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What Constitutes a Transfer of "All or Substantially All" of a Borrower's Assets for Purposes of Indentures and Credit Agreements?

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As the credit markets have slowly tightened and borrowers look for creative solutions to delever and refinance their balance sheets outside of bankruptcy, it is important to keep in mind that a transfer that is otherwise allowed under a borrower's debt documents may still be attacked if there are indicia that the transfer is for "all or substantially all" of the borrower's assets.

Indentures and credit agreements often contain standard provisions limiting or prohibiting the ability of borrowers and their restricted subsidiaries from transferring "all or substantially all" of their assets. These provisions provide lenders with a valuable defense—ensuring that the entity to which they loaned money remains the entity from which they can expect and seek repayment—even when the debt documents otherwise provide the borrower with the ability to transfer valuable assets away from a lender's collateral or guarantor pool. Accordingly, it is important for lenders and borrowers alike to understand how courts evaluate whether a transfer violates an "all or substantially all" restriction.

Two Perspectives

Although "all or substantially all" provisions have become ubiquitous, there is a surprising lack of case law analyzing whether transfers may violate those restrictions in debt documents. In the limited circumstances in which these provisions have been addressed, courts have recognized that "to promote market stability," a uniform interpretation of such provisions is appropriate. *See Bank of N.Y. Mellon Trust Co. v. Liberty Media Corp.*, 29 A.3d 225, 241 (Del. 2011) (applying New York law).

The courts have established two doctrines to determine whether a transfer constitutes "all or substantially all" of a borrower's assets. Most courts evaluate "all or substantially all" transfers both from a quantitative and qualitative perspective. Additionally, in certain circumstances, courts will aggregate a series of transfers and evaluate them as one when determining whether a transfer violated an "all or substantially all" restriction.

Many courts focus on the "quantitative vitality" of a transfer. *See Hollinger Inc. v. Hollinger Int'l*, 858 A.2d 342, 380 (Del. Ch. 2004). In making that determination, courts consider factors such as: (i) the revenue generated by the asset transferred as compared to the total enterprise, (ii) the potential future cash-flow of the asset as compared to the total enterprise, (iii) the amount of EBIDTA contributed by the asset, and (iv) the asset's percentage of the borrower's total book value. *Id.* at 379-81; *see also HFTP Investments v. Grupo TMM, S.A.*, 2004 WL 5641710, at *3-6 (Sup. Ct. N.Y. C'ty. Jun. 4, 2004).

Even when a transfer might arguably violate an "all or substantially all" provision from a quantitative perspective, courts nevertheless "weigh both the quantitative and qualitative factors as a totality" before making a determination that an "all or substantially all" provision has been violated. *See In re BankAtlantic Bancorp, Inc. Litig.*, 39 A.3d 824, 838 (Del. Ch. 2012) (applying New York law); *Roseton OL v. Dynegy Holdings*, No. CIV.A. 6689-VCP, 2011 WL 3275965, at *13 (Del. Ch. July 29, 2011) (applying New York law and finding that, even though a transfer arguably violated the operative "all or substantially all" restriction from a quantitative perspective, the transfer was permitted because of its qualitative nature). The qualitative portion of the "all or substantially all" analysis is guided by the following factors: (1) whether the transfer "changed the nature or character of the entity's business," (2) whether the transfer "involves primarily the entity's operating assets, rather than its liquid assets," and (3) whether the transfer "was one not in the normal and regular course of the entity's business." *HFTP*, 2004 WL 5641710, at *7; *see also Bancorp,* 39 A.3d at 838.

