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2019 Alexander L. Paskay Memorial Bankruptcy Seminar

Great Debates

Leonard H. Gilbert, Moderator

Holland & Knight LLP; Tampa

Resolved: A Chapter 13 Debtor Who Completes Plan Payments But is Behind in Direct Payments Should Get a Section 1328 Discharge.

Hon. Michael G. Williamson

U.S. Bankruptcy Court (M.D. Fla.); Tampa

Hon. Catherine P. McEwen

U.S. Bankruptcy Court (M.D. Fla.); Tampa

Resolved: Restrictions on a debtor's authority to file bankruptcy should be enforced.

G. Eric Brunstad, Jr.

Dechert LLP; Hartford, Conn.

Michael P. Richman

Steinhilber Swanson LLP; Madison, Wis.

43rd Annual Alexander L. Paskay Memorial Bankruptcy Seminar



GREAT DEBATES

Resolved: Use of the phrase "with respect to the debtor" in 11 U.S.C. § 362(c)(3) makes this provision applicable to termination of the automatic stay only as it relates to actions against the debtor and property of the debtor; this provision does not terminate the stay as to actions against property of the estate.

Section 362 operates as a stay of...

- ▶ “The commencement or continuation . . . of a judicial, administrative, or other action or proceeding **against the debtor . . .**” --(a)(1)
- ▶ “The enforcement, **against the debtor or property of the estate**, of a judgment” --(a)(2)
- ▶ “Any act to obtain possession of **property of the estate**” --(a)(3)
- ▶ “Any act to create, perfect, or enforce any lien **against property of the estate.**” --(a)(4)
- ▶ “Any act to create, perfect, or enforce **against property of the debtor any lien**” --(a)(5)

§ 362(c)(3)(A)

if a single or joint case is filed by or against a debtor who is an individual in a case under chapter 7, 11, or 13, and if a single or joint case of the debtor was pending within the preceding 1-year period but was dismissed, other than a case refiled under a chapter other than chapter 7 after dismissal under section 707(b)—

. . .

the stay under subsection (a) with respect to any action taken **with respect to a debt or property securing such debt** or with respect to any lease **shall terminate with respect to the debtor on the 30th day after the filing of the later case;**

§ 362(c)(4)(A)

(i) if a single or joint case is filed by or against a debtor who is an individual under this title, and if 2 or more single or joint cases of the debtor were pending within the previous year but were dismissed, other than a case refiled under a chapter other than chapter 7 after dismissal under section 707(b), **the stay under subsection (a) shall not go into effect upon the filing of the later case;**

Confirmation of No Stay

- ▶ “On request of a party in interest, the court shall issue an order under subsection (c) confirming that the automatic stay has been terminated.”
- ▶ --§ 362(j)



Resolved: Section 362(c)(3) terminates the automatic stay only as it relates to the debtor and property of the debtor and not to property of the estate.

- Agree
- Disagree
- No Opinion



Tampa Bay judges crack down on serial bankruptcy filers

Bay area judges are cracking down on the growing number of debtors filing multiple bankruptcy petitions in a bid to hang on to their homes.



Walter Powell is going to take the photos before. This is his fourth bankruptcy filing at his home. AP/WIDE

By Susan Laska-Martin

Published: 09/22/2019
Updated: November 15, 2019

Rodney Brown, Brandon, Fla.

"I find and conclude that you are a serial abusive bankruptcy filer," McEwen said in a recent hearing, reading off a list of seven separate filings since 2008. "I am going to ban you for two full years from filing. I'm sorry, Mr. Brown, you've just had too many chances."

...on getting an overworked bankruptcy court in the past year and a half, at least by Tampa Bay residents have been barred from refiling for up to two years after it became obvious they declared bankruptcy primarily to block foreclosures.

THE END

We can all agree serial filers are

a "drain on the system"



Rochelle's Daily Wire | ABI Exclusive

August 30, 2016

Alabama Judge Takes Majority View on Automatic Stay Termination for Repeat Filers

“ For serial filers, automatic stay held to terminate only on the debtor's property.

The split among the lower courts widens on the automatic termination of the automatic stay as to property of the estate belonging to a repeat filer.

In the case of an individual whose prior bankruptcy was dismissed within a year of a new filing, Section 362(c)(3)(A) automatically terminates the stay in 30 days “with respect to the debtor.” District Judge William R. Sawyer of Montgomery, Ala., took sides with the majority by holding that the stay does not also terminate automatically with regard to estate property.

Judge Sawyer's Aug. 25 opinion admirably lays out and analyzes decisions going both ways. No circuit court has tackled the question, but three district courts and the First Circuit Bankruptcy Appellate Panel are in the majority by holding that the stay evaporates automatically only with respect to property of the debtor.

