

Commercial Law Newsletter

Joint Newsletter of the Commercial Finance and Uniform Commercial Code Committees



November 20, 2014

Fall 2014

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Joint Report from the Chairs

Dear Members:

Several weeks ago, many of us gathered in Chicago for the Business Law Section's first stand-alone annual meeting. The Section's goal was 900 attendees; its dream 1200. We had over 1560 registered attendees, roughly a third of them first-time attendees. Both committees thanked outgoing, and welcomed incoming, subcommittee and task force officers. Materials from CLE programs are available on the Section of Business Law website.

In this edition of the newsletter, we offer three (3) diverse articles as well as the Spotlight. In the Spotlight column, Professors Steve Sepinuck and Kristen Adams consider four recent UCC cases. In *In re Purdy*, a divided (6th) circuit court confused and conflated basic principles of law, leading it to reverse a bankruptcy court decision dealing with the distinction between a lease and a sale with a retained security interest. In the *Thompson-Young* case, the Illinois Appellate Court was likely correct on the merits of a breach-of-peace claim (teaser – agents repossessing an automobile somehow end up in the debtor's bedroom at 4:00 am, awakening and terrifying him), but jumped the gun by disposing of the matter on a motion to dismiss. In *Tenet Health Care*, the Texas Court of Appeals allowed a judgment creditor of an office space tenant to garnish the obligation of a sublessee. While its conclusion may have been sound, its reasoning erroneously invoked UCC Article 9, from which is excluded most real estate interests, including rents. Finally, in *Heartland Bank & Trust Co.*, the Illinois Appellate Court, considering a conversion claim, misconstrued concepts of negotiability and negotiation (Article 3, anyone?), and conflated the distinct concepts of priority and value.

In their annual summary, John J. Paschetto and Norm Powell explain this year's legislative amendments to Delaware's corporation and alternative entity laws. The amendments, which took effect on August 1, 2014, include (i) confirming that individuals can effectively provide written consents as directors even if they are not directors when they actually sign the consents; (ii) replacing with less-burdensome alternatives the unanimous-vote requirements for revoking the dissolution of a limited liability company or a limited partnership; and (iii) streamlining the means by which the organization of a corporation can be completed when the incorporator is unavailable or uncooperative. They also discuss a widely anticipated amendment that was *not* made – an amendment that would have prevented fee-shifting provisions in bylaws of stock corporations (a recent Delaware Supreme Court decision – *ATP Tour, Inc.* – upheld such provisions in the context of a nonstock corporation). In our second article, Peter Washkowitz, Robert S. Finley, Michael S. Goldman, Stephen M. Kessing, and Janet Vance report on 2014 mid-year trends in large cap and middle market loan terms. Finally, Jeffrey M. Goldfarb and Michael I. Zinder expound on the directors' consent issue, the district court decision that gave it salience (*U.S. Bank v. Verizon*), and Delaware's legislative response.

We hope you enjoy this issue, and invite you to get involved in your committee(s).

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November 21-22, 2014 – ABA Business Law Section Fall Meeting – The Ritz-Carlton, Washington, D.C. Click [here](#) for more information.

November 25, 2014 – 1:00 p.m. to 2:30 p.m. EST – Article 9 Security Interests: Complexities in Drafting Legal Opinions (CLE Webinar). Click [here](#) for more information.

December 4, 2014 – 10:00 a.m. to 11:30 a.m. PST – Structuring Intercreditor Agreements in Split Collateral Lien Structures Between ABL and Term Lenders (CLE Webinar). Click [here](#) for more information.

April 16-18, 2015 – ABA Business Law Section Spring Meeting – Marriott Marquis and Inter Continental, San Francisco, California Click [here](#) for more information.

VIEW CURRENT REPORTS AND DEVELOPMENTS OF THE FOLLOWING COMMITTEES AND TASK FORCES:

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Featured Notes

The Annotated Ontario Consumer Protection Act, 2015 Edition. Suhuyini Abudulai has prepared the [Annotated Ontario Consumer Protection Act, 2015 Edition](#). The book will be published by LexisNexis Canada on November 30, 2015. The *Consumer Protection Act* (Ontario) (the “Act”) applies to virtually all consumer transactions in Ontario, spanning a wide range of industries. Lawyers in different areas of practice come across consumer protection issues. The book annotates provisions of the Act, and contains commentary, case law, and helpful tables which assist in determining the application of various provisions of the Act and its associated regulations.

With certain exceptions, the Act applies to all consumer transactions (as defined in the Act) in Ontario, making its interpretation and judicial treatment particularly relevant in today's legal landscape. Consumer protection is germane to all manner of transactions across a broad range of industries. As a result, lawyers in virtually all areas of practice can benefit from a comprehensive and in-depth understanding of the Act and the issues that may arise in relation to it.

Featured Articles

RECENT AMENDMENTS TO DELAWARE'S ENTITY LAWS: DELAWARE EXPRESSLY PERMITS FUTURE-EFFECTIVE WRITTEN CONSENTS BY DIRECTORS AND LIBERALIZES THE MEANS OF REVOKING DISSOLUTION OF LLCs AND LPS, AMONG OTHER CHANGES

By [Norman M. Powell](#) and [John J. Paschetto](#)¹

The Delaware legislature recently adopted amendments to the State's entity laws that should, among other things, simplify a variety of common transactions. The amendments, which went into effect on August 1, 2014, include (i) confirming that individuals can effectively provide written consents as directors even if they are not directors when they actually sign the consents, (ii) replacing with less-burdensome alternatives the unanimous-vote requirements for revoking the dissolution of a limited liability company (an “LLC”) or a limited partnership (an “LP”), and (iii) streamlining the means by which the organization of a corporation can be completed when the incorporator is unavailable or uncooperative. Of perhaps equal importance, however, is a widely anticipated amendment that was *not* made.

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Possible Legislation on Fee-Shifting Bylaws

On May 8, 2014, the Delaware Supreme Court issued an opinion in which it held, among other things, that the board of a Delaware nonstock corporation could validly adopt a bylaw under which any member that unsuccessfully sues the corporation or another member would be required to bear the litigation expenses of the corporation or defendant member. *ATP Tour, Inc. v. Deutscher Tennis Bund*, 91 A.3d 554, 557-58 (Del. 2014). This ruling, in response to one of four questions certified by the United States District Court for the District of Delaware, dealt only with the challenged bylaw's facial validity, and spoke only in the context of a nonstock corporation. Many practitioners, however, have viewed the court's reasoning in *ATP Tour* as equally valid in the case of stock corporations. It was therefore expected that boards of Delaware stock corporations would adopt fee-shifting bylaws, as has since occurred to an apparently limited extent.²

The committee of the Delaware State Bar Association responsible for proposing amendments to the General Corporation Law of the State of Delaware (the "DGCL") drafted amendments that would have prevented application of *ATP Tour* to stock corporations. But on June 18, 2014, the Delaware Senate adopted a joint resolution requesting Delaware's corporate bar to "continue its ongoing examination" and consider what legislation, if any, may be appropriate on this issue. S.J. Res. 12, 147th Gen. Assemb. (Del. 2014). Legislative consideration of any amendments on the subject of fee-shifting bylaws has thus been effectively postponed until 2015.

Future-Effective Consents by Directors and Others

Among the default rules of corporate governance under the DGCL is that a board of directors may take action without a meeting if the directors unanimously consent in writing to the action. 8 *Del. C.* § 141(f). Like telephonic meetings, unanimous consents have become one of the indispensable features of modern board procedure. And on occasion, in the interests of efficiency and certainty, signatures to a board consent are collected from individuals who are not yet, but soon will be, directors. This strategy is particularly valuable in the context of a corporate acquisition, in order that certain actions (such as replacing senior officers) can be effected immediately after the new board is seated, without requiring the incoming directors to hold themselves in readiness to act as soon as they get word of their election. Typically, when a board consent is signed before the signers become directors, the signature pages are held by counsel until the consent's intended time of effectiveness.

