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# Tearin' up iHeart: The Recent Trend with Troubled Companies and The Unrestricted Subsidiary Transfer Tactic

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# TEARIN' UP iHEART: THE RECENT TREND WITH TROUBLED COMPANIES AND THE UNRESTRICTED SUBSIDIARY TRANSFER TACTIC

## I. INTRODUCTION

Controlling shareholders ("controllers"[1]) of various struggling companies have recently inspired news stories by using an innovative strategy called "The Unrestricted Subsidiary Transfer Tactic."[2] The Unrestricted Subsidiary Transfer Tactic involves controller use of unrestricted subsidiaries to skirt loan covenant restrictions.[3] Complaints filed by lenders and minority shareholders demonstrate the concerns that this tactic generates.[4] The cases centered on the use of The Unrestricted Subsidiary Transfer Tactic by iHeartMedia, Inc. ("iHeart") have been resolved in iHeart's favor thanks to established case law surrounding loan covenant review and the fiduciary duties of controllers to minority shareholders.[5] However, one recent Delaware Supreme Court case reaffirmed certain internal measures which could protect parent corporations that wish to draw resources from their unrestricted subsidiaries from liability.[6]

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1. Flood v. Synutra Int'l, Inc., 195 A.3d 754, 756 (Del. 2018) (using the term "controller" pervasively in reference to the controlling shareholder); JAMES D. COX & THOMAS LEE HAZEN, BUSINESS ORGANIZATIONS LAW § 11.11, at 271 (4th ed. 2016) (describing a controller, or controlling stockholder, as a "person [or organization which] owns a majority of the voting shares" of a corporation).

2. Emma Orr, *Retail's Creditors Left Grasping as Brands Are Put out of Reach,* CHICAGO TRIB. (Feb. 23, 2017, 9:04 AM), http://www.chicagotribune.com/business/ct-retail-creditors-owners-20170223-story.html (summarizing use of unrestricted subsidiaries in J. Crew and Claire's transactions).

3. Franklin Advisers, Inc. v. iHeart Commc'ns Inc., No. 04-16-00532-CV, 2017 WL 4518297 (Tex. App. Oct. 11, 2017) (displaying aggrieved lender iHeart case this note analyzes); Gamco Asset Mgmt. Inc. v. iHeartMedia Inc., No. 12312, 2016 WL 6892802 (Del. Ch. Nov. 23, 2016, revised Nov. 29, 2016) (displaying aggrieved minority shareholder iHeart case this note analyzes), *aff'd,* No. 593, 2017 WL 4607413 (Del. Oct. 12, 2017); Orr, *supra* note 2 (summarizing use of unrestricted subsidiaries in J. Crew and Claire's transactions).

4. *Franklin Advisers, Inc.*, 2017 WL 4518297; *Gamco Asset Mgmt. Inc.*, 2016 WL 6892802; Orr, *supra* note 2.

5. *Gamco Asset Mgmt. Inc.*, 2016 WL 6892802 ("[iHeart] is a Delaware corporation engaged in the mass media industry. Through its subsidiaries, iHM owns and operates more than 850 radio stations throughout the United States, making it the largest owner and operator of radio stations in the nation."); *see infra* Parts II-III.

6. *See Flood*, 195 A.3d at 756 (proposing "approval by an independent Special Committee and an affirmative vote by a majority of the minority stockholders" as such a curative means).

This Note discusses the reasons why the iHeart cases were correctly decided and what these decisions mean for The Unrestricted Subsidiary Transfer Tactic moving forward.[7] Part II explains The Unrestricted Subsidiary Transfer Tactic and then summarizes the iHeart cases as a collective example of a transfer of assets by a controller, iHeart's subsidiary iHeartCommunications ("iHC"), from restricted subsidiary Clear Channel Outdoor Holdings ("CCOH") to unrestricted subsidiary Broader Media.[8] Part III delves into the legal concepts involved in The Unrestricted Subsidiary Transfer Tactic and why those concepts demonstrate that the iHeart cases were decided correctly.[9] Part IV describes the proposed curative methods based upon the iHeart decisions and then reviews more recent and ongoing lawsuits filed because of controller use of The Unrestricted Subsidiary Transfer Tactic.[10] Part V then concludes the Note.[11]

## II. UNRESTRICTED SUBSIDIARIES AND IHEART'S CRITICAL CONDITION

### A. *Overview of Unrestricted Subsidiaries as a Parent Debtor's Tactic*

Certain companies have found themselves in positions where they are unlikely to meet the obligations under their lending covenants.[12] These troubled companies stand to lose assets that are either held by the companies themselves or that are held by their subsidiaries as pursuant to their loan obligations.[13] As is standard practice, these loan packages require that the borrowing company, and any of its subsidiaries, restrict certain actions as outlined in finance documents or agreements.[14]

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7. *See infra* Parts II–IV.

8. *Franklin Advisers, Inc.*, 2017 WL 4518297; *Gamco Asset Mgmt. Inc.*, 2016 WL 6892802; *see infra* Part II.

9. *See infra* Part III.

10. *See Flood*, 195 A.3d at 756 (proposing "approval by an independent Special Committee and an affirmative vote by a majority of the minority stockholders" as such a curative means); *see also infra* Part IV.

11. *See infra* Part V.

12. Orr, *supra* note 2 (furnishing J. Crew Group Inc. and Claire's Stores Inc. as two examples).

13. Orr, *supra* note 2 (providing intellectual property like a recognizable company name as one such asset).

14. COLIN CHANG ET AL., WHITE & CASE LLP, CLIENT ALERT: THINKING OUTSIDE THE BOX: THE BASICS OF UNRESTRICTED SUBSIDIARIES (June 2, 2017), https://www.whitecase.com/publications/alert/thinking-outside-box-basics-unrestricted-subsidiaries ("A typical

Restricted activities can include incurring additional debts, selling assets, and paying dividends.[15] The borrowing company and its subsidiaries that are subject to these restrictions are defined collectively as the "restricted group."[16] Subsidiaries become part of the restricted group unless they have been designated by the borrower as "unrestricted subsidiaries."[17] Unrestricted subsidiaries can protect assets such as money[18] or intellectual property[19] from seizure in the event the borrower cannot pay back the loan because assets within an unrestricted subsidiary are not subject to the respective loan agreements.[20] Borrowers make such designations because unrestricted subsidiaries do not have to adhere to loan covenant restrictions.[21] However, this designation turns the unrestricted subsidiary into something of a third party which cannot flexibly engage in inter-

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covenant package will limit a corporate group from taking certain actions by applying restrictions to a designated entity . . . and its 'Restricted Subsidiaries.'").

15. *Id.*

16. *Id.*

17. Maura O'Sullivan & Benjamin Cheng, *Term Loans and High Yield Bonds: Tracking the Convergence*, Practical Law Article 5-520-2458 (differentiating between restricted and unrestricted subsidiaries in the context of loan agreements); *see also* MICHAEL FRIEDMAN ET AL., CHAPMAN AND CUTLER LLP, CLIENT ALERT: WHAT YOU NEED TO KNOW ABOUT UNRESTRICTED SUBSIDIARIES (Feb. 9, 2017), https://www.chapman.com/insights-publications-Restructure_Covenants_Capital_Structure.html. Friedman describes the circumstances under which subsidiaries may be designates as unrestricted:

> Financing agreements will typically permit the company to designate a subsidiary as an "unrestricted subsidiary" if certain conditions are satisfied. Such conditions may include: (1) that such subsidiary at the time of determination would not hold liens on, indebtedness of, or equity interests in its parent company or a restricted subsidiary; (2) that the company is permitted by the financing agreement covenants to make an investment in the unrestricted subsidiary in an amount equal to, or greater than, the fair market value of such unrestricted subsidiary; (3) that the company and its restricted subsidiaries are not responsible for any debt incurred by such unrestricted subsidiary; and/or (4) that the debt incurrence test (contained in the restrictions on indebtedness covenant) must be satisfied at the time of, and after giving effect to, the designation of such unrestricted subsidiary.

*Id.*

18. Gamco Asset Mgmt. Inc. v. iHeartMedia Inc., No. 12312, 2016 WL 6892802, at *7 (Del. Ch. Nov. 23, 2016, revised Nov. 29, 2016) (describing the process by which money assets were protected using The Unrestricted Subsidiary Transfer Tactic), *aff'd,* No. 593, 2017 WL 4607413 (Del. Oct. 12, 2017).

19. Orr, *supra* note 2 (providing that intellectual property, like a recognizable company name, is an asset that can be protected using the unrestricted subsidiary tactic).

20. FRIEDMAN ET AL., *supra* note 17.

21. O'Sullivan & Cheng, *supra* note 17.

affiliate transactions with restricted group members as restricted group members can with one another.[22]

Distressed companies, such as iHeart, have used The Unrestricted Subsidiary Transfer Tactic to alleviate their debt pressures.[23] In fact, parent companies have gone so far as to create unrestricted subsidiaries for the purpose of receiving assets from a restricted subsidiary.[24] The parent can then use the assets transferred to the unrestricted subsidiary as collateral to back new debts that are then used to pay back the original debt.[25]

Investors have been frustrated by the use of unrestricted subsidiaries to skirt obligations to creditors.[26] To investor-creditors, the unrestricted subsidiary tactic constitutes an event of default.[27] Despite these

22. CHANG, *supra* note 14 ("[T]here are several advantages to being in the Restricted Group, which are often overlooked. This includes unlimited transfers of assets, intra-group loans and capital contributions/investments as well as all actions permitted under the Affiliate Transactions and other relevant covenants.").

