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ACCRUED INTEREST

A Finance Newsletter from Haynes and Boone, LLP **December 2015**

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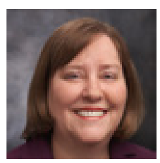
Welcome to the inaugural edition of Accrued Interest - a nascent newsletter which will be published several times a year by the Finance Practice at Haynes and Boone. We will provide timely and concise information about changes, developments and trends in legal issues relating to finance transactions, as well as news and profiles about the diverse group of attorneys who comprise our domestic and international Finance Practice. We hope to keep you interested, informed, and occasionally amused. Please don't hesitate to contact our lawyers if you have questions on any of the topics we are covering. Have a safe and happy holiday.

TRENDS IN FINANCE LAW: PREPAYMENT PENALTIES – EXPRESS LANGUAGE AIDS ENFORCEMENT

Deborah P. Low, Sue P. Murphy

Deborah Low



Sue Murphy

Loan agreements commonly contain provisions permitting or requiring the early repayment of all or a portion of the indebtedness under the loan agreement prior to the stated maturity date of such indebtedness. These provisions may specify that prepayments may be made at any time, at the borrower's election ("***Optional Prepayments***"), or that prepayments must be made upon the occurrence of certain events ("***Mandatory Prepayments***"). Several courts have recently examined whether the acceleration of the maturity of indebtedness under a loan agreement, either automatically, in the event of certain events of default, or at the election of the lenders in accordance with the terms of the loan agreement, constitutes a prepayment of the loan that would give rise to the obligation of the borrower to pay a premium or penalty. This issue has been most prevalently discussed by the courts in a number of bankruptcy proceedings where lenders have been unable to recover such penalty or premium payments. While each court holding relies on the specific facts of the case being considered, recent decisions indicate that lenders which clearly specify in the operative loan documents that a prepayment penalty is due upon acceleration of the maturity of the indebtedness have a significantly better chance of having the penalty enforced than those who do not include express language to that effect.

WHAT ARE PREPAYMENT PREMIUMS?

Loan agreements often expressly provide that the borrower is required to pay a premium in connection with its prepayment (a "***Prepayment Premium***," sometimes called a "make whole payment"). The Prepayment Premium is intended to compensate the lender for interest or other fees that it expected to earn on the prepaid indebtedness, had it remained outstanding to stated maturity. Additionally, Prepayment Premiums in connection with Optional Prepayments provide important protection for the lender against market conditions in which the borrower may be tempted to prepay the loan in order to obtain financing at lower rates and/or where the lender may need coverage for "breakage costs" — the cost of redeployment of funds obtained by the lender at a fixed rate for a fixed period in the LIBOR or other similar markets for the period from the prepayment until the end of the relevant interest period.

Loan Agreements also often provide for the acceleration of indebtedness automatically following the commencement of bankruptcy or other insolvency proceedings by or against the borrower. This is because once a bankruptcy proceeding is commenced, an automatic stay is imposed prohibiting the lender from pursuing any remedies outside the proceeding. In order to avoid the automatic stay, acceleration will occur automatically, and under such circumstances the consequences of default and acceleration, including the imposition of a default interest rate, are not dependent on any affirmative post-petition action. However, a number of recent cases have arisen in which the lender has asserted that an automatic acceleration of indebtedness constitutes an Optional Prepayment or Mandatory Prepayment, which would obligate the borrower to pay a Prepayment Premium. This assertion has then been challenged in bankruptcy proceedings where the borrower or other creditors are attempting to limit the lender's recovery.

ARE PREPAYMENT PREMIUMS ENFORCEABLE?

Courts have generally held that Prepayment Premiums are enforceable, if properly assessed by the lender in accordance with the terms of the loan agreement. Courts have further held that to the extent that a Prepayment Premium was due and payable by the borrower prior to the commencement of bankruptcy proceedings by or against the borrower, then such Prepayment Premium may be recoverable by the creditor in a bankruptcy proceeding. An example of this is *In re School Specialty, Inc., No. 13-10125, 2013 WL 1838513 (Bankr. D. Del. Apr. 22, 2013)*, a case decided by the United States Bankruptcy Court for the District of Delaware. In that case, the terms of the loan agreement expressly provided that the borrower would be required to pay a Prepayment Premium if the loan was accelerated. Further, when the loan was accelerated, the borrower agreed in a forbearance agreement that an event had occurred which triggered the borrower's obligation to pay the Prepayment Premium. The court therefore upheld the validity of the Prepayment Premium and required the borrower to pay it in bankruptcy. The fact that the lender in *In re School Specialty* declared the Prepayment Premium due prior to the commencement of bankruptcy proceedings distinguishes this case from subsequent cases in which lenders attempted to argue that the obligation of the borrower to pay the Prepayment Premium was only triggered upon the commencement of bankruptcy proceedings.

