Proxy Voting Rights are Rocking the Board

In the evolving landscape of private credit, proxy voting rights have emerged as a powerful tool for creditors seeking to assert influence in distressed situations. When an event of default occurs, creditors may invoke proxy voting rights with minimal notice—sometimes with no notice —to replace a company's board of directors (commonly referred to as "board flipping"), effectively stripping equity sponsors of control. In fact, in many of Lincoln's current amendment discussions on behalf of clients, lenders are specifically asking to amend credit agreements to reduce or altogether eliminate notice periods to effectuate the exercise of proxy rights.

These rights, embedded in the majority of private credit agreements, allow creditors to initiate governance changes when they believe existing equity holders—often private equity Sponsors—are unwilling or unable to take the necessary actions to preserve value on behalf of all stakeholders, including creditors.

Historically, creditors viewed the exercise of these rights as a measure of last resort, concerned about the operational disruption, strained sponsor relationships, and potential cross-defaults in other financial instruments. While those concerns remain valid, the market environment has shifted. As a result, proxy voting rights are no longer seen solely as a defensive measure, but rather as a strategic mechanism to enhance governance and improve outcomes. For many creditors, this includes replacing the board and initiating a near-term sale or refinancing process—particularly when they perceive sponsors to be misaligned or lacking economic incentive to pursue a transaction.

Lincoln's capital advisory experts are uniquely positioned to support sponsors throughout complex and distressed negotiations. This playbook, informed by navigating a wide array of proxy voting rights scenarios, examines the market trends shifting creditor strategies, the mechanics of proxy voting rights and the implications for sponsors.

Market trends toward board flipping

Multiple rounds of amendments and forbearances, often without a viable path to repayment, have pushed some creditors to reassess their tolerance for delay—and to act decisively. Per Lincoln's conversations with credit leaders, three key market trends have led to growing frustration within lending groups to drive this shift:

- A slowdown in mergers and acquisitions (M&A) activity reduces exit opportunities and prolongs distress holding patterns
- Diminished sponsor capacity to inject additional equity—often due to fund level constraints or other investment priorities—can lead to misalignment with creditors and reluctance to act
- Increasing reliance on creditors to provide liquidity places a heavier burden on creditors while exposing investments to greater risk

These dynamics have shifted creditor perspectives, leading many to reconsider their patience for delayed resolutions and embrace proactive measures. Lincoln has observed creditors increasingly leveraging proxy voting rights to expedite governance changes and drive more strategic alternatives and outcomes.

Understanding the mechanics of proxy voting rights

In most secured credit arrangements, the borrower's equity is pledged to lenders as collateral. Under normal circumstances, this pledge does not interfere with the sponsor's voting rights. However, upon a default, the collateral agent—acting on behalf of the required lenders—may exercise the pledged rights to appoint new board members at the borrower or its subsidiaries.

The mechanics of effectuating a board transition can move swiftly. Depending on lenders' level of preparedness and risk tolerance, a new board can be installed within a matter of weeks. In some cases, sponsors receive notice simultaneously with the board change, underscoring the urgency and surprise often associated with these actions.

Implications for sponsors

Once a board flip occurs, the sponsor retains its equity stake but loses nearly all operational and strategic control. The authority to appoint directors, engage advisors, initiate sale / refinancing processes and evaluate bids—even those below the level of the existing debt—rests entirely with the new board, typically composed of independent directors who are more likely to look to maximize value for all stakeholders, not just the equity. Moreover, the sponsor's ability to use Chapter 11 as a negotiating tool is effectively neutralized, and recent case law (e.g., In re CII Parent, Inc., 2023) has shown board changes made via board flipping are rarely reversible, even in bankruptcy.

Given these implications, it is essential that sponsors act early at the first signs of distress. Engaging constructively with creditors prior to any covenant breach can preserve optionality—whether through an amendment, forbearance, or a broader restructuring solution. Once a default occurs without a cure and governance rights shift, a sponsor's leverage is significantly reduced.

Lincoln's differentiated value

Lincoln's deep connectivity and credibility with private credit lenders uniquely position us to support sponsors through complex negotiations. Whether helping negotiate amendments where lenders want to change notice periods, working proactively to avoid a board flip or intervening in situations where control has already shifted, Lincoln facilitates collaborative solutions that seek to maximize recoveries for all stakeholders. Our proprietary database of amendment terms and extensive restructuring experience enable us to navigate these negotiations efficiently and strategically. Reach out today to ensure your path forward maximizes recovery and preserves value.

Ready to discuss the opportunities ahead for you?
Connect with a senior professional at connect@lincolninternational.com