The Golden Share: Attaching Fiduciary Duties to Bankruptcy Veto Rights

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Under bankruptcy law, a debtor cannot enter into a binding agreement with a creditor to not file for bankruptcy in the future. However, creditors can in effect prevent a corporate debtor from filing for bankruptcy by obtaining a special "golden share" in the debtor and exercising the right to veto its bankruptcy concomitant with such a share. Currently, courts decide whether to invalidate a golden share veto right based on whether the right is equivalent to a bankruptcy waiver. However, the current rule may lead to either underdeterrence of bad faith vetoes or discouragement of good faith corporate decision-making.

This Comment advances a novel approach that draws on the fiduciary duty doctrine in corporate law. It argues that golden shareholders should be viewed as controlling shareholders of the debtor company and therefore bear fiduciary duties with respect to the debtor's decision to file for bankruptcy. This way, any golden shareholder who vetoes bankruptcy to advance its interests as a creditor risks being punished for a duty of loyalty violation, while shareholders who veto bankruptcy in good faith are protected.

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INTRODUCTION

Suppose you are a large investment fund that just loaned money to a company. Like many large lenders, you secured the loan with the company's equipment as collateral. But unfortunately, the company missed an interest payment and defaulted under the terms of its notes. What's worse, it subsequently filed for bankruptcy.

The automatic stay kicks in. Now you cannot foreclose on your collateral or sue the company.[1] The company happened to

[1] See 11 USC § 362.

file for protection under Chapter 11 and gets to keep the equipment while it manages to stay in business.[2] In the meantime, you watch your collateral depreciate, knowing that even if you finally get your hands on it, you will never fully recoup what you are owed. You swear you will never let this happen to you again.

You make a secured loan to another company. This time, in the loan agreement, you add a clause that reads: "The Company shall not file for bankruptcy." Your lawyer quickly crosses it out. "A court will never enforce this," says the lawyer. "It's against public policy. The court will think you're blocking the debtor's right to a fresh start."[3] You are puzzled: "What fresh start? It's a *company*. Companies dissolve all the time!" The lawyer shrugs. "For the interest rate I'm accepting, I at least deserve some peace of mind!" you grumble. Your lawyer promises to get you what you want.

The next day, the lawyer tells you that the company is willing to give you 100 percent of its authorized preferred shares to get you to agree to make the loan. What's more, the company will amend its charter so that it can never file for bankruptcy without the consent of a majority of its preferred shareholders. You say: "So this means I can block its bankruptcy?"

The lawyer nods: "Now you would be doing it as the debtor's *shareholder*. Delaware allows shareholders to draft their corporate charter freely, including determining when the company can file for bankruptcy.[4] The court is not going to meddle in your decisions for the company because you're a *part* of the company, thanks to those shares. They are called the 'golden shares.'"[5] You are delighted. You have your lawyer draft the agreement overnight, and you sign it happily the next day.

Unfortunately, you cannot catch a break, and the company defaults. It then files for bankruptcy without letting you vote on the decision whether to file at all. Exasperated, you sue to dismiss the bankruptcy case, and the company argues that your veto right

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2 See 11 USC §§ 1101–95. See also Kenneth Ayotte and Stav Gaon, *Asset-Backed Securities: Costs and Benefits of "Bankruptcy Remoteness"*, 24 Rev Fin Stud 1299, 1307 (2011).

3 See, for example, *In re Adana Mortgage Bankers, Inc*, 12 Bankr 989, 1009 (Bankr ND Ga 1980) (refusing to enforce such a clause, emphasizing "the strong legislative purpose of the Bankruptcy Act to provide a 'fresh start' to debtors").

4 Like many companies, your debtor is incorporated in Delaware. See note 9.

5 See *In re Franchise Services of North America, Inc*, 891 F3d 198, 205 (5th Cir 2018). See also note 53 and accompanying text.

is an invalid bankruptcy waiver and therefore against public policy. The court looks at the loan and your preferred shares. "Those are a lot of shares," thinks the court. "And the charter does allow it to veto. In all invalid bankruptcy waiver cases, the contract is between a debtor and an external creditor. But a company's *owners* should manage it in the way they want, even if one of them is also a creditor." It then dismisses the case. You immediately foreclose on your security interests and get your money back. You are happy.

But the company is unhappy. It had a nice reorganization plan in mind that might have saved it if it still had its equipment. The company's other creditors are also unhappy. Some of them hold bonds in investment portfolios and had no idea for a long time why the trading price of the notes was falling. Others eventually realized what went wrong and managed to force the company into bankruptcy after some legwork.[6] But the company, crippled by the loss of its key assets, cannot make money anymore and has nothing left to offer. You're the only one that ends up happy in this story, and something does not seem quite right.

Ordinarily, the law prohibits a debtor from waiving the right to bankruptcy to prevent stories like this one from unfolding. But here, the secured creditor manages to block a debtor's bankruptcy by obtaining what is known as a golden share with a veto right. Courts sometimes invalidate those rights and sometimes do not, depending on whether the right is equivalent to a bankruptcy waiver.[7] But under the current state of the law, outcomes like this story's ending can still very well happen.

Advancing a novel approach drawing on corporate law, this Comment tries to fix the problem that occurs in this story. If we truly want to bar creditors from blocking bankruptcy in their self-interest, then courts have been asking the wrong question about golden shares. Instead of deciding whether the veto *right* is a waiver, courts should ask whether the golden shareholder exercised *each* veto for the company's benefit or its own benefit. To do that, courts should impose fiduciary duties that exist under state corporate law on the golden shareholder—that is, by viewing the golden shareholder as the debtor's controlling shareholder. As a

6 Under the Bankruptcy Code, creditors can initiate a bankruptcy case for their debtor as an involuntary petition, thus effectively forcing the debtor into bankruptcy, if they satisfy certain conditions. For details, see 11 USC § 303.

7 See Part III.

fiduciary, the golden shareholder would have to further the interests of the debtor and the other creditors in deciding whether to veto the debtor's bankruptcy petition.[8] This Comment discusses how this approach is viable only for Delaware business organizations, but the basic fiduciary principles underlying this approach should be consistent with the spirit of corporate law in most states.[9]

This Comment proceeds in four Parts. Part I examines the reasons for bankruptcy waiver prohibitions that courts have proffered and argues that bankruptcy is made mandatory to protect creditors' common interest and maximize collective recovery. Part II explains in detail how the golden share can be used to block bankruptcy. Part III discusses existing case law on golden share provisions and problems resulting from courts' focus on whether a provision constitutes a bankruptcy waiver. Part IV proposes that courts should treat vetoes exercised by golden shareholders as "interested transactions" and apply entire fairness review and explains why, in light of both corporate and bankruptcy law doctrine, a fiduciary duty should be imposed on golden shareholders.

I. Why Bankruptcy Waivers Are Prohibited

Under settled bankruptcy law, an agreement with a creditor not to file a voluntary bankruptcy petition in the future is unenforceable as an ipso facto clause.[10] While the Supreme Court has not decided the issue, in *United States v Royal Business Funds Corp*,[11] the Second Circuit acknowledged the "general rule[ ] that a debtor may not agree to waive the right to file a bankruptcy petition."[12] Likewise, the Ninth Circuit has held that a debt settlement agreement provision obliging the debtor not to file for

8 See Part IV.A.

9 In almost every state, "courts have held that majority shareholders have a fiduciary duty to minority shareholders as a class." 12B *Fletcher Cyclopedia of the Law of Corporations* § 5811 (West 2019). See also id at § 5811.50 ("[I]t is possible for a shareholder to be subject to a fiduciary duty even though not a majority shareholder, provided he or she is the 'controlling' shareholder."). This Comment discusses Delaware law as most large corporations are incorporated in Delaware. See Delaware Division of Corporations, *Annual Report Statistics* (2018), archived at https://perma.cc/N5DH-HLEA.

