WHO'S GOT A GOLDEN TICKET?—LIMITING CREDITOR USE OF GOLDEN SHARES TO PREVENT A BANKRUPTCY FILING

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INTRODUCTION

Bankruptcy law allows a debtor to shelter itself from the advances of creditors seeking to collect their debts.[1] While it does not prevent the debtor from having to pay *all* of its debts,[2] it provides the debtor relief in two primary ways. First, the automatic stay[3] takes effect to provide the debtor with a "breathing spell"—time to coordinate its financial affairs without the ever-present threat of collection efforts.[4] Second, the discharge eviscerates many of the debts to the extent not paid in the bankruptcy case.[5] Together, these protections provide a fresh start for bankruptcy debtors—a chance to start anew.[6] Not surprisingly, creditors frequently hope that the debtor will not file for bankruptcy protection because the stay prevents them from engaging in collection actions permitted under state law, and the discharge potentially eliminates any chance of full payment. This Article considers the development of "golden shares"—a procedure by which a creditor becomes an owner of a debtor entity with the goal of

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1 *See What Are the Main Purposes of Bankruptcy?*, AM. BANKR. INST. (Apr. 9, 2013, 5:32 PM), http://bankruptcyresources.org/content/what-are-main-purposes-bankruptcy [https://perma.cc/Q6RQ-TN78]; *What Happens When You File Bankruptcy?*, DEBT.ORG, https://www.debt.org/bankruptcy/ [https://perma.cc/D2Z7-X54L].

2 *See What Are the Main Purposes of Bankruptcy?*, *supra* note 1; *What Happens When You File Bankruptcy?*, *supra* note 1.

3 *See* 11 U.S.C. § 362 (2012).

4 Wohleber v. Skurko (*In re* Wohleber), 596 B.R. 554, 567 (B.A.P. 6th Cir. 2019) (quoting *In re* Glenn, 760 F.2d 1428, 1436 (6th Cir 1985)).

5 *See* 11 U.S.C. § 727(b) (2012); *Discharge in Bankruptcy – Bankruptcy Basics*, U.S. CTS., https://www.uscourts.gov/services-forms/bankruptcy/bankruptcy-basics/discharge-bankruptcy-bankruptcy-basics [https://perma.cc/2SVF-DE26].

6 The Bankruptcy Code's policy of providing a fresh start to debtors allows "certain insolvent debtors [to] reorder their affairs, make peace with their creditors, and enjoy 'a new opportunity in life with a clear field for future effort, unhampered by the pressure and discouragement of preexisting debt.'" Grogan v. Garner, 498 U.S. 279, 286 (1991) (quoting Local Loan Co. v. Hunt, 292 U.S. 234, 244 (1934)). However, that fresh start is reserved for "honest but unfortunate" debtors. *Id.* at 287 (quoting *Local Loan Co.*, 292 U.S. at 244).

preventing the entity from filing for bankruptcy protection,[7] and argues for the use of a bad-faith standard akin to designation of creditor votes in acceptance of a chapter 11 plan for determining whether a creditor's golden shares can be used to block a bankruptcy filing.

I. HOW BUSINESSES ENTER BANKRUPTCY

A. Formation, Structure, and Control

1. Corporations

Those creating a corporation do so by filing a relatively simple document known as the articles of incorporation.[8] This document provides basic information about the business, such as the name of the business, shares authorized for issuance, and the names of those incorporating the business.[9] It might also provide information about the purpose of the business or limitations on the fiduciary duties of those managing the business.[10] Most businesses also create bylaws, which provide more detail about the governance of the business.[11]

Once formed, shareholders select directors to oversee the business.[12] The board of directors, in turn, selects officers to oversee the daily affairs of the business.[13] The primary roles of the shareholder-owners of the corporation after incorporation include selection of the directors and approval of major business decisions, such as amendment of the articles of incorporation.[14] Separation of function between the shareholders and management constitutes one of the defining features of a traditional corporation.[15]

However, some corporations, colloquially known as "close corporations" differ from the traditional corporation. In Delaware, a close corporation must have no more than thirty shareholders and

[7] *See* Franchise Servs. of N. Am. v. U.S. Trs. (*In re* Franchise Servs. of N. Am.), 891 F.3d 198, 205 (5th Cir. 2018).

[8] *See* MODEL BUS. CORP. ACT § 2.01 (AM. BAR ASS'N 2016). Delaware calls the same document the *certificate* of incorporation. *See* DEL. CODE ANN. tit. 8, § 101(a) (2019).

[9] *See* MODEL BUS. CORP. ACT § 2.02(a).

[10] *See id.* § 2.02(b); *see also* DEL. CODE ANN. tit. 8, § 102(a)(3), (b)(7) (2019).

[11] *See* MODEL BUS. CORP. ACT § 2.06; *see also* DEL. CODE ANN. tit. 8, § 109 (2019).

[12] *See* MODEL BUS. CORP. ACT §§ 2.05(a), 8.01(b); *see also* DEL. CODE ANN. tit. 8, §§ 141(a), 211(b) (2019).

[13] *See* MODEL BUS. CORP. ACT §§ 8.40, .41.

[14] *See id.* §§ 7.01, 10.03; *see also* DEL. CODE ANN. tit. 8, § 242(b)(2) (2019).

[15] *See* Brian R. Cheffins, *The Rise and Fall (?) of the Berle-Means Corporation*, 42 SEATTLE U. L. REV. 445, 452–53 (2019) (discussing Adolf A. Berle, *Modern Functions of the Corporate System*, 62 COLUM. L. REV. 433, 437 (1962)).

affirmatively elect close corporation status.[16] Other states, such as those that have adopted provisions of the Revised Model Business Corporation Act, lack a specific close corporation designation, but do allow shareholder agreements to limit the function of directors or even eliminate the board of directors altogether.[17] Because such shareholder agreements often require unanimous agreement of the shareholders,[18] they are most likely in a very small corporation. Whether in a state that allows a designation of a close corporation or in a Model Act state, which allows shareholder agreements, a close corporation provides more overlap of the shareholder-owners of the company and management of the company.

2. Limited Liability Companies

Limited liability companies (LLCs) start with the same process as corporations, being formed under state law by the filing of the articles of organization.[19] The articles of organization require minimal information about the LLC, such as its official name and address.[20] The real heart of the LLC lies in the operating agreement, which provides a contractual relationship between members—the owners of the LLC—regarding the various rights and obligations of its members.[21] While the operating agreement resembles corporate bylaws in that it provides more detail about the operations of the business, its impact on an LLC is hard to overstate. Where a corporation is controlled by the officers and directors of the business guided by the bylaws provisions,[22] the LLC's operating agreement can provide a clear and more direct framework to manage the LLC and provides the flexibility to modify almost any provision of law.[23] The Uniform Limited Liability Company Act, promulgated by the National Conference of Commissioners on Uniform State Laws,

[16] *See* DEL. CODE ANN. tit. 8, §§ 342–44 (2019).

[17] *See* MODEL BUS. CORP. ACT § 7.32(a).

[18] *See id.* § 7.32(b).

[19] *See* DEL. CODE ANN. tit. 6, § 18-201(a) (2019) ("certificate of formation"); UNIF. LTD. LIAB. CO. ACT § 201 (2006) (NAT'L CONFERENCE OF COMM'RS ON UNIF. STATE LAWS, amended 2013).

[20] *See* DEL. CODE ANN. tit. 6, § 18-201(a); UNIF. LTD. LIAB. CO. ACT § 201(b).

[21] *See* DEL. CODE ANN. tit. 6, § 18-101(9) ("[l]imited liability company agreement"); *id.* § 18-1101(b) ("It is the policy of this chapter to give the maximum effect to the principle of freedom of contract and to the enforceability of limited liability company agreements."); UNIF. LTD. LIAB. CO. ACT § 110 cmt. ("A limited liability company is as much a creature of contract as of statute.").

[22] *See* MODEL BUS. CORP. ACT §§ 8.01, .41.

[23] *See, e.g.*, Gary W. Derrick, *Oklahoma Limited Liability Companies and Limited Liability Partnerships*, 22 OKLA. CITY U. L. REV. 643, 650 (1997); Joseph W. Boucher & Leonard S. Sosnowski, *The Wisconsin Limited Liability Company*, WISC. LAW., Dec. 1993, at 9, 9.

demonstrates the breadth of what may be regulated by the operating agreement.[24] It provides for a handful of things that *cannot* be done by the operating agreement,[25] but otherwise provides that

> the operating agreement governs:
> (1) relations among the members as members and between the members and the limited liability company;
> (2) the rights and duties under this [act] of a person in the capacity of manager;
> (3) the activities and affairs of the company and the conduct of those activities; and
> (4) the means and conditions for amending the operating agreement.[26]

The section continues by expressly allowing the operating agreement to eliminate the duties of a member to account for property or compete with the company;[27] define behaviors that meet or violate fiduciary duties if reasonable;[28] or limit the ability to obtain damages for some breaches of fiduciary duties.[29] These broad provisions allowing the members of an LLC to contractually define their relationship are the central identifying feature of LLCs.[30]

By default, members run limited liability companies,[31] a model commonly known as "member-managed" LLCs. Unlike a traditional corporation, a member-managed LLC merges the ownership and

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[24] *See* UNIF. LTD. LIAB. CO. ACT § 105. The 2006 version of the Limited Liability Company Act has been adopted by twenty-one states. *Limited Liability Company Act, Revised*, UNIF. L. COMM'N, https://my.uniformlaws.org/committees/community-home?CommunityKey=bbea059c-6853-4f45-b69b-7ca2e49cf740 [https://perma.cc/4JED-DNPF]. The Uniform Limited Liability Company Act was initially drafted in 1996; in addition to the 2006 version, it was modified in 2011 and 2013. *Id.*

[25] Section 110(c) restricts the operating agreement's ability to change the LLC's ability to sue or be sued; modify the law governing the LLC; eliminate the signing/filing authority given by judicial order; eliminate fiduciary duties; prevent members from obtaining information from or taking action against the LLC; prevent wind up or dissolution of the LLC under some circumstances; prevent some mergers or conversions; or restrict rights of nonmembers and nonmanagers. REVISED UNIF. LTD. LIAB. CO. ACT § 110(c) (NAT'L CONFERENCE OF COMM'RS ON UNIF. STATE LAWS 2006).

[26] REVISED UNIF. LTD. LIAB. CO. ACT § 110(a).

[27] *See id.* § 110(d).

[28] *See id.* § 110(d)(2)–(5), (e).

[29] *See id.* § 110(g).

[30] *See* Elf Atochem N. Am., Inc. v. Jaffari, 727 A.2d 286, 291 (Del. 1999).

[31] *See* DEL. CODE ANN. tit. 6, § 18-402 (2019) (providing that members manage in proportion to their ownership interest in the company); REVISED UNIF. LTD. LIAB. CO. ACT § 407(a), (b)(2) (providing that members manage equally).

management of the business.[32] In a member-managed LLC, every member may participate in decision making, though the member might lack authority to bind the LLC.[33] However, LLC documents can provide for management by persons selected by the members, generally known as "manager-managed" LLCs.[34] Manager-managed LLCs more closely resemble the traditional corporate separation of ownership and management of the business.[35]

B. Who Represents Businesses

Most business forms enjoy a separate legal identity from the owners of the business,[36] and exist as legal "persons" for the purpose of a bankruptcy filing.[37] However, though persons, the businesses cannot speak for themselves or sign a bankruptcy petition. Instead, they rely upon the constituencies within the business—typically the management of the business—to make decisions.[38] In determining authority to file for bankruptcy, courts look to the law of the state of

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[32] *See* REVISED UNIF. LTD. LIAB. CO. ACT § 407(b)(1).