23. *See* Orr, *supra* note 2 (summarizing use of unrestricted subsidiaries in J. Crew and Claire's transactions).

24. Second Amended Counterclaims at 4, 20, Argos Holdings, Inc. v. Wilmington Tr., N.A., No. 1:18-cv-05773 (S.D.N.Y. filed Oct. 15, 2018) (stating that PetSmart created unrestricted subsidiary Buddy Chester Corp, which is 100% privately owned by PetSmart, to receive equity assets from restricted subsidiary Chewy.com); Eliza Ronalds-Hannon & Katherine Doherty, *PetSmart Moves Part of Chewy.com out of Creditors' Reach*, BLOOMBERG (June 4, 2018, 6:31 PM), https://www.bloomberg.com/news/articles/2018-06-04/petsmart-is-said-to-move-chewy-stake-in-j-crew-style-transfer (stating PetSmart's transfer "mimics asset transfers initiated by other distressed retailers, especially those owned by private equity sponsors," and then noting that "J. Crew Group Inc. and Claire's Stores Inc. have created subsidiaries to hold assets including intellectual property, insulating them from creditors while freeing them up for use as collateral to back new debts"). *But see* Gamco Asset Mgmt. Inc. v. iHeartMedia Inc., No. 12312, 2016 WL 6892802, at *7 (Del. Ch. Nov. 23, 2016, revised Nov. 29, 2016) (describing the iHeart unrestricted subsidiary transfer that took place December, 2015), *aff'd,* No. 593, 2017 WL 4607413 (Del. Oct. 12, 2017); *Broader Media, LLC: Private Company Information*, BLOOMBERG (Oct. 27, 2018, 5:40 PM), https://www.bloomberg.com/research/stocks/private/snapshot.asp?privcapId=319095502 (providing that iHeart unrestricted subsidiary Broader Media was founded in 2009).

25. FRIEDMAN ET AL., *supra* note 17 ("[I]n some cases, the parent of the unrestricted subsidiary is free to grant liens to third parties on the stock of the unrestricted subsidiary."); Jodi Xu Klein, *Distressed Retailers Scour Loan Fine Print for Debt Tactics*, BLOOMBERG (Dec. 20, 2016), https://www.bloomberg.com/news/articles/2016-12-20/distressed-retailers-scour-loan-fine-print-for-debt-strategies (describing J. Crew's use of The Unrestricted Subsidiary Transfer Tactic "to shift its brand name . . . to an unrestricted entity in the Cayman Islands" to allow the company "to borrow against the assets and use the proceeds to buy back a portion of its roughly $2 billion in debt at a discount").

26. Second Amended Counterclaims at 3, Argos Holdings, Inc. v. Wilmington Tr., N.A., No. 1:18-cv-05773 (S.D.N.Y. filed Oct. 15, 2018) (providing investor description of the PetSmart unrestricted subsidiary transfer as "a corporate shell game designed to impair PetSmart's existing creditors"); FRIEDMAN ET AL., *supra* note 17 (describing agitation felt by investors in the iHeart and J. Crew cases which led to litigation).

27. FRIEDMAN ET AL., *supra* note 17 (referencing default notices sent by investors in the iHeart and J. Crew cases after the transfers to unrestricted subsidiaries).

sentiments, courts have recently upheld uses of unrestricted subsidiaries by well-known companies J. Crew Group, Inc. ("J. Crew") and iHeart.[28] Because the J. Crew actions were resolved by a settlement made between J. Crew and its lender,[29] only "the iHeart actions"[30] offer an opportunity to examine why the current legal environment surrounding unrestricted subsidiary transfers needs revision.[31]

### *B. Case History on the iHeart Actions*

The iHeart actions involved parent company iHeart, subsidiary iHeartCommunications ("iHC"),[32] iHC restricted subsidiary Clear Channel Holdings ("CC Holdings"),[33] CC Holdings publicly-traded restricted subsidiary Clear Channel Outdoor Holdings ("CCOH"),[34] and iHC

28. Franklin Advisers, Inc. v. iHeart Commc'ns Inc., No. 04-16-00532-CV, 2017 WL 4518297, at *4 (Tex. App. Oct. 11, 2017) (holding that use of Unrestricted Subsidiary Transfer Tactic was not violative of lending agreement); Eaton Vance Mgmt. v. Wilmington Sav. Fund Soc., FSB, No. 654397, 2018 WL 1947405, at *10-11 (N.Y. Sup. Ct. Apr. 25, 2018) (holding that no-action clause of lending agreement between J. Crew and WSFS barred Eaton Vance creditors from bringing fraud suit against J. Crew for transfer of assets to unrestricted subsidiary, as the J. Crew v. WSFS action was discontinued); *Gamco Asset Mgmt. Inc.*, 2016 WL 6892802 (holding the facts alleged by plaintiff in derivative suit flowing from iHeart asset transfer failed to sufficiently rebut the presumption under the business judgment rule that iHeartMedia transferred assets to unrestricted subsidiary CCOH in good faith such that defendant's motion to dismiss was granted).

29. *Eaton Vance Mgmt.*, 2018 WL 1947405, at *10-11 (holding that a settlement between J. Crew and a majority meant minority owner plaintiffs could not bring suit against J. Crew for asset transfer to unrestricted subsidiary due to no-action clause, which only allowed such actions to be brought by a majority of shareholders).

30. Note refers to both *Franklin Advisers, Inc.*, 2017 WL 4518297 and *Gamco Asset Mgmt. Inc.*, 2016 WL 6892802 collectively as "the iHeart actions."

31. *Franklin Advisers, Inc.*, 2017 WL 4518297, at *4 (concluding iHeart unrestricted subsidiary transfer to be a permissible investment); *Gamco Asset Mgmt. Inc.*, 2016 WL 6892802, at *16-19 (concluding iHeart unrestricted subsidiary transfer not to be a conflicted transaction).

32. *Gamco Asset Mgmt. Inc.*, 2016 WL 6892802, at *3 ("iHC, formerly known as Clear Channel Communications, Inc., is a Texas corporation and an indirect wholly owned subsidiary of iHM.").

33. *Franklin Advisers, Inc.*, 2017 WL 4518297, at *3 (acting as restricted subsidiary of iHC and as both controller and parent company of CCOH); *Clear Channel Holdings Inc*, BLOOMBERG, https://www.bloomberg.com/profiles/companies/1804881Z:US-clear-channel-holdings-inc (last visited Feb. 9, 2019) (stating that CC Holdings is privately owned).

34. *Gamco Asset Mgmt. Inc.*, 2016 WL 6892802, at *3 ("CCOH is a Delaware corporation. It is among the largest providers of outdoor or 'out-of home' advertising in the United States and throughout the world. It owns and operates more than 650,000 outdoor advertising displays worldwide . . . ."); Clear Channel Outdoor Holdings Inc., Registration Statement Under the Securities Act of 1933 (Form S-1) (Nov. 9, 2005) (detailing the CCOH initial public offering).

unrestricted subsidiary Broader Media.[35] Two cases comprise the iHeart actions, each of which centers upon iHC using its controlling interest of CCOH to transfer assets from CCOH to unrestricted subsidiary Broader Media.[36] In the first case, iHC filed suit against investment fund management firms and iHC debt holders Franklin Advisers Inc., Oz Management LP, Oz Management II LP, and Benefit Street Partners LLC ("Franklin and Oz").[37] This suit stemmed from a transfer of CCOH assets to Broader Media.[38] In the second case, CCOH minority investor Gamco filed suit against iHC, alleging that the transfer constituted a controlling shareholder breach of the duty of loyalty to minority shareholders.[39] At that time, Gamco and its affiliates owned roughly ten percent of outstanding CCOH publicly-offered common stock while iHC owned the remainder, hence their status as controller of CCOH.[40]

As of the beginning of 2015, CCOH was in a sufficiently strong financial situation to contemplate acquisition opportunities.[41] By September of that year, CCOH made an about-face and instead decided to sell assets.[42] The decisions regarding these sales were made at a meeting between the iHeart, iHC, and CCOH boards of directors.[43] In November, CCOH decided to distribute the proceeds from the September asset sales as dividends so that iHC could use their portion to bail iHeart out of its

35. *Franklin Advisers, Inc.*, 2017 WL 4518297, at *4 ("On December 3, 2015, [iHC] directed one of its restricted subsidiaries, CC Holdings, to transfer $516 million worth of shares of Clear Channel Outdoor Holdings stock to one of [iHC's] unrestricted subsidiaries, Broader Media.").

36. *Id.*; *Gamco Asset Mgmt. Inc.*, 2016 WL 6892802, at *6–7.

37. *Franklin Advisers, Inc.*, 2017 WL 4518297, at *1 ("On March 7, 2016, some of the noteholders issued formal notices of default. On the same day, [iHC] filed the underlying suit in which it sought declarations that it had not violated the indentures and was not in default on the notes. [iHC] also sought injunctive relief.").