While this practice was generally viewed as permissible under the DGCL, an unreported United States District Court opinion, applying Delaware law, cast doubt on its effectiveness. *See U.S. Bank Nat'l Ass'n v. Verizon Commc'ns Inc.*, No. 3:10-CV-1842-G (N.D. Tex. Aug. 8, 2012). On its motion for partial summary judgment, the plaintiff argued that a purportedly unanimous written consent by one defendant's board of directors was invalid because two individuals had signed it the day before they became directors. In response, the defendants maintained that the signatures of those individuals were properly "held" by counsel until the individuals were duly seated on the board. *Id.* at 6-7. The court, however, after noting the weak evidentiary support for this factual contention, appeared to hold that even if the challenged signature pages had been held in escrow, they were invalid because action taken by individuals when they are not directors cannot "be carried forward" to a time when they are. *Id.* at 7 (relying in part on *AGR Halifax Fund, Inc. v. Fiscina*, 743 A.2d 1188 (Del. Ch. 1999)).³

The 2014 amendments to the DGCL have now settled this issue under Delaware law, confirming that a board consent is not necessarily invalid if some or all of the directors were not yet directors when they actually signed it. The amendments also make clear that such consents need not be subject to a formal escrow arrangement to be effective. As amended, § 141(f) of the DGCL provides that any director consent (including one signed by a person who is "not then a director") may be made effective as of a future time, including the happening of a future event, "whether through instruction to an agent or otherwise." The

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consent will be deemed to have been given at the future effective time if (a) that time is no more than 60 days “after such instruction is given or such provision is made” regarding future effectiveness, (b) the person who signed the consent is a director when the consent is to become effective, and (c) the consent has not previously been revoked. Every such consent “shall be revocable prior to its becoming effective.” 8 *Del. C.* § 141(f).

A similar amendment has been made to the DGCL provisions dealing with written consents by stockholders. 8 *Del. C.* § 228. Language added to § 228(c) provides that, “whether through instruction to an agent or otherwise,” a stockholder consent may be made effective as of a time up to 60 days in the future. If “evidence” of the instruction or provision regarding future effectiveness is furnished to the corporation, “such later effective time shall serve as the date of signature.” Unlike future-effective consents given by directors, such a stockholder consent may provide that it is irrevocable. *Id.*

The legislative synopsis pertaining to the 2014 DGCL amendments makes the important point that the amendment to § 228(c) “does not affect the requirement that the consent bear the actual date of signature.” In addition, the synopsis explains that the amendment to § 228(c) does not “expressly state [that] the signatory need not be a stockholder when the consent is signed,” because “under current law” the person signing the consent must be a stockholder “only on the relevant record date.” H.R. 329 synopsis, 147th Gen. Assemb. (Del. 2014).

To confirm that future-effective consents are permitted also with respect to Delaware LLCs and LPs, amendments similar to the foregoing have been made to the Delaware Limited Liability Company Act (the “[DLLCA](#)”) and the Delaware Revised Uniform Limited Partnership Act (the “[DRULPA](#)”). These amendments provide that any consent given by a person “as a member” or a manager of an LLC, or as a limited or general partner of an LP, whether or not such person is “then a member” (or manager or partner), may be made effective as of a future time, and “such person shall be deemed to have consented” in such capacity as of such future time if such person is a member (or manager or partner) as of such future time. 6 *Del. C.* §§ 18-302(d) (member consent), 18-404(d) (manager consent), 17-302(e) (limited partner consent), 17-405(d) (general partner consent).

In several respects, the future-effective consent amendments to the DLLCA and the DRULPA permit greater flexibility than those made to the DGCL. Future-effective consents in the LLC or LP context may be made more than 60 days before their future effectiveness, and (unlike a stockholder) a member or partner need not provide to the entity evidence of an instruction or provision regarding a consent’s future effectiveness for the consent to be deemed given at the future time. In addition, the DLLCA and DRULPA amendments are silent regarding what steps a person must take to provide for future effectiveness, whereas the DGCL amendments refer to “instruction to an agent or otherwise.” 8 *Del. C.* §§ 141(f), 228(c). Finally, the DLLCA and DRULPA amendments expressly recognize (as is common in those Acts) that an LLC or LP agreement may opt out of the statutory future-effectiveness rules. Presumably, however, a corporation may also opt out, by means of a provision in its certificate of incorporation in the case of stockholder consents, and by means of a provision in its certificate of incorporation or bylaws in the case of director consents. 8 *Del. C.* §§ 141(f) (director consent), 228(a) (stockholder consent).

Revocation of Dissolution of LLCs and LPs Without Unanimous Votes

Under the DLLCA and DRULPA, the dissolution of an LLC or LP is separate from, and precedes, the termination of the LLC’s or LP’s existence.⁴ Dissolution, by itself, commences a period of indefinite length during which the LLC or LP is to wind up its affairs in preparation for its death as a juridical person. 6 *Del. C.* §§ 18-803(b) (winding-up of LLC), 17-803(b) (winding-up of LP). The LLC or LP finally ceases to exist upon the effectiveness of a certificate of cancellation filed with the Delaware Secretary of State. 6 *Del. C.* §§ 18-203(a) (LLC certificate of cancellation), 17-203(a) (LP certificate of cancellation).

During the period between an LLC’s or LP’s dissolution and death, it is not uncommon for those who own or control the entity to wish to revoke the dissolution. This may happen if the dissolution was inadvertent (e.g., by the triggering of a provision in an LLC or LP agreement providing for automatic dissolution), or if an unanticipated beneficial transaction did not surface until after dissolution.

Before the 2014 amendments, the DLLCA and DRULPA required the unanimous vote of the remaining members or the remaining general and limited partners, respectively, for dissolution to be revoked. Moreover, if the entity had been dissolved pursuant to a vote

of the members or partners, dissolution could not be revoked unless every person who voted for dissolution also voted to revoke it. Thus, the mere unavailability or indifference of a single person could prevent a value-creating transaction involving the dissolved entity. Almost entirely rewriting § 18-806 of the DLLCA and § 17-806 of the DRULPA, the 2014 amendments have made revocation of dissolution considerably easier to accomplish. The amendments have done away with the blanket requirement of a unanimous vote by remaining members or partners, and the requirement of a unanimous vote of all persons who voted in favor of dissolution if the LLC or LP was dissolved pursuant to a vote. Those requirements have been replaced with a series of alternative revocation methods whose availability depends in part on how dissolution was effected.

First, if the entity was dissolved pursuant to a vote, then its dissolution may be revoked by such vote. 6 *Del. C.* §§ 18-806(i), 17-806(i). Thus, where dissolution was effected by vote under the default provisions of the DLLCA or DRULPA, the dissolution may now be revoked by the same vote—i.e., the vote of members owning more than two thirds of all the members' interests in profits, in the case of an LLC, 6 *Del. C.* § 18-801(a)(3), and the vote of all general partners plus the vote of limited partners owning more than two thirds of all the limited partners' interests in profits, in the case of an LP, 6 *Del. C.* § 17-801(2). Similarly, if dissolution was effected pursuant to the vote of some different proportion as set forth in the LLC or LP agreement, that proportion would govern a vote to revoke dissolution. There is now no requirement that the revocation be approved by the same persons who voted for the dissolution.

Second, if dissolution resulted from the expiration of a time period or the occurrence of an event as set forth in the LLC or LP agreement, that dissolution can be revoked by whatever vote is required to amend the provision in the LLC or LP agreement that caused it. 6 *Del. C.* §§ 18-806(ii), 17-806(ii). Note, however, that this alternative does not apply if the “event” causing dissolution was a vote to dissolve, the withdrawal of a general partner (in the case of an LP), or an event that caused the last remaining member or limited partner to cease to be a member or limited partner. *Id.* The revocation of a dissolution resulting from those “events” is covered by other subsections of § 18-806 and § 17-806, as discussed above and in the next paragraph.

Third, in the case of an LLC, if dissolution resulted from an event that caused the last remaining member to cease to be a member, revocation can be achieved by the vote of the personal representative of the last remaining member or the vote of “the assignee of all of the [LLC] interests in the [LLC].” 6 *Del. C.* § 18-806(iii). In the case of an LP, if dissolution resulted from the withdrawal of a general partner or an event that caused the last remaining limited partner to cease to be a limited partner, revocation can be achieved by the vote of all remaining general partners and, where any limited partners remain, the vote of the limited partners owning more than two thirds of all the limited partners' interests in profits. If no limited partners remain, the requirement of their vote can be satisfied by the vote of the personal representative of the last remaining limited partner or the vote of “the assignee of all of the limited partners' partnership interests in the limited partnership.” 6 *Del. C.* § 17-806(iii).

The amendments also confirm that an LLC or LP agreement may specify “the manner in which a dissolution may be revoked” or may prohibit revocation of dissolution altogether. They further provide that § 18-806 and § 17-806 “shall not be construed to limit the accomplishment of a revocation of dissolution by other means permitted by law”—a recognition that under certain circumstances, it may be possible to revoke dissolution by, for example, merging a dissolved LLC or LP into an entity that has not been dissolved.