[33] *See id.* § 301 (providing that member does not automatically serve as agent of the LLC); *id.* § 407(b)(2) (providing that every member has equal right in management of the LLC).

[34] *See* DEL. CODE ANN. tit. 6, § 18-402 (2019); REVISED UNIF. LTD. LIAB. CO. ACT § 407(a)(1)(A).

[35] 13 ELIZABETH S. MILLER & ROBERT A. RAGAZZO, TEXAS METHODS OF PRACTICE § 57.1 (3d ed. 2019).

[36] *See* Dole Food Co. v. Patrickson, 538 U.S. 468, 474 (2003) (corporations); Am. Nat. Res., LLC v. Eagle Rock Energy Partners, L.P., 374 P.3d 766, 771 (Okla. 2016) (limited liability companies).

[37] *See, e.g.*, First Nat'l City Bank v. Banco Para El Comercio Exterior De Cuba, 462 U.S. 611, 625 (1983).

[38] *See* DEL. CODE ANN. tit. 6, § 18-402 ("Unless otherwise provided in a limited liability company agreement, the management of a limited liability company shall be vested in its members in proportion to the then current percentage or other interest of members in the profits of the limited liability company owned by all of the members, the decision of members owning more than 50 percent of the said percentage or other interest in the profits controlling; provided, however, that if a limited liability company agreement provides for the management, in whole or in part, of a limited liability company by a manager, the management of the limited liability company, to the extent so provided, shall be vested in the manager who shall be chosen . . . in the manner provided in the limited liability company agreement."); DEL. CODE ANN. tit. 8, § 141(a) (2019) ("The business and affairs of every corporation organized under this chapter shall be managed by or under the direction of a board of directors, except as may be otherwise provided in this chapter or in its certificate of incorporation."); MODEL BUS. CORP. ACT § 8.01(b) (AM. BAR ASS'N. 2016) ("All corporate powers shall be exercised by or under the authority of, and the business and affairs of the corporation managed by or under the direction of, its board of directors, subject to any limitation set forth in the articles of incorporation or in an agreement authorized under section 7.32."); UNIF. LTD. LIAB. CO. ACT § 407(b)(1), (c)(1) (2006) (NAT'L CONFERENCE OF COMM'RS ON UNIF. STATE LAWS, amended 2013) ("In a member-managed limited liability company, . . . [t]he management and conduct of the company are vested in the members. . . . In a manager-managed limited liability company, . . . any matter relating to the activities and affairs of the company is decided exclusively by the manager, or if there is more than one manager, by the managers.").

organization for the business.[39] Thus, when a business opts to voluntarily[40] file for bankruptcy protection, it is typically the directors of a corporation, the members in a member-managed LLC, or the managers in a manager-managed LLC who make that decision on the business's behalf.[41]

C. Fiduciary Duties

In a corporation, those charged with making decisions—including the decision to put the business into a bankruptcy proceeding—have fiduciary duties in connection with that decision making.[42] As with the board of directors in a corporation, those managing an LLC owe fiduciary duties to the LLC.[43] Limited liability companies evolved as a hybrid of partnerships and corporations,[44] and share the same basic fiduciary duties as those types of businesses.[45] The duties owed by those managing a business generally include the duty of care[46] and the duty of loyalty,[47] with an underlying obligation to act fairly and

[39] *See* Franchise Servs. of N. Am. v. U.S. Trs. (*In re* Franchise Servs. of N. Am.), 891 F.3d 198, 206 (5th Cir. 2018) (quoting Price v. Gurney, 324 U.S. 100, 106 (1945)); Ullrich v. Welt (*In re* Nica Holdings, Inc.), 810 F.3d 781, 789–90 (11th Cir. 2015) (citing *Price*, 324 U.S. at 106).

[40] A company may be involuntarily placed into a bankruptcy proceeding by the requisite number of creditors holding undisputed claims against the debtor. *See* 11 U.S.C. § 303(b) (2012).

[41] *See In re* Delta Starr Bd., No. Civ.A. 05-2783, 2006 WL 285974, at *3 (E.D. La. Feb. 6, 2006); *In re* Avalon Hotel Partners, 302 B.R. 377, 381 (Bankr. D. Or. 2003) (noting that the manager lacked authority to file LLC into bankruptcy proceeding due to restrictions placed in articles of organization); 2 JAMES D. COX & THOMAS LEE HAZEN, TREATISE ON THE LAW OF CORPORATIONS: AUTHORITY AND POWERS OF THE DIRECTORS § 9.5 (3d ed. 2018).

[42] *See* McMullin v. Beran, 765 A.2d 910, 917 (Del. 2000) (quoting Emerald Partners v. Berlin, 726 A.2d 1215, 1221 (Del. 1999)); MODEL BUS. CORP. ACT § 8.30.

[43] *See* DEL. CODE ANN. tit. 6, § 18-1101(c), (e); REVISED UNIF. LTD. LIAB. CO. ACT § 409 (NAT'L CONFERENCE OF COMM'RS ON UNIF. STATE LAWS 2006). *But see* Gardner Davis & Danielle Whitley, *Blocking Director's Fiduciary Duty Essential for Successful Remote Entity Structure*, 31 WESTLAW J. DEL. CORP., Feb. 27, 2017, at 1, 2 (noting that an operating agreement may limit or eliminate most fiduciary duties).

[44] *See* Turner v. Andrew, 413 S.W.3d 272, 275 (Ky. 2013) ("A limited liability company is a 'hybrid business entity having attributes of both a corporation and a partnership.'" (quoting Patmon v. Hobbs, 280 S.W.3d 589, 593 (Ky. Ct. App. 2009))).

[45] *See Patmon*, 280 S.W.3d at 594 (finding that default fiduciary duties of members and managers of LLCs comport with those of partnerships and corporations); Michelle M. Harner & Jamie Marincic, *The Naked Fiduciary*, 54 ARIZ. L. REV. 879, 891–93 (2012).

[46] *See* UNIF. P'SHIP ACT § 404(c) (NAT'L CONFERENCE OF COMM'RS ON UNIF. STATE LAWS 1997) ("A partner's duty of care . . . is limited to refraining from engaging in grossly negligent or reckless conduct, intentional misconduct, or a knowing violation of law."); MODEL BUS. CORP. ACT § 8.30(b).

[47] *See* UNIF. P'SHIP ACT § 404(b) (providing that the duty of loyalty requires accounting for partnership assets held by partner, not acting on an "interest adverse to the partnership," and not competing with the partnership); MODEL BUS. CORP. ACT § 8.60 ("conflicting interest transaction[s]"); *id.* § 8.70 ("business opportunities").

in good faith.[48] These duties fall upon the officers and directors of a corporation,[49] managers of a manager-managed LLC,[50] and members of a member-managed LLC.[51] Consistent with the policy of maximum flexibility for LLC's, the operating agreement may modify or even eliminate fiduciary duties as long as those modifications do not eliminate the requirements to act fairly and in good faith.[52] The same is true in corporations,[53] particularly for close corporations.[54] Nonmanaging owners of a company generally do not have any fiduciary duty to the company.[55]

II. PREVENTING BUSINESSES FROM FILING FOR BANKRUPTCY PROTECTION

Creditors employ several techniques in an effort to prevent businesses from filing for bankruptcy protection. The bankruptcy code and the courts have limited the use of these techniques in order to ensure the debtor's ability to use the bankruptcy system when needed.[56] In response, creditors continue to find clever new ways to prevent or dissuade bankruptcy filings.[57]

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[48] *See* Stone v. Ritter, 911 A.2d 362, 370 (Del. 2006) (citing Cede & Co. v. Technicolor, 634 A.2d 345, 361 (Del. 1993) (noting that the obligation of good faith is incumbent in duties of care and loyalty); UNIF. P'SHIP ACT § 404(d); MODEL BUS. CORP. ACT § 8.30(a); *see also* Nicole M. Sciotto, *Opt-In vs. Opt-Out: Settling the Debate over Default Fiduciary Duties in Delaware LLCs*, 37 DEL. J. CORP. L. 531, 538–39 (2012) (discussing split among courts as to whether corporate law duties apply in an LLC if the operating agreement is silent on such duties); *cf.* Rawcliffe v. Anciaux, 416 P.3d 362, 370 (Utah 2017) (recognizing good faith as a duty separate from the duties of care and loyalty).

[49] *See* Gantler v. Stevens, 965 A.2d 695, 708–09 (Del. 2009); MODEL BUS. CORP. ACT §§ 8.30, .42.

[50] *See* Auriga Capital Corp. v. Gatz Props., 40 A.3d 839, 849–51 (Del. Ch. 2012); REVISED UNIF. LTD. LIAB. CO. ACT § 409(g) (NAT'L CONFERENCE OF COMM'RS ON UNIF. STATE LAWS 2006). Note, however, that the duty of good faith applies to members as well as to managers in a manager-managed LLC. *See* REVISED UNIF. LTD. LIAB. CO. ACT § 409(d), (g)(3).

[51] *See* Feeley v. NHAOCG, LLC, 62 A.3d 649, 662 (Del. Ch. 2012) (noting that only "managing members" have fiduciary obligations to the LLC); REVISED UNIF. LTD. LIAB. CO. ACT § 409(a).

[52] *See* DEL. CODE ANN. tit. 6, § 18-1101(c), (e) (2019); REVISED UNIF. LTD. LIAB CO. ACT § 409(d).

[53] *See* DEL. CODE ANN. tit. 8, § 102(b)(7) (2019); *Feeley*, 62 A.3d at 661 (citing *Auriga*, 40 A.3d at 849–56).

[54] *See* Allison v. Eriksson, 98 N.E.3d 143, 152 (Mass. 2018) (citing Donahue v. Rodd Electrotype Co., 328 N.E.2d 505, 512, 515 (Mass. 1975)).

[55] Katris v. Carroll, 842 N.E.2d 221, 222–23 (Ill. App. Ct. 2005).

[56] *See* Davis & Whitley, *supra* note 43, at 2.

[57] *See, e.g.*, *id.* at 3–4; Bruce H. White & William L. Medford, *Ipso Facto Clauses and Reality: I Don't Care What the Documents Provide*, AM. BANKR. INST. J., Apr. 2002, at 28, 28, 52.

A. Ipso Facto Clauses

The Bankruptcy Code generally disapproves of ipso facto provisions that absolutely prohibit a company (or individual debtor) from filing for bankruptcy protection, or that operate to eliminate the benefits of a bankruptcy filing for the debtor:[58]

- property enters the estate regardless of contract provisions providing otherwise in the event of a bankruptcy filing;[59]
- property of the estate may be used, sold, or leased despite contractual provisions limiting the ability to do so in bankruptcy;[60]
- provisions in law or in an executory contract[61] that modify that contract upon a bankruptcy filing are unenforceable;[62] and
- an executory contract may be assigned to another party in most cases despite a provision providing otherwise in the event of bankruptcy.[63]

These prohibitions ensure that debtors do not forfeit the ability to obtain a fresh start through bankruptcy before such a need comes to fruition.[64] Even in the absence of a specific Bankruptcy Code provision invalidating a specific type of ipso facto clause, courts have extended the policy to invalidate other types of clauses that limit a debtor's rights upon a bankruptcy filing.[65] Because creditors cannot

[58] *See* Michael J. Di Gennaro & Harley J. Goldstein, *Can Ipso Facto Clauses Resolve the Discharge Debate?: An Economic Approach to Novated Fraud Debt in Bankruptcy*, 1 DEPAUL BUS. & COM. L.J. 417, 419 (2003); White & Medford, *supra* note 57, at 28.

