

Client Alert

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DE Court Rules That Reverse Triangular Merger Does Not Trigger Anti-Assignment Clause

On February 22, 2013, in *Meso Scale Diagnostics, LLC v. Roche Diagnostics GmbH*, the Delaware Court of Chancery ruled on a motion for summary judgment that an anti-assignment clause in a contract was not triggered by a reverse triangular merger in which one of the contracting parties was the surviving entity. The court reasoned that no assignment of rights took place by virtue of the merger. In an earlier ruling, the court denied the defendants' motion to dismiss, finding that the anti-assignment clause was ambiguous and susceptible to competing constructions. Although Delaware courts had not previously addressed this issue, that decision was of concern because many practitioners believed that, similar to a change in ownership, a reverse triangular merger does not involve an assignment. Thus, the court's summary judgment decision is an important development for parties negotiating contracts and performing due diligence review in connection with M&A transactions.

Background and Court's Ruling

Meso involved a complicated transaction history consisting of multiple license agreements, a joint venture, a spin-off, and two acquisitions. A key issue, however, was whether a licensee had a claim for breach of an anti-assignment provision of a contract when its counterparty was acquired by a third party through a merger. The merger was structured as a "reverse triangular merger," meaning that a wholly-owned subsidiary of the third-party acquiror was merged with and into the counterparty, with the counterparty surviving the merger and becoming a wholly-owned subsidiary of the acquiror.

The anti-assignment provision stated, in pertinent part, that:

Neither this Agreement nor any of the rights, interests or obligations under this Agreement 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 a 2011 ruling, the court addressed this issue of first impression by denying the defendants' motion to dismiss.¹ The court found that each party had submitted a competing, but reasonable, construction of the anti-assignment clause in the context of the reverse triangular merger. The court also said the situation was distinguishable from stock acquisition cases because the plaintiff alleged that the counterparty was "gutted and converted into a shell company."

In its latest ruling, the court granted summary judgment in favor of the defendants on this issue. The court reasoned that there is no transfer or assignment of rights or assets by a surviving corporation in a merger.² It also rejected the plaintiff's argument that the phrase "by operation of law" was intended to

¹ See *Meso Scale Diagnostics, LLC v. Roche Diagnostics GmbH*, C.A. No. 5589-VCP, mem. op. (Del. Ch. Apr. 8, 2011).

² The court also cited to prior Delaware decisions in which anti-assignment clauses were deemed ambiguous in the context of a forward triangular merger. See *Star Cellular Tel. Co. v. Baton Rouge CGSA, Inc.*, 1993 WL 294847 (Del. Ch. Aug. 2, 1993), *aff'd*, 647 A.2d 32 (Del. 1994) (ORDER); *Tenneco Auto. Inc. v. El Paso Corp.*, 2002 WL 453930 (Del. Ch. Mar. 20, 2002); see also *ClubCorp, Inc. v. Pinehurst, LLC*, C.A. No. 5120-VCP, mem. op. (Del. Ch. Nov. 15, 2011) (finding that an anti-assignment provision was ambiguous in the context of a forward triangular merger).

encompass any kind of merger. In addition, the court refused to follow the holding of a 1991 California decision, which held that a software license agreement prohibiting assignments by operation of law was triggered by a reverse triangular merger.³ *Meso* stated that the California decision was inconsistent with Delaware precedent, holding that a change of ownership effected through a stock acquisition is not an assignment by operation of law.⁴

Conclusion

The latest *Meso* decision is an important clarification on the meaning of a common contract provision and provides further predictability in contracts governed by Delaware law. One reason M&A transactions are usually structured as reverse triangular mergers is to avoid triggering anti-assignment provisions. Although the court's 2011 ruling involved complicated and unusual facts surrounding an intellectual property license, it came as a surprise to many observers who believed a reverse triangular merger does not constitute an "assignment" of the target company's rights or assets.

If contracting parties wish to prohibit a change in control, whether through a merger, stock purchase, or otherwise, they should clearly articulate that prohibition in their contract. Parties should also be aware that few jurisdictions have addressed this issue, and assignments of intellectual property may also be subject to federal law.⁵ Moreover, as illustrated by the California decision noted above, some jurisdictions may reach the opposite result of *Meso*.⁶

Contact

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

⁴ See, e.g., *Baxter Pharm. Prods., Inc. v. ESI Lederle Inc.*, 1999 WL 160148 (Del. Ch. Mar. 11, 1999).

⁵ See, e.g., *Cincom Sys., Inc. v. Novelis Corp.*, 581 F.3d 431 (6th Cir. 2009) (finding that an anti-assignment provision in an intellectual property license was triggered by mergers among affiliated entities).

⁶ See generally David Shine, *Applicability of Anti-Assignment Clauses in Reverse Triangular Mergers*, 11 M&A LAWYER 1, 8 (2007).