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Are We All Fiduciaries Now? Consent Rights After *Pace Industries*—Part I

By David S. Forsh, Corby J. Baumann, and Matthew J. Kerschner*

A bankruptcy court recently issued an oral ruling that a shareholder consent right over a voluntary bankruptcy filing was unenforceable as a matter of public policy and that a minority shareholder with this right would be a controlling shareholder under Delaware law with associated fiduciary duties. In the first part of this two-part article, the authors provide background on the issue and proceedings. In the second part of this article, which will appear in the next issue of Pratt's Journal of Bankruptcy Law, *the authors will discuss the policy implications of and legal issues with this ruling, particularly with respect to the fiduciary duties of minority shareholders under Delaware law, the effect on the estate, and certain related issues that may be developed in future litigation.*

Can a bona fide shareholder have a consent right over a voluntary bankruptcy filing by a company? The bankruptcy court overseeing the Pace Industries Chapter 11 proceedings recently issued an oral ruling that such a consent right was unenforceable as a matter of federal public policy and that a minority shareholder with this right would be a controlling shareholder under Delaware law with associated fiduciary duties.[1]

This is the first such ruling and is an adverse development for bankruptcy remoteness and for minority investor protections even outside of the bankruptcy context. Many investors consider consent rights over significant corporate actions, such as the incurrence of indebtedness, asset divestitures, or the voluntary commencement of a bankruptcy case, to be essential deal terms and rely upon such rights.

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[1] *May 5, 2020 Hearing Transcript* [Docket No. 148], Case No. 20-10927 (MFW) (Bankr. D. Del. May 5, 2020) ("Pace Tr.").

BACKGROUND

Bankruptcy Policies and Waivers

Freedom of contract is a key principle underpinning American jurisprudence, but agreements between private parties may be unenforceable if contrary to public policy. This is a long-established but unruly feature of common law that has broad application, including to agreements for illegal or certain tortious activity, affecting familial relationships or minor children, or that are contrary to the administration of justice or public interest.[2] In principle, agreements should be invalidated on public policy grounds "with caution" and only when the interest in its enforcement is "clearly outweighed" by the interest against such enforcement.[3] This should be determined after balancing, among other things, the strength of the public policy at issue and its connection with the specific terms of the agreement against the forfeiture that would result from denial of enforcement and any public interest in enforcement.[4]

Bankruptcy courts have broad jurisdiction over the debtor, its assets and creditor relationships in a process that relies on both state and federal law, with rights under non-bankruptcy law being preserved unless preempted by federal law or otherwise required by federal policies.[5] Many policies and principles underlie the Bankruptcy Code, including but not limited to affording honest debtors a fresh start, providing debtors with a breathing spell from creditors, providing a centralized forum for resolution of all creditor and debtor issues, preventing a race to the courthouse, promoting equality of treatment among similarly situated creditors, ensuring transparency of the process, preserving going concern value, preserving employment, permitting rehabilitation of the

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[2] *See generally* 15 Corbin on Contracts §§ 79–89.

[3] *Twin City Pipe Line Co. v. Harding Glass Co.*, 283 U.S. 353, 357 (1931) ("The principle that contracts in contravention of public policy are not enforceable should be applied with caution and only in cases plainly within the reasons on which that doctrine rests. It is only because of the dominant public interest that one who, like respondent, has had the benefit of performance by the other party will be permitted to avoid his own promise.") (citations omitted); Restatement (Second) of Contracts § 178 (describing the "clearly outweighed" standard and identifying factors for and against enforcement to be considered).

[4] *Id.*

[5] *Butner v. United States*, 440 U.S. 48, 55 (1979) (property rights "are created and defined by state law. Unless some federal interest requires a different result, there is no reason why such interests should be analyzed differently simply because an interested party is involved in a bankruptcy proceeding."); *see also, e.g., In re Tribune Co. Fraudulent Conveyance Litig.*, 946 F.3d 66 (2d Cir. 2019) (the policies underlying the safe harbor provision of Section 546(e) of the Bankruptcy Code warrant preemption of state law fraudulent transfer claims).

debtor, and promoting settlements and negotiated resolutions among the parties in interest. Bankruptcy courts have broad powers to carry out the provisions of the Bankruptcy Code and are called on in many circumstances to balance these interests against each other or against other federal statutes and policies.

One of the most fundamental bankruptcy policies is the "fresh start," which gives to the "honest but unfortunate debtor . . . a new opportunity in life and a clear field for future effort, unhampered by the pressure and discouragement of preexisting debt."[6] This is a policy for individuals, whose existence necessarily continues with future earnings potential but who do not have any other mechanism to force a resolution of their outstanding obligations.[7] The fresh start policy "is simply not at issue" for business entities,[8] which may unilaterally cease operations or existence with limited liability for its debt and equity investors.[9] In particular, the fresh start policy is effected by the

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[6] *Local Loan Co. v. Hunt*, 292 U.S. 234, 244 (1934) (citations omitted); *see also Cent. Va. Cmty. Coll. v. Katz*, 546 U.S. 356, 363 (2006) ("Foremost on the minds of those who adopted the [Bankruptcy] Clause were the intractable problems, not to mention the injustice, created by one State's imprisoning of debtors who had been discharged (from prison and of their debts) in and by another State.").

[7] The term "individual" is not defined in the Bankruptcy Code but generally refers to a natural person, as distinct from other types of persons, and is used herein solely with that meaning. "Business entity" or "company" is used herein to refer to a person organized and existing under state or federal law.

[8] *See generally, e.g.*, Douglas G. Baird & Thomas H. Jackson, *Corporate Reorganizations and the Treatment of Diverse Ownership Interests: A Comment on Adequate Protection of Secured Creditors in Bankruptcy*, 51 U. Chi. L. Rev. 97, 110 n.45 (1984) (the fresh start is "not relevant when the debtor is a corporation . . . There may be a need to provide continuing corporations with a discharge, but the reasons for doing so have nothing to do with a fresh-start policy . . . the social policy embodied in the rights of individuals to a "fresh start" through the bankruptcy process is simply not at issue when one is discussing rights among [debt and equity] investors in a corporation.").

[9] The fresh start policy for individuals is distinct from the policy "*to permit* successful rehabilitation of [business] debtors." *NLRB v. Bildisco & Bildisco*, 465 U.S. 513, 527 (1984) (emphasis added); *United States v. Whiting Pools, Inc.*, 462 U.S. 198, 203 (1983) ("By permitting reorganization, Congress anticipated that the business would continue to provide jobs, to satisfy creditors' claims, and to produce a return for its owners" and thereby preserve going concern value greater than if the assets were "sold for scrap.") (citing H. R. Rep. No. 95-595, p. 220 (1977)); Elizabeth Warren, *Bankruptcy Policy*, 54 U. Chi. L. Rev. 775, 787 (1987) ("Congressional comments on the Bankruptcy Code are liberally sprinkled with discussions of policies to protect the investing public, protect jobs, and help save troubled businesses, of concern about the community impact of bankruptcy, and of "the public interest" beyond the interests of the disputing parties.") (citations and internal quotations omitted); *but see, e.g., In re Ionosphere Clubs, Inc.*, 98 B.R. 174, 178 (Bankr. S.D.N.Y. 1989) ("the paramount policy and goal of

Bankruptcy Code provisions that expansively define the claims to be resolved in the bankruptcy case and, with certain conditions, discharge such claims.[10]

There is a long history of bankruptcy courts invalidating prepetition agreements between an individual and his or her creditors to waive the benefits of the discharge and thereby negate a fresh start.[11] One of the seminal cases on this issue explains:

> It would be repugnant to the purpose of the Bankruptcy Act to permit the circumvention of its object by the simple device of a clause in the agreement, out of which the provable debt springs, stipulating that a discharge in bankruptcy will not be pleaded by the debtor. . . . It would be vain to enact a bankruptcy law with all its elaborate machinery for settlement of the estates of bankrupt debtors, which could so easily be rendered of no effect.[12]

This reasoning is similarly applicable to prepetition agreements by individuals not to voluntarily commence a bankruptcy case.[13]

Chapter 11, to which all other bankruptcy policies are subordinated, is the rehabilitation of the debtor"). While in many instances it may further bankruptcy policies to permit a rehabilitation of or preserve the corporate debtor entity, such as where doing so would preserve employment or maximize value for creditors by preserving net operating losses or non-assignable contracts, no provision of the Bankruptcy Code or policy defaults to or mandates such rehabilitation, which outcome may not be in the best interests of the creditors or other stakeholders in any particular instance and would not be available in Chapter 7 or liquidating Chapter 11 cases. *See generally In re Coltex Loop Central Three Partners, LP*, 138 F.3d 39, 44 (2d Cir. 1998) (considering the new value exception to the absolute priority rule, noting that "reorganization is often preferable to liquidation, but Congress recognized the dangers, as well as the benefits of this approach, and provided certain limitations. The Code thus strikes a considered balance between creditor and debtor interests, which creditors, debtors, and courts must scrupulously respect.").

[10] 11 U.S.C. §§ 101(5), 727, 1141, 1192, 1228, 1328.

[11] *Federal Nat'l Bank v. Koppel*, 148 N.E. 379, 380 (Mass. 1925); *In re Weitzen*, 3 F. Supp. 698 (S.D.N.Y. 1933) (quoting *Koppel*); *see also Hayhoe v. Cole (In re Cole)*, 226 B.R. 647, 654 (B.A.P. 9th Cir. 1998) (a discharge waiver by an individual in a state court stipulated judgment is not enforceable, it "would effectively be creating an exception to discharge that Congress had not enumerated" and would "impair the debtor's fresh start"); *cf. Klingman v. Levinson*, 831 F.2d 1292, 1296 n.3 (7th Cir. 1987) (where an individual had stipulated to a consent judgment as to certain facts and that the judgment would not be dischargeable, affirming the collateral estoppel effect of the stipulated facts, explaining that "[f]or public policy reasons, a debtor may not contract away the right to a discharge in bankruptcy. However, a debtor may stipulate to the underlying facts that the bankruptcy court must examine to determine whether a debt is dischargeable.").

[12] *Koppel*, 148 N.E. at 380.

