Milbank

Corporate Governance Group
Client Alert

Beijing Frankfurt Hong Kong London Los Angeles Munich New York São Paulo Singapore Tokyo Washington, DC

June 7, 2011

DELAWARE COURT DECLINES TO AGGREGATE FOUR CORPORATE SPLITOFF TRANSACTIONS FOR PURPOSES OF INDENTURE'S SUCCESSOR OBLIGOR PROVISION

Fact-based analysis provides useful guidance on step-transaction doctrine and the meaning of "substantially all" of a corporation's assets

In *Liberty Media Corp. v. Bank of New York Mellon Trust Company, N.A.*,[1] the Delaware Court of Chancery recently considered whether a series of four splitoff transactions – taking place over the course of seven years along with various asset acquisitions and swaps – should be aggregated for purposes of determining whether a corporation had sold "substantially all" of its assets under the terms of its bond indenture. The Court analyzed this question under the judicially developed step-transaction doctrine, which "treats the 'steps' in a series of formally separate but related transactions … as a single transaction, if all the steps are substantially linked." In ruling that the four transactions should *not* be aggregated, the Court provided valuable guidance on both the meaning of "substantially all" and the application of the step-transaction doctrine.

Background

Liberty Media Corporation, led by cable TV giant John Malone, is a major distributor of entertainment, sports and other television programming. Liberty was created in 1991 by Tele-Communications, Inc. amid a threat by federal regulators to separate its programming assets from its cable systems. After a series of corporate transactions engineered by Malone, Liberty emerged in August 2001 as a publicly-traded company.

At that time, Liberty held assets characterized by the Court of Chancery as "a 'fruit salad' of assets, consisting mainly of minority equity positions in public and private entities." In addition, Liberty was subject to an indenture for outstanding bonds

[1] C.A. No. 5702-VCL (Del. Ch. Apr. 29, 2011).

For further information about this Client Alert, please contact:

Roland Hlawaty
Partner
212-530-5735
rhlawaty@milbank.com

David Schwartz
Of Counsel
212-530-5260
dschwartz@milbank.com

Peter Heller
Associate
212-530-5561
pheller@milbank.com

Editor: Bob Reder

www.milbank.com

(the "Indenture") containing a "successor obligor provision". This provision prohibited Liberty "from selling, transferring, or otherwise disposing of 'substantially all' of its assets unless the entity to which the assets are transferred assumes Liberty's obligations under the indenture …." The Indenture, which is governed by New York law, does not define the term "substantially all".

Because many of Liberty's assets were minority investments that did not generate cash flow, Liberty management sought to acquire controlling interests in those businesses. If the path to control was blocked, management would "evaluate[ ] all possible alternatives for the asset." In furtherance of this strategy, Liberty "engaged regularly in acquisitions, dispositions, [and] complex swaps," as well as the following dispositive transactions:

- *LMI*. In 2004, management engineered the spinoff to Liberty stockholders of a subsidiary, Liberty Media International, Inc., which held Liberty's international cable businesses in Europe, Latin America and Japan. This transaction removed $11.79 billion in assets from Liberty's balance sheet, representing 19% of Liberty's book value as of March 31, 2004.

- *Discovery*. In 2005, Liberty dividended to stockholders its minority interest in the joint venture that owns the Discovery cable channel. This transaction removed $5.8 billion in assets from Liberty's balance sheet, representing 10% of Liberty's book value as of March 31, 2004.

- *LEI*. In 2009, Liberty split off its interest in DirectTV (as well as certain other businesses) into a new entity called Liberty Entertainment, Inc. ("LEI"). This transaction removed $14.2 billion in assets from Liberty's balance sheet, representing 23% of Liberty's book value as of March 31, 2004.

- *Capital Splitoff*. Finally, in June 2010, Liberty announced the "Capital Splitoff," pursuant to which it would split off its Capital and Starz Groups into a new public entity. This proposed transaction would remove $9.1 billion in assets from Liberty's balance sheet, representing 15% of Liberty's book value as of March 31, 2004.

