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Despite Applying Step-Transaction Doctrine, Court Does Not Aggregate Transactions and Fails to Find Sale of "Substantially All" Assets

The Court of Chancery, despite application of the step-transaction doctrine, held that independent transactions occurring over a seven year period and not pursuant to a specific plan may not be viewed in the aggregate and thus did not amount to a sale of "substantially all" assets. *Liberty Media Corp. v. The Bank of New York Mellon Trust Co.*, C.A. No. 5702- VCL (Del. Ch. Apr. 29, 2011).

This suit revolves around the proposed splitoff of Liberty Media Corporation and its wholly owned subsidiary, Liberty Media LLC (collectively "Liberty"). Through this proposal, Liberty will create a new entity out of Liberty's Capital Group and Starz Group (the "Capital Splitoff"). Various bondholders objected to the Capital Splitoff arguing that, when considered in the aggregate with three other splitoffs since March 2004, Liberty will have dispensed with "substantially all" of its assets, which Liberty was contractually prohibited from doing. Liberty brought an action for declaratory judgment and injunctive relief. Judgment was entered for Liberty.

The Indenture's Prohibition of Sale or Transfer of "Substantially All" Assets

As a subsidiary of AT&T, Liberty entered into an indenture (the "Indenture"), under which it has approximately $4.213 billion in issued and currently outstanding debt. Under the Indenture, Liberty may not sell or transfer "substantially all" of its assets unless the recipient assumes the obligations under the Indenture. The term "substantially all" is not defined by the Indenture. Under the Indenture, an event of default would occur if Liberty disposed of "substantially all" of its assets where the recipient entity did not assume Liberty's obligations under the Indenture. That would be the case whether it is a single transaction or "a series of transactions," although the Indenture does not specify when transactions should be considered in the aggregate.

In August 2001, AT&T split off Liberty, resulting in a new entity that held a variety of unrelated assets, including numerous minority equity positions. After the splitoff, Liberty developed a strategy to use those minority holdings to acquire controlling ownership in "supporting operating businesses that would generate cash flow." Over the next decade, Liberty pursued transactions in furtherance of that strategy.

The Alleged Disaggregation Strategy

From 2001 to 2003, Liberty's first step was to increase ownership in international cable television companies. However, Liberty's pursuit of becoming a player in international cable hit a rough patch in 2004. In need of capital, Liberty changed course and spun off its entity that held the controlling interest in the international cable television companies purchased from 2001 to 2003, Liberty Media International, Inc. ("LMI"). As of March 31, 2004 and after moving LMI's assets off the balance sheet, Liberty's book value was reduced by 19.4%. (This is the date that the objecting bondholders relied upon for arguing Liberty has dispensed of "substantially all" of its assets.) As with its plans for international cable television, Liberty's strategic endeavors over the subsequent years were a combination of acquisitions and spin offs, which were not necessarily consistent with Liberty's initial strategy:

- In September 2003, Liberty improved its minority interest in QVC, Inc. by acquiring a 56.5% ownership stake.

- From 2003 to 2004, Liberty created Discovery Holding Company, to which Liberty spun off its ownership in Discovery, a cable channel. This move represented 10% of Liberty's book value as of March 31, 2004.

- In 2006, Liberty exchanged its interest in News Corp. for a 38.5% interest in DirecTV, three sports networks, and $550 million. By 2008, Liberty acquired a majority interest in DirecTV, but agreed to cap its voting power at 48.5%. However, Liberty soon realized it could not purchase the rest of DirecTV and in 2009 split it off into a new entity it created called Liberty Entertainment, Inc. ("LEI"). This splitoff accounted for 23% of Liberty's asset base as of March 31, 2004.

- In 2007, Liberty exchanged its minority ownership in CBS Corporation and some of its interest in Time Warner, Inc.

- In 2009, Liberty received shares in Sirius XM Radio Inc., which was convertible into a 40% common stock interest.

- In December 2010, Liberty exchanged its equity ownership in InterActiveCorp ("IAC") for $220 million and ownership of Evite.com and Gifts.com.

- Liberty announced the Capital Splitoff in June 2010. Valued at $9.1 billion, the proposed assets to be split off represent 15% of Liberty's assets as of March 2004.

Aggregation & The Step-Transaction Doctrine

Standing alone, the Capital Splitoff did not comprise substantially all of Liberty's assets. Rather, the question is "whether Liberty's business mix following the Capital Splitoff in 2011 should be compared with Liberty's business mix before the LMI spinoff in March 2004."

The step-transaction doctrine, "treats the 'steps' in a series of formally separate but related transactions involving the transfer of property as a single transaction, if all the steps are substantially linked. Rather than viewing each step as an isolated incident, the steps are viewed together as components of an overall plan." For the step-transaction doctrine to apply, one of three tests must be met:

> "First, under the 'end result test,' the doctrine will be invoked '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.' Second, under the 'interdependence test,' transactions will be treated as one 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 third and 'most restrictive alternative is the binding-commitment test 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.'"

When applying the step-transaction doctrine, the Court may "consider the transactions the debtor had not yet identified at the time its board embarked on its *de facto* liquidation plan."

No Aggregation Here

The Court found that "the Capital Splitoff is not sufficiently connected to the LMI and Discovery spinoffs or the LEI splitoff to warrant aggregating the four transactions. Each of the transactions resulted from a distinct and independent business decision based on the facts and circumstances that Liberty faced at the time." It was not enough that the transactions "share[d] the same theme of distributing assets to Liberty's stockholders," as the transactions were not part of a master plan. Instead, each decision was made in consideration of the specific context Liberty found itself.

Liberty's transactions failed the three tests of the step-transaction doctrine. First, without any contractual connection among the transactions, the binding-commitment test failed. Second, each test "stood on its own merits. None was so interdependent on another that it would have been fruitless in isolation." So, the interdependence test failed. Finally, the end result test failed. Occurring over seven years, the transactions at issue were not part of "a single overarching plan to achieve a desired ultimate result." For example, the decision to spin off Discovery occurred only after Liberty's attempts at obtaining control were stymied. The Court also gave weight to the fact that the transactions occurred over a seven year span, as opposed to closer in time, "[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."

This summary was prepared by Ryan P. Newell.

Ryan Patrick Newell
Connolly Gallagher LLP
The Brandywine Building
1000 West Street, Suite 1400
Wilmington, Delaware 19801
Direct Dial: (302) 888-6434
Fax: (302) 757-7302
E-Mail: rnewell@connollygallagher.com