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Potential Liability for PE Firms and Directors When Preferred Stock Held by a Controller-Sponsor Is Redeemed by a Non-Independent Board—Hsu v. ODN *and Practice Points*

In *Frederic Hsu Living Trust v. ODN Holding Corporation* (April 14, 2017, corrected April 25, 2017), Hsu, a common stockholder (and co-founder) of ODN Holding Corporation (the "Company"), brought suit claiming that the Company's directors had breached their fiduciary duties to the common stockholders, aided and abetted by Oak Hill Capital Partners, a private equity firm that was the controlling stockholder and the holder of the Company's Preferred Stock. The plaintiff contended that, over the two-year period prior to the exercise date of Oak Hill's redemption right, rather than managing the Company to maximize its long-term value for the benefit of the common stockholders, the directors had operated the Company so that it would be in a position to redeem the maximum amount of Preferred Stock as quickly as possible after the redemption right was exercised.

The Delaware Court of Chancery, giving the benefit of all reasonable inferences to the plaintiff (as required at the pleading stage), declined to dismiss the plaintiff's claims. Vice Chancellor Laster concluded that, given the economic terms of the Preferred Stock (*i.e.*, no accruing dividend in the event of non-redemption) and the apparent business prospects of the Company, the alleged facts supported a reasonable inference that rather than effecting a "de facto liquidation" of the Company at "seemingly fire-sale prices" and "stockpiling cash" to benefit the Preferred Stockholder, the board "could have grown [the Company's] business, gradually redeemed all of the preferred stock, and then generated returns for its common stockholders."

Key Points

- **The decision highlights the potential *under certain circumstances* for liability of portfolio company directors and sponsors when preferred stock held by the sponsor is redeemed.** Importantly, the decision was made in the context of review by the court under the "entire fairness" standard—which was applied because the court viewed the sponsor as being a controlling stockholder and viewed the board as being under the controller's influence. (In *Trados*, a 2013 decision also by Vice Chancellor Laster, under similar circumstances relating to a liquidation preference on preferred stock, the court applied the same legal analysis under entire fairness review.) We note that, when the preferred stockholder is *not* a controller, the "business judgment" standard of review typically should apply, under which the court generally would defer to directors' judgments relating to redemptions. Moreover, even when business judgment review would *not* apply (because there is a controller or a non-independent board), we note that the result could well be different than it was in *Hsu* if (unlike the apparent fact situation in *Hsu*) a committee of independent directors

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functioned effectively to consider the common stockholders' interests and maintained an appropriate record that established the foundations for the committee's actions relating to the redemptions.

- **It has been well established that directors—including those elected by the preferred stock—may be in breach of their fiduciary duties when their actions favor the interests of the preferred stockholders over the common stockholders, even if the company has a clear contractual obligation to the preferred stockholders.** Even in the face of a mandatory redemption (or other) obligation under the terms of preferred stock, a board has a continuing fiduciary duty to the common stockholders when considering *how to meet* the contractual obligation. The Vice Chancellor noted that a board's fiduciary duty requires it to consider even *whether* to meet the obligation (*i.e.*, whether it would be in the best interests of the company and the common stockholders for the company to breach the obligation).
- **A critical consideration for the court was that the Company viably could have been run for the benefit of the common stockholders notwithstanding the redemption obligation.** The court emphasized that the Preferred Stock carried no cumulative dividend in the event of non-redemption and that the Company had been successfully pursuing a growth strategy until it was faced with the looming redemption obligation. Therefore, in the court's view, it was reasonably conceivable (the applicable standard at the pleading stage to survive a motion to dismiss) that the Company could have met its redemption obligation by redeeming Preferred Stock gradually over time while continuing as a going concern for the benefit of the common stockholders.
- **Abstaining from a formal vote may not be shield a director from liability if the director was otherwise actively involved in the various steps underlying the redemption.** The sponsor-elected directors abstained from the two board votes approving redemptions of the Preferred Stock. The court held that their abstentions did not shield them from potential liability, however, as they had been actively involved in all steps of the process.
- **Practice points.** The issue of divergence of the interests of preferred stockholders and common stockholders has typically *not* created liability for boards or sponsors—although *Hsu* and *Trados* highlight the potential for liability in the context of entire fairness review and another recent Court of Chancery decision, *TradingScreen* (2015), highlights the potential for liability in the context of preferred stock redemptions that would render the company insolvent. Under "Practice Points" below, we recommend that sponsors' preferred stock investments provide for a cumulative dividend (and/or other rights or remedies) in the event a company does not satisfy a mandatory redemption obligation; and that boards engage in a reasonable process to consider the interests of the common stockholders when meeting obligations to the preferred stockholders, including documenting the reasons for board actions. If future judicial decisions under more positive fact situations intensify the risk of liability relating to redemption of preferred stock, the advantages and disadvantages of possible alternative investment structures (discussed below) also could be considered.