10 See 11 USC § 363(*l*). For a discussion of ipso facto clauses generally, see Thomas H. Jackson, *Bankruptcy, Non-Bankruptcy Entitlements, and the Creditors' Bargain*, 91 Yale L J 857, 887–92 (1982). See also Mikel R. Bistrow, *Waiver of Bankruptcy Protections in Pre-Bankruptcy Workout Agreements*, 8 Loyola Consumer L Rptr 291, 292 (1996).

11 724 F2d 12 (2d Cir 1983).

12 Id at 15.

bankruptcy is unenforceable, announcing that prepetition waivers of Bankruptcy Code protections are "against public policy,"[13] which is also the rationale numerous lower courts have offered. This Part explains that the public policy underlying the rule against corporate bankruptcy waivers aims to solve the "common pool" problem and to maximize the collective benefits of all creditors of an insolvent corporation. This Part also clarifies that the familiar "fresh start" policy of bankruptcy law does not apply to corporations.

A. Solving the Common Pool Problem

The common pool problem—similar to the tragedy of the commons—refers to a scenario in which owners of a limited common resource tend to deplete the resource for their individual self-interest, even though a restraint on usage would benefit all the owners in the long run.[14] Each owner has an incentive to overuse the resource because each of them will be left with nothing if only one of them exercises restraint.[15] This problem is particularly acute for an insolvent debtor with multiple creditors. Knowing that the debtor does not have enough assets to pay off all of the debts, creditors want to sue as soon as they can, as whoever first secures a judgment can access everything in the debtor's asset pool to satisfy their claim.[16] After the quicker creditors have moved, the slower-moving creditors will then take whatever remains in the pool. The process dismantles the debtor and destroys the synergy in its assets that it enjoyed as a "going concern"—a continuing business.[17] Furthermore, the resources spent on monitoring other creditors can generate more value elsewhere than in the race to the courthouse—a race in which unsophisticated creditors are disadvantaged.[18]

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13 *In re Huang*, 275 F3d 1173, 1177 (9th Cir 2002).

14 See Thomas H. Jackson, *Logic and Limits of Bankruptcy Law* 10–12 (Harvard 1986).

15 See id at 12.

16 See id at 12, 15.

17 See id at 14–15; Barry E. Adler, Douglas G. Baird, and Thomas H. Jackson, *Cases, Problems, and Materials on Bankruptcy* 14, 21 (Foundation 2007).

18 See Jackson, *Logic and Limits* at 15 n 18, 16 (cited in note 14) ("Because of the 'race,' many of the special advantages one creditor holds may be worthless. Participation in or monitoring against the race will be costly for *all* creditors.").

The Bankruptcy Code has broadly been thought to attempt to resolve this issue through what is known as the "creditors' bargain."[19] Both Chapter 7 and Chapter 11 impose a collective proceeding upon everyone and generally prohibit any creditor from recovering from the debtor outside of that proceeding via an automatic stay.[20] Under a Chapter 7 liquidation, the debtor's assets are allocated to each creditor pro rata according to its priority status prescribed by law,[21] eliminating the race to the courthouse and the associated monitoring costs.[22] On the other hand, under a Chapter 11 reorganization, valuable corporate debtors restructure to survive as going concerns and generate revenue, also for the benefit of the creditors. The certainty of what each creditor receives in bankruptcy is also valuable for risk-averse creditors.[23] Even if a particular creditor might have fared better without bankruptcy, creditors *as a whole* benefit from the reduced costs and certainty of recovery when their claims are resolved collectively in a single forum and paid pro rata per the statutory priority order. And in Chapter 11 cases, successful reorganization allows both the creditors and society to benefit from the debtor's revival. But the system's purpose would be defeated if any creditor could opt out and pursue the self-interested strategy. Hence, any independent attempt to secure a bankruptcy waiver from the debtor should be invalid to protect all creditors' collective interest.

In cases invalidating waivers of rights under the Bankruptcy Code by either individuals or corporations, courts have justified their decisions as in the creditors' collective interest. For example, in *In re Pease*,[24] the court voided an automatic stay waiver in a Chapter 11 case. The court reasoned that the waiver would enable the secured party to take the collateral away from the debtor, which could have helped the debtor successfully reorganize itself

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19 This term is widely attributed to the academic scholarship of Professors Thomas Jackson and Douglas Baird. For the seminal works, see Jackson, 91 Yale L J at 858, 859–71 (cited in note 10); Douglas G. Baird and Thomas H. Jackson, *Fraudulent Conveyance Law and Its Proper Domain*, 38 Vand L Rev 829, 835–36 (1985). For a recent analysis of the theory, see generally Anthony Casey, *Chapter 11's Renegotiation Framework and the Purpose of Corporate Bankruptcy*, Colum L Rev (forthcoming 2020), archived at https://perma.cc/H8JL-HBY8.

20 See 11 USC § 362. See also Douglas G. Baird and Anthony J. Casey, *No Exit? Withdrawal Rights and the Law of Corporate Reorganizations*, 113 Colum L Rev 1, 3 n 2 (2013).

21 See 11 USC § 507(a).

22 See Jackson, 91 Yale L J at 858, 861–62 (cited in note 10).

23 Jackson, *Logic and Limits* at 15 (cited in note 14).

24 195 Bankr 431 (Bankr D Neb 1996).

and thus benefitted other creditors, and concluded that a creditor may not "opt out of the collective consequences" of bankruptcy.[25] The court in *In re Trans World Airlines, Inc*[26] agreed with *Pease*. It voided a debtor's contractual waiver of its right to reject executory contracts under § 365(a) of the Bankruptcy Code because the waiver could harm the bankruptcy estate by depriving the debtor of a Code protection, thus disregarding "other parties with a legitimate interest" in the bankruptcy case.[27] If, as the bankruptcy courts suggest, the creditors' interest in specific bankruptcy protections is great enough to justify prohibiting waivers of those protections, their collective interest in not having the entire bankruptcy case rendered pointless by someone opting out must also be just as strong. As one bankruptcy court put it, "since bankruptcy is designed to produce a system of reorganization and distribution different from [that] under nonbankruptcy law, it would defeat the purpose of the Code to allow parties to provide by contract that the provisions of the Code should not apply."[28]

B. The Misguided "Fresh Start" Rationale

In addition to solving the common pool problem, another major purpose of bankruptcy law is to give an "honest but unfortunate" individual a "fresh start" from past obligations.[29] Therefore, bankruptcy law enables an individual to discharge—in other words, extinguish—her debts after liquidation of her assets.[30] Accordingly, courts have consistently held that individual debtors may not waive the right to discharge *prior to* bankruptcy filing.[31]

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25 Id at 433–35.

26 261 Bankr 103 (Bankr D Del 2001).

27 Id at 114 (listing various decisions holding that a contractual waiver of objection to a lift stay motion is unenforceable to the extent that it jeopardizes the right of other parties within the bankruptcy case to enjoy that benefit).

28 *In re 203 N LaSalle St Partnership*, 246 Bankr 325, 331 (Bankr ND Ill 2000).

29 *Local Loan Co v Hunt*, 292 US 234, 244 (1934).

30 Id. See also Jackson, *Logic and Limits* at 225 (cited in note 14). The legislature's concern with waivers of the discharge right is embodied in Bankruptcy Code provisions allowing only postpetition discharge waivers with court approval. See 11 USC §§ 524(c), 727(a)(10); S Rep No 95-989, 95th Cong, 2d Sess 98 (1978) ("[Section 727(a)] is the heart of the fresh start provisions of the bankruptcy law.").

