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Delaware Supreme Court Clarifies When a Series of Dispositions will not Trigger an "All or Substantially All" Indenture Covenant

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In *The Bank of New York Mellon Trust Co., N.A., v. Liberty Media Corp.*, No. 284, 2011 WL 4376552 (Del. Sept. 21, 2011), the Delaware Supreme Court held that Liberty Media Corp's proposed split-off was not sufficiently connected to previous transactions to warrant aggregation of both the proposed and previous transactions, and thus the proposed split-off did not constitute a sale of "substantially all" of its assets. Bond indentures issued by corporate borrowers typically contain a covenant that the issuer will not sell "all or substantially all" of its assets without the substitution of the purchaser as successor obligor or without otherwise causing a default and acceleration. This landmark ruling should allow corporate issuers accessing the debt capital markets greater flexibility to manage assets and dealmakers' increased clarity in interpreting a standard indenture provision.

Background

The dispute arose out of Liberty Media Corp's proposed split-off of its Capital Group and Starz Group. Bondholders argued that the proposed split-off would violate the "all or substantially all" covenant in the indenture unless the recipient assumed Liberty's obligations. While the parties agreed that the proposed split-off did not, in isolation, violate the covenant, the trustee, acting on behalf of the bondholders, maintained that the proposed split-off should be aggregated with three previous transactions, which, together constituted a sale of "substantially

all" of Liberty's assets. Liberty brought an action for declaratory judgment and injunctive relief to resolve the issue of whether aggregation of the transactions was appropriate in interpreting the language of the indenture.

When will a series of asset sales constitute the sale of "substantially all" of a corporate issuer's assets?

The Court of Chancery applied the Second Circuit's reasoning in *Sharon Steel Corp. v. Chase Manhattan Bank, N.A.,* 691 F.2d 1039 (2d Cir. 1982) to the aggregation issue. In *Sharon Steel*, the court held that aggregation was appropriate where individual transactions were a part of a "plan of piecemeal liquidation" and an "overall scheme to liquidate." If, however, each transaction "stands on its own merits without reference to each other, courts have declined to aggregate for purposes of a 'substantially all' analysis." Under this precedent, the court declined to aggregate the proposed split-off with the previous transactions, finding that each transaction resulted from an independent business decision made in the context of unique facts and circumstances.

The court added a second layer of analysis to its inquiry through application of the step-transaction doctrine, which the court deemed proper based on the framework laid out in *Sharon Steel*. The step-transaction doctrine utilizes three tests to determine whether the steps in a series of formally separate transactions are sufficiently related to warrant consideration as components of an overall plan. First, the end result test examines whether the transactions were executed as parts of a plan to achieve a desired end result. Second, the interdependence test scrutinizes the independence of the transactions by analyzing whether any one transaction would have been fruitless without a completion of the series. Finally, the binding-commitment test measures whether, at the time of the first step, there was a binding commitment to follow through with the other steps.

The court viewed the contested transactions through each lens crafted under the step-transaction doctrine and determined that aggregation was improper in

this context. The transactions did not meet the end result test because there was no evidence to suggest that the transactions were executed to evade the bondholder's claims. Moreover, in finding that the interdependence test was not met, the court found it significant that each transaction stood on its own merits and was separated by a number of years. Finally, the court found that because the transactions were not contractually connected, the binding-commitment test was not met.

On appeal, the Delaware Supreme Court affirmed the use of the *Sharon Steel* analysis to determine the proper degree of interrelationship necessary to warrant aggregation of a series of transactions. The Delaware Supreme Court explained that each transaction was "the result of a discrete, context based decision" and that no "overall plan to deplete Liberty's asset base over time" existed. Thus, because the transactions were not a "plan of piecemeal liquidation" and because no "overall scheme to liquidate" could be found, the Delaware Supreme Court declined to aggregate the transactions.

The Court also declined to adopt the step-transaction doctrine for the purposes of determining whether aggregation was proper in this context. Rather than respond to the trustee's claim that such analysis was improper, the Court rested its decision solely by utilizing the *Sharon Steel* framework. Thus, the Delaware Supreme Court found that aggregation was improper and that a sale of "substantially all" of Liberty's assets would not occur upon completion of the proposed split-off.

Why is this case significant?

It is important for the efficiency of the capital markets that language routinely used in bond indentures be accorded a consistent and uniform construction and meaning. Corporate bond issuers have traditionally struggled with confronting business environments which may call for a general business strategy of spinning-out assets as opportunities arise for fear of triggering the "all or substantially all" covenants in their indentures.

The opinions of each of the Delaware Court of Chancery and the Delaware Supreme Court give greater certainty and clarity to bond issuers that opportunistically execute divestiture strategies. In order to avoid triggering an "all or substantially all" covenant through aggregation of divestitures, a corporate board should make each divestiture decision independently and with consideration of and reference to the unique facts and circumstances that drive each individual decision. We recommend that boards of directors document carefully these analyses.

What if you have questions?

For any questions or more information on these or any related matters, please contact any attorney in the firm's corporate practice group. A list of such attorneys can be found by clicking "Lawyers" on this page.

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