Background. In 2008, funds sponsored by Oak Hill acquired $150 million of Preferred Stock of the Company, which had been formed as a holding company for Oversee.net (a technology company). In 2009, Oak Hill acquired $24 million of the Company's common stock (from Company co-founder Lawrence Ng) and became the controlling stockholder. Of the Company's eight directors, Oak Hill elected three, all of whom were Oak Hill principals or officers (the "Oak Hill Directors"). The Preferred Stock included a right of redemption for all of the shares, exercisable in 2013 (the "Redemption Right"). Starting in 2011, the Company, which had previously operated under a growth strategy, sold almost all of its businesses and retained cash. On Oak Hill's exercise of the Redemption Right in 2013, the Company

used all legally available funds to redeem as many shares of the Preferred Stock as it could. It then sold a large part of the sole remaining business and used the proceeds to redeem additional shares. The two redemptions totaled $95 million. Both of the redemptions, and the one asset sale that occurred *after* the Redemption Right had been exercised, were approved by a special committee of two "outside" directors (the "Committee"). There was no stockholder vote on the sales or other board actions.

The Redemption Provisions. The terms of the Preferred Stock stated that, on exercise of the Redemption Right:

> [T]he Company shall redeem, out of funds legally available therefor, all of the outstanding shares of Preferred Stock…in cash…. If the funds…legally available for redemption…are insufficient to redeem the total number of shares…, (i) those funds which are legally available will be used to redeem the maximum possible number of such shares…, and (ii) the Company *thereafter shall take all reasonable actions (as determined by the Company's Board of Directors in good faith and consistent with its fiduciary duties) to generate, as promptly as practicable, sufficient legally available funds to redeem [the remaining shares], including by way of…sale of assets…or otherwise*; [and,] [a]t any time thereafter when additional funds of the Company are legally available for the redemption of shares of Preferred Stock such funds will immediately be used to redeem the balance of the shares which the Company has become obliged to redeem… (Emphasis added).

The stock did not carry a cumulative dividend or other contractual penalty in the event of non-redemption.

Discussion

When a company has an obligation to redeem preferred stock, the directors are obligated to act in the best interests of the *common* stockholders in considering *how* (and even *whether*) to meet the obligation. A board has fiduciary duties to the common stockholders to maximize the value of the company for their benefit; whereas a preferred stockholder's rights are contractual in nature. A "board does not owe fiduciary duties to preferred stockholders," the court wrote, even "when considering whether or not to take corporate action that might trigger or circumvent the preferred stockholders' contractual rights." Fiduciary duties to the common stockholders "continue to operate" in the context of an obligation to redeem preferred stock (or any other contractual obligation)." Indeed, the court stated, "[i]t generally will be the duty of the board, where discretionary judgment is to be exercised, to prefer the interests of common stock—as the good faith judgment of the board sees them to be—to the interests created by the special rights, preferences, etc., of preferred stock." There is *always* "room for fiduciary judgment," the court explained, because, even in the face of "an iron-clad contractual obligation" (such as to redeem preferred stock), the board will have to consider "how to handle th[e] contractual obligation," and even "may decide that its most advantageous course is to breach and pay damages." These principles had "even greater salience" in this case, the court wrote, because the "Redemption Provisions themselves recognize that a plaintiff could assert a claim for breach of fiduciary duty." We note, however, that where a majority of a board is viewed by the court as independent and disinterested and there is no controller, and therefore business judgment review applies, the likely result would be judicial deference to the directors' decisions with respect to redemptions.