Led by the Ninth Circuit B.A.P.'s opinion in *In re Reswick*, the minority find the statute ambiguous and hold that the stay terminates as to both the estate's and the debtor's property.

Although he followed the majority, Judge Sawyer conceded that terminating the stay only with regard to the debtor's property makes the statute “relatively toothless” against repeat filers. In practical effect, a repeat filer can be evicted under the majority's opinions, but can retain an automobile that is property of the estate.

In an opinion that is debtor-friendly in substance, Judge Sawyer said that the plain meaning of the statute is “unambiguous but not absurd.” He therefore declined to correct what may have been a drafting error by Congress.

To read ABI's analysis of *Vitalich v. Bank of New York Mellon*, where a district judge in the Northern District of California took sides with the minority earlier this month, [click here](#).

Opinion Link

[View Opinion](#)

Case Details

Judge Name	William R. Sawyer
Case Citation	In re Roach, 16-10574, (M.D. Ala. Aug. 25, 2016)
Case Name	In re Roach

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Case Type	Consumer
Court	11th Circuit Alabama Alabama Middle District
Bankruptcy Tags	Automatic Stay Consumer Bankruptcy



Bill Rochelle
EDITOR-AT-LARGE, ABI
[@BillRochelle](#)

An insightful writer known for his authoritative take on legal developments affecting bankruptcy practice, Bill Rochelle published for Bloomberg every day from 2007 through 2015.

Prior to his second career in journalism, he practiced bankruptcy law for 35 years, including 17 years as a partner in the New York office of Fulbright & Jaworski LLP.

By The Numbers

Total cases in system	1067
Business Cases	407
Consumer Cases	464
Circuit Splits Cases	44
Supreme Court Cases	63
Total Judges	592



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66 Canal Center Plaza,
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Alexandria, VA 22314

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Rochelle's Daily Wire | ABI Exclusive

August 15, 2016

California Judge Adopts Minority View on Automatic Termination of the Stay

“ District judge follows Ninth Circuit BAP on stay termination for serial filers.

Adopting the minority view, a district judge in California decided that the automatic stay terminates automatically in 30 days as to the debtor and property of the estate, not just with respect to an individual whose prior bankruptcy was dismissed within a year.

District Judge Beth Labson Freeman of San Jose followed a 2011 Ninth Circuit Bankruptcy Appellate Panel opinion named *In re Reswick*, which she called “lengthy and well-reasoned.”

In the case of an individual whose prior bankruptcy was dismissed within a year of a new filing, Section 362(c)(3)(A) automatically terminates the stay in 30 days “with respect to the debtor.”

According to Judge Freeman’s Aug. 10 opinion, the majority of courts hold that the stay does not terminate automatically as to property of the estate. The majority, she said, draws an “unambiguous distinction between the debtor and the debtor’s property.”

The minority, including the Ninth Circuit B.A.P., believe the majority’s “plain meaning” argument is “reasonable,” but they see “other reasonable constructions,” Judge Freeman said. Given several possible interpretations, she concluded that the “plain meaning approach” does not resolve the matter.

Judge Freeman analyzed the 2005 BAPCPA amendments in Section 362 and the intention of Congress “to correct perceived abuses of the bankruptcy system.” She said it would be “inconsistent with this scheme of deterrence” if the stay with regard to a serial filer remained in effect with regard to estate property, “which as a practical matter usually consists of all significant assets.”

Judge Freeman therefore upheld the bankruptcy court which had ruled that the stay terminated automatically as to estate property as well.

Case Details

Judge Name	Beth Labson Freeman
Case Citation	Vitalich v. Bank of New York Mellon, 16-0420 (N.D. Cal. Aug. 10, 2016)
Case Name	Vitalich v. Bank of New York Mellon
Case Type	Consumer
Court	9th Circuit

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[California](#)
[California Northern District](#)

Bankruptcy Tags [Automatic Stay](#)
[Consumer Bankruptcy](#)



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Feature

BY DAVID P. HOLTkamp

The Meaning of “with Respect to the Debtor” Revealed

A lot of ink has been spilled over the language in § 362(c)(3) providing that the automatic stay “shall terminate with respect to the debtor” after 30 days,¹ and it seems that there will soon be more ink. The Seventh Circuit recently accepted a direct appeal in *In re Wade* from the U.S. Bankruptcy Court for the Northern District of Illinois that might resolve the issue, at least in that circuit.² However, while there is considerable commentary regarding this section for the circuit court to chew on, none of it is truly satisfactory. Only when the language of § 362(c)(3) is read in context of its originally proposed version does the purpose of the phrase “with respect to the debtor” reveal itself.

David Holtkamp is an assistant corporation counsel supervisor with the City of Chicago’s Department of Law, where he oversees the Bankruptcy Unit.