38. *Id.* (describing the asset transfer); *see infra* Part III.

39. *Gamco Asset Mgmt. Inc.*, 2016 WL 6892802, at *1 ("Gamco filed a Verified Stockholder Derivative Complaint . . . against members of the CCOH Board, iHC, an iHC affiliate and certain financial sponsors . . . .").

40. *Id.* at *3 ("Gamco, along with certain of its affiliates, owned 9.9% of the outstanding publicly-traded Class-A common stock of CCOH. . . . iHC owns approximately 90% of CCOH's outstanding shares . . . .").

41. *Id.* at *6 ("[I]n early 2015, CCOH was in an acquisitions mode. In February and May 2015, the Board received reports of particular acquisition opportunities in strategic markets, such as New York City.").

42. *Id.* ("By September 2015, in a rather abrupt volte-face, the discussion turned from new acquisitions to potential sales of assets.").

43. *Id.* ("At a joint meeting of the Boards of CCOH and the iHeart Defendants on September 29, 2015, the directors in attendance discussed selling certain CCOH Latin American businesses and certain United States assets and considered recommendations regarding the retention of financial advisors for the asset sales.").

debt obligations through the end of 2017.[44] On December 3, 2015, iHC tapped CCOH parent CC Holdings to use The Unrestricted Subsidiary Transfer Tactic by initiating the transfer of $516 million worth of CCOH stock to iHC's unrestricted subsidiary Broader Media.[45] As a result of the transfer, CCOH stock moved from its parent CC Holdings to an extraneous unrestricted subsidiary, meaning that Gamco's minority shares were no longer buttressed by those assets.[46]

The transfer of shares to Broader Media was the first step in a scheme wherein CCOH made a series of dividend payments.[47] The only aspect of these payments with importance to this Note is that Broader Media received *pro rata* dividend payments along with all other shareholders.[48] These payments only came in because iHC controlled both CC Holdings and Broader Media and orchestrated the transfer of CCOH shares from the former to the latter.[49] Franklin and Oz believed the stock transfer to Broader Media violated certain indenture terms and accordingly constituted an event of default.[50] iHC sued Franklin and Oz for a declaratory judgment that the transfer did not trigger a default.[51] Meanwhile, Gamco believed the dividend payments were an unfair monetary boon to iHeart and iHC at minority shareholder expense.[52] Gamco sued iHeart.[53] Both cases were resolved in iHeart's favor at the trial and appellate levels.[54]

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44. *Id.*

45. Franklin Advisers, Inc. v. iHeart Commc'ns Inc., No. 04-16-00532-CV, 2017 WL 4518297, at *4 (Tex. App. Oct. 11, 2017) ("On December 3, 2015, [iHC] directed one of its restricted subsidiaries, CC Holdings, to transfer $516 million worth of shares of Clear Channel Outdoor Holdings stock to one of [iHC's] unrestricted subsidiaries, Broader Media.").

46. FRIEDMAN ET AL., *supra* note 17; *see Gamco Asset Mgmt. Inc.*, 2016 WL 6892802, at *6 ("[Gamco] alleges that in approving the Asset Sales the CCOH Board 'divested assets at suboptimal prices' on a 'timetable' that benefited only the iHeart Defendants.").

47. *Gamco Asset Mgmt. Inc.*, 2016 WL 6892802, at *7.

48. *Id.* at *6.

49. *Franklin Advisers, Inc.*, WL 4518297, at *4.

50. *Id.* at *1.

51. *Id.* ("[iHC] filed the underlying suit in which it sought declarations that it had not violated the indentures and was not in default on the notes. [iHC] also sought injunctive relief.").

52. *Gamco Asset Mgmt. Inc.*, 2016 WL 6892802, at *7 (describing Gamco's unjust enrichment suit against iHeart and iHC).

53. *Id.*

54. Gamco Asset Mgmt. v. iHeartMedia Inc., No. 593, 2017 WL 4607413 (Del. Oct. 12, 2017) ("[W]e affirm largely on the basis of the Court of Chancery's thorough decision dated November 23, 2016."); *Franklin Advisers, Inc.*, WL 4518297, at *1 ("On appeal, Franklin and Oz argue the judgment should be reversed because the trial court erred in construing the contracts at issue in this case. We conclude the trial court did not err, and therefore, affirm its judgment."); *Gamco Asset Mgmt. Inc.*, 2016 WL 6892802, at *2; *see also* MEYER C.

## III. UNRESTRICTED SUBSIDIARY TACTIC PROGNOSIS: WHY THESE TRANSFERS SEEM, BUT ARE NOT, LEGALLY UNFAIR TO LENDERS AND MINORITY SHAREHOLDERS

### A. *Overview of the Perceived Unfairness*

Each of the iHeart actions presents a type of entity positioned to feel slighted by controller use of The Unrestricted Subsidiary Transfer Tactic.[55] The Franklin and Oz suit shows that controllers who pay off debts via unrestricted subsidiary transfers risk angering the holders of those debts because the move appears to violate the lending covenants.[56] The Gamco suit illustrates that controllers who transfer assets from partially-owned restricted subsidiaries risk angering minority shareholders because the tactic appears to violate the controller's fiduciary duty to those minority shareholders.[57] However valid these grievances may have been, the courts in both cases ruled correctly.[58]

### B. *Why Unrestricted Subsidiary Transfers Seem, but Are Not, Unfair to Lenders*

When it comes to The Unrestricted Subsidiary Transfer Tactic, the primary source of tension between controllers like iHC and debt holders like Franklin and Oz boils down to whether the loan covenants allow

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DWORKIN ET AL., DAVIS POLK & WARDWELL LLP: OPPORTUNITIES AND RISKS IN LIABILITY MANAGEMENT TRANSACTIONS AND LOAN DOCUMENTS, at 14 (June 21, 2018), https://www.davispolk.com/files/2018_credit_fund_general_counsel_summit_presentation_materials.pdf ("Designating a subsidiary as an unrestricted subsidiary is itself typically considered an investment.").

55. *See Franklin Advisers, Inc.*, 2017 WL 4518297 (presenting lenders as an aggrieved party to the unrestricted subsidiary transfer); *Gamco Asset Mgmt. Inc.*, 2016 WL 6892802 (presenting minority shareholders of restricted subsidiary CCOH as an aggrieved party to the unrestricted subsidiary transfer).

56. *Franklin Advisers, Inc.*, 2017 WL 4518297.

57. *Gamco Asset Mgmt. Inc.*, 2016 WL 6892802; COX, *supra* note 1, at 272 (citing Chiles v. Robertson, 767 P.2d 903, 912 (Or. Ct. App. 1989)) ("The overall objective of the controlling stockholder's fiduciary obligation is not to bar the controlling stockholder from acting in his own self-interest but to assure that when so acting the interests of the corporation are also served.").

58. *See Franklin Advisers, Inc.*, 2017 WL 4518297 (presenting lenders as an aggrieved party to The Unrestricted Subsidiary Transfer Tactic who sued and lost to the controller); *Gamco Asset Mgmt. Inc.*, 2016 WL 6892802 (presenting minority shareholders of restricted subsidiary CCOH as an aggrieved party to The Unrestricted Subsidiary Transfer Tactic who sued and lost to the controller).

for such a move.[59] This confusion is justified because loan documents have historically allowed controllers to use unrestricted subsidiaries, albeit for a different implied purpose.[60] The prior use of unrestricted subsidiaries involved the controller making an off-the-bat designation in the covenant package of any subsidiaries that "were not considered part of the core credit."[61] The historic manner differs from the current use of unrestricted subsidiaries as a way to alleviate loan pressures because it required controllers to make upfront statements regarding how they intend to use the subsidiaries.[62] Additionally, the upfront subsidiary designation often entailed controller compliance with certain ratio tests, a requirement that has since fallen out of practice.[63] Instead, loans issued to controllers, like iHC, have come with carte blanche in that the controller can at a later date create unrestricted subsidiaries which will be exempt from covenant restrictions.[64] Although lenders approved such terms while assuming that controllers would not use unrestricted subsidiaries for impermissible purposes, the terms themselves did not define which purposes were and were not agreeable.[65]

Across the historic and current unrestricted uses of unrestricted subsidiaries, one key factor has remained constant: the text of loan agreements controls how courts will interpret them, lender assumptions notwithstanding.[66] This jurisprudential axiom was key to the Franklin and

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59. *See Franklin Advisers, Inc.*, 2017 WL 4518297, at *1 ("[iHC] filed the underlying suit in which it sought declarations that it had not violated the indentures and was not in default on the notes. [iHC] also sought injunctive relief.").

60. DWORKIN ET AL., *supra* note 54, at 15 (describing difference between historic and current use of unrestricted subsidiaries).

61. DWORKIN ET AL., *supra* note 54, at 15 ("For example, unrestricted subsidiary capacity [would be used for] separating out project or receivables financings and in temporarily housing the financing for an acquisition prior to consummation (e.g., in an escrow closing structure).").

62. DWORKIN ET AL., *supra* note 54, at 15 ("Historically, unrestricted subsidiary capacity was intended to allow borrowers to carve out from the covenant and collateral package certain subsidiaries and business that were not considered part of the core credit.").