The U.S. Court of Appeals for the Second Circuit examined this issue in *US Bank Trust Nat'l Ass'n v. AMR Corp. (In re AMR Corp.)*, 730 F.3d 88, 98-105 (2d Cir. 2013), and determined that the underlying loan documents did not permit the creditors to recover a Prepayment Premium as part of their recovery in bankruptcy. In *In re AMR Corp.*, an event of default occurred under an indenture as a result of the borrower filing for bankruptcy, which mandated an automatic acceleration of the maturity date of all outstanding indebtedness. The lenders argued that the borrower's bankruptcy filing was an attempt by the borrower to take advantage of more favorable market conditions through the bankruptcy filing. Therefore, the automatic acceleration of the indebtedness as a result of the bankruptcy filing was effectively equivalent to an Optional Prepayment under the loan agreement, which would give rise to the obligation to pay a Prepayment Premium. In rejecting the lender's argument, the court noted that the terms of the indenture expressly stated that if the loan was accelerated automatically in the event of a bankruptcy proceeding, the accelerated indebtedness would be "without Make-Whole Amount." The court therefore refused to imply the obligation of the borrower to pay the Prepayment Premium in the wake of specific language to the contrary in the indenture.

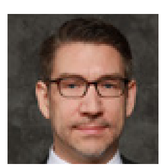
Following the decisions in *In re School Specialty* and *In re AMR Corp.* courts have increasingly focused on the express language contained in the underlying loan documents in their determination as to whether a Prepayment Premium can be included in a creditor's recovery in a bankruptcy proceeding. Recently the Federal Bankruptcy Court of the Southern District of New York weighed in on the issue in *In re MPM Silicones, LLC*, No. 14-22503, 2014 WL 4436335 (Bankr. S.D.N.Y. Sept. 9, 2014). In this bench decision, the court held that under New York law a lender will forfeit its right to compensation for early payment by accelerating the balance of the loan (including in the event of an automatic acceleration due to bankruptcy), unless the underlying loan document contains "clear and unambiguous" language providing for payment of the Prepayment Premium when the indebtedness is repaid prior to scheduled maturity for any reason, including after acceleration. The *In re MPM Silicones* decision was heavily relied on in *Del. Trust Co. v. Energy Future Intermediate Holding Co. LLC (In re Energy Future Holdings Corp.*), 527 B.R. 178 (Bankr. D. Del. 2015), in which the Delaware Bankruptcy Court noted that the provisions of the applicable indenture that mandated automatic acceleration of the indebtedness upon a bankruptcy proceeding did not expressly include a requirement that payment of the Prepayment Premium was due upon acceleration. However, the court in *In re MPM Silicones* further held that a lender could recover a Prepayment Premium in a situation where the borrower intentionally defaulted in order to trigger an acceleration of indebtedness and avoid paying a Prepayment Premium, which was an argument made by the lender that was unsuccessful in *In re AMR Corp.* in light of the specific language in the indenture.

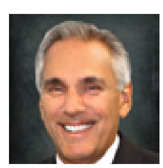
CONCLUSION

In light of recent case law, the enforceability of Prepayment Premiums incurred as a result of acceleration of indebtedness remains murky. However, recent decisions provide important guidance to lenders that are expecting to recover Prepayment Premiums in the event of acceleration of the maturity of indebtedness. There is a strong trend toward respecting express language in the underlying loan agreement, indenture or other applicable contract which either allows for, or prohibits, the payment of a Prepayment Premium upon default and/or acceleration of the debt. Lenders that are looking to recover such amounts should consider whether to revise loan document drafts to include explicit language that a Prepayment Premium will be payable in the event of acceleration of the indebtedness, as without such language it appears increasingly likely that a court would prohibit such recovery.