Why the Phrase “with Respect to the Debtor” Appears in § 362(c)(3)

Since § 362(c)(3) was added to the Bankruptcy Code by the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA), courts have questioned the meaning of its stay-termination provision. Courts have found it difficult to determine whether the entire stay terminates after 30 days, or whether only the sliver of the stay prohibiting acts against the debtor personally is terminated.³ While the former continues to be the minority view,⁴ it is most likely the correct interpretation of the provision.

Courts accepting the minority view have pointed out that it is most consistent with the Code’s text and Congress’s intent.⁵ This is certainly true, but the reason the minority view is correct is revealed when the statute’s language is read in the context of the legislation as it originally appeared in the Bankruptcy Reform Act of 1998.⁶

The text of the proposed act provided nearly identical language to what is now in § 362(c)(3), including the language that the stay will termi-

nate “with respect to *the debtor*.”⁷ However, the proposed legislation also included the addition of § 362(c)(5) to terminate the stay “with respect to *real or personal property*.”⁸ Therefore, while these provisions were drafted and proposed in tandem and included identical “with respect to” language, proposed § 362(c)(5) was not enacted,⁹ leaving confusion as to why the language was in § 362(c)(3). When reading the proposed provisions as originally drafted together, it becomes clear that the language was meant to merely distinguish between the termination of the entire stay as to a particular debtor that has filed a second time under § 362(c)(3), and a judge’s ability to terminate the stay as to a particular piece of property under the proposed § 362(c)(5). The language in § 362(c)(3) has nothing to do with slicing up the different portions of the automatic stay provided in § 362(a), as the majority courts have held.

Legislative History

BAPCPA took years to pass, and many of its provisions find their origins in the proposed Bankruptcy Reform Act of 1998.¹⁰ At the time, there were a number of perceived (at least) abuses of “the bankruptcy process that prevent lenders from foreclosing, even when the debtor is clearly unable to pay the mortgage debt.”¹¹ Debtors could simply file case after case to stall the foreclosure of their property, even if they had no ability or intent to ever come current.¹² To address this abuse, § 121 of the Bankruptcy Reform Act of 1998, “Discouraging Bad Faith Repeat Filings,” provided for the following language to be added as § 362(c)(3):

If a single or joint case is filed by or against an individual debtor under chapter 7, 11, or 13, and if a single or joint case of that debtor was pending within the previous [one]-year period but was dismissed, other than

1 See *Smith v. Maine Bureau of Revenue Servs.*, No. 17-cv-00340-jaw, 2018 WL 2248586 (D. Me. May 16, 2018) (collecting authorities discussing 11 U.S.C. § 362(c)(3)).

2 See *Wade v. Kreister Law PC*, No. 18-2564 (7th Cir. Aug. 17, 2018) (order accepting direct appeal with conditions).

3 There appears to be a third view that “with respect to the debtor” means with respect to the property of the debtor, as opposed to the property of the estate. See *In re Daniel*, 404 B.R. 318 (Bankr. N.D. Ill. 2009) (discussing different views). However, because the estate retains most property under 11 U.S.C. § 1306, this distinction makes little difference — and it is likely incorrect, too.

4 Courts determine which view is the majority by the number of written opinions, not by polling judges on how they apply the section in practice. This could lead to a very different result, because not all decisions and practices are in the form of written opinions.

5 *In re Daniel*, 404 B.R. at 329.

6 H.R. 3150, 105th Cong. § 121 (1998).

7 *Id.*

8 *Id.*

9 Proposed § 362(c)(5) was reworded and enacted as § 362(d)(4) as part of BAPCPA. See *In re Montalvo*, 416 B.R. 381, 386 (Bankr. E.D.N.Y. 2009). Section 362(d) is a more natural place to put this section because it grants the court the ability to modify the stay, instead of providing when the stay terminates automatically. However, by moving this provision to § 362(d), the “with respect to” language in § 362(c)(3) was left to be interpreted in isolation.

10 See generally H.R. 3150, 105th Cong. § 121 (1998).

11 Bankruptcy Reform Act of 1998; Responsible Borrower Protection Act; and Consumer Lenders and Borrowers Bankruptcy Accountability Act of 1998, Part III: Hearings on H.R. 3150, H.R. 2500, and H.R. 3146 Before the Subcomm. on Comm. and Admin. Law of the House of Rep. Committee on the Judiciary, 105th Cong. 275 (1998) (referred to as the “Hearing Report”).