[13] *See, e.g., Fallick v. Kehr*, 369 F.2d 899, 904 (2d Cir. 1966) (noting the fresh start policy for individuals and distinguishing the agreement at issue from "an advance agreement to waive

In general, prepetition agreements limiting specific rights available to debtors within bankruptcy are also void, with some notable exceptions relating to waivers of the automatic stay.[14] The primary bases for decisions invalidating such waivers—beyond reliance on decisions invalidating waivers of discharge or commencement by individuals for the proposition that *all* prepetition waivers of bankruptcy rights are unenforceable[15]—are that such waivers should not be binding on the debtor-in-possession as a new legal entity with fiduciary duties to the estate, should not be binding on other parties-in-interest in the bankruptcy case, would unacceptably undermine the overall bankruptcy system, or are explicitly overridden or otherwise preempted by the Bankruptcy Code.[16]

Many decisions have also stated that agreements with creditors by business entities not to file for bankruptcy are void. These decisions are based, directly or indirectly and without significant discussion, on prior decisions invalidating

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the benefits of the [Bankruptcy Act, which] would be void.").

[14] *E.g., In re Cheeks*, 167 B.R. 817, 819 (Bankr. D. S.C. 1994) (lifting automatic stay based on prepetition agreement, noting that "enforcement of the [underlying] agreement would further the public policy in favor of encouraging out of court restructuring and settlements."); *In re Pease*, 195 B.R. 431, 435 (Bankr. D. Neb. 1996) (holding that "the pre-bankruptcy waiver of the automatic stay of 11 U.S.C. § 362 is unenforceable, per se").

[15] *E.g.*, *In re Thorpe Insulation Co.*, 671 F.3d 1011, 1026 (9th Cir. 2012) (relying on decisions invalidating waivers by individuals to conclude that, to the extent covenants within a prepetition asbestos insurance settlement agreement would prohibit actions by the debtor in bankruptcy, such covenants were not enforceable).

[16] *Id.* at 1026–27 (the anti-assignment provisions of the prepetition agreement were void by operation of Section 541); *Pease*, 195 B.R. at 433–35 (prepetition stay waivers are unenforceable because of a lack of capacity to act on behalf of the debtor in possession, by operation of Sections 363, 365, and 541 of the Bankruptcy Code, and "the Bankruptcy Code extinguishes the private right of freedom to contract around essential provisions."); *In re Trans World Airlines, Inc.*, 261 B.R. 103, 114 (Bankr. D. Del. 2001) (an agreement not to reject a contract in a subsequent bankruptcy is ineffective by operation of Section 365, and "violates public policy in that it purports to bind the debtor-in-possession to a course of action without regard to the impact on the bankruptcy estate, other parties with a legitimate interest in the process or the debtor-in-possession's fiduciary duty to the estate."); *In re Trans World Airlines, Inc.*, 275 B.R. 712, 723 (Bankr. D. Del. 2002) ("*TWA*") (dismissing claims that the debtor had breached a prepetition contract by disposing of assets in a Section 363 sale and that the purchaser tortuously interfered with such contract because of a conflict with the debtor's rights under Sections 363 and 365); *In re 203 N. LaSalle St. P'ship*, 246 B.R. 325, 331 (Bankr. N.D. Ill. 2000) (considering an intercreditor agreement and declining to permit the senior creditor to vote the subordinated creditor's claim after consideration of Sections 510(a) and 1126(a), "bankruptcy is designed to produce a system of reorganization and distribution different from what would [be] obtain[ed] under non-bankruptcy law, it would defeat the purpose of the Code to allow parties to provide by contract that the provisions of the Code should not apply.").

prepetition waivers by individuals of discharge or commencement, and some also rely on prior decisions invalidating prepetition waivers of specific rights available to the debtor in bankruptcy.[17] Enforcing such agreements may well frustrate the purpose of the Bankruptcy Code by allowing it to "so easily be rendered of no effect,"[18] although creditors would remain able to commence an involuntary case.[19] In other respects, the applicability of the policies and principles underlying these decisions do not readily extend to a voluntary waiver of rights by a business entity in a private agreement, where such a waiver may be fully informed after consultation with counsel and in the best interests of the company at the time.[20]

Whatever the underlying merits, the settled view is that agreements by companies with creditors not to file for bankruptcy are not enforceable.

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[17] *See, e.g.*, *In re Adana Mortgage Bankers, Inc.*, 12 B.R. 989, 1009 (Bankr. N.D. Ga. 1980), *vacated by joint motion*, 687 F.2d 344 (11th Cir. 1982) (holding that the voluntary petition was not void for failure to comply with a prepetition agreement requiring notice to GNMA before commencing bankruptcy, because agreements to waive the benefits of bankruptcy are void, citing *Fallick*, *Weitzen*, and *Koppel*); *In re Shady Grove Tech Ctr. Assocs. Ltd. P'ship*, 216 B.R. 386, 390 (Bankr. D. Md. 1998) (in dicta, "courts have uniformly held that a waiver of the right to file a bankruptcy case is unenforceable," citing *Fallick*, other individual debtor waiver decisions, *Adana*, and *In re Heward Bros.*, 210 B.R. 475, 479 (Bankr. D. Id. 1997), which in relevant part states that an installment land sale agreement would not be treated as an executory contract in bankruptcy based on its prepetition documentation by the parties, because parties cannot contract to waive the benefits of bankruptcy, citing individual debtor waiver decisions); *In re Tru Block Concrete Prods., Inc.*, 27 B.R. 486, 492 (Bankr. S.D. Cal. 1983) (where a liquidating trust was created to resolve the affairs of a predecessor corporation with the trust agreement containing a covenant to dismiss any subsequent bankruptcy petition, holding the covenant to be void based on the "well settled principal [sic] that an advance agreement to waive the benefits conferred by the bankruptcy laws is wholly void as against public policy," citing *Fallick*, *Weitzen*, and other individual debtor waiver decisions); *In re Intervention Energy Holdings, LLC*, 553 B.R. 258, 265 (Bankr. D. Del. 2016) (agreements waiving bankruptcy rights are not enforceable, citing *Fallick*, *Weitzen*, *Klingman, Cole*, *Tru Block*, *203 N. LaSalle, TWA*, and *Pease*); *In re Lake Mich. Beach Pottawattamie Resort LLC*, 547 B.R. 899, 912 (Bankr. N.D. Ill. 2016) ("In the same way that individuals may not contract away their bankruptcy rights, corporations should be similarly constrained," citing Section 362(e), *Klingman*, and *Shady Grove Tech*).

[18] *Koppel*, 148 N.E. at 380.

[19] 11 U.S.C. § 303(b) (providing creditors with the ability to commence an involuntary bankruptcy case against the debtor, subject to certain conditions).

[20] Marshall E. Tracht, *Contractual Bankruptcy Waivers: Reconciling Theory, Practice and Law*, 82 Cornell L. Rev. 301, 308–09 (1997) (noting the "missing analysis" from decisions invalidating contractual prohibitions of voluntary filings on public policy grounds); *see also* Bruce A. Markell, *Fool's Gold?: Opting Out of Bankruptcy by Manipulating State Entity Law*, 36 No. 8, Bankruptcy Law Letter (Aug. 2016) (questioning application of bankruptcy policies to override LLC authority limitations that are valid under state law).

However, no such consensus has yet emerged with respect to provisions in charter documents that may operate with similar results.

Constraints on Business Entities

Business entities can have great flexibility under state law in determining their valid purposes and the scope of authority for directors or managers.[21] Constraining that authority can be in the best interests of the business entity or its owners under various circumstances for reasons of corporate governance, risk allocation or the availability of funding.

Bankruptcy remote financing may be the most common example of such an arrangement. In these transactions, a special purpose entity is established as the borrower to operate under strict constraints and with segregated assets from its affiliates. Lenders benefit from this structure through an improved borrower credit profile and a lower risk of a borrower bankruptcy and its attendant costs, delays, and uncertainties, while borrowers benefit from significantly improved financing availability and terms. Among the key considerations in such arrangements is the presence of at least one "independent director" for the borrower, who is not appointed by the borrower or its affiliates and from whom consent is required for major corporate actions, and who is generally perceived to function with greater regard for the interests of creditors than other directors.

As companies look to raise capital from sophisticated debt and equity investors, including through joint ventures, preferred stock investments, issuances of convertible or mezzanine debt, and PIPE transactions, constraints on company actions that are considered fundamental to the operation of the business, the existence of the entity or the underlying investment are often bargained for and received by minority investors entering into a significant transaction with a non-controlled entity. These rights can take many forms but typically involve some combination of share classification, director or manager designations, supermajority or unanimous voting requirements for directors or

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[21] *E.g.*, 8 Del. C. § 102(b)(1) (among other things, the certificate of incorporation may contain any provision for the conduct of the affairs of the corporation and any provision regulating the powers of the directors or stockholders); 8 Del. C. § 141(a) (the corporation shall be managed by a board of directors "except as may be otherwise provided in this chapter or in its certificate of incorporation."); *Jones Apparel Grp., Inc. v. Maxwell Shoe Co.*, 883 A.2d 837, 845 (Del. Ch. 2004) (upholding charter restriction on the ability of the board of directors to set a record date, noting that the DGCL "leaves the parties to the corporate contract (managers and stockholders) with great leeway to structure their relations, subject to relatively loose statutory constraints."); 6 Del. C. § 18-1101(b) ("It is the policy of [DLLCA] to give the maximum effect to the principle of freedom of contract and to the enforceability of limited liability company agreements."); 7 Del. C. § 17-1101(c) ("It is the policy of [DRULPA] to give maximum effect to the principle of freedom of contract and to the enforceability of partnership agreements.").

managers, and explicit consent requirements for major corporate actions such as amendments to charter documents, capital raises, acquisitions, asset sales, or bankruptcy.

While the transaction structures may vary, approval rights (also referred to as consent rights, blocking rights or minority protective provisions) are included in the company's organizational documents or a shareholders' agreement in order to specifically limit the powers otherwise exercisable by the directors, managers or other governing body of the entity under state law. These approval rights are often negotiated as part of the terms of the underlying security (for example, specifically granted to the class of preferred stock or membership interest held by the investor) so as to separate the actions taken by shareholders from the fiduciary duty requirements that may impact actions taken by directors or managers. These rights provide the partner or investor with highly valuable, if not critical, protections that otherwise would not be available without majority ownership or actual control. In particular, consent rights provide the investor with an enhanced ability to monitor its investment by requiring its involvement in the decision-making process for major corporate actions. By offering these protections, the business entity may attract a wider pool of potential partners or investors and with funding on better terms than would otherwise be available.