INTERNATIONAL LEGAL DEVELOPMENTS: IRAN NUCLEAR SANCTIONS BEING LIFTED

Eric Filipink, Edward M. Lebow


Eric Filipink


Edward Lebow

Trade relations with Iran and the legal framework that governs them are going to be changing markedly in the near future as longstanding trade sanctions which were implemented to curtail Iran's nuclear capabilities are being lifted. The Iran nuclear deal, more formally known as the Joint Comprehensive Plan of Action

(JCPOA), has come into effect as of “Adoption Day” on October 18, 2015. It survived both the 60-day U.S. Congressional review period which concluded on September 17 and opposition from hardliners in Iran’s parliament, which approved the deal on October 13. Although Adoption Day had already occurred, the deal overcame its final hurdle a few days later on October 21 when it finally won approval from Iran’s Supreme Leader Ayatollah Khamenei. Agreed upon between Iran and its negotiating partners – the United States, United Kingdom, France, Russia, China, Germany and the European Union – the JCPOA will roll back Iran’s nuclear program and subject Iran to years of international monitoring in exchange for sanctions relief.

Under the JCPOA, the United Nations, the European Union and the United States will be lifting the international sanctions imposed in response to Iran’s nuclear program. For the United States, this means suspending its so-called “secondary” sanctions, which blocked non-U.S. entities from doing business in Iran. These include sanctions on banking and financial transactions involving Iran, financial messaging services, insurance and re-insurance, investment in the oil, gas and petrochemical sectors, the purchase and sale of petroleum and refined petroleum products, shipping, shipbuilding and the transport sector, exports of gold, minerals, precious metals and software, and transactions involving the automotive sector – all of which will now be permitted activities when undertaken by non-U.S. entities. In addition, the United States has also agreed to allow exports of U.S. commercial passenger aircraft and related parts and services to Iran for civilian use and to allow imports of Iranian carpets and foodstuffs such as pistachios and caviar. Furthermore, the United States will also allow non-U.S. entities that are owned or controlled by a U.S. person to engage in the permitted activities listed above. The removal of international sanctions by the United States under the JCPOA means that non-U.S. persons will be able to conduct business with Iran once the sanctions are lifted, although such transactions will probably not be able to be conducted in U.S. dollars or pass through banks in New York. While sanctions relating to Iran’s nuclear program are being lifted, the United States will not be removing its sanctions related to Iran’s support for international terrorism, its human rights abuses and its destabilizing use of conventional weapons in the Middle East region. Apart from the few current exceptions to the U.S. sanctions regime, such as U.S. exports of food, medicine, basic medical supplies, humanitarian relief and certain IT hardware and software to Iran, this means that U.S. companies will still be prohibited from dealing with Iran even after the other international sanctions are lifted.

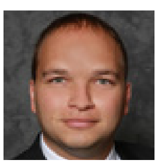
The changes to the international sanctions regime against Iran will occur over the course of the next several months. On Adoption Day, the United States and European Union took action to prospectively suspend their sanctions (the United Nations had already taken a similar step on July 20). The suspension of sanctions will be contingent upon the successful implementation of Iran’s obligations to limit uranium enrichment, phase out its centrifuges and dismantle and convert its reactors. In this regard, President Barack Obama issued a memorandum to the United States Secretary of State, Secretary of the Treasury, and the Secretaries of Commerce and Energy instructing them to take all appropriate measures to ensure the prompt and effective implementation of the US commitments set forth in the JCPOA; and Secretary of State John Kerry issued contingent waivers of certain statutory sanctions. Given their contingent nature, these waivers will only become effective as of “Implementation Day,” which is the day on which the International Atomic Energy Agency (IAEA) will verify that Iran has implemented the required nuclear-related measures. Implementation Day will probably occur four to six months after Adoption Day, meaning within the first or second quarter of 2016. On Implementation Day, the sanctions will be suspended automatically.

At present, U.S. sanctions against Iran remain in place, except for those limited sanctions that were eased under the earlier Joint Plan of Action which took effect on November 24, 2013. Despite the arrival of

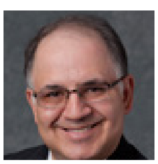
Adoption Day, the U.S. Treasury Department's Office of Foreign Assets Control (OFAC) has warned that U.S. persons continue to be prohibited from entering into contracts involving Iran or its government, including with individuals and entities on the List of Specially Designated Nationals and Blocked Persons (SDN List). This prohibition even includes contracts contingent upon the eventual implementation of sanctions relief under the JCPOA. OFAC has advised that it will provide further information and detailed guidance on implementation of U.S. sanctions commitments under the JCPOA prior to Implementation Day.

