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**Milbank**

# Corporate Governance Group

# Client Alert

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## DELAWARE COURT CONSIDERS WHETHER REVERSE TRIANGULAR MERGER CONSTITUTES ASSIGNMENT OF TARGET'S ASSETS "BY OPERATION OF LAW"

*In rejecting motion to dismiss, Court indicates that post-closing activities could impact whether anti-assignment clause is triggered*

One of the issues driving the structuring of an M&A transaction is the impact on anti-assignment clauses contained in contracts of the target corporation. Contractual anti-assignment clauses take a variety of forms, including some which require a contracting party's consent before the contract, and the other party's rights and obligations thereunder, may be assigned "by operation of law." A recent decision of the Delaware Court of Chancery in *Meso Scale Diagnostics, LLC v. Roche Diagnostics GMBH*<sup>1</sup> leaves unanswered (at least for now) the question whether a reverse triangular merger constitutes an assignment of the target corporation's assets and properties, including its contracts, "by operation of law."<sup>2</sup>

In a reverse triangular merger, an acquiring corporation forms a new subsidiary for the sole purpose of merging *into the target corporation*, with the target corporation surviving the merger as a wholly-owned subsidiary of the acquiring corporation. In the merger, the target corporation's former stockholders generally receive cash and/or stock of the acquiring corporation in exchange for their target corporation shares. This acquisition structure is often favored because the target corporation does not "incur[] any change in its corporate existence" and, as a result, "the rights and obligations of [the target corporation] . . . are not transferred, assumed, or affected."

<sup>1</sup> C.A. No. 5589-VCP (Del. Ch. Apr. 8, 2011).

<sup>2</sup> Not addressed by this decision is an even more vexing issue: whether an anti-assignment clause that *does not specifically mention* either assignments by operation of law or changes in ownership of a contracting party is triggered by a stock sale or a merger, as opposed to a sale of the target corporation's assets (which does require the other party's consent under a typical anti-assignment clause).

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Recognizing that Delaware “apparently has not yet confronted this issue,” Vice Chancellor Parsons reviewed the current state of Delaware law applicable to various transaction structures in considering whether the reverse triangular merger before him triggered the target corporation’s contractual anti-assignment clause:

- *Stock Acquisitions.* The Vice Chancellor explained that a purchase by an acquiring corporation of the stock of a target corporation directly from its stockholders “exemplif[ies] a situation in which a mere change of ownership, without more, does not constitute an assignment as a matter of law.” As such, “courts in this State and elsewhere have held that ‘[w]here an acquiror purchases stock of a corporation, that purchase does not, in and of itself, constitute an ‘assignment’ to the acquiror of any contractual rights or obligations of the corporation whose stock is sold.’”<sup>3</sup>
- *Forward Triangular Mergers.* In contrast to a reverse triangular merger, in a forward triangular merger, the target corporation merges *into the acquirer’s newly-created subsidiary*. Because “the target company is not the surviving entity and its rights, interests, and obligations vest in the surviving entity,” Delaware courts have determined that this transaction structure represents an assignment of the target corporation’s contracts and other assets by operation of law.
- *Reverse Triangular Mergers.* Not surprisingly, the Vice Chancellor did not consider the forward triangular merger decisions to be binding for purposes of reverse triangular mergers. On the other hand, he acknowledged that stock acquisitions are “similar in some respects” to reverse triangular mergers because the acquirer becomes the owner of all of the stock of the target corporation. The Vice Chancellor was not prepared, however, to conclude that the precedents addressing stock acquisitions necessarily dictate that a reverse triangular merger does not effect an assignment of the target corporation’s contracts and other assets by operation of law. Specifically, the Vice Chancellor noted that after the merger in question was completed, the target corporation “was gutted and converted into a shell corporation for [the acquirer’s] benefit.” This alone was sufficient for the Vice Chancellor to require a hearing on the merits to determine whether the merger “resulted in more than a mere change in control” with respect to which “the parties intended to require [the other contracting party’s] consent in this situation by using the term ‘by operation of law.’”

\* \* \*

Although the Vice Chancellor’s ruling leaves open the question whether a typical reverse triangular merger constitutes an assignment of a target corporation’s contracts “by operation of law,” it does indicate that an acquirer’s post-acquisition actions with respect to the assets of the target corporation could ultimately have a bearing on the issue, making this a case-by-case analysis. This obviously impacts post-closing integration planning and efforts. The decision also should serve as a reminder of the care that must be taken, during the due diligence process, in reviewing anti-assignment clauses in target corporation contracts, particularly bearing in mind potential acquisition structures under consideration.

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<sup>3</sup> Based on this analysis, a stock acquisition presumably also would not trigger an anti-assignment clause that does not specifically mention assignments by operation of law.

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