ARTICLE: Coal Instead of Golden Shares: The Enforceability of Bankruptcy Filing Consent Rights

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Author: by Patrick J. Archambault and Marie A. MacCune *

* Patrick Archambault is a Senior Associate with Choate, Hall & Stewart LLP in Boston, Massachusetts, where he works in the firm's Finance and Restructuring practice. He is a 2016 cum laude graduate of Suffolk University Law School, where he served as Executive Editor of the Suffolk University Law Review. Marie MacCune is an incoming litigation Associate at Goodwin Procter LLP in Boston, Massachusetts, and currently a third-year law student at Suffolk University Law School where she serves as Executive Editor of the Suffolk University Law Review.

Highlight

"Even so long ago as 1912, the United States Supreme Court was forced to address parties attempting to circumvent the bankruptcy laws by 'circuity of arrangement.' Today's resourceful attorneys have continued that tradition."[1]

I. INTRODUCTION

When countries around the globe entered into lockdown to fight the novel coronavirus disease ("COVID-19"), the U.S. economy stalled, placing companies in severe economic distress.[2] With business operations ruthlessly disrupted across sectors and revenue streams upended, many companies faced sharp liquidity shortages.[3] Consequently, the number of chapter 11 bankruptcies filed in 2020 increased and are expected to continue increasing in future years because of the economic downturn caused by COVID-19.[4] As U.S.

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[1] *In re Intervention Energy Holdings LLC, 553 B.R. 258, 264 (Bankr. D. Del. 2016)*.

[2] *See* Michael J. de la Merced, *Experts Warn of a Gathering Storm of Corporate Bankruptcies*, N.Y. Times: Business (July 17, 2020), *https://www.nytimes.com/2020/07/17/business/experts-warn-of-a-gathering-storm-of-corporate-bankruptcies.html* (noting well-known companies like Hertz and Neiman Marcus were among those impacted).

[3] Aisha Al-Muslim, *U.S. Retail Store Closures Hit Record in First Half*, Wall St. J. (Sept. 29, 2020, 4:12 PM), https://www.wsj.com/articles/u-s-retail-bankruptcies-store-closures-hit-record-in-first-half-11601371800#::text=AIsha%20Al%2DMuslim,-Biography&text=retail%20store%20closings%20in%20the,report%20on%20the%20downturn's%20severity (describing the pandemic's impact on the retail landscape). Mandated government closures and social-distancing measures resulting from the pandemic compounded the impact of an already poor market for brick-and-mortar retail businesses. *See id.* Stores are facing excessive debt, high unemployment nationwide, and a significant change in shopper behavior as the world moves out of the office and into a work from home routine. *See id.*

[4] *See Bankruptcy Filings Fall 11.8 Percent for Year Ending June* 30, U.S. Courts (July 29, 2020), *https://www.uscourts.gov/news/2020/07/29/bankruptcy-filings-fall-118-percent-year-ending-june-30*. Through October 2020, the United States had seen nearly 6700 chapter 11 bankruptcies, compared to 6445 for the whole of 2019. *See* Statistics from Epiq, *October 2020 Bankruptcy Statistics - State and District*, Am. Bankr. Inst. (Oct. 2020), *https://abi-org-corp.s3.amazonaws.com/articles/aacer-oct-2020-nationwide-bankruptcy-filings-by-state-and-jurisdiction.xlsx*.

companies endure their worst earnings season since the Great Recession, well-advised investors constantly seek ways to structure their transactions with certain protections, both to minimize the risk of losing control over the decision to file for bankruptcy and to preserve the value of their investment in distressed scenarios.[5] One way to secure such protections is by obtaining a **[*3]** consent right to approve voluntary bankruptcy filings through "golden shares."[6]

A golden share refers to an equity interest in a company that affords the owner certain consent rights, including the right to block a company from filing for bankruptcy.[7] Typically, investors will seek an amendment to the company's organizational documents to obtain the blocking vote as a condition precedent to their investment.[8] Investors seeking a golden share can vary from the entity's lenders, which hold no economic or governance rights, to traditional private equity investors, which are not creditors but hold only an equity interest in the entity.[9]

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[5] *See* Patti Domm, *Market Heads into Worst Earnings Season in 12 Years Amid Worries Virus is Slowing Recovery*, CNBC (July 10, 2020, 1:51 PM), *https://www.cnbc.com/2020/07/10/market-heads-into-worst-earnings-season-in-12-years-amid-worries-virus-is-slowing-recovery.html* (projecting poor quarterly performance); *Bankruptcy: What Happens When Public Companies Go Bankrupt*, SEC: Investor Publ'ns (Feb. 3, 2009), *https://www.sec.gov/reportspubs/investor-publications/investorpubsbankrupt* htm.html [hereinafter SEC Investor Publication] (explaining the risk to investors when a company files bankruptcy); Cloe Pippin, *VIII. Bankruptcy Control Tools: Good News for Creditors, 38 Rev. Banking & Fin. L. 88, 88 (2018)* (describing the long history of creditors attempting to control an entity's authority to file for bankruptcy); Kathryn A. Coleman et al., *Blocking Use of "Blocking Rights"*, Am. Bankr. Inst. J., July 2020, at 30, 30 (noting investors always want to minimize risk); Theresa J. Pulley Radwan, *Who's Got A Golden Ticket? - Limiting Creditor Use of Golden Shares To Prevent A Bankruptcy Filing*, *83 Alb. L. Rev. 569, 575 (2020)* (noting that creditors try to minimize bankruptcy risk through a variety of methods); Bruce H. White & William L. Medford, *Ipso Facto Clauses and Reality: I Don't Care What the Documents Provide*, Am. Bankr. Inst. J., Apr. 2002, at 28, 52 (explaining that creditors look for alternate ways to avoid the consequences of bankruptcy). "Investors and creditors are always looking for ways to minimize the risk that the companies in which they invest will file a chapter 11 petition without investor consent." Coleman et al., *supra*, at 30 (2020). While some corporations may leave bankruptcy as a viable entity, generally the creditors and the bondholders become owners of the shares. *See* SEC Investor Publication, *supra* (noting that bankruptcy often results in cancellation of existing equity shares). Common stockholders are the last interested party paid by the bankruptcy plan. *See id.*

[6] *See The "Golden Share": All That Glitters is Not Gold*, Proskauer (May 18, 2020), *https://www.proskauer.com/alert/the-golden-share-all-that-glitters-is-not-gold* [hereinafter *All that Glitters*] (summarizing the general purpose of golden shares); *see also* Pippin, *supra* note 5, at 88 (noting that creditors often use golden shares to try to limit the risk of bankruptcy). Recently, more and more investors insist, "as a quid pro quo for its investment, that the company's certificate of incorporation be amended to give the investor the right to block a bankruptcy filing." Coleman et al., *supra* note 5, at 30.

[7] *See All that Glitters*, *supra* note 6; *see also* Franchise Servs. of N. Am., Inc. v. U.S. Trustee (*In re Franchise Servs. of N. Am.), 891 F.3d 198, 205 (5th Cir. 2018)* (giving a practical definition of "golden share"); Yiming Sun, Comment, *The Golden Share: Attaching Fiduciary Duties to Bankruptcy Veto Rights*, *87 U. Chicago L. Rev. 1109, 1119-20 (2020)* (describing golden shares). The unique characteristic of golden shares is that they provide their holders with decisive authority over certain corporate governance issues but do not give their holders a controlling stake in the entity. *See id.* at 1119 (highlighting the key difference between golden shares and common stock).

[8] *See* Coleman et al., *supra* note 5, at 30; *In re Franchise Servs., 891 F.3d at 202* (noting that the debtor amended its certificate of incorporation to award the investor preferred stock with a bankruptcy-consent right).

[9] *See e.g.*, *In re Franchise Servs., 891 F.3d at 203* (in which the investor was also an unsecured creditor by virtue of $ 3 million unpaid bill); *In re Intervention Energy Holdings, LLC, 553 B.R. 258, 264-65 (Bankr. D. Del. 2016)* (noting that the moving party held only nominal equity in the debtor and was primarily the debtor's creditor); Macquarie Septa (US) I, LLC's Motion For an Order Dismissing the Chapter 11 Cases of KPI Intermediate Holdings, Inc. and Its Direct and Indirect Subsidiaries at 15, *In re* Pace Indus., LLC, No. 20-10927 (MFW) (Bankr. D. Del. Apr. 17,

Courts are divided over whether golden shares are enforceable as a matter of federal public policy or under applicable state law.[10] In the most recent **[*4]** case, *In re Pace Industries, LLC* (" *In re Pace*"), the Delaware bankruptcy court refused to dismiss on the motion of a preferred equity holder, despite the fact that the movant possessed a bankruptcy-veto right and did not consent to the filing.[11] In so ruling, the court examined the parties' relationship, fiduciary duties, and federal public policy surrounding what the court purported to be debtors' constitutional right to seek bankruptcy relief, noting that "there is no case directly on point, holding that a blocking right by a shareholder who is not a creditor is void as contrary to [such] federal public policy."[12] However, given the facts, the judge in *In re Pace* was willing to be the first to do so.[13]

The *In re Pace* court denied the motion without a written opinion after issuing its ruling from the bench.[14] In her bench decision, the judge held, "The provision in the charter of one of the debtors that bars the filing by that debtor and all its subsidiaries I believe violates public policy and is void as it is exercised by a minority shareholder."[15] The court also found that "a blocking right, such as exercised in the circumstances of this case, would create a fiduciary duty on the part of the shareholder; a fiduciary duty that, with the debtor in the zone of insolvency, is owed not only to other shareholders, but to all creditors."[16]

The *In re Pace* decision disrupted a spectrum of developing case law on golden-share enforceability. On one side of the spectrum is a lender that acquires a single unit of equity with the right to exercise ultimate consent over a bankruptcy filing, which right courts typically refuse to enforce. On the other side of the spectrum is a bona fide investor that receives the consent **[*5]** right as an inducement for a capital

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2020) [hereinafter *In re Pace* Motion], ECF No. 88 (noting that the movant was an equity holder only, not a creditor of the debtor).

[10] *See e.g.*, *In re Franchise Servs., 891 F.3d at 207, 209* (discussing federal policy and bankruptcy-law implications); *In re Intervention Energy Holdings, 553 B.R. at 265-66* (finding void as against public policy the agreement to waive bankruptcy rights).

[11] *See* Order Denying Macquarie Septa (US) I, LLC's Motion for an Order Dismissing the Chapter 11 Cases of KPI Intermediate Holdings, Inc. and Its Direct and Indirect Subsidiaries at 1, *In Re* Pace Indus., LLC, No. 20-10927 (MFW) (Bankr. D. Del. May 11, 2020) [hereinafter *In re Pace* Order], ECF No. 173; Transcript of Telephonic Hearing on Macquarie Septa (US) I, LLC's Motion for an Order Dismissing the Chapter 11 Cases of KPI Immediate Holdings, Inc., and its Direct and Indirect Subsidiaries Before the Honorable Mary F. Walrath United States Bankruptcy Judge at 38-42, *In re* Pace Indus., LLC, No. 20-10927 (MFW) (Bankr. D. Del. May 6, 2020) [hereinafter *In re Pace* Transcript], ECF No. 148 (denying shareholder's motion to dismiss); *In re Pace* Motion, *supra* note 9, at 3 (noting the circumstances of the petition filings).

[12] *In re Pace* Transcript, *supra* note 11, at 38 (establishing new case law). This Article occasionally uses the term "purported" when courts articulate a debtor's so-called constitutional right to a bankruptcy filing because the Bankruptcy Clause of Article I merely grants the "power" to Congress to establish uniform laws on bankruptcy. *U.S Const. art. 1, § 8 cl. 4*. The text of the Constitution does not grant individuals a nonwaivable right to file: "The Congress shall have Power ... to establish an uniform Rule of Naturalization, and uniform Laws on the subject of Bankruptcies throughout the United States." *See infra* notes 36-39 and accompanying text (explaining the difference between authorization to create a bankruptcy system and a constitutional right to access such a system).

[13] *See In re Pace* Transcript, *supra* note 11, at 38.

[14] *Id.* at 38-42; *In re Pace* Order, *supra* note 11, at 1.

[15] *In re Pace* Transcript, *supra* note 11, at 39.