As they did prior to the 2014 amendments, § 18-806 and § 17-806 continue to provide that dissolution may not be revoked once a certificate of cancellation has been filed for the dissolved entity. They also continue to require the admission of a member when the dissolution of an LLC with no remaining members is revoked, and the appointment of a general partner or a limited partner when the dissolution of an LP with no remaining general or limited partners is revoked (with new text that specifically addresses when an LP has no remaining partners at all, whether general or limited).

Perfecting Corporate Organization in the Absence of the Incorporator

Under Delaware law, a corporation's initial certificate of incorporation must be signed by one or more “incorporators.” 8 *Del. C.* § 103(a)(1). In addition, an initial certificate of incorporation may, but need not, state the names and addresses of the corporation's initial directors. 8 *Del. C.* § 102(a)(6). When the initial directors are named in the certificate of incorporation, any authority of the incorporator terminates upon the filing and effectiveness of the certificate of incorporation, and the initial directors then have exclusive authority to perfect the corporation's organization. *Id.*; see also 8 *Del. C.* § 108(a). More commonly, however, certificates of incorporation do not name the initial directors, sometimes in the interest of privacy, and sometimes simply because the selection of the initial directors has not yet been finalized when the certificate of incorporation is filed.

When the initial directors have not been named in the certificate of incorporation, the incorporator has the exclusive authority to elect them. Until the incorporator does so, the corporation is effectively paralyzed. Without a board of directors, it has no power to issue stock, with the result that the ability to elect directors to manage the business and affairs of the corporation cannot be shifted from the incorporator to stockholders.

Not infrequently, once a certificate of incorporation is filed, the interested parties fail to see that the incorporator finishes the job by electing the initial directors. Years sometimes pass before this oversight is detected, and in such situations, the incorporator may be impossible to locate or, if located, unwilling to cooperate. A somewhat cumbersome remedy for the missing or inert incorporator was

possible before the 2014 amendments, by means of § 103(a)(1) of the DGCL (which has also been amended this year, as discussed below). Under that section, if one of several specified circumstances caused an incorporator to be unavailable (and the initial directors were not named in the certificate of incorporation), any person for whom the incorporator had acted in signing the certificate of incorporation could sign any other filing with the Delaware Secretary of State until the initial board was elected. Relying on this provision, the principal for whom the incorporator had acted could sign and file a certificate of amendment that would add to the certificate of incorporation a provision naming a cooperative individual as the initial director. Then, as the initial director, that individual would proceed to complete the corporation's organization (adopting bylaws, electing officers, authorizing the initial issuances of stock, etc.).

The 2014 amendments have made the unavailability of an incorporator much easier to overcome. Under new § 108(d), "[i]f any incorporator is not available to act, then any person for whom or on whose behalf the incorporator was acting directly or indirectly as employee or agent, may take any action that such incorporator would have been authorized to take" pursuant to the DGCL. Thus, no filing must now be made with the Delaware Secretary of State to enable the principal of an unavailable incorporator to step into the incorporator's shoes. The only associated formality is that any instrument signed by the principal in place of the incorporator (and the minutes of any meeting where the principal acts in concert with multiple incorporators) must state that the incorporator is unavailable, "the reason therefor," that the incorporator was acting "directly or indirectly as employee or agent" for the principal, and that the principal's signature (or participation in an incorporators' meeting) "is otherwise authorized and not wrongful." 8 *Del. C.* § 108(d).

An amendment regarding incorporator unavailability has also been made to § 103(a)(1) of the DGCL. Previously, § 103(a)(1) stated that the principal for whom an incorporator acted could sign filings with the Secretary of State if the incorporator was "not available *by reason of death, incapacity, unknown address, or refusal or neglect to act.*" Act of June 23, 2000, ch. 343, § 2, 72 Del. Laws 619, 619 (emphasis added). The emphasized language has now been removed by the amendment. However, that language should remain significant insofar as it aids interpretation of "not available"—a phrase that most readers would not normally take to encompass a refusal or neglect to act by someone who physically is available. Importantly, the legislative synopsis indicates that this amendment was not intended to narrow the meaning of "not available"; rather, its purpose was just the opposite, i.e., "to remove any limitation on the reason for the incorporator's unavailability." H.R. 329 synopsis.

Refinement of the Second-Step Merger Provisions Added to the DGCL in 2013

Last year, the Delaware legislature amended the DGCL's basic merger statute, 8 *Del. C.* § 251, to simplify the consummation of a merger when it forms the second step of a standard two-step acquisition of a public corporation (in which a merger follows a successful tender offer for the target corporation's shares). Under then-new § 251(h), if various requirements were met, the acquiring corporation would be spared the necessity of obtaining approval of the merger from the target corporation's stockholders if, following the tender offer, the acquiring corporation owned enough shares to determine the outcome of any stockholder vote on the merger (typically, anything over 50% of the shares entitled to vote). This was a significant innovation because, under prior law, approval by the target's stockholders could be avoided only if the acquirer held at least 90% of the target's voting shares after the tender offer and any subsequent "top-up" purchases.⁵

The streamlined transaction structure offered by § 251(h) was quickly put to use by M&A practitioners. Their experience in crafting merger agreements so as to come within the new provisions led to a number of amendments that have made § 251(h) clearer and more practical.⁶

First, the agreement of merger need no longer provide that the merger "shall" be governed by § 251(h) and "shall" be effectuated as soon as possible after the tender offer. Instead, the agreement need only "permit" the merger to be effectuated under § 251(h) and provide that its effectuation will follow the tender offer as soon as possible *if* the merger is under § 251(h). Second, the amendments have made clear that the tender offer, which must be for "any and all" of the target's outstanding voting shares, nevertheless need not include target shares already held by the acquirer, by any person that directly or indirectly owns all of the stock in the acquirer, or by any direct or indirect wholly owned subsidiary of such person, of the target, or of the acquirer.

Third, following the tender offer, the acquirer need no longer "own" sufficient target shares to control the outcome of a merger vote. Instead, the acquirer can reach the required threshold by including shares "irrevocably accepted" in the offer and "received" by the target's depository before the offer expired. Fourth, the amendments have removed the former requirement that no party to the agreement of merger be an "interested stockholder" under Delaware's anti-takeover statute, 8 *Del. C.* § 203. Finally, the amendments have added definitions that helpfully specify what § 251(h) means by "consummation" of a tender offer and stock "received" by a "depository."

Additional Amendments to the DGCL

The 2014 amendments to the DGCL have also made it possible for a corporation to change its name without stockholder approval. Changing a corporation's name requires an amendment to its certificate of incorporation. Previously, the approvals needed for such an amendment (as set forth in 8 *Del. C.* § 242) were the same as those for any other amendment to a certificate of incorporation: if the

corporation had received payment for any of its stock, the amendment had to be approved by both the board of directors and the holders of a majority of the outstanding shares entitled to vote. As a result of the 2014 amendments, however, no stockholder approval is now needed to amend a certificate of incorporation to change the corporation's name.

In addition, § 242 has been amended to permit the removal of obsolete provisions from a certificate of incorporation without a stockholder vote and without restating the entire certificate. Since 1967, § 245 of the DGCL has set forth a procedure by which a certificate of incorporation can be "restated"—i.e., "integrat[ing] into a single instrument all of the provisions . . . which are then in effect and operative" as a result of earlier certificates of amendment or other filings with the Delaware Secretary of State. 8 *Del. C.* § 245(a). If the corporation merely restates its certificate without simultaneously further amending it, no stockholder approval has been required. 8 *Del. C.* § 245(b). Moreover, no stockholder approval has been required if the restated certificate of incorporation also "omit[s]" certain obsolete provisions, including provisions naming the incorporator and initial directors, and provisions effectuating a stock split or similar recapitalization that has since taken place. 8 *Del. C.* § 245(c). Not until now, however, could such obsolete provisions be removed, without stockholder vote, by means of a certificate of amendment. The 2014 amendments to § 242 now permit a certificate of incorporation to be amended, without a stockholder vote, to remove the types of obsolete provisions described in § 245.

A third amendment this year to § 242 involves the notice that must be given to stockholders when an amendment to the certificate of incorporation requires their approval. Under § 242, the notice to stockholders must set forth in full or summarize the proposed amendment. 8 *Del. C.* § 242(b)(1). The 2014 amendments have inserted a qualification to this notice requirement, under which the notice need not set forth or summarize the proposed amendment if "such notice constitutes a notice of internet availability of proxy materials under the rules promulgated under the Securities Exchange Act of 1934." *Id.*

. Finally, the provisions of the DGCL regarding stockholder voting trusts have been amended to provide an additional means by which the settlors of a voting trust can cause the corporation to issue stock to the voting trustee. Previously, the voting trust agreement had to be "filed" in the corporation's registered office in Delaware. Now it will be sufficient if the agreement is "delivered" to either the corporation's registered office in Delaware or its principal place of business. 8 *Del. C.* § 218.

