Extract from 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, Commercial Law Newsletter (ABA Business Law Section, Chicago, IL), Summer 2013, citing Bigler & Tillman's Void or Voidable -- Curing Defects in Stock Issuances Under Delaware Law

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JOINT REPORT FROM THE CHAIRS

Dear Members:

With this summer edition we once again meet the goal of releasing up-to-date content immediately before the American Bar Association's annual meeting (in San Francisco, for the Business Law Section ("BLS"), Friday, August 9 to Sunday, August 11). As many of you know, this will be the last year in which the BLS fully participates in an ABA-wide annual meeting. In 2014, BLS will launch a separate Section-focused meeting, complete with subcommittee and task force meetings and CLE, patterned largely on our spring meetings. The first such meeting will be Thursday, September 11 to Saturday, September 13, 2014 in Chicago.

At this year's annual meeting, Commercial Finance ("ComFin") and UCC are prime sponsors of two CLE programs: (1) Venture Lending: I've Got the "Next Big Thing," Can Somebody Loan Me a Dime?, and (2) Making the Case: Tips for Using (or Being) a UCC Expert Witness. There will also be committee, subcommittee, and task force meetings for those in attendance, whether in person or via conference phone. Beyond that, we continue to explore other initiatives to bring us together and facilitate the exchange of ideas other than in-person meetings. Look for more information on podcasts, webinars, and conference calls in the time ahead.

This month marks the end of Jim Schulwold's tenure as Chairman of the ComFin Committee. Jim's efforts and contributions are many and significant, including laying the groundwork for a smooth transition for his successor, Neal King. If you're able to join us in San Francisco, be sure to take part in the joint ComFin/UCC dinner (Friday, August 9, McCormick & Kuleto's) as we thank Jim and welcome Neal.

The targeted effective date for the 2010 Amendments to UCC Article 9, July 1, 2013, is now behind us. The Amendments took effect on such date in no fewer than 46 jurisdictions. A great many of our members, acting in a variety of capacities, did a great deal to facilitate such enactment. We cannot list them all here, but extend a special "thank you" to Tom Buiteweg and John McGarvey, co-chairs of our Joint Task Force on Legislative Enactment of the amendments.

In this edition of the newsletter, our Recent Developments editors (Scott Burnham, Hilary Sledge, and Shadi Enos) provide an update on enactment of UCC Revised Article 1. In a separate article, Hilary Sledge considers the fraud exception to the parol evidence rule and the California Supreme Court's Riverisland decision. Sutherland Asbill & Brennan LLP's Carol P. Tello provides her third installment discussing the Foreign Account Tax Compliance Act's effect on commercial lenders and borrowers. A team of Finance editors at Practical Law, Matta Barclay, Tim Fanning, Sarah Mital, and Peter Wushkovitz provide a mid-year summary of trends in Large Cap and Middle Market Loans. Young Conaway's Norm Powell and John Paschette summarize this year's legislative amendments to Delaware's corporations and alternative entity laws. Finally, in the Spotlight column Steve Sepinuk considers a case that confuses bank accounts and money, an unnecessary determination of the commercial reasonableness of a secured party's decision to abandon its collateral, a confusion of contract formation and modification, and the challenge of describing collateral acquired from time to time on a consumer credit card.
• Issues around disqualified lender lists. Large cap borrowers continue to push for the inclusion of competitors and their affiliates on disqualified lender lists, as well as for the ability to add to the list after the date of the commitment letter and even post-closing. In several recent transactions, lenders have pushed back and even walked away from transactions in which the borrower has broad discretion to designate additional disqualified lenders post-closing. While disqualified lender lists are typically only available in large cap deals, they have also been appearing in recent middle market deals, though they are generally less of an issue because of investors’ predominant buy and hold strategy in the middle market.

• Inclusion of precap provisions. Precap (portability) provisions continue to be available for top-tier sponsors in large cap deals and, increasingly, in some middle market deals. Negotiations continue around:
  o the minimum threshold of assets under management required for the buyer (usually $1 billion);
  o the minimum equity contribution required (usually 30% to 35%);
  o the recalculation of certain financial metrics;
  o know-your-customer checks;
  o the borrower’s management team that will remain in place;
  o increased pricing (usually 25 to 75 basis points); and
  o the specified time horizon for the deal (usually two years).

Looking Ahead

In the years since the financial crisis, the demand-driven loan market has been characterized by short periods of high activity and sudden reversals of sentiment, including in response to broader macroeconomic concerns. By contrast, the loan markets have remained remarkably positive and stable in the last six months.

However, this steadiness is unlikely to last indefinitely. Even at press time, there are reports of increased “choppiness” in the market. Some deals are being pulled and in others, the borrower has dropped its request to loosen financial covenants. To the extent that there is a pullback in the market, and as M&A activity grows (so that more transactions are being done on a committed, rather than best efforts, basis), we can expect more lender pushback against the more aggressive features currently sought by borrowers.

