"Proxy Puts" - BLB&G Fights The Latest Effort To Undermine Shareholders' Rights

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In late March 2009, Bernstein Litowitz Berger & Grossmann LLP ("BLB&G"), representing the San Antonio Fire and Police Pension Fund, began a battle to vindicate perhaps the most important of shareholder rights - the right to vote annually to remove directors whose performance is inadequate, incompetent or worse. In the 1980s, companies began using "poison puts" in their debt agreements. Traditionally, a poison put provision accelerated debt at par when a company agreed to be acquired or completed a wide range of restructuring or recapitalizations that altered the economic risk of the loan. In recent years, however, some debt agreements contain poison puts that trigger acceleration upon a change in the majority of the board of directors (i.e., "Proxy Puts"). Proxy Puts are particularly harmful to shareholders' rights because they can act as a massive financial punishment for "daring" to vote to replace the existing directors. These provisions therefore coerce shareholders to vote for the existing directors to avoid the possibility of accelerating a company's debt. In fact, BLB&G's Mark Lebovitch stated in *The Wall Street Journal* that for "levered companies," Proxy Puts are "foolproof anti-activism devices."

The litigation at issue was filed in the Delaware Chancery Court against Amylin Pharmaceuticals, Inc. and its Board. Amylin's indenture agreement for $575 million of convertible notes and its $140 million credit agreement both contain Proxy Puts. Because of a cross-default trigger in other debt agreements, these Proxy Put obligations expose Amylin's shareholders to payments of more than $900 million - an amount exceeding one-half of the Company's current $1.7 billion market value - if they remove a majority of the board. In late January 2009, two of its largest shareholders, Eastbourne Capital Management and Icahn Capital LLP, notified Amylin of their intent to run separate minority slates of five directors each. Consequently, a majority of Amylin's twelve directors might be replaced, which could trigger the Proxy Puts. The complaint, thus, sought to invalidate the Proxy Puts, and to require the Board to "approve" the nomination of Eastbourne and Icahn nominees for shareholder consideration at the Company's 2009 annual meeting, which would disable the risk of acceleration under the Notes Indenture.

After six weeks of expedited proceedings, the Court held a trial and heard summary judgment arguments on May 4, 2009. Notably, prior to this case, no court had ever ruled about the validity of a Proxy Put or whether a Proxy Put could be disabled. The validity issue was deferred because on the day before trial, the lenders on the Credit Agreement waived any rights under the Proxy Puts for the 2009 election. On May 12, 2009, Vice Chancellor Lamb issued a ruling in favor of our client on the principal issue, that the Proxy Put in Amylin's indenture agreement must be interpreted to allow Amylin's board to "approve" an opposing slate of directors in its ongoing proxy contest. In reaching its decision, the Court accepted BLB&G's arguments that Proxy Puts "can operate as improper entrenchment devices that coerce stockholders." The Court also accepted BLB&G's argument that a provision that would trigger such a significant acceleration of debt upon a change in the majority of a Company's board in a proxy contest "would raise grave concerns." The Court reasoned that such a provision would raise an issue whether a board breached its fiduciary duty of good faith in accepting such a provision without obtaining "extraordinarily valuable economic benefits for the corporation," or whether a board breached its fiduciary duty of loyalty by acting with a purpose to frustrate stockholder voting rights. Finally, the Court noted "such a provision might be unenforceable as against public policy" -- as BLB&G argued at trial.

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Despite our success on the principal issue, BLB&G and its client decided to appeal this ruling, in part because the Opinion sets forth an overly broad standard for determining whether the sitting directors can permissibly withhold their approval of stockholder nominees for the purpose of disabling the Proxy Put. In other words, BLB&G will argue, when shareholders want to exercise their voting rights, directors must approve competing director candidates in virtually all instances, since the decision whether to allow a fair election to proceed is not something to be entrusted to the judgment of a board that obviously would prefer to keep its jobs.

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