Additional Amendments to the DLLCA and DRULPA

The 2014 amendments have added provisions to the DLLCA and DRULPA that expand the role of the "communications contact" that every LLC and LP has been required to have since 2006. 6 *Del. C.* §§ 18-104(g) (for LLCs), 17-104(g) (for LPs).⁷ A communications contact is a natural person whose name, business address, and business phone number are provided to the entity's registered agent in Delaware, and who is authorized by the entity to receive communications from the registered agent.

Provisions added by the 2014 amendments require that every LLC and LP, when requested by its communications contact, "shall provide the communications contact with the name, business address and business telephone number of a natural person who has access to the record required to be maintained pursuant to § 18-305(h) of this title [or, in the case of an LP, § 17-305(g)]." *Id.* Sections 18-305(h) and 17-305(g) of Title 6, which are new, in turn provide that every LLC or LP "shall maintain a current record that identifies the name and last known business, residence or mailing address" of each member and manager (in the case of an LLC) and each general and limited partner (in the case of an LP). Thus, an LLC or LP is now required to maintain a record similar to the list of stockholders that a corporation must periodically prepare, and make available for inspection by stockholders, pursuant to § 219 of the DGCL. 8 *Del. C.* § 219. Moreover, the DLLCA and DRULPA amendments have, in effect, established a chain of communication through which an LLC's or LP's registered agent in Delaware (whose identity and address are a matter of public record) can convey to the entity's communications contact (whose contact information the registered agent must have) a request for the record of members, managers, or partners that the entity is now required to maintain. The circumstances under which the possessor of that record may be compelled to provide it are beyond the scope of the amendments.

Lastly, the 2014 amendments have increased the similarity of the informational rights of members and limited partners to those of stockholders. The DLLCA and DRULPA provisions dealing with the rights of members (of an LLC) and limited partners (of an LP) to obtain information about the entity have been amended to provide that members and limited partners may assert such rights not only "in person" but also "by attorney or other agent." 6 *Del. C.* §§ 18-305(a) (for LLCs), 17-305(a) (for LPs). If the member or limited partner acts through an attorney or other agent, the demand for information must be accompanied by "a power of attorney or such other writing which authorizes the attorney or other agent to so act on behalf of" the member or limited partner. §§ 18-305(e), 17-305(d). This language tracks that of § 220 of the DGCL, which sets forth a stockholder's right to inspect books and records of a corporation. 8 *Del. C.* § 220.

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WHAT'S MARKET: 2014 MID-YEAR TRENDS IN LARGE CAP AND MIDDLE MARKET LOAN TERM

By [Peter Washkowitz](#) of Practical Law, [Robert S. Finley](#) of King & Spalding LLP, [Michael S. Goldman](#) and [Stephen M. Kessing](#) of Cravath, Swaine & Moore LLP and [Janet Vance](#) of Gibson, Dunn & Crutcher LLP

Following a strong 2013 that saw \$2.14 trillion in syndicated lending, the US loan market has remained solid through the first half of this year, increasing slightly from the same period in 2013. Total US syndicated lending reached \$873.3 billion through May 2014, a 3.3% increase over the same period in 2013.

Overview

Refinancings of existing loans continued to represent a majority of large corporate (large cap) and middle market loan issuance, accounting for 68% of the \$873.3 billion total issuance, compared to 78% from the same period in 2013. This decrease reflects a shift towards financing M&A activity and other new money issuance, with \$187.9 billion of M&A financing constituting a 76% increase over the same period in 2013.

Collateralized loan obligations (CLOs) continued to pump liquidity into the loan market, as CLO issuance totaled \$46 billion through May 2014, a 31% increase over the same period in 2013. The increase in CLO issuance, combined with low interest rates and an influx of capital from investors seeking higher yields, fueled a trend towards more borrower-friendly terms. As of the end of May 2014, \$181 billion of covenant-lite loans were issued, representing a 48% increase over the same period in 2013.

Large cap lending levels were relatively unchanged, with \$787.6 billion of large cap loan issuance through May 2014. This represents a slight increase of 2.5% over the same period in 2013. In contrast, middle market lending continued to attract lenders looking to put money to work, with middle market loan issuance increasing 11% from the same period in 2013. The \$85.7 billion in middle market loan issuance represented 9% of total US loan issuance through May 2014.

The loan markets have seen an uptick in second lien loans in 2014 with \$22.9 billion of second lien loans coming to market through May 2014, a 39% increase over the same period in 2013. While second lien loans typically have higher interest rates than high-yield bonds, many borrowers prefer second lien loans because, unlike bonds, these loans typically do not require payment of a call premium in the event of any refinancing or repricing of the debt by the borrower.

Gaining more popularity in the middle market, unitranche loans combine senior and subordinated debt into one financing with a blended interest rate (which is often less than the combined rate the borrower would pay for separate senior and subordinated facilities). The unitranche loan is divided into separate first-out and last-out loans. The agreement among lenders (AAL) provides for the treatment of priority issues among the two groups of lenders. AALs are rarely disclosed and not standardized between different lenders.

The loan market remained very active through May 2014, building on the momentum from 2013. Market observers remain hopeful that loan deal flow will increase in the second half of the year due to:

- The increasing pace of M&A activity.
- A growing interest by private equity sponsors in new acquisition opportunities.
- The continuing borrower-friendly lending environment.

An ongoing concern for lenders relates to the continued implementation of the leveraged lending guidelines which went into effect on May 21, 2013. Because of the uncertainty relating to certain compliance components of the guidelines, including the definition of leveraged lending and the underwriting standards applicable to lenders engaged in leveraged lending, lenders' appetites for and abilities to continue offering leveraged loans with the kind of borrower-friendly terms that are common today may be dampened. In anticipation of their July 2014 reviews under the Shared National Credit Program, it has been reported that banks are concerned that US bank regulatory agencies may impose fines for leveraged finance deals that have leverage ratios greater than 6:1, the limit under the guidelines.

2014 Mid-Year Trends

This article includes discussions by leading practitioners on the following trends in large cap and middle market loan agreements that emerged in the first half of 2014:

- Greater flexibility given to many borrowers to modify their capital structures during the term of the loan, including uncapped incremental facilities not subject to pro forma leverage ratios (for examples, search [J. Crew Group, Inc.](#) and [La Quinta Intermediate Holdings L.L.C.](#) in What's Market).
- Covenant flexibility in loan agreements giving borrowers more latitude in the way they operate their businesses, including:
 - builder baskets (for examples of builder baskets based on consolidated net income, search [Texas Competitive Electric Holdings Company LLC](#) and [J. Crew Group, Inc.](#) in What's Market);
 - borrower-friendly mandatory prepayment requirements (for examples of mandatory prepayments provisions that excluded asset sales and excess cash flow, search [Motorola Solutions, Inc.](#) and [TreeHouse Foods, Inc.](#) in What's Market); and
 - excluded property (for examples of loan agreements with expanded definitions of excluded property, search [American Tire Distributors, Inc.](#) and [Caesars Growth Properties Holdings, LLC](#) in What's Market).
 - A closer relationship among sellers, buyers and lenders in leveraged acquisitions, including the negotiation of the specified representations (for examples of commitment letters that include OFAC and anti-money laundering representations, search [KSTW Holdings, Inc.](#) and [KSTW Acquisition, Inc. Commitment Letter](#) and [BioScrip, Inc. Commitment Letter](#) in What's Market).

Looking Ahead

US loan market participants remain upbeat entering the second half of 2014. With approximately \$27 billion of M&A-related issuance in the loan market pipeline at the end of May 2014, market watchers are optimistic that the rebound in M&A activity and other new money issuance will continue. This activity, combined with interest rates that continue to be near historic lows and high levels of liquidity from investors searching for yield, is expected to lead to a well-performing US loan market through 2014.

The market statistics cited in this article were provided by Thomson Reuters LPC.

An Expert's View: Key 2014 Trends in Middle Market Loans

Robert S. Finley of King & Spalding LLP explains the differences in how “excluded property” is being defined in large cap and middle market loan agreements and identifies key trends in middle market loan agreements so far this year:

How, if at all, is “excluded property” being defined differently in large cap and middle market deals in transactions you have worked on?