12 *Id.*

a case refiled under a chapter other than chapter 7 after dismissal under section 707(b) of this title, the stay under subsection (a) with respect to any action taken with respect to a debt or property securing such debt or with respect to any lease will terminate *with respect to the debtor* on the 30th day after the filing of the later case.¹³

This section provides “that if a case filed by a debtor under Chapters 7, 11 or 13 was dismissed and *if the same debtor* files a second case within a year of the dismissal, the automatic stay will terminate within 30 days of the filing of the second case.”¹⁴ However, that was not the only perceived abuse from the mortgage lenders’ perspective. Another issue was the ability of debtors to transfer fractional interests in their properties to other people or entities, then serial file bankruptcy for those entities in order to obtain the protections of the stay almost indefinitely. The Consumer Mortgage Coalition provided an example:

In this case, the debtor was able to delay foreclosure for more than a year through the simple technique of repeatedly conveying a partial interest in the mortgaged property to a third party, who then filed for bankruptcy relief under Chapter 7. The filing by the third party triggered the automatic stay, delaying foreclosure on the property by two to three months. When the judge dismissed the Chapter 7 filed by the third party, the debtor simply found another transferee to whom a partial interest was conveyed and who filed under Chapter 7 following the conveyance again triggering the application of the automatic stay to the mortgaged property.¹⁵

To address this “situation in which a debtor transfers undivided interests in secured property to third party transferees,” § 121 of the Bankruptcy Reform Act also proposed the addition of § 362(c)(5).¹⁶ The section provided that the court could grant relief from the stay “*with respect to real or personal property*” so that the stay would not apply to such property — even in a subsequent case by a different debtor.¹⁷ Thus, any order under proposed § 362(c)(5) would be effective against “any entity” that filed a later case.¹⁸ In short, the section would have permitted “*in rem* relief [to] prevent third-party transferees who file a petition in bankruptcy from delaying foreclosure on [a] property covered by *in rem* relief because the automatic stay would not apply to the covered property,” even though there was a different debtor involved.¹⁹

The problem now appears to be that the final version of the amendments to § 362(c) included the provision that the stay shall terminate “with respect to the debtor” after 30 days, thereby addressing the issue of when a debtor files serial cases. However, the proposed amendment to add § 362(c)(5), allowing for the termination of the stay “with respect to real or personal property” to combat the problem of different debtors serial filing cases (including the same

property), was not enacted as part of § 362(c).²⁰ Even so, these provisions were drafted and proposed together; therefore, when interpreting § 362(c)(3), courts should be guided by the entire proposal, including proposed § 362(c)(5).²¹

When read together, these sections show that the language’s intent found in § 362(c)(3) terminating the stay “with respect to the debtor” means that the entire stay terminates as to cases filed by that same debtor. This is as opposed to the text of proposed § 362(c)(5), which was not tied to the particular debtor as § 362(c)(3) is, but was instead tied to cases involving a particular piece of property (*i.e.*, “with respect to real or personal property”).

It makes perfect sense to draft these provisions where one section provides for the termination of the stay “with respect to the debtor” irrespective of the property involved, and another section provides for the termination of the stay “with respect to real or personal property” irrespective of the debtor involved. This is what was done and how § 362(c)(3) should be interpreted. The minority approach is correct.

The Interesting Case of the Wades

A case before the Seventh Circuit has some interesting twists.²² Harold and Lorraine Wade filed a joint chapter 13 petition on Jan. 14, 2015.²³ The case was originally assigned to Bankruptcy Judge **Pamela S. Hollis**. The debtors filed a motion to extend the stay, but it was stricken from the case because it was noticed for the wrong date.²⁴ The debtors’ attorneys did not re-notice the motion, and this lack of action was likely based on the belief that Judge Hollis was of the view that under § 362(c)(3), the stay only terminated as to property of the debtor. Therefore, there was no need to be concerned.

At some point early in the case, a law firm obtained a judgment against the debtors and immediately recorded it.²⁵ The firm refused to release the judgment, resulting in competing motions: The firm filed a motion to confirm that the stay had been terminated, and the debtors filed a motion for sanctions, thus asserting a stay violation.²⁶ In the meantime, the case had been transferred to Bankruptcy Judge **LaShonda A. Hunt**, who agreed with the extremely thoughtful and persuasive analysis of § 362(c)(3) provided by Judge **Eugene R. Wedoff** (ABI’s immediate past president) in *In re Daniel*.²⁷

In *Daniel*, the court correctly reasoned that “termination of the stay ‘with respect to the debtor’ should begin by recognizing that the phrase can only be understood in context.”²⁸ After going through all of the different theo-

20 As provided in note 9, this section was reworded and enacted as § 362(d)(4).

21 See *Richards v. United States*, 369 U.S. 1, 11 (1962) (it is a fundamental canon of construction “that a section of a statute should not be read in isolation from the context of the whole Act, and that in fulfilling our responsibility in interpreting legislation, we must not be guided by a single sentence or member of a sentence, but (should) look to the provisions of the whole law, and to its object and policy”) (internal quotations omitted).

22 *In re Wade*, No. 15-bk-01035, 2018 WL 5092954 (Bankr. N.D. Ill. June 6, 2018).

23 *Id.* at 1.