Voluntary Commencement by Business Entities

Any eligible debtor may commence a voluntary bankruptcy case by filing a petition for relief.[22] For a business entity, the filing of the petition—just as with any other corporate action—must be validly authorized, as determined by generally applicable state law and the applicable charter documents.

This principle is well-settled and has been upheld in many contexts. In *Price v. Gurney*, the U.S. Supreme Court unanimously held that a bankruptcy petition filed by a shareholder on behalf of a corporation, but without valid authority to do so under state law, had to be dismissed despite allegations of misconduct, illegalities, breaches of fiduciary duty and actual conflicts of interest against the directors, who were controlled by the bondholders through a voting trust of a majority of the corporation's equity.[23] The Supreme Court explained that the bankruptcy court "must of course determine whether [bankruptcy petitions] are filed by those who have authority to act. In the absence of federal incorporation, that authority finds its source in local law," and that if "those who purport to act on behalf of the corporation have not been

[22] 11 U.S.C. § 301(a).

[23] 324 U.S. 100 (1945).

granted authority by local law to institute the proceedings, [the court] has no alternative but to dismiss the petition. It is not enough that those who seek to speak for the corporation may have the right to obtain that authority."[24] The Supreme Court acknowledged the shareholder's arguments that the bankruptcy process would avoid unnecessary litigation and provide enhanced remedies, but without proper authority for case commencement as determined under state law, the bankruptcy court did not have jurisdiction to proceed.[25]

Accordingly, courts have dismissed voluntary bankruptcy petitions for lack of authorization when filed by a former officer, a current officer without authority to do so, a director based on fiduciary duties but without a board meeting, based on a meeting of the board of directors without a proper quorum, on behalf of a partnership by a general partner after filing an individual bankruptcy, and other such situations, all in accordance with substantive non-bankruptcy law.[26]

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[24] *Id.* at 106.

[25] *Id.* at 106, 107.

[26] *In re Sino Clean Energy, Inc.,* 901 F.3d 1139, 1142 (9th Cir. 2018) (after the state-appointed receiver had replaced the corporation's board of directors with a new board, the former board had no authority to commence a bankruptcy case for the corporation, "[n]o matter the equitable considerations, state law dictates which persons may file a bankruptcy petition on behalf of a debtor corporation."); *Keenihan v. Heritage Press Inc.*, 19 F.3d 1255, 1258 (8th Cir. 1994) (where the borrower had pledged a controlling equity stake to its lender as collateral with a voting proxy for such shares and power of attorney to record transfer after default, court held that lender had prevented borrower from validly filing for bankruptcy after exercising on pledged shares, recording such transfers and removing officer who then attempted to commence a bankruptcy case on behalf of the borrower); *In re Phillips*, 966 F.2d 926, 929, 934 (5th Cir. 1992) (holding that under Texas law a general partner could not place the partnership into bankruptcy after commencing an individual bankruptcy case, noting that "[f]or many years, courts have consistently looked to state law to determine whether a person has authority to file a voluntary petition on behalf of a corporation . . . Throughout the many revisions to federal bankruptcy law, courts continue to resolve authority-to-file disputes according to state law."); *In re Gen–Air Plumbing & Re-modeling, Inc.*, 208 B.R. 426, 430 (Bankr. N.D. Ill. 1997) (holding that an individual who was a 50 percent shareholder, officer and one of three directors of the debtor lacked authority to unilaterally file a voluntary petition on its behalf notwithstanding the individual's alleged fiduciary duties compelling the bankruptcy filing); *In re Stavola/Manson Elec. Co.,* 94 B.R. 21, 25 (Bankr. D. Conn. 1988) (dismissing as unauthorized the voluntary petition filed by individual, who was a 50 percent shareholder, an officer and one of two directors, and who had been authorized to engage in dissolution proceedings); *In re Giggles Rest., Inc.*, 103 B.R. 549, 554 (Bankr. D.N.J. 1989) (dismissing the case for lack of jurisdiction where the debtor's petition had been authorized at a meeting of the board of directors without a proper quorum); *In re Autumn Press, Inc.*, 20 B.R. 60, 62 (Bankr. D. Mass. 1982) (dismissing a voluntary filing on behalf of a corporation that was authorized by the sole director on the grounds that the corporation was required by statute to have at least three directors and therefore the petition was

As with any general principle, the requirement for valid corporate authorization has been pragmatically applied in some circumstances. In particular, courts have declined to dismiss bankruptcy cases for lack of valid authorization when the movant's allegations regarding unobtained shareholder consents would have required extensive discovery impractical under the circumstances, where the partner seeking dismissal for breach of an unanimity provision had previously utterly ignored such requirement, or where the filing was subsequently ratified.[27] Such decisions do not support a broad judicial power to look

not validly authorized in accordance with state law, and holding that a shareholder who was also a creditor had standing as a shareholder to bring the dismissal motion); *In re Joseph Feld & Co.*, 38 F. Supp. 506, 507 (D.N.J. 1941) (dismissing bankruptcy case when the voluntary petition was authorized in a board meeting attended by two of the three directors but without notice to or waiver by the third director, "[t]he Court, however, should not assume jurisdiction of a "voluntary proceeding", which, as in this case, is based on an invalid resolution which had its origin in an illegal meeting of directors."); *cf. In re Cedar Tide Corp.,* 859 F.2d 1127, 1132–33 (2d Cir. 1988) (holding that a New York corporation that had been dissolved by the state for failure to pay corporate franchise taxes could validly commence Chapter 11 proceedings because under state law it continued to exist for purposes of actions and proceedings and was capable of being reinstated *nunc pro tunc* upon payment of past due taxes and penalties); *Hager v. Gibson*, 108 F.3d 35, 39 (4th Cir. 1997) (holding that a bankruptcy petition that would otherwise require dismissal for lack of authorization could be subsequently ratified and thereby avoid dismissal, noting that *Price* "stand[s] for the proposition that . . . the bankruptcy court does not acquire jurisdiction [over a voluntary petition] unless those purporting to act for the corporation have [such] authority under local law" and "for the corollary that where authority under local law is found lacking, the court "has no alternative but to dismiss the petition."); Fed. R. Bankr. P. 1004, Advisory Committee Note to 2002 Amendment (former FRBP 1004(a) concerning the voluntary commencement of a bankruptcy case by a general partnership was deleted to avoid interfering with non-bankruptcy substantive law, noting that "the Supreme Court has held in the corporate context that applicable non-bankruptcy law determines whether authority exists for a particular debtor to commence a bankruptcy case. . . . Since this is a matter of substantive law beyond the scope of these rules, Rule 1004(a) is deleted as is the designation of subdivision (b).") (citing *Price* and other cases).

[27] *See, e.g.*, *In re Am. Globus Corp.*, 195 B.R. 263, 266 (Bankr. S.D.N.Y. 1996) (where the shareholder agreement required unanimous consent for any corporate action, declining to dismiss for lack of unanimity the voluntary petition filed by one shareholder after the other began taking corporate action unilaterally that evidenced his "acquiescence in the abrogation of the unanimity provision" and was acting "in complete disregard" of other shareholder agreements); *Mgmt. Techs., Inc. v. Morris*, 961 F. Supp. 640 (S.D.N.Y. 1997) (where the corporation had a deadlocked board of directors and was facing an imminent threat to its existence, and with allegations of board members being subject to conflicts of interest and having breached their duties of loyalty, the unilateral actions of the CEO to replace all directors and commence UK administration proceedings did not warrant summary judgment in favor of the former directors and issuing a preliminary injunction against interference by the former directors with the CEO); *In re Quad-C Funding LLC*, 496 B.R. 135, 143 (Bankr. S.D.N.Y. 2013) (with ongoing contentious litigation between key members, where one member claimed that the voluntary

past deficiencies in the corporate authorization. State law may also not receive absolute deference in the context of entities that may be automatically dissolved under state law upon a bankruptcy filing by a constituent member or partner, or when considering the effect of a state court order appointing a receiver that enjoins interference with the receiver or commencement of a bankruptcy case.[28] Such decisions are rooted in the federal preemption of the insolvency field[29] and are not readily applicable to questions of prebankruptcy corporate authority.

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petition was not validly authorized because the member vote authorizing the petition relied on the votes of members who were not "accredited investors" but had improperly purchased member units, and where such claims had not previously been asserted by the member despite knowing of such issuance for two years or more, declining to investigate whether the units had been validly issued, noting also that dismissal would, among other things, "permit parties to obstruct a bankruptcy filing, damage creditor interests, possibly doom a chance at rehabilitation, and possibly allow a creditor to escape liability on a preference"); *In re Adorn Glass & Venetian Blind Corp.*, No. 03-14423(CB), 2004 Bankr. LEXIS 2411, at *15-17 (Bankr. S.D.N.Y. Dec. 14, 2004) (where the petition had been filed a year and a half previously, noting multiple factual issues that required resolution in order to determine whether the petition had been validly authorized and that under the circumstances creditors "may truly benefit from reorganization" and "may be prejudiced by the delay" unless in bankruptcy, relying on a case that converted an unauthorized voluntary petition by a general partner into an involuntary petition to decline to find cause for dismissal but appointing a Chapter 11 trustee based on the debtor's mismanagement).

[28] *E.g.*, *In re Clinton Court*, 160 B.R. 57, 60 (Bankr. E.D. Pa. 1993) (holding that the debtor general partnership had not been previously dissolved by operation of state law upon the prior bankruptcy filing of one of the partners because the partnership agreement was an executory contract that could not be terminated by an ipso facto by operation of Section 365(e)(1)); *In re Corp. & Leisure Event Prod., Inc.*, 351 B.R. 724, 728 (Bankr. D. Ariz. 2006) (directors and officers could file bankruptcy petitions on behalf of the debtor notwithstanding state court receivership order barring the debtor from filing for bankruptcy and even after removal by the receiver); *In re Kreisers, Inc.*, 112 B.R. 996 (Bankr. D.S.D. 1990) (directors could pass resolution to file bankruptcy despite contrary state court order in pending receivership proceeding); *contra Sino Clean,* 901 F.3d at 1142 ("To the extent that *Corporate & Leisure* [permits an officer actually removed by a state court receiver to file a petition], it is wrong. No matter the equitable considerations, state law dictates which persons may file a bankruptcy petition on behalf of a debtor corporation.").

