

When Do a Company's Assets Include Assets of Its Subsidiaries?

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In *Roseton OL, LLC v. Dynegy Holdings, Inc.*, C.A. No. 6689-VCP 2011 Del. Ch. LEXIS 113 (Del. Ch. July 29, 2011), the Court of Chancery found that plaintiffs were not likely to succeed on the merits of their claims that a proposed transfer by Dynegy Holdings, Inc. (“DHI”) of the entire equity interest in some of its subsidiaries would violate a restrictive covenant in guaranties DHI made in favor of plaintiffs’ parent company that prohibited DHI from transferring “its properties and assets substantially as an entirety.” (emphasis added). The DHI subsidiaries held DHI’s most profitable power plants, and DHI was proposing to transfer its equity interest in those subsidiaries to newly formed bankruptcy remote subsidiaries. In reaching its decision, the Court relied largely on a comparison of the restrictive covenant at issue with another restrictive covenant in the guaranties that prohibited DHI “and any Principle Subsidiary” from taking action with respect to certain liens. According to the Court, “this demonstrated that when the parties intended to make a particular restriction applicable to both DHI and its subsidiaries, they knew how to do so.” *Id.* at *41. Since the provision at issue only prohibited DHI from selling “its properties and assets substantially as an entirety,” the Court found that plaintiffs were not likely to succeed on the merits of their claims and denied the plaintiffs’ request for a preliminary injunction. An appeal to the Delaware Supreme Court was subsequently denied.

The principle of contract construction articulated by the Court of Chancery in *Roseton OL, LLC v. Dynegy Holdings, Inc.*—that the use of a restriction in one provision of a contract evidences the parties’ intent not to include such a restriction in other provisions is consistent with Delaware law. While not cited in *Roseton OL, LLC*, the Court of Chancery’s opinion in *Superwire.com, Inc. v. Hampton*, 805 A.2d 904 (Del. Ch. 2002) applied the same principle to find that an ambiguous provision in a certificate of designations did not restrict a company from issuing a class of preferred stock where another provision in the designation contained a clear and unequivocal provision prohibiting the company from issuing other classes of preferred stock. The Court stated: “Obviously, the drafters of the Certificate of Designation knew how to prohibit share issuances when they meant to do so.” *Id.* at 911.

Had the guarantee not contained the second restrictive covenant that specifically referred to DHI and its subsidiaries, the decision may have been decided differently. Section 271 of the Delaware General Corporation Law (the “DGCL”) specifically provides that the assets of wholly owned subsidiaries of a parent corporation are consolidated with the assets of the parent corporation when determining whether the parent has sold “substantially all of its property and assets” such that a vote of the parent’s stockholder is required under the DGCL. *See* 8 *Del. C.* 271(a), (c). Further, in *Liberty Media Corp. v. Bank of N.Y. Mellon Trust Co., N.A.*, 2011 Del. Ch. LEXIS 66 (Del. Ch. Apr. 29, 2011), *aff’d*, the Court found that the terms “substantially all” in a

restrictive covenant in an indenture governed by New York law should be read consistently with Section 271 of the DGCL.

However, it is not entirely clear that a different result would have ensued had the guaranties at issue in *Roseton OL, LLC*, not contained a restrictive covenant addressing both DHI and its subsidiaries, especially if the context had been the interpretation of a preferred stock designation. In *In re Sunstates Corp. S'holder Litig.*, 788 A.2d 530 (Del. Ch. 2001), the Delaware Court of Chancery held that a corporation did not violate a restrictive covenant in a designation for one of its series of preferred stock, which prohibited the company from repurchasing its shares of preferred and common stock when dividends were in arrears, by allowing its subsidiaries to repurchase such shares. Preferred stock terms are narrowly construed under Delaware law, and the Court relied on this rule in reaching its decision. *See id.* at 535.