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By Matthew J. O'Toole, R. Stephen McNeill, and Eric R. Glickman [*]

The Golden Share: An Analysis of the Latest Failure to Create Bankruptcy-Proof Entities

Recent case law re-affirms the long-standing principle that a lender may not by contract eliminate a borrower's ability to seek federal bankruptcy protection. In the context of structured finance transactions, some lenders have pursued inventive ways of evading this tenet, but courts continue to strike down attempts "to circumvent the bankruptcy laws by 'circuity of arrangement.'" [1] This article provides a brief overview of the use of bankruptcy-remote, special purpose entities, particularly Delaware limited liability companies, in structured finance transactions, and focuses on the doctrine of federal preemption as a basis for courts' steadfast refusal to enforce contractual provisions that would in effect waive the availability of bankruptcy protections. It also evaluates the potential impact recent case law may have on structured finance transactions, and discusses some practical considerations for structuring bankruptcy-remote, special purpose entities.

I. Structured Finance Transactions

A. An Overview of Bankruptcy-Remote, Special Purpose Entities

The special purpose entity—e.g., an entity formed for the sole purpose of owning assets that constitute collateral for a loan—is a hallmark of structured finance transactions. [2] Assets used as the basis for a financing are transferred to a special purpose entity to separate the credit risk of the transferor from the credit quality of the assets. [3] "Structured financings are based on one central, core principle—a defined group of assets can be structurally isolated, and thus serve as the basis of a financing that is independent as a legal matter, from the bankruptcy risks of the former owner of the assets." [4]

A structured financing provides comfort to a lender that it will recover on a debt. The structure of the special purpose entity offers one means of providing this reassurance. For example, the typical organizational documentation of a special purpose entity restricts it from engaging in any business unrelated to the financing for which the entity is formed. This reduces the likelihood that the special purpose entity will become insolvent by engaging in unanticipated business activities. [5] The special purpose entity is also less likely than the transferor to be subject to claims of preexisting creditors, as most often it is newly formed and has no prior business activities. [6]

A structured financing ameliorates concerns about bankruptcy risks. Special purpose entities are often structured to be bankruptcy remote, that is, set up in a manner making it less likely that a voluntary or involuntary bankruptcy case will be commenced by or against the entity. [7] For example, the narrow range of the special purpose entity's permitted business activities will prevent it from incurring debt to a creditor other than the lender; such debt, if unpaid, could enable the other creditor to file an involuntary bankruptcy petition against the entity. [8]

To buttress the entity's bankruptcy remoteness, its organizational structure typically requires it to maintain strict formalities with respect to the transferor of the assets now held by the special purpose entity. [9] The special purpose entity will be required among other things to conduct business in its own name, maintain its own separate books and records and bank accounts, pay liabilities only out of its own funds, and not commingle its assets with the assets of the transferor. Observance of these formalities reduces the likelihood that a court will consolidate the respective assets and liabilities of the transferor and the special purpose entity if a bankruptcy petition is filed by or against the transferor. [10]

To foster bankruptcy remoteness, the unanimous approval of one or more independent decision-makers (often designated as the "Independent Managers") frequently will be required to authorize the filing of a voluntary bankruptcy petition on behalf of the special purpose entity. [11] Provisions in the special purpose entity's organizational documentation requiring such Independent Manager consent reduce the likelihood that the entity will file a voluntary bankruptcy petition (which could impede enforcement of the lender's remedies against the entity). [12]

By reducing insolvency and bankruptcy concerns, a structured financing reduces the cost of borrowing and permits access to a preferred source of credit or enables funding that might not be available if the assets were to remain with the transferor. [13] The special purpose entity as borrower often can obtain a lower interest rate from a lender than can the transferor, with its associated credit risk, as borrower. [14]

B. Preference for Delaware Limited Liability Companies

A Delaware limited liability company ("DLLC") is often the special purpose entity of choice in structured financings. [15] Moody's Investors Service has characterized Delaware as "the preferred state for the LLC's formation." [16] The burgeoning popularity of the DLLC supports this proposition. DLLCs have been formed at a steadily increasing rate, with 70,274 formed in 2009, 103,271 formed in 2012, and 128,852 formed in 2016. [17] The number of DLLCs formed annually significantly outpaces the number of new Delaware corporations or limited partnerships. [18] "The phenomenon of business arrangements using [limited liability companies] has been developing rapidly over the past several years." [19]

The Delaware Limited Liability Company Act, 6 Del. C. § 18-101 et seq. (the "DLLC Act")—Delaware's statute governing formation, dissolution, and other aspects of the DLLC—invests a DLLC with certain statutory characteristics that make the DLLC especially useful as a special purpose entity. The DLLC combines attractive features of the corporation and the partnership and is "characterized as the 'best of both worlds.'" [20] It "combines corporate-type limited liability with partnership-type flexibility and tax advantages." [21] Under the DLLC Act, for example, a member or manager of a DLLC is not personally liable for the company's debts solely by reason of being a member or acting as a manager. [22]

Limited liability protections are consistent with the DLLC's status under the statute as a separate legal entity. [23] The DLLC has a legal existence separate from its members and can enter into contracts, sue and be sued, and hold title to property, all in its own name. [24] The DLLC's assets are protected from the creditors of its members, as the DLLC Act provides that no creditor of a member has a right to exercise remedies with respect to DLLC property. [25] The holder of a limited liability company interest in a DLLC has no interest in specific DLLC property, but instead is entitled to receive a share of the DLLC's profits and losses and distributions of DLLC assets. [26] The legal separateness of the DLLC from the transferor reduces the likelihood that a bankruptcy court will consolidate their assets and liabilities.

