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Cadwalader, Wickersham & Taft LLP
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February 2021

Structured Finance Fact Sheet

Independent Directors for Special Purpose Entity Borrowers

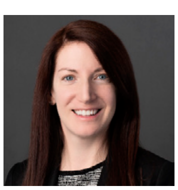
Introduction

- Independent Directors are used in structured finance transactions to address two issues:
  - First, the Bankruptcy Code does not have an insolvency requirement for a voluntary bankruptcy filing, so a Borrower does not need to prove that it is insolvent or unable to pay its debts in order to file a voluntary bankruptcy petition.
  - Second, courts have found that a Borrower's waiver of its right to file for bankruptcy is unenforceable as against public policy, because it restricts access to relief under the Bankruptcy Code. Courts have also found that creditor control over whether a Borrower can file for bankruptcy (often called a creditor "blocking vote") is similarly unenforceable, because it functions as a waiver.
- Independent Directors limit the risk of a voluntary bankruptcy filing by a solvent Borrower, but do not cross the line into a waiver or creditor blocking vote, because the Independent Director is a third party that is not controlled by the Lender.

How it Works

- Independent Directors are disinterested third parties who serve as directors of the Borrower, and whose vote is required in order for the Borrower to file a voluntary bankruptcy petition. The Independent Directors' scope of authority is limited solely to voting on bankruptcy matters.
- Under Delaware state law, a LLC can restrict or expand the fiduciary duties of its directors or managers in its LLC Agreement, other than the implied contractual covenant of good faith and fair dealing, which cannot be restricted or eliminated. The Borrower's LLC agreement should provide that the Independent Directors' fiduciary duties are limited to the Borrower and its creditors, and should provide that the Independent Directors disclaim any fiduciary duties to the Borrower's equityholders and affiliates, other than the implied contractual covenant of good faith and fair dealing.
- The Independent Directors should look at the Borrower's financial condition, in isolation, to determine whether they should vote to approve the Borrower's bankruptcy filing. The Independent Directors should not consider the financial condition of the Borrower's equityholders or affiliates.
- The goal is to prevent a solvent Borrower with performing assets from filing for bankruptcy due to the financial condition of its parent or affiliates.

For more information on these issues, contact:



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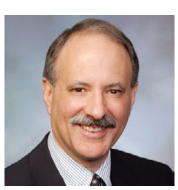

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Practice Tips

- In securitized deals, rating agencies generally require 1 Independent Director for any deal over $20 million, and 2 Independent Directors for any deal over $50 million.
- The Independent Directors should meet independence standards that are included in both the LLC agreement and the Loan Agreement, should be provided by certain rating agency-approved providers (in rated deals), and should only be removed from the Borrower for "Cause", which should be narrowly defined.
- LLCs that are not formed in Delaware present structural complications, because it is unclear whether the Independent Directors' fiduciary duties may be restricted in other states.
- Delaware statutory trusts can restrict the fiduciary duties of their trustees, and can have Independent Trustees that function like Independent Directors of an LLC.
- A Delaware corporation cannot limit the fiduciary duties of its directors, and a Delaware limited partnership cannot have non-partner managers, and therefore cannot have Independent Directors that comply with rating agency criteria.
- If the Borrower is not a Delaware LLC or a Delaware statutory trust, a two-tier Special Purpose Entity structure may be necessary to ensure protection.