Maria Barclay, Tim Fanning, Sarah Mital and Peter Washkowitz are Finance editors at Practical Law. 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 Marker: 2013 Mid-year Trends in Large Cap and Middle Market Loan Terms, Practical Law, at http://us.practicallaw.com/7-532-9265.

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

By Norman M. Powell and John J. Paschetta

The Delaware legislature recently adopted what may be the most significant amendments to the state’s corporation law since its current “anti-takeover” statute, 8 Del. C. § 203, was added in 1987. The amendments include (i) a new provision that will make so-called “top-up options” unnecessary in two-step corporate takeovers; (ii) two new sections creating procedures by which defective corporate acts, including the unauthorized issuance of stock, can be cured; and (iii) an entire new subchapter enabling the creation of Delaware public benefit corporations. In addition, the Delaware Limited Liability Company Act has been amended to make clear that the managers and possibly members of a limited liability company may owe fiduciary duties unless the company’s operating agreement provides otherwise.

Simplifying Two-Step Takeovers

In recent years, the top-up option has been accepted as one of the tools available to transactional lawyers in structuring acquisitions of Delaware corporations. When included in a merger agreement, a top-up option typically provides that if the acquirer makes a tender offer for the target corporation’s shares, and the number of shares tendered into the offer give the acquirer a controlling stake, the acquirer will then have the option of buying, in exchange for a note, a sufficient number of shares from the target to bring the acquirer’s ownership percentage to at least 90%. Following a successful tender offer and exercise of the option, the acquirer will then hold a large enough stake in the target to be able to cash out any remaining target stockholders without a stockholder meeting or Commercial Law Newsletter Page 9 Summer 2013
The use of a top-up option to avoid a stockholder vote in the second step of a traditional two-step, tender-offer-plus-merger takeover has not been viewed unfavorably by the Delaware Court of Chancery, despite invitations to the contrary. See e.g. Olson v. e*st, Inc., 2011 Del. Ch. LEXIS 34, at 2-5 (Del. Ch. 2011). The court thus has implicitly acknowledged that no purpose is served by requiring a stockholder vote before a cash-out merger where the acquirer has just purchased enough shares to control the outcome of the vote.

This reasoning is reflected in new subsection (b) of Delaware’s basic merger statute, § 251 of the DGCL. The new provision will enable merger agreements entered into after July 31, 2013, to eliminate the stockholder-vote requirement in a two-step takeover if the target’s charter does not provide otherwise, the target’s shares are publicly traded (or held of record by more than 2,000 stockholders), and six other requirements are met. First, the parties must expressly provide in their merger agreement that the second-step, cash-out merger will be governed by § 251(b), and that the merger will be effectuated “as soon as practicable” if the acquirer’s tender offer is successfully consummated. Second, the tender offer must be for any and all shares of the target’s outstanding stock that would otherwise be entitled to vote on the merger. Third, after the tender offer, the acquirer must own at least the number of shares that would otherwise need to be voted for the merger to be approved under the DGCL and the target’s charter. This ensures that § 251(b) will not enable an acquirer to avoid a stockholder vote on the cash-out merger unless, as a result of its tender offer, the acquirer owns enough shares to control the outcome of such a vote. Fourth, at the time the merger agreement is approved by the target’s board, no party to the agreement may be an “interested stockholder” of the target under the anti-takeover statute § 203 of the DGCL. This requirement should prevent parties from using the new § 251(b) procedure as a way of circumventing the default defensive measures built into § 203. The fifth and sixth requirements are that the acquirer actually merge with the target following the tender offer, and that the stockholders who are cashed out in the merger receive the same consideration that was paid to the stockholders who tendered their shares. The amendments do not specify that a certificate of merger filed with the Delaware Secretary of State to effectuate a merger under § 251(b) be different in form from those commonly used under § 251.

Curing Defective Corporate Acts

The Delaware Supreme Court’s holding in STAAR Surgical Co. v. Weigman, 588 A.2d 1130 (Del. 1991), created a challenge for advisers of Delaware corporations. In that case, the court held that stock issued without board authorization was void, not merely voidable. Under settled Delaware jurisprudence, a void corporate act (unlike a merely voidable act) cannot be cured through ratification. Thus, when a corporation has discovered long after the fact that its issuance of outstanding shares was not properly authorized, there has been no clear path toward remedying the problem. The predicament is particularly awkward when shares of doubtfully valid have been traded or have affected the outcome of a stockholder vote.

New §§ 204 and 205 of the DGCL will give practitioners two procedures by which a corporation can cleanse the unauthorized issuance of shares and similar unauthorized corporate acts. Section 204 details a cleansing procedure that will not require a court proceeding, while § 205 makes available a proceeding in the Delaware Court of Chancery that may, among other things, achieve the same result. Both sections, along with conforming amendments to other sections of the DGCL, will take effect on April 1, 2014.