[59] *See* 11 U.S.C. § 541(c)(1) (2012).

[60] *See id.* § 363(l).

[61] Courts are divided on the issue of whether operating agreements constitute executory contracts. *Compare In re* Denman, 513 B.R. 720, 724–25 (Bankr. W.D. Tenn. 2014) (noting that an operating agreement is not an executory contract but is instead a governance documents that outlines respective rights of parties), *with In re* Daugherty Constr., 188 B.R. 607, 612 (Bankr. D. Neb. 1995) ("The member relationships are essentially executory in character.").

[62] *See* 11 U.S.C. § 365(e).

[63] *See id.* § 365(f).

[64] *See* Di Gennaro & Goldstein, *supra* note 58, at 443; *see also* 1 NAT'L BANKR. REVIEW COMM'N, BANKRUPTCY: THE NEXT TWENTY YEARS 432 (1997) ("The policy reason behind rendering *ipso facto* agreements unenforceable in bankruptcy is to prevent an automatic forfeiture of a debtor's interest in property as a result of a bankruptcy filing in order to preserve the value of the bankruptcy estate for creditors.").

[65] For example, some courts have found pre-petition agreements to waive the debtor's ability to challenge a creditor's motion for relief from stay unenforceable *ipso facto* provisions, though the Code has no express prohibition on such clauses. *See, e.g.*, *In re* Pease, 195 B.R. 431, 433, 435 (Bankr. D. Neb. 1996) (noting that waiver of stay would prevent debtor from using property, which violates *ipso facto* restrictions, and that inability to use property would impact debtor-

require debtors to absolutely give up the right to file for bankruptcy protection,[66] creditors developed other mechanisms that make bankruptcy filings technically possible, but difficult to achieve.[67] These mechanisms involve the use of either managers or owners of the business to block the decision to file for bankruptcy protection.

B. Bankruptcy Remote Entities/Blocking Directors

A bankruptcy remote entity (BRE) is not absolutely prohibited from filing a bankruptcy case, but it is unlikely to do so as a result of its structure.[68] The BRE is often formed as a single-purpose entity tied to a larger business conglomerate.[69] The BRE's sole function is to insulate the debt owed to the creditor from other parts of the business that may enter a bankruptcy case.[70] The BRE structure requires unanimous approval of the board of directors (or managers in an LLC) in order for the entity to file for bankruptcy protection.[71] Thus, even if sister corporations enter bankruptcy, the BRE remains out of the bankruptcy system. In addition, a BRE's board includes one "independent" director or manager—one not affiliated with or selected by the parent business, typically chosen by the BRE's most significant creditor.[72] Because the independent director or manager will make a decision unrelated to the entity's or parent company's wishes, and presumably favoring the interests of the creditor who selected the director, the lender can effectively block the bankruptcy filing.[73] This director or manager, often known as the blocking director, "is the lynchpin that holds together a bankruptcy remote special purpose entity, formed to ring fence assets from creditors

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in-possession's fiduciary obligations); *cf. In re* Triple A&R Capital Invest., Inc., 519 B.R. 581, 586 (Bankr. D.P.R. 2014) (providing pre-petition stay waiver is enforceable by creditor); *In re* Bryan Road, LLC, 382 B.R. 844, 848–49, 854 (Bankr. S.D. Fla. 2008) (citing Sw. Ga. Bank v. Desai (*In re* Desai), 282 B.R. 527, 532 (M.D. Ga. 2002)) (noting pre-petition automatic stay waiver not "per se" enforceable but may constitute cause for creditor to obtain relief from stay).

[66] Davis & Whitley, *supra* note 43, at 2.

[67] *See, e.g.*, *id.* at 1; White & Medford, *supra* note 57, at 52 (discussing development of Bankruptcy Remote Entities).

[68] *See* White & Medford, *supra* note 57, at 52.

[69] *See* Davis & Whitley, *supra* note 43, at 1.

[70] *See* Basic Capital Mgmt. v. Dynex Commercial, 348 S.W.3d 894, 896 (Tex. 2011).

[71] *See* White & Medford, *supra* note 57, at 52.

[72] *See* Gardner F. Davis & John J. Wolfel Jr., *Blocking Director May Not Prevent Bankruptcy Remote Entity from Filing Bankruptcy*, BLOOMBERG L. (Mar. 22, 2017, 2:23 PM), https://news.bloomberglaw.com/bankruptcy-law/blocking-director-may-not-prevent-bankruptcy-remote-entity-from-filing-bankruptcy [https://perma.cc/C5LP-CY8T].

[73] *See id.*

other than a secured creditor."[74] This makes a bankruptcy filing for the BRE unlikely, though still possible, and incentivizes the controlling creditor to extend credit to the BRE under more favorable terms than it otherwise might provide.[75]

Generally, "cases indicate the bankruptcy court will be sympathetic with the [debtor's] desire to file bankruptcy and will not tolerate a blocking director without a fiduciary duty to the [debtor] because doing so would appear tantamount, in practice, to an absolute bar to bankruptcy."[76] Thus, the problem for those courts is not the unanimity requirement for a bankruptcy filing, but the fact that a director or manager can block the bankruptcy filing *without* making that decision in the interest of the company that the director serves. As one court noted,

> The essential playbook for a successful blocking director structure is this: the director must be subject to normal director fiduciary duties and therefore in some circumstances vote in favor of a bankruptcy filing, even if it is not in the best interests of the creditor that they were chosen by.[77]

BREs offer the primary bankruptcy-blocking arrangement effectuated through use of a corporate director or LLC manager.

As noted, courts sometimes allow a BRE structure as long as the blocking director holds fiduciary duties, not to the creditor that selected the director, but to the entity that the director or manager serves.[78] Directors and managers typically owe fiduciary duties to the entity that they direct, but most of those duties can be disavowed by the company.[79] In the context of the decision to file for bankruptcy protection, however, the equitable policy of ensuring a fresh start to a debtor,[80] and ensuring that the debtor does not essentially give that right to file bankruptcy away,[81] justifies limiting the ability to put (or not put) a company into bankruptcy to those managers who do so in

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[74] *In re* Lake Mich. Beach Pottawattamie Resort LLC, 547 B.R. 899, 911 (Bankr. N.D. Ill. 2016).

[75] *See* Felton E. Parrish, Paloian v. LaSalle Bank NA*: Just How Remote Is That Bankruptcy-Remote Entity?*, AM. BANKR. INST. J., Feb. 2011, at 30, 30.

[76] Davis & Whitley, *supra* note 43, at 3.

[77] *In re Lake Mich. Beach Pottawattamie Resort*, 547 B.R. at 913.

[78] *See* Davis & Whitley, supra note 43, at 3.

[79] *See supra* notes 42–55 and accompanying text.

[80] *See* Grogan v. Garner, 498 U.S. 279, 286 (1991) (quoting Local Loan Co. v. Hunt, 292 U.S. 234, 244 (1934)).

[81] *See* Davis & Whitley, *supra* note 43, at 2.

the interest of the company rather than acting for the benefit of a creditor.

The rule requiring that a blocking director or manager owe a fiduciary duty to the business seems simple enough: it requires that this director or manager hold the same obligations as all other directors of managers.[82] But that simple rule creates other possible issues. Consider, for example, a situation in which the blocking director for a company is an officer with the creditor that insisted upon the blocking-director unanimous vote provision. When the board is considering a bankruptcy filing, the blocking director faces a potential conflict of interest.[83] As a director of the debtor corporation, the director should vote in favor of the bankruptcy filing if that is in the corporation's best interest.[84] But the director may act against the creditor's best interest, which could create a breach of fiduciary obligation owed to the creditor. While this creates a dilemma for the director, the appropriate remedy is not to invalidate the blocking director provision, but to focus on the remedies for breach of fiduciary duty depending upon how the director casts the vote on filing for bankruptcy protection.[85]

A second complication regarding the blocking director's (and, in fact, all directors') fiduciary duty involves emerging caselaw disagreeing as to the extent to which a troubled business's board owes fiduciary duties both to the owners *and* creditors of the company.[86] It is clear that while a company is financially stable, directors owe fiduciary duties to the shareholders or members of the business.[87] And it is relatively established that when a company becomes insolvent, that duty shifts to the creditors.[88] But a company does not transition from stable to insolvent in one moment. That transition

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[82] *See* Davis & Wolfel, *supra* note 72.

[83] The creditor may have an inherent conflict of interest if it serves as either a director or shareholder with fiduciary duties of the debtor. *See id.* As noted in *Franchise Services*, the proper remedy in such a situation is not to take away the creditor's right to vote if that vote is proper, but instead to bring a claim for breach of that fiduciary duty. *See* Franchise Servs. of N. Am. v. U.S. Trs. (*In re* Franchise Servs. of N. Am.), 891 F.3d 198, 214 (5th Cir. 2018).

[84] *See In re* Lake Mich. Beach Pottawattamie Resort LLC, 547 B.R. 899, 913 (Bankr. N.D. Ill. 2016).

[85] *See In re Franchise Servs. of N. Am.*, 891 F.3d at 214.

[86] *See* White & Medford, *supra* note 57, at 52. While this is true in corporate law, it is not clearly applicable to creditors of limited liability companies. *See* CML V, LLC v. Bax, 28 A.3d 1037, 1043, 1046 (Del. 2011), *aff'g* 6 A.3d 238 (Del. Ch. 2010).

[87] *See* Anadarko Petroleum Corp. v. Panhandle E. Corp., 545 A.2d 1171, 1172, 1174 (Del. 1988).

[88] *See* N. Am. Catholic Educ. Programming Found., Inc. v. Gheewalla, 930 A.2d 92, 101 (Del. 2007) ("When a corporation is *insolvent*, however, its creditors take the place of the shareholders as the residual beneficiaries of any increase in value.").

occurs over time and, as a result, courts disagree as to whether to recognize a fiduciary obligation to creditors when the debtor enters the "zone of insolvency."[89] To the extent that the blocking director serves the interest of just one of the creditors rather than the creditors as a whole during the zone of insolvency or when the company is insolvent, the director fails to meet his or her fiduciary obligations to both the shareholders and other creditors.

Finally, while blocking directors or managers (including member-managers) must hold a fiduciary duty for the blocking provision to be effective, courts have not yet fleshed out *what* fiduciary duty must exist. Traditionally, directors owe the duties of care and loyalty to the business.[90] In the context of an affirmative decision, such as the decision whether to file or not file for bankruptcy protection, the duty of care requires that a director act with appropriate diligence in making that decision,[91] including obtaining and reviewing information, asking appropriate questions, and giving adequate consideration when making decisions for the company.[92] The duty of loyalty requires that the director not put his or her interests ahead of the interest of the company, and primarily includes a prohibition on self-dealing[93] or taking opportunities away from the company.[94] And, finally, the obligation that a director act in good faith, while not a separate duty but included in the obligations of a director or manager in fulfilling fiduciary duties,

[89] Delaware has expressly rejected a fiduciary duty to creditors when a corporation is in the zone of insolvency. *See id.* at 101. Other states allowed such a duty before the *Gheewalla* decision, and some have continued that practice post-*Gheewalla*. *See* Carrieri v. Jobs.com, Inc., 393 F.3d 508, 534 (5th Cir. 2004) (recognizing fiduciary duty to creditors when business is in zone of insolvency); J. Haskell Murray, *"Latchkey Corporations": Fiduciary Duties in Wholly Owned, Financially Troubled Subsidiaries*, 36 DEL. J. CORP. L. 577, 590–91 (2011).