The court's qualitative analysis considers a transfer in terms of its overall effect on the corporation. Put another way, "the guiding inquiry" in evaluating whether a transfer is for "all or substantially all" of a borrower's assets is whether, by virtue of the transfer, the borrower would "cease to operate the business to which, in practical effect, the debentureholders have looked for payment of the debentures." *Bancorp,* 39 A. 3d at 838 (citation and internal quotations omitted). For instance, courts applying New York law have held that when a transfer does not change the borrower's core business, the transfer may not violate the operative "all or substantially all" restriction. *See, e.g.*, *Roseton*, 2011 WL 3275965, at *13 (holding, in the alternative, that transfer was not for "all or substantially all" of a borrower's assets where, among other things, transferees remained subsidiaries of the transferor, and thus "any assets transferred to them are not being transferred away from [the borrower's] ultimate

ownership"); (citing *Bank of New York v. Tyco Int'l Group, S.A.*, 545 F. Supp. 2d 312, 320-21 (S.D.N.Y. 2008)); *see also, e.g.*, *Resnick v. Karmax Camp*, 540 N.Y.S.2d 503, 504 (2d Dept. 1989) (holding, in a related context, that transfer of respondent's operations to newly-formed wholly-owned subsidiaries was not for "all or substantially all" of respondent's assets because, among other things, "these transactions did not result in a liquidation…of the…business operated by the respondent").

Finally, when making a determination as to whether a transfer is for "all or substantially all" of a borrower's assets, New York courts will aggregate a series of transfers that were conducted as part of an overall plan in order to analyze the series as a single transfer. In the leading case addressing "all or substantially all" provisions in the context of debt documents, *Sharon Steel Corp. v. Chase Manhattan Bank*, the U. S. Court of Appeals for the Second Circuit held that when a transfer is made as part of a borrower's plan to liquidate its assets, the court should aggregate the multiple interrelated transfers as one when conducting the "all or substantially all" analysis. 691 F.2d 1093, 1051 (2d Cir. 1982).

Reaffirming this holding, the Delaware Supreme Court, applying New York law, held that aggregation of multiple steps in a transfer is appropriate whenever a series of transfers are part of a plan of liquidation "and not where each transaction stands on its own merits without reference to the others." *Liberty Media*, 29 A.3d at 243 (citing *Sharon Steel*, 691 F.2d at 1051).

Ongoing Litigation

As the credit markets have slowly tightened and borrowers look for creative solutions to delever and refinance their balance sheets outside of bankruptcy, it is important to keep in mind that a transfer that is otherwise allowed under a borrower's debt documents may still be attacked if there are indicia that the transfer is for "all or substantially all" of the borrower's assets. This contention was raised by a group of lenders in the ongoing litigation regarding J. Crew's December 2016 and July 2017 transfers of certain of its intellectual property to a wholly-owned subsidiary and subsequent refinancing of its payment-in-kind unsecured notes. The lenders there argued that the transfers, and J. Crew's amendment of its credit agreement to ratify those transfers, were invalid because the credit agreement barred amendments affecting "all or substantially all" of the company's assets without unanimous lender consent. Because, as the lenders' argued, the transfers were for "all or substantially all" of J. Crew's assets, and because they did not consent to the amendment, the amendment was not effective and breached the agreement. *See Eaton Vance Management v. Wilmington Sav. Fund Soc., FSB*, 2018 N.Y. Slip Op. 30727(U), at *6-7 (Sup. Ct. N.Y. C'ty. Apr. 25, 2018) (recognizing that if the lenders prove that the transfers were for "all or substantially all" of J. Crew's assets, the amendment "would have been violative of the 2014 Agreement" and the lenders "would be

able to seek redress for this breach"). Discovery relating to the "all or substantially all" issues is currently underway and no decision has yet been rendered.

Similarly, the indenture trustee for the Global Marine 2028 7% notes recently brought suit against Global Marine arguing that through a series of transfers spanning over a decade—during which, as alleged in the complaint, Global Marine engaged in a campaign to transfer 32 out of its 33 operational offshore drilling rigs and ceased to operate as "one of the largest offshore drilling contractors in the world"—Global Marine transferred "all or substantially all" of its income-producing assets in violation of the indenture's restriction on such transfers. As with J. Crew, the litigation is pending.

Conclusion

As the above cases demonstrate, notwithstanding whether a transfer may be facially permitted under a borrower's debt documents, before engaging in any transfers relating to a borrower's primary assets — whether individually or through a series — market participants engaging in out of court restructurings should be mindful of any "all or substantially all" transfer restrictions, lest the transaction be subject to a subsequent challenge.

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