

Delaware: Reverse Triangular Mergers Don't Result in Assignment

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The Delaware Chancery Court recently published an important decision that holds that reverse triangular mergers do not result in the assignment of a target corporation's contracts by operation of law. The decision clarified a 2011 ruling in the same case, *Meso Scale Diagnostics v. Roche Diagnostics GmbH* ("Meso 2011"),² in which the court refused to arrive at that conclusion. Meso 2011 left acquirers uncertain about whether structuring transactions as reverse triangular mergers would give contract counterparties the right to terminate their contracts with acquisition targets under anti-assignment provisions. The new decision ("Meso 2013") provides comfort to corporations that have long structured acquisitions and reorganizations as reverse triangular mergers, in part, to avoid triggering such termination rights.

Reverse Triangular Mergers

In a reverse triangular merger or "RTM," an acquirer forms an acquisition subsidiary that merges with a target corporation, the target's stockholders receive merger consideration and the target survives the merger and becomes a wholly-owned subsidiary of the acquirer. Acquisitions are often structured as RTMs when a target has such a large number of stockholders that it would be impractical or too time-consuming to obtain their signatures to a purchase agreement, and it is anticipated that the number of shares held by a target's stockholders who would vote in favor of a merger is more than 50% of the target's outstanding stock, the default percentage required to adopt a RTM under Delaware's and many states' laws.

RTMs are also employed when a target is a party to one or more material contracts that contain anti-assignment provisions and the acquirer wishes to avoid consummating an acquisition using a structure such as an asset purchase or forward triangular merger that could provide the counterparty with a basis for terminating those contracts under such provisions. In either case, a significant benefit of RTMs is that they eliminate or reduce the risk that termination rights will be invoked by contract counterparties.

The Meso Decisions

In 2003, Meso Scale Diagnostics entered into a non-exclusive intellectual property license pursuant to which it licensed technology to BioVeris Corp. A subsequent agreement between the parties prohibited the assignment of the intellectual property by BioVeris Corp. "by operation of law or otherwise."³ In 2007, Roche acquired BioVeris Corp. for \$1.25 billion by way of a RTM with BioVeris Corp. surviving the merger and becoming a wholly-owned subsidiary of Roche.

In Meso 2011, which involved a motion to dismiss, Meso claimed that BioVeris Corp.'s RTM with the Roche subsidiary constituted an assignment by operation of law entitling Meso to terminate the license. To support its position, it asserted that RTMs are akin to forward triangular mergers in which a target corporation is merged with and into an acquirer's merger subsidiary with the merger subsidiary surviving the merger. Meso also pointed to an unpublished federal court case, *SQL Solutions*,⁴ which applied California law and held that RTMs result in assignments by operation of law. Roche argued that RTMs are distinguishable from forward triangular mergers in which the target ceases to exist and are akin to stock purchases in which the owners' identity changes, but the target's contractual and other legal relationships remain unaltered.

When considering a motion to dismiss, a Delaware court must determine whether a complaint offers sufficient facts to plausibly suggest that the plaintiff is entitled to relief. In Meso 2011, the court concluded that, because Delaware had not considered whether RTMs involve the assignment of assets by operation of law, it was unable to dismiss the case in Roche's favor. Consequently, the case left open the possibility that RTMs result in assignments of a target's contracts by operation of law and during the period between Meso 2011 and Meso 2013, practitioners were unable to provide their clients with definitive

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² *Meso Scale Diagnostics, LLC v. Roche Diagnostics GmbH*, 62 A.3d 62 (Del. Ch. Feb. 22, 2013).

³ *Id.* at 65.

⁴ *SQL Solutions, Inc. v. Oracle Corp.*, 1991 WL 626458 at 4 (N.D. Cal. Dec. 18, 1991).

advice about whether RTMs under Delaware law would permit contract counterparties to terminate certain contracts with a target.