[29] *E.g.*, *Corp. & Leisure*, 351 B.R. at 728 ("the bankruptcy power "preempts and supersedes all state bankruptcy and insolvency laws and other state law remedies that might interfere with the uniform federal bankruptcy system"), at 731 ("obviously, however, there is a federal common law exception to this reliance on state law [for authority to file] when the state law is in the form of a receivership order that attempts to preclude any of the original constituents of the organizational entity from filing a petition on its behalf."); *Kreisers*, 112 B.R. at 1000 ("Neither a state court injunction nor the pendency of a state receivership can bar the filing of an otherwise permitted bankruptcy due to the grant of the exclusive bankruptcy jurisdiction to the federal courts and the constitutional principle of supremacy.") (citations omitted).

There have been relatively few decisions to date on such "blocking rights" or "golden shares" as applied to the voluntary commencement of bankruptcy.[30] Where such rights are held by creditors, or by parties primarily motivated as creditors,[31] the trend has been against enforceability, on the grounds that such a right is tantamount to a waiver agreement with a creditor that would be void.[32] At least two courts have also held that such rights must be invalidated if not exercised by someone with fiduciary duties to the business entity.[33]

However, courts have generally upheld the validity of consent rights among equity holders in the absence of such creditor influences.[34] In the only circuit

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[30] Generally, the term "blocking right" or "blocking provision" is used "as a catch-all to refer to various contractual provisions through which a creditor reserves a right to prevent a debtor from filing for bankruptcy" and a "golden share" is "[a] share that controls more than half of [the entity's] voting rights and gives the shareholder veto power over changes to the company's charter." *In re Franchise Servs. of N. Am., Inc.*, 891 F.3d 198, 205 (5th Cir. 2018).

[31] Bankruptcy courts are able to look through the form of a transaction to its substance when determining the true nature of claims against the debtor's estate or transactions involving the debtor. *Pepper v. Litton*, 308 U.S. 295, 304–05 (1939) ("substance will not give way to form," and "technical considerations will not prevent substantial justice from being done."); *Newport Bank v. Herkimer Bank*, 225 U.S. 178, 184 (1912) (analyzing a potential avoidance action, "[i]f the bankrupt has made a transfer of his property . . . circuity of arrangement will not avail to save it.").

[32] *Intervention Energy*, 553 B.R. at 265; *see also Lake Mich. Beach*, 547 B.R. at 913–14; *In re Lexington Hosp. Grp., LLC*, 577 B.R. 676, 684–86 (Bankr. E.D. Ky. 2017); *In re Bay Club Partners–472 LLC*, No. 14-30394 (RLD), 2014 Bankr. LEXIS 2051 (Bankr. D. Or. May 6, 2014) (where the LLC agreement prohibited the commencement of a bankruptcy case until all secured indebtedness had been repaid, with uncontroverted testimony that the bankruptcy restriction had been included solely at the secured creditor's request and without discussion among the members, reasoning that the provision being in a member agreement rather than in a loan document was a "distinction without a meaningful difference" and was therefore an unenforceable "maneuver of an astute creditor") (internal marks omitted). *Contra In re Global Ship Sys. LLC*, 391 B.R. 193, 203 (Bankr. S.D. Ga. 2007) (where the debtor's operating agreement had been amended three years previously as part of a workout in order to forestall the lender's foreclosure and included the grant of a 20 percent equity interest to the lender with a consent right for such shares over a bankruptcy filing, characterizing the lender as wearing "two hats" and affirming the lender's right as an equity holder to withhold consent to a bankruptcy filing).

[33] *Lake Mich. Beach*, 547 B.R. at 913–14, *Lexington Hosp.*, 577 B.R. at 685–86.

[34] *In re NNN 123 N. Wacker, LLC*, 510 B.R. 854, 861 (Bankr. N.D. Ill. 2014) (dismissing the case "because it was filed without authority" pursuant to Section 1112(b) when the manager filed the petition without obtaining unanimous member consent as required by the operating agreement); *In re Orchard at Hansen Park, LLC*, 347 B.R. 822, 827 (Bankr. N.D. Tex. 2006) (dismissing voluntary petition for failure to obtain unanimous member consent as required by LLC operating agreement); *In re Squire Court Partners Ltd. P'ship*, 574 B.R. 701, 708 (E.D. Ark.

court opinion on the issue, the U.S. Court of Appeals for the Fifth Circuit held that federal public policy did not prevent a bona fide shareholder from exercising its blocking right over a voluntary bankruptcy petition even when the shareholder was also a creditor.[35] Four years before the commencement of that bankruptcy, the debtor had enlisted the services of an investment bank, Macquarie, to assist it in acquiring another company. To help finance the acquisition, Macquarie formed a fully-owned special purpose vehicle ("SPV") that invested $15 million as preferred equity into the debtor, a Delaware corporation, and obtained amendments to its certificate of incorporation that included a bankruptcy blocking right. Macquarie also earned $3 million in fees in connection with the acquisition transaction, which remained unpaid at the time of the debtor's bankruptcy. After the debtor filed for bankruptcy without obtaining the SPV's consent, the bankruptcy court determined that the SPV's blocking right was not contrary to federal public policy or Delaware law and granted the SPV's motion to dismiss.

On direct appeal from the bankruptcy court, the Fifth Circuit relied on the principle that authority to file is determined by state law, as articulated by the Supreme Court in the *Price* decision, to uphold the SPV's blocking right and conclude that "there is no compelling federal law rationale for depriving a bona fide equity holder of its voting rights just because it is also a creditor."[36] The Fifth Circuit noted that even if Macquarie and the SPV were treated as a single entity, there was no evidence that the equity investment "was merely a ruse" and that "[i]t is one thing to look past corporate governance documents and the structure of a corporation when a creditor has negotiated authority to veto a

2017) (rejecting argument that fiduciary duties are necessary when voting on bankruptcy and affirming dismissal of a voluntary petition filed by the general partner without the consent of the limited partners as required by the limited partnership agreement); *In re DB Capital Holdings, LLC*, No. 10-046, 2010 Bankr. LEXIS 4176 (B.A.P. 10th Cir. Dec. 6, 2010) (affirming dismissal of a voluntary petition filed by the LLC manager without unanimous member consent as required by the amended operating agreement, despite the amendment being executed at the demand and for the sole benefit of the secured creditor five months after formation and more than two years before financial difficulties, reasoning that cases "involv[ing] a debtor's agreement with third parties to waive the benefits of bankruptcy" do not "stand . . . for the proposition that members of an LLC cannot agree among themselves not to file [for] bankruptcy" or that "such [an] agreement [would be] void as against public policy"); *see also, e.g., In re Avalon Hotel Partners, LLC*, 302 B.R. 377, 381 (Bankr. D. Or. 2003) (same judge as *Bay Club*, determining that the petition filing by the manager without the consent of the members was not authorized under Oregon law or the operating agreement and would have been dismissed but for subsequent ratification by members).

[35] *Franchise Servs.*, 891 F.3d at 209.

[36] *Id.* at 208–09 (citing *Price*). The *Price* decision is not discussed by the *Lake Michigan, Intervention Energy,* or *Lexington Hospital* decisions.

debtor's decision to file a bankruptcy petition; it is quite another to ignore those documents when the owners retain for themselves the decision whether to file bankruptcy."[37]

The Fifth Circuit rejected the debtor's argument that the shareholder's consent right was void without a related fiduciary duty, finding "no good legal or logical rationale for such a holding," and concluded that "[a]s a matter of federal law, fiduciary duties are not required to allow a bona fide shareholder to exercise its right to prevent a voluntary bankruptcy petition."[38] The Fifth Circuit also rejected the debtor's argument that the mere existence of the blocking right was sufficient to transform the SPV, which had a minority equity stake in the debtor and had appointed a minority of its board, into a controlling shareholder under Delaware law with associated fiduciary duties, noting that the debtor had offered no evidence of the "actual control" necessary under Delaware law for controlling shareholder status.[39] However, even assuming that the SPV was a controlling shareholder and that a refusal to consent to the bankruptcy would be a breach of its fiduciary duties, "the proper remedy is not to deny an otherwise meritorious motion to dismiss the bankruptcy petition. Instead, to the extent that [SPV] breached any fiduciary duty owed as a controlling shareholder, [the debtor] must seek its remedy under state law."[40]

After the *Franchise Services* decision, parties could have been reasonably confident that the charter document rights of equity owners acting in that capacity would be enforced. After all, if federal public policies do not void the blocking right of a shareholder who is also a creditor, surely federal public policies do not void the blocking right of a shareholder who is not a creditor. At that time, all decisions to the contrary could have been readily distinguished as addressing situations where the equity owner was also a creditor and was primarily motivated as such or where the agreement among the equity owners was unduly controlled by the creditor.[41] The recent *Pace Industries* ruling is a significant setback for any such expectations.

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[37] *Id.* at 208 (quoting *Squire Court Partners*, 574 B.R. at 708).

[38] *Id.* at 209.

[39] The Fifth Circuit assumed without deciding that a provision in a certificate of incorporation conditioning a corporation's right to file bankruptcy petition on shareholder consent was permissible as a matter of Delaware corporate law, noting that the debtor had waived this argument on appeal and that it was a matter of first impression. *Id.* at 210–11.

[40] *Id.* at 214.

[41] *See, e.g., supra* n. 32.

Pace Industries

On April 12, 2020, Pace Industries, LLC and certain of its affiliates (collectively, the "Pace debtors") filed voluntary petitions for relief in the U. S. Bankruptcy Court for the District of Delaware. The Pace debtors had over $300 million in prepetition asset-based loans ("ABL") and term loan debt maturing no later than July 2020 and secured by liens on substantially all assets, and had been engaged in capital raise, sale and restructuring efforts for more than a year before experiencing a liquidity crunch in March 2020 attributed to the COVID-19 pandemic.[42] The Pace debtors commenced their cases with 100 percent support from the prepetition term loan lenders for a prepackaged plan that, in relevant part, would refinance the existing ABL in full with a new ABL exit facility, cancel all existing equity interests and issue 100 percent of the equity in the reorganized company to the term lenders, reinstate or pay in full all unsecured claims, and provide releases for management and directors.

