Chancery Court Holds that a Board has the Power to "Approve" the Nomination of a Dissident Slate of Director Nominees in Order to Qualify the Dissident Nominees as "Continuing Directors" for Purposes of a Change of Control Put Provision in a New York Law Indenture

On May 12, 2009, the Delaware Chancery Court, in an unpublished opinion by Vice Chancellor Lamb, interpreted a New York law-governed indenture to permit an issuer's board of directors to "approve" the nomination for election as directors members of a slate proposed by dissident stockholders. The purpose of the approval was to enable the issuer to avail itself of a "continuing directors" exception to a change in majority of directors prong of a "Change in Control" covenant and thus avert triggering a put right at par with respect to the notes issued under the indenture.[1] Board approval was given for this purpose even though the board, in the context of a proxy fight, did not recommend that stockholders elect any of the dissidents' proposed nominees, actively and publicly opposed their election and recommended a board-proposed slate of directors.

San Antonio Fire & Police Pension Fund v. Amylin Pharmaceuticals, Inc.[2] arose out of a proxy contest in which stockholders Icahn Partners LP ("Icahn") and Eastbourne Capital Management, L.L.C. each nominated its own five-member slate of directors (collectively, the "Dissident Nominees") for election to the 12-member board of directors of Amylin Pharmaceuticals, Inc. ("Amylin") at Amylin's annual stockholders' meeting to be held on May 27, 2009. The indenture governing Amylin's 3% convertible senior notes due 2014 (the "Indenture") contains a "fundamental change" provision giving noteholders a put right at par if at any time "Continuing Directors" do not constitute a majority of Amylin's board of directors. The Indenture defines "Continuing Directors" as:

> (i) individuals who on the Issue Date constituted the Board of Directors and (ii) any new directors whose election by the stockholders of the Company was approved by at least a majority of the directors then still in office (or a duly constituted committee thereof) either who were directors on the Issue Date or whose election or nomination for election was so previously approved.

Stockholder San Antonio Fire & Police Pension Fund sought, among other relief, a declaration that Amylin's board had the sole right and power to approve the Dissident Nominees for the purpose of the Continuing Directors provision of the Indenture. Amylin, in a cross-claim against the trustee (the "Trustee") under the Indenture, sought a declaration that the board had the right under the Indenture to approve the election of any and all of the Dissident Nominees at any time up to their election.

The Trustee contended that, for purposes of the Continuing Directors definition, the word "approve" is synonymous with "endorse" or "recommend", and that the board's determination, in the context of the proxy fight, not to recommend the election of any of the Dissident Nominees, to publicly state that the election of the Dissident Nominees would not be in the best interest of Amylin and to recommend its own competing slate cannot be reconciled with the plain meaning of the term "approved". Amylin contended that to "approve" in this context means to give formal sanction to the nomination of the Dissident Nominees for purposes of the Indenture, but does not necessarily imply a recommendation or endorsement of the Dissident Nominees. Vice Chancellor Lamb, applying New York law in interpreting the Indenture, held that Amylin's reading of the Indenture was the correct one.

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1 Because the notes were trading at a deeply discounted price, triggering the put right would have posed substantial economic problems for the issuer and its stockholders.

2 2009 WL 1337150 (Del.Ch.)

In so holding, Vice Chancellor Lamb noted that to read the provision as the Trustee suggested would mean that any election of stockholder nominees resulting from a contested election, even over insubstantial matters, would bar the board from approving such nominees as "continuing directors", and would prohibit any change in the majority of the board as a result of number of contested elections regardless of the context in which they arose.[3] Vice Chancellor Lamb specifically noted that under the Continuing Directors definition in the Indenture a non-Continuing Director would remain so for the life of the notes (which mature in 2014).[4] Vice Chancellor Lamb concluded that interpreting the Indenture in this manner would turn the Continuing Directors definition into an "entrenchment mechanism" having a "eviscerating effect" on the stockholder franchise. Such a result would, in turn, raise grave concerns relating to the exercise of the board's fiduciary duties in agreeing to such a provision. To allay those concerns, the court would want, at a minimum, to see evidence that the board believed in good faith that, in accepting such a provision, it was obtaining in return "extraordinarily valuable economic benefits for the corporation that would not otherwise be available to it." In addition, Vice Chancellor Lamb stated that a court would have to closely consider the degree to which such a provision might be unenforceable as against public policy, and that such a provision would likely put a trustee and noteholders on constructive notice of the possibility of its ultimate unenforceability. Seemingly to avoid the troubling result outlined, Vice Chancellor Lamb concluded, therefore, that a "board has, in the abstract, the power to approve a stockholder-nominated slate and still engage in a proxy contest against that slate."

However, given the state of the record in the case, Vice Chancellor Lamb declined to decide whether the Amylin board had properly exercised its right. The Vice Chancellor took note of two troubling sets of circumstances in the record before the court in this regard. First, were the negative statements made in proxy fight letters by the Amylin board about the dissident nominees. The court appeared willing to ascribe those comments to "[e]lection 'puffery'" and thus distinguishable from a formal exercise of board power to approve a nominee. The second set of circumstances was the timing of the board's approval of the dissident nominees. A period of just over one month elapsed between the date on which the plaintiff asked the board to approve the dissident nominees and the date on which the board issued its approval. Such approval was given in connection with plaintiff agreeing to remove allegations of breach of the duty of loyalty by the individual defendants, and not to seek money damages against them. Thus the court found the record unclear as to whether the board gave its approval of the dissident nominees in the good faith exercise of its business judgment, or simply to avoid facing a suit for money damages against them personally. Therefore the Court did not rule on whether or not the board exercised its power properly and dismissed that element of the case without prejudice.

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[3] The court took note of the economic harm Amylin and its stockholders would have suffered if the notes could have been put back to Amylin at par.

[4] Amylin's credit agreement contained a change of control event of default that would be triggered if *during any period of 24 consecutive months* a majority of the members of the board cease to be comprised of continuing directors. Continuing directors under the credit agreement cannot include any individual whose initial nomination occurs as a result of an actual or threatened solicitation of proxies for election of directors by any person other than a solicitation by or on behalf of the board of directors. This provision would appear to be even more restrictive than the analogous Indenture provision. However, Amylin was successful in obtaining a waiver of the credit agreement provision by agreeing to pay a 50 basis point fee on any outstanding balance in the event the "continuing director" provision was triggered by the election, as well as a 25 basis point solicitation fee. Vice Chancellor Lamb noted that continuing director provisions are somewhat less concerning in syndicated credit agreements than they are in public debt instruments because of the relative ease with which consent or waivers can be obtained from bank lenders. The opinion does not discuss whether the uncertainty of the enforceability of the continuing directors provision in the credit agreement facilitated lender's providing consent.

Even with this result, the case is instructive as to a board's need to consider its fiduciary duties before agreeing to a contractual provision that could be construed as impacting the right of shareholders to vote for directors. Further, underwriters and lenders should consider providing flexibility to an issuer with respect to the continuing director provision because, notwithstanding the approach which may taken by an issuer's board in approving the provision, this decision leaves open the possibility that a provision viewed by a court as overly restrictive might be held to be unenforceable as a matter of public policy.

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If you have any questions about the issues addressed in this memorandum or if you would like a copy of any of the materials mentioned, please do not hesitate to call or email Richard E. Farley at 212.701.3434 or rfarley@cahill.com; or Jon Mark at 212.701.3100 or jmark@cahill.com; or John Schuster at 212.701.3323 or jschuster@cahill.com .