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# Is the "Golden Share" Losing its Luster? Delaware Bankruptcy Court Denies Dismissal of Chapter 11 Petitions Not Authorized By Lender Holding "Golden Share"

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## I. Introduction

In our earlier client alert, dated September 13, 2016, we described how during the period of the collapse of the real estate market from 1989 – 1993, countless real estate borrowers attempted to block their mortgage lenders from foreclosing by filing petitions for relief under chapter 11 of the Bankruptcy Code, and then sought to involuntarily restructure their mortgage loans by availing themselves of the cram-down provisions of Section 1129 of the Bankruptcy Code. In the aftermath of this downturn, when real estate mortgage lenders began to contemplate making new mortgage loans, they sought to create new legal structures to prevent their prospective borrowers from filing for chapter 11, and to ameliorate the adverse consequences, if such a filing were to occur. One such structure, has as its centerpiece, a device commonly referred to as the “Golden Share.” As more fully described below, the essence of this device is to provide the lender, at the time the loan is made, with a non-economic equity interest, whose affirmative vote would be necessary, and presumably not forthcoming, for its borrower to file chapter 11 in order to stymie the lender’s mortgage enforcement remedies following a loan default or maturity. The lender thereby could proceed to freely foreclose – without facing a chapter 11 filing. A recent decision of the important U.S. Bankruptcy Court of Delaware calls into question the effectiveness of the “Golden Share” device, creating yet another crack in the legal armor of real estate mortgage lenders.

In *In re Intervention Energy Holdings, LLC*, no. 16-11247 (Bankr. D. Del. June 3, 2016) (“*Intervention*”), the United States Bankruptcy Court for the District of Delaware (the “Court”) refused to invalidate a bankruptcy filing made without the consent of its lender, which held a “Golden Share” of a Delaware limited liability company (“LLC”) issued as part of a pre-bankruptcy forbearance agreement. In so doing, the Court held that the Golden Share issued in this case (discussed below) was void as a matter of federal public policy. However, the Court did not rule that Golden Shares *per se* violate federal bankruptcy policy.

In the bankruptcy context, the term “Golden Share” generally describes a membership interest provided to a lender for the purpose of voting on any resolution to approve a voluntary bankruptcy filing, coupled with a provision in the LLC’s operating agreement that requires the unanimous consent of all members of the LLC to such a bankruptcy filing.

*Intervention* highlights an overall fact pattern which the Court determined to be an “absolute waiver” of the right of the LLC to seek federal bankruptcy relief which is contrary to federal bankruptcy policy. While the debtors in *Intervention* were private, non-operated oil and natural gas exploration and production companies, the Court’s decision has implications in real estate transactions (and their subsequent restructurings) which utilize Golden Shares.

## II. Background

Intervention Energy Holdings, LLC (“IEH”) and its subsidiary, Intervention Energy, LLC (collectively, the “Debtors”), are limited liability companies organized under the laws of the state of Delaware. Based primarily in North Dakota, the Debtor’s operations focus on natural gas exploration and production.

In January 2012, the Debtors entered into a Note Purchase Agreement with EIG Energy Fund IV-A, L.P (the "Lender") for up to $200 million in senior secured notes (the "Notes"). After an event of default in October 2015, stemming from the Debtors' failure to comply with certain maintenance covenants, the Lender and the Debtors entered into a forbearance agreement in December 2015. As part of the agreement, the Lender agreed, among other things, that it would waive all defaults if the Debtors raised $30 million of equity capital to pay down a portion of the remaining principle on the Notes. Critically, this agreement was conditioned on (i) admitting the Lender as a member of IEH and (ii) amending IEH's operating agreement to require the unanimous approval of all unit holders prior to any voluntary bankruptcy filing (*i.e.,* the granting of a Golden Share to the Lender). IEH complied with the conditions and sold a single common unit to the Lender for $1.00 with the remainder of the 22,000,000 common units in IEH to be held by Intervention Energy Investment Holdings, LLC.

On May 20, 2016, the Debtors each filed voluntary petitions for relief pursuant to chapter 11 of title 11 of the United States Code (the "Bankruptcy Code") with the Court. The Lender moved to dismiss the petition on the grounds that IEH lacked the proper authorization to file for chapter 11 because Lender had not consented to the filing as required under the Consent Provision.

