

“Continuing Director” Provisions After *Amylin Pharmaceuticals*

In *San Antonio Fire & Police Pension Fund v. Amylin Pharmaceuticals, Inc.*, the Delaware Chancery Court found that a board of directors, if acting in good faith and in accordance with its fiduciary duties, may approve the nomination of stockholder nominees for purposes of a “continuing director” provision in an indenture while actively opposing the election of those stockholder nominees.

Two stockholders each nominated five candidates (a total of ten nominees) for election to the twelve-member board of Amylin Pharmaceuticals, Inc. Because the corporation was party to an indenture governed by New York law that gave noteholders the right to demand redemption of their notes at face value (the notes were then trading at a significant discount to face value) upon the occurrence of certain change of control events, including if the “continuing directors” no longer constituted a majority of the directors of the corporation, the stockholder nominees had to be approved by the board to avoid acceleration of the corporation’s obligations under the indenture and a credit agreement. The definition of continuing directors included “any new directors whose election to the Board of Directors or whose nomination for election by the stockholders of the Company was approved by at least a majority of the directors then in office . . . either who were directors on the [date the notes were issued] or whose election or nomination for election was previously so approved.” The board eventually agreed to approve the nomination of the stockholder nominees as part of a partial settlement in which claims against the incumbent directors were dropped.

Approval v. Endorsement:

In *Amylin*, Vice Chancellor Lamb found that a board could approve the nomination, while simultaneously actively opposing the election, of the stockholder nominees for the purposes of the indenture. This was premised on:

- the distinction between approval of the nomination and endorsement of the candidates (noting that one can approve a candidate’s nomination without endorsing the candidate); and
- the Court’s concerns about the effects on the stockholder franchise (including limitations on stockholders’ range of discretion in exercising their franchise and entrenchment of the board that could result from a prohibition on “any change in the majority of the board as a result of any number of contested elections[] for the life of the notes”) if the indenture were read to preclude the board from approving the nomination of the stockholder nominees and whether such a provision would be unenforceable as against public policy.

Good Faith and Fiduciary Duties:

The Court in *Amylin* noted that the holding of *Hills Stores Company v. Michael Bozic* is applicable to the *Amylin* facts. The *Hills Stores* court:

- held that a board need not approve a change of control in order to avoid triggering severance payments to executives if it had determined after careful consideration and with the advice of outside lawyers and financial advisers that the change of control would be adverse to the interests of the corporation and its stockholders;
- noted that the record did not support a finding of a breach of fiduciary duties by a board (i) the minutes of whose meetings reflected the deliberations of the board on the

transaction, (ii) which had relied in good faith on outside lawyers and financial advisers in considering the change of control transaction, and (iii) which had allowed stockholders to choose that change of control transaction in a fair election;

- noted that the board's good faith determination that the change of control transaction was adverse to the interests of the stockholders was relevant to the corporation's decision to trigger the severance payments; and
- rejected the argument that the decision to trigger the rights of the executives to severance under their employment agreements should have been based on the effect of the severance on the stockholders.

Under both *Amylin* and *Hills Stores*, a board taking a position with respect to a contract that is inconsistent with its determination of what is best for the corporation and its stockholders is unlikely to be deemed to have acted in good faith. In *Amylin*, the Court declared that the board may approve stockholder nominees if it determines in good faith that the election of one or more of the stockholder nominees "would not be materially adverse to the interests of the corporation or its stockholders" (note that the Court went further to add that the board is under "absolutely no obligation to consider the interests of the noteholders in making this determination"). Although negative statements made by the board in fight letters could have been viewed as supporting a conclusion that the board had determined that the election of the stockholder nominees was adverse to the interests of the corporation, the Court dismissed such statements as "[e]lection 'puffery'" which is "hardly the same" as a determination by the board that the election of insurgent directors is adverse to the interests of the corporation.

When negotiating contracts with "continuing director" provisions, the Court noted that "[o]utside counsel advising a board in such circumstances should be especially mindful of the board's continuing duties to the stockholders to protect their interests. Specifically, terms that may affect the stockholders' range of discretion in exercising the franchise should, even if considered customary, be highlighted to the board. In this way, the board will be able to exercise its fully informed business judgment." In turn, while the board need not "review, discuss, and comprehend every word" of an indenture, directors approving an indenture should be mindful of its provisions that may infringe upon the stockholder franchise or affect the range of stockholder discretion in exercising the stockholder franchise. A board faced with a change of control, the approval or non-approval of which will have effects under the corporation's indentures, credit agreements or employment agreements, must separately consider both the change of control itself and whether transaction should be "approved" for purposes of any continuing director provisions. The decision of the board to approve a change of control transaction must be consistent with its fiduciary duties to the corporation and may be relevant to the determination of whether the corporation acted in good faith under the relevant contract.

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