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Sale of Less than 60 Percent of a Corporation's Assets Will Not Constitute a Sale of "Substantially All" under Section 271 of the Delaware General Corporation Law if the Remaining Assets are Economically Vital

On July 29, 2004, Vice Chancellor Leo Strine of the Delaware Chancery Court rendered an important decision in the case of Hollinger Inc. v. Hollinger International Inc.[1] on the meaning of "substantially all" the assets of a Delaware corporation under Section 271 of the Delaware General Corporation Law. Section 271 authorizes a Delaware corporation to sell "all or substantially all of its property and assets, including goodwill and corporate franchises" only with the approval of its stockholders.

The decision is an important guide for senior management and boards of directors contemplating major asset sales without stockholder approval.

The case arose on a motion for a preliminary injunction by Hollinger Inc. ("Canadian Hollinger"), a Canadian investment company controlled by Conrad Black, to prevent its affiliate, Hollinger International Inc., a publicly traded Delaware corporation ("International"), from completing its announced sale of a major asset, the *Daily Telegraph* newspaper of London, to a company controlled by Sir David and Sir Frederick Barclay of Great Britain. Canadian Hollinger owns 18 percent of the equity of International but holds 68 percent of International's voting securities through Canadian Hollinger's ownership of super-voting Class B shares. Canadian Hollinger sought a stockholder vote in which it would control the outcome.

Vice Chancellor Strine denied the motion for a preliminary injunction and, following the decision of a three-judge panel of the Delaware Supreme Court not to stay or enjoin the transaction pending appeal, the sale of the *Telegraph* to the Barclays was completed.

In his opinion, emphasizing that it is a fundamental principle of Delaware law to apply statutes in accordance with their plain meaning, the Vice Chancellor reviewed several dictionary definitions of "substantially all." The definition he preferred was "essentially everything." The Vice Chancellor went on to apply the facts of this case to the standards articulated in the key Delaware decision, Gimbel v. Signal Cos.[2] In order to require a stockholder vote, Gimbel first provided that the assets

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[1] C.A. No. 543-N, decided July 29, 2004

[2] 316 A.2d 599 (Del. Ch.)

being sold must be vital to the operations of the corporation. Canadian Hollinger argued that the *Telegraph* sale constituted a sale of 56-57 percent of International's asset value (an argument the Vice Chancellor did not accept). By contrast, the measures cited by International for total assets, operating assets, revenues and EBITDA, showed that the sale of the *Telegraph* constituted approximately half or less than half of International, depending on which measure was used. The opinion contains detailed charts submitted by International regarding the composition of International's assets, revenues and EBITDA. Based on a review of these measures and other information, the Vice Chancellor concluded that the sale of the *Telegraph* was not "quantitatively vital" to the operations of International and that the remaining businesses were "profitable, valuable economic assets." The Vice Chancellor concluded in essence that a sale of less than 60 percent of these measures of value did not meet the Section 271 test of "substantially all," if the remaining assets were "quantitatively vital economic asset[s]."

The Vice Chancellor also pointed to a second test in Gimbel, a qualitative test that a sale not "substantially affect the existence and purpose" of the corporation without a stockholder vote. Stating that the relationship of the quantitative and qualitative tests in Gimbel is unclear, the Vice Chancellor suggested that both the quantitative and qualitative tests may in fact be the same – a sale cannot "substantially affect the existence and purpose" of a corporation if it is not "quantitatively vital." He pointed to International's long history of buying and selling newspapers, including an earlier sale of Canadian newspapers constituting half of the enterprise at that time, without a stockholder vote. He determined that the sale of a "trophy" asset, such as the *Telegraph*, or even the sale of its most valuable asset, would not have "substantially affected the existence and purpose" of International based on the nature and vitality of the assets remaining. After the sale, the Vice Chancellor determined, International's stockholders will remain investors in a profitable company, and the sale did not "strike a blow to International's heart."

Canadian Hollinger also advanced a non-statutory equitable argument for a stockholder vote based on the fact that a consent decree entered in the United States Federal District Court for the Northern District of Illinois, and an earlier injunction entered against Canadian Hollinger, Conrad Black and certain other parties in a case before Vice Chancellor Strine, interfered with Canadian Hollinger's ability as the stockholder with a majority of the votes from removing the board of directors of International. Canadian Hollinger argued that it was prevented from approving the sale at the board level and therefore should have a right to do so at the stockholder level. The Vice Chancellor had little sympathy for the equitable argument. Pointing, among other things, to the fact that Canadian Hollinger had chosen and elected the very independent directors who approved the *Telegraph* sale, the Vice Chancellor declared that "controlling stockholders have no inalienable right to usurp the authority of boards of directors they elect." Instead, he concluded that controlling stockholders, like all other stockholders, must "live with the informed (i.e., sufficiently careful) and good faith (i.e., loyal) business decisions of the directors unless the DGCL requires a vote.

Another issue in the case involved International's assertion that the sale of the *Telegraph* could not require International stockholder approval under Section 271 because the stock of the *Telegraph* being sold was owned by wholly owned subsidiaries of International and by not International itself. After the sale, International would still own the stock of the same subsidiaries, which would then hold cash rather than the stock of the *Telegraph*. Since all of the subsidiaries had properly maintained their corporate formalities, to hold otherwise, International asserted, would raise serious issues of Delaware corporate law about validity of the use of corporate subsidiaries. Vice Chancellor Strine elected not to rule on this issue because he found other grounds to determine that the sale did not constitute "substantially all" under Section 271. The opinion does, however, contain important suggestions that the Vice Chancellor did not favor this interpretation of Section 271 when a parent corporation orchestrates and participates in a transaction effected through its wholly owned subsidiaries.

Paul, Weiss, Rifkind, Wharton & Garrison LLP served as counsel to Hollinger International in the matter described in this memorandum, along with Delaware counsel Young, Conaway, Stargatt & Taylor LLP.

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This memorandum constitutes only a general description of the *Hollinger* opinion. It is not intended to provide legal advice and no legal or business decision should be based on its contents. Any questions concerning the foregoing should be addressed to any of the following firm partners:

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