

## Delaware court's decision could affect reverse triangular mergers

By John C. Levy

The reverse triangular merger, the process by which an acquiring entity forms a subsidiary to merge into a target company, resulting in the target becoming a subsidiary of the acquiring entity, has long been a favored structure for acquisitions because it was thought (and it has been accepted M&A practice) that no transfer of any of the target's assets occurs and therefore anti-assignment clauses in target contracts are not triggered. This assumption has now been called into question with the decision by the Delaware Court of Chancery in *Meso Scale Diagnostics, LLC v. Roche Diagnostics GmbH*, which was published on April 8, 2011. In that case, the Delaware Chancery Court held that the acquisition of a company in a reverse triangular merger may trigger an anti-assignment clause and therefore violate a prohibition on assignment by operation of law.

In the decision, the court rejected the defendant's motion to dismiss on the issue of whether a reverse triangular merger constituted an assignment that required consent under a contract that had an anti-assignment clause (but no change in control clause) on the basis that the issue depends on what the phrase "by operation of law" means in the context of the anti-assignment clause and, apparently, what the acquiring entity does

with the target after the transaction.

### Background

In 2007, Roche acquired a company called BioVeris in a transaction structured as a reverse triangular merger. Meso alleged that Roche's purpose in acquiring BioVeris was to improperly obtain certain intellectual property rights to use electrochemiluminescence ("ECL") technology in violation of a global consent that had been entered into by Roche, Meso and other parties in connection with a 2003 transaction. That global consent transaction prohibited assignments, "in whole or in part, by operation of law or otherwise" of rights to the technology. Roche had previously contracted for rights to this technology from a company called IGEN International Inc., which was subsequently acquired by Roche.

Before the IGEN acquisition, however, IGEN transferred all of its intellectual property rights, subject to outstanding license rights, to newly created BioVeris Corp., a public company. Allegedly in an effort to obtain nonlicensed rights to this technology, Roche ended up purchasing BioVeris in the reverse triangular merger. Meso alleged that the acquisition of BioVeris, and the attendant acquisition of the remaining technology rights, violated the anti-assignment provisions of the global consent.



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### Court's analysis

The court acknowledged that the anti-assignment provision of the global consent did not expressly prohibit a "change of control" or change of ownership of BioVeris. Nevertheless, this was not sufficient to conclude that the merger did not violate a prohibition on assignment "by operation of law or otherwise" in the anti-assignment provision. Delaware courts had never explicitly considered the question in the context of a reverse triangular merger. The court addressed previous decisions holding that stock purchase transactions do not constitute an assignment to the acquiror of any contractual rights or obligations of the corporation whose stock is sold because a change of ownership of securities "without more" is not regarded as assigning or delegating the contractual rights or duties of the corporation whose securities are purchased. It declined to follow this line of cases, however, finding that the stock purchase cases were not controlling.

The court also declined to follow the plaintiffs' argument that all mergers, regardless of their form, are assignments by operation of law. This argument relied on a series of Delaware cases holding that forward triangular mergers do constitute assignments of contracts by operation of law (and one California case relative to reverse triangular mergers whose reasoning the court questioned), but of course it was always common practice to assume this was the case because such transac-



# Mergers Court looks at “outcome” of merger in decision

tions terminate the continued corporate existence of the target entity. The court did not adopt this reasoning, either.

Perhaps most significantly, the court also appeared to rely in part on the actions that Roche had taken with respect to BioVeris after the merger. It noted that within months of the merger BioVeris was “gutted and converted into a shell company for Roche’s benefit,” with all of its employees laid off, facilities closed and customers notified that product lines were being discontinued.

## Discussion

The decision is surprising on several fronts, not the least of which is that the court has, in essence, ruled that a reverse triangular merger may be viewed as an assignment, thereby triggering anti-assignment clauses, and refuting the long-held belief that reverse triangular mergers and stock sales are treated equally for purposes of transactional law and practice. This was particularly striking because, in making its ruling, the court acknowledged that the functional effect of stock sales and reverse triangular mergers are the same; in neither scenario are the contractual rights and obligations of the acquiring entity assigned to the target.

So how did the court explain away these facts and reach its decision? In short, it looked at the outcome of the reverse triangular merger, and noted that “more than a mere change of ownership occurred ... as a result of the merger.” Although only a preliminary ruling on a motion to dismiss, this was a striking and somewhat shocking decision, essentially stating (in so many words) that the structure of an acquisition cannot be fully judged until *after* the merger is complete.

The ruling in this case, which is admittedly limited in the sense that it was merely the denial to dismiss the case as a matter of law at a preliminary stage, is nonetheless significant in several respects. First, it challenges the long-held

belief that reverse triangular mergers are essentially the equivalent of stock sales when it comes to anti-assignment clauses in agreements. Secondly, it presents significant due diligence and opinion issues in the context of mergers of this sort. It also implies that the actions of the buyer in these transactions can have an effect on the interpretation of these clauses. Finally, it’s likely to affect the way these clauses are drafted in the future, with the need to clarify the scope of what is intended and not intended by the phrase “by operation of law.”

Reverse triangular mergers have been a preferred structure for participants in mergers and acquisitions because of the relative simplicity of the transaction and precisely to avoid having to worry about third-party consents to assignment. It was thought that there was no assignment of assets in

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such circumstances. In addition, it is a structure that enables the acquiring entity to complete the purchase without having to obtain its equity owners’ approval and only a majority (with certain significant exceptions) approval of the target shareholders. The effect of this decision can be to call into doubt one of the principal reasons for structuring acquisitions in this way.


From a due diligence perspective, the decision also presents challenges. Historically, it was not believed that anti-assignment clauses in contracts would be triggered in reverse triangular mergers. We can no longer provide that advice. With this opinion, it will be more difficult to advise clients on the effect of such clauses, which could cause unnecessary delay and uncertainty in the deal context. It could also have an impact on opinion practice on transactions.

Perhaps most significantly, the decision appears to take into account post-transaction actions by the buyer in determining the applicability of pre-transaction contractual provisions. This certainly makes our job as advisers more difficult. It could even have implications for pure stock acquisitions. Essentially the court was using the “without more” language that it had framed in the stock purchase cases to imply that gutting a company after the acquisition constitutes “more.” Does this even call into question a transaction structured as a pure stock deal?

At a minimum, in the merger context, practitioners will have to advise their acquisition clients about the possible requirement to obtain third-party consents on contracts with these types of anti-assignment clauses because we can no longer rely on the assumption that such transactions do not amount

to assignments by operation of law. This is particularly so in the context of key agreements, such as the intellectual property which was the subject of this litigation.

I think it’s likely that the Delaware Chancery Court will clarify this issue, either

in the context of further proceedings in this case or in future cases. There has been enough of an outcry over this case to bring a lot of attention to the issue. It’s clear to most practitioners in the M&A world what the right outcome is — a clear signal that reverse triangular mergers will not trigger anti-assignment clauses in contracts “by operation of law or otherwise.” Leave it to practitioners drafting contracts intended to prohibit transfers of such rights to install appropriate change of control provisions in the first place, as we always have done. 

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