24 *Id.*

25 *Id.*

26 *Id.*

27 *Id.* at 2 (citing *In re Daniel*, 404 B.R. 318 (Bankr. N.D. Ill. 2009)).

28 *Id.* at 321.

continued on page 96

13 Bankruptcy Reform Act of 1998, H.R. 3150, § 121(3) (emphasis added).

14 Hearing Report at 276.

15 *Id.* at 275.

16 *Id.* at 276.

17 See Bankruptcy Reform Act of 1998, H.R. 3150, § 121(3) (emphasis added).

18 *Id.*

19 Hearing Report at 276.

The Meaning of “with Respect to the Debtor” Revealed

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ries, the court concluded that the phrase was meant to differentiate between spouses in a joint case when only one of them had a prior case subjecting them to § 362(c)(3).²⁹ The court reasoned that “the phrase ‘with respect to the debtor’ can be read as referring to the serially filing spouse, making that debtor subject to collection actions, both *in personam* and *in rem* (against estate and non-estate property), while leaving the stay completely in effect as to the newly filing spouse’s person and property.”³⁰ Following this analysis, Judge Hunt denied the debtors’ motion for sanctions and granted the firm’s motion to confirm that the stay had terminated.³¹

The *Daniel* court was certainly correct in its observation that context matters, and its conclusion is consistent with that observation. In addition to the context provided in the provisions as passed, courts should also read § 362(c)(3) in

the context of the provision as originally drafted and proposed, as provided above. In the end, the courts in *Wade* and *Daniel* are both correct in that the language “with respect to the debtor” merely means that the stay termination provision follows a particular debtor, and when that same debtor files successive cases, the entire stay terminates after 30 days. This reading is consistent with the statute as passed, and the statute as originally proposed.

Conclusion

When § 362(c)(3) language terminating the stay “with respect to the debtor” is read along with its sister section, which has been proposed but not passed, providing that the stay might be terminated “with respect to real or personal property,” its use in the section becomes clear. The disputed language in § 362(c)(3) is merely designed to ensure that there is no confusion that the termination follows the particular debtor that files the case, as opposed to a particular piece of property. **abi**

²⁹ *Id.* at 362.

³⁰ *Id.*

³¹ *Id.*

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Feature

BY JOHN D. DEMMY

Controlling a Borrower's Decision to Seek Bankruptcy Relief

Editor's Note: Mr. Demmy was a guest on ABI's "Eye on Bankruptcy" program in June 2018, where he discussed the cases presented in this article. Watch the episode at eyeonbankruptcy.com.



John D. Demmy
Saul Ewing Arnstein
& Lehr LLP
Wilmington, Del.

John Demmy is a partner with Saul Ewing Arnstein & Lehr LLP in Wilmington, Del. He represents debtors, creditors' and ad hoc committees, asset-buyers, insurers and creditors in bankruptcy cases and related litigation matters.

Lenders seek to minimize risk, and a bankruptcy filing that a lender does not suggest or support presents risk. Thus, lenders consider loan structures involving "bankruptcy-remote" or "single-purpose" borrower entities, or other devices, in order to limit or eliminate that risk. Some of those "other devices" involve so-called "blocking provisions" or "golden shares,"¹ which (as described in an ABI Secured Credit Committee newsletter article²) have been met with disfavor by courts.

Whether an entity has authority to file for bankruptcy is governed by state law, and unauthorized filings must be dismissed.³ Thus, lenders as a condition to financing sometimes might require adoption by a borrower of provisions in its organizational and internal governance documents bearing on the mechanisms by which a company may file a bankruptcy case and who must authorize the bankruptcy filing.

Independent Directors, Managers or Members as a "Workable Option"

A commonly used device requires the unanimous consent to a bankruptcy filing of all the borrower's managers, members or directors and the installation of one or more independent managers, members or directors whose duties are limited, usually solely to the decision of whether the borrower should seek bankruptcy relief. This will ordinarily involve a process by the independent person to evaluate whether the best interests of the company and its creditors (and not just the lender) would be served by a bankruptcy filing.

Assuming an appropriate discharge of the independents' duties, the "independent professional" construct likely reduces the risk of obvious bad-faith or futile filings sought to simply delay or assert improper leverage against a lender with no reasonable expectation of benefit to other creditors. However, such likely actions do not block all bankruptcy filings, as independents are expected to, and it is anticipated that they will, exercise their duties (whether fiduciary or not) in such a manner that they will consent to a bankruptcy filing if such is in the best interests of the company and its creditors.⁴