C. Limited Liability Company Agreement and Freedom of Contract Principle

The limited liability company agreement ("LLC Agreement") is the governing instrument of a DLLC. [27] It governs the affairs of the DLLC and the conduct of its business. [28] "[T]he purpose of an LLC agreement … is to define the rules of the game so that all parties know what to expect." [29] As a contract, the LLC Agreement is subject to contract interpretation principles. [30] Unlike an ordinary contract, however, it also is governed by the DLLC Act.

The DLLC Act is characterized as a gap-filling statute. The statute contains governance provisions that apply by default to a DLLC, many of which can be modified or eliminated in the LLC Agreement. "The basic approach of the [DLLC Act] is to provide members with broad discretion in drafting the [LLC] Agreement and to furnish default provisions when the members' agreement is silent." [31]

A fundamental characteristic of the DLLC Act is the principle of freedom of contract. [32] "An LLC is primarily a creature of contract, and the parties have wide contractual freedom to structure the company as they see fit." [33] The stated policy of the DLLC Act is "to give the maximum effect to the principle of freedom of contract and to the enforceability of limited liability company agreements." [34] The DLLC Act's overarching freedom of contract principle enables drafters to custom-fit the LLC Agreement to meet their business needs.

This freedom of contract principle makes the DLLC a preferred vehicle for structured financings. Business planners have substantial flexibility to tailor the LLC Agreement for a particular loan transaction. To structure a DLLC as a special purpose entity, for example, its LLC Agreement may set forth a narrow purpose for the DLLC, e.g., a purpose limited solely to engaging in the relevant financing and related activities. [35] A narrow purpose denies the borrower DLLC the legal power to engage in activities unknown to the lender that could hamper the borrower's ability to perform its obligations. [36] Negative covenants in an LLC Agreement frequently are used to prohibit the DLLC from incurring debt or owning assets unrelated to the relevant financing. [37] An LLC Agreement may also authorize the DLLC's execution, delivery, and performance of certain transaction documents to confirm that the DLLC is empowered to enter into a particular financing arrangement. [38]

II. Federal Bankruptcy Policy

A. Doctrine of Federal Preemption

The United States Bankruptcy Code (the "Bankruptcy Code") [39] and the doctrine of federal preemption act as a counterbalance to the DLLC Act's freedom of contract principle and lenders' desires to keep special purpose entity borrowers out of bankruptcy. Concerns arise when a lender overreaches, beyond bankruptcy remoteness, and endeavors to structure a borrower DLLC as bankruptcy proof. One form of excess is pursuit of a waiver in the LLC Agreement of the DLLC's right to file a voluntary petition under the Bankruptcy Code. Notwithstanding the DLLC Act's freedom of contract principle, such an outright waiver is likely unenforceable under the doctrine of preemption.

In general, the Supremacy Clause of the United States Constitution provides that all federal laws "shall be the supreme law of the land" and shall preempt enforcement of any conflicting state law. [40] The Supreme Court of the United States has held that state law may be preempted by federal law in several different ways. First, federal law may preempt state law when Congress has expressly stated its intention to preempt state law in statutes (often referred to as "express preemption"). [41] Second, federal law may preempt state law when the scheme of federal regulation is sufficiently comprehensive to make reasonable the inference that Congress "left no room" for supplementary state law (often referred to as "field preemption"). [42] Third, in circumstances where Congress has not completely displaced state regulation, federal law may preempt state law when state law actually conflicts with federal law (often referred to as "conflict preemption"). [43] Such a conflict occurs either because (i) compliance with both the federal and state regulations is

impossible or (ii) the state law stands as an obstacle to the accomplishment and execution of the purposes and objectives of Congress. [44]

Express preemption likely does not provide a basis for a court to invalidate a provision in an LLC Agreement that in effect would renounce the DLLC's right to seek federal bankruptcy relief. Congress, in enacting the Bankruptcy Code, did not expressly preempt state law (e.g., the DLLC Act and its freedom of contract principle). Although the Bankruptcy Code expressly voids waivers of certain types of bankruptcy protections [45] and eliminates a debtor's ability to waive the discharge of debt before the filing of a bankruptcy petition, [46] there is no blanket prohibition in the Bankruptcy Code against a contractual waiver of the right to file a bankruptcy petition. [47]

Field preemption also provides no basis for a court to invalidate a term in an LLC Agreement that would surrender the DLLC's ability to file for bankruptcy protection. Although the United States Constitution grants Congress the power to regulate bankruptcies, [48] there is no indication that the Bankruptcy Code is intended to displace state law arguably permitting such a waiver. Rather, the Bankruptcy Code is heavily dependent on state law for much of its substance, [49] and the United States Supreme Court has found that determining who has the authority to file a voluntary bankruptcy petition on behalf of a corporation is a question governed by state law. [50]

Conflict preemption, however, does provide an appropriate basis for a court to invalidate a provision in an LLC Agreement that would eliminate the DLLC's right or power to seek bankruptcy relief. A court could invalidate such a term in an LLC Agreement on the ground that this use of the DLLC Act's freedom of contract principle obstructs the fulfilment of Congress's purposes and objectives in enacting the Bankruptcy Code (i.e., that such a waiver violates federal public policy).