[90] Stone v. Ritter, 911 A.2d 362, 370 (Del. 2006).

[91] *Cf.* Mills Acquisition Co. v. Macmillan, Inc., 559 A.2d 1261, 1279–81 (Del. 1989) (holding that the board of directors was not adequately diligent in its deliberative process during the sale of the corporation).

[92] *See* Smith v. Van Gorkom, 488 A.2d 858, 872, 875 (Del. 1985) (quoting Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984)).

[93] Cede & Co. v. Technicolor, Inc., 634 A.2d 345, 361 (Del. 1993) (citing Pogostin v. Rice, 480 A.2d 619, 624 (Del. 1984)). "Classic examples of director self-interest in a business transaction involve either a director appearing on both sides of a transaction or a director receiving a personal benefit from a transaction not received by the shareholders generally." *Id.* at 362 (citing Nixon v. Blackwell, 626 A.2d 1366, 1375 (Del. 1993); Gilbert v. El Paso Co., 575 A.2d 1131, 1146 (Del. 1990); Weinberger v. Uop, 457 A.2d 701, 710 (Del. 1983); Sterling v. Mayflower Hotel Corp., 93 A.2d 107, 110 (Del. 1952)).

[94] Broz v. Cellular Info. Sys., 673 A.2d 148, 154–55 (Del. 1996) (quoting Guth v. Loft, Inc., 5 A.2d 503, 511 (Del. 1939)).

> equates to "honesty of purpose" and requires a "genuine care" for one's constituents. A director fails to act in good faith where the director *intentionally* (i) acts with a purpose other than that of advancing the corporations' [sic] best interest, (ii) acts to violate applicable law, and (iii) fails to act in the face of a known duty to act thereby showing conscious disregard for his duties.[95]

Before the court will even consider whether the board member's conduct rises to the level of a breach of fiduciary duty, however, the party challenging the blocking member's decision—presumably the company that wants to file for bankruptcy protection over the objection of the blocking member—must pass the hurdle of the business judgment rule.[96] The business judgment rule

> creates "a presumption that in making a business decision, the directors of a corporation acted on an informed basis [i.e., with due care], in good faith and in the honest belief that the action taken was in the best interest of the company." The presumption initially attaches to a director-approved transaction within a board's conferred or apparent authority in the absence of any evidence of "fraud, bad faith, or self-dealing in the usual sense of personal profit or betterment."[97]

In other words, if the company employing or selecting the director is a creditor seeking to prevent a bankruptcy filing, the most likely scenario for avoiding the business judgment rule presumption *and* for establishing a breach of fiduciary duty by a blocking director is a demonstration of self-interest. To make such a showing, the plaintiff would need to demonstrate that the blocking director put his or her own self-interest, tied directly to the interest of the creditor, ahead of the interest of the debtor company when the blocking director chooses

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[95] O'Toole v. McTaggart (*In re* Trinsum Grp., Inc.), 466 B.R. 596, 611 (Bankr. S.D.N.Y. 2012) (quoting *In re* Walt Disney Co. Derivative Litig., 907 A.2d 693, 753 (Del. Ch. 2005)) (citing Brehm v. Eisner (*In re* Walt Disney Co. Derivative Litig.), 906 A.2d 27, 67 (Del. 2006)).

[96] *See* AC Acquisitions Corp. v. Anderson, Clayton & Co., 519 A.2d 103, 111 (Del. Ch. 1986) (citing *Aronson*, 473 A.2d at 812; Kaplan v. Centex Corp., 284 A.2d 119, 124 (1971); *Smith*, 488 A.2d at 872).

[97] Citron v. Fairchild Camera and Instrument Corp., 569 A.2d 53, 64 (Del. 1989) (alteration in original) (first quoting *Aronson*, 473 A.2d at 812; and then quoting Grobow v. Perot, 539 A.2d 180, 187 (Del. 1988)) (citing Allaun v. Consolidated Oil Co., 16 Del. Ch. 318, 325 (1929)).

not to vote in favor of the bankruptcy filing.[98] It is not difficult to envision exactly that scenario occurring—after all, the blocking director provision exists to *prevent* a bankruptcy filing so that the creditor could avoid the consequences of a bankruptcy filing. In order for the blocking director mechanism to be effective then, the director must owe fiduciary duties *and* actually exercise them appropriately such that a bankruptcy filing will not be blocked when that filing is in the debtor's best interest.

This may become a particularly important issue in the context of LLCs, which can and frequently do waive many of the fiduciary obligations of members or managers.[99] Arguably, the blocking director would need the fiduciary duties of care and loyalty in this context as well, but unanswered questions remain. For example, is the blocking director required only to hold the *same* fiduciary obligations as other directors or managers? It is possible that *all* directors lack fiduciary obligations to the extent permitted by law. If the directors' duties are limited as permitted by law, it is unlikely that those limitations would stand in the context of most decisions, but fall in the context of a decision to file for bankruptcy protection. Would it be inequitable that a blocking director would hold a higher duty than any other director in making that decision?[100]

The goal of requiring that blocking directors hold a fiduciary duty is to ensure that those directors do not put the interest of the creditor ahead of the interest of the debtor, and operate with the good faith belief that they make decisions in the company's best interest.[101] Even if other directors' duties are limited or even completely done away with, to the extent allowed by law, typical directors will likely seek to act in the company's best interest. But for blocking directors affiliated with the creditor, there is no such interest, which may

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[98] Such self-interest may be shown, for example, if the director has a significant financial connection to the creditor, such as serving as an employee of the creditor. *See generally In re* The Limited, Inc. S'holders Litig., No. CIV.A. 17148-NC, 2002 WL 537692 (Del. Ch. Mar. 27, 2002) (noting that significant financial connections suffice to establish conflict of interest in determining whether to bring lawsuit against another director).

[99] *See* REVISED UNIF. LTD. LIAB. CO. ACT § 110(d) (NAT'L CONFERENCE OF COMM'RS ON UNIF. STATE LAWS 2006). Corporations may, and frequently do, limit the fiduciary obligations of their directors as well. *See* DEL. CODE ANN. tit. 8, § 102(b)(7) (2019).

[100] The requirement to act in good faith cannot be exculpated in either the corporate or LLC context. *See* DEL. CODE ANN. tit. 8, § 102(b)(7); REVISED UNIF. LTD. LIAB. CO. ACT § 110(d). As such, even if all of the directors or managing members of an LLC were exculpated from their duties of due care and loyalty to the extent permitted by law, the requirement would serve to ensure that the blocking director makes a decision under the good-faith belief that the decision is within the company's best interest. *See supra* note 95 and accompanying text.

[101] *See, e.g.*, *In re* Lake Mich. Beach Pottawattamie Resort, 547 B.R. 899, 912–13 (Bankr. N.D. Ill. 2016).

suggest a need for *additional* duties for blocking directors, even if other directors for the business do not share the same duty because the violation of a duty of good faith can never be exculpated for any director.

C. Golden Shares/Blocking Members

The challenge of putting in place an effective blocking director or manager, in light of the need for any blocking director or manager to hold *at least* the same fiduciary obligations as any other director or manager, led to the use of golden shares. Unless also serving in a management role, the primary role of owners of a business entity, whether shareholders of a corporation or members of an LLC, is to vote. Voting typically involves major decisions, such as selecting the management of the entity,[102] approving changes to certain business documents,[103] or approving mergers.[104] The business entity's documents may also include other matters that require the approval of shareholders or members.[105]

Owners of the business entity, particularly minority owners, generally lack fiduciary obligations to the entity or other owners.[106] Indeed, owners are presumed to act in a self-interested manner when making decisions about the business.[107] Replacing the blocking vote of a director holding fiduciary obligations with the blocking vote of an owner holding no such obligations provides the newest approach to limit the ability of a company to file for bankruptcy protection. When such a blocking vote is given to a creditor, it is called a "golden share."[108] The golden share is given to the creditor in conjunction with a provision in the business documents requiring the unanimous approval of all business owners to file a bankruptcy case.[109] Given the unanimity requirement, a golden share provision is most likely

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[102] *See In re* Giant Portland Cement Co., 21 A.2d 697, 699 (Del. Ch. 1941).

[103] *See* DEL. CODE ANN. tit. 8, § 242(b) (2019); Berlin v. Emerald Partners, 552 A.2d 482, 486–87 (Del. 1988);

[104] *See In re* MONY Grp. Inc. S'holder Litig., 853 A.2d 661, 675–76 (Del. Ch. 2004); *Berlin*, 552 A.2d at 486–87.

[105] *See* DEL. CODE ANN. tit. 8, § 109(a); MODEL BUS. CORP. ACT §7.32 (AM. BAR ASS'N 2016).

[106] *See* Katris v. Carroll, 842 N.E.2d 221, 222–23 (Ill. App. Ct. 2005);

[107] *See, e.g.*, Thorpe by Castleman v. CERBCO, 676 A.2d 436, 440 (Del. 1996).

[108] Franchise Servs. of N. Am. v. U.S. Trs. (*In re* Franchise Servs. of N. Am.), 891 F.3d 198, 205 (5th Cir. 2018) ("As used in the bankruptcy context, the term [*golden share*] generally refers to the issuance to a creditor of a trivial number of shares that gives the creditor the right to prevent a voluntary bankruptcy petition.").

[109] *See id.* at 205, 207; *In re* Intervention Energy Holdings, 553 B.R. 258, 26 (Bankr. D. Del. 2016); White & Medford, *supra* note 57, at 52.

in the context of a company with a relatively small number of owners, such as a closely-held corporation or an LLC.[110]

State law recognizes the LLC operating agreement as a contract with the idea of maximum flexibility for the members of the LLC.[111] The members may agree to limitations designed to reduce or altogether eliminate the possibility of a bankruptcy filing, including an absolute prohibition on bankruptcy filing, a requirement that certain members vote in favor of a bankruptcy filing, or a supermajority or unanimity requirement[112] to file for bankruptcy protection. Provisions that completely eliminate the ability to file for bankruptcy protection are more likely to be deemed unenforceable,[113] but provisions that protect members by allowing them more of a voice in the decision to file for bankruptcy do not present the same policy concerns as do absolute bankruptcy prohibitions. Corporate law, in which the ability to make decisions is vested in the directors rather than in the shareholders, requires that a transfer of the decision-making authority from directors to shareholders be found in the articles of incorporation,[114] or in a shareholder agreement.[115] Thus, a provision requiring the consent of 100% of shareholders of the corporation to file for bankruptcy could exist, as long as it is provided in the appropriate corporate document.

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[110] *See, e.g.*, *In re Intervention Energy Holdings*, 553 B.R. at 260–61; *In re* Lake Mich. Beach Pottawattamie Resort LLC, 547 B.R. 899, 902–04 (Bankr. N.D. Ill. 2016).

[111] *See supra* note 23 and accompanying text.