Case Law Has Not Been Kind to Blocking Provisions or Golden Shares

A "blocking provision" or "golden share" construct is more aggressive than the independent professional approach, as it lodges the bankruptcy authorization decision with the lender rather than an independent third party. To date, such provisions have not been well received by the courts, including *Lake Michigan Beach* (blocking provision not requiring the lender/special member of the LLC borrower to consider the interests of the company in exercising its authority contrary to Michigan law), *Intervention Energy Holdings* (golden share that gave the forbearing creditor, "which owes no duty to anyone but itself," the ability to "viscerate the right of [the LLC] to seek federal bankruptcy relief" was unenforceable as being contrary to federal policy favoring access to bankruptcy relief); and *In re Lexington Hospitality Group LLC*⁵ (LLC's agreement to add an affiliate of the lender as a 30 percent member (which later became 50 percent), and giving such member a veto on a bankruptcy filing, was contrary to federal public policy).⁶

1 In the bankruptcy context, (1) a "blocking provision" can be obtained by, for example, obtaining an agreement to appoint a director to the company's board and requiring unanimous board approval for a bankruptcy filing (see, e.g., *In re Lake Michigan Beach Pottawattamie Resort LLC*, 547 B.R. 899, 911 (Bankr. N.D. Ill. 2016)); and (2) a "golden share" ordinarily is a *de minimus* amount of equity issued by the borrower to the lender coupled with the requirement of unanimous equity consent to bankruptcy (see, e.g., *In re Intervention Energy Holdings LLC*, 553 B.R. 258, 261-62 (Bankr. D. Del. 2016)).

2 See John D. Demmy, "Lender-Inspired Operating Agreement Limitations on a Limited Liability Company's Authority to Seek Bankruptcy Relief: 'Perfect' Is the 'Enemy' of the Achievable 'Good,'" *ABI Secured Credit Committee Newsletter* (Feb. 3, 2018), available at abi.org/membership/committees/secured-credit (last visited June 27, 2018).

3 *Price v. Gurney*, 324 U.S. 100, 106-07 (1945). For a Delaware corporation or limited liability company (LLC), the Delaware General Corporation Law (DGCL) and the Delaware Limited Liability Company Act, respectively, identify the persons or entities that have the authority to manage the affairs of the company (including whether to commence a bankruptcy case), and such default provisions can be altered by the company's certificate of incorporation or LLC agreement. See 8 Del. C. § 141(a) and 6 Del. C. § 18-402.

4 The lender nevertheless could seek dismissal because the case was filed "in bad faith" based on all the facts and circumstances, but such is very likely a lengthier, costlier and more uncertain process than showing at the very outset of the case that the filing was without proper "corporate" authority under state law. See, e.g., *In re JER/Jameson Mezz Borrower III LLC*, 461 B.R. 293 (Bankr. D. Del. 2011) (dismissing single-asset LLC's chapter 11 case because bankruptcy had been filed on eve of foreclosure and primarily as "litigation tactic").

5 *In re Lexington Hosp. Grp. LLC*, 577 B.R. 676 (Bankr. E.D. Ky. 2017).

6 These decisions represent almost a "heads you win, tails I lose" proposition for lenders: *Lake Michigan Beach*, *Intervention Energy Holdings* and *Lexington Hospitality Group* involved "foolproof" bankruptcy-blocking provisions and "veto" power; if such are void as contrary to federal public policy (even if valid under state law), then the unintended consequence of such a contractual provision upon invalidation by a court is that the decision to file a bankruptcy case in effect will be left with the people — the principals of the company — that the lender was trying to prevent from having such control.

What If an Equity Owner Holds the Veto or Blocking Power?

*In re Squire Court Partners Ltd. P'ship*⁷ dealt with a similar but different construct: unanimous equity consent was required for the company to file for bankruptcy, but none were creditors. A general partner (NHDC Texas) owned 0.01 percent of the company, and two limited partners owned 99.98 percent and 0.01 percent, respectively. The partnership defaulted on its mortgage obligations, the lender accelerated, and the guarantor of such obligations (NHDC's affiliate) refused to pay.

After failing to obtain consent from the limited partners, NHDC Texas caused the partnership to file for bankruptcy. It argued that the unanimous-consent provision was contrary to federal policy in part because a fiduciary must decide whether to seek bankruptcy relief, and the limited partners (which did not owe any fiduciary duties to the partnership and did not consider the interests of the partnership) had exercised an improper and self-interested veto.

In affirming the bankruptcy court's holding that the bankruptcy case was unauthorized and must be dismissed, the district court distinguished the *Lake Michigan Beach* and *Intervention Energy Holdings* decisions. Although not fiduciaries, the limited partners held "bona fide" equity positions in the company. Thus, those courts' policy concerns were not implicated.