Large cap (as opposed to middle market) transactions generally exclude from collateral:

- Stock in non-profit corporations.
- Stock in immaterial subsidiaries.
- Stock in captive insurance companies.
- Stock in subsidiaries and joint ventures whose organizational documents prohibit a pledge.
- Stock or assets the pledge of which would create adverse or materially adverse tax consequences.
- Stock in special purpose vehicles organized for securitization transactions.

The exclusion of stock that is subject to organizational document prohibitions often is limited to prohibitions that either exist on the closing date or that are adopted in the future but not in order to take advantage of the exclusion.

Excluded property continues to include items such as collateral whose pledge is prohibited by applicable law or items whose pledge requires governmental consent (to the extent that such law is enforceable under the anti-assignment provisions of the Uniform Commercial Code). That exclusion is dangerous, broad and, in transactions in which the debtor is a regulated entity (such as a broadcaster or distributor or seller of pharmaceuticals or alcoholic beverages), the lender has to be careful not to exclude inadvertently the prime collateral.

Additionally, middle market excluded property definitions often require the borrower to use reasonable commercial efforts to obtain third-party consents that are necessary for the pledge of excluded property, while large cap borrowers generally do not have this obligation. Large cap transactions typically will not require perfection by control (such as deposit accounts), while middle market transactions often do not have this exclusion.

It is good practice to distinguish between collateral in which a grant is excluded and collateral where perfection is not required. One category in which this is often blurred is motor vehicles. The exclusion is intended to eliminate the need to note the lien on the title, but not to exclude a grant in the collateral (such as a lien on vehicles of a borrower that is in the business of selling or leasing vehicles, which can be perfected by filing a financing statement).

What were the key developments in middle market loan documentation that you saw in the first half of 2014?

Disqualified lender provisions seem to be crystallizing. The typical middle market disqualified lender provision includes financial institutions as “disqualified lenders,” as well as competitors of the borrower named by the sponsor or borrower at the time of signing the commitment letter and reasonably identifiable affiliates of these persons (or, more conservatively, affiliates that are “clearly identifiable by reference solely to their names”).

Typically, the borrower can, without the administrative agent’s approval, supplement the disqualified lender list with competitors (but not financial institutions) after the original list is submitted and may supplement the list with financial institutions only with the administrative agent’s approval. While the most highly negotiated point is whether the disqualified lender list is still effective during a payment or bankruptcy default, it is generally accepted that the list survives during other defaults. In large cap deals the disqualified lender list generally survives a bankruptcy or payment default, while in middle market deals it generally does not.

Another new term is a requirement to contribute the proceeds of breach of representation and warranty insurance to a credit party. Many sponsors in competitive auctions are allowing the non-fundamental representations and warranties to lapse at closing. Instead of relying on the indemnification provisions, they are buying breach of representation and warranty insurance. As the policies are often not in the name of a loan party, lenders have been requiring that the collected proceeds of the policies be contributed to a loan party. At least one major middle market lender is requiring that the policy be assigned to the lenders as collateral (with the consent of the insurer). Lenders should be thinking about whether to add approval of the terms of the policy as a closing condition.

Finally, with the implementation of FATCA, tax provisions are getting some fine tuning and lenders are less willing to depart from standard terms, particularly the terms approved by the Loan Syndications and Trading Association.

Mr. Finley would like to acknowledge Ellen Marie Snare of King & Spalding LLP for her insights on this topic.

Experts’ View: Large Cap Loan Trends

Michael S. Goldman and Stephen M. Kessing of Cravath, Swaine & Moore LLP discuss trends in large cap loan agreements, including developments relating to incremental facilities, builder baskets and mandatory prepayment provisions:

Incremental facilities provide borrowers with greater flexibility to manage their financing needs by changing their capital structures. What are the most common areas of negotiation between a borrower and its lenders regarding these provisions?

Incremental facilities are frequently, if not universally, included in large cap loan agreements. Over the first half of 2014 we have continued to see three principal areas of negotiation with respect to incremental facilities:

- **Ratio-based limits.** In recent years, many borrowers have negotiated for flexibility to incur incremental facilities based on pro forma compliance with a specified leverage ratio. Many large cap loan agreements now include an absolute dollar basket for incremental facilities, as well as additional capacity to establish incremental facilities if the borrower meets a specified pro forma leverage ratio after giving effect to the incremental facilities and any related transactions, such as an acquisition. In older loan agreements, the dollar basket was often used first, with the ratio-based amount applying only after the dollar basket was exhausted. We are seeing greater acceptance in the market for deeming the leverage-based basket to be used prior to (or in conjunction with) the fixed dollar basket.
- **Scope of “Incremental Equivalent Debt.”** Borrowers continue to negotiate for flexibility in the form of incremental equivalent debt. Incremental facilities historically were limited to pari passu term loans or increases in commitments to an existing revolving facility, in each case to be incurred as an amendment to the existing loan agreement. Borrowers are increasingly negotiating for the ability to treat the incremental facility amount as a stand-alone debt basket to permit the incurrence of pari passu secured notes or junior lien, unsecured or subordinated loans or notes. To a lesser extent, borrowers

are also asking for the ability to incur *pari passu* secured loans under “sidecar” loan agreements.

- **“Most Favored Nation” provisions.** It is typical for incremental facilities to be subject to most favored nation (MFN) pricing provisions that prevent a *pari passu* incremental loan facility from being priced at a premium above the yield of the existing loans without increasing the interest rate on the existing loans (in most cases, subject to a permitted 50 basis point difference). Borrowers continue to negotiate for exceptions to the MFN provisions, such as:
 - a “sunset” (a period of time, often one year, after which the MFN provisions cease to apply); or
 - restricting the MFN provisions to apply only to loans incurred in reliance on the ratio-based incremental basket (and not to loans incurred in reliance on a fixed dollar basket).

Recently, loan agreements have started calculating builder baskets based on the borrower’s cumulative consolidated net income rather than its excess cash flow. What are the implications of this change?

This is one of several areas where we are seeing provisions in large cap loan agreements trend towards provisions that are more typically found in high-yield note indentures.

Many high-yield note indentures include the ability for an issuer to make restricted payments (such as certain dividends, junior debt prepayments and investments) under a builder basket equal to 50% of cumulative consolidated net income (CNI) plus certain other additional amounts, often subject to compliance with a fixed charge coverage ratio of 2.00 to 1.00.

Many large cap loan agreements have included a similar “available amount” basket, but in loan agreements the basket is often based on the borrower’s share of excess cash flow and historically could only be used to make certain restricted payments if the borrower satisfied a pro forma leverage ratio and made any required excess cash flow mandatory prepayment.

Recently, however, there have been examples of the available amount basket in loan agreements building based on 50% of CNI and, in some cases, replacing the traditional leverage ratio condition with a coverage ratio condition similar to the typical high-yield note indenture formulation. The result of this is to provide borrowers with more flexibility to make restricted payments, investments and junior debt repayments, as a CNI basket is typically larger than a basket based on excess cash flow, and a coverage ratio condition is often easier to meet than a leverage ratio condition.

In addition to providing greater flexibility, adopting this construct allows a borrower with outstanding high-yield bonds to harmonize the baskets between its loans and bonds. Lenders, however, lose the protection they have traditionally received from having the available amount and the excess cash flow sweep based on the same calculation.

The mandatory prepayment provisions in loan agreements are becoming more borrower-friendly. How have these provisions changed in your recent deals?

We have continued to see deterioration of asset sale and excess cash flow prepayment requirements during the first half of 2014. Some loan agreements are including more exceptions to excess cash flow calculations, such as dollar-for-dollar credit for prepayments of other *pari passu* debt and, in some cases, junior secured debt. Borrowers are also requesting credit for expenditures made after the end of a calculation period and prior to the required excess cash flow prepayment date.

Asset sale covenants have generally become very permissive, incorporating bond-like concepts such as “designated non-cash consideration,” broad reinvestment rights (for the timing and the nature of the reinvestment) and per sale and annual thresholds that limit the circumstances under which an asset sale prepayment is required to be made.

An Expert’s View: Middle Market Deal Activity in the Second Half of 2014

Janet Vance of Gibson, Dunn & Crutcher LLP examines issues around OFAC and anti-money laundering representations and describes factors that may affect middle market deal activity in the second half of the year:

What are the most common borrower and lender concerns about the inclusion in acquisition financing commitment letters of representations relating to Office of Foreign Assets Control (OFAC) and anti-money laundering statutes in the specified representations?

