

# Court of Chancery Approves Settlement of Stockholder Challenge to “Dead Hand Proxy Put” and Offers Important Guidance on Prior Ruling

## Client Alert

05.14.2015

In approving a settlement of a stockholder class action challenging a so-called “dead hand proxy put” provision in a credit agreement between Healthways, Inc. and SunTrust Bank, Vice Chancellor J. Travis Laster provided important guidance regarding his prior ruling in the same case denying defendants’ motions to dismiss - a decision which he stated “was probably one of the more frequently misrepresented or misunderstood rulings of mine.” See *Pontiac Gen. Employees Retirement Syst. v. Ballantine*, C.A. No. 9789-VCL (Del. Ch. May 8, 2015). In explaining his prior ruling, Vice Chancellor Laster sought to dispel what he characterized as “an alarmist view that liability, in fact, was established” by his prior ruling.

The complaint in the action challenged the validity of a dead hand proxy put in the Healthways-SunTrust credit agreement, and alleged that the Healthways directors breached their fiduciary duties by agreeing to such a provision and that SunTrust aided and abetted the alleged breach. The provision at issue effectively would have accelerated debt if a majority of the board was replaced by nominees of insurgent stockholders over the span of two annual meetings (the “proxy put”) without the right for the board to approve the insurgent stockholder nominees as continuing directors whose election would not count toward determining if the proxy put had been triggered (the “dead hand” feature). The validity of similar provisions previously was addressed by the Court of Chancery in *San Antonio Fire & Police Pension Fund v. Amylin Pharm., Inc.*, 983 A.2d 304 (Del. Ch. 2009) and *Kallick v. SandRidge Energy, Inc.*, 68 A.3d 242 (Del. Ch. 2013) due to the possible negative effect such provisions could have on the stockholder franchise.

Healthways and its directors moved to dismiss the complaint on ripeness grounds because the provision could not be triggered until the Company’s 2015 annual meeting, which was expected to occur approximately 12 months from the date of the filing of the complaint, and SunTrust moved to dismiss for failure to state claim. In its October 14, 2014 bench ruling, the Court denied both motions

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finding that the claim was ripe and that the aiding and abetting claim stated a valid claim because, among other reasons, “[t]here was ample precedent from this Court putting lenders on notice that [dead hand proxy put] provisions were highly suspect and could potentially lead to a breach of duty.” After the motions to dismiss were denied, plaintiffs and defendants agreed to a settlement which, among other things, required that the credit agreement be amended to delete the dead hand proxy put language. In approving the settlement at a hearing on May 8, 2015, the Court expounded on his prior ruling in four key respects.

*First*, the Court emphasized that his denial of the motions to dismiss was not a finding of liability or a grant of final relief. Rather, Vice Chancellor Laster stated that it “was a determination, under the reasonably conceivable standard that applies in this situation, that given the facts surrounding the timing of the adoption of the proxy put [*i.e.*, after the adoption of a proposal to destagger the board], as well as the prior caselaw regarding these provisions, it was reasonably conceivable that the plaintiffs could prevail on their claims.” Such a finding, the Vice Chancellor emphasized, “certainly holds out the possibility that on the merits it may be proven otherwise and that the pleadings-stage determination could be wrong.”

*Second*, Vice Chancellor Laster stated the “general view” of his prior ruling as applying to “any change-in-control provision in any loan agreement” was “specious.” Rather, the Court clarified that his prior ruling “addressed a dead hand proxy put, adopted in the shadow of a proxy contest. It didn’t address things like other acceleration rights that might be triggered by breaches of debt covenants or similar lender-protective provisions that do not affect the stockholder franchise.”

*Third*, the Court stressed again that there was no “finding of liability on the aiding and abetting claim against any lender who at any point for any company or for any issuer put one of these things in place.”

*Finally*, the Court emphasized that the “plaintiffs might well not prevail on their claims” absent the settlement. The Court stated that, although the claims were meritorious when filed, they were claims that could be contested. Specifically, the Court noted that any claim for monetary damages would have been subject to Section 102(b)(7) and Section 141(e) defenses, and that there would have been factual disputes regarding the degree to which SunTrust knowingly participated in the alleged underlying misconduct.

This transcript ruling is important as it provides further guidance regarding the validity of dead hand proxy put provisions, an area of law that awaits still further development.

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