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Delaware Chancery Court Confirms Reverse Triangular Merger Is Not an Assignment, Averting Additional Third Party Consent Requirements in M&A Deals

We all have been there. The parties have reached agreement on all of the principal terms. Signature pages for all of the definitive transaction documents are being held in escrow. The treasury department has entered all of the wire information and the purchaser is ready to wire. All of the closing conditions have been satisfied and the parties are ready to consummate their deal, with one glaring exception—obtaining a third party consent to a contract that is material to the target's business.

Meso Scale I. Considering all of the effort that is exerted in negotiating a complicated M&A transaction, it can be frustrating for all parties to the transaction when the closing hinges on the availability of a landlord or the internal approval process of a large organization. Indeed, with difficult-to-assign contracts crucial to a target's business, M&A professionals routinely structure around the third party consent dilemma through stock acquisitions or by utilizing a reverse triangular merger structure. Accordingly, in 2011, when Vice Chancellor Parsons of the Delaware Chancery Court rendered a memorandum opinion in *Meso Scale Diagnostics, LLC v. Roche Diagnostics GmbH*, 2011 WL 1348438 (Del. Ch. Apr. 8, 2011) ("**Meso Scale I**") that suggested that a transaction structured as a reverse triangular merger may constitute "an assignment by operation of law" under Delaware law, it raised eyebrows in M&A circles and created concerns that the universe of contracts subject to third party consent in a reverse triangular merger context just increased exponentially. The disposition of *Meso Scale I*, however, did not require Vice Chancellor Parsons to make a definitive ruling on this point, which left M&A practitioners in limbo as to whether the following type of anti-assignment provision would trigger a consent requirement in a transaction structured as a reverse triangular merger:

*"X shall not assign, **by operation of law or otherwise**, any of its rights or interests under this Agreement, without the prior written consent of Y"*

Meso Scale II. Recently, Vice Chancellor Parsons issued a new memorandum opinion in the *Meso Scale* litigation (*Meso Scale Diagnostics, LLC v. Roche Diagnostics GmbH*, C.A. No. 5589-VCP (Del. Ch. Feb. 22, 2013) ("**Meso Scale II**")) in which the Court definitively ruled that a "reverse triangular merger was not an assignment by operation of law or otherwise, such that it would have required the plaintiffs' consent." Vice Chancellor Parsons explained that he reached this conclusion based on the following grounds:

- **Statutory Basis** – Under Section 259 of the Delaware General Corporation Law (the "**DGCL**"), the assets of the surviving entity prior to the merger are not assigned, but instead remain the property of the surviving entity following the merger.

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- **Case Law Basis** – Although not directly on point, relevant case law supported this interpretation of Section 259 of the DGCL.
- **Legal Commentary** – Vice Chancellor Parsons found that the “vast majority” of legal commentary had concluded that a reverse triangular merger would not constitute an assignment by operation of law. Accordingly, he concluded, that parties drafting contracts would have no expectation or intent to the contrary.

California Exception. Notably, in reaching his conclusion in *Meso Scale II*, Vice Chancellor Parsons explicitly rejected the holding of the federal district court for the Northern District of California in *SQL Solutions v. Oracle Corporation*, 1991 WL 626458 (N.D. Cal. 1991) (“**SQL**”). In that case, the Court concluded that a reverse triangular merger constituted an assignment by operation of law. Consequently, although the holding in *Meso Scale II* provides clarity in Delaware (and many other jurisdictions often defer to Delaware law on business and finance matters), deal professionals need to be mindful that *SQL* remains good law in California—meaning that if *SQL* is applied, a reverse triangular merger is an assignment by operation of law in California.

What Does This Mean for You? In large part, *Meso Scale II* simply confirms what many M&A practitioners believed to be the law with respect to reverse triangular mergers before *Meso Scale I*. However, *SQL* is still valid law in California and, as a result, parties to a reverse triangular merger with some nexus with California should be mindful of *SQL* when:

- determining which contracts will require third party consent prior to consummation of the reverse triangular merger;
- making representations and warranties in the merger agreement regarding non-contravention and enforceability of material contracts post-closing to the extent that such contracts may be governed by California law; and
- considering potential rights of counterparties to contracts that may be governed by California law, including evaluating whether the counterparty has a right to claim breach and/or to terminate an agreement if the parties elect not to obtain the counterparty’s consent despite the existence of an “assignment by operation of law” provision.

In today’s hypercompetitive M&A environment, you need legal counsel capable of doing more than just documenting your deal—you need a strategic partner who has been in the trenches, provides you with senior-level attention and understands the subtle legal and business points that can make or break a deal. From leveraged buy-outs to strategic acquisitions and dispositions, corporate reorganizations and more—Brownstein’s Mergers & Acquisitions/Private Equity Group delivers decisively sound, business-oriented judgment and will work closely with you to meet your objectives.

This document is intended to provide you with general information regarding reverse triangular mergers. The contents of this document are not intended to provide specific legal advice. If you have any

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questions about the contents of this document or if you need legal advice as to an issue, please contact the attorney listed below or your regular Brownstein Hyatt Farber Schreck, LLP attorney. This communication may be considered advertising in some jurisdictions.

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