Expert Q&A on Developments in Board Authorizations Post-*Verizon*

In August 2012, a memorandum decision in *U.S. Bank National Association 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 (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.

JEFFREY M. GOLDFARB
PARTNER
WILLKIE FARR & GALLAGHER LLP

Jeffrey is a member of the firm's Banking/Debt Finance Practice Group and specializes in corporate finance. He represents borrowers, sponsors, hedge funds, investment banks and other lenders in a wide array of complex debt transactions, including financings in support of leveraged buyouts and corporate acquisitions, bridge financings, debtor-in-possession and exit financings, first-lien/second-lien financings, mezzanine financings, asset-based lending, high-yield bonds, distressed debt strategies and workouts, and restructurings of existing financings.

MICHAEL I. ZINDER
PARTNER
WILLKIE FARR & GALLAGHER LLP

Michael is a member of the firm's Corporate and Financial Services Department and co-chair of the Banking/Debt Finance Practice Group. He has extensive experience representing domestic and foreign agents, arrangers and other financing parties, as well as sponsors and borrowers, in leveraged buyouts, hostile and friendly tender offers, recapitalizations and spin-offs, bridge and mezzanine financings, asset-based lending, first lien/second lien financings, project financings, workouts and restructurings, and debtor-in-possession and exit financings.

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 DGCL Section 141(f), 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" (*Del. Code Ann. tit. 8, § 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 Section 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 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.B. 329, 147th Gen. Assemb. (Del. 2014); Del. Code Ann. tit. 8, § 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 Section 141(f) and how do you anticipate that it will work in practice?

The new language inserted in Section 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.