63. DWORKIN ET AL., *supra* note 54, at 15 ("As these [unrestricted subsidiary designation] provisions have evolved, however, restrictions have loosened, so that the typical formulation today often does not include a ratio test as a condition to designation, so long as the deemed investment in such unrestricted subsidiary would be permitted by the investment covenant.").

64. *Franklin Advisers, Inc.*, 2017 WL 4518297, at *1 ("[T]he indentures allow iHeart to create unrestricted subsidiaries that are not subject to the indentures' restrictive covenants.").

65. DWORKIN ET AL., *supra* note 54, at 16.

66. MARK CHASS & YEKATERINA CHERNYAK, KRAMER LEVIN NAFTALIS & FRANKEL LLP, CLIENT ALERT: IHEART: THE ALCHEMY OF TRANSFERS TO UNRESTRICTED SUBSIDIARIES (Nov. 17, 2016), https://www.lexology.com/library/detail.aspx?g=40ff85f6-6390-48ef-af37-a20f4ff84e27 ("The basic canon of indenture interpretation is that parties will be held to the plain meaning of their documents, and absent ambiguity, courts will not rewrite the parties'

Oz appellate holding on multiple counts, the primary of which was based upon how the covenants defined the term "investment."[67] Although Franklin and Oz argued that the term "investment" necessarily entailed a profit motive, the court concluded that the documents would have included the term "profit motive" explicitly in the definition of "investment" if that were the case.[68]

### C. *Conflicted Tunneling Transactions and Why Unrestricted Subsidiary Transfers Seem Unfair to Minority Shareholders and Lenders*

To illustrate why The Unrestricted Subsidiary Transfer Tactic tends to create tension between controllers and minority shareholders—along with exacerbating the controller-lender tensions described above[69]—we must first delve into the closely-related concepts of "conflicted transactions" and "tunneling."[70] In tandem these elucidate why minority shareholders like Gamco may feel inclined to sue controllers who transfer assets out of their shared business and into an unrestricted subsidiary.[71] This explanation also serves as a foundation for why those controllers are likely to have their suits dismissed, as properly occurred in the Gamco suit.[72]

Controllers have a fiduciary duty to minority shareholders because their control entails power to dominate the company.[73] A controller

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bargain on perceived equitable grounds."); *see Franklin Advisers, Inc.*, 2017 WL 4518297, at *1 ("After reviewing the four corners of the indentures, we conclude that the pertinent language in the indentures is not ambiguous. Additionally, as will be discussed below, we conclude that only iHeart's interpretation of the pertinent language is reasonable."); DWORKIN ET AL, *supra* note 54, at 16 (June 21, 2018) ("The counterpoint from lenders is that the unrestricted subsidiary concept was always intended to serve a legitimate business purpose, not to accomplish indirectly what borrowers cannot accomplished directly.").

67. *Franklin Advisers, Inc.*, 2017 WL 4518297, at *4("[iHC] argues the indentures permitted capital contributions to affiliates without regard to profit motive based on the plain language of the definition of 'Investments' as 'all investments in the form of' 'capital contributions.' We conclude this is the only reasonable interpretation of the language in question.").

68. *Id.* ("Finally, we note that the term 'profit motive' never appears in the definition of 'Investments' in the indentures. If the parties had intended to require a capital contribution like the one in this case to have a profit motive, they could have used the term 'profit motive' in the definition of 'Investments.' The parties did not do so.").

69. *See supra* Part III.B.

70. *See infra* Part III.C.

71. *See infra* Part III.C.

72. *See infra* Part III.C.

73. Gamco Asset Mgmt. Inc. v. iHeartMedia Inc., No. 12312, 2016 WL 6892802, at *15 (Del. Ch. Nov. 23, 2016, revised Nov. 29, 2016) ("It is well-settled that Delaware law imposes

has breached their fiduciary duty by engaging in a "conflicted transaction,"[74] which is a transaction taken in their capacity as controller that benefits themselves but does not benefit the minority shareholders or the corporation.[75] Therefore, in shareholder derivative suits,[76] like the action brought by Gamco, the most critical determination is whether or not the decision at issue is a conflicted transaction.[77] This determination dictates the court's standard of review[78] and essentially determines which side will win the case.[79] A conflicted transaction takes place when the controller has engaged in self-dealing.[80] The landmark *Sinclair Oil Corp. v.*

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fiduciary duties on those who effectively control a corporation." (internal quotations omitted)), *aff'd,* No. 593, 2017 WL 4607413 (Del. Oct. 12, 2017); COX, *supra* note 1, at 272 ("[A] controlling stockholder may choose to exercise control to reap disproportionate benefits at the expense of the corporation or noncontrolling shareholders such that protection of their interest is desirable. That protection arises by imposing the fiduciary standards on the controlling stockholder exercising the controlling influence."); Sang Yop Kang, *Rethinking Self-Dealing and the Fairness Standard: A Law and Economics Framework for Internal Transactions in Corporate Groups*, 11 VA. L. & BUS. REV. 95, 114 (2016)) ("[D]omination over affiliates in a corporate group is usually exercised through the affiliates' board of directors, whom a controlling shareholder selects directly or indirectly through another affiliate that she controls." (citing Sinclair Oil Corp. v. Levien, 280 A.2d 717, 720 (Del. 1971)).

74. *E.g., Gamco Asset Mgmt. Inc.*, 2016 WL 6892802, at *15 (presenting conflicted transactions).

75. *Id.*at *14–19 ("[Gamco] has not alleged facts that meet this high burden because they have not pled facts that allow a reasonable inference that the challenged transactions were 'so one sided that no business person of ordinary, sound judgment could conclude that the corporation has received adequate consideration.'"); COX, *supra* note 1, at 272 ("The overall objective of the controlling stockholder's fiduciary obligation is not to bar the controlling stockholder from acting in his own self-interest but to assure that when so acting the interests of the corporation are also served." (citing Chiles v. Robertson, 767 P.2d 903, 912 (Or. Ct. App. 1989))).

76. *E.g.,* In re Walt Disney Co. Derivative Litig., 906 A.2d 27, 35 (Del. 2006) (introducing a shareholder derivative suit as one which is brought by corporate shareholders on behalf of the corporation against the board of directors).

77. *Gamco Asset Mgmt. Inc.*, 2016 WL 6892802, at *14–19.

78. *E.g., id.* at *15. *See infra* Part III.C.

79. COX, *supra* note 1, at 273 ("It would appear an extremely rare case where the controlling stockholder will be able to establish the transaction's intrinsic fairness after the court has concluded that the same transaction had allowed the controlling stockholder to receive a benefit 'to the exclusion of, and detriment to, the minority stockholders.'" (citing Sinclair Oil Corp. v. Levien, 280 A.2d 717, 720 (Del. 1971) (footnote omitted))).

80. *Sinclair Oil Corp.*, 280 A.2d at 720 ("Self-dealing occurs when the parent, by virtue of its domination of the subsidiary, causes the subsidiary to act in such a way that the parent receives something from the subsidiary to the exclusion of, and detriment to, the minority stockholders of the subsidiary."); In re Straight Path Commc'ns Inc. Consol. Stockholder Litig., No. CV 2017-0486-SG, 2018 WL 3120804, at *14 (Del. Ch. June 25, 2018) (describing "both sides of the deal" transactions as one of two conflicted transaction types, the second of which happens when "the controller does not stand on both sides of the deal but competes with minority shareholders for consideration" (internal quotations removed)). *See generally* In re Crimson Expl. Inc. Stockholder Litig., No. CIV.A. 8541-VCP, 2014 WL 5449419, at *12 (Del. Ch. Oct. 24, 2014) (describing "disparate consideration" cases as occurring when

*Levien* definition of self-dealing occurs when the controller receives a disproportionately larger amount of consideration from the transaction than the minority shareholders receive.[81] Self-dealing can also take place when money has been shared proportionately between controller and minorities when the context of the transaction indicates the controller uniquely benefitted from the transaction in a way the minorities did not.[82] Known as "unique benefit" self-dealing cases, this is the type of self-dealing Gamco alleged.[83]

The most fitting term for the kind of self-dealing that The Unrestricted Subsidiary Transfer Tactic resembles is "tunneling."[84] In parent-subsidiary scenarios, tunneling happens when a controller moves

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the controller receives more money for their shares than the minority stockholders receive); IRA Tr. FBO Bobbie Ahmed v. Crane, No. CV 12742-CB, 2017 WL 7053964, at *6 (Del. Ch. Dec. 11, 2017) (presenting continuing stake conflicted transaction type where "controller received, among other consideration, a continuing equity stake in the surviving entity, and the minority stockholders received cash" (citing *In re* John Q. Hammons Hotels Inc. S'holder Litig., No. 758-CC, 2009 WL 3165613, at *7–8, 12 (Del. Ch. Oct. 2, 2009))); *In re Straight Path Commc'ns Inc. Consol. Stockholder Litig.*, 2018 WL 3120804, at *15 (finding the occurrence of "unique benefit" conflicted transaction type when controlling shareholder indirectly self-dealt by making threats "to withhold support for any sale that would allow [an] indemnification claim" to proceed against a company of which his children were ten percent shareholders and of which his son was CEO).

