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May 6, 2011

Delaware Court Finds Reverse Triangular Merger May Violate Contractual Prohibition on Assignments by Operation of Law

By Michael G. O'Bryan

The Delaware Chancery Court, in *Meso Scale Diagnostics v. Roche Diagnostics* (Apr. 8, 2011), held recently that the acquisition of a company in a reverse triangular merger may constitute an assignment of an agreement by that company and, as such, violate a restriction in the agreement prohibiting assignments by operation of law.

The opinion calls into question the traditional assumption that, in most circumstances, the acquisition of a company through a reverse triangular merger, in which the acquiror forms a shell company and merges the shell company into the target company, with the target company surviving as a wholly-owned subsidiary of the acquiror, by itself is unlikely to violate a typical anti-assignment provision. Delaware courts had not directly addressed the question, but many practitioners assumed that for these purposes Delaware courts were likely to treat a reverse triangular merger as similar to a stock purchase, which the courts had held by itself did not generally constitute an assignment, since the identity of the shareholders would change but there would be no change to the entity.

The *Meso* court addressed the issue in the context of a preliminary motion, so the court ultimately may find that the acquisition did not violate the anti-assignment clause at issue in the litigation. However, the court's refusal to find as a matter of law that a reverse triangular merger generally is not an assignment and thus does not violate an anti-assignment clause, and the factors considered by the court in reaching its opinion, mean that parties planning an acquisition will need to consider thoroughly the implications of anti-assignment provisions in the target company's key contracts.

BACKGROUND

In 2007 Roche acquired BioVeris, in a transaction structured as a reverse triangular merger (in which a newly formed subsidiary of Roche merged into BioVeris, with BioVeris surviving as a wholly-owned subsidiary of Roche).

Meso claimed that the acquisition violated the anti-assignment provision of a Global Consent that had been signed by Roche, Meso and others in connection with a transaction in 2003 in which (i) Roche acquired IGEN and (ii) IGEN licensed certain technology desired by Roche to a new subsidiary of IGEN and transferred the remaining technology to BioVeris, a public company formed by IGEN in connection with the transaction. Meso also consented specifically to the license to the new subsidiary. The Global Consent included a provision prohibiting assignments, "in whole or in part, by operation of law or otherwise..." but did not include language otherwise purporting to prohibit a change of control of BioVeris or to treat a change of control as an assignment. Meso further alleged that "within months" after the acquisition Roche terminated BioVeris' operations, leaving BioVeris a shell company holding only the IGEN IP assets.

Roche moved to dismiss the claim on the basis, among others, that no assignment had occurred in connection with the merger.

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BIOVERIS MERGER AS AN ASSIGNMENT BY OPERATION OF LAW

The court noted that no Delaware court had addressed whether a reverse triangular merger constituted an assignment “by operation of law.” The court also noted that in interpreting the anti-assignment provision it would try to determine the parties’ “shared intent.”

Roche claimed that a reverse triangular merger was not an assignment, and that all that changed in the BioVeris merger was the ownership of BioVeris. Roche cited cases involving stock acquisitions, but the court found that such cases did not control a dispute over a reverse triangular merger. The court also noted that the stock acquisition cases “exemplify a situation in which a mere change of ownership, without more,” does not constitute an assignment, but that here Meso was alleging “more” since Meso alleged that Roche had “gutted” BioVeris.

Meso claimed that the prohibition on assignments “by operation of law” covered all mergers, including reverse triangular mergers. Meso cited cases involving forward triangular mergers (in which a subsidiary of the acquiror merges into the target and the subsidiary survives), including a case that provided that, “in isolation,” the phrase “by operation of law” in an anti-assignment clause should be read to preclude transfers by merger. The court found that the forward triangular merger cases, like the stock acquisition cases, did not control a dispute over a reverse triangular merger, but also noted that the effect of a reverse triangular merger “is closer to that of a stock acquisition than it is to a forward triangular merger.”

Meso also cited a 1991 case from the federal court in the Northern District of California, *SQL Sol’ns v. Oracle*, that held that a reverse triangular merger violated the anti-assignment provisions of a license to the target company (although the *SQL* court, unlike the *Meso* court, based its decision in part on the effect on assignment and transfer rights of the federal copyright law that applied to the license). The court did not find the *SQL* case dispositive, since as an unreported federal decision it was not controlling precedent even in California courts and, moreover, the court felt that the *SQL* court’s “reasoning is open to question.”

The court found that both Roche’s and Meso’s characterizations of the effect of the anti-assignment clause were reasonable, and accordingly declined to grant Roche’s motion to dismiss.

IMPLICATIONS

Absence of Bright Line for Reverse Triangular Mergers. *Meso* shows that a reverse triangular merger structure under some circumstances may violate anti-assignment provisions in a target company’s contracts governed by Delaware law, at least if the anti-assignment provisions expressly prohibit assignments by operation of law. Even prior to *Meso* parties had to consider whether a planned acquisition would violate anti-assignment provisions, but practitioners had believed (with some caveats, such as potentially with respect to IP licenses as noted in *SQL*) that a reverse triangular merger by itself generally was unlikely to raise issues in the absence of a more specific change in control clause.

Choice of Transaction Structure. Parties in some circumstances may wish to use an acquisition structure that is less likely to be seen as a violation of an anti-assignment clause. A stock purchase agreement, for example, may be less likely than a reverse triangular merger to violate an anti-assignment clause, although that structure also may be more difficult to implement, such as where the target has more than a few shareholders or if some shareholders are unlikely to support the transaction.

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Effect of Buyer Actions at the Target. Parties may need to consider the impact of other steps they intend to take, or later may choose to take, with respect to the target, including after the closing. The court in *Meso* noted that the parties to the Global Consent might have used the term “operation of law” to require consent where there was more than a “mere” change of control, such as Roche’s steps “within months” of the acquisition to reorganize BioVeris’ business. This potentially could cover many of the actions that an acquiror might wish, or later decide, to take as the owner of a newly-acquired business. It is not clear, however, whether the court would have raised the same questions if Roche had taken less comprehensive steps with respect to BioVeris, so that BioVeris was not a “mere” holding company for the IGEN IP. Similar questions might also be raised with respect to other transaction structures, including stock acquisitions.

Intellectual Property Law Context. The court’s opinion is not limited to IP licenses, and the court did not rely upon federal IP principles. However, the principal assets at issue were in fact IP assets, and other cases, such as *SQL*, have arisen in an IP context and noted the restrictive nature of federal IP rules. If the *Meso* opinion is not otherwise modified, it may be possible to argue that it should be limited to an IP context.

Underlying Agreements. Parties to contracts that contain anti-assignment provisions that may need to be applied in an acquisition of one of the parties to the contract should consider clarifying their intent, such as by including specific change of control provisions or by expressly allowing some forms of acquisitions. Parties may also wish to consider having the law of a state other than Delaware apply to such contracts, although it is not always clear how such provisions would be interpreted under other laws.

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