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## Restructuring Lessons Learned Alert – Pledge Agreement Voting Provisions

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This memorandum was prepared as part of our continuing focus to facilitate the collective sharing of best practices and lessons learned in the financial restructuring and documentation areas. If you have any questions or comments regarding this alert, or would like to discuss the issues raised in this alert, please contact us at Noble Law PLLC.

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The ability of the administrative agent under a secured loan to effectively exercise voting rights with respect to the equity interests in a borrower, or its parent entity, is often critical to the ability to execute a non-consensual restructuring, or to negotiate a consensual restructuring. Such voting rights are often an effective intermediate step to change the membership of the borrower's board of directors or similar body, without the need to take ownership of the pledged equity interests or to conduct a foreclosure sale.

The administrative agent customarily obtains voting rights with respect to pledged equity in connection with the supplemental remedies provided in the pledge or other collateral agreement. However, these voting rights may be inadvertently drafted in a manner that impairs their exercise, as indicated in the following examples (which have been modified for purposes of illustration):

**1. Example # 1:**

Upon the occurrence and during the continuance of an Event of Default, any Investment Property may, at the option of the Administrative Agent and the other Secured Parties, be registered in the name of the Administrative Agent or its nominee, and the Administrative Agent or its nominee may thereafter exercise all voting, corporate and other rights pertaining to such Investment Property at any meeting of shareholders or otherwise.

This voting provision is problematic for three reasons. First, the provision requires registration of the pledged equity interests in the name of an entity other than the pledgor as a



condition precedent to the exercise of voting rights by the administrative agent. Registration is a corporate function performed by the corporate secretary or other officer of the issuer of the pledged equity, and any delay or refusal of the officer to perform this function will, at a minimum, delay and impair the ability of the administrative agent to effectively exercise its voting rights.

Second, registration of the pledged equity in the name of the administrative agent or its nominee may be deemed to constitute a strict foreclosure by the agent with respect to the pledged equity, resulting in full satisfaction of the loan and the elimination of any deficiency claim against other collateral or the credit parties.<sup>1</sup>

Third, this provision requires an election by the Administrative Agent **and** the other Secured Parties, which may include letter of credit issuers, cash management providers or hedge counterparties other than the administrative agent. As a result, the ability of the administrative agent to deal with this collateral is more restricted than its ability to deal with other collateral, which is often left to the reasonable judgment of the administrative agent subject to certain exculpation.

This example could be improved as follows:

Upon the occurrence and during the continuance of an Event of Default, ~~any Investment Property may, at the option of the Administrative Agent following notice to the Pledgor, and the other Secured Parties, be registered in the name of the Administrative Agent or its nominee, and the Administrative Agent or its nominee may thereafter (i) exercise all voting, corporate and other rights pertaining to such Investment Property at any meeting of shareholders or otherwise and/or (ii) have the Investment Property registered in the name of the Administrative Agent or its nominee.~~

## 2. **Example # 2:**

Upon the occurrence and during the continuance of any Event of Default, all rights of the Pledgor to exercise or refrain from exercising the voting rights attributable to the Pledged Collateral or any part thereof shall cease, and Administrative Agent shall have the exclusive right to exercise or refrain from exercising such rights.

This voting provision is problematic because it automatically transfers voting rights to the administrative agent upon the occurrence of an event of default, regardless of whether the administrative agent elects to exercise those rights.

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<sup>1</sup> See, e.g., Banker v. Upper Valley Refrigeration Co., 771 F. Supp. 6 (D. N.H. 1991).



This example could be improved as follows:

Upon the occurrence and during the continuance of any Event of Default, and [3 Business Day's prior] written notice from the Administrative Agent to the Pledgor of the Administrative Agent's election to exercise its voting rights under this section, all rights of the Pledgor to exercise or refrain from exercising the voting rights attributable to the Pledged Collateral or any part thereof shall cease, and the Administrative Agent shall have the exclusive right to exercise or refrain from exercising such rights.

**3. Negotiation Point:**

Sponsors will often seek to restrict the agent's ability exercise voting rights with respect to pledged equity, and lenders may be willing to agree to these restrictions given competitive pressure. However, from a restructuring perspective, registration requirements create a significant impediment to the ability of the administrative agent to exercise voting rights. A preferable alternative may include a requirement that the administrative agent provide written notice prior to exercising such voting rights in a manner similar to revised example #2. In practice, this advance notice provision can provide constructive clarity and "tempo" to restructuring negotiations and, given the absolute priority rule applicable in Chapter 11, is not likely to result in a sponsor causing the borrower to file a defensive bankruptcy case.

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