[16] *Id.* at 40-41.

contribution, which right initially seemed more likely to pass muster but, with *In re Pace*, is now subject to a split of authority.[17]

When a *lender* obtains the consent right, courts consistently have hesitated to validate the golden share.[18] In this context, lenders seek to preserve the value of a borrower's assets in a downside scenario and to maximize their collection efforts by avoiding the automatic stay triggered by a bankruptcy filing.[19] If lenders and borrowers negotiate a deal, particularly if they intend the terms to provide relief to a distressed company (e.g., to reset economic terms, extend a forbearance, or fund additional capital needs), lenders risk agreeing to the deal only to have the borrower toss it away later by seeking bankruptcy protection.[20] To offset this risk, such lenders have negotiated inclusion of golden shares directly into the borrower's organizational documents.[21] This approach was tested in *In re Intervention Energy Holdings, LLC*, in which the lender waived all of the borrower's existing events of default in exchange for receipt of a consent right for a bankruptcy filing through the issuance of a single common share.[22] Because, however, the lender's equity was merely nominal and its primary relationship to the borrower was as a creditor, the court ruled that the parties may not bypass the borrower's so-called constitutional right to seek bankruptcy relief, thus declaring the golden share unenforceable.[23]

[*6] When, however, an *investor* obtains the consent right, courts have suggested a more deferential approach to enforcing the golden shareholder's right to consent, particularly when the shareholder is a traditional equity investor.[24] Such investors are concerned that a bankruptcy filing could render their equity worthless as part of an ex parte pre-packaged reorganization plan.[25] The Fifth Circuit's decision in *In re*

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[17] *See* discussion *infra* Section II.B.2 (summarizing the history of golden-share cases and positing that courts' decisions fall on a spectrum based on the "type" of golden shareholder).

[18] *See* discussion *infra* Section II.B.2.A (discussing case law that involves lenders who were granted a golden share as a quid pro quo for a lending arrangement or for rearrangement of a preexisting lending agreement).

[19] *See* Radwan, *supra* note 5, at 569 (summarizing key components of the debtor's fresh start); *see also* 11 U.S.C.§§362 (providing for the automatic stay on the filing of a bankruptcy petition), 727 (providing for the discharge of most debts at the end of bankruptcy).

[20] *See* Sun, *supra* note 7, 1119-20 (describing typical scenarios for the use of golden shares). Golden shares can be used in a variety of scenarios to block a debtor's bankruptcy filing. *Id.* Such shares frequently are found in debt-workout agreements by which a creditor agrees to restructure its loan (often by waiving existing defaults), in exchange for which the debtor grants the creditor a bankruptcy-consent right by the issuance of shares to the creditor. *See id.* Such a quid pro quo arrangement also can be seen in agreements to extend loans or even when creditors decide to invest in the debtor. *Id.*

[21] *See* discussion *supra* notes 5-6 (describing why and how creditors use golden shares).

[22] *In re Intervention Energy Holdings, LLC, 553 B.R. 258, 260-61 (Bankr. D. Del. 2016)*. The single unit of common stock was issued to give effect to the negotiated-for consent agreement under which the debtor amended its governance agreement so that it could not file for bankruptcy without the consent from the common stockholders. *See id. at 261*. This consent agreement operated as a quid pro quo for the creditor's waiver of default on debt of more than $ 100 million. *See id.*

[23] *See id. at 265* (emphasizing the lender's primary relationship with debtor was that of creditor, not equity holder, and stating, "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. It is beyond cavil that a state cannot deny to an individual such a right. I agree with those courts that hold the same applies to a 'corporate' or business entity, in this case an LLC." (footnotes omitted)).

[24] Franchise Servs. of N. Am., Inc. v. U.S. Trustee (*In re Franchise Servs. of N. Am.), 891 F.3d 198, 214 (5th Cir. 2018)* (describing the golden shareholder's motion to dismiss as "meritorious").

[25] *See* Coleman et al., *supra* note 5, at 30 (explaining that investors seek blocking rights to protect their investment during bankruptcy); *see, e.g.*, Declaration of Craig Potter in Support of First Day Relief at 2, *In re* Pace Indus., LLC,

Franchise Services of North America provides a prime example of this end of the spectrum. There, a "substantial equity holder" that sought to dismiss the bankruptcy filing had invested $15 million to become the largest single shareholder of the debtor, acquiring with its ownership a bankruptcy-consent right.[26] The bankruptcy court held that a bankruptcy-consent right owned by a bona fide, preferred equity holder was valid, and the case was properly dismissed because the filing was not authorized in accordance with the debtor's organizational documents, no federal public policy invalidated the bankruptcy-consent right, and the investor was not a fiduciary of the debtor.[27] The Fifth Circuit agreed.[28] Thus, notwithstanding nearly identical facts, *In re Franchise Services* and *In re Pace* have created a split concerning whether a bona fide investor holds a bankruptcy veto.[29]

[*7] The substantive disagreements among the courts involve whether a creditor or bona fide investor holds the golden share, whether the consent holder owes any fiduciary duties to the debtor, and whether the federal public policy in favor of bankruptcy renders the consent right unenforceable.[30] Even when courts find that consent holders owe fiduciary duties, they are inconsistent in the construction of such duties, including whether minority golden shareholders exercise control sufficient to create a fiduciary duty.[31] Generally, courts recognize a federal policy that promotes access to bankruptcy so that they typically void commercial

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No. 20-10927 (MFW) (Bankr. D. Del. Apr. 12, 2020), ECF No. 4 (describing a debt-for-equity swap as part of a restructuring transaction).

[26] Memorandum Opinion at 26, *In re* Franchise Servs. of N. Am., Inc., No. 17-02316-ee (Bankr. S.D. Miss. Dec. 18, 2017) [hereinafter *In re Franchise Servs.* Mem. Op.], ECF No. 253; *see id.* at 4, 9 (reciting the facts and the consent provision); *see also In re Franchise Servs., 891 F.3d at 202-03* (describing the investment and case background). The debtor made an "ill-fated acquisition of a new subsidiary" and then filed for bankruptcy without putting the matter to a vote, likely fearing that its golden shareholder would withhold authority. *In re Franchise Servs., 891 F.3d at 202*. As a result, the shareholder moved for dismissal, arguing that the debtor lacked authority to file. *See id. at 202-03*. In response, the debtor argued that the golden shareholder was merely an unsecured creditor and had no right to block the bankruptcy filing regardless of the consent provision. *See id. at 203*.

[27] *See In re Franchise Servs.* Mem. Op. at 22, 26.

[28] *In re Franchise Servs., 891 F.3d at 203* (affirming the trial court's decision, stating that "federal law does not prevent a bona fide shareholder from exercising its right to vote against a bankruptcy petition just because it is also an unsecured creditor").

[29] *Compare In re Franchise Servs., 891 F.3d at 208-09* (affirming the court's dismissal of debtor's bankruptcy petition for failure to obtain consent from golden shareholders), *and In re Global Ship Sys., LLC, 391 B.R. 193, 203-04 (Bankr. S.D. Ga. 2007)* (finding that a substantial equity holder's exercise of a bankruptcy-consent right is not contrary to public policy), *and In re Lake Mich. Beach Pottawattamie Resort LLC, 547 B.R. 899, 911-12 (Bankr. N.D. Ill. 2016)* (holding that an entity that is both a creditor and equity holder can, by use of a "blocking director," withhold consent for bankruptcy), *with In re Intervention Energy Holdings, LLC, 553 B.R. 258, 264 (Bankr. D. Del. 2016)* (finding unenforceable the nominal equity holder's blocking right), *and In re Pace* Transcript, *supra* note 11, at 40 (finding the golden-share right unenforceable as violative of federal policy). State law typically governs issues of requisite authority. *See* Carter G. Bishop & Daniel S. Kleinberger, Limited Liability Companies: Tax And Business Law § 1.04 (2020) (noting that although bankruptcy law is handled by federal courts, state law governs whether an entity had proper authority to file based on its governing documents).

[30] *See In re Franchise Servs., 891 F.3d at 211-13* (discussing fiduciary duty issues); *In re Intervention Energy Holdings, 553 B.R. at 263-65* (discussing relevant federal public policy surrounding enforceability of golden shares by a nominal equity holder). Although the Constitution contains no express right to bankruptcy, some courts found a constitutional right to access bankruptcy. *See* discussion *infra* notes 36-39 (explaining the difference between the constitutional authorization to create a bankruptcy system and a constitutional right to access such a system).

[31] *Compare In re Franchise Servs., 891 F.3d at 211-13* (refusing to impose fiduciary duties on a minority golden shareholder because it did not exercise actual control over the debtor), *with In re Pace* Transcript, *supra* note 11, at 40-41 (finding that the golden shareholder had a fiduciary duty when the debtor was in the "zone of insolvency").

agreements that restrict a company's ability to file for bankruptcy protection.[32] Some courts, however, disagree on whether bankruptcy-consent rights violate federal public policy, finding limitations to the policy in the context of corporate governance.[33] After the Fifth Circuit's decision in *In re Franchise Services*, a bona fide equity investor might have felt safe to enforce a consent provision as a golden shareholder.[34] After *In re Pace*, however, prospective investors should take pause.

This Article critiques the decision in *In re Pace* in light of other bankruptcy precedent and commercial practice. Section II provides a brief history of how lenders and investors have sought to limit the risk of bankruptcy by controlling a debtor's decision to file for such relief. Section III analyzes the *In re Pace* decision, arguing that the court incorrectly interpreted Delaware law because the investors neither were controlling shareholders nor did they have actual control over the debtor. The Article also posits that no federal bankruptcy law prevents an equity holder from exercising voting rights over a bankruptcy filing.[35] Lastly, Section III highlights the implications of *In re* ***[*8]*** *Pace* and discusses structuring options for investors to minimize the risks of bankruptcy beyond including bankruptcy-consent rights in a debtor's governing documents.

II. A HISTORY OF INVESTORS AND LENDERS SEEKING TO CONTROL THE DECISION TO PETITION FOR BANKRUPTCY

The Constitution authorizes Congress to create a uniform system of bankruptcy law.[36] Some bankruptcy courts interpret the Bankruptcy Clause to imbue business entity debtors with a constitutional right to seek relief through bankruptcy.[37] A plain reading of the Constitution and the Supreme Court's holding in *United States v. Kras*,[38] however, indicates that no constitutional right exists for a business entity to access the bankruptcy process.[39]

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[32] *See In re Pace* Transcript, *supra* note 11, at 40 (stating that federal public policy supports an entity's right to file bankruptcy regardless of any blocking right); *see also In re Franchise Servs., 891 F.3d at 207, 209* (discussing federal policy and bankruptcy law implications); *In re Intervention Energy Holdings, 553 B.R. at 263* (calling "well settled" that an advance agreement to waive bankruptcy benefits is void as against public policy).

[33] *See* cases cited *supra* note 32 (highlighting opposing rulings on whether golden shares violate federal public policy).

[34] *See In re Franchise Servs., 891 F.3d at 203*.

[35] *See infra* Section III.

[36] *U.S. Const. art. 1, § 8, cl. 4* (authorizing Congress to pass uniform bankruptcy laws).

[37] *See, e.g.*, *In re Intervention Energy Holdings, LLC, 553 B.R. 258, 265 (Bankr. D. Del. 2016)* (highlighting the federal public policy centered on a constitutional right to bankruptcy); *In re Pace* Transcript, *supra* note 11, at 38; *see also What Are the Main Purposes of Bankruptcy?*, Am. Bankr. Inst. Bankr. Res. (Apr. 9, 2013, 5:32 PM), *http://bankruptcyresources.org/content/what-are-main-purposes-bankruptcy*.

[38] *409 U.S. 434, 446 (1973)* (holding that there is no constitutional right to a discharge in bankruptcy).