B. The Prevailing View

Courts have long held that contractual provisions prospectively denying an entity's right to seek relief under the Bankruptcy Code are unenforceable as violating federal public policy. [51] "Congress made it a central purpose of the bankruptcy code to give debtors a fresh start in life and a clear field for future effort unburdened by the existence of old debts." [52] "[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." [53] "[I]t is axiomatic that a debtor may not contract away the right to a discharge in bankruptcy. It has been said many times and many ways." [54]

C. Recent Case Law on Bankruptcy Approval Provisions in LLC Agreements

Recent decisions on this issue, in the context of provisions in the LLC Agreement of a bankruptcy-remote borrower, continue to follow the well-established federal public policy against foreclosing bankruptcy protections. In *In re Intervention Energy Holdings, LLC*, [55] the United States Bankruptcy Court for the District of Delaware found that a provision, governing the manner of approving a voluntary bankruptcy filing, in the LLC Agreement of Intervention Energy Holding, LLC, a DLLC (the "Company"), was "void as contrary to federal public policy." [56]

By way of background, the Company and its wholly-owned subsidiary entered into a note purchase agreement with an institutional investor, through which the investor provided funding in the form of senior secured notes. [57] After an event of default occurred, the parties entered into a forbearance agreement providing that the investor would waive all defaults if certain equity capital was raised to pay a portion of the notes. [58] As a condition to entering into the forbearance agreement, the investor required the Company to amend its LLC Agreement (i) to admit the investor as a member of the Company holding one common unit, and (ii) to require the approval of each holder of common units for proper

authorization of the Company's filing a voluntary bankruptcy petition. [59] The Company issued the investor one common unit and admitted the investor as a member. [60] The Company's only other member held 22,000,000 common units. [61] The Company filed a bankruptcy petition without consent of the investor member. [62] The investor member challenged the filing as unauthorized, being non-compliant with the provision in the LLC Agreement requiring its consent. [63] The parties did not dispute that, but for the provision in the LLC Agreement requiring the investor member's consent, the Company would have been authorized to seek federal bankruptcy relief. [64]

The court resolved the dispute on federal public policy grounds, stating:

> 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. [65]

The implication is that a contractual provision effectively waiving the right to initiate a bankruptcy case, even if permitted under the DLLC Act's freedom of contract principle and effectuated indirectly through such a bankruptcy approval provision in an LLC Agreement, is void as contrary to federal public policy. [66] Relying on the Bankruptcy Code's preclusion of a debtor's ability to waive the discharge of debt before the filing of a bankruptcy petition, the court stated that "[t]he 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." [67] The court also stated that the parties had endeavored "to circumvent the bankruptcy laws by 'circuity of arrangement.'" [68]

The court also rejected the Tenth Circuit Bankruptcy Appellate Panel's unpublished decision in *In re DB Capital Holdings, LLC*, [69] which enforced a contractual waiver in an LLC Agreement of the entity's right to file for bankruptcy protection, noting simply that it " disagree[s]" with that decision. [70] In *DB Capital*, an amendment to the LLC Agreement of the debtor, a Colorado limited liability company, contained an express waiver of the debtor's right to commence a bankruptcy or other insolvency proceeding. [71] The debtor's manager, after filing a bankruptcy petition on behalf of the debtor, argued that the waiver should be invalidated because it "was executed at the demand, and for the sole benefit, of Debtor's main secured creditor …." [72] The appellate panel disagreed, finding no evidence that the amendment was the result of coercion from a creditor. [73] Further, the appellate panel stated, "[d]ebtor has not cited any cases standing for the proposition that members of an LLC cannot agree among themselves not to file bankruptcy, and if they do, such agreement is void as against public policy, nor has the court located any." [74] The appellate panel enforced the waiver and declined to opine whether an LLC Agreement "containing terms coerced by a creditor would be unenforceable." [75]

The *Intervention Energy* decision also distinguished *In re Global Ship Systems, LLC*, another decision addressing a bankruptcy approval provision in an LLC Agreement. [76] The court in *Intervention Energy* stated that the investor's contracting for one "golden share" solely for the purpose of controlling a potential bankruptcy filing by the Company could not be compared to the bankruptcy approval provision addressed in *Global Ship Systems.* [77] In *Global Ship Systems*, the debtor, a Georgia limited liability company, was initially formed to purchase certain property and received a bridge loan to finance the purchase. [78] At the closing of the loan, the lender received a promissory note and an "equity kicker" equal to a 20% Class B equity interest in the debtor. [79] The LLC Agreement of the debtor barred certain actions,

including the filing of a voluntary bankruptcy petition, without the consent of the lender in its capacity as Class B equity holder. [80] The United States Bankruptcy Court for the Southern District of Georgia found that the bankruptcy approval requirement was permissible. [81] The court explained that an absolute waiver of the right to file a voluntary bankruptcy petition violates federal public policy if asserted by a lender, but that the lender wore "two hats" (i.e., as lender and as equity holder) and held the right to preclude the filing of a bankruptcy petition by withholding consent as an *equity holder*. [82] The court observed, "[w]hile some of the consent requirements expire upon payment of the … loan in full, the consent requirement concerning bankruptcy filings survives the extinguishment of the debt. Thus, [the lender's] right in the [LLC] Agreement to prevent a bankruptcy filing to which it does not consent is dependent solely on its status as an equity holder." [83]