Five days later, a preferred shareholder of one of the intermediate holding companies in the Pace debtors' organizational structure filed a motion to dismiss the cases of that company and its direct and indirect subsidiaries. In January 2018, Macquarie Septa had purchased $37.15 million of preferred equity in KPI Intermediate Holdings, Inc., a Delaware corporation ("Intermediate"), in a transaction that included amendments to Intermediate's certificate of incorporation granting Macquarie Septa consent rights with respect to significant corporate actions by Intermediate and any of its subsidiaries,[43] including consent rights over any additional indebtedness, acquisitions, divestitures, and voluntary commencement of a bankruptcy case. Relying in particular on the *Price* and *Franchise Services* decisions, and on the flexibility afforded under Delaware law for corporate governance arrangements, Macquarie Septa sought dismissal of the subject bankruptcy cases, noting that the Pace debtors' directors and officers who sought to effect the prepackaged plan were "not unbiased" on account of the proposed plan releases.[44]

[42] Docket No. 4 ¶ 43–49, Case No. 20-10927(MFW) (Bankr. D. Del. Apr. 12, 2020).

[43] The amendment to Intermediate's certificate required the consent of Macquarie Septa to certain corporate actions of Intermediate or any of its controlled subsidiaries. Docket No. 88, Exh. B at 8, Case No. 20-10927 (MFW) (Bankr. D. Del. Apr. 17, 2020). As such, Macquarie Septa sought dismissal of the Chapter 11 cases filed by the Intermediate subsidiaries, such as Muskegon Castings, LLC, a fourth-tier subsidiary of Intermediate, based on consent rights that Macquarie Septa had in the Intermediate certificate. The *Pace Industries* briefing and ruling did not address how, as a matter of corporate authority rather than contract, the filings of each of the subsidiaries at issue would be constrained by these consent rights in the Intermediate certificate.

[44] Docket No. 88 ¶ 18, Case No. 20-10927 (MFW) (Bankr. D. Del. Apr. 17, 2020).

In opposition, the Pace debtors relied on decisions that blocking rights in charter documents for creditors were not enforceable and sought to distinguish *Price* and *Franchise Services*, among others, as decisions that did not address invalid blocking rights, arguing that "[b]ecause Macquarie Septa's exercise of its purported blocking right here is invalid on public policy and equitable grounds . . . this [bankruptcy court] may exercise subject matter jurisdiction here."[45] The Pace debtors also emphasized that the bankruptcy cases were in their best interests and the only viable option in light of the liquidity situation, that Macquarie Septa owed fiduciary duties to Intermediate under Delaware law but was acting only in its interests, and that Macquarie Septa would have no basis to contest the foreclosure or involuntary petition that would be filed by the term lenders.[46] The term loan lenders filed a joinder and supporting declaration attesting to their intention to "immediately file" involuntary petitions against the Pace debtors if the dismissal motion was granted.[47] Among other things, Macquarie Septa's reply argued that the potential involuntary filings were not relevant to the jurisdictional question, raised potential issues with such filings, and argued that the consent right was not sufficient under Delaware law to impose fiduciary duties on Macquarie.[48]

The hearing on the motion to dismiss was held on May 5, 2020. Among other things, Macquarie Septa took issue with the "circular argument" that the bankruptcy court could exercise jurisdiction because the blocking rights were invalid, noted that the directors voting in favor of the bankruptcy had "personal motivations and personal conflicts" on account of the releases, exculpations, indemnification and compensation that they could or would receive through the proposed bankruptcy process, and noted that all aspects of the prepackaged plan, particularly the restructuring of the secured debt while leaving unsecured creditors unimpaired, could be accomplished outside of bankruptcy except for the cancellation of Macquarie Septa's equity interests for no consideration.[49] The Pace debtors criticized Macquarie's attempt to extract leverage for itself, characterized the allegations of director conflicts as "relat[ing] to the details of the plan and hav[ing] nothing to do with the decision to file for bankruptcy," and raised the argument that the blocking right conflicted with "the company's constitutional right to seek bankruptcy relief."[50]

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[45] Docket No. 115 ¶ 27, Case No. 20-10927 (MFW) (Bankr. D. Del. Apr. 28, 2020).

[46] *Id.* at ¶¶ 17, 22–24.

[47] Docket No. 117 ¶ 13, Case No. 20-10927 (MFW) (Bankr. D. Del. Apr. 28, 2020).

[48] Docket No. 128 ¶¶ 11–14, Case No. 20-10927 (MFW) (Bankr. D. Del. Apr. 30, 2020).

[49] Pace Tr. at 17:6-10, 17:16-18:2, 34:7-23.

[50] Pace Tr. at 22:12-18, 25:11-13, 26:4-5, 37:21-24.

At the conclusion of the arguments, the bankruptcy court issued an oral ruling denying the dismissal motion. Acknowledging that it would be the first to do so, the court held that "a blocking right by a shareholder who is not a creditor is void as contrary to federal public policy that favors the constitutional right to file bankruptcy."[51] The court found that "it is clear that a lack of access to the Bankruptcy Code and the Bankruptcy Courts would violate the federal public policy [] to allow a debtor to file bankruptcy."[52] The court expressly disagreed with the Fifth Circuit that federal public policy did not prevent shareholders from blocking a bankruptcy filing.[53] The court also expressly disagreed with the Fifth Circuit that Delaware law would not impose a fiduciary duty on a shareholder seeking to exercise a consent right to block a bankruptcy filing, holding that in the present circumstances, there would be "a fiduciary duty on the part of the shareholder" under Delaware law.[54] In reaching its conclusions, the court noted the Pace debtors' liquidity constraints, near-term maturities and the impact of the pandemic, that the proposed plan "or any other plan that could be negotiated in the bankruptcy case, would offer a better prospect than leaving the company outside of bankruptcy," that Macquarie Septa had not identified any viable alternative and had conceded that it was considering only its own interests in seeking to exercise its blocking right, and that federal policy required the court to consider the best interests of all interested parties.[55]

On May 29, 2020, the bankruptcy court confirmed the Pace debtors' prepackaged plan. While the plan provided for broad releases of the debtors and lenders, and for the subordination of claims subject to Section 510(b) of the Bankruptcy Code, the confirmation order preserved any direct claims by Macquarie Septa against any entity other than the Pace debtors arising from the purchase of any security of the Pace debtors without release or impairment by the plan or confirmation order.[56]

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The potential ramifications of the Pace Industries ruling extend well beyond the bankruptcy context and could materially impact minority investment or joint venture strategies and related minority shareholder rights. As borrowers,

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[51] Pace Tr. at 38:10-15.

[52] Pace Tr. at 39:8-11.

[53] Pace Tr. at 40:13-19.

[54] Pace Tr. at 40:21-41:3.

[55] Pace Tr. at 41:9-42:7.

[56] Docket No. 215 ¶ 54, Case No. 20-10927 (MFW) (Bankr. D. Del. May 29, 2020).

lenders, investors and partners explore the substantial flexibility provided by state statutes to implement organizational structures providing the desired risk and governance characteristics, parties can be expected to continue testing their ability to enforce consent rights and otherwise restrict voluntary bankruptcy filings. The second part of this article, which will appear in the next issue of *Pratt's Journal of Bankruptcy Law*, will discuss the policy implications of and legal issues with the Pace Industries ruling, particularly with respect to the fiduciary duties of minority shareholders under Delaware law, and certain related issues that the authors expect will be developed in future litigation.

Are We All Fiduciaries Now? Consent Rights After *Pace Industries*—Part II

By David S. Forsh, Corby J. Baumann, and Matthew J. Kerschner*

A bankruptcy court recently issued an oral ruling that a shareholder consent right over a voluntary bankruptcy filing was unenforceable as a matter of public policy and that a minority shareholder with this right would be a controlling shareholder under Delaware law with associated fiduciary duties. In the first part of this two-part article, which appeared in the October 2020 issue of Pratt's Journal of Bankruptcy Law, *the authors provided background on the issue and proceedings. In this second part of the article, the authors discuss the policy implications of and legal issues with this ruling, particularly with respect to the fiduciary duties of minority shareholders under Delaware law, the effect on the estate, and certain related issues that may be developed in future litigation.*

DISCUSSION

The "Constitutional Right" to File

While some courts have stated that a constitutional right to file for bankruptcy exists, such statements have been made without discussion and do not withstand scrutiny.[57] The Constitution provides only that "Congress shall

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[Footnotes are continued from Part I of this article.]

[57] *E.g.*, *In re Pine Tree Feed Co.*, 112 F. Supp. 124 (D. Me. 1953) (holding that a state court order appointing a receiver and enjoining interference with the receiver did not prevent the debtor from commencing a voluntary bankruptcy case because "otherwise it would have the effect of depriving the debtor of its constitutional right to relief under Chapter XI of the Bankruptcy Act."). In support of this proposition, the *Pine Tree* court cited *In re Mt. Forest Fur Farms of Am.*, 103 F.2d 69, 71 (6th Cir. 1939), where the court held that a state court order restraining the debtor and its officers and agents from commencing a reorganization proceeding "depriv[ed]

have Power . . . To establish . . . uniform Laws on the subject of Bankruptcies throughout the United States."[58] The Constitution does not require that any such law be established, and for many years and at various periods no such law was in effect. Nor does the Constitution grant to any person the right to file for bankruptcy, and Congress has expanded or restricted the eligibility of persons and entities to file for bankruptcy (and with what effect) at various times and for various reasons.[59]

Rather, "[t]here is no constitutional right to obtain a discharge of one's debts in bankruptcy."[60] In *Kras*, the Supreme Court considered the dismissal of a voluntary bankruptcy case commenced by an indigent individual for failure to pay the statutory fees, and concluded that the right to file for bankruptcy was not a fundamental right and could be limited by Congress merely with rational justification.[61] Although four justices dissented in *Kras*, viewing the issue as one of access to the courts "with monopolization" of the means to obtain debt relief,[62] this concern applies only to individuals and not to business entities that may cease activity, be dissolved or become subject to other resolution proceedings such as receiverships or assignments for the benefit of creditors, all without resort to the bankruptcy process. The *Kras* holding is applicable with even greater strength in the context of a business entity that is not entitled to any fresh start.[63]

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them of their constitutional right to relief" under the Bankruptcy Act, citing only the Bankruptcy Clause as support.

58 U.S. Const. art. I § 8 cl. 4.

59 *See, e.g.*, 11 U.S.C. §§ 109(d) (limiting availability of relief under Chapter 11 to certain types of persons), 109(g) (restricting certain past filers from further filings), 523(a)(8) (limiting dischargeability of student loans), and 707(b)(2)(A) (conditioning eligibility for Chapter 7 relief on a financial means test). Indeed, as originally enacted, the Bankruptcy Act did not permit voluntary filings by corporations. Act of July 1, 1898 § 4(a), ch. 541, 30 Stat. 544.