The Fifth Circuit Enters the Fray

In *In re Franchise Services of North America Inc.*,⁸ the veto was held by a party that (according to the debtor) was both a creditor and equityholder, and as such invoked the policy concerns expressed in *Lake Michigan Beach* and *Intervention Energy Holdings* (again, according to the debtor). In May 2013, the debtor engaged an investment bank in connection with its acquisition of another company. The debtor agreed to pay the investment bank \$3 million in fees but did not pay. A subsidiary of the investment bank bought the company and was then merged into the debtor. Another investment bank subsidiary invested \$15 million in the debtor to help finance the acquisition and received convertible preferred stock representing a 49.76 percent equity interest in the debtor if converted (the largest equity interest in the debtor). The investment bank subsidiary's investment was conditioned on the debtor's adoption of a certificate of incorporation preventing the debtor from filing for bankruptcy unless a majority of each class of the company's equity authorized the filing.

The debtor filed for chapter 11 relief without soliciting the vote of the investment bank subsidiary. In response to the subsidiary's motion to dismiss the bankruptcy, the debtor argued that the shareholder-consent provision was contrary to federal policy and violated Delaware law. After an evidentiary hearing, the bankruptcy court granted the motion, ruling that requiring the investment bank subsidiary's consent was not contrary to federal policy — even if, as the debtor argued, the investment bank and investment bank subsidiary

were treated as a single entity. The bankruptcy court declined to rule on whether the shareholder-consent provision was contrary to Delaware law, opting instead to leave the issue for the Delaware courts to decide in the first instance.⁹ On the debtor's motion, the bankruptcy court certified a direct appeal to the Fifth Circuit on three questions:

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

The Fifth Circuit determined that it could not answer these questions as stated because it would result in an advisory opinion. The court stated that the right held by the investment bank subsidiary did not fit neatly into either the "blocking provision" or "golden share" construct. In any event, ruling generally on the validity of "blocking provisions" or "golden shares" rather than on the facts — an equity interest obtained for \$15 million coupled with the bankruptcy consent right — would not be appropriate. Thus, the court declined to answer the overly broad Question 1; it also seemed to decline to opine on whether a "blocking provision" or a "golden share" is valid under Delaware law.¹⁰

In answering Question 2 in the negative, the court stated that "there [was] no compelling federal law rationale for depriving a bona fide equityholder of its voting rights just because it is also a creditor of the corporation."¹¹ Thus, the Fifth Circuit held, and limited its holding, as follows:

This is not an advisory opinion, and our holding is limited to the facts actually presented in this case. We hold simply that federal bankruptcy law does not prevent a bona fide equityholder from exercising its voting rights to prevent the corporation from filing a voluntary bankruptcy petition just because it also holds a debt owed by the corporation and owes no fiduciary duty to the corporation or its fellow shareholders.¹²

The Fifth Circuit then went on to seemingly answer certified Question 3, stating that it was turning to "the main

⁹ The Delaware bankruptcy court in *Intervention Energy* also declined to rule on whether the "golden share" provision in that case violated Delaware law.

¹⁰ The Fifth Circuit stated that it "declined to resolve whether the shareholder-consent provision violate[d] Delaware law," in part because on appeal, the debtor expressly waived such argument by stating that the "abstract question as to whether Delaware would ever allow a blocking provision need not be debated." *Slip Op.* at p. 210.

¹¹ *Slip Op.* at p. 209.

¹² *Id.* at p. 209. In the context of this holding, the Fifth Circuit discussed and rejected the debtor's argument that even if federal policy did not prevent a creditor/equityholder from holding a veto over the company's bankruptcy filing, it would if that party did not owe any fiduciary duty to the company (*i.e.*, to consider the interests of the company and its other creditors in exercising the veto), stating that the debtor had offered "no good legal or logical rationale for such a holding." *Id.*

⁷ *In re Squire Court Partners Ltd. P'ship*, 574 B.R. 701 (E.D. Ark. 2017).

⁸ *In re Franchise Servs. of N. Am. Inc.*, 891 F.3d 198 (5th Cir. 2018), as revised (June 14, 2018) (hereafter, the "*Slip Op.*").

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event,” and posited the following: “[D]oes Delaware law allow [the investment bank subsidiary] to exercise the blocking right?”¹³ However, such seems at odds both with the phrasing of Question 3 and with the court’s conclusion that the debtor had waived its argument on “whether the shareholder-consent provision violates Delaware law.”¹⁴ In answering, the court referenced the DGCL provisions that allow a company’s charter to make provisions respecting the company’s management authority other than as set forth in the DGCL. In the absence of any on-point Delaware case, the court declined “to decide in the first instance” whether the DGCL would tolerate a shareholder veto provision. Finally, it is assumed that it would.¹⁵ In effect, the Fifth Circuit, like the bankruptcy court, declined to rule substantively on the first part of Question 3.