III. Lessons for Structured Finance Transactions

A. Lender/Member Distinction

The case law distinguishes between the rights of a lender and the rights of an equity holder under an LLC Agreement. *Intervention Energy* establishes that a lender's contracting for a provision solely to afford it, by way of a token equity unit (i.e., a "golden share"), control over the debtor DLLC's bankruptcy filing, violates federal public policy. [84] In addition, the LLC Agreement of a debtor requiring a particular party's consent to the commencement of a bankruptcy proceeding is unenforceable if that party's "primary relationship with the debtor is that of creditor—not equity holder." [85] On the other hand, *DB Capital* indicates that members of a limited liability company may agree among themselves not to file a bankruptcy petition. [86] *Global Ship Systems* similarly found that an LLC Agreement requiring the consent of a 20% equity holder (who also was a lender) for the limited liability company to file for bankruptcy did not violate federal public policy, at least if the consent right were to survive repayment of the debt. [87]

The distinction between status as a lender and status as an equity holder could be the subject of future litigation. Consider a scenario, for example, where a lender in a structured finance transaction agrees to accept equity (i.e., become a member holding a limited liability company interest) in a borrower DLLC, in lieu of taking additional collateral, and contracts for a right under the LLC Agreement to approve a bankruptcy filing in such capacity. If the equity interest is significant enough and such approval right does not expire upon repayment of the debt, the lender could argue that the approval right is enforceable and does not violate federal public policy.

Few lenders, however, accept equity in lieu of additional collateral, likely due to practical considerations. Regardless of the reason, if a lender wishes to adopt an aggressive stance and, notwithstanding associated risks, seek an additional measure of control over its debtor's ability to file a bankruptcy petition, *DB Capital* and *Global Ship Systems* could provide a roadmap for structuring a bankruptcy-remote, special purpose entity without violating federal public policy.

In the meantime, *Intervention Energy* is unlikely to influence greatly the manner in which special purpose entities are organized in structured financings or the preference for the DLLC as the special purpose entity of choice. The decision is consistent with well-established case law indicating that a waiver of the right to commence a bankruptcy case is unenforceable. The decision also did not involve an arrangement that is typically used in structured financings. The provision in the LLC Agreement in *Intervention Energy* required the lender's consent (in its capacity as a member holding a common unit) to authorize the debtor DLLC's filing of a voluntary bankruptcy petition. Structured financings, by comparison, commonly involve structuring a DLLC to be bankruptcy *remote* by requiring the consent of two independent decision-makers (i.e., the "Independent Managers") for the DLLC to file a voluntary bankruptcy petition.

B. Drafting Considerations for LLC Agreements in Structured Finance Transactions

In structured finance transactions, certain provisions concerning Independent Managers are commonly included in the LLC Agreement of a borrower DLLC to foster bankruptcy remoteness. Lenders might overreach by requesting changes to these common provisions that could cross the line between bankruptcy-remote and bankruptcy-proof status. Lenders are sure to face federal preemption concerns if they "push the envelope." The discussion below considers some common provisions and circumstances in which modifications may give rise to federal preemption concerns.

1. Eligibility Criteria for Independent Managers

Lenders frequently request that the LLC Agreement require the unanimous approval of multiple Independent Managers to authorize the filing of a voluntary bankruptcy petition on behalf of the borrower DLLC. [88] Language such as the following is often used in an LLC Agreement to impose this requirement:

> Notwithstanding any other provision of this Agreement and any provision of law that otherwise so empowers the Company, the Member or any other Person, so long as any Obligation is outstanding, neither the Member nor any other Person shall be authorized or empowered on behalf of the Company to, nor shall they permit the Company to, and the Company shall not, without the prior unanimous written consent of the Member and all Independent Managers, file a voluntary bankruptcy petition.

Consistent with the DLLC Act's freedom of contract principle, the LLC Agreement often restricts who may serve as an Independent Manager. The purpose of such Independent Manager eligibility criteria is to prevent the Independent Manager from having divided loyalties between the equity holders and the lender. [89] To that end, the LLC Agreement often requires that a person serving as an Independent Manager have three years' prior experience in such capacity and be provided by a nationally-recognized service company providing professional Independent Managers. The LLC Agreement also often prohibits the Independent Manager from being a member, manager, or officer of, or a creditor to, the DLLC or its affiliates. Such requirements are intended to promote impartiality. An impartial Independent Manager is not beholden to, or biased against the interests of, the lender, and can make decisions (i.e., whether to authorize filing for bankruptcy relief) on the merits without being influenced by extraneous factors. A provision requiring a truly independent Independent Manager's consent to authorize a bankruptcy filing fosters bankruptcy remoteness without raising federal preemption concerns.

Federal preemption concerns arise, on the other hand, if an Independent Manager is the lender itself or a representative, agent, or employee of the lender. Similarly, such concerns exist if, under the LLC Agreement, the appointment of an Independent Manager is subject to the approval of the lender. The lender, exercising its rights under such a provision, could veto the appointment of Independent Manager candidates that do not favor its interests. The lender also might block the appointment of any and all Independent Manager candidates, which would in effect preclude a bankruptcy filing in a case where the DLLC has a vacant Independent Manager position and the LLC Agreement requires the consent of two Independent Managers to authorize a bankruptcy filing.