[112] By default, all members must consent to major changes for an LLC in any state adopting the Uniform Act. *See* REVISED UNIF. LTD. LIAB. CO. ACT § 407 (b)(4), (c)(3) (NAT'L CONFERENCE OF COMM'RS ON UNIF. STATE LAWS 2006); *see also In re* Crest by the Sea LLC, 522 B.R. 540, 545–46 (Bankr. D.N.J. 2014) (holding that filing for bankruptcy is a major change, and absent change via the operating agreement, requires unanimous vote of members). Delaware's LLC Act does not contain an analogous provision, though it does provide for non-unanimous member consent to dissolve the LLC. *See* DEL. CODE ANN. tit. 6, § 18-801(a)(3) (2019).

[113] *See In re Intervention Energy Holdings*, 553 B.R. at 265 ("A provision in a limited liability company governance document . . . the sole purpose and effect of which is to place into the hands of a single, minority equity holder the ultimate authority to eviscerate the right of that entity to seek federal bankruptcy relief, and the nature and substance of whose primary relationship with the debtor is that of creditor—not equity holder—and which owes no duty to anyone but itself in connection with an LLC's decision to seek federal bankruptcy relief, is tantamount to an absolute waiver of that right, and . . . is void as contrary to federal public policy."). *But see* DB Capital Holdings, LLC v. Aspen HH Ventures, LLC (*In re* DB Cap. Holdings, LLC), Nos. CO-10-046, 10-23242, 2010 WL 4925811, at *3 (B.A.P. 10th Cir. Dec. 6, 2010) ("Debtor has not cited any cases standing for the proposition that members of an LLC cannot agree among themselves not to file bankruptcy, and that if they do, such agreement is void as against public policy, nor has the court located any.").

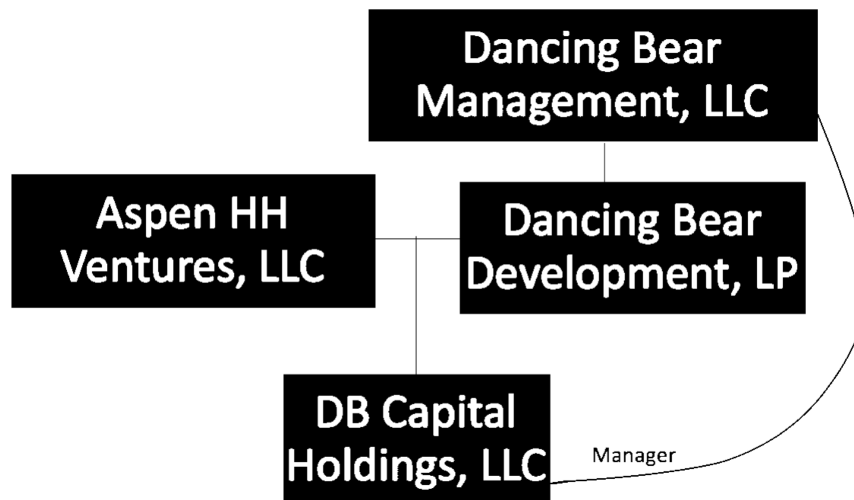
[114] *See* DEL. CODE ANN. tit. 8, § 102(b)(1) (2019); MODEL BUS. CORP. ACT § 2.02(b) (AM. BAR ASS'N 2016).

[115] *See* DEL. CODE ANN. tit. 8, § 350 (2019); MODEL BUS. CORP. ACT § 7.32(a)(6).

Whether owned by a member/shareholder, or a creditor who is given a membership interest, the idea of a blocking member provision is to ensure that bankruptcy cannot be filed over the objection of the party holding that interest.

1. Provisions Allowing "True" Owners to Prevent a Bankruptcy Filing

Though courts have generally met this new form of bankruptcy protection with skepticism,[116] courts might uphold even a complete ban on bankruptcy filing in limited situations designed to protect the non-creditor owners of the company. In *DB Capital Holdings*, the debtor LLC engaged in developing real property.[117] The debtor's two members included Aspen HH Ventures, LLC, and Dancing Bear Development, LP.[118] Dancing Bear Management, LLC, owned Dancing Bear Development, LP, and also managed the affairs of the debtor:[119]



The case presented the issue of the authority of Dancing Bear Management, LLC, to voluntarily file for bankruptcy on behalf of the

[116] *See, e.g.*, Hayhoe v. Cole (*In re* Cole), 226 B.R. 647, 651 (B.A.P. 9th Cir. 1998) (citing Giaimo v. Detrano (*In re* Detrano), 222 B.R. 685, 688 (Bankr. E.D.N.Y. 1998) ("[M]any trial courts have held that prepetition waivers of the bankruptcy discharge are unenforceable.").

[117] *See DB Capital Holdings*, 2010 WL 4925811, at*1.

[118] *Id.*

[119] *See id.*

debtor.[120] In determining whether the bankruptcy filing properly occurred, the court considered whether Dancing Bear Management had authority to file under state law.[121] The state LLC statute deferred to the company's operating agreement to determine authority.[122] That operating agreement, as amended, provided that the debtor "will not institute proceedings to be adjudicated bankrupt or insolvent; . . . or file a petition seeking, or consent to, reorganization or relief under any applicable federal or state law relating to bankruptcy."[123] In dicta, the court noted that the members of an LLC may agree among themselves *not* to allow a bankruptcy filing, but the court distinguished cases where a creditor coerces the debtor to agree not to file under threat of litigation or foreclosure.[124] From a policy perspective, allowing the LLC's members to prevent a bankruptcy filing keeps the debtor from owing fiduciary duties in bankruptcy to someone other than the members (for example, the creditors), and maintains the fiduciary duties owed instead to the members of the LLC.[125] Thus, if the members' agreement preventing the bankruptcy filing was intended to protect their own interest, rather than that of creditors, the agreement could withstand scrutiny. The Operating Agreement, however, required the consent of the members to effectuate such a significant change in the LLC's operations and, thus, the manager lacked authority to put the debtor into bankruptcy.[126] Not all courts and commentators agree that an absolute prohibition on a bankruptcy filing—even one designed to protect all of the company's owners—can be enforced.[127]

In *In re NNN 123 North Wacker, LLC*,[128] the LLC operating agreement required consent of all members to file for bankruptcy protection, without an absolute prohibition on the bankruptcy filing.[129] Troy Thomas (along with several other ostensible members) argued that he was a member of the debtor, and never gave his consent to the bankruptcy filing.[130] The issue did not involve the propriety of member consent requirement to the filing, but rather

[120] *See id.* at *2.
[121] *See id.* (citing Price v. Gurney, 324 U.S. 100, 106 (1945)).
[122] *See id.*
[123] *Id.*
[124] *See id.* at *1, *3.
[125] *See id.* at *3.
[126] *See id.* at *5.
[127] *See, e.g.*, *In re* Lexington Hosp. Grp., LLC, 577 B.R. 676, 683 (Bankr. E.D. Ky. 2017).
[128] *In re* NNN 123 N. Wacker, LLC, 510 B.R. 854 (Bankr. N.D. Ill. 2014).
[129] *Id.* at 856.
[130] *See id.*

involved a determination of which parties were members of the debtor entity.[131] The confusion arose because Thomas answered a call for investors at debtor's formation, completing a subscription agreement and paying for the membership interest in debtor.[132] He received a certificate of membership.[133] However, a certificate had also been issued showing that an organizational member held a 100% membership interest in the debtor.[134] The organizational member and the debtor had the same name.[135] The debtor argued that it appropriately filed for bankruptcy because the organizational member voted in favor of the bankruptcy filing, and that Thomas held an interest in the organizational member, not in the debtor.[136] Thomas responded that the organizational member had, by issuing membership certificates, assigned part of its ownership in debtor to Thomas.[137] The court agreed,[138] and dismissed the bankruptcy filing.[139] While the issue in the case was not the validity of the unanimity requirement for filing, clearly the court allowed such a requirement, as Thomas's lack of opportunity to vote for or against the filing led to the decision to dismiss the case as improperly filed.

Shareholders in a closely-held corporation or members of an LLC should have the ability to block a bankruptcy filing if they consider the possibility and provide a restriction in the appropriate documents or the operating agreement. LLCs are uniquely contractual in nature and designed to provide the maximum flexibility for their members, and closely-held corporations are designed to provide more control for shareholders. In many ways both entities operate more like partnerships,[140] where the shareholders or members enjoy a more intimate working relationship with the company. Members or shareholders are more likely to be employed with the entity than owners of a large corporation,[141] and their investment is likely to be more substantial to them than that of shareholders in a large

[131] *See id.* at 858.
[132] *See id.* at 857.
[133] *Id.*
[134] *Id.*
[135] *Id.* at 856.
[136] *Id.* at 856–57, 858–59.
[137] *Id.* at 858–59.
[138] *See id.* at 860–61.
[139] *Id.* at 862.
[140] *See, e.g.*, B&L Cellular v. USCOC of Greater Iowa, L.L.C., No. 7628-VCL, 2014 WL 6882207, at *1 (Del. Ch. Dec. 8, 2014).
[141] *See, e.g.*, DEBORAH BOUCHOUX & CHRISTINE SGARLATA CHUNG, BUSINESS ORGANIZATIONS LAW IN FOCUS 540 (2017).

corporation because of their intimate working relationship.[142] For those reasons, members of an LLC or shareholders in a closely-held corporation have an even more vested interest in having a say in how the business operates.

The cases have been more willing to allow shareholders/members to enforce unanimity requirements in bankruptcy approval provisions than creditors who purchase golden shares.[143] Sometimes, however, the distinction between true owner and creditor is not so clear, as in the case of *Franchise Services of North America*.[144] Debtor's certificate of incorporation required approval of each class of shareholders to file for bankruptcy protection.[145] Boketo held all shares in the preferred class of stock; Boketo obtained the stock when it provided $15 million in equity for the debtor to acquire a car rental company.[146] The change to the debtor's certificate to require shareholder approval occurred at the same time.[147] But Boketo was a subsidiary of Macquarie, an investment bank that actually provided the $15 million investment.[148] The $15 million was not a loan, but Macquarie held a separate claim as a creditor because the debtor owed Macquarie $3 million in fees for arranging the investment transaction.[149] The debtor filed for bankruptcy without seeking shareholder approval, arguing that the approval provision lacked effect.[150] The bankruptcy court allowed the provision, concluding that caselaw prohibiting a *creditor* from using a golden share to block a bankruptcy filing did not apply because the investor was an owner of the company rather than a creditor and did not have or need fiduciary obligations to the company to enforce the unanimity provision.[151] In deciding on the appeal, the Fifth Circuit considered "whether U.S. and Delaware law permit the parties to . . . amend a corporate charter to allow a non-fiduciary shareholder fully controlled by an unsecured creditor to prevent a voluntary

[142] *See id.*

[143] *See, e.g.*, Franchise Servs. of N. Am. v. U.S. Trs. (*In re* Franchise Servs. of N. Am.), 891 F.3d 198, 203 (5th Cir. 2018); *In re* Intervention Energy Holdings, 553 B.R. 258, 265–66 (Bankr. D. Del. 2016).

[144] *See In re Franchise Servs. of N. Am.*, 891 F.3d at 206–07.

[145] *Id.* at 202.

[146] *Id.* at 203.

[147] *See id.* Changing the debtor's certificate of incorporation required the consent of the other shareholders. *See* DEL. CODE. ANN. tit. 8, § 242 (2019).