RECENT CASE ANALYSIS: FIRST CIRCUIT CONFIRMS THAT RIGHT TO PAYMENT UNDER INSURANCE POLICY NOT COVERED BY ARTICLE 9 OF THE UCC

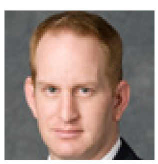
Alexander T. Grishman, Steven H. Epstein, Craig S. Unterberg



Alexander Grishman



Steven Epstein



Craig Unterberg

When a company enters into a secured line of credit, it presumably expects to repay the lender on a timely basis. But what happens when an unforeseen tragic event results in economic collapse and bankruptcy for the borrower? If there are monies resulting from an insurance settlement with the borrower, the lender may wish to claim these proceeds to repay the loan. Unless the insurance proceeds are deemed "proceeds" of collateral, an interest in an insurance policy is outside the purview of Article 9 as recently reaffirmed by the First Circuit Court of Appeals.

In *In Re Montreal, Maine & Atlantic Railway, Ltd.,* No. 15-9003 (1st Cir. August 19, 2015), the First Circuit held in August of 2015 that a settlement of a casualty insurance claim was not Article 9 collateral in which a lender had perfected its security interest with a financing statement filing under the UCC. Since the lender had not perfected its security interest under the common law in the State of Maine, the lender, a railway company, was not entitled to the insurance settlement as collateral for its loan to the debtor, another railway company.

The case arose out of the July 2013 freight train accident in Quebec, Canada in which 72 tanker cars filled with oil derailed, sparking massive explosions and killing 47 people. The railway line that owned the train that exploded had previously entered into a secured line of credit with another railway company lender. The loan was secured by, among other things, accounts (including payment intangibles), inventory and proceeds, specifically including insurance proceeds. The lender sought to perfect its security interest by filing a UCC-1 financing statement with the Delaware Department of State, since under Maine's UCC the proper place to file was the location of the debtor, and the debtor was located in Delaware. The lender took no other action to perfect its interest in any insurance policies of the debtor.

A few months prior to the train accident, a commercial property insurance policy was issued to the debtor providing coverage in an amount greater than the loan amount and including a section purporting to provide coverage for business interruption. About a month after the accident, the debtor filed for bankruptcy under Chapter 11 of the Federal Bankruptcy Code. The casualty insurance company initially denied coverage but eventually agreed to a settlement that provided a significant payment to the debtor that was less than the full amount outstanding under the secured line of credit.

The lender then made a claim with the bankruptcy court for the amounts due to the debtor under the insurance settlement, arguing that it held a perfected security interest in all payment rights of the debtor and that the proposed settlement amount constituted proceeds of the debtor's right to payment under the policy. The bankruptcy court held that the lender's asserted security interest wasn't enforceable because

Article 9 of the UCC doesn't apply to an interest in a claim under an insurance policy and the debtor hadn't perfected its interest under the common law in Maine, as would have been necessary in respect of an asset not subject to Article 9. The bankruptcy court therefore awarded the settlement proceeds to the debtor's bankruptcy estate and denied the lender's claim.

Both the bankruptcy appellate panel and the First Circuit Court of Appeals upheld the ruling of the bankruptcy court to the effect that the lender had not properly perfected its security interest in the insurance settlement under applicable law. The court pointed out that the UCC is quite clear that Article 9 excludes the "transfer of an interest in or an assignment of a claim under a policy of insurance." The lender's argument was that this exclusion doesn't cover payment rights under insurance policies. The First Circuit rejected this argument stating, "the assignment of a right to payment under an insurance policy, which is inseparable from the policy itself, falls squarely within the heartland of the exclusion. … Indeed, the very purpose of the exclusion was to place this type of financing transaction beyond the reach of Article 9."

Having determined that the rights in the insurance policy were beyond the scope of Article 9, the First Circuit determined that proper perfection in the policy would be governed by the common law of the State of Maine, as provided in the relevant security agreement. The court observed that Maine's highest court had not addressed the common-law requirements for perfecting a security interest in insurance rights. After some analysis, the First Circuit declined to make a determination of these common law requirements under Maine law, but did conclude that since the lender did nothing more than filing a UCC financing statement, it clearly did not do enough. Accordingly, the insurance settlement remained in the bankruptcy estate of the debtor.