2. Replacement of Independent Managers

In structured finance transactions, an LLC Agreement will usually address the replacement of an Independent Manager. An Independent Manager's removal or replacement has important implications if the LLC Agreement requires the prior unanimous written consent of all Independent Managers to authorize a bankruptcy filing on behalf of the DLLC.

The lender may require that it receive notice of an Independent Manager's removal or replacement. Consistent with the DLLC Act's principle of freedom of contract, language such as the following often appears in an LLC Agreement to express this requirement:

> No Independent Manager shall be removed or replaced unless the Company provides the Lender with no less than five (5) business days' prior written notice of (a) any proposed removal of such Independent Manager, and (b) the identity of the proposed replacement Independent Manager, together with a certification that such replacement satisfies the requirements for an Independent Manager set forth in this Agreement.

The purpose of a notice requirement is to make the lender aware that an Independent Manager is leaving that position and to afford the lender an opportunity to review the qualifications of a proposed replacement. The lender may use a notice period to confirm that the proposed new Independent Manager satisfies the eligibility requirements set forth in the LLC Agreement, and to object if such requirements are not met.

Federal preemption concerns may emerge, however, if the LLC Agreement requires unnecessarily extensive prior written notice to the lender of an Independent Manager's replacement. A lengthy notice period may amount to an unenforceable moratorium on the DLLC's right to seek bankruptcy relief, as a vacancy in the position of Independent Manager would preclude the borrower DLLC's petitioning for federal bankruptcy relief for the duration of that period.

As another example, an LLC Agreement may limit the circumstances in which an Independent Manager may be removed. An LLC Agreement could prohibit an Independent Manager's removal except for "Cause," and set forth a narrow definition of "Cause." Federal preemption concerns could arise if an Independent Manager is unable to perform his or her duties for a reason not contemplated by the definition of "Cause." The ability to seek federal bankruptcy relief would be undermined if the LLC Agreement were to require the unanimous approval of two Independent Managers to authorize the filing of a voluntary bankruptcy petition, and one of those Independent Managers were unavailable but nonetheless immune from removal under the terms of the LLC Agreement.

For the same reason, it is important that a DLLC have a full complement of Independent Managers if the LLC Agreement requires the unanimous approval of multiple Independent Managers to authorize the DLLC's pursuit of bankruptcy relief. The approval requirement may be unenforceable as violating federal public policy if the DLLC lacks the minimum number of required Independent Managers and the LLC Agreement includes no mechanism for appointing successor Independent Managers. To address this concern, the LLC Agreement may (and often does) require that a member of the DLLC appoint a successor Independent Manager as soon as practicable in the event of a vacancy in the position of Independent Manager.

3. Fiduciary Duties of Independent Managers

Parties to an LLC Agreement enjoy considerable flexibility under the DLLC Act to define the scope of their fiduciary duties. The DLLC Act provides that fiduciary duties may be expanded, restricted, or eliminated under an LLC Agreement. [90] The DLLC Act's freedom of contract principle, similarly, enables parties to define fiduciary duties as they see fit. [91]

Consistent with this statutory flexibility, the LLC Agreement may provide that the Independent Managers shall consider the interests of the DLLC, including its creditors in addition to its members, in determining whether to authorize the DLLC's filing of a bankruptcy petition. Such a contractual requirement avoids federal preemption concerns insofar as the Independent Manager is not constrained to advance only the interests of the lender, and accordingly there could be circumstances in which the Independent Managers would, consistently with their fiduciary duties, authorize a bankruptcy

filing.[92] Federal preemption concerns would be implicated, however, if the LLC Agreement were to provide that the Independent Managers shall consider the interests of the lender, to the exclusion of the interests of any other DLLC constituency, as this limitation could in effect preclude a bankruptcy filing.

IV. Conclusion

The DLLC remains the vehicle of choice for the formation of bankruptcy-remote, special purpose entities in structured finance transactions, primarily because of statutory features of DLLCs and the DLLC Act's freedom of contract policy. Notwithstanding exceptional cases contemplating that the provisions of an LLC Agreement may impose restrictions amounting to a waiver of the company's right to file a voluntary bankruptcy petition, *Intervention Energy* followed the well-established federal public policy voiding such a waiver. Further developments in the case law may clarify whether, how, and in what circumstances a limited liability company may effectively waive bankruptcy protections. In the meantime, lenders should continue to proceed cautiously when requesting that an LLC Agreement contain contractual terms designed to minimize a borrower limited liability company's bankruptcy exposure beyond the point of bankruptcy remoteness.

* Matthew J. O'Toole is a partner, and R. Stephen McNeill and Eric R. Glickman are associates, with the Wilmington, Delaware law firm of Potter Anderson & Corroon LLP. Robert L. Symonds, Jr. and Jeremy W. Ryan, who are partners at Potter Anderson & Corroon LLP, contributed to this article. The views expressed by the authors are not necessarily the views of Potter Anderson & Corroon LLP or any of its clients.