Lenders are increasingly requesting representations with respect to sanctions laws (including OFAC), PATRIOT Act, anti-money laundering and anti-bribery statutes due to concerns that violations of these laws might:

- Result in related violations and liabilities of the lenders.

- Damage the quality of the credit and value of the borrower.
- Result in highly damaging reputational issues for the lenders.

Including these representations in the narrow list of “specified representations” (which allows lenders to refuse to fund at closing regardless of the provisions of the relevant purchase agreement) creates a real risk for borrowers in acquisition financings that they may be required to fund under a purchase agreement and yet not be able to force funding by the debt sources.

Techniques by borrowers to reduce this risk include:

- Narrowing the list of relevant laws to named statutes in specified jurisdictions (for example, referring to the “UK Bribery Act” rather than “anti-corruption laws”).
- Negotiating limits on the scope of required compliance, applying only to violations resulting from entering into the debt documents and the use of proceeds of the loan.
- Including the concept of “materiality” (if the lenders will not accept a standard of “material adverse effect,” which often they will not).
- Increasing protections from the seller side, by adding corresponding representations to be made by the seller or target in the purchase agreement and/or conducting due diligence on the target.

Lenders, for their part to reduce risk, should “follow the money” and spend the time to understand the jurisdictions where the companies are doing business, including by reviewing vendor and supply arrangements, inquire about company policies and records and obtain representations that are relevant and tailored to the business of the company rather than relying only on form documents.

What factors do you see potentially affecting the level of deal activity in the middle market in the second half of 2014?

Looking ahead to the future is always exciting. We have seen throughout history that macro events can impact stability of US and global economies and dramatically affect the availability of liquidity, which is a huge driver of deal flow. Absent such events, this low interest rate environment, record high levels of capital raised by private equity firms and strong demand for yield by debt investors all contribute to a sense that deal activity will remain robust in the second half of 2014.

However, there are limits. Current sky high enterprise valuations will deter some players in the market and will favor strategic buyers (with their rich opportunities for synergies) over financial buyers. Also, the leveraged lending guidance issued by the Federal Reserve, the Federal Deposit Insurance Corporation and Comptroller of the Currency in 2013 is having an increasing impact on the market this year and reducing the availability of some higher leverage loans.

Previously, lenders were routinely doing deals above the limits set forth in the guidance, but in the face of recent statements by the Federal Reserve, lenders are becoming more conservative. As a result, we would expect larger equity checks and capital structures designed not to be subject to the guidance. Overall, however, the future looks busy, which is good news.

[Peter Washkowitz](#) is a What's Market Senior Analyst in the Finance service at Practical Law, [Robert S. Finley](#) is a partner of King & Spalding LLP, [Michael S. Goldman](#) and [Stephen M. Kessing](#) are partners of Cravath, Swaine & Moore LLP, and [Janet Vance](#) is a partner of Gibson, Dunn & Crutcher LLP. For a copy of this article published on the Practical Law website which includes links to recent examples of loan agreements, see Practice Note, What's Market: 2014 Mid-year Trends in Large Cap and Middle Market Loan Terms, Practical Law, at <http://us.practicallaw.com/2-572-8570>

EXPERT Q&A ON DEVELOPMENTS IN BOARD AUTHORIZATIONS POST-VERIZON

An expert Q&A by Practical Law with [Jeffrey M. Goldfarb](#) and [Michael J. Zinder](#) of Willkie Farr & Gallagher LLP on the issues raised by U.S. Bank National Ass'n v. Verizon Communications Inc. and the recent amendments to the Delaware General Corporation Law permitting board consents to be placed in escrow.

In August 2012, a memorandum decision in *U.S. Bank National Ass'n v. Verizon Communications Inc.* threw into doubt the commonly accepted means of authorization of many corporate transactions by providing that board resolutions could not be signed in advance and reserved in escrow by incoming board members prior to their actually becoming directors. No. 3:10-CV-1842-G (N.D. Tex. Aug. 8, 2012) (mem.). Recently, however, the Delaware General Assembly amended the Delaware General Corporation Law (the “DGCL”) (effective August 1, 2014), to permit board consents to be placed in escrow. Practical Law asked Jeffrey Goldfarb and Michael Zinder of Willkie Farr & Gallagher LLP to discuss the issues raised by *Verizon*, the amendments to the DGCL and practice tips for giving due

authorization opinions in corporate transactions.

What was the background in *Verizon* and which factors did the court consider in determining the validity of the incoming directors' written consents?

Previously owned by Verizon, Idearc, a publisher of yellow pages directories and related media, was spun off in 2006 as an independent company to Verizon's stockholders. By March 2009, the economy had shifted dramatically, and Idearc filed for Chapter 11 bankruptcy in the US Bankruptcy Court for the Northern District of Texas.

Idearc's Plan of Reorganization created a litigation trust to pursue claims of its bankruptcy estate, including fraudulent conveyance claims, against Verizon and certain of its affiliates. U.S. Bank, as Trustee for the trust, filed suit in the US District Court for the Northern District of Texas in Dallas. The Trustee asserted that under Delaware law the spin-off was never properly authorized by the board of Idearc.

Like many newly formed corporations, Idearc initially had a single director, which in this case was a senior executive at Verizon. The initial director approved the spin-off transaction and authorized Idearc to move forward on the transaction. Immediately before the completion of the transaction, the initial director appointed five new independent directors and then resigned from the board entirely. The new board then attempted to enter into a unanimous written consent to ratify all of the actions of the initial director. However, the court found these actions to be problematic.

Under § 141(f) of the DGCL, absent a prohibition in the certificate of incorporation or by-laws of a Delaware corporation, "any action required or permitted to be taken at any meeting of the board of directors...may be taken without a meeting if all members of the board ... consent thereto in writing." 8 *Del. C.* § 141(f). In Idearc's case, all five of the new directors signed the written consent.

Further, the decision did not indicate that any of the directors did not intend to sign the consent (though the court noted that "the parties have provided no evidence at all about what [one of the directors] thought he was signing"). The Trustee argued, however, that the written consent was invalid because two of the directors had actually signed the written consent the day before they were appointed as directors, and a written consent could not be effective without the signature of all directors at a time when they are technically directors.

Applying Delaware law, the court agreed and held that "individuals who have not yet been elected to a corporation's board of directors cannot act as directors Therefore, actions taken by individuals that are not members of a corporation's board of directors are a nullity." The court found that this is true even if these individuals are subsequently appointed to the board.

In reaching this conclusion, the court relied on *AGR Halifax Fund, Inc. v. Fiscina*, which similarly ruled that a written consent was invalid when it was executed by the right individuals (a group of newly appointed directors) at the wrong time (prior to their appointment as directors). 743 A.2d 1188 (Del. Ch. 1999). Interestingly, *AGR Halifax* predated *Verizon* by 13 years, but did not create the same level of concern as the later case, perhaps because it did not involve financing.

Notably, the courts in both *Verizon* and *AGR Halifax* rejected variations of the defense that signature pages are frequently collected prior to their release, for the purpose of facilitating deal closings. In its brief, Verizon called it "the standard corporate practice of gathering signature pages in advance of the closing of a major transaction." The defendants in *AGR Halifax* asserted that failure to allow pre-execution of a signature page would "wreak havoc upon the ability to use the consent mechanism" allowed under Delaware law. In each case, however, the court ruled that there was no way to construe § 141(f) to allow for resolutions executed by non-directors to become binding upon the election of these non-directors as directors.

Before *Verizon*, what was the usual process for obtaining incoming director authorizations in a typical leveraged buyout (LBO)?

In a typical leveraged buyout (LBO), a private equity fund (or sponsor) purchases a controlling stake in a target company by using a combination of equity and debt financing. The equity financing comes from the sponsor's own investors, while the debt financing is usually provided by outside lenders or investors. Significantly, the debt financing is borrowed not by the sponsor but essentially by the target company and its subsidiaries. Therefore, the credit of the target company and its subsidiaries is used to incur the debt needed (along with the equity financing) to pay the purchase price to their now prior owners.

Because the debt is incurred by, or based on the credit of, the target company, and usually guaranteed by its subsidiaries and secured by pledges of substantially all of the assets of the target company and its subsidiaries, the boards (or similar governing bodies) of those entities must pass resolutions authorizing incurrence of the debt and the associated guarantees and pledges. Often, however, the buyer intends to replace the board of the target company and its subsidiaries with its own designees.