In determining "how to handle" a redemption obligation, a board should consider the terms of the preferred stock, the prospects of the company, and the impact of redeeming the stock as well as the impact of not redeeming the stock. The court stated that, based on the terms of the Preferred Stock, "if the Company lacked either surplus or legally available funds when the Redemption Provisions

otherwise came into play, then the Company would not have been able or obligated to redeem the Preferred Stock. At that point, the Board could have continued to manage the Company for the benefit of the undifferentiated equity without having to make a massive redemption payment." Importantly, the Preferred Stock "did not carry a cumulative dividend...[which] often…steadily increases the liquidation preference…[and thereby] reduces the prospect that a corporation will generate value for the undifferentiated equity, because the company not only must continue as a going concern but also generate a sufficient return to escape the gravitational pull of the large liquidation preference and cumulative dividend." The court concluded that, given the Company's "prospects," it "conceivably could have continued as a going concern even while meeting its redemption obligation." We note that Vice Chancellor Laster's legal analysis was the same in *Trados,* but the analysis of Trados's business prospects led to a different result, as the liquidation preference payable on the Trados preferred stock rendered the common stock "functionally worthless.") Based on *Hsu*, we note that a board also should consider the impact of the utilization of cash for a redemption, as compared to the damages—contractual and reputational—that would flow from failure to meet a redemption obligation.

Neither the price nor the process may have been fair to the common stockholders. Vice Chancellor Laster found that the facts alleged supported a reasonable inference that (i) Oak Hill had been concerned that the Company could not maintain its rapid growth rate and wanted to exit the investment as soon as possible via its redemption right; and (ii) the board had operated the Company to "create a pool of cash" so that funds would be legally available for redemptions. In the court's view, the directors engaged in "hasty divestitures" at "seemingly fire-sale prices that virtually wiped out the Company's ability to generate income." Having found it reasonably conceivable that "the directors acted in bad faith by effectively liquidating the company to maximize the value of Oak Hill's Preferred Stock," it would be "difficult to demonstrate fair process," the court stated. The court also noted the plaintiff's contention that "particular aspects of the process" were unfair, including the board's using bonuses to incentivize management to favor sales (which, the court stated, aligned their interests with the Preferred Stockholder rather than the common stockholders); and the Company's sale of assets during periods that management considered "unfavorable."

Key distinguishing features in *Hsu*. As noted, entire fairness review was applied because the court deemed the Preferred Stockholder to be a controller and viewed the board (including the special committee) as meaningfully influenced by the controller and not independent—even though the Preferred Stockholder had elected only three of the eight directors.) With no record establishing the bases for the board's actions, the court, at the pleading stage, based on the alleged facts, found it to be at least reasonably conceivable that the board's actions were taken to favor the sponsor and were not in the best interests of the common stockholders. We note that, with a contemporaneous record, the board might have established that, in its judgment, the Company likely never would have achieved value materially in excess of what was required to redeem the Preferred Stock; that the Company's change in business strategy, to sell off businesses rather than grow, was related to the board's view of the Company's prospects; and/or that the prices obtained in the sales reflected the fair value of the businesses sold.

Abstaining from voting on the resolutions authorizing the redemptions did not shield the preferred stock-elected directors from potential liability because they had been "involved" in the process. The eight-member board was comprised of the three Oak Hill Directors, the Company CEO, and four "outside" directors. The Committee, which was formed just before the exercise date of the Redemption Right, was comprised of two of the outside directors. The Committee negotiated with Oak Hill relating to its upcoming exercise of the Redemption Right and negotiated the one asset sale that occurred after the Redemption Right was exercised. The full board approved the two redemptions of Preferred

Stock, with the Oak Hill Directors abstaining. The abstentions may not have shielded the Oak Hill Directors from liability, however, the court ruled, as they "were involved in many of the decisions that gave rise to the Complaint"—including voting for and, in some cases being otherwise involved in, the change in 2011 from a "growth strategy" to one of selling businesses and accumulating cash; the decision in 2012 to sell two of the Company's four lines of business; the decision in 2013 to tie officers' bonuses to redemptions; and the decision in 2014 to engage in a restructuring that would free up additional cash. Moreover, "in light of the allegations of the Complaint as a whole," the court concluded, "it was reasonably conceivable that the abstaining directors engaged in behind-the-scenes communications with their fellow directors…on critical matters."