81. *Sinclair Oil Corp.*, 280 A.2d at 720–22 ("The dividends resulted in great sums of money being transferred from Sinven to Sinclair. However, a proportionate share of this money was received by the minority shareholders of Sinven. Sinclair received nothing from Sinven to the exclusion of its minority stockholders. As such, these dividends were not self-dealing."); In re Crimson Expl. Inc. Stockholder Litig., No. CIV.A. 8541-VCP, 2014 WL 5449419, at *12 (Del. Ch. Oct. 24, 2014) (labelling disproportionate transactions as "disparate consideration" cases).

82. *In re Straight Path Commc'ns Inc. Consol. Stockholder Litig.*, 2018 WL at *15; COX *supra* note 1, at 273 ("[E]ven though all stockholders received the same type and amount of consideration per share, the controlling stockholder's significant need for cash was itself a unique benefit derived by approving the firm's sale that it triggered and entire fairness review." (citing N.J. Carpenters Pension Fund v. infoGROUP, Inc., 2011 WL 4825888 (Del. Ch. Oct. 6, 2011))).

83. *Gamco Asset Mgmt. Inc.*, 2016 WL 6892802, at *16 ("[Gamco] argues that this is a 'unique benefit' case. In a 'unique benefit' case, 'the controller receives some sort of special benefit not shared with the other stockholders.' In essence, 'the controller extracts something uniquely valuable to the controller . . . .'" (quoting *Crimson*, 2014 WL 5449419, at *13) (citing *N.J. Carpenters Pension Fund*, 2011 WL 4825888; In re Answers Corp. S'holders Litig., C.A. No. 6170-VCN, 2012 WL 1253072, at *1–2, *7 (Del. Ch. Apr. 11, 2012); McMullin v. Beran, 765 A.2d 910, 921 (Del. 2000))).

84. Simon Johnson et al., *Tunneling*, 90 AM. ECON. REV. 22, 22 (2000) ("[W]e use the term 'tunneling,' coined originally to characterize the expropriation of minority shareholders in the Czech Republic (as in removing assets through an underground tunnel), to describe the transfer of assets and profits out of firms for the benefit of those who control them."); *see Gamco Asset Mgmt. Inc.*, 2016 WL 6892802, at *16 ("[Gamco] has seized upon a line of cases in which Delaware courts have applied entire fairness when a controller causes a company to enter into a transaction for the purpose of addressing an acute liquidity crisis confronting the controller.").

resources out of a subsidiary.[85] Controller use of an unrestricted subsidiary to evade loan covenants is a form of tunneling.[86] Although the concept of tunneling is not widely-known in U.S. corporate law, tunneling is a pervasive evil in less-developed national legal systems where controllers eviscerate minority interests with impunity.[87] Tunneling and The Unrestricted Subsidiary Transfer Tactic both entail controllers moving resources out of a subsidiary to the detriment of other parties with interests in that subsidiary; considering the concepts side-by-side underlines why The Unrestricted Subsidiary Transfer Tactic makes those it seems to hollow-out feel slighted.[88] The fact that controllers in both scenarios need not fear judgment against them makes for an even better conceptual fit.[89]

Tunneling encapsulates unique benefit self-dealing transactions wherein the parent drains the subsidiary in order to resolve its own issues.[90] One such unique benefit transaction takes place when a parent controller moves assets from a subsidiary it controls but does not own in full to another subsidiary that it both controls and owns privately in order to satisfy a crisis that specifically involves the controller.[91] This is

85. Johnson et al., *supra* note 84, at 22.

86. *See* Johnson et al., *supra* note 84, at 22 ("We use the term 'tunneling' narrowly to refer to the transfer of resources out of a company to its controlling shareholder . . . .").

87. Sang Yop Kang, *"Generous Thieves": The Puzzle of Controlling Shareholder Arrangements in Bad-Law Jurisdictions*, 21 STAN. J.L. BUS. & FIN. 57, 72 (2015) ("The piracy of controlling shareholders is, in practice, a default rule in many bad-law countries. In other words, expropriation of minority shareholders is understood as an "unavoidable tax" imposed by corporate bandits.").

88. Franklin Advisers, Inc. v. iHeart Commc'ns Inc., No. 04-16-00532-CV, 2017 WL 4518297, at *2 (Tex. App. Oct. 11, 2017) ("On appeal, Franklin and Oz argue that the trial court erred when it concluded that the stock transfer from CC Holdings to Broader Media was permissible under the indentures."); *Gamco Asset Mgmt. Inc.*, 2016 WL 6892802, at *16; Johnson et al, *supra* note 84, at 22.

89. Kang, *supra* note 73, at 127 ("[It is] difficult, if not impossible, for outsiders (non-controlling shareholders or law enforcement agencies) to detect [tunneling] and attribute such wrongdoing to the controlling shareholder." (footnotes omitted)); *see, e.g., Franklin Advisers, Inc.*, 2017 WL 4518297, at *4 ("[iHC] argues the indentures permitted capital contributions to affiliates without regard to profit motive based on the plain language of the definition of 'Investments' as 'all investments in the form of' 'capital contributions.' We conclude this is the only reasonable interpretation of the language in question.").

90. *See Gamco Asset Mgmt. Inc.*, 2016 WL 6892802, at *16 (citing N.J. Carpenters Pension Fund v. infoGROUP, Inc., 2011 WL 4825888 (Del. Ch. Oct. 6, 2011)) ("[Gamco] argues that this is a 'unique benefit' case."); *see also* Kang, *supra* note 73, at 105–06 n.39 ("There are various forms of tunneling. . . . [T]unneling covers any type of wealth transfer including, but not limited to, 'asset sales and contracts such as transfer pricing advantageous to the controlling shareholder, excessive executive compensation, loan guarantees, [or] expropriation of corporate opportunities.' " (first citing Johnson et al., *supra* note 84, at 22; then quoting Johnson et al., *supra* note 84, at 23) (internal alteration in original))).

91. *See* In re Synthes, Inc. S'holder Litig., 50 A.3d 1022, 1036 (Del. Ch. 2012) (defining such a situation as a "fire sale"); *Gamco Asset Mgmt. Inc.*, 2016 WL 6892802, at *16

tunneling because the controller gains full control of the asset by grace of its full ownership of the company in which the assets reside.[92] This complete control can also constitute the basis of a unique benefit the controller receives.[93] Meanwhile, minority shareholders of the depleted subsidiary have lost all stakes they previously had in that asset because they do not own any shares of the receiving subsidiary, meaning they do not share in the unique benefit.[94]

In the iHeart actions, iHC appeared to tunnel CCOH in pursuit of a unique benefit by demanding that CC Holdings relinquish CCOH shares to iHC's fully-owned unrestricted subsidiary Broader Media.[95] From Gamco's perspective assets that underlaid their CCOH minority shares had been tunneled by iHC because the move was a transfer of assets out of CCOH that benefitted the controller at Gamco's expense.[96] Because unique benefit tunneling transactions were not explicitly and directly permitted by the loan covenants, Franklin and Oz believed them to be impermissible.[97]

### *D. The Business Judgment Rule and Why Tunneling Does Not Have to Be Fair*

Grievances of lenders and minority shareholders notwithstanding, The Unrestricted Subsidiary Transfer Tactic is permissible so long

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(discussing "unique benefit" cases); *see also* Kang, *supra* note 73, at 105–06 n.39 (discussing tunneling).

92. Kang, *supra* note 73, at 118 (describing "the controlling shareholder's personal payoff" which is derived from this version of tunneling).

93. *See Gamco Asset Mgmt. Inc.*, 2016 WL 6892802, at *16 (citing *N.J. Carpenters Pension Fund*, 2011 WL 4825888); *see also* Kang, *supra* note 73, at 118 (describing "the controlling shareholder's personal payoff" which is derived from this version of tunneling).

94. Kang, *supra* note 73, at 118*; see Gamco Asset Mgmt. Inc.*, 2016 WL 6892802, at *16 (citing *N.J. Carpenters Pension Fund*, 2011 Del. Ch. WL).

95. Kang, *supra* note 73, at 98–99 ("In the corporate group setting, tunneling often takes place via internal transactions among affiliated companies. . . . [A tunneling controller] transfers corporate value to herself. Victims of the internal-transaction tunneling are noncontrolling shareholders of the latter affiliate."); *see Gamco Asset Mgmt. Inc.*, 2016 WL 6892802, at *3 (describing iHC's use of unrestricted subsidiary Broader Media to tunnel).

96. *See Gamco Asset Mgmt. Inc.*, 2016 WL 6892802, at *7 ("[Gamco] alleges that in approving the Asset Sales [at the direction of controller iHC] the CCOH Board 'divested assets at suboptimal prices' on a 'timetable' that benefited only the iHeart Defendants.").