Sections 204 and 205 pertain to “putative stock” and “defective corporate acts.” Putative stock is either stock that was not properly authorized (but would otherwise be valid) or stock whose validity simply cannot be determined by the issuer’s board. A defective corporate act is, in essence, an issuance of shares beyond what is authorized in the issuing corporation’s charter, an election of directors without due authorization, or any corporate act or transaction that was within the corporation’s power but was not authorized or effected in accordance with the DGCL, the corporation’s charter and bylaws, and other applicable documents.

According to § 204, no putative stock or defective corporate act “shall be void or voidable solely as a result of a failure of authorization” if it is either “ratified” under § 204 and not challenged in the Court of Chancery within 120 days thereafter, or “validated” by the Court of Chancery under § 205. The ratification procedure of § 204 requires, first, that the board of directors adopt a resolution setting forth certain details of the defective act and that the board “approve” the ratification of the act. The resolution must then be submitted to a stockholder vote, unless (1) no such vote was required when the defective act was taken or would be required if the defective act were taken today, and (2) the defective act was not the result of “a failure to comply with § 203 [i.e., the anti-takeover statute].”

The quorum and voting requirements at both the board and stockholder levels are those that would have applied to the defective act at the time the act was taken, unless the currently applicable quorum or voting requirements are greater. No approval is needed, however, from any class or series of shares, or from any person, that was required to give approval but is now no longer outstanding or a stockholder, respectively, or from any director that such a class, series, or person was entitled to elect or nominate. In addition, if the defective act to be ratified is the election of a director, the ratification must be approved by a majority of the shares present at the stockholder meeting and entitled to vote (or such greater proportion as the charter or bylaws may require now or may have required when the defective act was taken). In the case of a defective act resulting from a failure to comply with § 203 of the DGCL, ratification will require the vote specified in § 203, even if such a vote would not have been required otherwise.
7. The International Association of Commercial Administrators (IACA) maintains links to state model administrative rules (MARS) and contact information for state level UCC administrators. This information can be accessed at http://www.iaca.org

8. The Uniform Law Commissioners maintains information regarding legislative reports and information regarding upcoming meetings, including the Joint Review Committee for Uniform Commercial Code Article 9. You can access this information at http://www.uniformlaws.org/Committee.aspx?title=Commercial%20Code%20Article%209


11. The Secretariat of Legal Affairs (SLA) develops, promotes, and implements the Inter-American Program for the Development of International Law. For more information, go to http://www.oas.org/DIL/

12. The National Law Center for Inter-American Free Trade (NLCLF) is dedicated to developing the legal infrastructure to build trade capacity and promote economic development in the Americas. For more information, go to http://www.nlclf.com


14. International Factoring Association magazine has a variety of articles and can be accessed at http://www.factoring.org/index.cfm?page=information_news

With your help, our list of electronic resources will continue to grow. Please feel free to forward other electronic resources you would like to see included in future editions of the Commercial Law Newsletter, by sending them to Annette C. Moore, Glen Strong, or Celeste B. Pese, the Uniform Commercial Code Committee Editors or Christina B. Restle, Shabzial Abdulai, or Harold J. Lee, the Commercial Finance Committee Editors.

ENDNOTES:

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

2 At the risk of gross oversimplification, an “interested stockholder” of a corporation is defined in DGCL § 203 as any person that, directly or indirectly, owns or has the power to vote at least 15% of the outstanding voting shares of the corporation. 8 Del. C. § 203(c)(5).

3 The § 251(h) procedure is also available in mergers of Delaware and non-Delaware corporations, pursuant to an accompanying amendment to § 252 of the DGCL.

4 For an insightful discussion of the relevant issues and the then-applicable case law, see C. Stephen Bigler & Seth Barrett Tillman, Void or Voidable?—Curing Defects in Share Issuance Under Delaware Law, 65 BUS. LAW. 1159 (2007-2009).

5 Briana Cummings, Note, Benefit Corporations: How to Enforce a Mandate to Promote the Public Interest, 112 COL. L. REV. 578, 594 n.111 (2012).

6 A copy of the model legislation, with commentary, can be downloaded at http://benefitcorp.net/fac-attorneys/model-legislation.


8 CAL. CIV. PROC. CODE § 1856 (West 2007).

9 Riverland, 55 Cal. 4th at 1174.


11 Id.

12 Id.

13 Id. CAL. CIV. PROC. CODE § 1856.

14 Riverland, 55 Cal. 4th at 1175.

15 Id. at 1172-73.

16 Id. at 263.

17 Timothy Murray, California Supreme Court Sigs Fraud May Challenge Validity of Written Agreement, 2013 EMERGING ISSUES 6896 (2013).

18 Id.

19 Id.

20 Riverland, 55 Cal. 4th at 1172.

21 Id. at 1172-73.

22 Id.

23 Id. at 1173.