MERGERS & ACQUISITIONS

Reverse Triangular Mergers: Mere Change of Ownership? Maybe Not.

A recent decision of the Delaware Court of Chancery may change the way buyers and sellers determine how best to structure an acquisition of a target company.

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The acquisition of a target company may take several different forms, with the most traditional being the acquisition of the target's equity, the acquisition of the target's assets or a merger with the target. Participants in an acquisition typically will consider a number of factors in choosing the most advantageous way to effect the acquisition. These include the tax and accounting consequences of the acquisition, the allocation of the target's liabilities among the purchasing parties and the selling parties, and the relative ease of execution inherent in the different acquisition methods. For example, a target with many stockholders would likely make an acquisition through the purchase of the target's equity very difficult to execute; yet a target that has multiple assets (e.g., contracts) requiring third party consent to their assignment could preclude structuring an acquisition as the purchase of the target's assets.

A recent decision of the Delaware Court of Chancery may change the way buyers and sellers determine how best to structure an acquisition of a target company. It is widely accepted that a sale of a target company's equity generally would not violate an "anti-assignment provision" in one of the target's contracts (i.e., a provision that prohibits the target company from assigning any of its rights or liabilities under that contract). A sale of a target company's assets would generally violate an anti-assignment provision absent the requisite third party consent. Mergers, whether they are reverse triangular mergers (RTM) with the target surviving the merger or forward triangular mergers (FTM) with the acquiring entity and not the target company surviving the merger, have been widely viewed as more akin to a sale of a target's equity than a sale of its assets.

New York case law generally supports this proposition, even though courts in Delaware or New York have not considered specifically whether an RTM would violate an anti-assignment provision. There is an established body of law in New York that stands for the general principle that mergers do not constitute assignments. In the case of Torrey Delivery, Inc. v. Chautauqua Truck Sales and Serv., Inc., the Court, citing New York Business Corporation Law Sections 901 and 902 governing mergers, stated that mergers are corporate reorganizations and they affect the corporate form of existence of a target entity and not its corporate property. A merger brings about changes in corporate structure, the Court reasoned, and does not involve separation or divestment of corporate assets. Other cases you can look to are Modern Comm'ns Servs., Inc. v. NEP Image Group, LLC, and Brentsun Realty Corp. v. D'Urso Supermarkets, Inc.

Recently, however, the Delaware Court of Chancery signaled a possible change in how courts may view mergers, in particular, RTM's, in the context of an anti-assignment provision. In April of this year, the case of Meso Scale Diagnostics, LLC v. Roche Diagnostics GMBH, involved, among other things, license rights to use electroluminescence technology (ECL). In 2003, as part of a series of complicated transactions, defendant Roche Diagnostics GMBH obtained a non-exclusive ECL license from defendant IGEN International, Inc. in which IGEN's rights as licensor became vested in defendant BioVeris Corporation. A dispute later arose as BioVeris alleged that Roche's use of the underlying intellectual property exceeded the scope of the ECL license. Soon thereafter, Roche purchased Bioveris for approximately $600 million by means of an RTM. Roche then shut down BioVeris's operations, leaving it "as nothing more than a holding company for its intellectual property and license rights."

In 2010, plaintiffs Meso Scale Diagnostics, and Meso Scale Technologies, collectively the Meso Entities, brought suit alleging, amongst additional complaints, that Roche's acquisition of BioVeris violated the anti-assignment provision contained in an agreement executed as part of the 2007 transactions, because the acquisition had been effected without their consent. The anti-assignment provision read as follows:

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.

The Meso Entities further alleged that they had specifically negotiated for the right to consent to any acquisition of BioVeris because of a perceived threat that Roche may acquire BioVeris in order to expand the scope of its ECL license. As a preliminary matter, the Court found that an assignment of Bioveris's intellectual property could reasonably be interpreted to be prohibited by the anti-assignment provision and, therefore, turned to the issue of whether an RTM violates the anti-assignment provision.

In its opinion denying the defendants' motion to dismiss, the Court focused on the language that prohibited a transfer "by operation of law or otherwise," noting that the meaning of this language in the context of an RTM had not yet been considered by a Delaware court. It acknowledged that there is ample Delaware jurisprudence in the context of stock acquisitions, and that this stands for the premise that where an acquirer purchases the stock of a corporation, that purchase does not, in and of itself, constitute an assignment to the acquirer of any contractual rights or obligations of the corporation whose stock is sold. It also acknowledged Delaware jurisprudence involving FTMs, suggesting, although not ruling, that the phrase "by operation of law" in an anti-assignment provision could be commonly understood to include (i.e., prohibit) a merger. The Court then noted a case in which the federal court in the Northern District of California, which applied California law, ruled that an RTM violated an anti-assignment provision; however, it declined to follow this ruling.

The Court refused to dismiss the complaint because it considered that the plaintiffs and the defendants had offered two competing, but reasonable, constructions of the phrase "by operation of law." It declined to rule whether an RTM was more akin to a stock acquisition or an FTM for purposes of determining its effect on an anti-assignment provision on the grounds that the pertinent phrase was ambiguous - and, in so doing, it pointed out that the stock acquisition cases and the FTM cases were distinguishable from the case before it.

The Court's ruling implied that a full hearing on the merits was necessary to establish its meaning and that the facts and circumstances and the intent of the parties in any specific case may not only be relevant, but pivotal, in determining whether an RTM violates an anti-assignment provision. Specifically, in the Meso case, the Court hinted that an ultimate decision could hinge on what happens to the target company's business operations after the transaction, indicating that an RTM after which the target company essentially ceases business operations, may be deemed to violate an anti-assignment provision because the RTM would constitute much more than a mere change in ownership. The Court seemed very concerned that after the consummation of the RTM in the Meso case, Roche laid-off all of BioVeris's 200 employees, vacated BioVeris's Maryland facility and notified BioVeris's existing customers that its product lines were being discontinued.

The lasting consequence of the Meso case will likely be considerable uncertainty. The Court ruled only on the procedural motion to dismiss and did not rule on the substantive merits of the case - and a ruling on the merits may not come soon because of the possibility that Meso will be resolved by arbitration, rather than by the Delaware Chancery Court. An issue that was not before the Court, but which could create additional uncertainty in this area is how a Court should approach a case involving a target that is a Delaware entity and a contract containing an anti-assignment provision that is governed by the law of another State, or vice-versa.

The Court clearly declined to apply a bright-line rule, instead suggesting that it would analyze all facts and circumstances and the intent and actions of the parties involved in reaching a decision on a case-by-case basis. Accordingly, buyer and sellers structuring an acquisition as a merger have little guidance as to the effect of the acquisition on any contract of a target company containing an anti-assignment provision. Prudence would therefore dictate that when negotiating contracts, contracting parties should specifically address whether a merger or other form of change of control involving a contracting party would constitute a breach of the underlying contract. It would also dictate that purchasers and sellers structuring an acquisition as a merger should consider obtaining third party consents with respect to any of the target's contracts that do not specifically address this issue - a prospect which could have important implications for many such acquisitions.

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