97. *See* Franklin Advisers, Inc. v. iHeart Commc'ns Inc., No. 04-16-00532-CV, 2017 WL 4518297, at *2 (Tex. App. Oct. 11, 2017) (presenting lender belief "that the plain language of the indentures required the stock transfer at issue in this case to have a 'profit motive'" as indicative of their belief that controller use of tunneling, which did not yield profits, constituted an event of default).

as it does not constitute a breach of the controller's fiduciary duty to minority shareholders.[98] Without a breach, a tunneling transaction will not be considered a conflicted transaction, which means the plaintiffs must face the default standard of review in Delaware: the business judgment rule.[99] On the other hand, conflicted transactions are met with a higher judicial standard of review: entire fairness.[100] Therefore, tunneling a unique benefit from minority shareholders into an unrestricted subsidiary does not need to be fair; it just cannot egregiously blare controller disloyalty to the point of disregarding the tunneled company.[101]

The business judgment rule is a principle of non-review that assumes, pending plaintiff rebuttal, the decisionmakers in question had an acceptable basis for initiating the transaction in question.[102] Although more frequently associated with decisions made by a corporation's board of directors,[103] the business judgment rule is also the appropriate standard of review for addressing fairness issues in parent-subsidiary shareholder contexts because the nuances of structuring intra-family transactions can dictate matters such as corporate tax incentives.[104] Rebutting the business judgment rule is extremely difficult because it places a high burden of proof on plaintiff complaints.[105] Additionally, the process plaintiffs face

98. *Gamco Asset Mgmt. Inc.*, 2016 WL 6892802, at *15.

99. Sinclair Oil Corp. v. Levien, 280 A.2d 717, 720 (Del. 1971) ("A parent does indeed owe a fiduciary duty to its subsidiary when there are parent-subsidiary dealings. However, this alone will not evoke the intrinsic fairness standard. This standard will be applied only when the fiduciary duty is accompanied by self-dealing . . . ."); *Gamco Asset Mgmt. Inc.*, 2016 WL 6892802, at *15; Quadrant Structured Prod. Co. v. Vertin, 102 A.3d 155, 183 (Del. Ch. 2014) ("Delaware's default standard of review is the business judgment rule . . . .").

100. Kahn v. Tremont Corp., 694 A.2d 422, 428 (Del. 1997) (concluding entire fairness standard of review to be appropriate due to conflicted transaction determination); *see* Reis v. Hazelett Strip–Casting Corp.*,* 28 A.3d 442, 457 (Del. Ch.2011) ("Delaware has three tiers of review for evaluating director decision-making: the business judgment rule, enhanced scrutiny, and entire fairness.").

101. *See Gamco Asset Mgmt. Inc.*, 2016 WL 6892802, at *18 ("[Gamco's fire sale] allegations are undercut by the Board minutes to which [Gamco] has cited which reveal that the Board in fact considered and discussed the negative consequences for CCOH should the iHeart Defendants be forced into bankruptcy.").

102. In re Trados Inc. S'holder Litig., 73 A.3d 17, 56 (Del. Ch. 2013) ("[The business judgment rule] reflects and promotes the role of the board of directors as the proper body to manage the business and affairs of the corporation." (internal citations removed).

103. *Id.*

104. *Sinclair Oil Corp.*, 280 A.2d at 720 (ruling that the business judgment rule is the appropriate default standard of review in addressing issues of fairness in parent-subsidiary contexts); COX, *supra* note 1, at 274 ("The environment of parent-subsidiary corporations is rife with instances where for tax or other regulatory purposes the activities of the parent and subsidiary may be combined.").

105. Malpiede v. Townson, 780 A.2d 1075, 1092 (Del. 2001).

is akin to shooting at an erratically moving target, especially in the case of conflicted transactions taking place in parent-subsidiary contexts like those involving unrestricted subsidiary transfers.[106] Plaintiffs who fail to meet this burden are likely to have their complaints dismissed.[107]

However, if the plaintiff minority shareholders have alleged that the defendant controller engaged in a conflicted transaction, the controller bears the burden of satisfying the judicial scrutiny of the entire fairness test.[108] The entire fairness standard requires the defendant to meet two concurrent requirements: "fair dealing and fair price."[109] Fair dealing analysis considers how the deal evolved from a simple idea to a fleshed-out proposition presented at a meeting.[110] When considering fair dealing, the defendant controller must assure the court that every phase of the transaction was fair.[111] Fair price analysis delves into the financial and economic situation of the company and of the greater market at the time of the transaction.[112]

Tunneled minority shareholders would benefit from entire fairness review because furnishing that standard would require the tunneling controllers to justify their actions as fair.[113] To achieve entire fairness is no small task, as the minority must plead facts so compelling that they convince the court that—*pro rata* dividends aside in unique benefit cases like that which Gamco alleged[114]—the controller has been so

106. COX, *supra* note 1, at 274.

107. *E.g.* Gamco Asset Mgmt. Inc. v. iHeartMedia Inc., No. 12312, 2016 WL 6892802, at *20 (Del. Ch. Nov. 23, 2016, revised Nov. 29, 2016) ("For the foregoing reasons, [Gamco] has failed to state viable claims for breach of fiduciary duty . . . . Accordingly, Defendants' Motion to Dismiss the Complaint with prejudice is GRANTED."), *aff'd,* No. 593, 2017 WL 4607413 (Del. Oct. 12, 2017).

108. Kahn v. Tremont Corp., 694 A.2d 422, 428 (Del. 1997) ("[If the action at issue is a conflicted transaction] the conduct of the parties will be viewed under the more exacting standard of entire fairness as opposed to the more deferential business judgment standard.").

109. Weinberger v. UOP, Inc., 457 A.2d 701, 711 (Del. 1983) ("The concept of fairness has two basic aspects: fair dealing and fair price.").

110. *Id.* ("[Fair dealing] embraces questions of when the transaction was timed, how it was initiated, structured, negotiated, disclosed to the directors, and how the approvals of the directors and the stockholders were obtained.")

111. *Id.*

112. *Id.*

113. *In re Trados Inc. S'holder Litig.*, 73 A.3d 17, 44 ("[To satisfy the entire fairness standard,] the transaction itself must be objectively fair, independent of the board's beliefs." (quoting Gesoff v. IIC Insus. Inc., 902 A.2d 1130, 1145 (Del. Ch. 2006))); Kang, *supra* note 73, at 105–06 (2016) (describing tunneling as inherently unfair to the tunneled company).

114. In re Synthes, Inc. S'holder Litig., 50 A.3d 1022, 1035 (Del. Ch. 2012) ("As a general matter, therefore, if one wishes to protect minority stockholders, there is a good deal of utility to making sure that when controlling stockholders afford the minority *pro rata* treatment, they know that they have docked within the safe harbor created by the business judgment rule.");

unconscionably disloyal that they have been pre-approved for the VIP section of Hell's Ninth Circle.[115] These "very narrow circumstances"[116] compound with the insidious nature of tunneling that allows even the worst offenses to remain unnoticed.[117] This may be an extremely tough pill to swallow for minority shareholders like Gamco and lenders like Franklin and Oz, but it should come as no surprise because these complaints against controllers must penetrate a business-friendly doctrine in business-friendly jurisdictions like Delaware.[118]

## IV. iHEART TRANSPLANT: THE LESSONS LEARNED FROM THE UNRESTRICTED SUBSIDIARY TRANSFER TACTIC

### *A. Bypassing Litigation with Improved Covenant Drafting and*

Gamco Asset Mgmt. Inc. v. iHeartMedia Inc., No. 12312, 2016 WL 6892802, at *16 (citing *N.J. Carpenters Pension Fund*, 2011 Del. Ch.), *aff'd,* No. 593, 2017 WL 4607413 (Del. Oct. 12, 2017).

115. *See In re Synthes,* 50 A.3d at 1036. Then-Chancellor Strine offers the following scenario:

> The world is diverse enough that it is conceivable that a mogul who needed to address an urgent debt situation at one of his coolest companies (say a sports team or entertainment or fashion business), would sell a smaller, less sexy, but fully solvent and healthy company in a finger snap (say two months) at seventy-five percent of what could be achieved if the company sought out a wider variety of possible buyers, gave them time to digest non-public information, and put together financing. In that circumstance, the controller's personal need for immediate cash to salvage control over the financial tool that allows him to hang with stud athletes, supermodels, hip hop gods, and other pop culture icons, would have been allowed to drive corporate policy at the healthy, boring company and to have it be sold at a price less than fair market value, subjecting the minority to unfairness.

*Id.*; *see also* DANTE ALIGHIERI, THE DIVINE COMEDY I: INFERNO 271 (Dorothy L. Sayers trans., Penguin Classics 1983) (1320) ("The Ninth Circle is the frozen Lake of Cocytus, which fills the bottom of the Pit [which lies at the bottom of Hell], and holds the souls of the Traitors.").

116. *Gamco Asset Mgmt. Inc.*, 2016 WL 6892802, at *17.

117. *See* Kang, *supra* note 73, at 127 ("[It is] difficult, if not impossible, for outsiders (non-controlling shareholders or law enforcement agencies) to detect [tunneling] and attribute such wrongdoing to the controlling shareholder.").

118. *See* Sinclair Oil Corp. v. Levien, 280 A.2d 717, 720 (Del. 1971) (ruling that the business judgment rule is the appropriate default standard of review in addressing issues of fairness in parent-subsidiary contexts); *see also* THOMAS L. HAZEN, JERRY W. MARKHAM & JOHN F. COYLE, CORPORATIONS AND OTHER BUSINESS ENTERPRISES: CASES AND MATERIALS 5–10 (West Acad., 4th ed. 2016) (describing how states such as Delaware and Nevada which attract incorporation within their borders do so by enacting laws which benefit corporate officers and directors over minority shareholders).

