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Delaware Chancery Court Holds That Grant of Security Interest Is a “Transfer”

*By Richard M. Assmus, Brian J. Massengill, Jennifer L. Keating,
Brian Trudgen, Beth D. Vogel and Colleen E. Reider**

In this article, the authors discuss a decision by the Delaware Court of Chancery holding that a grant of a security interest constituted an “assignment” and “transfer” of payments under a license agreement, triggering the right of first negotiation and the right of first refusal provisions in the license agreement.

The Delaware Court of Chancery (the Chancery Court) has granted partial summary judgment for Commave Therapeutics SA (Commave) against Zevra Therapeutics, Inc. (Zevra), holding, in part, that the pledge of the parties’ 2019 Collaboration and License Agreement (the License Agreement) by Zevra, as part of the collateral for a loan, constituted an “assignment” and “transfer” to the lenders of the payments under the License Agreement.

The License Agreement granted Commave an exclusive license to develop, manufacture, and commercialize certain pharmaceutical products developed by Zevra, as well as a right of first negotiation (ROFN) and a right of first refusal (ROFR) in the event that Zevra ever sold, assigned, or otherwise transferred to a third party any or all of its rights to receive payments under the License Agreement.

The Chancery Court held that Zevra’s grant of a security interest constituted an “assignment” and “transfer” of the payments under the License Agreement at the time the security interest was granted triggering the ROFN and ROFR.

BACKGROUND

The License Agreement contained two sets of obligations relevant to Zevra’s conduct: (i) exclusivity in connection with the development of competing products, and (ii) specific procedures required to be taken in connection with assignments or transfers of Zevra’s right to receive payments under the License Agreement to third parties.

The License Agreement specifically provided that, if Zevra “either receives a bona fide offer that its Board of Directors intends to accept, or the Board of Directors of [Zevra] decides to sell, assign, contribute, convey, grant or otherwise transfer to any Third Party (other than DPDF) . . . all or any of

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[Zevra’s] rights to receive payment and the corresponding royalty reports under this Agreement (each a Payment Assignment),” then the ROFR and ROFN are triggered, and Zevra must notify Commave of the decision to sell or transfer its right to receive payments under the License Agreement to a third party.

Upon the receipt of notice, Commave has (i) the ROFN to exclusively negotiate the acquisition of those rights for 30 days, and (ii) the ROFR to enter into the Payment Assignment instead of the third party on the same material terms.

In 2024, Zevra entered into a credit agreement; in order to secure the loan, Zevra granted the lenders a first-priority perfected lien on, and security interest in, substantially all of Zevra’s assets. Zevra granted “a continuing security interest in any and all right, title and interest” in the collateral, whether then owned or later acquired by Zevra, including “all license agreements . . . of any Intellectual Property.”

Commave asserted that the pledge of collateral included Zevra’s rights under the License Agreement and constituted a “Payment Assignment” under the License Agreement that invoked its ROFN and ROFR. Zevra disagreed.

THE CHANCERY COURT’S ANALYSIS AND HOLDINGS

The Chancery Court found that Zevra’s grant of a security interest sweeping in “all license agreements” under its 2024 Credit Agreement qualified as a “Payment Assignment,” because it “assigned” or “otherwise transferred” an interest in Zevra’s right to receive payments under the License Agreement at the time the security interest was granted. That triggered Commave’s notice, ROFN, and ROFR processes, which Zevra failed to follow.

Zevra’s position was that pledging a License Agreement as part of the collateral for the 2024 Credit Agreement was not an assignment of the royalty payments stream under the License Agreement, and therefore was not a “Payment Assignment.” The court disagreed. The court cited Black’s Law Dictionary, which defines an “assignment” as “the transfer of rights or property . . . including an assignment of property as collateral security for a loan.” The court concluded that the security interest fell within that definition, finding that, “[b]y pledging all license agreements as collateral, Zevra necessarily transferred an interest in the rights arising from those contracts. . . . This bundle of rights includes the right to receive royalty and milestone payments. To hold that a debtor could pledge a contract as collateral while retaining the payment rights that give the contract value would be divorced from commercial reality.”

The court also noted that the drafters of the License Agreement included an exclusion – “(other than DPDF)” – from the Payment Assignment language. This reference was to a prior security interest granted by Zevra to another

lender, DPDF. The court viewed the inclusion of such reference as evidence that the drafters intended security interests to otherwise be considered “Payment Assignments” that would trigger Commave’s ROFN and ROFR.

The court also rejected Zevra’s defense that the Delaware Uniform Commercial Code (UCC) § 9-406(d) invalidates the ROFN/ROFR, as § 9-406(d) applies only to “terms that prohibit, restrict, or require consent” to assignments; however, Section 15.5(c) of the License Agreement doesn’t legally prohibit an assignment—it merely imposes procedural requirements (notice, negotiation, matching rights), which the UCC commentary treats as mere “practical impairments.” The court went on to note that “ROFN and ROFR provisions are common features of commercial contracts and adopting Zevra’s interpretation would lead to the unreasonable result that all such provisions are unenforceable under the UCC.”

Zevra’s defense that an “Excluded Property” clause in the 2024 credit agreement excluding agreements that prohibit the granting of a lien thereon avoided the transfer was rejected as the court found that the License Agreement did not prohibit liens outright but just imposed the notice obligations and the ROFN and ROFR if a lien was granted. The court also rejected Zevra’s argument that any assignment in violation of the License Agreement would be “null and void”—explaining that this clause is to protect the non-breaching party’s rights, not to allow the breaching party to escape liability. Commave sought damages for failing to honor the ROFN and ROFR, not to void the lien.

PRACTICAL TAKEAWAYS

This decision could impact all secured financings. Historically, absent specific language to the contrary, practitioners have typically been of the view that security interests are not considered “transfers” until an event of default occurs and the secured party forecloses on its security interest. The court turned that view on its head. This decision has yet to be tested or clarified (in an appeal or subsequent decisions), but parties to commercial agreements that contain transfer or assignment restrictions or financing agreements under which assets are pledged as security should consider this ruling (i) when drafting what constitutes an assignment or transfer under the agreement (and consider making clear whether a security interest is or is not an assignment or transfer unless the secured party has foreclosed on its security interest), and (ii) when specifying the types of agreements that are excluded from the collateral as “Excluded Property” or “Excluded Assets” in a financing agreement (for example, excluding agreements that contain any restriction or limitations on assignment rather than just prohibitions on assignment).

In addition, drafters of ROFN and ROFR clauses should consider how the triggers are drafted to include (or exclude) the grant of security interests or other

similar transactions. Finally, in the M&A context, it may be prudent for an acquiror to review the target’s material contracts for restrictions on transfer or assignment (such as ROFRs and ROFNs) that, while not triggered by the acquisition itself, may be triggered if acquisition financing is obtained or by a future secured financing. This would allow the parties to evaluate the potential impact of the specific restrictions and to consider whether to seek consent from the applicable counterparty.