At the same time, the existing directors of the target company and its subsidiaries, who are being replaced in the transaction, have no interest in authorizing (and assuming fiduciary duties in connection with) the buyer's financing. Therefore, it becomes necessary to

have the new board execute resolutions to authorize the financing.

Prior to the *Verizon* case, standard practice was to have the written consent of the new board “on the table” at the closing of the transaction, along with stockholder resolutions appointing the new directors. Upon consummation of the acquisition, the exiting directors would resign (their resignation letters would also be signed prior to and delivered at the closing), the stockholder consents appointing the new directors would be released (before the signatories were technically stockholders) and the resolutions signed by the new directors would take effect essentially all at the same time.

What other aspects of LBO closing mechanics were affected by *Verizon*?

Commercial lenders almost always require the borrower’s legal counsel to provide an opinion letter for the benefit of the lenders, including an opinion that the financing transactions have been duly authorized by the borrower. Effective resolutions are essential to providing this opinion. In light of the *Verizon* case, however, many law firms became uncomfortable giving this opinion based on written consents signed prior to the closing.

As a result, law firms devised practices designed to ensure that financings were approved by the new directors following their appointment. This often requires the burden and expense of generating and providing separate outside counsel legal opinions for the acquisition vehicle and the target company, with an assumption that the target company’s board will approve the transaction in the afternoon of the closing date, following the consummation of the sale in the morning. This procedure requires that the board convene immediately post-closing to execute resolutions and enable the second legal opinion to be released. While this is possible, ensuring that all the required parties are available on the same day is challenging, and the dual opinion procedure is complicated.

How do the Delaware General Assembly’s recent amendments to the DGCL address the issues raised by *Verizon*?

The Delaware General Assembly passed an amendment to Section 141(f), and a corresponding amendment to the provision of the DGCL allowing written consent by stockholders. H.R. 329, 147th Gen. Assemb. (Del. 2014); 8 *Del. C.* § 218(c).

These amendments establish a procedure for “escrowing” signature pages for written consents signed before the relevant signatory has actually been elected or appointed as a director or has become a stockholder. These amendments took effect on August 1, 2014.

What is the new language that has been added to § 141(f) and how do you anticipate that it will work in practice?

The new language inserted in § 141(f) states that:

Any person (whether or not then a director) may provide, whether through instruction to an agent or otherwise, that a consent to action will be effective at a future time (including a time determined upon the happening of an event), no later than 60 days after such instruction is given or such provision is made and such consent shall be deemed to have been given for purposes of this subsection at such effective time so long as such person is then a director and did not revoke the consent prior to such time. Any such consent shall be revocable prior to its becoming effective.

In the context of a transaction, this provision allows for a future director to execute a written consent and instruct an agent (such as the future director’s attorney) that the consent will go into effect upon his appointment as a director. Alternatively, it suggests that the text of the consent itself could be drafted in such a way as to state that it becomes immediately effective upon the occurrence of the same event.

Notably, these pre-signed documents have a “shelf life” of 60 days under the new laws and the signatories may revoke their consent at any time prior to its effective date, so a confirmation of non-revocation is advisable. The rules for future stockholders are essentially identical. As a result of these amendments, it is now clear that under Delaware law, all relevant transaction documents can be signed prior to closing the transaction, facilitating a smooth closing.

Following the amendments, what steps should counsel take when giving a “due authorization” opinion?

Counsel giving a due authorization opinion based on pre-signed resolutions should be careful to preserve some evidence of an instruction indicating when the resolutions are to take effect. The statute is silent as to the form of authorization, but prudence dictates that the instruction be made in writing. Although this can be in the form of an e-mail, it would be better to have it written into the text of the written consent itself.

The addition of the following language to the written consent would likely be sufficient to meet the requirements of the statute:

“The undersigned hereby instruct the secretary of the corporation that this written consent will take effect immediately upon the

appointment of the undersigned as directors of the corporation, unless any of the undersigned revoke this consent prior to such appointment.”

Additionally, counsel should consider obtaining confirmation by e-mail immediately prior to delivery of their opinion that the written consent has not been revoked. By doing so, counsel may avoid any potential argument that the relevant signatures are no longer valid.

[Jeffrey M. Goldfarb](#) and [Michael I. Zinder](#) are partners of Willkie Farr & Gallagher LLP. For a copy of this article published on the Practical Law website, see [Expert Q&A on Developments in Board Authorizations Post-Verizon](#).

UCC Spotlight

By **Stephen L. Sepinuck** and **Kristen Adams**



The purpose of this column is to identify some of the most disconcerting judicial decisions interpreting the Uniform Commercial Code or related commercial laws. The purpose of the column is not to be mean. It is not to get judges recalled, law clerks fired, or litigators disciplined for incompetence. Instead, it is to shine a spotlight on analytical errors, and thereby provide practitioners and judges with reason to disregard the decisions.

In re Purdy, [2014 WL 3953729](#) (6th Cir. 2014)

This is easily one of the most troubling UCC decisions of the year. In it, a divided circuit court confused and conflated basic principles of law, leading it to reverse a completely sound bankruptcy court decision dealing with the distinction between a lease and a sale with a retained security interest.

The facts of the case are fairly simple. Sunshine Heifers, LLC “leased” 435 dairy cows to Purdy for 50 months. Under the terms of the agreement, Purdy had no right to terminate the lease early, was required to replace any cows culled from the herd, and was required to return the cows or their replacements at the end of the lease term.

In Purdy’s bankruptcy, Citizens National Bank, which had a perfected security interest in Purdy’s existing and after-acquired farm products, claimed that Purdy’s transaction with Sunshine was a sale with a retained security interest, not a lease. Although Sunshine had filed a financing statement to perfect its residual rights in the cows, in case those rights were deemed to be a security interest, Sunshine had apparently not complied with the rules of § 9-324(d) for obtaining PMSI priority in livestock. Citizens therefore claimed that its security interest had priority over Sunshine’s security interest.

The bankruptcy court ruled in favor of Citizens. Under § 1-203(b), a transaction in the form of a lease is conclusively deemed to be a sale with a retained security interest if it is not subject to termination by the lessee and is for longer than the economic life of the goods. Because uncontradicted testimony indicated that 30% of a dairy herd is culled annually, the court concluded that none of the cows originally provided under the putative lease would be returned at the end of the 50-month term of the agreement, and thus the transaction was for longer than the economic life of the goods. *See In re Purdy*, [490 B.R. 530](#), 536 (Bankr. W.D. Ky. 2013).

The circuit court reversed. It began its analysis by correctly noting that § 1-203 provides a two-step inquiry for distinguishing a lease from a sale. Subsection (a) indicates that the distinction is generally governed by the facts of the case but that subsection (b) provides a bright-line test applicable in some situations. In then dealt with the bright-line test of subsection (b), on which the bankruptcy court had relied, in just two scant paragraphs.

Because Sunshine’s owner had testified that it made little difference whether Sunshine received back the same cows that it originally leased – the main thing was to receive the same number of cows back – the circuit court perfunctorily concluded that “it is clear to us that the relevant ‘good’ is the herd of cattle, which has an economic life far greater than the lease term, and not the individual cows originally placed on Purdy’s farm.” Thus, the court, concluded, the bright-line test of § 1-203(b) was not satisfied. The court then concluded that under the facts-and-circumstances test of § 1-203(a), there was no reason to re-characterize the lease as a sale.

The problem with the court’s analysis is that it confuses property and contract. In a true lease, the lessor remains the owner of the goods and has a right to the goods back at the end of the lease term while the goods still have some value. In short, the lessor has *property* rights in the goods subject to the lease. In this case, Sunshine was never going to get any of the original cows back. Instead, Purdy was obligated to return the same number of cows, but at the time the lease was entered into, the cows to be returned were not

and could not be identified. Indeed, it is likely that some or all of them had not yet been born or conceived. Thus, when the parties entered into the lease, Sunshine did not have property rights in those as-yet unidentified cows; it merely had Purdy's contractual promise to return the specified number of cows. While Sunshine's contractual rights did ripen into property rights as Purdy acquired new cows to replace those culled, those rights were nothing more than a security interest in after-acquired collateral, a security interest junior to the perfected security interest of Citizens National Bank. In addition, as the dissent noted, if the herd were considered the relevant good the transaction would inevitably fail the bright-line test with respect to economic life, thus rendering that factor meaningless under the facts of this case.

There are reasons why property and contract are taught in separate courses. Those reasons should not be so blithely ignored and the two concepts should not be so thoroughly confused.