Footnotes

1 In re Intervention Energy Holdings, LLC, 553 B.R. 258, 264, 62 Bankr. Ct. Dec. (CRR) 179 (Bankr. D. Del. 2016) (quoting National Bank of Newport v. National Herkimer County Bank, 225 U.S. 178, 184, 32 S. Ct. 633, 56 L. Ed. 1042 (1912)).

2 Alvin L. Arnold & Marshall E. Tracht, Avoiding Bankruptcy Problems—Special Purpose Bankruptcy Remote Entities, 2 Construction & Development Financing § 6:54, at 1 (2016).

3 The Committee on Bankruptcy and Corporate Reorganization of The Association of the Bar of the City of New York, Structured Financing Techniques, 50 Bus. Law. 527, 533 (1995) [hereinafter Committee on Bankruptcy]. The transfer is structured as a "true sale" to remove the assets from the transferor's bankruptcy estate. See Steven L. Schwarcz, The Alchemy of Asset Securitization, 1 Stan. J.L. Bus. & Fin. 133, 135 (1994) (citing 11 U.S.C.A. § 541 (1988)).

4 Committee on Bankruptcy, supra note 3, at 529.

5 See Structured Finance: Asset Isolation And Special-Purpose Entity Methodology, S&P Global Ratings, Mar. 29, 2017, at 6 (providing criteria for assessing legal risks in certain structured finance transactions).

6 See Committee on Bankruptcy, supra note 3, at 554.

7 See Committee on Bankruptcy, supra note 3, at 553.

8 Schwarcz, supra note 3, at 135–36; Steven L. Schwarcz, Securitization and Structured Finance, Elsevier's Encyclopedia of Financial Globalization, 2011, at 6.

9 Schwarcz, supra note 8, at 6.

10 Schwarcz, supra note 8, at 6.

11 See Robert L. Symonds, Jr. & Matthew J. O'Toole, Symonds & O'Toole on Delaware Limited Liability Companies § 6.01[C] (2d. ed. 2017).

12 See J. Bradley Boericke et al., Independent Manager Provisions Ineffective to Preclude Bankruptcy Filing by Supposedly "Bankruptcy-Remote" Entities, 64 Consumer Fin. L.Q. Rep. 45, 46 (2010).

13 Committee on Bankruptcy, supra note 3, at 530; Symonds & O'Toole, supra note 12, § 6.01[C].

14 Schwarcz, supra note 8, at 1.
15 Symonds & O'Toole, supra note 11, § 1.05.
16 Symonds & O'Toole, supra note 11, § 1.02[B][1][a][iv], at n.26.
17 Delaware Division of Corporations.
18 Symonds & O'Toole, supra note 11, § 1.02[A].
19 Elf Atochem North America, Inc. v. Jaffari, 727 A.2d 286, 289–90, 79 A.L.R.5th 803 (Del. 1999).
20 Jaffari, 727 A.2d at 290 (quoting Martin I. Lubaroff & Paul M. Altman, Delaware Limited Liability Companies, in Delaware Law of Corporations & Business Organizations, § 20.1 (R. Franklin Balotti & Jesse A. Finkelstein eds., 1998)).
21 Jaffari, 727 A.2d at 290 (citations omitted).
22 6 Del. C. § 18-303(a).
23 See 6 Del. C. § 18-201(b).
24 See Symonds & O'Toole, supra note 11, §§ 2.05, 2.08.
25 6 Del. C. § 18-703(e); see also Symonds & O'Toole, supra note 11, § 6.01[C], at n.35, n.37.
26 6 Del. C. §§ 18-101(8), 18-701.
27 Symonds & O'Toole, supra note 11, § 4.01[B].
28 6 Del. C. § 18-101(7).
29 In re NextMedia Investors, LLC, 2009 WL 1228665, *7 (Del. Ch. 2009) (citation omitted).
30 Symonds & O'Toole, supra note 11, § 4.01[B].
31 Elf Atochem North America, Inc. v. Jaffari, 727 A.2d 286, 291, 79 A.L.R.5th 803 (Del. 1999) (citing Martin I. Lubaroff & Paul M. Altman, Delaware Limited Liability Companies, in Delaware Law of Corporations & Business Organizations, § 20.4 (R. Franklin Balotti & Jesse A. Finkelstein eds., 1998)).
32 See Jaffari, 727 A.2d at 290 (citing 1 James D. Cox et al., Corporations, § 1.12, at 1.37–.38 (1999)); Sutherland v. Sutherland, 2009 WL 857468, *4 (Del. Ch. 2009), on reargument, 2010 WL 1838968 (Del. Ch. 2010) ("[F]reedom of contract is the guiding and overriding principle [under the DLLC Act].").
33 In re Seneca Investments LLC, 970 A.2d 259, 261 (Del. Ch. 2008).
34 6 Del. C. § 18-1101(b).
35 See Symonds & O'Toole, supra note 11, § 2.11.
36 See Symonds & O'Toole, supra note 11, § 6.01[C].
37 See Arnold & Tracht, supra note 2, at 2.
38 See Symonds & O'Toole, supra note 11, § 2.11.
39 The Bankruptcy Code is codified in Title 11 of the United States Code.
40 U.S. Const. art. VI, cl. 2.
41 See California Federal Sav. and Loan Ass'n v. Guerra, 479 U.S. 272, 280, 107 S. Ct. 683, 93 L. Ed. 2d 613, 7 Employee Benefits Cas. (BNA) 2657, 42 Fair Empl. Prac. Cas. (BNA) 1073, 41 Empl. Prac. Dec. (CCH) P 36641 (1987).
42 Guerra, 479 U.S. 272 at 280–81.
43 Guerra, 479 U.S. 272 at 280–81.
44 Guerra, 479 U.S. 272 at 280–81. See also CTS Corp. v. Dynamics Corp. of America, 481 U.S. 69, 79, 107 S. Ct. 1637, 95 L. Ed. 2d 67, Fed. Sec. L. Rep. (CCH) P 93213 (1987); Silkwood v. Kerr-McGee Corp., 464 U.S. 238, 248, 104 S. Ct. 615, 78 L. Ed. 2d 443, 20 Env't. Rep. Cas. (BNA) 1229, 14 Envtl. L. Rep. 20077 (1984); Matter of Phillips, 966 F.2d 926, 933, 23 Bankr. Ct. Dec. (CRR) 247, 27 Collier Bankr. Cas. 2d (MB) 464, Bankr. L. Rep. (CCH) P 74751 (5th Cir. 1992) (quoting Guerra, 479 U.S. at 281). At least one court has indicated that the conflict between state law and federal policy must be a "sharp" conflict. Integrated Solutions, Inc. v. Service Support Specialties, Inc., 124 F.3d 487, 492 n.3, 31 Bankr. Ct. Dec. (CRR) 422, 38 Collier Bankr. Cas. 2d (MB) 805 (3d Cir. 1997) ("[S]ince bankruptcy is a field traditionally occupied by the states, there must be a 'sharp' conflict between state law and federal policy before we may conclude that federal law preempts state law in the bankruptcy context.").