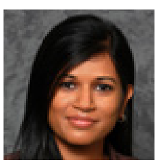
The holding in this case clearly indicates that insurance proceeds that are not deemed to constitute "proceeds" of collateral, such as business interruption insurance, are outside the scope of Article 9 of the UCC. To perfect in these insurance proceeds, a lender must look to applicable state common law rules. While these rules are clearly not uniform among the various state jurisdictions, they commonly require a written assignment of the beneficiary's rights under the policy, notice to the insurer of the assignment of these rights, acknowledgment by the insurer of the assignment of these rights, and/or making the lender an additional insured or loss beneficiary under the relevant policy.

It has also become more common for lenders to enter into control agreements with the borrower and a third party "securities intermediary" under Article 8 of the UCC for purposes of purportedly perfecting a security interest in insurance policies in the same manner as security interests in investment securities are perfected. This is done by having the various parties agree to deem the insurance policy as a "financial asset" under Article 8 and depositing that financial asset into a "securities account" of the borrower that is "controlled" by the lender. Generally, when this type of perfection is attempted, the control agreement will contain the following key agreements: (i) that all property in the securities account will be treated as 'financial assets' under Section 8-102(a)(9) of the UCC; (ii) that the securities intermediary will act as 'securities intermediary' for the benefit of the borrower, as 'entitlement holder'; and (iii) that the securities intermediary will comply with entitlement orders from the lender without further consent from the entitlement holder. The third provision is essential because it allows for perfection by control under Section 8-106(d)(2) of the UCC. In addition, after a securities intermediary is selected, the insurance policy is generally changed to reflect the securities intermediary as the new owner and beneficiary of the policy for purposes of demonstrating that the insurance policy is being held by the Securities Intermediary.

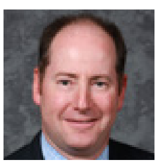
While this Article 8 perfection in respect of insurance policies (including life insurance policies in the structured settlements arena) has become more common, its efficacy in obtaining perfection is not free from doubt. There is little or no case law whereby the courts have blessed this method, and some commentators have indicated it's not entirely clear from the Official Comment that the UCC contemplates "financial assets" that are otherwise outside the scope of Article 9. Accordingly, the most conservative method for perfecting a security interest in insurance proceeds that will not be considered "proceeds" of collateral is to conform to the requirements of applicable state common law, if the rules can be effectively determined. The requisite steps under Maine common law remain unsettled after *In Re Montreal, Maine & Atlantic Railway, Ltd.*

TRENDS IN FINANCE LAW: DECLINE OF THE "DEAD HAND" PROXY PUT

Monika Singh Sanford, Scott G. Night



Monika Sanford



Scott Night

Should parties extending credit be allowed to accelerate their debt solely as a result of a change in the majority of the borrower's Board of Directors? As shareholder activism continues to rise, lender-friendly covenants known as "dead hand" proxy puts in credit agreements and indentures have recently faced increased judicial scrutiny. The flood of litigation has been driven, in part, by the conclusion of the Delaware Court of Chancery in October 2014 that "dead hand" proxy puts are "highly suspect" entrenchment tools employed by lenders and corporate borrowers to discourage shareholder activism. In an effort to avoid costly litigation, lenders and noteholders are rethinking the value, and evaluating the risk, of including "dead hand" proxy put provisions in their debt agreements.

PROXY PUTS, GENERALLY, IN DEBT AGREEMENTS

Typically, a "proxy put" (or "change of control") covenant in a credit agreement or indenture will provide that lenders or noteholders, as applicable, may accelerate their indebtedness ahead of scheduled maturity upon the occurrence of a change in a majority of the borrower's directors, within a 12- or 24-month period, *without the consent of the borrower's "continuing directors."* The term "continuing directors" is generally defined to mean persons who were on the board when the debt agreement was entered into, or replacement directors who were nominated by a majority of the directors who were either in office when the debt agreement was entered into or whose nomination was previously so approved. Lenders frequently add the proxy put concept in their loan documents to protect themselves from unanticipated changes in a borrower's executive management team out of concern that such changes may adversely impact a borrower's creditworthiness. A change of control based on a proxy put is typically included in addition to a triggering event based on a material change in the equity ownership of the borrower (e.g., in the event that more than 25 to 35 percent of the voting control of the borrower changes hands).