A number of holders of bonds issued under the Indenture objected, claiming that the Capital Splitoff, combined with the LMI, Discovery and LEI transactions, constituted "a 'disaggregation strategy' designed to remove assets from the corporate structure against which the bondholders have claims and shift the assets into the hands of Liberty's stockholders." As a result of this strategy, the bondholders claimed, once the Capital Splitoff is completed, Liberty will have effectively engaged in a sale of "substantially all of its assets" without arranging for the various successor entities to assume its obligations under the Indenture. As such, Liberty allegedly will be in violation of its obligations under the Indenture's successor obligor provision.

Faced with this "threatened event of default" under the Indenture, Liberty sought declaratory and injunctive relief in the Court of Chancery against Bank of New York Mellon, in its capacity as Indenture trustee.

The Court's Analysis

The Step-Transaction Doctrine

The Court noted that the "threshold question" before it was "whether the Capital Splitoff should be aggregated with the prior spinoffs of LMI and Discovery and the splitoff of LEI" for purposes of determining whether the Indenture's successor obligor provision had been triggered. The Court began its analysis by observing that "[c]ourts applying New York law have recognized that, under appropriate circumstances, multiple transactions can be considered together when determining whether a transaction constitutes a sale of all or substantially all of a corporation's assets." Recognizing that "[n]one of these sources, however, has articulated a clear standard for determining when transactions should be aggregated," the Court proceeded to a review of the relevant case law.

Based on this review, the Court decided to apply the step-transaction doctrine as articulated in "the leading decision on aggregating transactions for purposes of a 'substantially all' analysis," *Sharon Steel v. Chase Manhattan Bank, N.A.*[2] According to the Court, the doctrine will be invoked if the transaction in question meets any one of three tests:

- The "*end result test*" triggers aggregation "if it appears that a series of separate transactions were prearranged parts of what was a single transaction, cast from the outset to achieve the ultimate result."
- The "*interdependence test*", under which transactions will be aggregated if "the steps are so interdependent that the legal relations created by one transaction would have been fruitless without a completion of the series."
- The "*binding commitment test*", characterized by the Court as the "most restrictive alternative" under which "a series of transactions are combined only if, at the time the first step is entered into, there was a binding commitment to undertake the later steps."

DGCL §271 – Sale of Substantially all the Assets

Before applying the *Sharon Steel* analysis to the facts before it, the Court addressed the Indenture trustee's claim that the term "substantially all", when used in an indenture's successor obligor provision, provides a corporation with "less freedom of action" than does that same term as used in Section 271 of the Delaware General Corporation Law ("DGCL"). DGCL §271 requires stockholder approval when a corporation proposes to sell "all or substantially all of its property and assets."

The Court rejected this argument, noting that "[t]he term 'substantially all' did not spring forth from the inspired mind of a creative drafter of a form indenture. It has long been part of the corporate lexicon." Moreover, the Court observed that the purposes of the typical indenture successor obligor provision – to "provide corporations with flexibility while protecting bondholders from being severed from the assets that will repay the debt" – and the typical corporate stockholder approval statute – to "allow corporations to engage in [sale of assets] transactions while protecting stockholders against radical change" – "parallel each other and point towards uniform interpretation."

[2] 691 F.2d 1039 (2d. Cir. 1982).

"*Aggregation is not Appropriate*"

Returning to the issue at hand, the Court concluded that because "the Capital Splitoff is not sufficiently connected to the LMI and Discovery spinoffs or the LEI splitoff to warrant aggregating the four transactions," Liberty would not be in violation of the Indenture's successor obligor provision by completing the Capital Splitoff. The Court found that each of the four transactions resulted from a "distinct and independent business decision based on the facts and circumstances that Liberty faced at the time." Furthermore, "[a]lthough the transactions share the same theme of distributing assets to Liberty's stockholders, they were not part of a master plan to strip Liberty's assets out of the corporate vehicle subject to bondholder claims."

In reaching this conclusion, the Court found that none of the three tests discussed in *Sharon Steel* was met. The Court readily dismissed applicability of the "*binding commitment test*", noting that "[n]one of the four transactions was connected contractually to any of the others." Similarly, the "*interdependence test*" was not met because each transaction "was a distinct corporate event separated from the others by a matter of years," none of which "would have been fruitless in isolation." Finally, with respect to the "*end result test*", although the four transactions were "part of Liberty's broad and dynamic business strategy", and despite Liberty management's references to its "disaggregation strategy," the Court found that "Liberty has not pursued a unified disaggregation strategy with a sufficiently well-defined starting point or a sufficiently definitive end result to warrant applying the step-transaction doctrine."