60 *United States v. Kras*, 409 U.S. 434, 446–47 (1973).

61 *Id.*

62 *Id.* at 456 n.7.

63 *Cf. United States v. Royal Bus. Funds Corp.*, 724 F.2d 12, 15–16 (2d Cir. 1983) (when the borrower attempted to file for bankruptcy, after defaulting on its SBA loans and then agreeing to substantial additional financing from the SBA and to federal receivership, reasoning that "no public or private interest is served by allowing [borrower] to repudiate the arrangements it made with the SBA" and rejecting an "absolute right to file a bankruptcy petition").

The Bankruptcy Access Policy

The *Pace Industries* court based its ruling on a federal public policy "to allow a debtor to file bankruptcy" or "that favors the [] right to file bankruptcy."[64] That such a policy generally exists is indisputable, as it does for access to the courts more broadly. But it is rarely discussed or relied on by courts, and usually appears in the context of whether a bankruptcy petition was filed in good or bad faith and in reference to the goal of Congress to facilitate early resort to the bankruptcy process without a showing of balance sheet insolvency without delaying until going concern value has been lost.[65]

This access policy, and the general policy to avoid frustration of Congress's intent, may warrant invalidating agreements with creditors by companies that restrict its ability to commence bankruptcy. However, it is difficult to evaluate the strength or importance of such policies relative to the other policies at issue when considering the validity of charter documents and agreements among

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[64] Pace Tr. at 38:12-13, 39:10-11; *see also Intervention Energy*, 553 B.R. at 265 ("The federal public policy to be guarded here is to assure access to the right of a person, including a business entity, to seek federal bankruptcy relief as authorized by the Constitution and enacted by Congress.") (no citations).

[65] *E.g.*, *In re Johns-Manville Corp.*, 36 B.R. 727, 736 (Bankr. S.D.N.Y. 1984) (in considering whether the case had been commenced in bad faith in light of the debtor's solvency, noting the "open access" policy to encourage early resort to the bankruptcy) (citing Report of the Commission on the Bankruptcy Laws of the United States, H.R. Doc. No. 137, Part II, 93rd Cong., 1st Sess. 75, 79 (1973) ("1973 Report")). The 1973 Report identified an "open access" goal for a reformed bankruptcy process, which generally referred to the desirability of significantly streamlining the procedural requirements for the voluntary commencement of a case from the Bankruptcy Act and did not envision amending the requirement for valid authorization of commencement by business entities. *See, e.g.,* 1973 Report at 47 ("the barriers to access to relief under the Act have been in many instances too great."), at 75 (describing the "open access" goal as "[t]here should be no legal barrier to voluntary petitions . . . . The process should encourage resort to it, by debtors and creditors, that cuts short the dissipation of assets and the accumulation of debts. Belated commencement of a case may kill an opportunity for reorganization or arrangement," noting the moral stigma impeding resort to bankruptcy and the need for bankruptcy to be "intellectually accessible" with simplified rules, "physically accessible" and "economically accessible."). In addition to this consideration to preserve going concern value and the opportunity for rehabilitation, the 1973 Report promoted open access since "[a]ny new restraints on the access of failing business units to bankruptcy relief would risk an undesirable effect on economic growth by deterring the risk-taking that leads to new and expanded enterprise." 1973 Report at 54. However, strong limited liability protections for equity owners seem to be of considerably greater significance for any such *ex ante* considerations by business owners and entrepreneurs, particularly since bankruptcy is not necessarily a likely or attractive option for resolving a failed business.

owners,[66] particularly freedom of contract and the principle that property interests (including contract interests) should be determined by state law unless a federal interest "requires a different result."[67] In addition, the internal affairs doctrine calls for strong deference to the laws of the state of organization when considering corporate authority and related issues.[68] Even within bankruptcy, the governance rights of the debtor's equity owners will be impaired only for clear abuse, which does not exist merely because equity holders intend to exercise their bargaining power.[69] While courts have found clear abuse for actions that would overly delay and jeopardize reorganization, and have enjoined such actions within bankruptcy by equity owners, they generally have not done so or voided rights in advance of bankruptcy.

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66 The source of the consent right at issue will impact the analysis. While company action taken in violation of a certificate of incorporation, limited liability company agreement or other charter document may be ultra vires and void, violations of a shareholders' agreement or similar contract may raise only breach of contract claims and specific enforceability or damages issues.

67 *Butner*, 440 U.S. at 55. While the property of the bankruptcy estate is comprised of "all legal or equitable interests of the debtor in property as of the commencement of the case," 11 U.S.C. § 541(a)(1), "courts must look to state law to determine whether and to what extent the debtor has any legal or equitable interests in property as of the commencement of the case." *In re Pettit*, 217 F.3d 1072, 1078 (9th Cir. 2000) (citing *Butner*).

68 *In re Fedders N. Am., Inc.*, 405 B.R. 527, 539 (Bankr. D. Del. 2009) ("Under the internal affairs doctrine, only one state has the authority to regulate a corporation's internal affairs—matters peculiar to the relationships among or between the corporation and its current officers, directors, and shareholders . . . . [C]ourts have long recognized that few, if any, claims are more central to a corporation's internal affairs than those relating to alleged breaches of fiduciary duties by a corporation's directors and officers.") (citations omitted); *cf.* 28 U.S.C. § 1334(c)(1) (providing for permissive abstention by bankruptcy courts "in the interest of justice, or in the interest of comity with State courts or respect for State law"); *see also, e.g., In re New York City Off-Track Betting Corp.*, 434 B.R. 131, 155 (Bankr. S.D.N.Y. 2010) (applying *Burford* discretion based on principles of federalism and comity to abstain from interference with state gambling regulations) (citations omitted).

69 *E.g.*, *In re Johns-Manville Corp.*, 801 F.2d 60, 64 (2d Cir. 1986) ("we cannot agree that the [shareholders'] professed desire to arrogate more bargaining power in the negotiation of a plan—in contrast to some secret desire to destroy all prospects for reorganization—may in itself constitute clear abuse."); *cf. In re SS Body Armor I, Inc.*, 527 B.R. 597, 607 (Bankr. D. Del. 2015) ("the bankruptcy court may enjoin the occurrence of a shareholder meeting as well as the implementation of the results of such a meeting when there is "clear abuse," in other words, a showing of delay and real jeopardy to a debtor's reorganization."). Notably, under this doctrine the shareholder right is enjoined, not void. In the context of the blocking right, unless the blocking right is voided, the petition would not be authorized even if the future exercise of the right is enjoined.

Impact on the Estate

The *Pace Industries* ruling also noted the Bankruptcy Code's disapproval of waivers of bankruptcy rights and the negative impact from exercise of the blocking right on the bankruptcy estate and the debtor-in-possession's options, and the general task of bankruptcy courts to consider the best interests of all parties.[70]

Similar concerns could be applied to many other prebankruptcy actions or decisions that impact any subsequent bankruptcy estate. For example, the prebankruptcy incurrence of highly levered indebtedness secured by substantially all of the borrower's assets may adversely impact the recoveries for other creditors. Such financing may also as a practical matter be largely determinative of the options available to the debtor-in-possession, particularly as the prepetition lender is likely to be the source of postpetition financing with attendant collateral surcharge and equity of the case waivers, rollups and milestones. Directors may also pursue courses of action to maximize the value of the company, even when it is insolvent and when the risks are borne by creditors while the rewards accrue to equity.[71] It is difficult to see a limiting principle if these policy concerns are applicable to prebankruptcy actions.

Rather, these policy concerns are a consideration in the context of prebankruptcy waivers of specific rights or provisions with effect within the bankruptcy case—such as the automatic stay or the ability to reject executory contracts—where the waiver of such rights may undermine the overall bankruptcy structure and its balancing of competing policy goals and stakeholder interests. The best interests of the parties have generally not been considered by bankruptcy courts when evaluating whether a petition has been validly authorized,[72] and where discussed it has been in the context of broader factual questions over the requisite authority.[73] Other courts may give these policy concerns less weight

[70] Pace Tr. at 39:22-40:4, and 41:7-42:4.

[71] *See, e.g.*, *Quadrant Structured Prods. v. Vertin*, 102 A.3d 155 (Del. Ch. 2014) (while creditors may gain derivative standing to enforce fiduciary duty claims against directors after insolvency, such directors are not dual fiduciaries with obligations to creditors but rather continue to have fiduciary duties to the corporation to maximize its value, and the decision by directors who are the sole owners of an insolvent corporation to pursue a risky course of action with significant risks to creditors for the purposes of realizing a return to equity may be entitled to the protection of the business judgment rule).

[72] *See, e.g.*, *supra* note 26.

[73] *See, e.g.*, *supra* note 27; *cf. Squire Court Partners*, 574 B.R. at 707 ("Cases holding that the decision to file for bankruptcy rests with a corporation's board of directors focus on the delegation of authority, not the fact that the directors have fiduciary duties.") (citing cases).

when considering the threshold question of whether a case has been validly commenced or where there are no facts in dispute regarding the necessary corporate authorizations.[74]

Fiduciary Duties & Controlling Minority Shareholders

In addition to ruling that the blocking right for a minority shareholder was void as a matter of federal public policy, the *Pace Industries* court also concluded that Macquarie Septa was subject to fiduciary duties under Delaware law in the exercise of its blocking right.[75] Although the Pace Debtors briefed and argued that the blocking right could only be valid if exercised by a decisionmaker with fiduciary duties, the court did not make this ruling.[76]

The idea that a blocking right to be valid must be exercised by a decisionmaker with fiduciary duties may be attributable to the *Lake Michigan* decision, which Macquarie Septa attempted to distinguish as dealing with blocking rights for a creditor with no economic equity interest in the debtor. There, the court addressed a golden share with blocking rights issued to a creditor, in the context of a forbearance and restructuring agreement and with zero economic value by its terms, and with the attempted disclaimer of all fiduciary or other duties by the creditor in its capacity as a member of the debtor.[77] The court reasoned that blocking director structures could be valid as a matter of federal bankruptcy law only when the director remained subject to fiduciary duties, and that the same restriction would apply to the blocking right of a member.[78] The court concluded that the attempt to disclaim fiduciary duties for the creditor-member was invalid because Michigan law requires that LLC managers have fiduciary duties,[79] and therefore that the blocking right was

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[74] *Cf. Sino Clean Energy*, 901 F.3d at 1142 ("No matter the equitable considerations, state law dictates which persons may file a bankruptcy petition on behalf of a debtor corporation.").