Meso 2013 involved a motion for summary judgment and the court ruled for Roche. Meso contended that RTMs result in an acquisition target assigning its assets to the surviving entity. The court disagreed. The court stated 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.”⁵ In support of its position, the court cited Section 259(a) of Delaware’s General Corporation Law which sets forth the consequences of a RTM for the constituent corporations. The court observed that, under Section 259(a), a RTM results in the transfer of the non-surviving corporation’s rights and obligations to the surviving corporation by operation of law, but does not constitute an assignment by operation of law as to the surviving entity because that entity is the same legal entity as the original contracting party.

Moreover, the court noted that Roche’s interpretation of the anti-assignment provision was consistent with the reasonable expectation of the parties, given that the “vast majority of commentary discussing reverse triangular mergers indicates that a reverse triangular merger does not constitute an assignment by operation of law as to [even] the nonsurviving entity.”⁶ Meso also argued that a RTM results in a target corporation changing its corporate form and that a change of corporate form results in an assignment. Again, the court disagreed and concluded that a RTM does not change an acquisition target’s corporate form in the way that a LLC’s form is changed when it is converted into a corporation. Finally, the court refused to adopt the approach of the federal district court in *SQL Solutions*. Instead, the court analogized what happens in a RTM to what happens in a stock purchase where the purchase of securities results in a change of ownership of the securities, but is not regarded as assigning or delegating the contractual rights or duties of the corporation whose securities are purchased.

Implications

Meso 2013 effectively provides a bright-line rule for determining the effect of certain acquisition structures on the assignment of contractual rights under Delaware law: RTMs and stock purchases will not result in the assignment by operation of law of a target corporation’s contracts. Thus, the case reaffirms that, in Delaware, RTMs may be employed by contracting parties to avoid triggering anti-assignment provisions in targets’ contracts. This is not the case in all states, however.

1. *The “California” Approach*

SQL Solutions is part of a line of California cases recognizing that an “an assignment or transfer of rights does occur through a change in the legal form of ownership of a business.”⁷ As such, practitioners typically treat the question of whether a RTM in California triggers an anti-assignment provision as settled.⁸ At least one court has favorably cited *SQL Solutions*, finding that a RTM results in an assignment by operation of law. In *DBA Distribution*⁹, a federal court held that a RTM constitutes an assignment by operation of law under New Jersey law, citing the New Jersey merger statute, which, the court noted, “provides that the property belonging to each of the constituent corporations ‘shall be vested in the surviving or new corporation.’” The court also cited *SQL Solutions* for the proposition that, “when a company becomes a

⁵ *Meso Scale Diagnostics, LLC*, 62 A.3d 62, at 82.

⁶ *Id.* at 83.

⁷ Among other cases, the court cited *Trubowitch v. Riverbank Canning Co.*, where the court held that if an assignment results merely from a change in the legal form of ownership of a business, its validity depends upon whether it affects the interests of the parties protected by the nonassignability of the contract. 30 Cal.2d 335, 344–45 (1947); see also, *People ex rel. Dep’t of Pub. Works v. McNamara Corp. Ltd.*, 28 Cal.App.3d 641, 648 (1972).

⁸ In the authors’ view, for several reasons, a California state court considering facts akin to *Meso* could reach a different result than the court in *SQL Solutions*. First, *SQL Solutions* is a California federal district court decision, so it is only persuasive authority in California courts, which have not yet ruled definitively on the issue. Second, a number of commentators have called into question the holding in *SQL Solutions*. Finally, in arriving at its conclusion, *SQL Solutions* court relied on cases in which a RTM had not occurred. For instance, in *Trubowitch*, 30 Cal.2d 335, 337 (1947), the contract in question was assigned in connection with the dissolution of a corporation that was a counterparty to the contract.

⁹ *DBA Distribution Services, Inc. v. All Source Freight Solutions, Inc.*, 2012 WL 845929 at 4 (D.N.J. Mar. 13, 2012).

wholly-owned subsidiary, a fundamental change in its form of ownership occurs.”¹⁰ The court held that “[t]he act of merger therefore caused the transfer of the Agreement by operation of law.”¹¹

Because *DBA Distribution* is a New Jersey federal district court decision, it is only persuasive authority in New Jersey courts, which have not yet ruled definitively on the issue. It remains to be seen whether favorable citation of *SQL Solutions* was a one-off event or will ultimately gain traction in other state courts.