Next, the court considered whether the investment bank subsidiary as a shareholder nevertheless owed fiduciary duties to the debtor, a determination that could arguably impact the analysis (but at the end of the day, for the Fifth Circuit, apparently would not have). The Fifth Circuit’s survey of Delaware case law led it to conclude that a shareholder has fiduciary duties only when the shareholder holds a majority of the equity and if the minority shareholder “exercises control over the business affairs of the corporation” through control of the company’s board.¹⁶

Ultimately, the Fifth Circuit rejected the debtor’s argument that the investment bank/investment bank subsidiary exercised control over the debtor based on its near-50 percent ownership,¹⁷ its appointment of two of the company’s five directors and its veto right.¹⁸ The fact that the debtor had filed a voluntary petition (without soliciting the investment bank subsidiary’s vote) itself tended to show that the investment bank subsidiary did not have the required control.¹⁹ The court

further considered that whether the filing was authorized and whether control for fiduciary duty purposes existed are separate issues, and that the remedy for an alleged breach of a controlling shareholder’s fiduciary duty is not to ignore the requirements of a company’s charter in commencing bankruptcy, but rather to sue the shareholder for the breach.²⁰

What’s Next?

In the ABI newsletter article, it is speculated that lenders that chose not to go with the “independent professional” approach could try to avoid courts striking down contractually bargained-for bankruptcy filing veto provisions à la *Lake Michigan Beach* and *Intervention Energy Holdings* if they made a real equity investment in the company in return for such a right, rather than tying it to the lender’s status as creditor. The result in *Franchise Services* (and in *Squire Court Partners*) tends to confirm that view. However, what is the utility of this kind of bankruptcy-blocking mechanism if the lender simply wants to lend money and not invest in equity? What if the lender makes an equity investment of only a percentage point or two of the face amount of the loan in return for a “golden share”?²¹ Would that still be a “bona fide” equity interest that when coupled with a bankruptcy veto would not violate federal policy? Assuming that the Delaware legislature or courts do not issue a blanket prohibition over the inclusion or validity of blocking or golden share provisions in LLC agreements or corporate charters (and the prediction here is that they will not), and so long as there are smart and inventive lender and debtor lawyers, litigation over these concepts will continue, limited only by the creativity of counsel in formulating bankruptcy-remote lending scenarios and arguments in response thereto. **abi**

13 *Id.* at p. 209.

14 *Id.* at p. 210.

15 *Id.* at p. 211.

16 *Id.*

17 *Id.* at p. 212 (discussing, and citing cases with respect to, whether substantial minority ownership is “control”).

18 *Id.*

19 *Id.*

20 *Id.* at p. 214. The Fifth Circuit stated further that because it had concluded that the investment bank subsidiary was not a controlling shareholder, it did not need to decide whether it had breached any fiduciary duty. *Id.*

21 At least twice in its opinion, the Fifth Circuit in *Franchise Services* suggested that the outcome could be different if the equity investment was simply a “ruse” to protect the lender’s claim. *See, e.g., Slip Op.* at p. 209.

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Summarized by [LARS FULLER](#), BakerHostetler

8 months 1 week ago

Case Type: [Business](#)

Case Status: [Affirmed](#)

Citation: No. 18-60093 (5th Circuit, May 22, 2018) [Published](#)

Tag(s): [5th Circuit](#), [Bankruptcy Process and Procedure](#), [Corporate Governance](#), [Practice and Procedure](#), [Professional Practice Areas](#), [Business Reorganization](#), , [§ 301](#)

Ruling: Fifth Circuit affirmed bankruptcy court (SD Miss) on direct appeal of order dismissing chapter 11 case based on failure to obtain shareholder consent for bankruptcy. Federal law does not prevent bona fide shareholder from exercising its right to vote against a bankruptcy petition

“The appeals court avoids ruling broadly on the ability of a golden share or blocking provision to bar a company from filing bankruptcy voluntarily.”

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just because it is also an unsecured creditor. Issue of corporate authority to file bankruptcy petition determined by state law. Debtor, as Delaware corporation, was governed by Delaware corporate law. Under Delaware law, shareholder is entitled to vote against filing a bankruptcy petition.

Procedural context: Bankruptcy court granted shareholder's motion to dismiss chapter 11 case. The bankruptcy court certified the debtor's direct appeal to the Fifth Circuit.

Facts: Macquarie Bank formed subsidiary Boketo to acquire 100% of FSNA's preferred stock for \$15 million equity investment. At same time, FSNA, national auto rental car company, reincorporated in Delaware and amended its certificate of incorporation. Amended certificate required consent of majority of each class of FSNA's common and preferred shareholders. Preferred stock carried with it right, granted in certificate of incorporation, to vote on certain corporate matters, including any "liquidation event," which included bankruptcy. FSNA acquired subsidiary, Advantage Rent-A-Car, but acquisition caused insolvency. FSNA filed bankruptcy without obtaining approval of Boketo. Boketo and Macquarie moved to dismiss for failure to obtain Boketo's consent.

Judge(s): King, Jones, Graves

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