[39] *See U.S. Const. art. 1, § 8, cl. 4*; *see also* 2 Bankr. Service L. Ed. § 13:7 (Jan. 2021) (citing to cases concerning the constitutional right to bankruptcy); *In re Camden Ordnance Mfg. Co. of Arkansas, Inc. (In re Camden Ordnance Mfg. Co. of Ark., Inc.), 245 B.R. 794, 805 (E.D. Pa. 2000)* ("There is no constitutional right of access to federal bankruptcy court."); *In re Wolf, 390 B.R. 825, 834 (Bankr. D.S.C. 2008)* ("There is no constitutional right to bankruptcy relief."); Neary v. McKittrick (*In re McKittrick), 349 B.R. 569, 571 (Bankr. W.D. Wis. 2006)* ("In fact, there is no constitutional right to a discharge at all."). Some scholars have noted that the so-called constitutional right to file for bankruptcy protection is "the most flagrantly false of the myths." *See* Thomas G. Kelch & Michael K. Slattery, *The Mythology of Waivers of Bankruptcy Privileges*, *31 Ind. L. Rev. 897, 900 (1998)*. Further, "not only is there no constitutional right to file bankruptcy, but Congress need not even create a bankruptcy law. In fact, there was (with three short unsuccessful exceptions) no bankruptcy law for more than the first 100 years of our history." *Id*. The "fresh start" the

Bankruptcy's statutory scheme provides debtors with a fresh start through two primary mechanisms: the automatic stay and the discharge of debts.[40] The automatic stay, which temporarily blocks creditors' collection efforts, effectively grants the debtor a "breathing spell" while it evaluates and coordinates its financial affairs without the "ever-present threat of collection efforts."[41] At the end of the bankruptcy proceeding, the debtor is able to **[*9]** discharge remaining debt with few exceptions.[42] As a result, lenders often are wary of the specter of bankruptcy because the stay would prevent them from engaging in state-law collection actions and a discharge would deprive them of full repayment through liquidation of the debtor's assets.[43] Shareholders, too, are wary of bankruptcy because they would be the last to receive repayment and they risk that they will receive nothing.[44]

Under chapter 7 liquidation, a debtor's assets are distributed among three primary categories of stakeholders based on a gradual increase in risk: secured creditors, unsecured creditors, and stockholders.[45] Secured creditors are paid first.[46] Next, unsecured creditors receive distribution on a priority schedule established in the Bankruptcy Code.[47] Lastly, stockholders will receive nothing unless assets remain after the secured and

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Bankruptcy Code provides is merely a function of congressional policy, not a constitutional guarantee. *In re Lenartz, 263 B.R. 331, 341-42 (D. Idaho 2001)*.

[40] *See* Radwan, *supra* note 5, at 569 (summarizing key components of debtors' fresh start); *see also* *11 U.S.C.§§362* (providing for the automatic stay on the filing of a bankruptcy petition), 727 (providing for discharge of most debts at the end of bankruptcy).

[41] *See* Radwan, *supra* note 5, at 569 (providing a brief explanation of automatic stay); *see also* *11 U.S.C. § 362* (outlining the automatic stay's statutory requirements). "The automatic stay is one of the fundamental debtor protections provided by the bankruptcy laws. It gives the debtor a breathing spell from his creditors. It stops all collection efforts, all harassment, and all foreclosure actions. It permits the debtor to attempt a repayment or reorganization plan, or simply to be relieved of the financial pressures that drove him into bankruptcy." H.R. Rep. No. 595, at 339 (1977), 95th Cong., 1st Sess. 340, *as reprinted in* 1978 U.S.C.C.A.N. 5963, 6296-97. The automatic stay is not just a shield for debtors. *See id.* (describing benefits to creditors, including the provision of an orderly, single forum for equitable treatment of claims and that the automatic stay prevents creditors from being forced into a race to pursue state remedies against the debtor's property).

[42] *See* Radwan, *supra* note 5, at 569 (highlighting the benefit of the bankruptcy discharge); *11 U.S.C. § 727* (outlining statutory requirements for discharge). The bankruptcy discharge constitutes a permanent order that prevents creditors from initiating any collection action on discharged debts. *Discharge in Bankruptcy - Bankruptcy Basics*, United States Courts: Bankruptcy Basics [hereinafter *Discharge*], *https://www.uscourts.gov/services-forms/bankruptcy/bankruptcy-basics/discharge-bankruptcy-bank* ruptcy-basics, (last visited Feb. 12, 2021). Debt that is not discharged at the end of bankruptcy includes "valid liens (i.e., a charge upon specific property to secure payment of a debt) that has not been avoided (i.e., made unenforceable) in the bankruptcy case." *Discharge*, *supra*. Thus, secured creditors retain a right to enforce a lien after entry of a discharge order. *See id*.

[43] *See* Radwan, *supra* note 5, at 569 (noting how a fresh start for debtors causes concern for creditors).

[44] *See supra* note 5 and accompanying text (discussing reasons for shareholder concerns when an entity files a bankruptcy petition).

[45] *See* SEC Investor Publication, *supra* note 5 (discussing asset distribution in bankruptcy); *see also* Matt Lee, *What Happens to the Stock of a Company that Goes Bankrupt?*, Investopedia, *https://www.investopedia.com/ask/answers/06/bankruptpublicfirm.asp* (last updated Sept. 18, 2020).

[46] *See id.* Secured creditors are also in a better position relative to other stakeholders because their liens are not discharged at the conclusion of a bankruptcy case. *See supra* note 42.

[47] *See* Lee, *supra* note 45; *see also* ***11 U.S.C. § 507*** (outlining the priority scheme for unsecured claims in bankruptcy).

unsecured creditors' claims are paid in full.[48] When a debtor is deemed insolvent,[49] stockholders receive nothing in bankruptcy.[50]

An entity's bankruptcy petition is effective only on proof that the person filing possesses general or special authority to file the petition.[51] The entity for which a bankruptcy petition is filed or its creditors may challenge filing **[*10]** authority, or the ratification of an unauthorized petition, by a motion to dismiss for lack of personal jurisdiction.[52] Bankruptcy courts resolve requisite authority issues by reference to state law.[53] The default rule requires the vote of a simple quorum of the debtor's board to authorize the filing of a bankruptcy petition.[54] Bankruptcy courts must analyze an entity's governing documents to determine whether a petition was authorized under state law.[55] Because the Bankruptcy Code does not define who has authority to file a voluntary petition for an entity, an entity's governing documents may modify the default rule under state law.[56] Nevertheless, this right to contract is not limitless.[57] As explored below, courts are

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[48] *See* SEC Investor Publication, *supra* note 5 (noting that stockholders are the last to get paid).

[49] Insolvency occurs when a debtor's liabilities exceed the value of the debtor's assets. *See id.*

[50] *See id.* (noting the impact of entity insolvency on an equity owner's shares).

[51] *See* Bishop & Kleinberger, *supra* note 29, at § 1.04 (discussing the authority to file voluntary bankruptcy petitions). The Bankruptcy Code does not explicitly dictate "who may file a petition, who has authority to file such a petition, nor the consequences of an improper filing." *Id.* These issues have been left to the courts, often with reference to relevant state law. *See id.* Even when the person filing the petition lacked authority, the petition may still be ratified by the requisite authority. *See id.*

[52] *See id.* (explaining the common procedure for dismissing unauthorized petitions); *see e.g.*, *In re Pace* Motion, *supra* note 9, at 2 (requesting that the court dismiss the bankruptcy petition for lack of jurisdiction resulting from unauthorized filing); *Price v. Gurney, 324 U.S. 100, 106 (1945)* (holding that courts must dismiss petitions filed without proper authority); *Hager v. Gibson, 108 F.3d 35, 39 (4th Cir. 1997)* (relying on *Price* for the proposition that "the bankruptcy court does not acquire jurisdiction unless those purporting to act for the corporation have authority under local law 'to institute the proceedings'"); *In re Mid-South Bus. Assocs., LLC, 555 B.R. 565, 570 (Bankr. N.D. Miss. 2016)* (same).

[53] *See* Bishop & Kleinberger, *supra* note 29, at § 1.04 (explaining that bankruptcy courts look to local law to resolve issues of filing authority); *see also Price, 324 U.S. at 107* ("Nowhere is there any indication that Congress bestowed on the bankruptcy court jurisdiction to determine that those who in fact do not have the authority to speak for the corporation as a matter of local law are entitled to be given such authority and therefore should be empowered to file a petition on behalf of the corporation.").

[54] *See* Bishop & Kleinberger, *supra* note 29, at § 1.04 (stating the default rule for petition-filing authority). A quorum is the minimum acceptable level of stakeholders in a company needed to make the proceedings of a meeting valid under the governing document. *See* Adam Hayes, *Quorum*, Investopedia, https://www.investopedia.com/terms/q/quorum.asp#::text=A%20quorum%20is%20a%20minimum,or%20action%20can%20take%20place.&text=A%20quorum%20could%20be%20a,appropriate%20formula%20for%20their%20quorum (last updated Sept. 3, 2019) (providing an overview of quorums in the corporate governance context). The default rule, of course, can be modified by contract. *See supra* note 6 and accompanying text (discussing one way shareholders seek to control authority to file bankruptcy); *see also* Pippin, *supra* note 5, at 89-92 (describing creditors' attempts to control filing authority).

[55] *See* Bishop & Kleinberger, *supra* note 29, at § 1.04.

[56] *See id.* (describing bases of the right to modify filing authority and suggesting "that on the authority to file determination, state law should control" and such a "conclusion is consistent with the notion that the owners of an entity have the power and right to choose, by means of their constitutive documents, who has authority to file a voluntary petition on behalf of the entity").

[57] *See infra* Section II.A-C (discussing case law regarding contractual modifications of entities' right to file for bankruptcy).

hesitant to allow investors and lenders to restrain completely a debtor's ability to seek relief through the Bankruptcy Code.[58]

A. Bankruptcy Waivers

For nearly a century, lenders have sought contractual waivers of an entity's right to file for bankruptcy.[59] Having grappled with the issue for the same length of time, courts consistently have refused to enforce such *ipso* ***[*11]*** *facto*[60] clauses in agreements between borrowers and their lenders.[61] These clauses are so named because such a provision mandates that the filing of a bankruptcy petition terminates the agreement.[62] Courts generally infer the prohibition of *ipso facto* clauses from the Bankruptcy Code on grounds of public policy.[63] Notably, "even in the absence of a specific Bankruptcy Code provision invalidating a specific type of ipso facto clause, courts have extended the policy to invalidate other types of clauses that limit a debtor's rights upon a bankruptcy filing."[64]

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[58] *See id.*

[59] *See* Coleman et al., *supra* note 5, at 30 (noting the issue's long history in American bankruptcy caselaw); *see also* MBNA Am. Bank, N.A. v. Trans World Airlines, Inc. (*In re Trans World Airlines, Inc.), 275 B.R. 712, 723 (Bankr. D. Del. 2002)* ("Courts have held that pre-petition agreements purporting to interfere with a debtor's rights under the Bankruptcy Code are not enforceable.").

[60] *Ipso facto* is Latin for "by the fact itself." Bob Eisenbach, *Are "Termination On Bankruptcy" Contract Clauses Enforceable?*, Cooley: In the Red (Sept. 16, 2007), *https://bankruptcy.cooley.com/2007/09/articles/business-bankruptcy-issues/are-termination-on-bankruptcy-contract-clauses-enforceable/*.

[61] Sun, *supra* note 7, at 1113 (noting such agreements "unenforceable as an ipso facto clause"); Radwan, *supra* note 5, at 576 & n.65 (explaining that the Bankruptcy Code impliedly disapproves of *ipso facto* clauses); R. Stephen McNeill & Eric D. Torres, *Loyalty to the Bar: An Analysis of Corporate Charter Bankruptcy Blocking Provisions*, 29 No. 2 Norton J. of Bankr. L. & Prac. Art. 3 § I (Apr. 2020) (recognizing that courts prohibit creditors from negotiating a right to block debtors from seeking bankruptcy protection); *see also* Michael J. Di Gennaro & Harley J. Goldstein, *Can Ipso Facto Clauses Resolve the Discharge Debate?: An Economic Approach to Novated Fraud Debt in Bankruptcy*, 1 DePaul Bus. & Com. L.J. 417, 419 (2003). Generally, courts will not enforce these types of prepetition agreements waiving rights because "'before the bankruptcy case is filed, the debtor does not have the capacity to waive the rights bestowed by the Bankruptcy Code.'" Coleman et al., *supra* note 5, at 31 (quoting *In re Pease, 195 B.R. 431, 433 (Bankr. D. Neb. 1996))*; *see also* Mikel R. Bistrow, *Waiver of Bankruptcy Protections in Pre-Bankruptcy Workout Agreements*, 8 Loyola Consumer L. Rev. 291, 292 (1996); Thomas H. Jackson, *Bankruptcy, Non-Bankruptcy Entitlements, and the Creditors' Bargain*, 91 Yale L.J. 857, 887-92 (1982).

[62] *See* Di Gennaro & Goldstein, *supra* note 61, at 435.