31 See, for example, *Klingman v Levinson*, 831 F2d 1292, 1296 n 3 (7th Cir 1987) ("For public policy reasons, a debtor may not contract away the right to a discharge in bankruptcy."); *In re Cole*, 226 Bankr 647, 654 (BAP 9th Cir 1998) ("[W]e conclude that a prepetition waiver of the dischargeability of a debt undermines the purpose of the Code to give an honest but unfortunate debtor a fresh start."); *In re Weitzen*, 3 F Supp 698, 698 (SDNY 1933) ("To sustain a contractual obligation of this character would frustrate the object of the Bankruptcy Act.").

But a number of bankruptcy courts have erred in relying on the fresh start rationale to invalidate both individuals' and *corporations'* bankruptcy waivers.[32]

The reasons why individuals are entitled to a fresh start are irrelevant to a business entity.[33] First, a corporation's owners are not personally liable for its debts beyond their initial capital contributions, even without the aid of bankruptcy.[34] Second, the charitable concerns afforded to flesh-and-blood people also do not apply to corporations. Finally, the economic functions that the fresh start policy serves do not align with bankruptcy principles in the corporate context. By insulating an *individual* debtor from pre-bankruptcy debts, the fresh start policy ensures that creditors cannot tap the individual's future earning power forever, thus incentivizing individuals to work hard once they emerge from bankruptcy.[35] But a *corporation's* future earning power can only be measured by the productivity of its existing assets,[36] which by definition constitutes property of the bankruptcy estate from which creditors *can* draw.[37] Thus, the fresh start justification is ill-suited to corporate bankruptcy contexts.

Because the fresh start rationale applies poorly to corporate bankruptcy cases, we are left with one main reason why the law prohibits corporate bankruptcy waivers: to protect the creditors' collective interest in maximized debtor value, reduced costs, and certainty of recovery resulting from the bankruptcy process.[38] This means that any rule should prohibit uses of golden shares that

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32 See *In re Adana Mortgage Bankers, Inc*, 12 Bankr 989, 1009 (Bankr ND Ga 1980) (pointing to the fresh start to justify its avoidance of a covenant prohibiting a corporation from filing bankruptcy); *In re Tru Block Concrete Products, Inc*, 27 Bankr 486, 492 (Bankr SD Cal 1983) (holding that a corporation's bankruptcy waiver is unenforceable as a "well settled princip[le]," and citing for support four cases which all concern waivers by individuals); *In re Shady Grove Tech Center Associates LP*, 216 Bankr 386, 389 (Bankr D Md 1998) (stating that "[t]he courts have uniformly held that a waiver of the right to file a bankruptcy case is unenforceable," and collecting cases).

33 See Jackson, *Logic and Limits* at 225 (cited in note 14); Douglas G. Baird and Thomas H. Jackson, *Corporate Reorganizations and the Treatment of Diverse Ownership Interests: A Comment on Adequate Protection of Secured Creditors in Bankruptcy*, 51 U Chi L Rev 97, 110 n 45 (1984); Elizabeth Warren, *Bankruptcy Policymaking in an Imperfect World*, 92 Mich L Rev 336, 341 (1993).

34 See Stephen M. Bainbridge, *Corporate Law* 6 (Foundation 3d ed 2015).

35 See Baird and Jackson, 51 U Chi L Rev at 110–11 n 45 (cited in note 33).

36 See id.

37 See 11 USC § 541(a).

38 See Jackson, *Logic and Limits* at 14 (cited in note 14); Adler, Baird, and Jackson, *Bankruptcy* at 14, 21 (cited in note 17).

would harm that collective interest, but spare the golden shareholders when their actions leave the collective interest intact. With this in mind, I proceed to explain how golden shareholders can block bankruptcies.

II. GOLDEN SHARES

This Part discusses how golden shareholders can block a corporation's bankruptcy by wielding their governance rights. Part II.A explains the background corporate case law and statutes that confer on corporations the power to file for bankruptcy. Part II.B discusses how creditors use golden shares, originally a governmental device to retain control of privatized companies, to obtain this power.

A. The Authority to File

A corporation can act only through its agents. This is no different when it comes to filing for bankruptcy. Thus, when an agent files a bankruptcy petition on behalf of their corporation, the first question a court considers is whether that agent is authorized to file that petition. The Supreme Court answered this question in *Price v Gurney*.[39] The Court held that state corporate law—rather than bankruptcy law—grants the authority to file for bankruptcy on behalf of a corporation, reasoning that "the initiation of the [bankruptcy] proceedings, like the run of corporate activities, is left to the corporation itself, i.e. to those who have the power of management."[40] In other words, as a governance matter, a corporation can define the circumstances under which a bankruptcy petition is authorized (and when it will be dismissed for lack of authority) by setting various conditions on its own ability to file for bankruptcy, so long as those conditions do not violate the laws of its state of incorporation.

Corporate law, on the other hand, often gives corporations significant latitude in deciding how to manage their affairs.[41] This

[39] 324 US 100 (1945).

[40] Id at 104. See also id at 106 ("If the District Court finds that those who purport to act on behalf of the corporation have not been granted authority by local law to institute the proceedings, it has no alternative but to dismiss the petition.").

[41] See, for example, *Sterling v Mayflower Hotel Corp*, 93 A2d 107, 117–18 (Del 1952) (explaining that a Delaware corporation's shareholders enjoy great power in deciding corporate charter provisions).

Comment discusses Delaware law because most major corporations incorporate in that state.[42] By default, a Delaware corporation's board of directors manages its affairs.[43] But the board's authority may be limited by the certificate of incorporation,[44] which can contain "*any* provision creating, defining, limiting and regulating the powers of the corporation, the directors, and the stockholders."[45] This means that the corporate charter can take away a power originally vested in the board and give it to shareholders, including the power to decide for the corporation when to file for bankruptcy. In other words, the special power of golden shares comes from the corporation's charter.

Having examined the legal foundations of golden shares, I now proceed to discuss the history of golden shares and their mechanics.

B. The Ascendence of Golden Shares

Golden shares were first popularized in the 1980s during the privatization of large state-owned corporations in Great Britain.[46] These shares vested in the government veto rights over former state-owned corporations' governance matters, such as a corporation's decisions to merge or dispose of material assets, enabling the government to block foreign control over strategically important enterprises even after it privatized those corporations.[47] The distinctive feature of golden shares, then, is the decisive power over certain corporate affairs given to a shareholder without a controlling financial stake.[48]

Creditors can use many variations of golden shares to block a debtor's bankruptcy filing. For example, golden share provisions are commonly found in debt workout agreements. In these agreements, in exchange for the share, the creditor agrees to restructure a loan to make it easier for the debtor to pay, often by waiving existing defaults (typically called forbearance).[49] Creditors

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42 See *Annual Report Statistics* (cited in note 9).

43 See 8 Del Code Ann § 141(a).

44 See 8 Del Code Ann § 141(a).

45 8 Del Code Ann § 102(b)(1) (emphasis added).

46 See Saule T. Omarova, *Bank Governance and Systemic Stability: The "Golden Share" Approach*, 68 Ala L Rev 1029, 1044 n 65 (2017).