[148] *See In re Franchise Servs. of N. Am.*, 891 F.3d at 203.

[149] *See id.* at 203–04.

[150] *See id.* at 202.

[151] *See id.* at 204.

bankruptcy petition."[152] Though a creditor controlled the shareholder, the court would not treat the case as if the unsecured creditor directly enjoyed a right to vote against the filing and prevent it from happening.[153] Instead, the court held that an owner may enjoy the right to prevent a bankruptcy filing without violating public policy against bankruptcy prohibitions when that owner is not itself a creditor.[154] The court then went on to discuss a situation in which the owner happens to be a creditor, but did not receive its ownership interest in order to ensure repayment of the debt—as it determined to be the case at hand.[155] In such a situation, the court held, "No statute or binding caselaw licenses this court to ignore corporate foundational documents, deprive a bona fide shareholder of its voting rights, and reallocate corporate authority to file for bankruptcy just because the shareholder also happens to be an unsecured creditor."[156] Though such a provision can be granted, the court then needed to consider whether under *Delaware* law the owners—as owners—then owed a fiduciary duty to the company or other shareholders.[157] Under Delaware law, a minority shareholder holds fiduciary obligations only if it has control over the company, and more specifically dominates the board of directors.[158] While such control does not

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[152] *Id.* at 206. The lower court certified three questions to the appellate court:

> 1. Is a provision, typically called a blocking provision or a golden share, which gives a party (whether a creditor or an equity holder) the ability to prevent a corporation from filing bankruptcy valid and enforceable or is the provision contrary to federal public policy?
> 2. If a party is both a creditor and an equity holder of the debtor and holds a blocking provision or a golden share, is the blocking provision or golden share valid and enforceable or is the provision contrary to federal public policy?
> 3. Under Delaware law, may a certificate of incorporation contain a blocking provision/golden share? If the answer to that question is yes, does Delaware law impose on the holder of the provision a fiduciary duty to exercise such provision in the best interests of the corporation?

Id. at 204. The court clarified that it intended to focus on the case at hand, not issuing a decision for any type of blocking provision or golden share. *See id.* at 205. Blocking provisions comprise a broader concept, including any attempt by a creditor to keep a debtor from filing for bankruptcy, while golden shares are a type of blocking provision in which the creditor's attempt to prevent filing occurs by obtaining an ownership interest in the company and requiring unanimous consent to file a case. *Id.* Neither truly applied to these facts. *See id.*

[153] *See id.* at 208.

[154] *Id.* at 209.

[155] *See id.* at 208–09 (quoting Squire Court Partners Ltd. P'ship v. Centerline Credit Enhanced Partners Ltd. P'ship Series J (*In re* Squire Court Partners Ltd. P'ship), 574 B.R. 701, 708 (E.D. Ark. 2017)).

[156] *Id.* at 209.

[157] *See id.*

[158] *See id.* at 210–11.

require a majority interest,[159] the fact that the investor here elected some (but not a majority) of the board and could theoretically prevent any bankruptcy filing did not suffice to establish the requisite control.[160] Thus, the holder of the golden share could vote for or against a bankruptcy filing, without incurring any fiduciary responsibility to the remaining shareholders.[161] The distinction between the fiduciary duties of a manager and the lack of such duties by a non-controlling owner of the company makes sense as a manager's role is to act on behalf of the company, where an owner's role is to act on behalf of himself or herself.

2. Provisions Regarding "True" Creditors and Bankruptcy Blocking

But the willingness to enforce an owner-unanimity requirement before a bankruptcy filing—or even a mechanism that effectively bans a bankruptcy filing—ends when the party with the golden share is a creditor seeking to prevent the filing to benefit itself as a creditor.[162] The reticence to allow creditors to prevent a debtor from filing for bankruptcy protection exists beyond just an outright restriction on filing. When a creditor has an ownership interest in a company—particularly when that ownership interest came into existence in order to protect the creditor from the possibility of a bankruptcy filing—courts generally refuse to uphold the agreement.[163]

For example, in *In re Intervention Energy Holdings*, Intervention Energy Holdings, LLC, and Intervention Energy, LLC, filed chapter 11 bankruptcy petitions.[164] EIG Energy Fund held one unit of ownership in Intervention Energy Holdings, which in turn owned all of Intervention Energy.[165] During the years prior to the bankruptcy filing, Intervention Energy Holdings became indebted to EIG Energy Fund through a series of Note Purchase Agreements and Amendments.[166] About six months before the bankruptcy filing, the

[159] *See id.* at 212 (first citing *Kahn*, 638 A.2d at 1113–14, 1115; Kaplan v. Centex Corp., 284 A.2d 119, 122–23 (Del. Ch. 1971), then citing *In re* KKR Fin. Holdings LLC S'holder Litig., 101 A.3d 980, 991 (Del. Ch. 2014); and then citing *In re* Cysive, Inc., S'holder Litig., 836 A.2d 531, 552–53 (Del. Ch. 2003)).
[160] *See id.* at 212–13.
[161] *See id.* at 213.
[162] *See In re* Intervention Energy Holdings, 553 B.R. 258, 265–66 (Bankr. D. Del. 2016).
[163] *Id.*
[164] *Id.* at 260.
[165] *Id.*
[166] *See id.* at 261.

debtors and EIG entered into a forbearance agreement, which gave EIG its one unit of ownership in the debtors and required Intervention Energy Holdings to amend its operating agreement to require unanimous approval of owners before the company could file for bankruptcy protection.[167] The court focused on the essential rule that parties may not contract away a right to file for bankruptcy protection. While the granting of the golden share did not entirely prevent a bankruptcy filing, it effectively allowed the creditor—a party without a fiduciary duty to the company or other creditors—to prevent the company from filing for bankruptcy protection and could not be enforced.[168] The holding reckons to the idea of using a blocking director controlled by a creditor in order to prevent a bankruptcy filing—requiring that a creditor with the power to prevent a bankruptcy filing hold a fiduciary obligation to the debtor in making such a decision, even if a true shareholder (and, in the director scenario, another director) would not need the same obligation.

When it comes to true creditors (creditors whose equity interest exists for the sole purpose of ensuring the creditor's payment from the LLC outside of bankruptcy),[169] fiduciary duties play a more significant role than for creditors who also happen to hold an interest in the debtor. As noted in the *In re Franchise Services* case, a creditor who is a bona fide owner of the entity enjoys the ability to block a bankruptcy filing through a unanimity provision.[170] Even though nonmanaging members with a blocking share may consider only their own interests in making that determination, courts have been unwilling to extend such latitude to creditors.[171] For example, in *In re Lake Michigan Beach Pottawattamie Resort*, the court refused to

[167] *See id.* 260–61.

[168] *See id.* at 264–66.

[169] For other questions that the cases raise, see Eric L. Johnson & Mark G. Stingley, Intervention Energy Holdings*: Good Public Policy, or Unnecessary Intrusion into State Law?*, AM. BANKR. INST. J., Nov. 2016, at 20, 78. Johnson and Stingley raise one question that has since been answered by the Fifth Circuit: "[W]ould it be a different outcome if filing for bankruptcy required unanimous consent and an existing member was also a creditor?" *Id.* But they also raise a yet-unanswered issue: "[W]ould the outcome be different if the requirement of unanimous consent to file for bankruptcy existed at the time of creation and the creditor subsequently purchased one share from another member for fair value?" *Id.* Given the courts' focus on the fiduciary obligations of lenders, and the fact that lenders with golden shares obtain those shares for the exclusive purpose of protecting their own interests, courts would likely not distinguish cases in which the unanimity requirement existed before issuance of the golden share from ones where the unanimity requirement was implemented at the same time that the share was issued.

[170] *See supra* notes 143–161 and accompanying text.

[171] *See, e.g.*, *In re* Lake Mich. Beach Pottawattamie Resort LLC, 547 B.R. 899, 913–14 (Bankr. N.D. Ill. 2016).

allow a creditor-blocking member provision to prevent the debtor's bankruptcy filing because the operating agreement's disclaimer of fiduciary duties on the member "expressly eliminates the only redeeming factor that permits the blocking director/member construct."[172]

The *Pottawattamie Resort* case arose after the debtor borrowed money from the lender, securing[173] the loan with real property.[174] Upon default, the parties entered into a forbearance agreement whereby the debtor promised to make full payment a few months later, and the debtor modified its operating agreement to add the lender as a "Special Member" whose approval was required before taking any "Material Action" such as a bankruptcy filing.[175] When the debtor missed the payment deadline under the forbearance agreement, the lender instituted foreclosure proceedings.[176]

Debtor filed under chapter 11 of the bankruptcy code on the eve of the foreclosure sale.[177] The court noted that contracts to prevent a bankruptcy filing generally cannot be enforced, but "the long-standing policy against contracting away bankruptcy benefits is not necessarily controlling when what defeats the rights in question is a corporate control document instead of a contract."[178] It then likened the situation to that of a blocking director in a bankruptcy remote entity.[179] As with a BRE, the blocking member could be allowed, but only if the director or member holds fiduciary obligations to the business.[180] In the case at hand, the operating agreement specifically disclaimed any fiduciary duty of the lender to the business, despite the existence of such duties under state law,[181] and could not be

[172] *Id.* at 914.

[173] The facts of the case provide an example of the challenge faced in a bankruptcy case, even by a fully secured creditor. The parties agreed that the debtor had equity in the property because it was valued higher than the creditor's claim. *See id.* at 903–05. While a secured creditor generally wants to be oversecured, that position also makes it difficult for the creditor to lift the automatic stay imposed by a bankruptcy filing because the grounds for lifting the stay under 11 U.S.C. § 362(d)(2) would not be met. Without that basis for lifting the stay, the creditor must show cause or another basis for lifting the stay. *See* 11 U.S.C. § 362(d) (2012) (providing bases for lifting the stay). Until the stay is lifted, the creditor cannot take the property. *See* 11 U.S.C. § 362(a).

[174] *See In re Lake Mich. Beach Pottawattamie Resort*, 547 B.R. at 903.

[175] *Id.* at 903–04.

[176] *See id.* at 904.

[177] *See id.*

[178] *Id.* at 912 (citing Klingman v. Levinson, 831 F.2d 1292, 1296 (7th Cir. 1987)).

[179] *See id.* at 911.

[180] *See id.* at 913.

[181] *See id.* at 914. In fact, the operating agreement specifically stated that the addition of the lender as a "Special Member" entitled to vote against major changes was "for the express benefit of the Lender." *Id.* at 910 (emphasis omitted).

enforced"[182] The court distinguished true owners of a company from this type of "Special Member" because the special member "ha[d] no interest in the profits or losses of the Debtor, no right to distributions or tax consequences and [was] not required to make capital contributions to the Debtor" and "was kept separate and apart from the Debtor in all ways but for its authority to block the Debtor from petitioning for bankruptcy relief."[183] That distinction allowed the court to treat the special member differently than it would treat a true owner of the company.

D. Argument for Bad Faith Designation of Vote to Block a Bankruptcy Filing

At first glance, the requirement of a fiduciary duty in order to be entitled to block a bankruptcy filing seems misplaced in that it requires more of a creditor with a golden share than of a member or shareholder with a blocking share, even when state law provides the exact same rules for both.[184] The Bankruptcy Code, as interpreted by the courts, adds a layer onto state law, providing that the operating agreement or articles' provisions requiring unanimity lack effect in cases where a creditor holds a golden share, unless that creditor must exercise that vote in the company's best interest rather than just its own best interest.[185] While that may initially appear inequitable, it is a concept that is familiar in the bankruptcy arena.