[63] *See* Radwan, *supra* note 5, at 576 & n.65; *see also* ***11 U.S.C.§§365(b)(2)*** (invalidating *ipso facto* clauses), 522(e) (stating that exemptions and certain avoidance-power waivers unenforceable); 524(c), (d) (providing detailed requirements to waive dischargeability rights through reaffirmation), 541(c) (nullifying *ipso facto* clauses affecting property of the estate), 1307(a), (b) (voiding dismissal waivers and waiver of any right to convert a case to chapter 7). The policy behind holding *ipso facto* clauses unenforceable in bankruptcy is largely to prevent any automatic distribution of a debtor's interest in property because of a bankruptcy filing so that the value of the bankruptcy estate is preserved for creditors. Radwan, *supra* note 5, at 576 n.64 (quoting 1 Nat'l Bankr. Rev. Comm'n, Bankruptcy: The Next Twenty Years 432 (1997)).

[64] *Id. at 576* (explaining that courts find ways to invalidate waivers although no explicit prohibition exists in the Bankruptcy Code); *see also* Bank of China v. Huang (*In re Huang), 275 F.3d 1173, 1177 (9th Cir. 2002)* (holding such waivers contrary to public policy); *United States v. Royal Bus. Funds Corp., 724 F.2d 12, 15 (2d Cir. 1983)* (recognizing "the general rule[ ] that a debtor may not agree to waive the right to file a bankruptcy petition"). Courts have justified these decisions as protecting the collective interests of all creditors involved with the debtor. *See* Sun, *supra* note 7, at 1115 (discussing the reasoning behind refusing to enforce individual bankruptcy waivers). One of the main purposes of bankruptcy law is to provide an organized and equitable process through which all a debtor's creditors can pursue their claims. *See* Sun, *supra* note 7, at 1114-16 (providing background information on the

B. Golden Shares

1. Contrasted with Bankruptcy Waivers

In response to courts' consistent refusal to enforce bankruptcy waivers, golden shares have become a popular alternative method of controlling the risk of bankruptcy.[65] In contrast to bankruptcy waivers, which outright prohibit an entity from filing a bankruptcy petition, golden shares merely require the debtor to obtain the shareholder's consent before filing.[66] The investor acquires this right in conjunction with a provision in the entity's governance documents that often mandates the unanimous approval of a specified class of (or, sometimes, all) shareholders to file a bankruptcy case.[67] The utility of golden shares is grounded in the idea that courts lack jurisdiction over bankruptcy cases initiated by parties who do not have authority to file.[68] Thus, golden-share investors do not need a prebankruptcy agreement with a bankruptcy waiver; instead, they can block the bankruptcy by seeking dismissal for lack of jurisdiction if the debtor files a petition without the golden shareholders' approval.[69]

2. Case Law Has Created a Spectrum of Enforceability of Golden Shares

The spectrum of bankruptcy court rulings over the validity of such golden-share consent rights ranges from creditors that hold nominal shares to bona fide investors.[70] Courts appear to be much more reluctant to enforce bankruptcy blocks baked into governing documents in favor of lenders than golden-share rights that

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"common pool" problem). This is because without a single forum or set of procedural rules, creditors would "deplete the resource [-the debtor's remaining equity -] for their individual self-interest, even though a restraint on usage would benefit all the owners in the long run." *See id.* at 1114. "As one bankruptcy court put it, 'since bankruptcy is designed to produce a system of reorganization and distribution different from [that] under nonbankruptcy 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.'" *Id.* at 1116 (alteration in original) (quoting Bank of Am. V. N. LaSalle St. Ltd. P'ship (*In re 203 N LaSalle St. P'ship), 246 B.R. 325, 331 (Bankr. N.D. Ill. 2000)*).

[65] *See* Coleman et al., *supra* note 5, at 30; *see also* Radwan, *supra* note 5, at 576-77 (explaining that creditors have had to find alternative mechanisms to control bankruptcy risk in the face of the unenforceability of bankruptcy waivers); Pippin, *supra* note 5, at 90 (highlighting creditors' attempts to find workarounds to general bankruptcy-waiver bans). This method has proven much more difficult for courts to handle than the typical outright ban on filing contained in a bankruptcy waiver. *See id.* Initially, golden shares were popularized in the 1980s as state-owned corporations in the United Kingdom were privatized. *See* Sun, *supra* note 7, at 1119.

[66] *See supra* text accompanying notes 7 (defining golden shares) and 59-61 (describing bankruptcy waivers).

[67] *See* Radwan, *supra* note 5, at 583 (explaining the basic components of golden shares).

[68] *See* Sun, *supra* note 7, at 1118-19 (providing a general overview of interplay between golden shares and authority to file); *see also supra* note 52 and accompanying text (discussing motions to dismiss for lack of jurisdiction when proper authority for the petition is lacking). Bankruptcy courts must resolve requisite authority issues by reference to state law. *See* Bishop & Kleinberger, *supra* note 29, at § 1.04 (explaining that bankruptcy courts look to local law to resolve issues of filing authority and that bankruptcy courts have no power under the Code to disregard relevant state law).

[69] *See e.g.*, Franchise Servs. of N. Am., Inc. v. U.S. Trustee (*In re Franchise Servs. of N. Am.), 891 F.3d 198, 202-03 (5th Cir. 2018)* (noting that the investor moved to dismiss after the debtor failed to call a vote or obtain written consent from the golden shareholder).

[70] *See* discussion *supra* Section II.B.2.

preclude bankruptcy filings absent preapproval by **[*13]** shareholders.[71] Although the Fifth Circuit is the only appellate court to rule on the efficacy of golden shares held by a minority investor, courts generally accept the consent right when it is exercised by majority shareholders.[72]

a. Lenders

Courts typically strike golden shares when held by lenders.[73] In *In re Lake Michigan Beach Pottawattamie Resort LLC*, the debtor granted a first-priority lien on all of its assets in favor of BCL-Bridge Funding LLC ("BCL") when BCL provided senior secured financing to the debtor in the amount of $ 1.8 million.[74] The debtor defaulted and, in exchange for BCL's agreement to forbear pursuing collection remedies, the debtor stipulated to a monetary default and amended its operating agreement to establish BCL as the fifth member of the debtor, with the right to approve or disapprove any "material action" by the debtor, including the decision to file bankruptcy.[75] The amendment further provided that BCL "shall be entitled to consider *only* such interests and factors as it desires, including its own interests, and shall to the fullest extent permitted by applicable law, have no duty or obligation to give any consideration to any interest of or factors affecting the Company or the Members."[76] When the debtor filed for bankruptcy without obtaining BCL's approval, BCL moved to dismiss on a number of grounds, including that debtor's petition was unauthorized.[77] The bankruptcy court noted that bankruptcy law is clear that corporate formalities and state corporate law must be satisfied when commencing a bankruptcy petition.[78] Nonetheless, because the governing documents relieved BCL of any fiduciary duty to the debtor, the court invalidated the provision in the debtor's governing documents that clearly gave BCL a bankruptcy-consent right.[79] The court denied the motion **[*14]** to dismiss, finding that such a limitation of BCL's fiduciary duties violated both Michigan and bankruptcy law.[80]

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[71] *See, e.g.*, *In re Intervention Energy Holdings, LLC, 553 B.R. 258, 265 (Bankr. D. Del. 2016)* (emphasizing the lender's primary relationship with debtor was that of creditor instead of equity holder).

[72] *See, e.g.*, Squire Ct. Partners Ltd. P'ship v. Centerline Credit Enhanced Partners LP Series J (*In re Squire Ct. Partners Ltd. P'ship., 574 B.R. 701, 708 (E.D. Ark. 2017)* (enforcing bankruptcy-consent right held by limited partners).

[73] *See, e.g.*, *In re Intervention Energy Holdings, 553 B.R. at 265*; *In re Lexington Hosp. Grp.,, LLC, 577 B.R. 676, 683 (Bankr. E.D. Ky. 2017)*; *In re Lake Mich. Beach Pottawattamie Resort LLC, 547 B.R. 899, 911-14 (Bankr. N.D. Ill. 2016)*.

[74] *In re Lake Mich. Beach Pottawattamie Resort, 547 B.R. at 903* (describing the original mortgage agreement between the debtor and BCL, which involved a mortgage and assignment of rents to secure a $ 1,336,000.00 loan and $ 500,000.00 line of credit).

[75] *Id. at 903-04* (outlining the details surrounding the creation of the golden share). Notably, BCL had no interest in the profits or losses of the debtor and no right to distributions or tax consequences and was not required to make capital contributions to the debtor. *See id.* (highlighting the limited capacity of the "special member" role awarded to BCL by the new credit agreement).

[76] *Id. at 914*.

[77] *Id. at 909*. BCL also argued that debtor filed its petition in bad faith. *Id. at 905*.

[78] *See id. at 912* (analyzing relevant considerations in determinations about petition-filing authority).

[79] *Id. at 913-14*. As a special member, BCL, by the express terms of the governing document, owed no duties to the debtor, despite otherwise being one of its members. *See id. at 914*.

[80] *Id.* As a member of a Michigan limited liability company, BCL was required to consider the interests of the debtor. *Id.* (citing *Mich. Comp. Laws Ann. § 450.4404*). Bankruptcy-consent rights, however, can provide an enforceable workaround to the general bankruptcy prohibition against bankruptcy-right waivers. *See id. at 12* (explaining how a

Likewise, in *In re Lexington Hospitality Group, LLC*, creditor PCG Credit Partners, LLC ("PCG") moved to dismiss a bankruptcy petition filed by the debtor's manager for lack of proper filing authority.[81] Years prior, PCG had provided the financing for one of the debtor's hotel acquisitions. [82]Contemporaneously with the initial financing, a subsidiary of PCG was issued a thirty percent membership interest in the debtor "'in exchange for, among other things' financing that PCG provided for the acquisition of the hotel."[83] Under the amendments, the debtor could not file for bankruptcy absent affirmative votes from seventy-five percent of the members.[84] Because PCG owned a thirty-percent membership interest, the debtor could not file a bankruptcy petition without PCG's consent.[85] The court denied PCG's motion to dismiss, finding that the governing documents had the effect of prohibiting a bankruptcy filing so that they were void as contrary to federal public policy.[86] The court stated: "A contract term imposed *by a creditor* that prohibits a bankruptcy filing is void as contrary to federal public policy."[87]

Similarly, in *In re Intervention Energy Holdings, LLC*, the creditor, EIG Energy Fund XV-A, L.P. ("EIG"), waived all of the borrower's existing events of default in exchange for a bankruptcy-consent right through the issuance of a single common unit.[88] This single unit gave effect to the negotiated-for consent agreement under which the debtor amended its limited liability agreement so that it could not seek bankruptcy protection without consent from the common stockholders.[89] When the debtor filed for bankruptcy without such consent, EIG moved to dismiss.[90] The court emphasized that "the **[*15]** 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."[91] Because the single unit of common stock made EIG only a nominal equity holder and its primary relationship to the borrower remained that of creditor, the court invalidated the golden-share right, finding the arrangement to be tantamount to a bankruptcy waiver, which the court noted clearly is void as against federal public policy.[92]

b. Minority Equity Holders

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blocking director who possesses and adheres to the general fiduciary duties owing to the debtor complies with the law).

[81] *See 577 B.R. 676, 682 (Bankr. E.D. Ky. 2017)*.

[82] *See id. at 679*. The original loan totaled $ 6.15 million. *Id.*

[83] *Id*. (citation omitted).

[84] *Id. at 680*.

[85] *See id. at 680-81*. PCG also negotiated for additional protections against bankruptcy, including an addendum to the agreement that "provided that [the debtor] shall not file bankruptcy 'without the advance, written affirmative vote of [PCG] and all members of the Company.'" *Id.*

[86] *Id. at 683* (emphasizing the strong federal public policy favoring individuals' and entities' right to a fresh start under the Bankruptcy Code). The court did note that members are free to "agree among themselves not to file bankruptcy" but found that PCG had negotiated consent rights as a creditor, not as a member. *Id. at 684-85*.

[87] *Id. at 683* (emphasis added).

[88] *553 B.R. 258, 260-62 (Bankr. D. Del. 2016)*.

[89] *See id. at 261*.

[90] *See id.*

[91] *Id. at 265* (footnote omitted).