47 See id at 1044; Alice Pezard, *The Golden Share of Privatized Companies*, 21 Brooklyn J Intl L 85, 91 (1995).

48 See Omarova, 68 Ala L Rev at 1044 (cited in note 46).

49 See, for example, *In re Intervention Energy Holdings, LLC*, 553 Bankr 258, 261 (Bankr D Del 2016).

may also insert golden share provisions in agreements that extend a loan or otherwise invest in the debtor corporation.[50] These provisions can come in a variety of forms.[51] Creditors may be given only one nominal share.[52] Alternatively, they may also hold a significant but noncontrolling stake in the debtor company, say, 49 percent,[53] and wear "two hats" in the corporation.[54] Correspondingly, the debtor may flatly provide in its charter that only unanimous shareholder consent can authorize a bankruptcy filing. But in a subtler fashion, the debtor may also allow a bankruptcy filing as long as 70 percent of the shareholders consent, while giving a 35 percent interest to the creditor.[55] The creditors may obtain the shares and vote to *amend* the charter to give the shares a veto right in return for financing the debtor's business operations.[56] With the initial charter granting them the veto right, the creditors may have also invested in the corporation upon its formation and only begun to extend credit after becoming a shareholder. But under all scenarios, the creditor's vote is required to authorize the debtor's bankruptcy filing.

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50 See, for example, *In re Lexington Hospitality Group, LLC*, 577 Bankr 676, 679–80 (Bankr ED Ky 2017).

51 Golden shares can be similar to special purpose entities (SPEs), sometimes called special purpose vehicles (SPVs). A typical SPE is a subsidiary that buys from its parent assets that generate regular cash flows, such as mortgages, which it then securitizes and sells to investors. If the *parent* files bankruptcy, the SPE is unaffected and its assets will not be used in the parent's bankruptcy, thus protecting the SPE's investors. The SPE also reduces risks of its *own* bankruptcy by requiring unanimous board consent for bankruptcy filings and having an "independent director" whose purpose is to veto any filing. See Michael J. Cohn, Note, *Asset Securitization: How Remote Is Bankruptcy Remote?*, 26 Hofstra L Rev 929, 931 (1998); Ayotte and Gaon, 24 Rev Fin Stud at 1300–01 (cited in note 2); Katherine J. Baudistel, *Bankruptcy-Remote Special Purpose Entities: An Opportunity for Investors to Maximize the Value of Their Returns While Undergoing More Careful and Realistic Risk Analysis*, 86 S Cal L Rev 1309, 1313–17 (2013). For an example in case law, see *In re General Growth Properties, Inc*, 409 Bankr 43, 49 (Bankr SDNY 2009).

52 See, for example, *Intervention Energy Holdings*, 553 Bankr at 261.

53 See, for example, *In re Franchise Services of North America, Inc*, 891 F3d 198, 203 (5th Cir 2018). The Fifth Circuit in that case distinguishes a "golden share" from a 49 percent shareholder, see id at 205, but I include the latter in the former's definition to streamline the Comment's organization. "Golden share" is not a term of art and the difference between the court's definition and mine does not impact the substance of this Comment.

54 See, for example, *In re Global Ship Systems, LLC*, 391 Bankr 193, 203 (Bankr SD Ga 2007) (explaining the situation of a creditor with a golden share who also holds a significant percentage of the debtor's voting stock).

55 See, for example, *Lexington Hospitality Group*, 577 Bankr at 680.

56 See, for example, *Franchise Services*, 891 F3d at 203.

III. TREATMENT OF GOLDEN SHARES IN COURTS

As discussed in Part II, golden share provisions come in several variations. This Part analyzes the courts' different approaches to golden share provisions, highlights the rules that courts employ, and points out the weaknesses of these rules. Part III.A discusses the "bona fide equity holder" rule—that is, a creditor can veto a company's bankruptcy filing if it holds substantial equity in the company and the corporate charter grants it the veto right as a shareholder. However, this rule tends to create false negatives by letting a bona fide equity holder's self-interested veto off the hook. Part III.B discusses the alternative "fiduciary duty" rule—that is, if the golden shareholder owes fiduciary duties to the company under current law, courts treat its veto as exercised prima facie in good faith. But this rule creates false positives by punishing nonfiduciary golden shareholders' vetoes made in consideration of the company's best interests. As discussed below, underlying both rules is the inquiry whether a veto right equals an impermissible bankruptcy waiver. However, to avoid false positives and negatives, courts should not question the validity of the veto right per se, but they should scrutinize each veto exercised under that right.

A. "Bona Fide Equity Holder"

Many courts, recently joined by the Fifth Circuit, draw a distinction between bona fide equity holders, who hold substantial equity in a company, and mere creditors to decide whether a golden share provision is valid.[57] Notwithstanding the rule against bankruptcy waivers, these courts accept that a corporation's bona fide equity holder has a right, if granted by the corporate charter in accordance with state law, to block the corporation's bankruptcy filing.[58] As the cases below illustrate, these courts reason that once the charter vests the right, bankruptcy law cannot take the right away from the bona fide equity holder simply because it also happens to be the corporation's creditor.[59] The first two cases below concluded that the golden shareholders were bona fide equity holders and upheld their bankruptcy veto.

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[57] See, for example, *In re Franchise Services of North America, Inc*, 891 F3d 198, 208 (5th Cir 2018); *In re Global Ship Systems, LLC*, 391 Bankr 193, 203 (Bankr SD Ga 2007); *In re Intervention Energy Holdings, LLC*, 553 Bankr 258, 265 (Bankr D Del 2016).

[58] See, for example, *Franchise Services*, 891 F3d at 208–09; *Global Ship Systems*, 391 Bankr at 203.

[59] See *Franchise Services*, 891 F3d at 208–09.

The third case concluded that the golden shareholder merely held a nominal share in the company, and it treated the veto right of the share as an invalid bankruptcy waiver.

1. *In re Franchise Services of North America, Inc.*[60]

The debtor in this case was a Delaware corporation that sought to acquire another corporation.[61] To help finance the acquisition, the debtor entered into a contract with the creditor, an investment bank.[62] Under the contract, the creditor invested $15 million in the debtor, in exchange for 100 percent of the debtor's preferred shares, equal to a 49.76 percent equity stake in the debtor.[63] As a condition to the investment, the debtor adopted a new charter providing that it could not file for bankruptcy without the approval of a majority of preferred shareholders, enabling the creditor to veto its bankruptcy filing.[64] The debtor incurred service fees of $3 million payable to the creditor for its services.[65] After the acquisition proved to be a poor decision, the debtor filed for bankruptcy without conducting a shareholder vote.[66] The creditor moved to dismiss the bankruptcy case for lack of authority.[67]

The Fifth Circuit held that by holding the preferred shares, the creditor obtained the right to veto bankruptcy filings under the debtor's amended charter.[68] Rejecting the argument that bankruptcy law prohibits the arrangement as a de facto bankruptcy waiver, the court reasoned that the case involved an amended corporate charter "triggered by a substantial *equity* investment" of $15 million, rather than an agreement granting a veto right to a mere *creditor* in exchange for forbearance of past defaults.[69] Thus, the charter amendment could not solely be a "ruse" to ensure the repayment of a $3 million debt when the creditor was a "bona fide equity holder" that invested $15 million in the debtor.[70] The court concluded that nothing in bankruptcy law compels the court to deprive a corporation's bona fide equity

60 891 F3d 198 (5th Cir 2018).
61 Id at 203.
62 Id.
63 Id.
64 *Franchise Services*, 891 F3d at 203.
65 Id.
66 Id at 204.
67 Id.
68 *Franchise Services*, 891 F3d at 205.
69 Id at 207 (emphasis added).
70 Id at 208–09.