[75] In light of the ruling that the blocking right held by a shareholder was void on federal public policy grounds as an impermissible restriction on the right to file for bankruptcy, it is not clear how the shareholder would be in a position to exercise its blocking rights, whether or not in accordance with any fiduciary duties imposed under Delaware law.

[76] The *Pace Industries* court did not address the allegations that the decision by the Pace directors to pursue bankruptcy was not disinterested in light of the proposed plan providing them with releases or other benefits.

[77] *Lake Mich. Beach*, 547 B.R. at 914.

[78] *Id.* (by "allowing [the creditor] to consider only its best interests, the [operating agreement] also expressly eliminates the only redeeming factor that permits the blocking director/member construct.").

[79] *Id.* (concluding that the creditor as a member had fiduciary duties to the LLC because managers have fiduciary duties to the LLC under Michigan law). The decision does not discuss

unenforceable as a matter of both Michigan and federal bankruptcy law and was void.[80]

Lake Michigan relied on the *General Growth* and *Kingston Square* decisions to support its conclusion that the "essential playbook" for a blocking director requires fiduciary duties for such directors.[81] However, *General Growth* found that the operating documents of the Delaware LLCs at issue there had incorporated Delaware fiduciary law for corporations, which as applied required the SPV directors to consider the needs of the parent corporations, and with that context a decision on behalf of the SPV to commence a bankruptcy case in support of its parent was not bad faith warranting dismissal of the petition.[82] Similarly, *Kingston Square* held that the actions by certain directors to orchestrate an involuntary bankruptcy filing when other directors were disregarding their own fiduciary duties did not constitute bad faith warranting dismissal of the involuntary petition.[83]

Neither case stands for the proposition that blocking directors, let alone minority shareholders or LLC members seeking to exercise blocking rights, must as a matter of federal public policy be subject to fiduciary duties, or that any such rights are void if not exercised (or not expected to be exercised) subject to fiduciary duties. Further, neither case addressed a situation where otherwise applicable fiduciary duties had been validly eliminated under state law or articulated any guiding principles for such a situation, and neither suggests that blocking rights under such circumstances would be void.

More broadly, the notion that decision making on behalf of a business entity requires fiduciary duties is questionable. "A corporation typically delegates the board of directors authority to manage the business and affairs of the corporation. The authority does not originate with the board of directors but comes to it by corporate delegation, whether by default statutory provisions or

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the existence of a manager for the LLC or how that would affect the members' fiduciary duties. *See* M.C.L.A. § 450.4401 (LLC members have manager duties if the operating agreement does not provide for a manager).

[80] *Lake Mich. Beach*, 547 B.R. at 914. The *Lake Michigan* decision does not explain how the invalid attempt to absolve the creditor-member from any fiduciary duties rendered the blocking right provision unenforceable or void (under either of which the bankruptcy petition would have been filed with the requisite corporate authorization), rather than being enforceable but with fiduciary duties for the creditor-member, in which case the bankruptcy petition would not have been filed with the requisite corporate authorization.

[81] *Id.* at 913 (citing *In re Gen. Growth Props., Inc.*, 409 B.R. 43, 64 (Bankr. S.D.N.Y. 2009), *In re Kingston Square Assocs.*, 214 B.R. 713, 736 (Bankr. S.D.N.Y. 1997)).

[82] *Gen. Growth*, 409 B.R. at 64–65.

[83] *Kingston Square*, 214 B.R. at 734, 736.

corporate governance documents."[84] This principle is demonstrated by the many state statutes explicitly permitting such delegation without fiduciary duties.[85] Even in the context of the decision to file for bankruptcy, "[c]ases holding that the decision to file for bankruptcy rests with a corporation's board of directors focus on the delegation of authority, not the fact that the directors have fiduciary duties."[86]

The relationship between fiduciary duties and shareholders is even more attenuated. As a general matter, shareholders are free to act in their own self-interest without fiduciary duties of any kind, except for majority shareholders and minority controlling shareholders.[87] "The standard for minority control is a steep one. Potential control is not enough."[88] Prior Delaware cases have declined to find that a minority shareholder is transformed into a controlling shareholder with fiduciary duties merely as a result of such shareholder exercising its blocking rights.[89] The *Pace Industries* ruling runs

[84] *Squire Court Partners*, 574 B.R. at 707; *see also, e.g., Malone v. Brincat*, 722 A.2d 5, 9 (Del. 1998) ("An underlying premise for the imposition of fiduciary duties [on directors of a Delaware corporation] is a separation of legal control from beneficial ownership. Equitable principles act in those circumstances to protect the beneficiaries who are not in a position to protect themselves.").

[85] *E.g.*, 6 Del. C. § 18-1101(c) (DLLCA); 6 Del. C. § 17-1101(d) (DRULPA).

[86] *Squire Court Partners*, 574 B.R. at 707 (citing cases).

[87] *Ivanhoe Partners v. Newmont Min. Corp.*, 535 A.2d 1334, 1344 (Del. 1987) (stating that a "shareholder owes a fiduciary duty only if it owns a majority interest or exercises control over the business affairs of the corporation").

[88] *Franchise Servs.*, 891 F.3d at 211.

[89] *See In re Morgans Hotel Group Co. Stockholder Litig. Consol.,* No. 12433-VCL, 2017 Del. Ch. LEXIS 880 (Del. Ch. Oct. 24, 2017) (finding that a preferred shareholder that held blocking rights was not a controlling shareholder by virtue of exercising those rights); *Superior Vision Servs. v. ReliaStar Life Ins. Co.*, No. 1668-N, 2006 Del. Ch. LEXIS 160 (Del. Ch. Aug. 25, 2006) (indicating that a shareholder's exercise of a contractual right, which contractual right limits or restricts the actions that the corporation may take, is not sufficient to make the shareholder a controlling shareholder); *Thermopylae Capital Partners, L.P. v. Simbol, Inc.*, No. 10619-VCG, 2016 Del. Ch. LEXIS 15, at *45 (Del. Ch. Jan. 29, 2016) (stating that "[u]nder Delaware law . . . contractual rights held by a non-minority stockholder do not equate to control, even where the contractual rights are allegedly are exercised by the minority stockholder to further its goals."); *cf. Basho Techs. Holdco B, LLC v. Georgetown Basho Inv'rs, LLC*, No. 11802-VCL, 2018 Del. Ch. LEXIS 222 (Del. Ch. Jul. 6, 2018), *aff'd*, 221 A.3d 100 (Del. 2019) (finding that a minority shareholder may exercise actual control over a corporation). In *Basho*, the transaction involved a blocking right exercised by a preferred holder, which ultimately provided additional financing to the corporation and became a majority stockholder as a result of the acquisition of the additional equity interests by such shareholder in the financing. While the *Basho* decision involves a blocking right held by a preferred stockholder, the context was a transaction where the

counter to that orthodoxy, on reasoning that merely by exercising its blocking right the minority shareholder "controls" the corporation and thereby owes fiduciary duties to other shareholders. In contrast, the Fifth Circuit concluded that there was "no good legal or logical rationale" for the blocking right to be void as a matter of federal law without a concomitant fiduciary duty, or that Delaware law required any such duty.[90]

Similarly, the Supreme Court of Delaware has emphasized the freedom of creditors to bargain for their desired protections.[91] It is difficult to see how imposing fiduciary duties for obtaining such protections, either on creditors or on equity investors that may bargain for such protections with broad freedom explicitly provided for by statute, would be consistent with such freedom.

The court in *Superior Vision* noted that "there may be circumstances where the holding of contractual rights, coupled with a significant equity position and other factors, will support the finding that a particular shareholder is, indeed, a 'controlling shareholder,' especially if those contractual rights are used to induce or to coerce the board of directors to approve (or refrain from approving) certain actions."[92] While the *Pace Industries* ruling noted the debtors' financial constraints, the lack of viable alternatives offered by the minority shareholder, and the benefits of proceeding with the debtors' preferred course of action, it is not clear how these external factors operate to impose fiduciary duties without other action by the minority shareholder and the ruling does not provide guidance for evaluating when a minority shareholder may be deemed to have "control." As similar arguments may be made for many other corporate decisions and transactions, the risk of the *Pace Industries* ruling is that it supports the imposition of fiduciary duties or the outright invalidation of related consent rights in a broad range of circumstances even outside of bankruptcy.

While *Pace Industries* may have limited precedential impact as a bench ruling and as a decision concerning the fiduciary duties for a corporation rather than

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preferred stockholder effectively was (and maneuvered to be) on both sides of the transaction.

[90] *Franchise Servs.* at 209.

[91] *CML V, LLC v. Bax*, 28 A.3d 1037, 1046 (Del. 2011) (holding that the DLLCA does not by default permit creditors to pursue derivative claims against the LLC irrespective of solvency, observing that "[the creditor] could have negotiated its remedies by contract. It did not. Instead, it chose to lend on what later turned out to be unfavorable terms . . . . For example, [the creditor] could have negotiated for a provision that would convert its interests to that of an "assignee" in the event of insolvency. Or, it could have negotiated for a term that would give [the creditor] control of the LLC's governing body in such an event. These are but two examples.").

[92] *Superior Vision Servs.*, 2006 Del. Ch. LEXIS 160 at *20.

for an entity where fiduciary duties have been validly eliminated under state law,[93] its reasoning is potentially broadly applicable. Minority investors are left to wonder whether their specifically negotiated contractual rights will be enforceable and when they will be transformed into a "controlling shareholder."

Future Battlegrounds

Borrowers, lenders, investors, and partners will continue exploring the substantial flexibility provided by state statutes to implement organizational structures providing the desired risk and governance characteristics. As this occurs, parties will continue testing the ability to enforce consent rights and otherwise restrict voluntary bankruptcy filings, and courts will continue to develop and apply the competing policies at issue.

Any such attempts to implement effective blocking rights should begin with the valid elimination under state law of fiduciary obligations for the person to make or consent to the relevant decision. As directors or managers, such persons should be explicitly required to consider only the interests of the organization itself (and its creditors, if desirable for the investor under the circumstances) and not the interests of other members, parents/affiliates or guarantors in making the relevant decision. As an equity owner or member, such persons should have no greater burden and should be explicitly constrained further to the fullest extent permissible under state law.

