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Delaware Chancery Court Rules that a Reverse Triangular Merger May Constitute an "Assignment by Operation of Law"

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Reverse triangular mergers are a popular deal structure used to acquire all of the outstanding equity interests of a target company. In a reverse triangular merger, the acquiror forms a subsidiary which is merged with and into the target company with the target company surviving the merger, and the target stockholders receive cash, acquiror stock, or a combination of cash and stock. The end result is the same as a pure stock purchase, but reverse triangular mergers offer the advantage of requiring only the approval of a majority in interest of stockholders (unless a higher percentage is required by the target company's governing documents), subject to statutory appraisal and dissenter's rights, instead of the approval of all stockholders (or at least a sufficient amount of shares to qualify for a follow-on short-form merger).

Deal attorneys have long believed that a reverse triangular merger, like a stock purchase, does not involve an assignment of the target company's assets and, therefore, does not trigger anti-assignment provisions in the target company's contracts that restrict an "assignment by operation of law." However, in a case of first impression, the Delaware Court of Chancery (the "Court") in *Meso Scale Diagnostics LLC v. Roche Diagnostics GMBH* concluded that there was ambiguity regarding whether such a provision should apply in the context of a reverse triangular merger and denied defendants' motion to dismiss, thus calling into question this long-held belief.

Background

Meso Scale Diagnostics LLC v. Roche Diagnostics GMBH involved a series of agreements related to license rights to use electrochemiluminescence ("ECL") technology, which is used to detect and measure the presence of specific molecules in a test sample (e.g., blood). Following the revocation of an earlier ECL technology license from IGEN International, Inc. ("IGEN") to Roche Diagnostics Ltd. ("Roche") due to a breach by Roche, in 2003, through a series of several complex transactions, Roche acquired a non-exclusive limited field license to use the ECL technology (the "Roche License") in connection with the transfer of such technology from IGEN to BioVeris, a newly formed company. Meso Scale Diagnostics, LLC ("MSD") and Meso Scale Technologies, LLC ("MST") held exclusive licenses to use the ECL technology in certain broadly-defined fields. As part of the 2003 transactions, Roche, IGEN, MSD and MST entered into a Global Consent pursuant to which the parties consented to the 2003 transactions.

The focal point of the case and the crux of MSD and MST's breach of contract action against Roche is the anti-assignment provision in the Global Consent, which reads as follows:

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 2007, allegations by BioVeris that Roche violated the Roche License ultimately resulted in Roche acquiring BioVeris through a reverse triangular merger, with BioVeris as the surviving entity and the BioVeris stockholders receiving cash for their shares.

Court's Analysis of Anti-Assignment Provision

The Court conceded that the anti-assignment provision did not expressly prohibit a change of "control" or "ownership" of BioVeris, but this was not enough to conclude that the BioVeris merger did not trigger the prohibition on assignment "by operation of law or otherwise" in the anti-assignment provision. In the absence of precedent cases involving reverse triangular mergers, the Court considered earlier Delaware cases involving anti-assignment provisions in the context of stock purchases and forward triangular mergers.

Delaware courts have held that a stock purchase, *without more*, does not constitute an assignment of contractual rights or duties that triggers an anti-assignment provision. *See, e.g., Baxter Pharm. Prods., Inc. v. ESI Lederle Inc.*, 1999 WL 160148 (Del. Ch. Mar. 11, 1999); *Branmar Theatre Co. v. Branmar, Inc.*, 264 A.2d 526 (Del. Ch. 1970). The Court recognized the similarities between stock purchases and reverse triangular mergers but concluded that given the different transaction structures, the stock purchase cases were not controlling. Even if the stock purchase cases were controlling, the Court found that MSD and MST had made plausible allegations that something more *had* taken place in the BioVeris merger – within months of the merger Roche laid off all of BioVeris's 200 employees, vacated its facilities and discontinued its product lines, essentially rendering BioVeris nothing but a holding company for ECL intellectual property and license rights. It is notable that this "something more" upon which the Court focused involved *post-merger* business decisions by Roche.

Delaware courts have also held that a forward triangular merger *does* result in an assignment "by operation of law" because the target is not the surviving entity and its rights, liabilities and interests vest in the surviving entity. *See e.g., Tenneco Auto Inc. v. El Paso Corp.*, 2001 WL 453930 (Del. Ch. Mar. 20, 2002); *Star Cellular Tel. Co. v. Baton Rouge CGSA, Inc.*, 19 Del. J. Corp. L. 875 (Del. Ch. 1993). Without much analysis, the Court held that the forward triangular merger cases were not controlling given the obvious differences in effects between forward triangular mergers and reverse triangular mergers.

Since the Court found both parties' arguments to be reasonable interpretations of the term "by operation of law," the Court denied defendants' motion to dismiss ruling that a decision regarding this ambiguity was not appropriate at this stage of the transaction. Nonetheless, in light of the ambiguity surrounding the meaning of the anti-assignment provision, the Court also considered the fact that MSD and MST may have been harmed by the merger, because following BioVeris's acquisition by Roche, BioVeris could no longer serve as an independent watchdog to prevent encroachment on the ECL technology, and the field limitation in the Roche License ceased to be of any legal effect. For the Court these allegations were enough to raise an issue of fact as to what the parties intended in the "by operation of law or otherwise" language.

Conclusion

Although the decision in *Meso Scale Diagnostics LLC v. Roche Diagnostics GMBH* arose at the motion to dismiss stage, it is significant because it disturbs the widely held view that reverse triangular mergers do not trigger anti-assignment provisions restricting assignments “by operation of law.” Perhaps the most notable aspect of the case is the Court’s willingness to consider post-merger decisions and effects to discern the pre-merger intent of the parties. Following this decision, when structuring future transactions and prior to commencing due diligence, counsel should discuss with the acquiror its post-closing plans for the surviving company to evaluate the post-closing stature of the surviving company. Acquirors effecting a transaction through a reverse triangular merger should also consider whether to nonetheless seek third party consents for key contracts of the target company that prohibit assignments “by operation of law.” While a final decision by the Court on the merits may provide clarity regarding the exact circumstances in which a reverse triangular merger could run afoul of anti-assignment provisions that prohibit assignments by operation of law, increased care should be exercised in drafting and negotiating what are often considered “boilerplate” anti-assignment provisions.



If you have any questions concerning these developing issues, please do not hesitate to contact any of the following Paul Hastings lawyers:

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