In chapter 11 bankruptcy cases, creditors may vote on whether a proposed plan of reorganization is acceptable.[186] This vote does not require that the creditors act in anyone's interest but their own.[187] A creditor is free to vote in favor of or against a plan, and can even vote in favor of no plans or more than one competing plan of reorganization, without any consideration of the debtor or other creditors.[188] However, this free ability to vote is limited in cases in which a creditor's vote is designated—deemed made without "good

[182] *Id.* at 914.

[183] *Id.* at 904.

[184] *See supra* notes 169–172 and accompanying text.

[185] *See supra* Part IV.

[186] *See* Kenneth Pasquale et al., *What Conduct is Required to Designate Votes Pursuant to Bankruptcy Code Section 1126(e)?*, *in* NORTON ANNUAL SURVEY OF BANKRUPTCY LAW 67 (William L. Norton ed. 2014).

[187] *See In re* Landing Assocs., Ltd., 157 B.R. 791, 803 (Bankr. W.D. Tex. 1993) (quoting *In re* Fed. Support Co., 859 F.2d 17, 19 (4th Cir. 1988)); Pasquale et al., *supra* note 186, at 77 (citing *In re* 500 Fifth Ave. Assocs., 148 B.R. 1010, 1020 (Bankr. S.D.N.Y. 1993)).

[188] *See, e.g.*, Pasquale et al., *supra* note 186, at 73.

faith."[189] Section 1126(e) of the Bankruptcy Code provides that the court may designate votes cast or solicited without good faith, thereby rendering those votes uncounted.[190] Good-faith voting recognizes that a creditor acts in its own self-interest, but with an acceptance of the idea that a reorganization might effectuate its own self-interest.[191] Thus, a good-faith voting creditor is considering whether the reorganization proposal *at hand* is in the creditor's best interest, not assuming that *any* bankruptcy filing (whether a reorganization or liquidation) is against the creditor's interest.[192] The essence of the cases considering whether to designate a vote is their focus on whether

> the record contains evidence that the creditor has voted without regard to the treatment of its claim, but instead, to achieve some benefit or goal inconsistent with interests of the estate and its creditors, [such that] the Court must inquire into those motives in order to preserve the integrity of the Chapter 11 process.[193]

Section 1126(e) does not define a lack of good faith for the purpose of designating votes, but courts have developed guidance for these situations.[194] Creditor votes can be designated when the creditor's goal is to gain an advantage not enjoyed by other creditors or when the creditor has an "ulterior motive" in voting.[195] Examples of such an ulterior motive include control over a debtor, destruction of the debtor or putting the debtor out of business, or use of the voting

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[189] *In re Landing Assocs.*, 157 B.R. at 802.

[190] *See* 11 U.S.C. § 1126(e) (2012); Pac. W. Bank v. Fagerdala USA-Lompoc, Inc. (*In re* Fagerdala USA-Lompoc, Inc.), 891 F.3d 848, 854 (9th Cir. 2018). Courts use designation sparingly in recognition of the creditors' inherent rights under the Code to vote on a plan of reorganization. *See* Pasquale et al., *supra* note 186, at 71.

[191] *See* Figter Ltd.v. Teachers Ins. & Annuity Ass'n of Am. (*In re* Figter Ltd.), 118 F.3d 635, 639 (9th Cir. 1997); Pasquale et al., *supra* note 186, at 73.

[192] *See In re* Marin Town Ctr., 142 B.R. 374, 379 (Bankr. N.D. Cal. 1992) ("A vote cannot be said to have been cast in bad faith simply because it was voted for the purpose of blocking confirmation of a reorganization plan. . . . '[The creditor] believes its consummation will be more injurious to his investment . . . than liquidation . . . .'" (quoting *In re* Pine Hills Collieries Co., 46 F. Supp. 669, 671 (E.D. Pa. 1942))).

[193] *In re* Dune Deck Owners Corp., 175 B.R. 839, 845 (Bankr. S.D.N.Y. 1995). *Dune Deck* involved the purchase of claims from unsecured creditors in order to block the ability of the debtor to cram down the plan over the objection of a secured creditor. *See id.* at 840.

[194] *See id.* at 844 (citing *In re Marin Town Ctr.*, 142 B.R. at 379); *In re Landing Assoc.*, 157 B.R. at 802 (first citing *In re* Fed. Support Co., 859 F.2d 17, 19 (4th Cir. 1988); and then citing Young v. Higbee Co., 324 U.S. 204, 210–11, 211 n.10 (1945)).

[195] *In re Dune Deck*, 175 B.R. at 844 (citing *In re Marin Town Ctr.*, 142 B.R. at 379); *In re Landing Assocs.*, 157 B.R. at 802; Pasquale et al., *supra* note 186, at 72.

process to take advantage of an outside agreement between the debtor and the creditor.[196]

The case of *In re Landing Associates, Ltd.* considered the vote of the creditor bank against the debtor's proposed plan of reorganization.[197] It noted that designation seeks to prevent the vote of a creditor "whose selfish purpose was to obstruct a fair and feasible reorganization in the hope that someone would pay them more than the ratable equivalent of their proportionate part of the bankrupt's assets."[198] The court determined that the creditor's vote must result from business judgment related to the plan of reorganization.[199] The court expressed concern that the creditor-bank focused on its assistance agreement with the debtor; the debtor's success under the plan of reorganization would have negatively impacted the creditor-bank under the assistance agreement.[200] Even so, the creditor-bank held other, legitimate concerns about the maintenance and upkeep of property and creditworthiness of the debtor,[201] and the court reluctantly decided not to designate the creditor-bank's vote against the plan.[202] In the end, the court noted that a creditor may vote in its own favor, as long as it does so in a way that considers the plan and its own interests as a creditor under the plan.[203]

A common situation for designation of a vote occurs when the creditor votes against a plan, not because the creditor believes that the plan would not work or because the creditor believes it is not paid enough under the plan, but instead votes against the plan because it *might* work and the creditor is actually seeking to undermine any successful reorganization.[204] A creditor might, for example, compete

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[196] *See In re Dune Deck*, 175 B.R. at 844 (citing *In re Pine Hill*, 46 F. Supp. 669 at 671); Pasquale et al., *supra* note 186, at 72–73.

[197] *See In re Landing Assocs.*, 157 B.R. at 802.

[198] *Id.* at 802-03 (quoting *In re* Landau Boat Co., 8 B.R. 432, 434 (Bankr. W.D. Miss. 1981)); *cf.* Pac. W. Bank v. Fagerdala USA-Lompoc, Inc. (*In re* Fagerdala USA-Lompoc, Inc.), 891 F.3d 848, 855 (9th Cir. 2018) ("[B]ad faith explicitly does not include 'enlightened self interest, even if it appears selfish to those who do not benefit from it.'" (quoting Figter Ltd. v. Teachers Ins. & Annuity Ass'n of Am. (*In re* Figter Ltd.), 118 F.3d 635, 639 (9th Cir. 1997))).

[199] *See In re Landing Assocs.*, 157 B.R. at 803–04 (citing *In re* A.D.W., Inc., 90 B.R. 645, 651 (Bankr. D.N.J. 1988)).

[200] *See id.* at 804–05.

[201] *See id.* at 806.

[202] *See id.* at 809.

[203] *See id.* at 807 ("[A] creditor does not have an unfettered right to submarine a plan to serve a motive at best tangentially related to its position as a creditor . . . .").

[204] *See, e.g.*, Dish Network Corp. v. DBSD N. Am., Inc. (*In re* DSDB N. Am., Inc.), 634 F.3d 79, 103–04 (2d Cir. 2011) (citing *In re* MacLeod Co., 63 B.R. 654, 655–56 (Bankr. S.D. Ohio 1986)).

with the debtor and seek to eliminate its competition.[205] In such a case, the creditor's vote against any feasible plan of reorganization furthers its own interest outside of the case and does so in a way that cannot possibly further the debtor organization. Designation of a vote as being in bad faith does not require that the voting creditor consider the interests of the debtor or other creditors,[206] but does prevent the creditor from using its own self-interest to intentionally lead to the downfall of the debtor in order to promote the creditor's self-interest.[207]

Courts also recognize the ability to designate a vote when needed to prevent violation of express Code provisions,[208] while "[d]oing something allowed by the Bankruptcy Code and case law, without evidence of ulterior motive, cannot be bad faith."[209] *In re Media Central, Inc.* involved a question of solicitation of votes of creditors before the required approval of the disclosure statement[210] regarding the reorganization plan.[211] The debtor received approval of its disclosure statement before solicitation of votes on that official plan, but at the same time, the debtor solicited votes on alternative plans without court-approved disclosure statements.[212] Because the votes resulted from improper solicitation that did not conform to bankruptcy code requirements, they were disallowed.[213]

The idea of designation of votes in the confirmation process provides a strong comparison for designating the vote of a creditor-owner in the election for bankruptcy as invalid. While the creditor-owner, like all other owners, is presumed to vote in a self-interested manner, that self-interest cannot prevent the company from being able to operate in a reasonable manner.[214] Borrowing the standard

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[205] The Second Circuit in *In re DBSD North America, Inc.* discussed a variety of cases in which designation occurred because a creditor sought competitive advantage through vote. *Id.* at 103–04 (first citing *In re* Allegheny Int'l, Inc., 118 B.R. 282, 289–90 (Bankr. W.D. Pa. 1990); then citing *In re MacLeod*, 63 B.R. at 655–56; and then citing *In re* Applegate Prop., Ltd., 133 B.R. 827, 833–35 (Bankr. W.D. Tex. 1991)).

[206] *See* Pasquale et al., *supra* note 186, at 73.

[207] *See id.* at 72–73

[208] *See In re* Media Cent., Inc., 89 B.R. 685, 689–90 (Bankr. E.D. Tenn. 1988).

[209] Pac. W. Bank v. Fagerdala USA-Lompoc, Inc. (*In re* Fagerdala USA-Lompoc, Inc.), 891 F.3d 848, 855 (9th Cir. 2018) (noting that purchase of some, but not all, claims of unsecured class in order to prevent cram down of plan was not bad faith).

[210] 11 U.S.C. § 1125(b) (2012) (requiring an approved written disclosure statement to be sent with or before solicitation of votes on the plan).

[211] *See In re Media Cent.*, 89 B.R. at 685–86.

[212] *See id.* at 689.

[213] *See id.* at 690; *cf.* Century Glove, Inc. v. First Am. Bank, 860 F.2d 94, 101 (3d Cir. 1988) (allowing solicitation of rejection of plan including "mere requests for opinions" on potential competing plans before disclosure statement is approved).

[214] *See, e.g.*, *In re* Landau Boat Co., 8 B.R. 432, 433–34 (Bankr. W.D. Mo. 1981).

from the *In re Landing Associates, Ltd.* case, a creditor who used the golden share for a "selfish purpose . . . to obstruct a fair and feasible reorganization in the hope that someone would pay them more than the ratable equivalent of their proportionate part of the bankrupt's assets"[215] would prevent a creditor from using its vote as an owner of the company to prevent reorganization solely for the purpose of enhancing recovery outside of the bankruptcy process.[216] Unlike a traditional fiduciary duty for a director or manager, which requires the utmost loyalty by putting the interests of the company ahead of the interests of the director/manager,[217] this obligation recognizes that owners—even owners who are also creditors—may operate with some self-interest but limit that self-interest when it is designed specifically for the purpose of preventing the company from operating in a manner that might be in its own best interest.