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[93] In *Pace Industries*, the minority investor was seeking to exercise blocking rights in a Delaware corporation. Other business entity forms, particularly Delaware limited liability companies and limited partnerships, operate under a statutory policy "to give the maximum effect to the principle of freedom of contract and to the enforceability of limited liability company agreements." 6 Del. C. § 18-1101(b); 7 Del. C. § 17-1101(c) ("It is the policy of [DRULPA] to give maximum effect to the principle of freedom of contract and to the enforceability of partnership agreements."). Among other things, such entities are expressly empowered to eliminate fiduciary duties. 6 Del. C. § 18-1101(c) ("To the extent that, at law or in equity, a member or manager or other person has duties (including fiduciary duties) to a limited liability company or to another member or manager or to another person that is a party to or is otherwise bound by a limited liability company agreement, the member's or manager's or other person's duties may be expanded or restricted or eliminated by provisions in the limited liability company agreement; provided, that the limited liability company agreement may not eliminate the implied contractual covenant of good faith and fair dealing."); 6 Del. C. § 17-1101(d) ("To the extent that, at law or in equity, a partner or other person has duties (including fiduciary duties) to a limited partnership or to another partner or to another person that is a party to or is otherwise bound by a partnership agreement, the partner's or other person's duties may be expanded or restricted or eliminated by provisions in the partnership agreement; provided that the partnership agreement may not eliminate the implied contractual covenant of good faith and fair dealing.").

Decision Incentives & Remedies

Perhaps the most effective means of dissuading or at least protecting against the commencement of voluntary bankruptcy cases has been bad-boy or springing guaranties from key corporate decisionmakers or owners. Such guaranties have been attacked as impermissible influences over a corporate decisionmaker impeding the exercise of his or her fiduciary duties, using reasoning similar to that accepted by decisions invalidating blocking rights. However, courts have uniformly rejected such attacks.[94]

Parties should consider providing for similar consequences, either from other owners, principals or lenders, such that the blocking right is less likely to be violated and subsequently litigated.[95] For example, the secured lenders to the Pace Debtors who supported the proposed plan may have previously specifically

[94] *See, e.g.*, *F.D.I.C. v. Prince George Corp.*, 58 F.3d 1041, 1046 (4th Cir. 1995) (holding that a springing guaranty upon bankruptcy is not unenforceable as against public policy, "the [guaranty] did not prohibit [the guarantor] from resorting to bankruptcy" but merely provided for certain consequences upon various actions being taken); *Bank of Am. v. Lightstone Holdings, LLC*, 2011 N.Y. Misc. LEXIS 4412 (Sup. Ct. N.Y. Cty. 2011) (borrower principals liable on guaranty upon the borrower's bankruptcy filing); *UBS Commercial Mortg. Trust 2007-FL1 v. Garrison Special Opportunities Fund L.P.*, 2011 N.Y. Misc. LEXIS 4634 (Sup. Ct. N.Y. Cty. 2011) (same); *cf. In re Extended Stay Inc.*, 418 B.R. 49, 59 (Bankr. S.D.N.Y. 2009) (finding a lack of subject matter jurisdiction over the lender's springing guaranty claims against a principal of the debtor, which existed outside of and did not arise in the bankruptcy case and were not related to the bankruptcy case as the principal lacked offset or indemnity rights against the debtor with respect to the guaranty claim).

[95] The ability for a non-debtor to obtain damages for tort or breach of contract claims (as distinct from springing guaranty claims) raises federal preemption questions with diverging analyses and outcomes among the circuits, particularly in the absence of actual damages suffered prior to the occurrence of the bankruptcy. *In re Miles*, 430 F.3d 1083, 1091 (9th Cir. 2005) (affirming dismissal of state law tort claims brought by creditors against other creditors who had filed an involuntary bankruptcy case against the debtor, "we hold that 11 U.S.C. § 303(i) completely preempts state law tort actions for damages predicated upon the filing of an involuntary bankruptcy petition."); *NHL v. Moyes,* No. 10-01036 (GMS), 2015 U.S. Dist. LEXIS 153262 (D. Ariz. Nov. 12, 2015) (in relevant part, the NHL's state law tort claims against the prepetition owners of the Phoenix Coyotes for their pre-filing conduct leading to the bankruptcy were preempted by federal bankruptcy law and also did not result in actual damages prior to the filing, and the NHL's related contract claims against the owners were void, citing *Thorpe*, *Fallick*, and other individual debtor waiver cases); *In re Repository Techs., Inc.*, 601 F.3d 710, 723–24 (7th Cir. 2010) (holding that a creditor's state law claims against a debtor for abusive voluntary bankruptcy filing was not preempted by the Bankruptcy Code, declining to follow *Miles*); *Rosenberg v. DVI Receivables XVII, LLC*, 835 F.3d 414, 421–22 (3d Cir. 2016) (holding that state law tort claims by non-debtors against a creditor who had filed an involuntary bankruptcy case against a debtor were not preempted by Section 303(i) of the Bankruptcy Code, rejecting *Miles*).

consented to the amendments to the charter documents favoring Macquarie Septa, as such amendments occurred after the secured debt was incurred, and in other situations lenders could be lending into a situation with such charter document provisions already in place. When obtaining necessary consents for desired charter document amendments or when consent is being granted for other transactions, investors relying on blocking rights should seek to preserve or create direct claims against other parties and principals for inducing or participating in any violation of the consent right.

Forum Selection

Under the current state of affairs, the forum may be outcome determinative when litigating the validity of a voluntary commencement and consent rights. If forming or reforming the entity under the laws of a jurisdiction within the Fifth Circuit, or avoiding affiliates organized in potentially problematic jurisdictions, is not feasible or desirable, parties seeking to enforce consent rights may benefit from including a provision in the charter documents that requires any voluntary bankruptcy to be commenced in (or outside of) a specific venue, or that issues or disputes relating to that provision could be brought only in (or outside of) a specific venue. The provision could be drafted more broadly to encompass the affirmative assertion of any causes of action or the commencement of any judicial proceeding only in (or outside of) a specific venue, or with a consent right over the venue in which any judicial proceeding is commenced. Alternatively, such a provision could be drafted to refer all disputes relating to the exercise of a consent right to arbitration.[96]

While such provisions have yet to be tested in court, the validity of forum selection clauses in corporate organizational documents have recently been approved in a variety of other contexts.[97] The rationales supporting blocking rights, particularly freedom of contract, the internal affairs doctrine, and *Butner*, may be applicable to such provisions as well. Although debtors have broad rights to commence bankruptcy cases in a variety of venues under federal law and the authority for invalidating contractual agreements waiving bankruptcy rights may be argued to apply to a restrictive forum provision, a distinction could be drawn between waiving a right entirely and agreeing to exercise such right only in a specific venue.

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[96] *Cf. Henry Schein, Inc. v. Archer & White Sales, Inc.*, 139 S. Ct. 524, 202 L. Ed. 2d 480 (2019) (rejecting the "wholly groundless" exception to arbitrability).

[97] *Salzberg v. Sciabacucchi*, 227 A.3d 102 (Del. Ch. 2020) (federal forum selection bylaws and charter provisions for claims under the Securities Act of 1933 are facially valid under Delaware law); *Li v. LoanDepot.com*, LLC, C.A. No. 2019-0026-JTL, 2019 Del. Ch. LEXIS 139 (Del. Ch. Apr. 24, 2019) (upholding a forum selection clause in a DE LLC operating agreement requiring disputes relating to the operating agreement to be brought in Los Angeles).

Non-Bankruptcy Court Review

Whether a blocking right is valid under state or federal law or can be exercised without related fiduciary duties are questions that may arise and exist outside of the bankruptcy case. To date, bankruptcy courts have been less willing to uphold blocking rights than other courts and parties should proceed accordingly. In many cases, holders of consent rights will be able to commence and pursue a non-bankruptcy court action to enforce their rights or declare such rights to be valid before a voluntary case can be commenced or prepackaged plan negotiations or solicitations conclude. Once the bankruptcy case has commenced, investors may argue that such questions are merely "related to" the bankruptcy case, withhold consent from final adjudication by the bankruptcy court and seek a final judgment from the district court. In addition, a ruling on the validity of case commencement and related consent rights should be considered final and subject to appeal.[98]

CONCLUSION

Over the past several years, borrowers and their principals have been increasingly empowered at the expense of creditors. Among other things, recent decisions have reduced the ability of creditors to assert or establish fiduciary duty claims even after insolvency and have broadened the avoidance action safe harbors with preemption of related state laws. In addition, the low-rate environment, growth of private debt lenders and "dry powder" capacity have enabled borrowers to obtain EBITDA addbacks, covenant-lite loans and other favorable economic concessions. However, as investors become ever more diligent in protecting their collateral and governance rights from downside scenarios, we can expect that investors will continue to push for bankruptcy remoteness and the enforceability of consent rights.

The decisions applying the public policy to facilitate the voluntary access of business entities to bankruptcy have not identified limiting principles, particularly if fiduciary duties have been validly limited under state law or as among equity owners. A board supermajority consent requirement may be deemed an unreasonable restriction of the right to access bankruptcy, as might onerous requirements for advance notice of special meetings or for full disclosure of all relevant information concerning the options considered in addition to the

[98] *See Ritzen Group Inc. v. Jackson Masonry LLC*, 140 S. Ct. 582, 205 L. Ed. 2d 419 (2020) (holding that the adjudication of a motion may constitute a distinct procedural unit in the bankruptcy case yielding a final, appealable order); *In re Integrated Res., Inc.*, 3 F.3d 49, 53 (2d Cir. 1993) (to be final, a bankruptcy court order "must completely resolve all of the issues pertaining to a discrete claim, including issues as to the proper relief").

bankruptcy, or even the withholding of consent by a director or shareholder pending further negotiations or exploration of other options. Courts may find that holding a bright line on voluntary filings in accordance with the applicable charter documents and state law, even with a "disguised creditor" exception, may be a more attractive option than expanding the application of Bankruptcy Code policies to invalidate charter document restrictions.

Borrowers, lenders, investors, and partners will continue to explore the substantial flexibility provided by state statutes to develop organizational structures with the desired risk and governance characteristics for mutual benefit. Given the issues that remain unresolved after the *Pace Industries* ruling, we anticipate that courts will continue to be called upon to determine the validity of restrictions on the ability of companies to voluntarily commence a bankruptcy case and of borrower principals to orchestrate friendly involuntary bankruptcy cases.