The Lender also argued for enforcement of the amended provisions of the operating agreement under Delaware law. Citing the Delaware LLC Act, which permits limited liability companies wide latitude to abrogate fiduciary responsibilities, Lender argued that a Delaware LLC was permitted to contract away its right to file for bankruptcy. *See Intervention* at 7.[1] Lender argued that the amended provisions were valid because they were negotiated in good faith and it had paid for the common unit and the associated voting rights.

## III. Decision

The Court's decision not to dismiss the Debtors' chapter 11 petitions was grounded in federal bankruptcy policy that a debtor's right to file for bankruptcy cannot be contracted away.

> It has been said many times and many ways. "[P]repetition agreements purporting to interfere with a debtor's rights under the Bankruptcy Code are not enforceable." "If any terms in the Consent Agreement ... exist that restrict the right of the debtor parties to file bankruptcy, such terms are not enforceable." "[A]ny attempt by a creditor in a private pre-bankruptcy agreement to opt out of the collective consequences of a debtor's future bankruptcy filing is generally unenforceable. The Bankruptcy Code pre-empts the private right to contract around its essential provisions." "[I]t would defeat the purpose of the Code to allow parties to provide by contract that the provisions of the Code should not apply." "It is a well settled principal that an advance agreement to waive the benefits conferred by the bankruptcy laws is wholly void as against public policy."

*Intervention* at 6 (citations omitted).

[1] *See* 6 Del. C. § 18-1101(c) ("To the extent that, at law or in equity, a member or manager or other person has duties (including fiduciary duties) to a limited liability company or to another member or manager or to another person that is a party to or is otherwise bound by a limited liability company agreement, the member's or manager's or other person's duties may be expanded or restricted or eliminated by provisions in the limited liability company agreement; provided, that the limited liability company agreement may not eliminate the implied contractual covenant of good faith and fair dealing."). The *Intervention* Court does not opine whether members of Delaware LLCs who have contracted away their fiduciary duties of care and loyalty, still "retain a duty to vote in the best interest of the potential debtor to comport with federal bankruptcy policy." *Intervention at 5.*



 

The Court did not address the Lender's arguments under the Delaware LLC. Rather, the Court's analysis focused heavily on the circumstances that gave rise to the pre-petition amendment of the operating agreement and issuance of the Golden Share versus the existence of the Golden Share itself. First, the Court observed that the Lender structured its receipt of the Golden Share with the sole intent of blocking the Debtors' chapter 11 filings. *See Intervention* at 7-8. Second, the Court distinguished the Lender's conduct in connection with its receipt of the Golden Share from a decision issued by the Southern District of Georgia which recognized that a party may wear two hats (creditor and equity holder) and could block a bankruptcy filing. *See In re Global Ship Sys.*, 391 B.R. 193 (S.D. Ga. 2007). The Court observed, that "Global Ship Sys. in which a creditor who also owned Class B equity interests in the LLC valued initially at 20 percent was held to 'wear two hats' and therefore could block a bankruptcy where an entity who is exclusively a creditor could not. However, the method by which the creditor in Global Ship Sys. received its equity interests was not subject to question or analysis. There is no way to compare that creditor's interests to EIG's contracting for one golden share solely for the purpose to control any potential filing." *Intervention at 9*, n.25 (citations omitted). Indeed, the Court's ultimate conclusion that the Debtors possessed the necessary authority to commence their chapter 11 cases was factually couched as follows:

> A provision in a limited liability company governance document obtained by contract, the sole purpose and effect of which is to place into the hands of a single, minority equity holder the ultimate authority to eviscerate the right of that entity to seek federal bankruptcy relief, and the nature and substance of whose primary relationship with the debtor is that of creditor—not equity holder—and which owes no duty to anyone but itself in connection with an LLC's decision to seek federal bankruptcy relief, is tantamount to an absolute waiver of that right, and, even if arguably permitted by state law, is void as contrary to federal public policy. Under the undisputed facts before me, to characterize the Consent Provision here as anything but an absolute waiver by the LLC of its right to seek federal bankruptcy relief would directly contradict the unequivocal intention of EIG to reserve for itself the decision of whether the LLC should seek federal bankruptcy relief.

