# Movin' on Up: Fifth Circuit is Asked to Consider the Validity of the 'Golden Share'

January 30, 2018 Lawrence Mittman

PRACTICES Commercial Real Estate Leasing, Distressed Real Estate, Real Estate, Restructuring

In our client alert dated September 14, 2016, we discussed the decision of the United States Bankruptcy Court for the District of Delaware in *In re Intervention Energy Holdings, LLC*, which refused to invalidate a bankruptcy filing made without the consent of its lender who held a "Golden Share" as void against federal public policy. In December 2017, the United States Bankruptcy Court for the District of Mississippi (the "Mississippi Bankruptcy Court") issued a decision in *In re Franchise Services of North America, Inc.*, no. 1702316EE (Bankr. S.D. Mich., Dec. 18, 2017) (hereinafter "*In re Franchise Services*"), which dismissed a bankruptcy filing made without the consent of a party holding a "Golden Share." In January 2018, the Mississippi Bankruptcy Court certified the appeal of its decision directly to the United States Court of Appeals for the Fifth Circuit. The Fifth Circuit would be the highest court to consider the validity of "Golden Shares" and whether or not it violates bankruptcy policy.

As we described in our prior client alert, in the aftermath of the real estate downturn from 1989 to 1993, 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." 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. While *In re Franchise Services of North America, Inc.* is not a decision in the real estate context, the decision (and the potential ruling from the Fifth Circuit) is nonetheless important to those who may seek to rely upon this device.

Prior to the commencement of its Chapter 11 case, Franchise Services of North America, Inc. ("FSNA"), then a Canadian company, acquired the Advantage rent-a-car business from Hertz with $15 million of financing provided by affiliates of Macquarie Capital (USA), Inc. ("Macquarie"). In exchange for the financing, Macquarie's wholly-owned affiliate, Boketo LLC ("Boketo") was given a 49.76 percent interest in FNSA in the form of Class a Preferred Stock. Macquarie was also entitled to advisory and arrangement fees from FNSA in the amount of $3 million, but was never paid.

As part of the transaction, FNSA was redomiciled as a Delaware corporation and its certificate of incorporation included a provision ("Section 4(j)") which required the affirmative vote of the holders of a majority of the Class A Preferred Stock and the holders of a majority of the holders of common stock in order to file a petition for bankruptcy. Accordingly, Boketo (the wholly-owned affiliate of Macquarie) held a "golden share" and, as a matter of its formation documents, could prevent FNSA from filing for bankruptcy.

On June 26, 2017, FNSB filed a Chapter 11 petition with the Mississippi Bankruptcy Court along with an undated certificate of resolution from its board of directors authorizing the filing.[1] In August,

2017, Macquarie filed a motion seeking the dismissal of FNSB's Chapter 11 case in violation of its certificate of incorporation. Boketo, the holder of the Class A Preferred Shares, filed a joinder to Macquarie's motion. FNSB opposed the motions arguing, primarily, that any provision restricting the right of a company to file for bankruptcy is void as a matter of public policy. As discussed below, the Mississippi Bankruptcy Court denied Macquarie's motion, but granted Baketo's motion to dismiss and enforced the validity of the "Golden Share."