Application of the entire fairness standard of review. The court did not find that the negotiations by Oak Hill with the Company in anticipation of its exercising the Redemption Right had constituted a controller standing on both sides of a transaction—because, while Oak Hill negotiated "directly opposite the Company," the negotiations occurred "in the shadow of the pre-existing Redemption Right." However, according to the court, "Oak Hill used its influence at the Board-level by having the Oak Hill Directors participate in key votes." Because the controller apparently tried to extract a benefit from board action (*i.e.*, maximization of the value of the Redemption Right) that was not shared equally with the other stockholders, the court applied the entire fairness standard of review. The court noted that, under *MFW*, business judgment review would have applied instead if "the twin procedural protections of *both* an independent committee and a majority-of-the-minority vote" had been satisfied. We note that typically the *MFW* prerequisites will *not* be satisfied in connection with a preferred stock redemption, as the redemption is pursuant to a contractual right and no vote of stockholders is involved. In our view, even without a stockholder vote and the application of business judgment review under *MFW*, however, if the Committee had been viewed by the court as independent and had functioned effectively, and the Oak Hill Directors had *not* been involved in the actions relating to the redemptions, the judicial result could well have been different.

Use of the Committee did not shift the burden of proof under entire fairness review because the Committee had not functioned effectively. Under entire fairness review, the defendants have the burden of proving that the challenged actions were "entirely fair" (*i.e.*, fair both as to process and as to price) to the common stockholders. If *either* a well-functioning independent committee of directors *or* the disinterested stockholders approve the challenged actions, then the burden of proof can shift to the plaintiff to prove that the actions were *not* entirely fair. The court stated that "shifting the burden of proof at the pleading stage normally will be impossible because defendants do not have the luxury of arguing facts that would counter the plaintiffs' well-pled allegations that are assumed as true." Here, the use of the Committee did not shift the burden of proof to the plaintiff, the court ruled, because the alleged facts supported a reasonable inference that the Committee had not "functioned effectively." The Committee appeared to have improperly favored Oak Hill's interests, including by negotiating with Oak Hill to provide an in-kind dividend on any unredeemed shares in exchange for a forbearance agreement that was "illusory" as Oak Hill could terminate it on 30 days' notice; rejecting management's business plans several times, insisting instead that deeper staff cuts and more divestitures be made (which would result in more cash available); and, when the Redemption Right was exercised, asking management to re-assess its previous view about the level of the cash reserve that the Company needed to retain (which management then did, reducing the suggested reserve from $10 million to $2 million, which facilitated the first redemption, in the amount of $45 million).

The factual context. According to the court:

- ***The sales constituted a "de facto liquidation" of the Company***. Virtually *all* of the Company's businesses were sold, in a "marked shift" from the Company's previous growth strategy. Over "a remarkable two years," the court stated, the Company sold assets that had generated 92% of its revenue and almost quadrupled its cash reserves (which went from $13.2 million at the end of 2010 to $50 million). The Company also undertook "changes in management" (involving a new CEO and the resignation of an outside director), which apparently were "linked to a new business strategy that sought to maximize the value of the Redemption Right;" and the board rejected management's business plans, demanding further staff reductions and sales of businesses (which would result in more cash available).
- ***The sales were at "seemingly fire-sale prices."*** In 2012, the board approved the sale of two of its four business lines, with the proceeds totaling just $15.4 million, which was "less than a third of what the Company had paid [in recent years] to buy just two of the companies that comprised part of the divested businesses." In 2014, the Company sold the "crown jewel" of its sole remaining line of business (which represented its principal remaining source of revenue) for $600,000, although it had acquired the business in 2010 for $17 million. We note, again, that there was no record establishing that there had been a decline in value of the businesses (which could well have been the case, particularly given the volatile profile of many technology companies).
- ***The management was incentivized to achieve redemptions.*** In 2012, the board's Compensation Committee, comprised of one Oak Hill Director and one outside director, structured bonuses for the three senior officers of the Company, which were triggered if the Company achieved redemptions of at least $75 million. The CEO received a bonus of almost $600,000 on this basis.
- ***The directors may not have been independent and disinterested.*** At the pleading stage, the court viewed the three Oak Hill Directors and the Company CEO as not independent and disinterested directors. The court also viewed three of the four "outside" directors as potentially not independent. "[T]taken as a whole, the allegations of the Complaint identify a constellation of actions [approved by the outside directors], all of which favored the interests of Oak Hill by maximizing the value of its Redemption Right," the court wrote. "Within this context, [their] links [to Oak Hill] take on greater color." Those "links" were, for one of the directors, that he had worked for 15 years as a corporate attorney with the law firm that acted as Oak Hill's long-time outside counsel; had served with one of the Oak Hill Directors on another board; and his son and the Oak Hill Director's son were friends. The other director serving on the Committee (Ng) had received $24 million when Oak Hill purchased the block of his "otherwise illiquid [Company common] stock." We note that the concern was compounded by the court's view (discussed above) that the Committee had not functioned effectively to advance the interests of the Company and the common stockholders.