Rather, in the Court's view, Liberty "deployed different tactics depending on the facts on the ground" that "took place over the course of seven years under distinct circumstances." Moreover, any argument that Liberty sought to strip assets to evade paying its creditors was belied by the facts that "[t]he majority of Liberty's debt will not mature for quite some time" and most of the assets Liberty had split off or spun off "were not the type of cash-generating operating businesses to which lenders typically look for repayment." In sum, the Court observed, "[f]ollowing a consistent business strategy and deploying signature M&A tactics does not transmogrify seven years of discrete, context-specific business decisions into a single transaction."

Conclusion

The *Liberty Media* decision, although essentially fact-driven, provides a useful analysis of highly technical concepts frequently encountered by dealmakers and their advisers. Of particular note is the Court's rejection of the Indenture trustee's argument that indenture provisions referring to sales of substantially all of an entity's assets should be interpreted more narrowly than the similar concept as used in DGCL §271. By carefully spelling out the facts driving its decision, the Court has provided something of a roadmap for companies who are pursuing assets sales to determine whether and when indenture successor obligor provisions, as well as DGCL §271, may be triggered.

Please feel free to discuss any aspect of this Client Alert with your regular Milbank contacts or with any of the members of our Corporate Governance Group, whose names and contact information are provided below.

Beijing
Units 05-06, 15th Floor, Tower 2
China Central Place, 79 Jianguo Road, Chaoyang District
Beijing 100025, China

Anthony Root	+86-10-5969-2777	aroot@milbank.com
Edward Sun	+86-10-5969-2772	esun@milbank.com

Frankfurt
Taunusanlage 15
60325 Frankfurt am Main, Germany

Norbert Rieger	+49-89-25559-3620	nrieger@milbank.com

Hong Kong
3007 Alexandra House, 18 Chater Road
Central, Hong Kong

Anthony Root	+852-2971-4842	aroot@milbank.com
Joshua Zimmerman	+852-2971-4811	jzimmerman@milbank.com

London
10 Gresham Street
London EC2V 7JD, England

Stuart Harray	+44-20-7615-3083	sharray@milbank.com

Los Angeles
601 South Figueroa Street, 30th Floor
Los Angeles, CA 90017

Ken Baronsky	+1-213-892-4333	kbaronsky@milbank.com
Neil Wertlieb	+1-213-892-4410	nwertlieb@milbank.com

Munich
Maximilianstrasse 15 (Maximilianhöfe)
80539 Munich, Germany

Peter Nussbaum	+49-89-25559-3430	pnussbaum@milbank.com

New York
One Chase Manhattan Plaza
New York, NY 10005

Scott Edelman	+1-212-530-5149	sedelman@milbank.com
Roland Hlawaty	+1-212-530-5735	rhlawaty@milbank.com
Thomas Janson	+1-212-530-5921	tjanson@milbank.com
Joel Krasnow	+1-212-530-5681	jkrasnow@milbank.com
Alan Stone	+1-212-530-5285	astone@milbank.com
Douglas Tanner	+1-212-530-5505	dtanner@milbank.com
Paul Wessel	+1-212-530-5077	pwessel@milbank.com

São Paulo
Rua Colombia, 325
Jardim América
São Paulo, SP
01438-000

Andrew Janszky	+55-11-3927 7701	ajanszky@milbank.com

Singapore
30 Raffles Place, #14-00 Chevron House
Singapore 048622

David Zemans	+65-6428-2555	dzemans@milbank.com
Naomi Ishikawa	+65-6428-2525	nishikawa@milbank.com

Tokyo
21F Midtown Tower, 9-7-1 Akasaka, Minato-ku
Tokyo 107-6221 Japan

Gary Wigmore	+813-5410-2840	gwigmore@milbank.com

Washington, DC
International Square Building, 1850 K Street, NW
Suite 1100
Washington, DC 20006

Glenn Gerstell	+1-202-835-7585	gerstell@milbank.com