Often, it is clear that blocking shareholder/member provisions exist for the protection of a creditor. The only ownership tie of the member to the business is often a single share given after the making of a clear loan, and often in exchange for a forbearance agreement by the creditor.[218] In those situations, when the creditor votes against a bankruptcy, it seems that the creditor would vote against a bankruptcy filing under any factual scenario because the creditor has already determined that a bankruptcy filing is inherently against its personal interests. To give such a creditor a membership interest and vote equates to a complete prohibition on a bankruptcy filing.[219]

Using the standards for designating a vote in a plan of reorganization, such a creditor-owner's vote could be designated in bad faith because it is not designed to consider how a *particular* bankruptcy filing might benefit or injure the creditor but is instead a predisposed rejection of the filing. Under the standards for designation of voting, courts could find that a creditor who purchases

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[215] *In re* Landing Assocs., Ltd., 157 B.R. 791, 802–03 (Bankr. W.D. Tex. 1993) (quoting *In re Landau Boat*, 8 B.R. at 434).

[216] *See, e.g.*, Pac. W. Bank v. Fagerdala USA-Lompoc, Inc. (*In re* Fagerdala USA-Lompoc, Inc.), 891 F.3d 848, 856 (9th Cir. 2018) (citing Dish Network Corp. v. DBSD N. Am., Inc. (*In re* DSDB N. Am.., Inc.), 634 F.3d 79, 104 (2d Cir. 2011)).

[217] *See, e.g.*, Guth v. Loft, Inc., 5 A.2d 503, 510 (Del. 1939); REVISED UNIF. LTD. LIAB. CO. ACT § 409(a)–(b).

[218] *See* Franchise Servs. of N. Am. v. U.S. Trs. (*In re* Franchise Servs. of N. Am.), 891 F.3d 198, 207–08 (5th Cir. 2018) (citing *In re* Lexington Hosp. Grp., LLC, 577 B.R. 676, 679–81 (Bankr. E.D. Ky. 2017); *In re* Intervention Energy Holdings, 553 B.R. 258, 266 (Bankr. D. Del. 2016); *In re* Lake Mich. Beach Pottawattamie Resort LLC, 547 B.R. 899, 903–04, 915 (Bankr. N.D. Ill. 2016); *In re* Bay Club Partners-472, LLC, No. 14-30394-rld11, 2014 WL 1796688, at *1–2 (Bankr. D. Or. May 6, 2014)).

[219] *See, e.g.*, *In re Intervention Energy*, 553 B.R. at 265.

a golden share ownership interest in an entity acts without good faith when the creditor votes against *any* bankruptcy filing. While courts in the designation context often allow a creditor to vote its interest, when that interest inherently votes against *any* reorganization plan, the court has noted that the creditor believes that liquidation of the debtor will better serve the creditor's interest compared to a reorganization, still supporting a bankruptcy resolution.[220]

In the golden share context, the goal of the creditor may not be in the best interest of the creditor in a bankruptcy context, but staying out of the bankruptcy context altogether. If the goal is to prevent a debtor from *ever* being able to file for bankruptcy protection, the golden share violates bankruptcy code provisions that disallow clauses by which a debtor relinquishes its right to file for bankruptcy protection.[221] And the goal in doing so may be to allow the creditor remedies at state law that arose out of secondary agreements, such as additional rights given to the creditor as a result of forbearance on prior debt collection, as well as to avoid the *ipso facto* provisions found in the express language of the bankruptcy code. Courts have considered each of these in determining whether to designate votes in the chapter 11 acceptance process,[222] and can provide guidance to other courts to determine whether to designate a creditor's golden share vote against a bankruptcy filing as one made without good faith.

The factors for designating a creditor's vote against a bankruptcy filing as being outside of good faith will frequently mirror the consideration already done by some courts in the golden share context[223]—whether the creditor-shareholder is a true shareholder seeking to protect an ownership investment in the company or merely a creditor seeking to preserve its state-law remedies at the expense of other creditors and of the debtor's fresh start.

Franchise Services presented a different situation—one in which the owner gave money as an investment, but the debtor also owed a

[220] *See In re* Marin Town Ctr., 142 B.R. 374, 379 (Bankr. N.D. Cal. 1992) ("[R]ejection of a plan by 'a party . . . who withholds consent to a plan primarily because he believes its consummation will be more injurious to his investment in the Debtor than liquidation, meets the standard of good faith.'" (quoting *In re* Pine Hills Collieries Co., 46 F. Supp. 669, 671 (E.D. Pa. 1942))). *But see In re* Kovalchick, 175 B.R. 863, 875 (Bankr. E.D. Pa. 1994) (finding that creditor's goal of having case dismissed in order to exercise foreclosure remedy under state law did *not* provide grounds to designate vote).

[221] *See In re Intervention Energy Holdings*, 553 B.R. at 265.

[222] *See* Pasquale et al., *supra* note 186, at 71–73.

[223] *See id.* at 72–73.

claim to that investor as a creditor.[224] The court determined that the investor was "bona fide," and could exercise blocking shareholder rights, but the court did not provide much detail on the basis of its determination.[225] The idea of a bona fide investor suggests that the investor will adapt its voting and strategies to maximize its own self-interest in light of an underlying idea that its own self-interest is naturally tied to the success of the company and might in some cases be furthered by a bankruptcy filing.[226] In such a case, because the owner's self-interest may be tied to the success of the company, and even a successful bankruptcy filing, the owner's vote is genuine and presumably in good faith. But for a creditor that is not a "bona fide" investor, it may never consider the possibility that it may actually benefit by a bankruptcy filing and never consider that as a feasible possibility for the company. In such a case, the golden share effectively creates an ipso facto clause that will always prevent a bankruptcy filing.

CONCLUSION

Distinguishing between the lender as creditor or as a bona fide owner-investor can present a challenge. However, cases considering recharacterization of debt as equity in other contexts in bankruptcy provide some factors to consider in determining whether a shareholder or member is "bona fide" or if that ownership exists solely to ensure the ability to block a bankruptcy filing.[227] Supplemented by the facts of *Franchise Services*, several considerations may aid future courts in distinguishing bona fide investment from schemes designed to prevent use of the bankruptcy system:

1. Timing: to the extent that the ownership interest is given simultaneously with the money from the owner, it is more likely to be a true investment rather than a loan.
2. The repayment terms[228] and the relative risk: to the extent that the investment does not have a set

[224] *See* Franchise Servs. of N. Am. v. U.S. Trs. (*In re* Franchise Servs. of N. Am.), 891 F.3d 198, 202 (5th Cir. 2018).

[225] *See id.* at 203 & n.1, 208–09.

[226] *See* Cloe Pippin, *Bankruptcy Control Tools: Good News for Creditors*, 38 REV. BANKING & FIN. L. 88, 96–97 (2018).

[227] *See In re Franchise Servs. of N. Am.*, 891 F.3d at 209.

[228] *See* Fairchild Dornier GmbH v. Official Comm. of Unsecured Creditors (*In re* Dornier Aviation (N. Am.), Inc.), 453 F.3d 225, 233 (4th Cir. 2006) (listing factors to consider in

repayment date with consequences for the failure to pay, it is more likely to be a true investment.[229]

3. The amount of the investment: to the extent that the investor is both an owner *and* a creditor the relative amounts of the debt may be instructive as to which is the primary role.[230]
4. How the investor will make money off the transaction: To the extent that the investor will profit from the transaction only to the extent that the company itself profits, it is more likely to be a true investment. If the investor's profit is independent of the success of the company, however, it is more likely to be a loan.
5. Voting rights outside of bankruptcy filing: To the extent that the investor has the same voting rights as other shareholders or members of the business, the investment will likely be considered ownership.[231]

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recharacterizing debt as equity, including what parties called the investment, whether the agreement required regular and timely repayment, existence of an interest rate and payment, how debtor would repay debt, whether debtor was properly capitalized, "identity of interest between the creditor and the stockholder," whether collateral was given, whether debtor could obtain alternative funding, subordination to other creditors, what was purchased with the investment, and existence of a "sinking fund" for repayment (quoting Bayer Corp. v. MascoTech, Inc. (*In re* Autostyle Plastics, Inc.), 269 F.3d 726, 749–50 (6th Cir. 2001)); Cohen v. KB Mezzanine Fund II, LP (*In re* SubMicron Sys. Corp.), 432 F.3d 448, 455 n.8 (3d Cir. 2006) (quoting *Bayer Corp.*, 269 F.3d at 749–50) (discussing tests used by various circuits in recharacterization of debt); Stinnett's Pontiac Serv., Inc. v. Comm'r, 730 F.2d 634, 638 (11th Cir. 1984) (including factors of "participation in management" and "intent of the parties"); *see also* Friedman's Liquidating Trust v. Goldman Sachs Credit Partners, L.P. (*In re* Friedman's Inc.), 452 B.R. 512, 519 (Bankr. D. Del. 2011) ("Recharacterization is a question of fact. Courts have adopted various multi-factor tests to define the recharacterization inquiry.").

[229] But note that, as in *Franchise Services*, the investor may have "preferred" stock with a right to be paid *before* other equity holders and perhaps even a right to pre-determined, cumulating dividends. *In re Franchise Servs. of N. Am.*, 891 F.3d at 202; Ben Walther, *The Peril and Promise of Preferred Stock*, 39 DEL. J. CORP. L. 161, 167 (2014) (discussing the rights of preferred shareholders). A creditor can seek to enforce its right to payment as long as the contract terms regarding dates and amount of payment have been violated; a preferred shareholder or member is limited in enforcement of those rights. *See* Walther, *supra* note 229, at 163–64.

[230] In *Franchise Services*, the $3 million debt was dwarfed by the $15 million investment, and was incurred as part of the making of the investment. *See In re Franchise Servs. of N. Am.*, 891 F.3d at 208. These factors suggested that the primary purpose of the money was an investment rather than a loan. *See id.* at 208–09.

[231] Note, however, that in *Franchise Services*, the investor was the *sole* preferred shareholder. *See id.* at 202–03. Preferred shareholders frequently surrender some of the traditional voting rights or control given to common shareholders in favor of a preference in the payment of dividends. *See* BOUCHOUX & CHUNG, *supra* note 141, at 205; Walther, *supra* note 229, at 170, 221. As *Franchise Services* demonstrates, it is not necessary to have *identical* voting rights among all members or shareholders for a member to be "bona fide." *See In re Franchise Servs. of N. Am.*, 891 F.3d at 202–03.

As courts consider the propriety of golden shares and their use to block a bankruptcy filing, courts can look to both the factors outlined for identifying bona fide investors who should be entitled to exercise blocking mechanisms and the considerations outlined in vote designation cases to determine when a creditor votes without good faith in rejecting a bankruptcy filing and should be prohibited from exercising a golden share provision. Each of these factors focuses on the motives of the creditor in voting—a motive to prevent *any* bankruptcy filing by the debtor so that the creditor may employ state-law collection remedies versus a motive to protect the creditor-owner's interests by ensuring that a bankruptcy filing can happen when in the creditor's (and debtor's) interest, but will not occur otherwise. These factors balance the state-law goals of maximum flexibility in closely held corporations and limited liability companies with the bankruptcy code's goal of maximizing access of debtors to the bankruptcy system.