[92] *See id.*

In contrast to the courts that invalidated golden-share provisions of lenders who were nominal shareholders, the Fifth Circuit has upheld bankruptcy-consent rights of a bona fide minority equity investor.[93] In *Franchise Services of North America, Inc. v. U.S. Trustee (In re Franchise Services of North America, Inc.)*, an investor had contributed $ 15 million in preferred equity to the debtor.[94] The preferred equity equated to just under fifty percent of the debtor's common stock.[95] The arrangement also entitled the investor to certain management fees in connection with the transaction.[96] As a condition to the investment, the company amended its certificate of incorporation to provide that it could not initiate a "Liquidation Event," defined to include a bankruptcy filing, without consent of the holders of a majority of both its preferred and common stock.[97]

When the debtor filed a chapter 11 petition, it did not obtain the consent of a majority of its preferred and common stockholders, nor had it fully paid the management fees at the time of the filing.[98] The investor moved to dismiss the bankruptcy case, arguing that the petition was filed without proper authorization.[99] Finding that the investor was an owner, rather than a creditor, of the debtor, the court ruled that the bankruptcy-block right was not contrary to federal bankruptcy policy.[100] Therefore, the court dismissed the case.[101]

[*16] The Fifth Circuit affirmed on direct appeal.[102] The debtor unsuccessfully argued that even if Delaware law permitted the bankruptcy veto, such a provision should still be void because it would violate the public policy against waiving bankruptcy protections under federal law.[103] The appellate court disagreed, finding that "there is no prohibition in federal bankruptcy law against granting a preferred shareholder the right to prevent a voluntary bankruptcy filing just because the shareholder also happens to be an unsecured creditor by virtue of an unpaid consulting bill."[104]

The debtor also unsuccessfully argued that even if the law permits a shareholder-creditor to hold a bankruptcy block, the court should invalidate that right because the investor owes a fiduciary duty to the company.[105] However, the court rejected the argument, noting that no precedent allowed the court to "deprive a bona fide shareholder of its voting rights[ ] and reallocate corporate authority to file for bankruptcy."[106] Because the debtor failed to show that the investor was a controlling minority shareholder

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[93] Franchise Servs. of N. Am., Inc. v. U.S. Trustee (*In re Franchise Servs. of N. Am.), 891 F.3d 198 (5th Cir. 2018)*.

[94] *See id. at 202*. Through this investment, the investor received 100% of the debtor's preferred stock. *Id.*

[95] *Id. at 203*.

[96] *Id. at 203-04* (noting that the outstanding bill was subject to ongoing litigation in other forums).

[97] *Id. at 203*.

[98] *Id. at 203-04*.

[99] *See id. at 204*.

[100] *Id. at 214*.

[101] *See id.*

[102] *See id.*

[103] *See id. at 207*.

[104] *Id. at 208*.

[105] *Id. at 209*. The court distinguished between a creditor and a bona fide shareholder, "A different result might be warranted if a creditor with no stake in the company held the right. So too might a different result be warranted if there were evidence that a creditor took an equity stake simply as a ruse to guarantee a debt. We leave those questions for another day." *Id.*

[106] *Id.*

- the only circumstance under which a minority shareholder would owe fiduciary duties to an entity - the Fifth Circuit found that the investor owed no fiduciary duty to the debtor: "What matters is the dominating shareholder's *actual* exercise of control, not just the theoretical possibility that it might do so."[107]

c. Majority Equity Holders

Not surprisingly, courts are most deferential to the consent rights of majority equity holders.[108] One example is *Squire Court Partners Limited Partnership v. Centerline Credit Enhanced Partners LP Series J (In re Squire Court Partners Limited Partnership)*, [109] in which the court examined the enforceability of golden shares held by majority equity owners of the limited partnership that filed a bankruptcy petition. The general partner, NHDC, owned a .01% interest, and the limited partners owned .01% and 99.8% interests, respectively.[110]

After the partnership failed to pay its mortgage obligations and the lender **[*17]** accelerated its loan, NHDC unilaterally filed a bankruptcy petition for the partnership against the wishes of its limited partners.[111] The limited partners moved to dismiss the bankruptcy petition because NHDC failed to get their consent, in direct violation of the partnership agreement.[112] On appeal from the bankruptcy court, the district court found the limited partners to be bona fide equity owners and affirmed the bankruptcy court's dismissal of the bankruptcy case.[113] The court reasoned, "It is one thing for the courts to overrule a creditor that seeks to block a debtor from filing bankruptcy; it is quite another for the courts to overrule the owners of the entity."[114]

3. Fiduciary Duties

Courts inconsistently construe the fiduciary duties of golden shareholders, often finding that none exist.[115] First, bankruptcy courts are split on whether golden shareholders qualify as controlling minority shareholders, as minority shareholders generally owe no fiduciary duty to the entity.[116] When, however, a

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[107] *Id. at 213*; *see also* Michelle M. Harner & Jamie Marincic, *The Naked Fiduciary*, *54 Ariz. L. Rev. 879, 891-93 (2012)* (summarizing the fiduciary duties of LLC members).

[108] *Compare In re Squire Ct. Partners Ltd. P'ship v. Centerline Credit Enhanced Partners LP Series J (In re Squire Ct. Partners Ltd. P'ship., 574 B.R. 701, 707-08 (E.D. Ark. 2017)* (concerning majority equity owners), *with In re Franchise Servs., 891 F.3d at 207* (describing bankruptcy waivers held by creditors).

[109] *574 B.R. 701 (E.D. Ark. 2017)*.

[110] *See id. at 704*.

[111] *Id. at 703*.

[112] *Id. at 705*. An amended partnership agreement gave NHDC "exclusive authority to manage and control Squire Court's business, assets, and affairs." *See id. at 704*. Nevertheless, the amended agreement required unanimous consent of Squire Court's partners before it could "'file a petition seeking, or consent to, reorganization or relief under any applicable federal or state law relating to bankruptcy.'" *Id.*

[113] *Id. at 709*.

[114] *Id. at 708*.

[115] *Compare* Franchise Servs. of N. Am., Inc. v. U.S. Trustee (*In re Franchise Servs. of N. Am.), 891 F.3d 198, 211-13 (5th Cir. 2018)* (refusing to impose fiduciary duties on a minority golden shareholder because it did not exercise actual control over debtor), *with In re Pace* Transcript, *supra* note 11, at 40-41 (finding that a golden shareholder has a fiduciary duty when the debtor is in the "zone of insolvency").

[116] *See* discussion *supra* note 31 and accompanying text; *see also In re Franchise Servs., 891 F.3d at 211* (noting that minority shareholders do not owe a duty to anyone but themselves under Delaware law); *Ivanhoe Partners v. Newmont Mining Corp., 535 A.2d 1334, 1344 (Del. 1987)* ("It is well established that nothing precludes ... [a]

minority shareholder exercises actual control over the entity, courts impose a fiduciary duty.[117] Thus, whether golden shareholders owe a fiduciary duty depends on whether the golden share allows its holder to exert the kind of control and managerial power that triggers a fiduciary duty under state business-entity law.[118] Applying this analysis, the Fifth Circuit **[*18]** has refused to impose fiduciary duties on minority golden shareholders, reasoning that a bankruptcy-consent right does not give actual control over the debtor.[119] In contrast, a Delaware bankruptcy court found that a bankruptcy-consent right of golden shareholders constitutes control sufficient to create a fiduciary duty as soon as the entity enters the zone of insolvency.[120]

Other courts have addressed fiduciary duties outside of the minority-control issue, looking to other principles under state law or public policy. For example, a Michigan court held unenforceable a bankruptcy-blocking right because the golden-share agreement waived the general fiduciary duty held by LLC members under Michigan law.[121] Meanwhile, a Kentucky court refused to enforce the creditor-LLC member's bankruptcy-blocking provision because the governing documents eliminated the member's fiduciary duties so that the golden-share agreement amounted to a bankruptcy waiver, which is improper.[122]

4. Federal Public Policy

When examining the validity of golden shares, courts have grappled with whether enforcement of a consent right violates federal public policy that promotes the use of bankruptcy.[123] Historically, courts have been

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stockholder from acting in its own self-interest."); Douglas G. Baird and M. Todd Henderson, *Other People's Money*, *60 Stan. L. Rev. 1309, 1327-28 (2008)* (advocating for a "relatively forgiving business judgment rule").

[117] *See In re Franchise Servs., 891 F.3d at 211* ("The standard for minority control is a steep one. Potential control is not enough."). The minority shareholder exercises "actual control" only when its voting and managerial power is so formidable that, "as a practical matter, [the minority shareholder] is no differently situated than if [it] had majority voting control." *Id.* (last alteration in original) (quoting *In re* PNB Holding Co. S'holders Litig., No. CIV.A.28-N, 2006 WL 2403999, at 9 (Del. Ch. Aug. 18, 2006)); *see also Kahn v. Lynch Commc'n Sys., Inc., 638 A.2d 1110, 1113-14 (Del. 1994)* ("[A] shareholder owes a fiduciary duty only if it owns a majority interest in or exercises control over the business affairs of the corporation." (quoting *Ivanhoe Partners, 535 A.2d at 1344*)); *see also Lewis v. Knutson, 699 F.2d 230, 235 (5th Cir. 1983)* (applying Delaware law regarding shareholders' fiduciary duties).

[118] *See In re Franchise Servs., 891 F.3d at 211* (explaining the "actual control" test).

[119] *Id. at 211-13* (explaining that the ability to *potentially* control the filing of a bankruptcy petition through the consent right is different than *actually* controlling that decision and reasoning that the golden shareholder clearly had not exercised control of the decision, given that it had filed a motion to dismiss when the bankruptcy petition was filed without obtaining the shareholder's consent).

[120] *See In re Pace* Transcript, *supra* note 11, at 40-41 (finding that golden shareholders owe a fiduciary duty to debtors in the "zone of insolvency").

[121] *See In re Lake Mich. Beach Pottawattamie Resort LLC, 547 B.R. 899, 913-14 (Bankr. N.D. Ill. 2016)* (explaining the court's disposition and indicating that adherence to fiduciary duties is required for enforceability)); *see also* discussion *supra* notes 74-80 and accompanying text.

[122] *See In re Lexington Hosp. Grp., LLC, 577 B.R. 676, 685-86 (Bankr. E.D. Ky. 2017)*; *see* discussion *supra* notes 81-87 and accompanying text.

[123] *See e.g.*, *In re Pace* Transcript, *supra* note 11, at 40 (finding that federal public policy supports an entity's right to file bankruptcy regardless of who invokes a blocking right); *see also In re Franchise Servs., 891 F.3d at 207, 209* (discussing federal policy and bankruptcy law implications); *In re Intervention Energy Holdings, LLC, 553 B.R. 258, 263 (Bankr. D. Del. 2016)* (finding void as against public policy an advance agreement to waive bankruptcy benefits). Notably, some courts have found that this federal public policy arises from a debtor's purported constitutional right to access bankruptcy. *See supra* notes 36-39.

reluctant to enforce contractual limits on an entity's access to the bankruptcy process.[124] As creative attorneys invent ways around the established prohibition on bankruptcy waivers, courts increasingly find that golden-share rights do not violate public policy.[125] When a court considers the golden shareholder **[*19]** to be a bona fide equity owner, they seem more likely to enforce bankruptcy-consent rights.[126] The Fifth Circuit's decision in *In re Franchise Services*, allowing a bona fide equity owner to enforce the bankruptcy-consent right, illustrates the principle.[127] Courts, however, will invalidate golden-share rights as against public policy when they perceive that the golden shareholder is not a bona fide equity owner, either because their ownership is nominal or because they primarily are a creditor, not owner, of the debtor.[128]

C. Enter In re Pace

After the Fifth Circuit's decision in *In re Franchise Services*, it seemed likely that courts would analyze golden shareholder provisions along a spectrum to allow enforcement of bankruptcy-consent rights depending on the sufficiency of equity ownership. The Delaware bankruptcy court's decision in *In re Pace* likely has disrupted the spectrum.

In 2018, Macquarie[129] Septa and its affiliate, Macquarie Sierra Investment Holdings Inc., (collectively, the "Macquarie Investors") purchased a combined 350 shares of Series A Preferred Stock issued by KPI Intermediate for $ 37.15 million.[130] As a condition of the deal, the Macquarie Investors required KPI to amend and restate its certificate of incorporation (the "A&R Certificate") to provide that any voluntary bankruptcy filing "shall require the written consent or affirmative vote of the holders of a majority in interest of the Series A Preferred Stock, and any such action taken without such consent or vote shall be null and void *ab initio*, and of no force or effect."[131] Approximately two years later, the directors of KPI and its

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[124] *See supra* Section II.A (discussing unenforceability of bankruptcy waivers); *see also* Sun, *supra* note 7, at 1113-14 (noting that prepetition bankruptcy waivers are void because they are contrary to public policy).