Thompson–Young v. Wells Fargo Dealer Services, Inc.,
[2014 IL App \(1st\) 132479-U](#)

This is a case in which the court may ultimately have been correct on the merits as to the breach-of-peace claim, but jumped the gun by disposing of the matter on a motion to dismiss.

The debtors in the case alleged the following facts: the secured party's repossession agents somehow entered the debtor's apartment building, despite a locked security door, "banged loudly on [their] apartment door at approximately 4:00 a.m., waking them," and demanding to speak with them. The debtors claimed to have been "terrified by the agents' behavior, in part because they had not buzzed anyone into their building and they believed the agents had broken through the front security door . . . and . . . might break through their front door as well." The debtors also alleged that the agents awakened several of their neighbors and that "their fear was 'heightened' because they 'reside in one of the highest crime areas in Chicago.'" The complaint further alleged that they did not come out of the bedroom until 8:30, due to fear, and called police when they found a club on the car, placed by the agents. The agents returned and towed the car away before the police arrived.

In affirming the lower court's dismissal of the breach-of-peace claim, the court noted as a preliminary matter that "[t]here is a dearth of case law analyzing the term 'breach of the peace'" as that term is used in § 9-609(b). This is simply not true. There are hundreds of cases on what constitutes a breach of the peace and a quick Westlaw search revealed almost 70 cases in Illinois state and federal courts alone.

The court did analyze two cases: *Chrysler Credit Corp. v. Koontz*, [661 N.E.2d 1171](#) (Ill. App. Ct. 1996), and *Pantoja-Cabue v. Ford Motor Credit Co.*, [872 N.E.2d 1039](#) (Ill. App. Ct. 2007), and correctly cited the standard provided in *Koontz* that a breach of the peace means "conduct which incites or is likely to incite immediate public turbulence, or which leads to or is likely to lead to an immediate loss of public accord."

In *Koontz*, the debtor's car was parked on his front yard. When the debtor heard the repossession in progress, he rushed outside in his underwear and yelled "Don't take it." The repossessioner made no verbal or physical response and simply completed the repossession. The court ruled that the repossession did not breach the peace. In *Pantoja*, the debtor claimed that unknown repossession agents broke into the debtor's locked garage to repossess his car. The trial court dismissed the debtor's claim but the appellate court reversed, concluding that "breaking into a locked garage to effectuate a repossession may constitute a breach of the peace." 872 N.E.2d at 1046. In doing so, the court noted that "where a repossession is effectuated by an actual breaking into the lessee/debtor's premises or breaching or cutting of chains, gates, barricades, doors, or other barriers designed to exclude trespassers, the likelihood that a breach of the peace occurred is high."

In the case at issue, the court stated that it was "abundantly clear" that the facts alleged in the complaint more closely related to *Koontz* than *Pantoja*, and rather summarily concluded that there were no facts indicating that the repossession agents entered through a barricade or the like, that there was any incitement to public turbulence or a loss of public order or tranquility, or that there was any real probability of violence at the time of the repossession. Perhaps other readers will be persuaded by this analysis, but we are skeptical that the issue is so clear.

Tenet Health Care Systems Hospitals Dallas, Inc. v. North Texas Hospital Physicians Group, P.A.,
[2014 WL 3735885](#) (Tex. App. 2014)

In this case, a judgment creditor of an office space tenant sought to garnish the obligation of a sublessee. The appellate court that allowed the garnishment might well have reached the correct conclusion but its invocation of UCC Article 9 was erroneous and its analysis was therefore flawed.

The basic facts of the case are as follows. The debtor rented office space from a landlord. Shortly before a hospital obtained a

\$617,000 judgment against the debtor, the debtor subleased the office space to a related entity (the “sublessee”). The hospital sought to garnish the sublessee’s obligation to pay rent to the debtor. The trial court denied the requested relief and the hospital appealed.

The court first dealt with the argument that the sublease did not create an enforceable obligation of the sublessee to the debtor. Although the lease required the landlord’s consent to any sublease, and the landlord had not consented, the court ruled that this did not render the sublease void, merely voidable by the landlord. As the court put it, the sublessee could not enter into the sublease, occupy the premises, and then claim that the sublease was unenforceable. Moreover even though the sublessee had been paying the landlord directly, the only party to whom the sublessee was contractually obligated was the debtor.

The court then dealt with the argument that the landlord, which had a security interest in the debtor’s accounts, had a superior right to the rents payable under the sublease. In a single paragraph, the court observed that: (i) there was no evidence that the landlord filed a financing statement; (ii) under § 9-317(a), a security interest is subordinated to the rights of a person who acquires a judicial lien before the security interest is perfected; and (iii) the hospital acquired a judicial lien upon service of the writ of garnishment.

The problem with this analysis is, of course, that § 9-109(d)(11) excludes from Article 9 the creation of any interest in or lien on real estate, “including a lease or rents thereunder.” Although the parties’ letter agreement stated that the transaction was to be governed by the Uniform Commercial Code, comment 2 to § 9-109 makes clear that “the subjective intention of the parties with respect to the legal characterization of their transaction is irrelevant to whether this Article applies.” In other words, a transaction that is outside the scope of Article 9 cannot be brought within Article 9 by agreement of the parties. Thus, Article 9 had no relevance to the landlord’s interest, if any, in the debtor’s right to payment under the sublease. Accordingly, the landlord’s apparent failure to file a financing statement was immaterial and § 9-317(a) did not speak to the priority of the landlord and the hospital’s claims to the rent under the sublease.

Heartland Bank & Trust Co. v. Leiter Group,
2014 IL App (3d) 130498-U

This case involved a conversion claim by a lender with a security interest in a borrower’s equipment and accounts against the law firm that had deposited into the firm’s IOLTA account checks from the borrower’s customers and checks constituting proceeds of the borrower’s equipment. The law firm then used the IOLTA account to pay its fees. Although the court correctly held that the law firm did not take the funds free from the lender’s interest under § 9-332(b) because the deposit account was the law firm’s rather than the debtor’s, the court’s analysis and statements regarding the initial deposit of the checks was flawed.

First, the court misconstrued the concepts of negotiability and negotiation. The court stated that, because the lender’s security interest had attached at the time at which the checks were deposited into the law firm’s IOLTA account, “the checks were not negotiable without the security interest” and thus were not properly negotiated to the law firm. The test for whether an instrument is negotiable appears in § 3-104 and is purely formal. Although the attachment of the lender’s interest might affect a holder’s rights to the check, it has no bearing on whether the check itself qualifies as a negotiable instrument. In addition, whether the checks were properly negotiated to the law firm is governed by § 3-201 and rests on whether the checks were indorsed and whether possession was transferred. Attachment of the lender’s interest was not pertinent to the question of negotiation.

Second, although the court was probably correct in concluding that the law firm was not a holder in due course, because it knew of the lender’s security interest, the court’s analysis of that issue contained a distressingly wrong statement. Specifically, the court wrote that the law firm “was not entitled to the funds and thus did not take them for value.” Priority and value are distinct concepts. The law firm apparently provided legal services to the borrower, and this unquestionably constitutes “value” within the meaning of § 3-303(a).

Nevertheless, the court’s ultimate conclusion was correct. Because the law firm was not a holder in due course, its interest in the deposited funds remained subject to the lender’s claim. The firm’s subsequent withdrawal of the funds was therefore in violation of the lender’s rights.

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¹ The views expressed in this article are those of the authors and are not necessarily those of any organization with which either author is affiliated.

² See, e.g., Tom Hals, *U.S. companies adopt bylaws that could quash some investor lawsuits*, Reuters, July 7, 2014, available at <http://www.reuters.com/article/2014/07/07/us-usa-litigation-companies-idUSKBN0FC26O20140707>.

³ In *AGR Halifax Fund*, the Delaware Court of Chancery invalidated action taken pursuant to a board consent signed by several individuals before they became directors. 743 A.2d at 1194-95. However, it does not appear from the opinion that the consent was to be escrowed, or that if so, the possible effect of escrow was presented to the court.

⁴ The same is true for Delaware corporations. See 8 *Del. C.* § 278.

⁵ The original version of § 251(h) is discussed in greater detail in Norman M. Powell & John J. Paschetto, *Recent Amendments to Delaware’s Entity Laws: Delaware Simplifies Two-Step Corporate Takeovers and Confirms That Default Fiduciary Duties Apply to LLCs, Among Other Changes*, *Com. L. Newsl.*, Summer 2013, at 9.

⁶ The 2014 amendments to § 251(h) apply only to agreements of merger entered into on or after August 1, 2014.

⁷ Delaware corporations are also required to have communications contacts. 8 *Del. C.* § 132(d).