holder of its existing voting right in disregard of the corporate charter just because it also happens to be a creditor of the corporation.[71] Furthermore, it held that the creditor was not a controlling shareholder under Delaware law and owed no fiduciary duty to the debtor in exercising its veto right because the creditor did not have control over the debtor's board of directors.[72] And no bankruptcy law doctrine prohibits the creditor from exercising the right because of the lack of fiduciary duty per se.[73] The court nonetheless stated that the result might be different if the creditor held no equity stake in the debtor, or obtained equity "as a ruse to guarantee a debt."[74]

2. *In re Global Ship Systems, LLC*.[75]

Similar to *Franchise Services*, the court in this case held that a creditor's bankruptcy veto right is valid when it holds substantial equity in the debtor company. The debtor, a Georgia limited liability company (LLC),[76] was organized to purchase a shipyard, and obtained a secured loan from the creditor to finance the purchase.[77] In exchange for the loan, the creditor received Class B shares equal to a 20 percent interest in the debtor.[78] Upon the debtor's formation, its operating agreement[79] prohibited voluntary bankruptcy filings absent the Class B shareholder's consent, with the creditor being the sole Class B shareholder.[80] This prohibition did *not* expire upon payment of the loan in full.[81] The debtor solicited its other creditors to file an involuntary bankruptcy petition against it to circumvent the creditor's veto right.[82] The court

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71 Id.

72 *Franchise Services*, 891 F3d at 211–13. Part IV, however, argues that golden shareholders should be viewed as controlling shareholders by virtue of their actual control over the debtor's bankruptcy decision.

73 Id at 209.

74 Id.

75 391 Bankr 193 (Bankr SD Ga 2007).

76 A limited liability company is a popular form of business organization that retains the corporation's limited liability feature but typically provides pass-through taxation for its owners. See Fletcher, *Cyclopedia* at § 20 (cited in note 9).

77 *Global Ship Systems*, 391 Bankr at 196–97.

78 Id at 197.

79 As a key formation document and the equivalent to a corporate charter, an operating agreement lays out an LLC's management and operational rules. See Ijeoma S. Nwatu, *Basic Information About Operating Agreements* (US Small Business Administration, May 18, 2016), archived at https://perma.cc/KM44-9VY2.

80 *Global Ship Systems*, 391 Bankr at 199–200.

81 Id at 200.

82 Id at 202.

held that the case was the equivalent of a voluntary case filed by the debtor itself and was filed in bad faith under § 1112 of the Bankruptcy Code for disregarding the creditor's bankruptcy veto right.[83]

Among other considerations, the court pointed out that the creditor wears two hats—both creditor and shareholder—by virtue of holding a substantial equity interest in the debtor.[84] Further, the creditor's right to block bankruptcy granted by the LLC's operating agreement was "dependent solely on its status as an *equity holder*" rather than a creditor because the right did not expire when the debt was extinguished.[85] While a bankruptcy waiver obtained by a pure lender violates bankruptcy law, the creditor's separate voting right as an equity holder remained valid as long as Georgia permitted LLCs to make all management decisions on their own.[86]

On the other hand, things turn out differently when a creditor never attained the bona fide equity holder status and is technically only a shareholder. As illustrated by the following case, even if the charter enables such a shareholder to veto the debtor's bankruptcy filing, the provision would be deemed an unenforceable bankruptcy waiver.

3. *In re Intervention Energy Holdings, LLC*.[87]

The debtor here, a Delaware LLC, defaulted on a secured loan extended by the creditor.[88] In exchange for waiving all defaults, the creditor, among other things, required the debtor to amend its LLC agreement to admit the creditor as a member, and it mandated unanimous member consent for voluntary bankruptcy filings.[89] The debtor gave the creditor one common unit (the LLC equivalent to a common share) in exchange for contributing $1 to the debtor; including that unit, the debtor had issued 22,000,001 common units in total.[90] The debtor filed for voluntary bankruptcy, and the petition would have been authorized absent the LLC agreement's amendment.[91]

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83 Id at 202–04.
84 *Global Ship Systems*, 391 Bankr at 203.
85 Id at 199–200 (emphasis added).
86 Id at 204, citing Ga Code Ann § 14-11-304(a).
87 553 Bankr 258 (Bankr D Del 2016).
88 Id at 260–61.
89 Id at 261.
90 Id at 260–61.
91 *Intervention Energy Holdings*, 553 Bankr at 261.

The court held that the *purpose* of the parties' arrangement was precisely "to contract away the right to seek bankruptcy relief."[92] Because the creditor emphasized in its own motion to dismiss that it "specifically negotiated" the debtor's ability to file for bankruptcy,[93] the parties clearly intended to reserve the decision to file for bankruptcy to the creditor.[94] The court concluded that the arrangement at issue was:

> [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.[95]

Thus, even if Delaware LLC law may permit such a provision, it was nonetheless "tantamount to an absolute [bankruptcy] waiver" and hence violated bankruptcy law.[96]

* * *

We can surmise from these cases that a bona fide equity holder must hold a genuine equity interest in the debtor. While no exact threshold exists (49 percent in *Franchise Services* and 20 percent in *Global Ship Systems* sufficed),[97] a creditor must have a substantial capital contribution backing the equity interest. Thus, a shareholder would likely be a bona fide equity holder if it bought common shares as one of the corporation's first investors. On the contrary, if the "shareholder" obtained a nominal share with at most negligible consideration, or it took merely a "special" membership in the debtor, then the court would look

92 Id at 264.
93 Id.
94 Id at 265.
95 *Intervention Energy Holdings*, 553 Bankr at 265 (emphasis added).
96 Id.
97 *Franchise Services*, 891 F3d at 203; *Global Ship Systems*, 391 Bankr at 197.

past the formalities and refuse to acknowledge its equity holder status.[98]

Even though the dichotomy between bona fide and nominal shareholders is intuitive, it can lead to false negatives. Suppose *A* is a 30 percent shareholder of *B*, a fledgling corporation. Upon incorporation, *B*'s charter provides that shareholders can veto bankruptcy filings. *B* was incorporated in Delaware, whose laws allow this provision. Understanding that *B*'s business would thrive with more capital infusion, *A* then loaned *B* a large amount of money. *B* eventually filed for bankruptcy without securing *A*'s vote. *A* moved to dismiss.

A court would almost certainly hold that *A* is a bona fide equity holder and dismiss *B*'s bankruptcy case for lack of authority. But if *A* blocked the bankruptcy because it worried about *B* being unable to repay its loan, *B* and *B*'s other creditors could be in bad shape. *B* would lose the opportunity to get back on its feet through Chapter 11 bankruptcy. Theoretically, other creditors could file involuntary bankruptcy petitions against *B*,[99] but they may just be passive investors who have not been actively monitoring *B*'s financial health. Such creditors may be unable to bring the case quickly enough before *A* moves to collect and diminishes *B*'s value. For example, they might hold *B*'s bonds as part of index fund portfolios consisting of many companies and managed passively by institutional investors. It would be unimaginable for these bondholders to have to check how each company in the portfolio is doing. And even if they do file, *B* could have filed a timely case more easily anyway, as it would be best positioned to know when bankruptcy is optimal for everyone given its own financial condition. Because involuntary cases are intended to force unwilling debtors into bankruptcy, the creditors' extra monitoring costs incurred to commence the bankruptcy are wasteful when the debtor itself actually wants to file. By stripping *B* of its ability to file, *A* is able to block other creditors' access to bankruptcy's collective benefit (or at least make it more expensive) for its own benefit as a creditor.

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98 See *Intervention Energy Holdings*, 553 Bankr at 265; *In re Lake Michigan Beach Pottawattamie Resort, LLC*, 547 Bankr 899, 904 (Bankr ND Ill 2016) (describing the position of a creditor admitted as a special member as "separate and apart from the Debtor in all ways but for its authority to block the Debtor from petitioning for bankruptcy relief").

