



The Delaware Chancery Court Addresses Reverse Triangular Mergers and Assignment by Operation of Law Provisions

On April 8, 2011, the Delaware Court of Chancery handed down a decision (*Meso Scale Diagnostics, LLC v. Roche Diagnostics GMBH*, C.A. No. 5589-VCP (Del. Ch. April 8, 2011)) that might impact how M&A deals are structured and what third party consents must be obtained. In the first Delaware case to address the issue, the court held that a reverse triangular merger may qualify as an assignment by operation of law and, therefore, trigger certain anti-assignment provisions governed by Delaware contract law.

Determining whether certain third party consents are required with respect to a target company's contracts is an important part of the equation in deciding the structure of an acquisition. In an effort to avoid contractual complications related to assignability issues, the reverse triangular merger structure has been a popular form of merger among corporate practitioners. In a reverse triangular merger, the acquiring entity creates a subsidiary that merges with and into the target company; the target company survives and the subsidiary ceases to exist as a separate corporate entity. The former target company's shareholders receive consideration for their target company stock, and the acquiring entity becomes the sole shareholder of the target company. Thus, in a reverse triangular merger, only the ownership of the target company changes. The target company continues to exist and to own its own properties and assets following the merger, and no assets are transferred or contracts assigned to

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Contacts:

[Jae W. Park, Jr.](#)
+1.602.528.4181

[Frank M. Placenti](#)
+1.602.528.4004

[Joseph P. Richardson](#)
+1.602.528.4801

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the acquiring entity. The court's decision in *Meso Scale* appears to limit the use of reverse triangular mergers as a means to avoid anti-assignment provisions governed by Delaware contract law.

The plaintiffs, Meso Scale Diagnostics, LLC and Meso Scale Technologies, LLC (Meso Scale), and defendants Roche Holding Ltd. and BioVeris Corporation were parties to a licensing agreement providing for the license of certain patents owned by BioVeris. The agreement prohibited assignment "by operation of law or otherwise" without Meso Scale's prior written consent. In 2007, BioVeris was acquired by Roche pursuant to a reverse triangular merger without first obtaining consent from Meso Scale. Meso Scale subsequently brought a claim for breach of contract, alleging that the reverse triangular merger constituted an assignment by operation of law.

The court denied the defendant's motion to dismiss claims that it breached an anti-assignment provision of a licensing agreement. In its holding, the court focused on defendant's actions after the merger to convert the target into a non-operating, shell company including the layoff of all the target's employees and the discontinuation of its product lines.

The court's decision implies that a reverse triangular merger alone will not constitute an assignment by operation of law. However, although the case was not decided on the merits, the court's ruling shows that a reverse triangular merger may trigger a consent requirement under an anti-assignment clause when the acquirer converts the target into a non-operating shell company soon after completing the merger (within several months according to the allegations in the complaint). Accordingly, the court's ruling may or may not have a limiting effect on reverse triangular mergers based on a buyer's post merger integration plans, which could limit the synergies obtainable by the buyer if dramatic changes are intended. The ruling therefore has potentially significant implications for buyers during the due diligence stage with respect to determining deal structures and required consents. A final decision by the court on the merits will likely provide a more precise guideline for determining when a reverse triangular merger triggers the anti-assignment provisions of a contract governed by Delaware law.

If the reverse triangular merger structure is not available as a means to avoid triggering an anti-assignment provision, the only viable alternative may be to simply acquire all of the outstanding stock, or other equity interests, of the target company. A

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purchase of the stock of the target company would not be deemed to be an assignment by operation of law, as only the ownership of the target company would change and no assets would be transferred or contracts assigned to the acquiring entity. This structure, however, may not be ideal because of other considerations that make a merger preferable, such as the presence of a large number of shareholders or the presence of uncooperative minority shareholders.

If you have any questions regarding this decision, please contact your principal Squire Sanders lawyer or one of the lawyers listed in this alert.

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