Contrast with *Trados.* *Trados* involved a company that had obtained venture capital in 2000 to support a growth strategy that could lead to an initial public offering. The VC firms received preferred stock and appointed representatives to the company's board. In 2004, the VC sought to exit the investment and the directors adopted a management incentive plan (MIP) that compensated management for achieving a sale (even if the transaction yielded nothing for the common stock). The company was then acquired in a $60 million cash-and-stock merger that, under the terms of the preferred stock, constituted a liquidation

that triggered a liquidation preference of $57.9 million. Without the MIP, the common stockholders would have received $2.1 million. The MIP took the first $7.8 million of the merger consideration; the preferred stockholders received $52.2 million; and the common stockholders received nothing. Vice Chancellor Laster held (as he did in *Hsu*) that directors' fiduciary duties require that they try to maximize the value of the corporation for the benefit of its residual claimants; and that, where the transaction was not approved by a board majority comprised of disinterested and independent directors, the defendants had to prove that the transaction was entirely fair. The *Trados* plaintiff contended (as did the *Hsu* plaintiff) that, instead of selling the company, the board had a fiduciary duty to continue to operate the company independently in an effort to generate value for the common stock. In its post-trial decision, the court found that, despite what it viewed as the directors' failure to follow a fair process and a trial record replete with their contradictions and less-than-credible testimony, the defendants had carried their burden of proof on this issue. However, the court reasoned that, under the company's business plan, *the common stock had no economic value before the merger* (a major distinction from the *Hsu* situation), and that therefore, it was fair for the holders to receive in the merger the substantial equivalent of what they had before the merger ("which was zero").

Practice Points

- **Fiduciary duties of directors to favor the common stockholders' interests.** The court stated in *Hsu* (as it did in *Trados*) that, when directors weigh the interests of preferred stockholders against the interests of the common stockholders, they should generally prefer the interests of the common stock even if at the expense of the interests of the preferred stock. We note that, when the entire fairness standard of review applies—and particularly if (as in *Hsu*) there is also not an adequate record at the pleading stage establishing a foundation for the decisions the board made—the court may conclude, as it did in *Hsu*, that it is at least "reasonably conceivable" that the directors were motivated by furthering the interests of the preferred stockholder rather than the common stockholders. However, when business judgment review applies (*i.e.*, when there is not a controller and the board is independent)—or, even when there *is* a controller and thus business judgment review does *not* apply, but there was an effectively functioning independent committee (and particularly if there was also an appropriate record of the foundations for the board's judgments)—then the court should be unlikely to second-guess the directors' decisions.

- **When "entire fairness" applies.** To review, the entire fairness standard is applicable when an action (i) was approved by a board a majority of the directors of which were not independent and disinterested or (ii) a controller "stood on both sides" or had a benefit not shared at least by the other stockholder. Under entire fairness, the defendant directors have the burden of proving that the action taken was fair as to both price and process. When entire fairness applies, an action can be reviewed instead under the deferential business judgment standard of review *if* the action was approved by (a) a well-functioning special committee of independent and disinterested directors *and* (b) the fully-informed disinterested stockholders (the "*MFW* prerequisites"). If the action was approved by only *one* of the two *MFW* prerequisites, then entire fairness continues to apply but the burden of proof shifts to the plaintiff to prove that the action was *not* entirely fair.

- **A board must engage in a reasonable process to decide *how* the company should comply with a redemption obligation (or other contractual obligations) to preferred stockholders and should consider the advantages and disadvantages of the various available courses of action, including breaching the contractual obligation.** The board, or an independent committee, should:

- consider the actual terms of the preferred stock—with attention to what leverage the preferred stockholder does or does not have, as a contractual and economic matter, to force redemption in full at a given time;
- consider whether, in light of the redemption obligation, the common stock is "functionally worthless" or, instead, the company's prospects are such that it could meet (or temporarily default on) the redemption obligation and still continue as a going concern, generating value for the common stockholders over the long-term;
- establish whether the proceeds received for divestitures, the proceeds of which were used for redemptions, did or did not represent fair value for the businesses sold;
- consider engaging independent advisors; and
- set forth in the form of minutes or other appropriate documentation the board's reasons for, and its judgment as to the costs and benefits to the common stockholders of, the board's decision to meet a redemption obligation (even a mandatory redemption obligation), as well as the board's related decisions, such as changing from a growth strategy to selling businesses and retaining cash, incentivizing management to achieve redemptions, and other related actions taken.