*Internal Monitoring*

Lenders with current loan documents that do not explicitly prohibit borrower use of unrestricted subsidiaries to tunnel around covenant restrictions are unlikely to prevent tunneling from happening.[119] Fortunately, lenders who are now aware of this tactic can draft documents so as to protect against the types of tunneling to which they are most vulnerable.[120] This way, the covenant text will ensure wins instead of losses for lenders in future suits over unrestricted subsidiary breaches of covenant.[121]

Because the transfer of assets to an unrestricted subsidiary can result in lawsuits, corporations wishing to avoid suit should demonstrate on their own that they have not engaged in a conflicted tunneling transaction.[122] No case law yet exists with regards to how a corporation should cleanse itself when it uses an unrestricted subsidiary in this manner, but the Delaware Supreme Court in October, 2018, reaffirmed an internal monitoring method that allowed the defendant corporation to rebut application of entire fairness review and win the case under the business judgment rule.[123] Putting aside the favorable probability of prevailing in court, parent companies wishing to both transfer assets to an unrestricted subsidiary and avoid tunneling lawsuits would be wise to proactively

119. *See* Kang, *supra* note 73, at 127; *supra* Part III.B–C.

120. *See* DWORKIN ET AL., *supra* note 54, at 16 (providing first that "[o]ne way to reduce this risk is to permit the distribution from an unrestricted subsidiary solely to the extent the assets of such unrestricted subsidiary are not primarily cash," then offering that "[a]nother possibility is to more tightly control investments in unrestricted subsidiaries (e.g., exclude the use of the ratio investment basket for such purpose, limit investments to the specific unrestricted subsidiary basket and prohibit the investment of IP[)]," then concluding that "a more fruitful approach [may] be to add a ratio test on the designation of unrestricted subsidiaries that mirrored the RP ratio condition for use of the available amount basket").

121. *See* Franklin Advisers, Inc. v. iHeart Commc'ns Inc., No. 04-16-00532-CV, 2017 WL 4518297, at *3 (Tex. App. Oct. 11, 2017) ("After reviewing the four corners of the indentures, we conclude that the pertinent language in the indentures is not ambiguous. Additionally, . . . we conclude that only iHeart's interpretation of the pertinent language is reasonable.").

122. *See* Gamco Asset Mgmt. Inc. v. iHeartMedia Inc., No. 12312, 2016 WL 6892802 (Del. Ch. Nov. 23, 2016, revised Nov. 29, 2016) (providing example lawsuit resulting from use of Unrestricted Subsidiary Transfer Tactic) *aff'd,* No. 593, 2017 WL 4607413 (Del. Oct. 12, 2017); Kang, *supra* note 73, at 98–99 (describing tunneling).

123. *See* Flood v. Synutra Int'l, 195 A.3d 754, at 756 (Del. 2018) (stating that the business judgment rule is satisfied where a controller requires "approval by an independent Special Committee and an affirmative vote by a majority of the minority stockholders" as a prerequisite to a merger).

adopt these controls so as to make themselves less attractive targets to litigious minority shareholders like Gamco.[124]

The internal monitoring method entails two separate approvals of the transaction: "approval by an independent Special Committee and an affirmative vote by a majority of the minority stockholders."[125] Both approvals must be established before the controller begins to flesh-out the transaction.[126] The special committee should consist of sufficient non-conflicted attorneys and financial experts to properly evaluate the proposed transaction.[127] Upon evaluation, the special committee should negotiate with the controller as needed to ensure that the transaction is fair.[128] A minority shareholder wishing to rebut the decisions made by the special committee can only do so by alleging that the committee acted with gross negligence in approving the transaction.[129] Meanwhile, the majority vote between the minority shareholders should take place at the beginning phase of considering the transaction and before the controller and the special committee negotiate as to any transactional details.[130] This order of operations fits snugly with The Unrestricted Subsidiary Transfer Tactic because it requires the controller to request permission instead of forgiveness from the minority shareholders of the subsidiary.[131]

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124. *Id.*; *see* Allison McNeely, *Gabelli Sues Clear Channel Again Over Unpaid iHeart Note*, BLOOMBERG LAW (Aug. 29, 2018, 2:48 PM), https://www.bloomberglaw.com/document/PE8K8ASYF01S (referencing the three suits Gamco has filed against iHeart in its capacity as CCOH minority shareholder).

125. *Flood*, 195 A.3d at 756 ("[W]hat is critical for the application of the business judgment rule is that the controller accept that no transaction goes forward without special committee and disinterested stockholder approval early in the process and before there has been any economic horse trading.").

126. *See id.* at 762 ("To avoid [the] . . . adverse [scenario of controllers] using a majority-of-the-minority vote as a chit in economic negotiations with a Special Committee[,] *MFW* reviews transactions under the favorable business judgment rule if 'these two protections are established up-front.'" (quoting *In re* MFW S'holders Litig., 67 A.3d 496, 528 (Del. Ch. 2013))).

127. *Flood*, 195 A.3d at 758–59 (detailing the enlistment of the various attorneys, financial advisors, bankers, and economic experts that were on the special committee).

128. *Id.* at 759.

129. *Id.* at 756.

130. *See id.* at 763–64 ("[A] controller is required to condition the buyout on both the approval of an independent, fully empowered Special Committee and the approval of a majority of minority stockholders at the beginning stages of the process of considering a going private proposal . . . .").

131. *See id.* ("[W]hat is critical for the application of the business judgment rule is that the controller accept that no transaction goes forward without special committee and disinterested stockholder approval early in the process and before there has been any economic horse trading."); *infra* Part V.

Controllers are not required "to engage in self-sacrifice for the benefit of minority shareholders,"[132] and this Note does not assert otherwise.[133] However, there exists a legal and moral chasm between controllers that "vote their shares in their own interest"[134] and those that engage in minority shareholder sacrifice for the benefit of themselves.[135] Controllers who employ the internal monitoring method recuse themselves, thereby rendering the transaction unconflicted because the recusal "self-disables"[136] any temptations to self-deal.[137]

### B. *Taking the Ongoing Pressures of The Unrestricted Subsidiary Transfer Tactic*

The issues which surround the use of The Unrestricted Subsidiary Transfer Tactic by troubled companies are expected to continue arising.[138] For example, the bankruptcy proceedings of Claire's Stores Inc. ("Claire's") were stymied by creditor Oaktree Capital Group's complaints that the retailer engaged in the tactic.[139] In fact, the complaint cited issues pertaining to a dominated committee that could have been avoided with the above-discussed independent subcommittee curative measures.[140] Those issues have since been resolved: Claire's and Oaktree

132. In re Synthes, Inc. S'holder Litig., 50 A.3d 1022, 1040 (Del. Ch. 2012).

133. *See id.* at 1040–41("[T]he duty to put the 'best interest of the corporation and its shareholders' above 'any interest . . . not shared by the stockholders generally' does not mean that the controller has to subrogate his own interests so that the minority stockholders can get the deal that they want." (quoting Cede & Co. v. Technicolor, Inc., 634 A.2d 345, 361 (Del. 1993) (footnote omitted))).

134. *In re Synthes, Inc.*, 50 A.3d at 1041.

135. *See id.* at 1040–41 ("That is, the duty to put the best interest of the corporation and its shareholders above any interest . . . not shared by the stockholders generally does not mean that the controller has to subrogate his own interests so that the minority stockholders can get the deal that they want.").

136. Flood v. Synutra Int'l, Inc., 195 A.3d 754, 763 (Del. 2018).

137. *Id.* ("[T]he controller [is required] to self-disable before the start of substantive economic negotiations, and to have both the controller and Special Committee bargain under the pressures exerted on both of them by these protections.").

138. *See* Orr, *supra* note 2 (furnishing J. Crew Group Inc. and Claire's Stores Inc. as two current, prime examples of the troubled companies and unrestricted subsidiaries trend).

139. Motion of Oaktree Capital Mgmt., L.P. for Entry of an Order Granting Derivative Standing and Authority to Prosecute and Settle Claims on Behalf of Certain of the Debtors, at 2–3, In re Claire's Stores, Inc., et al., No. 18-10584 (Bankr. D. Del. filed July 19, 2018).

140. *See* Steven Church, *Oaktree Renews Attack on Apollo's Bankruptcy Deal for Claire's*, BLOOMBERG LAW (July 13, 2018, 2:25 PM), https://bnanews.bna.com/bankruptcy-law/oaktree-renews-attack-on-apollos-bankruptcy-deal-for-claires ("A subcommittee of Claire's board 'was not an independent committee, was operating under conflict, and did not

settled,[141] and the bankruptcy case has been closed.[142] PetSmart sued loan agent Citigroup (who was subsequently replaced by Wilmington Trust as loan agent[143]) for not releasing certain securities of subsidiary Chewy per a transfer directed at another private PetSmart subsidiary.[144] The loan agent did not release these securities because they contend the transfers were "designed to impair PetSmart's existing creditors" and were therefore in violation of the lending agreements.[145] Additionally, Gamco sued iHeart again, this time bringing a class action suit based upon the progression of the facts stated above which led to iHeart's bankruptcy filed on March 14, 2018.[146] However, Gamco will enjoy a more favorable outcome this time because the court has approved a settlement of its claims as part of approving iHeart's chapter 11 reorganization plan.[147]

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have the benefit of independent professional advice,' Oaktree claimed in its filing July 12 in U.S. Bankruptcy Court in Wilmington, Del."); *supra* Part IV.A.