[125] *See In re Franchise Servs., 891 F.3d at 207* ("Several courts of appeals - though not this one - have opined that a pre-petition waiver of the benefits of bankruptcy is contrary to federal law and therefore void.").

[126] *See* Radwan, *supra* note 5, at 588 (noting the shifting likelihood of enforceability based on characteristics of shareholders); *see also In re Franchise Servs., 891 F.3d at 207*; *In re Squire Ct. Partners Ltd. P'ship v. Centerline Credit Enhanced Partners LP Series J (In re Squire Ct. Partners Ltd. P'ship., 574 B.R. 701, 707-08 (E.D. Ark. 2017)* (distinguishing the treatment of consent rights held by majority equity owners from those involving nominal equity owners and creditors).

[127] *In re Franchise Servs., 891 F.3d at 207*.

[128] *See In re Intervention Energy Holdings, 553 B.R. at 265* (finding that the golden shares equated to a bankruptcy waiver); *In re Lexington Hosp. Grp., LLC, 577 B.R. 676, 684 (Bankr. E.D. Ky. 2017)* (finding bankruptcy shares void as contrary to public policy); *In re Lake Mich. Beach Pottawattamie Resort LLC, 547 B.R. 899, 911-12 (Bankr. N.D. Ill. 2016)* (explaining that bankruptcy blocking provisions are void as against public policy except for a few, specific circumstances).

[129] Notably, the golden shareholder in *In re Franchise Services* was created by Macquarie Capital (U.S.A.), Inc. *In re Franchise Servs., 891 F.3d at 203*. Presumably, the Macquarie Investors in *In re Pace* are related in some way to the golden shareholder in *In re Franchise Services.*

[130] *See In re Pace* Motion, *supra* note 9, at 2 (summarizing background facts).

[131] *Id.* at 3 (describing relevant amendments); *see also* SEC Investor Publication, *supra* note 5 (noting that stockholders are the last to get paid).

subsidiaries filed prepackaged chapter 11 cases in Delaware to effectuate a debt-for-equity swap that would flush preexisting equity interests and satisfy any outstanding debt of general unsecured creditors in full.[132]

[*20] The board of KPI and its affiliates did not obtain the prior written consent of the Macquarie Investors for the bankruptcy petition.[133] The Macquarie Investors moved to dismiss the petition, arguing the court did not have subject matter jurisdiction over the cases because KPI lacked the authority to file without the Macquarie Investors' prior consent.[134] To distinguish the line of cases invalidating the bankruptcy-consent rights of creditors, the Macquarie Investors argued that they were preferred equity holders, not creditors, so that no federal public policy would be violated by enforcement of the right.[135] The Macquarie Investors relied on the Fifth Circuit's non-binding holding in *In re Franchise Services* that a minority golden shareholder is not a controlling minority shareholder with fiduciary duties.[136] As support, they pointed to the fact that KPI's failure to obtain the Macquarie Investors' consent to the bankruptcy filings evidenced that they did not have actual control over KPI's board.[137] Notably, the Macquarie Investors proposed no alternative to bankruptcy.[138]

KPI, on the other hand, relied on the Delaware Chancery Court's decision in *Basho Technologies*[139] to argue that Delaware law imposes fiduciary obligations on minority shareholders when they control a "particular transaction" and that the Macquarie Investors' bankruptcy veto gave rise to such control.[140] In addition, they argued that the veto violated federal public policy because it eliminated the debtors' constitutional right to access the bankruptcy process.[141] They also argued that the COVID-19 pandemic caused significant financial distress that required closures of facilities and massive layoffs and that their directors, as fiduciaries, appropriately determined that a bankruptcy filing was in KPI's best interests.[142] Finally, they argued that the Macquarie Investors' motion to dismiss was merely a ruse to gain negotiating leverage.[143]

The hearing transcript of the court's bench decision reveals Bankruptcy **[*21]** Judge Mary Walrath's reasoning.[144] Ruling as a matter of first impression, Judge Walrath held that a blocking right owned by a shareholder - even if the shareholder is not a creditor - is unenforceable under federal public policy because

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[132] *See In re Pace* Motion, *supra* note 9, at 3.

[133] *Id.*

[134] *Id.* at 2.

[135] *See id.* at 10-12.

[136] *See id.*

[137] *See In re Pace* Transcript, *supra* note 11, at 16.

[138] *See id.* at 4.

[139] Basho Techs. Holdco B, LLC v. Georgetown Basho Invs., LLC, C.A. No. 11802-*VCL, 2018 WL 3326693 (Del. Ch. July 6, 2018)*.

[140] *See* Debtors' Opposition to Macquarie Septa (US) I, LLC's Motion for an Order Dismissing the Chapter 11 Cases of KPI Intermediate Holdings, Inc. and its Direct and Indirect Subsidiaries at 16-17, *In Re* Pace Industries, LLC, Case No. 20-10927 (MFW) (Bankr. D. Del. Apr. 28, 2020) [hereinafter *In re Pace* Debtors' Opposition], ECF No. 115.

[141] *See id.* at 11.

[142] *See id.* at 6, 9, 10.

[143] *See id. at 19*.

[144] *See In re Pace* Order, *supra* note 11, at 1 (denying shareholder's motion to dismiss); *see In re Pace* Transcript, *supra* note 11, at 38-42.

such a veto is a restriction on KPI's "constitutional right" to access the bankruptcy process.[145] The court was persuaded by the fact that KPI was in financial distress, particularly because of the COVID-19 pandemic.[146] The global pandemic and related government shutdowns, according to the court, exacerbated the dire financial situation that had crippled KPI even pre-pandemic.[147] Given this context, the court found that bankruptcy would benefit most stakeholders.[148]

The Court expressly rejected the Fifth Circuit's reasoning in *In re Franchise Services*, stating, "I see no reason to conclude that a minority shareholder has any more right to block a bankruptcy - the constitutional right to file a bankruptcy by a corporation than a creditor does."[149] Disagreeing with the Fifth Circuit's interpretation of Delaware law, the *In re Pace* court reasoned that under Delaware law, "a blocking right, such as exercised in the circumstances of this case, would create a fiduciary duty on the part of the shareholder; a fiduciary duty that, with the debtor in the zone of insolvency, is owed not only to other shareholders, but also to all creditors."[150] Following the fiduciary-duty analysis of *Basho Technologies*, Judge Walrath referenced the circumstances faced by KPI: they were in the zone of insolvency, had no liquidity, could not pay their debts in the absence of debtor-in-possession financing, and encountered severe operational disruptions because of COVID-19.[151] Such circumstances supported a finding that the blocking right created a fiduciary duty under Delaware law.

The court resolved the motion on the record by a two-page order denying the motion with no written opinion.[152] The Macquarie Investors did not **[*22]** appeal, and the deadline lapsed.[153]

II. QUESTIONING THE CORRECTNESS OF *IN RE PACE*

A. Is the Bankruptcy-Consent Right Valid Under Delaware Law?

Local law governs which parties possess authority to initiate a bankruptcy case on behalf of a business debtor.[154] Corporate formalities under state law must be satisfied to commence a bankruptcy on behalf of

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[145] *See id. at 38-39* (expressing a willingness to set new precedent and explaining why the court refused to enforce the golden-share provision, including a discussion of the general federal public policy of protecting an entity's right to file for bankruptcy).

[146] *See id. at 38-39* (describing the economic impact of COVID-19 pandemic)

[147] *See id.*

[148] *See id. at 39* (acknowledging the bankruptcy benefit to most interested parties).

[149] *Id. at 40*. The court found that the Fifth Circuit misinterpreted Delaware law, explaining that Delaware law would in fact impose a fiduciary duty. *See id.*

[150] *See id. at 40-41* (noting that the golden share triggered a fiduciary duty). *But see* Ellen Oberwetter, *Nearing the End Zone: Developments in The 'Zone of Insolvency'*, 13 No. 6 Westlaw J. Bankr. 1 (2016) (explaining that Delaware has retreated from finding a fiduciary duty is owed to creditors when the borrower is within the zone of insolvency).

[151] *See In re Pace* Transcript, *supra* note 11, at 41.

[152] *See In re Pace* Order, *supra* note 11.

[153] Denial of a motion to dismiss is interlocutory and appealable only by leave of court. *See* Travelstead v. Velazquez (*In re Travelstead), 250 B.R. 862, 865 (D. Md. 2000)* ("While an order dismissing a bankruptcy case is a final order appealable by right, orders denying a motion to dismiss are interlocutory in nature and are only appealable by leave of the court."); *see also Fed. R. Bankr. P. 8002*, 8003(a)(1) (apply to interlocutory appeals the deadline of *Fed. R. Bankr. P. 8002*). Had the Macquarie Investors appealed, the appeal would have been heard by the Delaware district court. *See 28 U.S.C. § 158(a)*.

[154] See *Price v. Gurney, 324 U.S. 100, 106 (1945)* (noting local law controls authority determinations absent federal law stating otherwise); *In re* NNN *123 N. Wacker, LLC, 510 B.R. 854, 858 (Bankr. N.D. Ill. 2014)* ("The authority to

an entity,[155] and any unauthorized bankruptcy filing must be dismissed.[156] In *In re Pace*, because the debtor was organized in Delaware, Delaware law controlled whether the bankruptcy filing was authorized.[157] Although the default rule in Delaware indicates that a company's decision-making authority is held by the board of directors, the certificate of incorporation may dictate otherwise.[158] When a certificate does not conform to the default rule, the certificate controls. Because the parties in *In re Pace* agreed to include the bankruptcy-consent right in the A&R Certificate in favor of the Macquarie Investors, absent any Delaware case law to the contrary, the default rule was overridden so that the A&R Certificate should have controlled.[159]

Notably, Delaware is perceived as having the most relaxed business-law statutes so that sophisticated parties have wide latitude to make and document commercial decisions.[160] Given that the intent of Delaware's "relatively loose" corporate laws is to favor flexibility in business arrangements, the bankruptcy-consent right given to the Macquarie Investors falls squarely into **[*23]** the flexibility that Delaware law permits.[161] Furthermore, Delaware courts, when interpreting Delaware law, generally will not invalidate certificate provisions that merely limit the "traditional power" of the board,[162] which is what the A&R Certificate did in withdrawing the KPI board's authority to file for bankruptcy. Finally, the KPI board, as manager of an expansive diecast supply company, and Macquarie Investors, as part of an investment management institution, certainly could appreciate the stakes of a bankruptcy veto when the investment deal was negotiated. The arms-length negotiation between sophisticated parties, combined with the reasonable expectation of Macquarie Investors that Delaware law would allow limitations on directors' authority, would seem to indicate that Delaware law should have been applied to allow enforcement of the bankruptcy-consent right.[163]

Counsel for KPI, however, argued that no Delaware state court had ruled on the specific issue before the bankruptcy court - whether a bona fide equity investor's bankruptcy-consent right would be valid under Delaware law before *In re Pace*. [164]KPI argued that under *Basho Technologies*, Delaware courts would

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file a bankruptcy petition on behalf of a corporation must derive from state corporate governance law." (quoting *In re Gen-Air Plumbing & Remodeling, Inc., 208 B.R. 426, 430 (Bankr. N.D. Ill. 1997))*.

[155] *See Price, 324 U.S. at 106* (holding that if the trial court "finds that those who purport to act on behalf of the corporation have not been granted authority by local law to institute the proceedings, it has no alternative to dismiss the petition"); *see also* John D. Demmy, *Controlling a Borrower's Decision to Seek Bankruptcy Relief*, Am. Bankr. Inst. J. (Aug. 2018), at 12, 12 (2018).

[156] *See Price v. Gurney, 324 U.S. 100, 106 (1945)*;

[157] *See In re Pace* Transcript, *supra* note 11, at 40; *see also In re Pace* Motion, *supra* note 9 , at 5.

[158] *See Del. Code Ann. tit. 8,§§102(b)(1)*,141(a) (2020).

[159] *See In re Pace* Transcript, *supra* note 11, at 37.

[160] *See Jones Apparel Grp., Inc. v. Maxwell Shoe Co., 883 A.2d 837, 845 (Del. Ch. 2004)*; *see also* Ann E. Conaway, *Lessons to Be Learned: How the Policy of Freedom to Contract in Delaware's Alternative Entity Law Might Inform Delaware's General Corporation Law*, *33 Del. J. Corp. L. 789, 789 (2008)* (noting Delaware well-known for flexibility of its business entity laws).

[161] *Jones Apparel Grp., 883 A.2d at 845*.