45 11 U.S.C.A. § 365(b)(2) (invalidating ipso facto clauses in executory contracts); 11 U.S.C.A. § 522(e) (invalidating certain types of waivers); 11 U.S.C.A. § 524(c) to (d) (providing detailed requirements to waive dischargeability rights through reaffirmation); 11 U.S.C.A. § 541(c) (nullifying ipso facto clauses affecting property of the estate); 11 U.S.C.A. § 1307(a) to (b) (voiding waivers of the right to dismiss or convert a case).

46 11 U.S.C.A. § 727(a)(10) (providing that a discharge waiver is enforceable only if it is in writing, executed by the debtor, filed post-petition, and approved by the court).

47 But see In re Madison, 184 B.R. 686, 691, 34 Collier Bankr. Cas. 2d (MB) 132 (Bankr. E.D. Pa. 1995) ("Since provisions in an agreement which merely hinder the chances of a successful reorganization are deemed invalid, we find waivers of the right to file bankruptcy cases at all to be clearly unenforceable.").

48 U.S. Const. art. I, § 8, cl. 4 ("The Congress shall have Power … To establish … uniform Laws on the subject of Bankruptcies throughout the United States …").

49 See, e.g., Butner v. U.S., 440 U.S. 48, 54, 99 S. Ct. 914, 59 L. Ed. 2d 136, 19 C.B.C. 481, Bankr. L. Rep. (CCH) P 67046 (1979) ("Congress has generally left the determination of property rights in the assets of a bankrupt's estate to state law.").

50 See Price v. Gurney, 324 U.S. 100, 106–07, 65 S. Ct. 513, 89 L. Ed. 776 (1945) ("The District Court in passing on petitions filed by corporations under Chapter X must of course determine whether they are filed by those who have authority so to act. In absence of federal incorporation, that authority finds its source in local law.").

51 See, e.g., In re Intervention Energy Holdings, LLC, 553 B.R. 258, 263, 62 Bankr. Ct. Dec. (CRR) 179 (Bankr. D. Del. 2016); In re Cole, 226 B.R. 647, 651–52, 33 Bankr. Ct. Dec. (CRR) 478 (B.A.P. 9th Cir. 1998) (collecting cases); Fallick v. Kehr, 369 F.2d 899, 904 (2d Cir. 1966) (stating that an advance agreement to waive the benefits of bankruptcy is void); National Hockey League v. Moyes, 2015 WL 7008213, *7-8 (D. Ariz. 2015).

One commentator has criticized early decisions on this subject as failing to adequately identify the federal public policy at issue, but also acknowledged two significant concerns with permitting an unlimited right to waive bankruptcy protections. See Marshall E. Tracht, Contractual Bankruptcy Waivers: Reconciling Theory, Practice, and Law, 82 Cornell L. Rev. 301, 332, 336, 341 (1997) [hereinafter Contractual Bankruptcy Waivers] ("Courts have often stated that bankruptcy waivers violate public policy and are therefore not enforceable. This argument is difficult to evaluate given the consistent failure to identify the policy at issue …"). First, secured creditors could implement waivers to reallocate value in their favor at the expense of unsecured creditors. See Contractual Bankruptcy Waivers, at 336; In re Madison, 184 B.R. at 690 (noting that even a temporary waiver of the right to file a bankruptcy case could permit a creditor to avoid the preference period under 11 U.S.C.A. § 547). Second, an unsophisticated borrower might not extract sufficient value from the lender requesting the waiver. Contractual Bankruptcy Waivers, at 341. While a debtor may have expertise in its own business and operations, lenders have a significant advantage when negotiating credit terms because they have more information regarding the prevailing credit market. Contractual Bankruptcy Waivers, at 341–42. A savvy lender could utilize this informational advantage to insert boilerplate waivers into loan agreements. Contractual Bankruptcy Waivers, at 341–42.