*Id.* at 9-10 (citations omitted).

IV. Discussion

Under the facts of this case, the Court found that if a provision of an operating agreement requires the unanimous consent of all members to commence a bankruptcy proceeding (the "Consent Provision") and (a) the governing LLC agreement exonerates the members from all fiduciary duties (except the implied duties of good faith and fair dealing), (b) one of the members is a lender to the LLC who required the Consent Provision pursuant to a pre-petition contract (*e.g.* a forbearance agreement) and (c) it is determined that the lender holds its interest in the LLC for the sole purpose of preventing a bankruptcy filing, the Consent Provision is void as a matter of federal public policy and the remaining members may authorize the bankruptcy filing without the lender's consent.

Courts have generally held that an absolute waiver of the right to file bankruptcy is unenforceable.[2] While the holding of *Intervention* may be read narrowly to apply specifically to the facts of that case, the Court's ruling underscores the careful scrutiny courts will bring to bear on consent provisions and other forms of creditor protections like Golden Shares. Indeed, two months prior to the Court's ruling in *Intervention*, the Bankruptcy Court for the Northern District of Illinois denied a lender's motion to dismiss a chapter 11 filing where its

[2] *In re Shady Grove Tech Center Assocs. Limited Partnership,* 216 B.R. 386, 389 (Bankr. D. Md. 1998)

"blocking director" had not authorized the bankruptcy filing. *See In re Lake Michigan Beach Pottawatamie Resort LLC*, 547 B.R. 899 (Bankr. N.D. Ill. Apr. 5, 2016). Creditors commonly negotiate these types of bankruptcy remoteness provisions into agreements with their borrowers and the lessons of Intervention should not be ignored.

The Court's ruling in *Intervention* also demonstrates the truism that bankruptcy remote does not mean bankruptcy proof. *See, e.g., In re General Growth Properties, Inc. et al.*, 409 B.R. 43 (Bankr. S.D.N.Y. 2009). As a result, it remains vital to pay close attention to structuring real estate loans to minimize the risks of cases such as *Intervention*. The negotiation of strong co-lender and/or intercreditor agreements is vital. Similarly, real estate lenders must ensure that they lend into bankruptcy-remote SPE structures in which they are the sole creditor. For this reason, the issuance of mortgage and mezzanine debt to separate SPEs is strongly favored over A/B note loan structures. This will aid the lender in arguing for dismissal of the bankruptcy case on the basis that the borrower cannot confirm a plan of reorganization over its objection. *See, e.g., In re JER/Jameson Mezz Borrower II, LLC*, 461 BR 293 (Bankr. D. Delaware 2011); 11 U.S.C. §§ 1129(a)(8), (a)(10).[3]

Additionally, since the courts have generally held non-recourse carveout guaranties – known colloquially as *bad boy guaranties* – to be enforceable and not contrary to public policy, lenders should seek such guaranties from credit-worthy individuals and/or entities as both an "insurance policy" in the event of a bankruptcy filing, and a disincentive to such a bankruptcy filing.

In the meantime, the *Intervention* ruling raises numerous questions. For example, will this ruling alter the response of future lenders faced with forbearance requests by distressed companies? In *Intervention*, the lender viewed the golden share as a condition for its forbearance, since the lender was otherwise being asked to defer enforcement of its contractual remedies. Will future lenders in similar situations refuse to forbear in light of the bankruptcy risks? Additionally, would the result here have been different if the golden share had been granted upfront, during the initial structuring of the loan (as opposed to on the eve of bankruptcy), or if the members had retained their fiduciary duties? Finally, if it is a violation of public policy to permit companies to grant golden shares and/or board seats, is it also a violation of public policy to permit companies to contract away their members and directors fiduciary duties to file for bankruptcy in appropriate instances?

The true extent to which the *Intervention* holding will affect lenders and creditors is unclear due to the paucity of court decisions on the matter. However, one thing is for certain – there will be more opportunities for courts to weigh in on this issue.

For more information contact one of the lawyers listed below.


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[3] The lender in *Intervention* also argued for dismissal of the bankruptcy case on this basis, however the Court stated that it would rule on the issue separately. To date, the docket does not reflect such a ruling.



 