99 In reality, involuntary bankruptcy cases are rare. Less than 0.5 percent of the Chapter 11 bankruptcy cases in fiscal year 2018 were commenced by involuntary petitions. See United States Courts, *Table 7.2—U.S. Bankruptcy Courts Judicial Facts and Figures* (Sept 30, 2018), archived at https://perma.cc/EH3K-9GJV.

Having explained the bona fide equity holder rule and its tendency to produce false negatives, I now discuss the fiduciary duty rule employed by other courts. While this rule avoids the bona fide equity holder rule's shortcomings, it creates its own problems.

B. "Fiduciary Duty"

Other courts conclude that fiduciary duties of the vetoing party are a decisive factor.[100] These courts see the existence of fiduciary duty as a safe harbor. Fiduciary duty allows the courts to assume that each exercise of the bankruptcy veto right is a prima facie good-faith decision made with the corporation's interests in mind. They thus differentiate such a right from a waiver, which blocks bankruptcy under *all* circumstances. And because the veto right is not a bankruptcy waiver, bankruptcy doctrines cannot render it invalid.[101] Curiously, no court has held that golden shareholders owe fiduciary duties to the debtor by virtue of their inherent ability to control the debtor's bankruptcy decision. The cases below exemplify this rule by holding that a waiver of fiduciary duties in a golden share clause dooms the entire provision. However, the fiduciary duty rule creates another problem: false positives in rejecting good-faith bankruptcy vetoes.

1. *In re Lake Michigan Beach Pottawattamie Resort, LLC*.[102]

The debtor, a Michigan LLC, obtained a loan from the creditor secured by the debtor's main asset.[103] After it defaulted, the debtor amended its operating agreement to admit the creditor as a "[s]pecial [m]ember" for as long as the loan remained outstanding, in exchange for the creditor's forbearance.[104] As a special member, the creditor had the right to veto the debtor's bankruptcy filing, and it did not have any financial stake in the debtor.[105] The amended operating agreement further provided that the special member provision was written "for the express benefit of" the creditor, who had no duty to consider the debtor or

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100 *Lake Michigan Beach*, 547 Bankr at 914; *In re Lexington Hospitality Group, LLC*, 577 Bankr 676, 685–86 (Bankr ED Ky 2017).

101 This means that if the veto right was indeed exercised in bad faith, a remedy is found in corporate law for breach of fiduciary duty. See *Franchise Services,* 891 F3d at 214.

102 547 Bankr 899 (Bankr ND Ill 2016).

103 Id at 903.

104 Id at 903–04, 910.

105 Id at 904.

its members' interests when exercising its rights.[106] The debtor filed for bankruptcy after another default to avoid foreclosure, and the creditor moved to dismiss the case on the grounds of, among other things, lack of authority.[107]

The debtor drew an analogy between the arrangement at issue and the permitted practice of "blocking directors" in special purpose entities (SPEs).[108] Responding to that argument, the court noted that in an SPE, the bankruptcy blocking mechanism is located in a "corporate control document," which the corporate owners must respect before commencing a bankruptcy case.[109] But an absolute bankruptcy waiver should always be void.[110] The SPE escapes unenforceability by making the blocking director "independent." The director must adhere to her fiduciary duty to the SPE, which means she must be able to vote in favor of bankruptcy (contrary to the interest of the creditor who appointed her) when filing for bankruptcy is in the SPE's best interest.[111] In this case, however, the special member expressly waived its fiduciary duties.[112] The creditor thus could disregard everybody's interest but its own when voting, rendering bankruptcy impossible whenever it could harm the creditor. The court held that such an arrangement was no different from a bankruptcy waiver unenforceable under bankruptcy law.[113]

Unlike the cases using the bona fide equity holder rule, courts employing the fiduciary duty rule are willing to void a creditor's veto right even if the creditor holds substantial equity in the debtor. However, courts will only take that step if they determine (1) that the creditor acquired this right solely to ensure its loan gets repaid and (2) that the creditor would not consider the debtor's interests in exercising its right. The following case

106 *Lake Michigan Beach*, 547 Bankr at 904, 910 (emphasis omitted).

107 Id at 904, 909.

108 Id at 911. For an explanation of SPEs, see note 51.

109 *Lake Michigan Beach*, 547 Bankr at 912.

110 Id.

111 Id at 912–13. See also *In re General Growth Properties, Inc*, 409 Bankr 43, 64 (Bankr SDNY 2009) ("[I]f Movants believed that an 'independent' manager can serve on a board solely for the purpose of voting 'no' to a bankruptcy filing because of the desires of a secured creditor, they were mistaken.").

112 *Lake Michigan Beach*, 547 Bankr at 914.

113 Id. Separately, Michigan LLC law requires that members owe fiduciary duties to each other. Therefore, the amended provision was void under Michigan law as well. See id, citing Mich Comp Laws Ann § 450.4404.

applies this test, with the court invalidating a golden share provision when the golden shareholder bargained for the provision only to exercise it in its own favor as a creditor.

2. *In re Lexington Hospitality Group, LLC*.[114]

The debtor, a Kentucky LLC, obtained a secured loan from the creditor to acquire a hotel and simultaneously amended its operating agreement.[115] The amended operating agreement provided that the creditor's subsidiary was admitted as a 30 percent member of the debtor *until* the debtor repaid the loan,[116] and it required authorization of an "[i]ndependent [m]anager" and the consent of 75 percent of its members to declare bankruptcy.[117] The independent manager would no longer have her role upon loan repayment; she was further instructed to consider the interests of the creditors in voting, and her fiduciary duty to other LLC members was "eliminate[d]."[118] The creditor also had an express right to veto the debtor's bankruptcy filing.[119] After defaulting on the loan, the debtor transferred another 20 percent of its interests to the creditor's subsidiary in exchange for the creditor's forbearance.[120] The debtor soon filed for bankruptcy.[121]

The court held that the creditor "imposed" the provisions at issue, which eliminated the debtor's right to file for bankruptcy without the creditor's consent, and was thus different from an agreement "among" the debtor's members to only file for bankruptcy under certain conditions.[122] The court reached this conclusion for three reasons. First, the provisions were a condition of the loan.[123] Second, the independent manager was linked to the loan and not truly independent from the creditor because she

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114 577 Bankr 646 (Bankr ED Ky 2017).

115 Id at 679–80.

116 Id at 680.

117 Id at 680.

118 *Lexington Hospitality Group*, 577 Bankr at 680–81.

119 Id at 681.

120 Id at 681–82.

121 Id at 682.

122 *Lexington Hospitality Group*, 577 Bankr at 684. See also *In re Squire Court Partners LP*, 574 Bankr 701, 708 (ED Ark 2017):

> It is one thing to look past corporate governance documents and the structure of a corporation when a creditor has negotiated authority to veto a debtor's decision to file a bankruptcy petition; it is quite another to ignore those documents when the owners retain for themselves the decision whether to file [for] bankruptcy.