141. Order (I) Confirming Third Amended Joint Chapter 11 Plan of Claire's Stores, Inc. and its Debtor Affiliates and (II) Granting Related Relief, at 6 ¶ 15, 7 ¶ 17, *In re* Claire's Stores, Inc., et al., No. 18-10584 (Bankr. D. Del. filed July 19, 2018).

142. *See* Final Decree (I) Closing the Subsidiary Cases and (II) Granting Related Relief, In re Claire's Stores, Inc., et al., No. 18-10584 (Bankr. D. Del. filed July 19, 2018) (granting relief in all related cases).

143. Katherine Doherty & Eliza Ronalds-Hannon, *Wilmington Trust Is Said to Replace Citi as PetSmart Loan Agent,* BLOOMBERG (July 19, 2018, 3:27 PM), https://www.bloomberglaw.com/document/PC4OPH6JTSE8?bc=W1siU2VhcmNoIFJlc3VsdHMiLCIvc2VhcmNoL3Jlc3VsdHMvNzhkYmU1OGNiNmQyNjM3YjJjYzdlZTg0ZmM3MTNjNjEiXV0—c60bcdaca8b6eb0bb8c84bffc6f06d47ead1e342.

144. Complaint at 1, Argos Holdings, Inc. v. Citibank, N.A., No. 1:18-cv-05773 (S.D.N.Y. filed June 26, 2018) ("This action is necessary because [Citibank] is refusing to fulfill its clear and explicit obligations, as Agent under the Credit Agreement, arising from two transactions executed by PetSmart and Argos Holdings on June 1, 2018 . . . ."); Ronalds-Hannon *supra* note 24 (describing the Chewy.com transfer).

145. Second Amended Counterclaims at 4–5, Argos Holdings, Inc. v. Wilmington Tr., N.A., No. 1:18-cv-05773 (S.D.N.Y. filed Oct. 15, 2018).

146. *See* Verified Class Action Complaint at 11, Gamco Asset Mgmt. Inc. v. Blair Hendrix, et al., No. 2018-0633 (Del. Ch. filed Aug. 27, 2018) ("Instead of employing the foregoing options that would have protected Minority Shareholders of Clear Channel . . . [defendants] decided to follow the years-long pattern of elevating the interests of the iHeart Entities, and by extension the Private Equity Defendants, above those of Minority Shareholders."); *see also* McNeely, *supra* note 124 ("Mario Gabelli's Gamco Asset Management Inc. files another lawsuit on behalf of Clear Channel Outdoor Holdings Inc. minority shareholders for breaches of fiduciary duty by the company's board of directors and the intercompany note committee."); *supra* parts II–III.

147. *See* Findings of Fact, Conclusions of Law, and Order Confirming the Modified Fifth Amended Joint Chapter 11 Plan of Reorganization of iHeartMedia, Inc. and its Debtor Affiliates Pursuant to Chapter 11 of the Bankruptcy Code ¶ 93, at 43, In re iHeartMedia, Inc., et al., No. 18-31274 (Bankr. S.D. Tex. Jan. 22, 2019) ("The CCOH Separation Settlement Agreement provided the Debtors with full releases of all claims, objections and all other causes of action that have been asserted, could have been asserted, or could ever be asserted by or on behalf of CCOH [or Gamco] . . . ."); *see also* Steven Church, *iHeartMedia Wins*

One element of the plan: iHeart will cease using The Unrestricted Subsidiary Transfer Tactic.[148]

## V. CONCLUSION

The previously discussed rash of proceedings is not surprising,[149] and these lawsuits foreshadow that more like them are to be expected.[150] As the law is currently structured, businesses like iHeart are within their rights to use The Unrestricted Subsidiary Transfer Tactic in order to skirt debts.[151] Fortunately, minority shareholder response may prod controllers that contemplate using their unrestricted subsidiaries accordingly to first employ one or both approval methods of *Flood v. Synutra International* in order to avoid lawsuits.[152] There is no dispute that the optics of The Unrestricted Subsidiary Transfer Tactic are bad, likely because the tactic seems similar to embezzlement.[153] Controllers who use the *Flood* approval methods before entering transactions that involve transferring

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*Initial Approval to Settle Clear Channel Suit*, BLOOMBERG LAW (Dec. 17, 2018, 5:39 PM), https://news.bloomberglaw.com/bankruptcy-law/iheartmedia-wins-initial-approval-to-settle-clear-channel-suit-1 (noting that Gamco Asset Mgmt. v. Blair Hendrix, et al., No. 2018-0633 was filed pursuant to the *In re* iHeartMedia, Inc., bankruptcy proceeding).

148. *See* Soma Biswas, *Judge Gives iHeartMedia the Green Light to Exit Bankruptcy*, WALL ST. J. (Jan. 22, 2019, 6:29 PM), https://www.wsj.com/articles/judge-gives-iheartmedia-the-green-light-to-exit-bankruptcy-11548199748 ("iHeart owns most of Clear Channel and for years has had an arrangement that allowed it to take cash from the billboard company's bank accounts . . . . The practice will end once Clear Channel breaks away from iHeart . . . .").

149. *See supra* Part IV.B.

150. *See* Order (I) Confirming Third Amended Joint Chapter 11 Plan of Claire's Stores, Inc. and its Debtor Affiliates and (II) Granting Related Relief, 6–7, In re Claire's Stores, Inc., et al., No. 18-10584 (Bankr. D. Del. filed July 19, 2018) (Claire's litigation flowing from use of unrestricted subsidiary to tunnel); Complaint, Argos Holdings, Inc. v. Citibank, N.A., No. 1:18-cv-05773 (S.D.N.Y. filed June 26, 2018) (PetSmart litigation flowing from use of unrestricted subsidiary to tunnel); McNeely, *supra* note 124 (third lawsuit filed by Gamco against iHeart for The Unrestricted Subsidiary Transfer Tactic).

151. *See* Eaton Vance Mgmt. v. Wilmington Sav. Fund Soc., 2018 N.Y. Slip Op. 30727(U) (Trial Order), FSB, No. 654397, 2018 WL 1947405 (N.Y. Sup. Ct. Apr. 25, 2018) (holding that minority owner plaintiffs could not bring suit against J. Crew for using The Unrestricted Subsidiary Transfer Tactic due to no-action clause which only allowed such actions to be brought by a majority of shareholders); *see also* FRIEDMAN ET AL., *supra* note 17 ("Companies may use unrestricted subsidiaries in order to . . . [facilitate] exchange[s] that would otherwise not be permitted by the financing agreement's covenants.").

152. *See supra* Part III-IV.

153. *See* Kang, *supra* note 73, at 126 ("Whether corporate value is transferred via an internal transaction or outright theft, the negative effect on public shareholders' payoff is basically the same in the sense that public shareholders lose a part of corporate wealth that should belong to them: embezzlement of $100 is functionally equivalent to internal-transaction tunneling when a controlling shareholder ends up with a $100 benefit (thus resulting in a $100 loss of corporate funds)."); *see also supra* Part IV.B.

assets to unrestricted subsidiaries will look less like embezzlers, an approach that will not go unnoticed by creditors.[154] Although creditors certainly do not expect guarantees when investing, they also do not expect to feel taken advantage of by their fiduciaries.[155] Parent companies that monitor their transactions will reassure investors in their subsidiaries that they will live up to their fiduciary duties in troubled times.[156] Meanwhile, companies expecting lenders and minority shareholders to remain loyal after surprising them with The Unrestricted Subsidiary Transfer Tactic instead telegraph why they needed to use it in the first place.[157]

BRAD CHEEK[*]

154. *See* Flood v. Synutra Int'l, 195 A.3d 754, 756 (Del. 2018); *see also* Kang, *supra* note 73, at 126 (comparing tunneling to embezzlement).

155. *See* Gamco Asset Mgmt. Inc. v. iHeartMedia Inc., No. 12312, 2016 WL 6892802, at *12 (Del. Ch. Nov. 23, 2016, revised Nov. 29, 2016) ("[I]t is not contested that [iHeart and iHC] owe fiduciary duties to the [Gamco] stockholders by virtue of their position as controllers of CCOH."), *aff'd,* No. 593, 2017 WL 4607413 (Del. Oct. 12, 2017); *see also* Sang Yop Kang, *"Generous Thieves": The Puzzle of Controlling Shareholder Arrangements in Bad-Law Jurisdictions*, 21 STAN. J.L. BUS. & FIN. 57, 72 (2015) ("[M]inority shareholders in [United States jurisdictions] are generally insulated from large-scale expropriation by corporate insiders.").

156. *See supra* Part IV.A.

157. *See* Verified Class Action Complaint at *2–3, Gamco Asset Mgmt. Inc. v. Blair Hendrix, No. 2018-0633 (Del. Ch. filed Aug. 27, 2018) ("[As bankruptcy loomed, the] Defendants did nothing, choosing to fiddle while Rome burned. By doing nothing, these Defendants continued to favor the increasingly unsalvageable interests of the iHeart Entities . . . in breach of their fiduciary duties to Minority Shareholders . . . .").

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