the result must be tested by the requirements of the second section.”

As a final argument, Meso Scale cited an unpublished 1991 decision of the United States District Court for the Northern District of California in *SQL Solutions, Inc. v. Oracle Corp.* that did conclude that a reverse triangular merger resulted in an assignment by operation of law. The *SQL Solutions* court further stated, more generally, that “an assignment or transfer of rights does occur through a change in the legal form of ownership of a business.” In declining to adopt the approach taken by the *SQL Solutions* court, the Court noted that this approach would upset Delaware’s well-settled law regarding stock acquisitions. The Court stated that “[b]oth stock



acquisitions and reverse triangular mergers involve changes in legal ownership, and the law should reflect parallel results.”

Implications

Under Delaware law, transactions structured as reverse triangular mergers, will generally not require that the surviving entity obtain the consents from the counterpartys to contracts that contain a general prohibition against an assignment by operation of law.

In its decision, the Court noted that Meso Scale could have negotiated for a “change of control provision.” When negotiating commercial agreements, carefully consider the impact of any change in control and whether an explicit prohibition is desirable rather than relying on mere boilerplate.

The Court decision is applicable to reverse triangular mergers governed by Delaware law. As the *SQL Solutions* decision demonstrates, different jurisdictions may reach a different conclusion on the issue and consideration to the laws of other jurisdictions must be given in the planning and structuring of any acquisition.

Federal intellectual property principles generally restrict assignments. While the Court did not discuss the federal intellectual property principles involved, due consideration should be given to such principles to the extent implicated in any transaction.

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