52 In re Bogdanovich, 292 F.3d 104, 107, 39 Bankr. Ct. Dec. (CRR) 197 (2d Cir. 2002).

53 In re 203 North LaSalle Street Partnership, 246 B.R. 325, 331, 35 Bankr. Ct. Dec. (CRR) 219, 43 Collier Bankr. Cas. 2d (MB) 1463 (Bankr. N.D. Ill. 2000).

54 Intervention Energy, 553 B.R. at 263 (citing debtor's response).

55 In re Intervention Energy Holdings, LLC, 553 B.R. 258, 62 Bankr. Ct. Dec. (CRR) 179 (Bankr. D. Del. 2016).

56 Intervention Energy, 553 B.R. at 265.

57 Intervention Energy, 553 B.R. at 260–61.

58 Intervention Energy, 553 B.R. at 261.

59 Intervention Energy, 553 B.R. at 261.

60 Intervention Energy, 553 B.R. at 261.

61 Intervention Energy, 553 B.R. at 260.

62 Intervention Energy, 553 B.R. at 260.
63 Intervention Energy, 553 B.R. at 260.
64 Intervention Energy, 553 B.R. at 261.
65 Intervention Energy, 553 B.R. at 265.
66 The court did not "decide what may well be a question of first impression of state law (i.e., determining the scope of LLC members' freedom to contract under [the DLLC Act])" and proceeded to resolve the dispute on federal public policy grounds. Intervention Energy, 553 B.R. at 262–63.
67 Intervention Energy, 553 B.R. at 265.
68 Intervention Energy, 553 B.R. at 264 (quoting National Bank of Newport v. National Herkimer County Bank, 225 U.S. 178, 184, 32 S. Ct. 633, 56 L. Ed. 1042 (1912)).
69 In re DB Capital Holdings, LLC, 463 B.R. 142 (B.A.P. 10th Cir. 2010), available at 2010 WL 4925811.
70 Intervention Energy, 553 B.R. at 265 n.25.
71 In re DB Capital Holdings, LLC, 463 B.R. 142 (B.A.P. 10th Cir. 2010).
72 In re DB Capital Holdings, LLC, 463 B.R. 142 (B.A.P. 10th Cir. 2010) (alternation in original).
73 In re DB Capital Holdings, LLC, 463 B.R. 142 (B.A.P. 10th Cir. 2010).
74 In re DB Capital Holdings, LLC, 463 B.R. 142 (B.A.P. 10th Cir. 2010).
75 In re DB Capital Holdings, LLC, 463 B.R. 142 (B.A.P. 10th Cir. 2010).
76 See In re Intervention Energy Holdings, LLC, 553 B.R. 258, 265 n.25, 62 Bankr. Ct. Dec. (CRR) 179 (Bankr. D. Del. 2016).
77 Intervention Energy, 553 B.R. at 265 n.25.
78 In re Global Ship Systems, LLC, 391 B.R. 193, 196–97, 199(Bankr. S.D. Ga. 2007).
79 Global Ship Sys., 391 B.R. at 197.
80 See Global Ship Sys., 391 B.R. at 199.
81 Global Ship Sys., 391 B.R. at 203.
82 Global Ship Sys., 391 B.R. at 203.
83 Global Ship Sys., 391 B.R. at 199–200.
84 In re Intervention Energy Holdings, LLC, 553 B.R. 258, 265 n.25, 62 Bankr. Ct. Dec. (CRR) 179 (Bankr. D. Del. 2016); see In re Lake Michigan Beach Pottawattamie Resort LLC, 547 B.R. 899, 62 Bankr. Ct. Dec. (CRR) 113 (Bankr. N.D. Ill. 2016) (finding that a provision in the LLC Agreement of a Michigan limited liability company that required the consent of a non-economic member, which was also a lender to the limited liability company, to authorize the filing of a voluntary bankruptcy petition and that also purported to eliminate such person's duties to consider the interests of the limited liability company was unenforceable under state law and federal bankruptcy law).
85 See Intervention Energy, 553 B.R. at 265.
86 See In re DB Capital Holdings, LLC, 463 B.R. 142 (B.A.P. 10th Cir. 2010), available at 2010 WL 4925811, at *3.
87 See Global Ship Sys., 391 B.R. at 199–200, 203.
88 See Symonds & O'Toole, supra note 11, § 6.01[C].
89 See Schwarcz, supra note 8, at 6.
90 6 Del. C. § 18-1101(c). The LLC Agreement, however, may not eliminate the implied covenant of good faith and fair dealing. 6 Del. C. § 18-1101(c).
91 See 6 Del. C. § 18-1101(b).
92 See In re Lake Michigan Beach Pottawattamie Resort LLC, 547 B.R. 899, 912–13, 62 Bankr. Ct. Dec. (CRR) 113 (Bankr. N.D. Ill. 2016) ("The essential playbook for a successful blocking director structure is this: the director must be subject to normal director fiduciary duties [to the debtor] and therefore in some circumstances vote in favor of a bankruptcy filing, even if it is not in the best interests of the creditor …").

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