DEAD HAND PROXY PUTS

In the case of a "dead hand" proxy put – which is less common in debt instruments than the standard proxy put provision – the definition of "continuing directors" expressly excludes any person whose nomination for election to the board of directors occurs as a result of an actual or threatened proxy fight. As a result, *even if the board approves* a dissident slate of nominees, a change of control would still be triggered under the debt agreement, thereby giving rise to an acceleration event. Such "dead hand" proxy put provisions are designed to safeguard lenders against the risk that a majority of a borrower's board of directors is unexpectedly replaced by activist shareholders that may want to institute lender-unfriendly corporate strategies, such as instituting share buybacks or paying dividends.

In the recent cases discussed below , complainants have argued, and courts have agreed, that proxy puts – primarily "dead hand" proxy puts – could be problematic because such provisions tend to entrench incumbent directors and discourage dissidents whose appointment to management could benefit all investors.

LITIGATION IN THE DELAWARE COURT OF CHANCERY

1. Unenforceable Against Public Policy?

In *San Antonio Fire & Police Pension Fund v. Amylin Pharmaceuticals*, C.A. No. 4446-VCL (Del. Ch. May 12, 2009), the Delaware Court of Chancery examined the impact of a standard proxy put provision in the context of a proxy fight. The provision in question did not contain the "dead hand" prong of the definition of "continuing directors." Nonetheless, the court was among the first to suggest that proxy put provisions "might be unenforceable as against public policy," and noted that a proxy put provision "can operate as improper entrenchment devices that coerce stockholders into voting only for persons approved by the incumbent board."

In *Amylin*, the board purported to "approve" a slate of directors nominated by dissident stockholders, solely for the purpose of avoiding a change of control under its indenture. The triggering of a change of control under Amylin's indenture provided the noteholders with a right to redeem Amylin's convertible notes at face value. In reality, the board publicly opposed the proposed slate of directors in a proxy contest. The plaintiffs argued that the board's ability to so "approve" the dissident nominees for the narrow purposes of the indenture was disingenuous and inconsistent with the terms of the indenture. The court ultimately held that the board could approve the slate as a contractual matter – even though the board did not affirmatively endorse the new slate – if it determined in good faith "that the election of one or more of the dissident nominees would not be materially adverse to the interests of the corporation or its stockholders." In dicta, the court indicated that proxy put provisions are likely to face ongoing skepticism.

2. Breach of Fiduciary Duties

Similar to *Amylin, in Kallick v. SandRidge Energy*, C.A. No. 8182-CS (Del. Ch. March 8, 2013), the Delaware Court of Chancery evaluated a board's actions during a proxy contest. Under the terms of SandRidge's indenture, the election of a dissident slate without the approval of at least two-thirds of the incumbent directors would constitute a change of control, thereby entitling SandRidge's noteholders to redeem approximately $4.3 billion of notes. As was the case in *Amylin*, the indenture contained a standard proxy put provision, and did not contain the "dead hand" prong in the definition of "continuing directors." In this case, SandRidge's board of directors refused to approve the dissident slate of director nominees. Further, SandRidge warned its stockholders that that the stockholder election of the proposed slate of nominees, without the approval of the continuing directors, would trigger a redemption right and cause severe financial distress for SandRidge. The court was highly critical of the actions of SandRidge's board. Using *Amylin* for support, the court stated "a board may only fail to approve a dissident slate if the board determines that that passing control to the slate would constitute a breach of the duty of loyalty, in particular, because the proposed slate poses a danger that the company would not honor its legal duty to repay its creditors."

By refusing to approve the new slate of directors and relying on proxy put implications in its indenture to dissuade the stockholders, the court found that the board was likely breaching its fiduciary duties to its stockholders. The court's decision highlighted the concern that proxy put provisions have the potential to disenfranchise stockholders by attaching dire economic consequences to their decision to elect new directors.

3. Aiding and Abetting Claim Plausible

In *Pontiac General Employees Retirement System v. Healthways*, C.A. No. 9789-VCL (Del. Ch. Oct. 14, 2014) (transcript ruling), the Delaware Court of Chancery refused to dismiss a stockholder's claims alleging that (a) the board of Healthways breached its fiduciary duties to its stockholders by agreeing to a credit agreement containing a "dead hand" proxy put and (b) SunTrust Bank, the administrative agent under Healthways' syndicated credit agreement, aided and abetted the board's breach of fiduciary duty to its stockholders. In this case, the Court examined a "dead hand" proxy put, which – unlike the proxy put provisions reviewed in *Amylin* or *SandRidge* – permitted the lenders to accelerate the indebtedness under the credit agreement in the event of the election of a dissident stockholder's nominees as a majority of the board of the borrower, regardless of whether the current board ultimately approves the dissident stockholder's nominees.