- **Importance of the issue of viability of the common stock.** In *Trados*, where the Court of Chancery reviewed under the entire fairness standard a sale of the company in which all of the proceeds went to pay the preferred stockholders' liquidation preference and the common stockholders received nothing, the court upheld the sale decision, reasoning that zero was a fair price for the common stock as it had no value prior to the merger in light of the liquidation preference. The result in *Hsu* was different, as the court viewed the terms of the Preferred Stock as not requiring immediate redemption in full and viewed the common stock as not being "functionally worthless" in the face of the redemption obligation.
- **An investor should consider seeking provisions in preferred stock that would provide a remedy in the event a mandatory redemption right is not satisfied**. A right or remedy triggered by a failure to redeem would not only provide protection to the preferred stockholder in the event of non-redemption, but would provide some protection to the directors making a decision to meet a redemption obligation as they would have had to take into consideration the impact of triggering the right or remedy. A right to any one or more of the following could be considered:
  - a cumulative dividend (which, possibly, could increase over time);
  - receive additional shares, an increased cumulative dividend, or other economic benefits;
  - make the preferred convertible into common at a favorable conversion price; and/or
  - require a sale of the company (unless the preferred stockholders do not then want it).
- **Need to draft rights on non-redemption so that they are triggered by "nonpayment" rather than "default."** We note that the Court of Chancery decision in *TradingScreen* (2015) underscores that any right that is triggered by non-redemption should reference the corporation's nonpayment of the full redemption amount "for any reason" upon the occurrence of a redemption triggering event, without characterizing the nonpayment as a "default" of the redemption obligation.
- **If future judicial decisions under more positive fact situations intensify the risk of liability relating to redemption of preferred stock, sponsors also could consider possible alternative**

investment structures that might result in the company board not having (or having only limited) fiduciary duties to the other investors. It might be possible to consider whether, instead of a preferred stock investment, an investment could be crafted to mirror (to the maximum possible extent) a preferred stock investment as a substantive matter while taking the form of an investment in a different vehicle. Although each of the following presents practical, business and legal issues, and the costs and benefits involved obviously would have to be evaluated, the following could be considered:

- ***LLC or LLP.*** Investment in a limited liability company or limited liability partnership (which is not subject to the same fiduciary duties owed to corporate stockholders, nor to the restriction that repurchases of interests be made out of "legally available funds"—although there *is* a not well-defined obligation to act in "good faith");
- ***Close corporation.*** Depending on the number of investors, investment in a "close corporation" (where there is significant leeway in contractually disclaiming fiduciary duties);
- ***Common stockholders' assignment of claims.*** If there is a small number of common stockholders, assignment (through a stockholders' agreement) to the preferred stockholder of claims that the common stockholders may have at any time for violation of certain limited, specified duties of the board to them;
- ***Small investment in common stock, with other investors taking a different class of preferred stock.*** Investment by the sponsor in a small amount of common stock, with most of its investment in "Class A" preferred stock, while the other investors do not acquire common stock and acquire only "Class B" preferred stock that carries only the minimal required preferences (such as a liquidation preference over the common stock)—so that the board owes fiduciary duties only to the sponsor through its ownership of the common stock; or
- ***Debt investment.*** If possible, investing in deeply subordinated debt, or crafting a debt investment (such as convertible debt or debt with a warrant exercisable for equity) that mirrors the benefits of an equity investment, while providing for a right of repayment that is not subject to the availability of surplus or "legally available funds."
- ***Letter of credit.*** In addition to the suggestions above, to the extent that preferred stock financing becomes more difficult or expensive, a sponsor could consider whether it would be possible to reduce the risk through a backup letter of credit or other mechanism to finance a mandatory redemption (which financing, as a practical matter, would have to be structured to ensure that the provider would be considered a debtholder in the event of insolvency of the company).

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