The Mississippi Bankruptcy Court reviewed the seven (7) existing decisions regarding the validity of "Golden Shares" and concluded that courts will uphold "golden shares" if it is held by an equity holder. *In re Franchise Services* at 11-18 (citing *In re Global Ship Sys., LLC*, 391 B.R. 193 (Bankr. S.D. Ga. 2007); *In re Bay Club Partners-472*, LLC, Case no. 14-30394, 2014 WL 1796688 (Bankr. Or. May 6, 2014); *In re Lake Michigan Beach Pottawattamie Resort, LLC*, 547 B.R. 899 (Bankr. N.D. Ill. 2016); *In re Intervention Energy Holdings, LLC*, 553 B.R. 258 (Bankr. D. Del. 2016); *In re Tara Retail Group, LLC*, Case no. 17-57, 2017 WL 1788428 (Bankr. N.D. W. Va., May 4, 2017); *In re Squire Court Partners Ltd. P'ship*, 574 B.R. 701 (Bankr. E.D. Ark. 2017); *In re Lexington Hospitality Group, LLC*, Case no. 17-51568, 2017 WL 4118117 (Bankr. E.D. Ky., Sept. 15, 2017)). The Mississippi Bankruptcy Court first denied Maquarie's motion to dismiss because Maquarie was a pre-petition creditor of FSNA being owed $3 million on account of its advisory and arrangement fees. Conversely, the Mississippi Bankruptcy Court determined that, although Boketo was a wholly-owned subsidiary of Macquarie, it wore only the hat of an equity holder on account of its Class A Preferred Shares which it received in exchange for a $15 million investment. The Mississippi Bankruptcy Court refused to view Maquarie and Boketo as the same entity despite Macquarie's acknowledgement that it completely controlled Boketo. The Mississippi Bankruptcy Court reasoned that even if Boketo and Macquarie were one in the same, the result would not change. The Court stated, "Macquarie [is] wearing 'two hats.' Macquarie's one hat is as the creditor owed $3,000,000.00, and the other hat as the equity holder Boketo with a $15,000,000.00 stake in [FSNA]. '[S]ince [Macquarie] wears two hats in this case . . . it has the unquestioned right to prevent, by withholding consent, a voluntary bankruptcy case." *In re Franchise Services* at 20 (citing *In re Global Ship Sys., LLC*, 391 B.R. at 203).

The Mississippi Bankruptcy Court further opined that the board of directors of FSNA acted in good faith and on an informed basis when it decided to grant the "golden share" to Boketo by incorporating Section 4(j) into its certificate of incorporation. See *In re Franchise Services* at 20-21. The Court further determined that, as a minority shareholder of a corporation, Boketo did not owe a fiduciary duty to FSNA or any of the members of the board of directors and could therefore vote in its own interest. See *In re Franchise Services* at 21-22. The Mississippi Bankruptcy Court then determined that Delaware law (specifically section 102(b)(1) of the Delaware General Corporations Law) permits a corporation to delegate authority to file for bankruptcy from the board of directors to an equity holder. See *In re Franchise Services* at 22-25.

Ultimately, the Mississippi Bankruptcy Court concluded as follows:

> The FSNA Board made the decision to take the authority to file for bankruptcy from the FSNA Board and give it to one if its substantial equity holders, Boketo. The Debtor failed to prove that [Section 4(j)] contravenes Delaware law and failed to provide the Court with case law which holds that a golden share/blocking provision is contrary to Delaware law. Consequently, the Court finds that [Section 4(j)] is not contrary to Delaware law and is valid.

*In re Franchise Services* at 26.

The Mississippi Bankruptcy Court did not reach the question of whether the "golden share" is void as a matter of federal public policy (i.e. bankruptcy law) presumably because it had concluded that Macquarie's primary relationship is that of an equity holder (through Boketo's $15 million investment) and not as a creditor (its $3 million claim). As stated by the Bankruptcy Court in *In re Intervention Energy Holdings, LLC*:

> 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.

*In re Intervention Energy Holdings, LLC*, 553 B.R. 258, 265-66 (Bankr. D. Del. 2016).

The Mississippi Bankruptcy Court appeared to give great weight to a factual distinction between its case and those in *In re Intervention Energy Holdings, Inc.* and other cases which did not dismiss the pending bankruptcy cases. Specifically, Macquarie's indirect equity interest in the debtor arose in exchange for an actual equity investment and was much greater than the amount of its unsecured claim ($15 million vs. $3 million). The lenders in *In re Intervention Energy Holdings, Inc.*, for example, were given a non-economic interest in the debtor as part of a restructuring of its existing debt. The Mississippi Bankruptcy Court's decision is fascinating. If it is indeed premised on a factual distinction, what facts could have persuaded the court to rule differently? While no valuation findings were made in the opinion, what if the debtor was insolvent and Macquarie's Class A Preferred Shares had no value but its $3 million claim could receive a near full recovery out of court? In that context, would the Mississippi Bankruptcy Court still find that Macquarie was using its "equity hat" when it did not consent to the bankruptcy filing? Given the potential for significant factual distinctions, if it affirms, whether the Fifth Circuit Court of Appeals determines that "golden shares" are invalid *per se* or simply on these facts will be closely watched.

---

[1] Prior to FNSB's chapter 11 filing, the FNSB subsidiary that owned that Advantage rent-a-car assets had filed for bankruptcy, sold its assets and had its case dismissed.