123 *Lexington Hospitality Group*, 577 Bankr at 684.

waived her fiduciary duty to the debtor's members.[124] Third, the creditor, owing no fiduciary duty to the debtor, could block bankruptcy using either its veto power or its control of the subsidiary, without which the members could not reach the 75 percent threshold.[125] The only purpose of these provisions was to frustrate the debtor's ability to file for bankruptcy and therefore to ensure repayment of the creditor's loan, amounting to an invalid bankruptcy waiver.[126]

C. Comparing the Two Rules

While the fiduciary duty rule eliminates the false negatives that the bona fide equity holder rule produces by punishing golden shareholders that exploit their veto rights, the fiduciary duty rule has the opposite problem: it can produce false positives. Let us return to the previous hypothetical in which *A*, a 30 percent shareholder and a creditor of corporation *B*, wants to veto *B*'s bankruptcy petition by invoking a golden share provision in *B*'s charter. Courts likely would not hold that *A* owes a fiduciary duty to *B* because *A* does not hold a majority of *B*'s voting shares. When the safe harbor of fiduciary duty is absent, courts tend to equate a creditor's bankruptcy veto right with absolute bankruptcy waivers.[127] The problem is that *A* may very well have moved to dismiss because there is a good reason why bankruptcy is not a wise choice for *B*: for example, bankruptcy generates bad publicity and *A* is confident in its plan to turn around *B*'s business without help from the bankruptcy court. Besides, under corporate law, *A* is entitled to vote on *B*'s bankruptcy as a shareholder. Flatly invalidating *A*'s vote not only precludes fair business decisions, but also disregards state law.

To avoid such false positives, a court might attempt to fine-tune the approach by invalidating *A*'s veto right only when its "*sole* purpose and effect"[128] is to block bankruptcy for *A*'s benefit *as a creditor*. But this is just replacing a per se rule with a fuzzy standard. While *B*'s charter—which innocuously grants every common shareholder a bankruptcy veto right among other voting rights—may pass this test, courts can easily produce inconsistent

[124] Id at 684–85.

[125] Id at 685–86.

[126] Id at 686.

[127] See *Lake Michigan Beach*, 547 Bankr at 914; *Lexington Hospitality Group*, 577 Bankr at 685–86.

[128] *Intervention Energy Holdings*, 553 Bankr at 265 (emphasis added).

results in closer cases.[129] Additionally, like the bona fide equity holder test, this test does little to prevent a bad-faith bankruptcy veto on *A*'s part in our first hypothetical. Lastly, this approach means the court needs to decide whether *A would* always exercise the right to veto bankruptcy only when it is against *A*'s interest as a creditor (not just that *A can* veto). This analysis is bound to be contrived because it implies, rather problematically, that a court can predict how a particular party will behave in the future.

As discussed above, the bona fide equity holder rule that permits substantial stockholders' bankruptcy veto rights facilitates self-interested vetoes. On the other hand, the fiduciary duty rule that carves out a safe harbor only for veto rights held by fiduciaries tends to punish good-faith vetoes by nonfiduciary golden shareholders. As Part I showed, the rule against bankruptcy waivers is really about prohibiting any single creditor from opting out of bankruptcy to recover its claim at every other creditor's expense. An ideal approach would be to invalidate a golden shareholder's bankruptcy veto when it uses the veto only to benefit itself as a creditor, regardless of the harm to all the creditors' collective interest.[130] At the same time, courts need to allow the golden shareholder's veto if it is a rational business decision made by an entitled decisionmaker per the corporate charter, as this both respects corporate law and allows the debtor to benefit from good judgments. The existing approaches, when taken to extremes, either fail to punish the former or tend to deter the latter. Invariably focusing on determining ex ante whether a veto right at issue is an impermissible bankruptcy waiver, the current approaches consistently permit or prohibit acts exercising that right for any reason once the courts conclude the right is valid or void.

To avoid false positives and negatives, courts should instead determine ex post whether to allow a specific veto exercised under that right. But courts cannot make that determination under the current bankruptcy law framework, which always asks whether

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[129] Practitioners generally agree on the difficulty in advising clients of a possible golden share provision's validity, given the current rules. The following articles exemplify their attempts to clarify the tests and predict future court rulings. See generally Jay M. Goffman and Christine A. Okike, *A Golden Share and the Conflict Between Freedom of Contract and Federal Policy*, 257 NY L J (June 12, 2017); Mark A. Cody and Mark G. Douglas, *Fifth Circuit Rules That Corporate Charter Provision Requiring Shareholder Consent for Bankruptcy Filing Is Enforceable but Declines to Rule on Validity of "Golden Shares"* (Jones Day, Oct 2018), archived at https://perma.cc/8ZDT-2K9A; Shmuel Vasser, *Fool's Gold? Circuit Court Taking Up Alternative Bankruptcy Proofing Mechanism* (Asset Securitization Report, Mar 27, 2018), archived at https://perma.cc/257Y-SN6C.

[130] See Part I; Part IV.A.

there is a waiver first—conceptually, a waiver corresponds to a right (to enforce that waiver), rather than a specific act exercising that right. The next Part argues that to conduct this ex post inquiry, courts should impose on golden shareholders fiduciary duties to the debtor in deciding whether to veto and examine whether they exercised each veto in violation of the duties. It further explains that the controlling shareholder principles from corporate law would provide the legal framework for imposing such duties.

IV. A Corporate Law Framework Based on Fiduciary Duties of Controlling Shareholders

As explained above, courts cannot straightforwardly apply bankruptcy law to bankruptcy waivers to decide whether *acts* exercising power under golden share provisions are legitimate. Rather, a framework that applies controlling shareholder principles from corporate law is a better fit. Specifically, I propose that a golden shareholder who is concurrently a creditor of a corporation should be viewed as a *controlling shareholder* under corporate law with respect to the debtor's decision to file for bankruptcy because it exercises "actual control" over that decision. As a controlling shareholder, then, the golden shareholder owes fiduciary duties to the debtor when it uses its veto power. This means that when deciding whether to veto the debtor's bankruptcy filing after the debtor becomes insolvent, the golden shareholder should always make the decision that would maximize the debtor's value for all its creditors. This novel framework departs from the approach courts take, which never finds that golden shareholders are controlling shareholders and thus does not impose fiduciary duties on them. This is because the courts usually examine control over the company's board in deciding controller status for a minority shareholder. But they have misapplied that test in golden shareholder contexts and ignored that the controller status hinges on the shareholder's actual control over a corporate decision.

My framework's mechanics work as follows: A debtor company's golden share provision itself would be valid as long as it approves the provision in compliance with its charter and bylaws. But if the golden shareholder attempts to veto the debtor's bankruptcy filing in a shareholder vote, the debtor's creditors may sue the golden shareholder in state court for breach of the duty of loyalty in a controlling shareholder transaction. In that litigation, so long as the court determines that the golden shareholder has a conflict of interest in the vote,[131] it would then examine that shareholder's actions under the entire fairness test, which Delaware courts employ to examine transactions involving potential breaches of the duty of loyalty.[132] If the veto fails to be entirely fair, the plaintiff would be entitled to either void the transaction—that is, to enjoin the veto—and proceed to file for bankruptcy, or obtain as damages the expected value it would have derived from the bankruptcy case had the veto not been exercised. This Part first explains the legal doctrines that enable a court to view the golden shareholder as a controlling shareholder, and impose on it fiduciary duties to the corporation's creditors when the corporation is insolvent. Second, it addresses arguments against viewing a golden shareholder as a controlling shareholder, and it explains that the framework works even when the debtor is an LLC and thus able to waive fiduciary duties. Third, it lays out factors that a court may consider in finding fiduciary duty violations. Finally, it argues that the approach will discourage creditors from using golden shares for their own benefit.

A. Creditors May Sue for Breach of Fiduciary Duty upon a Debtor's Insolvency

It is settled law in Delaware "that directors owe fiduciary duties to the *corporation*."[133] This means the directors should make business decisions in good faith aimed at maximizing the corporation's value.[134] But because corporate personhood is a legal fiction, applying this rule to a specific corporation's fiduciaries requires us to ask which stakeholders in that corporation the duty actually benefits.