The dispute in the *Healthways* case arose after Healthways became the target of a proxy contest, which resulted in a vote by the stockholders to de-stagger the board against the board's wishes. Within days of such vote, the board entered into an amendment to its credit agreement, providing for a "dead hand" proxy put that allowed lenders to declare a default under the credit agreement in the event that a majority of the board, during a two-year period, was comprised of non-continuing directors (including directors initially nominated as a result of an actual or threatened proxy contest, whether or not the incumbent board approved such slate). Earlier versions of the credit agreement contained the standard proxy put provisions. As a result, it appeared to the court that the "dead hand" feature was incorporated into the credit agreement immediately after the board became aware that it was dealing with "some degree of stockholder dissatisfaction."

The court ruled that the aiding and abetting claim had been adequately pleaded, and permitted subsequent proceedings to determine whether there had been a breach of fiduciary duty and, if so, whether SunTrust Bank knowingly participated in such breach. The court noted that, even if the negotiations between a borrower and its lenders are on arms-length terms, the lenders are not entitled to "insist on terms, demand terms, contemplate terms, incorporate terms that take advantage of a conflict of interest that the fiduciary counterparts of the other side of the negotiating table face." The court also noted that, in the wake of the decisions in *Amylin* and *SandRidge*, "[t]here was ample precedent from this court putting lenders on notice that these provisions were highly suspect and could potentially lead to a breach of duty on the part of the fiduciaries who were the counter-parties to a negotiation over the credit agreement."

At the settlement hearing for Healthways on May 8, 2015, the Vice Chancellor observed that the decision had been based upon, and should be limited to, the specific facts of the case. Nonetheless, increased judiciary scrutiny has caused some lenders to drop these types of provisions from their financing agreements.

IS THIS THE END OF THE DEAD HAND PROXY PUT?

The Delaware Court of Chancery has raised the concern that "dead hand" proxy put provisions improperly coerce and bully stockholders to vote for incumbent directors and against any dissident nominees or risk having the debt of the corporation accelerated. The threat of litigation has caused many borrowers to actively seek amendments to their debt agreements to remove such provisions. While lenders may argue that including a "dead hand" proxy put provision is both a customary and appropriate device to protect the lenders' prospects for repayment, the possibility of judiciary scrutiny has caused some lenders to reevaluate whether the risk of shareholder activist litigation is worth the benefit of these restrictive provisions. In recent months, a number of large institutional lenders have dropped the "dead hand" feature of the proxy put provision from their debt agreements. Instead, lenders should consider whether relying on a borrower's financial covenant tests and other protections in the credit agreement are sufficient to measure a borrower's ongoing strength and creditworthiness after an unexpected shift in management.

ATTORNEY SPOTLIGHT

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haynesboone.com

Gil Porter has led more than 150 project development and project finance transactions, and has advised on hundreds of others, in more than 35 countries throughout the world. For more than three decades, clients have reached out to Gil, Co-Chair of the Project Finance and Development Practice and a Partner in the Finance Practice Group of Haynes and Boone's New York office, for his guidance in connection with first-of-a-kind transactions, addressing new technologies, innovative structures and markets, and novel adaptations of existing products. Most recently he has been actively representing lenders and borrowers in connection with the second lien up-tiering model that is helping to redefine the oil and gas industry.

Gil is a founding member of the Finance practice at Haynes and Boone's New York office, which was launched in 2004. "We have built our New York Finance Section with market-leading practices in different complementary areas, including prime brokerage, commodities finance, subscription finance, trade finance and, of course, projects," says Gil. "These practices provide complementary opportunities, while at the same time helping us to establish a market reputation in the New York finance community."

As Gil puts it "the practice of law permits lawyers to develop skills in a range of different industries – the only limitation is how much time and effort we are willing to invest." Gil's clients and peers agree that Gil is a lawyer who has taken the time and invested the effort to develop that experience in the pursuit of serving his clients and the profession.

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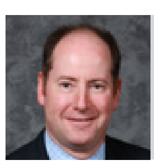

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