[162] Franchise Servs. of N. Am., Inc. v. U.S. Trustee (*In re Franchise Servs. of N. Am.), 891 F.3d 198, 210 (5th Cir. 2018)* ("A provision is not contrary to Delaware law just because it withdraws traditional power from the board.").

[163] *See e.g.*, *Jones Apparel Grp., 883 A.2d at 845* (interpreting broadly Delaware statutes governing parties' rights to negotiate certificates of incorporation); *see also In re Franchise Servs., 891 F.3d at 214* (holding valid under Delaware law the certificate provision conditioning the entity's right to file for bankruptcy on shareholder consent).

[164] *See In re Pace* Transcript, *supra* note 11, at 22-23.

restrict the bankruptcy block held by the Macquarie Investors because Delaware law imposes fiduciary duties on minority shareholders when they can "control a particular transaction."[165] This argument begs the question: Does the answer to whether Delaware's relaxed statutory law permits a bankruptcy-consent right of a minority shareholder depend on whether the golden shareholder owes a fiduciary duty to consider the debtor's best interest?

Although the bankruptcy court did not issue a written opinion, the court's bench decision makes clear that it was influenced by *Basho Technologies* in answering the question of first impression under Delaware law.[166] Without addressing the tradition of Delaware's statutory law favoring parties' ability to negotiate and narrow management powers in certificates, the court went straight into its inquiry of whether the Macquarie Investors' consent right gave rise to a fiduciary duty.[167]

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B. Were the Macquarie Investors Fiduciaries?

In answering the novel question of whether the Macquarie Investors' bankruptcy veto gave rise to a fiduciary duty, the *In re Pace* court concluded that Delaware law would create a fiduciary duty for the Macquarie Investors as a result of the bankruptcy-blocking right.[168] The court's ruling appears contrary to the Delaware rule that a shareholder typically may make decisions in its own self-interest without any fiduciary duty to the corporation, except if it is a majority shareholder or a minority shareholder with actual control.[169] The Macquarie Investors unquestionably were not majority equity holders of KPI.

The exception for minority shareholders with actual control also would seem inapplicable to the Macquarie Investors. Simply, the Macquarie Investors did not exercise actual control because their voting power was not so strong as to effectively control the board.[170] As evidenced by the A&R Certificate, the Macquarie Investors had no voting rights except as expressly enumerated.[171] Although the A&R Certificate defined certain, special consent rights - including rights concerning indebtedness, acquisitions in excess of $ 30 million, dispositions in excess of $ 20 million, expenditures in excess of $ 35 million, and modifications to key employee employment terms - KPI, like the debtor in *In re Franchise Services*, did not allege that the Macquarie Investors actually exercised any of these controls.[172] In fact, KPI pointed to no sign of control

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[165] *See id. at 23*.

[166] *See id. at 40-41*.

[167] *See id. at 38-42*.

[168] *See id. at 40-41*.

[169] *See supra* Section II.B.4; Franchise Servs. of N. Am., Inc. v. U.S. Trustee (*In re Franchise Servs. of N. Am.), 891 F.3d 198, 211 (5th Cir. 2018)* ("Delaware law thus imposes fiduciary duties on two kinds of shareholders: majority shareholders and minority controlling shareholders."); Basho Techs. Holdco B, LLC v. Georgetown Basho Invs., LLC, C.A. No. 11802-*VCL, 2018 WL 3326693, at 25 (Del. Ch. July 6, 2018)* (stating that in addition to stockholder, "Delaware law imposes fiduciary duties on those who effectively control a corporation").

[170] *See supra* Section II.B.4; *In re Franchise Servs., 891 F.3d at 211* ("A minority shareholder exercises 'actual control' only when it has 'such formidable voting and managerial power that [it], as a practical matter, [is] no differently situated than if [it] had majority voting control.'" (alterations in original)).

[171] *See* Exhibit B to *In re Pace* Motion at§§5-6, *supra* note 9, ECF No. 88-2.

[172] *See In re Pace* Transcript, *supra* note 11, at 16 (referencing the *Basho* court's indication that exercise of consent rights alone would not support a finding of control and emphasizing that KPI failed to obtain the Macquarie Investors' consent).

by the Macquarie Investors aside from the bankruptcy-consent right. As in *In re Franchise Services*,[173] the very fact that KPI filed the bankruptcy petition without consent of the Macquarie Investors undermined the debtors' argument that the Macquarie Investors possessed "formidable" and "potent" decision-making authority to impose a fiduciary duty.

Moreover, the Delaware court expressly noted in *Basho Technologies* that a single source of control will not imbue a minority investor with actual **[*25]** control sufficient to impose a fiduciary obligation.[174] In fact, a minority shareholder's control must have a "confluence" of sources.[175] The Macquarie Investors only sought to enforce their bankruptcy-consent right. KPI presented no evidence to suggest that the Macquarie Investors had asserted control over the debtors in the same way that the investor had exercised control in *Basho Technologies*, in which the minority shareholder exercised significant influence by meddling with material contracts, spreading misinformation, interfering with management, manipulating negotiations to raise capital, or participating in threatening and combative conduct.[176] In contrast to the finding of misconduct by the golden shareholders in *Basho Technologies*, the *In re Pace* court determined that the blocking right created a fiduciary duty merely because the debtors were in the "zone of insolvency," had inadequate liquidity, could not pay their debts in the absence of debtor-in-possession financing, and encountered severe operational disruptions as the result of COVID-19.[177] Critically, these issues were outside of the Macquarie Investors' control. In fact, the circumstances on which the court granted relief are irrelevant to the question of whether the Macquarie Investors had exercised control sufficient to create a fiduciary duty under Delaware law. Because the Macquarie Investors only sought to enforce a single right and because the debtors' distress was outside of the Macquarie Investors' control, the court's imposition of the fiduciary duty on Macquarie Investors appears contrary to Delaware law.

Notably, KPI's counsel distorted inconsistent statements from the *Basho Technologies* decision to support its argument that Macquarie Investors owed a fiduciary duty.[178] The *Basho Technologies* court stated that a minority investor could assume fiduciary duties if it exercises actual control over a "particular transaction," indicating that the facts of the transaction play an important role in determining whether such an investor exercises actual control.[179] The court provided several examples of particular facts that would give rise to actual control: whether the investor asserted a particular course of action, whether other fiduciaries gave resistance to a course of action, and whether the actions exceed customary conduct to involve "aggressive, threatening, disruptive, or punitive behavior."[180] The Delaware court's ruling made **[*26]** clear that seldom - if ever - will one lever of influence give rise to actual control.[181] In *In re Pace*, KPI's counsel exploited the example of control given in *Basho Technologies* that a fiduciary duty may exist when an investor has

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[173] *In re Franchise Servs., 891 F.3d at 213*.

[174] *See Basho Techs., 2018 WL 3326693, at 28* ("Rarely (if ever) will any one source of influence or indication of control, standing alone, be sufficient to make the necessary showing. A finding of control after trial, like a reasonable inference of control at the pleading stage, typically results when a confluence of multiple sources combines in a fact-specific manner to produce a particular result.").

[175] *Id.*

[176] *Id.*

[177] *See In re Pace* Transcript, *supra* note 11, at 38-39.

[178] *See In re Pace* Debtors' Opposition, *supra* note 140, at 16-17.

[179] *See Basho Techs., 2018 WL 3326693, at 28*.

[180] *Id.*

[181] *Id.*

"contractual rights to channel the corporation into a particular outcome by blocking or restricting other paths."[182]

The bankruptcy court in *In re Pace* relied on the single example offered by KPI without recognizing that, under *Basho Technologies*, a blocking right alone is insufficient to establish actual control because it is merely a single means of influence. That is, the *Basho Technologies* court listed *multiple* factors of the minority investor's overly aggressive conduct - willfully violating funding obligations, numerous examples of blocking favorable access to capital, spreading misinformation, and interfering with executives.[183] Such misconduct proved actual control.[184] Indeed, *Basho Technologies* specifically stated that "a blocking right standing alone is highly unlikely to support either a finding or a reasonable inference of control."[185]

Notwithstanding such reasoning in *Basho Technologies*, the *In re Pace* court looked beyond the investors' conduct and focused on the debtors' distress, which the Macquarie Investors had no role in causing or exacerbating. By misapplying the principles of *Basho Technologies*, the bankruptcy court effectively required the Macquarie Investors to propose an alternative to bankruptcy. Financial distress of a debtor, even depletion of liquidity, should not be sufficient to strip a minority shareholder of its bargain. *In re Pace* stands for the proposition that a minority shareholder must propose a viable plan outside of bankruptcy if its bargained-for bankruptcy veto is to be enforced. Such a standard is a step too far in imposing a fiduciary obligation on minority shareholders like the Macquarie Investors.[186]

In rejecting the Fifth Circuit's interpretation of Delaware law to find that the Macquarie Investors owed a fiduciary duty, the *In re Pace* court applied federal public policy to void the Macquarie Investors' bankruptcy-consent right.[187] Courts tend to reject outright golden shareholders' bankruptcy veto provisions when a creditor is merely a nominal shareholder, even when the consent right is the only lever of control, because such provisions violate the federal public policy of promoting debtors' access to the bankruptcy **[*27]** process.[188] Such precedent, however, leaves open a significant question: What happens if the investor is a genuine equity holder, like in *In re Franchise Services* and *In re Pace*?

C. Did Public Policy Favor Voiding the Macquarie Investors' Golden Shares?

Unlike the outcome in *In re Franchise Services*, the *In re Pace* court held that the right of a minority shareholder to block a bankruptcy filing violates federal public policy. Examination of the underpinnings of the right to access the bankruptcy process, considered in the context of the principle that parties have freedom to contract, suggests public policy should not prohibit an equity holder from exercising a negotiated right to approve a bankruptcy filing.

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[182] *See In re Pace* Debtors' Opposition, *supra* note 140, at 16-17 (quoting *Basho Techs., 2018 WL 3326693, at 26)*.

[183] *Basho Techs., 2018 WL 3326693, at 28-35*.

[184] *Id.*

[185] *Id. at 26 n.315*.

[186] *Cf.* Thermopylae Capital Partners, L.P. v Simbol, Inc., CV 10619-*VCG, 2016 WL 368170, 13 (Del. Ch. Jan. 29, 2016)* (discussing the type of actual control necessary for imposing a fiduciary duty).

[187] *See In re Pace* Transcript, *supra* note 11, at 40.

[188] *See, e.g.*, *In re Intervention Energy Holdings, LLC, 553 B.R. 258, 265 (Bankr. D. Del. 2016)*; *In re* NNN *123 N. Wacker, LLC, 510 B.R. 854 (Bankr. N.D. Ill. 2014)*; *In re Global Ship Sys., LLC, 391 B.R. 193, 203 (Bankr. S.D. Ga. 2007)*. *But see* Coleman et al., *supra* note 5, at 45 (arguing that when a party has unilateral control to block a filing, "the distinction between an explicit waiver of bankruptcy protection and blocking rights is less clear").

As an initial matter, KPI and the Macquarie Investors did not agree to a bankruptcy waiver by an *ipso facto* clause in loan documents, which courts generally invalidate.[189] Instead, the Macquarie Investors held a bankruptcy veto right as set forth in KPI's A&R Certificate. As minority equity holders, the Macquarie Investors reasonably should have expected to fall on the spectrum with the traditional minority equity investor described in *In re Franchise Services*.[190] The Macquarie Investors argued correctly that when courts invalidate golden shares as contrary to public policy, the golden shareholder usually is a substantial creditor with a nominal equity ownership. [191]The Macquarie Investors, however, held no debt, unlike the golden shareholder in *In re Intervention Energy Holdings*, which was primarily a creditor of the debtor.[192] Although scholars argue that any contractual arrangement with the substantive effect of blocking a voluntary bankruptcy filing should "run afoul" of public policy, such arguments have been limited to arrangements that require consent of a creditor, not a bona fide minority investor.[193] Even when the golden shareholder is both an equity holder and a creditor, **[*28]** courts have validated the golden shareholder's bankruptcy-consent right, as seen in *In re Franchise Services*.[194] Such decisions impliedly or expressly recognize that no federal public policy prohibits a preferred shareholder's right to exercise its bankruptcy veto when the shareholder is also a bona fide investor.[195]

Also troubling is the court's indication that a corporation has a constitutional right to file for bankruptcy protection.[196] In support, the court cited *In re Trans World Airlines*,[197] which involved a contractual bankruptcy waiver in favor of a lender rather than a bankruptcy-consent right held by a bona fide, minority equity holder.[198] This reliance on *In re Trans World Airlines* resulted in a finding that the Macquarie Investors' bankruptcy veto was unconstitutional under the same public policy analysis applicable to bankruptcy waivers between creditors and debtors.[199] Because the Bankruptcy Clause does not include a

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[189] *See* the discussion of bankruptcy waivers, *supra* Section II.A.