2. *The Statutory Approach*

A number of states, including Iowa, Kentucky, Massachusetts and Michigan have substantially implemented the 1984 version of the ABA Model Business Corporation Act (the “1984 Model Act”), which states that “the title to all real estate and other property and rights owned by each corporation party to the merger are vested in the surviving corporation without reversion or impairment”¹² and which includes a comment that “[a] merger is not a conveyance, transfer, or assignment. It does not give rise to claims of reverter or impairment of title based on a prohibited conveyance, transfer, or assignment. It does not give rise to a claim that a contract with a party to the merger is no longer in effect on the ground of nonassignability, unless the contract specifically provides that it does not survive a merger.”¹³

It can generally be assumed that RTMs do not constitute an assignment in states that have passed some version of the 1984 Model Act, though specific state statutes should be reviewed when determining their affect in connection with particular transactions because states often adopt model acts with modifications. Colorado has gone a step further than the 1984 Model Act and has adopted a merger statute that states that, “[a] merger does not constitute a conveyance, transfer, or assignment. Nothing in this section affects the validity of contract provisions or of reversions or other forms of title limitations that attach conditions or consequences specifically to mergers.”¹⁴

Some states, such as Alabama and Illinois, have promulgated merger statutes that include language or variations of language from the 1969 version of the ABA Model Business Corporation Act (the “1969 Model Act”). The 1969 Model Act is ambiguous about whether a merger constitutes an assignment of an agreement by operation of law and states that, in connection with a merger, the assets of each constituent entity “shall be taken and deemed to be transferred to and vested in such single corporation without further act or deed.”¹⁵ It is unclear whether RTMs and forward triangular mergers would be treated similarly under such statutes despite their fundamental differences. There have been some anomalous decisions in states with such statutes. Alabama’s merger statute, for instance, includes such language, but at least one appellate court there has ruled that a merger does not constitute a transfer or assignment by operation of law.¹⁶

The Bottom Line

Meso 2013 establishes that RTMs are not assignments by operation of law in Delaware. Therefore, where, as in *Meso*, Delaware law governs both a RTM and a contract containing an anti-assignment provision that permits a counterparty to terminate if there has been an assignment by operation of law, companies can be confident that there is no risk of contract counterparty termination.

We are not aware of cases in any state that have addressed which law controls when a RTM is governed by the laws of one state and an underlying contract is governed by the law of a different state and the two laws arrive at contrary conclusions about whether the RTM constitutes an assignment by operation of law. In such cases and where federal intellectual property law applies to a contract, a contract coun-

¹⁰ *Id.*

¹¹ *Id.*

¹² Mod. Bus. Corp. Act Ann. § 11.07(a)(3) (1984).

¹³ *Id.*, Comment to § 11.07.

¹⁴ C.R.S.A. § 7-90-204.

¹⁵ Mod. Bus. Corp. Act Ann. § 76(d) (1969).

¹⁶ *Int’l Paper Co. v. Broadhead*, 662 So.2d 277, 279 (Ala. Civ. App. 1995).

terparty could argue that the applicable law is that which would deem an assignment to have occurred upon the consummation of the RTM.

In those cases, in jurisdictions such as California in which RTMs constitute assignments by operation of law and when a RTM or a contract is governed by the law of any of the many jurisdictions that have not addressed the issue of whether a RTM constitutes an assignment by operation of law, acquirers should consider whether to obtain consents from contract counterparties as a condition to closing or structure their transactions as tender offers or stock purchases, forms of transactions that typically do not trigger contract counterparty termination rights.

Finally, *Meso 2013* should serve as a reminder that anti-assignment provisions in commercial contracts should be drafted precisely to reflect the parties' intentions with respect to the consequences of RTMs and forward triangular mergers on parties' rights under such contracts.