[190] Franchise Servs. of N. Am., Inc. v. U.S. Trustee (*In re Franchise Servs. of N. Am.), 891 F.3d 198 (5th Cir. 2018)*. See discussion *supra* Section II.B.

[191] *See In re Pace* Motion, *supra* note 9, at 14; *see also In re* Franchise Servs. of N. Am., Inc., No. 1702316EE, 2018 WL 485959, at 16 (Bankr. S.D. Miss. Jan. 17, 2018) ("It is clear from the seven (7) cases which have addressed golden shares or blocking provisions, either provision will be upheld as valid if it is held by an equity holder. If either provision is held by a creditor, however, the provision will be void as a matter of public policy."), *aff'd*, *891 F.3d 198 (5th Cir. 2018)*.

[192] *In re Intervention Energy Holdings, 553 B.R. at 265*; *see supra* text accompanying notes 88-92.

[193] *See, e.g.*, Daniel J. Bussel, *Corporate Governance, Bankruptcy Waivers, and Consolidation in Bankruptcy*, 36 Emory Bankr. Developments J. 99, 121 (2019).

[194] *See In re Franchise Servs., 891 F.3d at 203*.

[195] *See id. at 203, 209*.

[196] *See In re Pace* Transcript, *supra* note 11, at 39-40. For discussion of the Constitution's bankruptcy clause, s*ee supra* notes 36-39 and accompanying text (explaining the difference between authorization to create a bankruptcy system and a constitutional right to access such a system).

[197] *See In re Trans World Airlines, Inc., 261 B.R. 103 (Bankr. D. Del. 2001)*.

[198] *In re Pace* Transcript, *supra* note 11, at 39-40.

[199] *Id. at 40* ("I see no reason to conclude that a minority shareholder has any more right to block a bankruptcy - the constitutional right to file a bankruptcy by a corporation than a creditor does.").

right to access bankruptcy,[200] the court's holding on this point incorrectly applied the Constitution's mere authorization to Congress to establish bankruptcy laws.[201]

Moreover, public policy also recognizes that parties have freedom to contract.[202] The Macquarie Investors possessed the golden shares as an owner of the debtors, unlike the relationships typically seen in the context of bankruptcy waivers when lenders or third-party, non-equity holders are involved. The parties intentionally chose to be governed by the flexibility of Delaware law to allocate to the Macquarie Investors the authority over bankruptcy decision-making. In voiding that negotiated right, the *In re Pace* court rewrote **[*29]** the sophisticated parties' agreement, interfering with their freedom to contract.

Some commentary suggests that the "wider angle" requires a federal public policy in favor of bankruptcy relief because "no party looks to the future anticipating insolvency."[203] Parties to these types of arrangements, however, are sophisticated and typically are represented by counsel.[204] Insolvency is a "known-unknown" state of affairs, meaning that parties working with counsel generally are aware that the risk of insolvency exists. Decision makers no doubt should consider such a risk when evaluating whether they should allocate bankruptcy approval to investors.

D. Implications of In re Pace and Other Structuring Avenues

In the wake of *In re Pace*, a shareholder who seeks to enforce its bankruptcy-consent right may bolster its motion to dismiss the bankruptcy case by offering viable alternatives to the bankruptcy process.[205] Unfortunately, this approach leaves the golden shareholder guessing about what will be acceptable as a sufficiently viable alternative. To avoid the appearance of blocking a bankruptcy solely for an advantage in out-of-court negotiations, a golden shareholder should be prepared to offer substantive alternatives to a bankruptcy with an explanation of how such alternatives would be more beneficial than a bankruptcy. As the validity of bankruptcy-consent rights continues to be litigated, courts will be challenged to balance public policy that favors access to the bankruptcy process with public policy that recognizes sophisticated parties' freedom to contract.

With the validity of golden shares in question, parties will need either to structure transactions around the principles from *In re Pace* or be prepared to litigate the enforceability of golden shares. Until a higher court renders a decision that validates a bankruptcy-consent right, potential investors will be less likely to

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[200] *See supra* notes 36-39 and accompanying text (explaining the difference between authorization to create a bankruptcy system and a constitutional right to access such a system).

[201] *See U.S. Const. art. 1, § 8, cl. 4* ("The Congress shall have power ... to establish ... uniform laws on the subject of bankruptcies throughout the United States ... .").

[202] *BMD Contractors, Inc. v. Fid. & Deposit Co. of Md., 679 F.3d 643, 648 (7th Cir. 2012)* ("Indiana courts apply a strong presumption in favor of the freedom of contract."); *R.D. Legal Funding Partners, LP v. Robinson, 476 F. App'x 354, 360 (11th Cir. 2012)* ("It is the paramount public policy of the State [of Georgia] that courts will not lightly interfere with the freedom of parties to contract." (citation omitted)); *Wallace Hardware Co. v. Abrams, 223 F.3d 382, 396 (6th Cir. 2000)* ("Public policy in Kentucky favors parties' freedom to contract for substantive rights."). *But see In re Demczyk v. Mut. Life Ins. Co. of N.Y. (In re Graham Square, Inc.), 126 F.3d 823, 828 (6th Cir. 1997)* (recognizing that "in certain circumstances, complete freedom of contract is not permitted for public policy reasons").

[203] Coleman et al., *supra* note 5, at 45.

[204] *See In re Pace* Motion, *supra* note 9, at 15 (asserting that the parties are sophisticated).

[205] *See In re Pace* Transcript, *supra* note 11, at 41 ("It is hard to contemplate an alternative to the bankruptcy proceeding, and Macquarie has not suggested any; any viable one, anyway."); *see also In re Pace* Debtors' Opposition, *supra* note 140, at 19 (noting Macquarie Investors do "not stand ready to finance or support the debtors with an alternative").

negotiate inclusion of golden shares because of the risk of invalidation by a bankruptcy court. Unfortunately, with such a reduction in bargaining power, investment may be impacted negatively as the specter of invalidation discourages prospective investors from offering valuable consideration in exchange for a bankruptcy-consent right.[206] After all, the great benefit of doing business in Delaware is comfort in its fundamental principles **[*30]** favoring business flexibility and the expansive freedom of contract. The decision in *In re Pace* undermines these principles by imposing the Delaware bankruptcy court's sense of equity and fairness.

Prospective investors likely will pursue other avenues to safeguard their investments from bankruptcy risks. For example, investors may require a bankruptcy-remote special-purpose entity for installation of an independent director whose duties are limited to the decision of whether the company should seek bankruptcy relief.[207] A common practice is for the entity's governing documents to require consent of the independent director or manager before a bankruptcy petition is authorized.[208] The independent director then is charged with evaluating whether a bankruptcy filing would best serve the interests of the company.[209] If an independent director decided to object to a bankruptcy, it must be based on merit "rather than on extraneous considerations or influence" because an independent director has a fiduciary duty to act in the best interests of all shareholders, not just the shareholder who bargained for the director's appointment.[210] As a result, investors have little recourse if the independent director does not block the bankruptcy.[211]

III. CONCLUSION

The Delaware bankruptcy court's invalidation of a minority equity **[*31]** holder's bankruptcy-consent right in *In re Pace* demonstrates that courts are likely to evaluate the specific facts of each case when determining

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[206] *See* Steven Schwarcz, *Rethinking Freedom of Contract: A Bankruptcy Paradigm*, *77 Tex. L. Rev. 515, 585 (1999)* ("If parties to a prebankruptcy contract cannot determine its enforceability until the debtor is in bankruptcy, however, creditors would be discouraged from offering valuable consideration for the contract ... .").

[207] Demmy, *supra* note 156, at 12 (discussing the common, alternative method used to control the risk of bankruptcy); *see also* Cody & Douglas, *supra* note 154; *In re Lake Mich. Beach Pottawattamie Resort LLC, 547 B.R. 899 (Bankr. N.D. Ill. 2016)* (holding that the "blocking" member provision in the operating agreement of a "bankruptcy remote special purpose entity" was unenforceable because it did not require the member to comply with its fiduciary obligations under applicable corporate law).

[208] *See* Mark A. Cody & Mark. G. Douglas, *Mixed Signals on Enforcement of Provisions Precluding Bankruptcy Filing Absent Lender's Consent*, Jones Day: Insights (Dec. 2019), *https://www.jonesday.com/en/insights/2019/12/mixed-signals-on-enforcement* (explaining the mechanism of installing an independent director).

[209] *See id.* Lenders often will require that the entity's operating agreement either limit or eliminate the blocking director's fiduciary duty. Gardner F. Davis & John J. Wolfel Jr., *Blocking Director May Not Prevent Bankruptcy Remote Entity from Filing Bankruptcy*, Bloomberg L.: Bankr. L. News (Mar. 22, 2017, 2:23 PM), *https://news.bloomberglaw.com/bankruptcy-law/blocking-director-may-not-prevent-bankruptcy-remote-entity-from-filing-bankruptcy* (discussing the strategy used by lenders); *see also* Gardner Davis & Danielle Whitley, *Blocking Director's Fiduciary Duty Essential for Successful Remote Entity Structure*, 31 Westlaw J. Del. Corp. (Feb. 27, 2017), *https://www.foley.com/-/media/files/insights/publications/2017/03/davis-and-whitley-coauthor-article-about-bankruptc/files/full-article* - westlaw-journal-delaware-corporate/fileattachment/wj delaware-corporate davis.pdf (noting that operating agreements may limit or eliminate most fiduciary duties). Courts, however, have made clear that such elimination of a fiduciary duty to act in the best interest federal public policy surrounding the right to access bankruptcy protection. *See Davis & Wolfel, supra.*

[210] *Davis & Wolfel, supra note 209*; *see also* discussion *supra* note 207 and accompanying text.

[211] *See Davis & Wolfel, supra note 209* (explaining the "independence" test); *see also In re Gen. Growth Props., Inc., 409 B.R. 43, 68 (Bankr. S.D.N.Y. 2009)* (finding that the "independent managers did not have a duty to keep any of the debtors from filing a bankruptcy case").

whether to reject such a right, as evidenced both by the court's decision to diverge from the Fifth Circuit's decision in *In re Franchise Services* and the court's sympathy for the company's distress. During these times of unprecedented economic hardships, *In re Pace* suggests that courts will scrutinize golden shares closely. Having been influenced by the fact that COVID-19 wreaked havoc on the debtors' income and business operations, *In re Pace* shows courts' willingness to impose a fiduciary duty on the holder of a bankruptcy-consent right, even if it means fashioning new law against the grain of existing precedent. Such a decision neither fits squarely within precedent nor respects parties' bargained-for agreements; instead, it evidences courts' enthusiasm to unpredictably overextend principles of equity to grant distressed companies access to the bankruptcy process.

Because *In re Pace* is not binding precedent, it leaves unanswered the question of whether golden shares are enforceable, making likely litigation of the issue. In the meantime, the uncertainty emphasizes the need to understand what approach various courts have adopted. As *In re Pace* illustrates, courts faced with determining the enforceability of golden shares will examine closely the nature of debtor's distress, whether there are viable alternatives to the bankruptcy process, and whether a bankruptcy will benefit most stakeholders. Proponents of golden shareholders' rights may rely on the different rule from *In re Franchise Services*, which provides more predictability because parties are not left to anticipate how the court will impose its own notions of equity.

Courts deciding the issue should favor the consistency and predictability of the approach in *In re Franchise Services*, which also respects the freedom to contract by upholding sophisticated parties' negotiated bargain. Such a deferential approach to the parties' contractual choice is permitted by Delaware law, which does not impose a fiduciary duty on an equity investor that has not exercised actual control or engaged in misconduct harmful to the company or its shareholders. Upholding a bankruptcy-consent right of a minority equity owner also does not run afoul of federal public policy because there is no policy that bars allocation of bankruptcy approval to equity holders and debtors have no constitutional right to bankruptcy.

Ultimately, the *In re Pace* decision and the uncertainty resulting from the court's rejection of the negotiated bankruptcy-consent right may disrupt the renowned incentives to conduct business in Delaware. Businesses might look to other jurisdictions to ensure that they receive the benefits of their bargain.

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