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[131] See note 171 and accompanying text.

[132] See *Weinberger v UOP, Inc*, 457 A2d 701, 710 (Del 1983) ("When [fiduciaries] of a Delaware corporation are on both sides of a transaction, they are required to demonstrate their utmost good faith and the most scrupulous inherent fairness of the bargain.").

[133] *North American Catholic Educational Programming Foundation, Inc v Gheewalla*, 930 A2d 92, 101 (Del 2007) (emphasis added), citing *Guth v Loft, Inc*, 5 A2d 503, 510 (Del 1939).

[134] See *Shlensky v Wrigley*, 237 NE2d 776, 778–81 (Ill App 1968) (surveying case law standing for the proposition that directors must act in shareholders' best interests but cabining courts' review of such action); *Production Resources Group, LLC v NCT Group, Inc*, 863 A2d 772, 791 (Del Chanc 2004). See also Douglas G. Baird and M. Todd Henderson, *Other People's Money*, 60 Stan L Rev 1309, 1327–28 (2008) (comparing directors' obligation to maximize value for shareholders with trustees' obligation to maximize value for beneficiaries).

When the corporation is financially healthy, the shareholders benefit from the fiduciary duties as residual owners.[135] But Delaware case law has established that when the corporation becomes insolvent, the creditors obtain standing to sue derivatively for fiduciary duty breaches. The Court of Chancery first reasoned in *Credit Lyonnais Bank Nederland NV v Pathe Communications Corp*[136] that when the corporation is operating in the "vicinity of insolvency," the board of directors owes a duty to the "community of interest that sustained the corporation," as opposed to the shareholders only.[137] This duty compels the directors to exercise good-faith judgment to "maximize the corporation's long-term wealth creating capacity" rather than considering only the shareholders' benefit when dealing with the corporation's assets.[138] In *Production Resources Group, LLC v NCT Group, Inc*,[139] the court further explained why creditors stand in the shareholders' shoes upon actual insolvency. By the very nature of insolvency, shareholders cannot receive any residual value because the creditors' claims cannot be satisfied even after all the corporate assets are liquidated. This means the creditors now replace the shareholders insofar as they directly bear the risk of unwise or disloyal business decisions.[140]

In *North American Catholic Educational Programming Foundation, Inc v Gheewalla*,[141] the Delaware Supreme Court clarified that fiduciary duty does not shift to the creditors after the corporation's insolvency, nor is there a legally meaningful "zone of insolvency" during which the directors' duties might change.[142] Rather, upon insolvency, creditors acquire *standing* to sue derivatively for fiduciary duty breaches on behalf of the corporation as the "principal constituency injured by any fiduciary

[135] Residual owners get everything left in a company after all its debts are paid. When the company is solvent, whether it does well matters to the shareholders because they get all the upside of good governance decisions, while creditors are paid off with the fixed amount of what they are owed. Therefore, fiduciaries answer to the shareholders when the corporation is financially healthy. See *Gheewalla*, 930 A2d at 101–02.

[136] 1991 WL 277613 (Del Chanc).

[137] Id at *34.

[138] Id. If the board were to vindicate *only* the shareholders' interests when the corporation owes more debt than what it is worth, the court reasoned, the board would make risky businesses decisions that may bring the corporation huge gains or cause it to lose everything because shareholders would get nothing anyway if the board played it safe, even when playing it safe maximizes the corporation's expected value. Id at *34 n 55.

[139] 863 A2d 772 (Del Chanc 2004).

[140] Id at 791.

[141] 930 A2d 92 (Del 2007).

[142] Id at 101.

breaches that diminish the firm's value,"[143] just like shareholders in a healthy company. In the bankruptcy veto context, because filing bankruptcy can be either good or bad for an insolvent corporation, as long as the fiduciary made the decision not to file in good faith, courts generally will defer to the fiduciary's business judgment. However, if the decision is made only to benefit the fiduciary as a creditor, then the creditor is potentially in violation of its duty of loyalty to the company. Then, the creditor is not entitled to protection if the decision harms the corporation. Therefore, if a golden shareholder owes fiduciary duties to the debtor, another creditor may sue a golden shareholder who vetoed the debtor's bankruptcy in its self-interest for breach of the duty of loyalty. Then, the court will examine whether the veto is entirely fair to the debtor.[144] The next Section explains that the golden shareholder indeed owes such fiduciary duties by being a controlling shareholder.

B. Golden Shareholders Owe Fiduciary Duties to Debtors as Controlling Shareholders

Shareholders of a Delaware corporation generally owe no fiduciary duty to each other and can act exclusively in their own interests.[145] But there are two exceptions. "[A] shareholder owes a fiduciary duty only if it owns a majority interest in or *exercises control over the business affairs* of the corporation."[146] For a minority shareholder to become a "controlling minority shareholder,"[147] and hence the corporation's fiduciary, the shareholder must dominate the corporation "through actual control of corporation conduct."[148] Delaware courts have held that a minority shareholder does not need to exercise general control over *all* aspects of a corporation's affairs to be controlling. Instead, as long as the shareholder exerts "actual control with regard to the *particular* transaction that is being challenged," the shareholder is

143 Id at 101–02, quoting *Production Resources*, 863 A2d at 294 n 67.

144 See *Weinberger*, 457 A2d at 710.

145 See *Ivanhoe Partners v Newmont Mining Corp*, 535 A2d 1334, 1344 (Del 1987), citing *Unocal Corp v Mesa Petroleum Co*, 493 A2d 946, 958 (Del 1985).

146 Id (emphasis added).

147 *Franchise Services*, 891 F3d at 211.

148 *Citron v Fairchild Camera & Instrument Corp*, 569 A2d 53, 70 (Del 1989). See also *In re Sea-Land Corp Shareholders Litigation*, 1988 WL 49126, *3 (Del Chanc) ("A [minority] stockholder is not deemed controlling unless it . . . has exercised actual domination and control in directing the corporation's business affairs.").

controlling and assumes fiduciary duty as to that transaction.[149] By extension, golden shareholders can be the corporation's fiduciaries as long as they exercise actual control over the corporation's decision to not file for bankruptcy. Since a golden shareholder can veto a debtor's bankruptcy filings, the veto allows it to exercise actual control over the debtor's bankruptcy decision, and that alone should make it a fiduciary to the debtor.

Imposing fiduciary duties on golden shareholders eliminates the false positive and negative problems. Courts now can examine ex post whether each golden shareholder's veto violates these duties case by case. In this way, courts can invalidate self-interested decisions and preserve those made in good faith for the debtor corporation.

C. Addressing Counterarguments to Imposing Controller Fiduciary Duties on Golden Shareholders

This Section addresses two potential counterarguments deriving from Delaware Court of Chancery decisions that may obstruct imposing fiduciary duties on golden shareholders and explains why those counterarguments are ultimately inapplicable. The first counterargument is that the test for determining controlling shareholder status should focus on the shareholder's control over the board. The second counterargument is that the shareholder should not owe fiduciary duties for a veto right that it bargained for as part of a contract. This Section also addresses the scenario in which the debtor is an LLC and thus able to waive fiduciary duties, and explains that because such duties cannot be waived regarding the LLC's creditors, corporations are unable to circumvent the proposed rule by converting to LLCs.

[149] *Williamson v Cox Communications, Inc*, 2006 WL 1586375, *4 (Del Chanc) (emphasis added). See also *In re Western National Corp Shareholders Litigation*, 2000 WL 710192, *20 (Del Chanc); *In re Primedia Inc Derivative Litigation*, 910 A2d 248, 257 (Del Chanc 2006) ("[T]he plaintiffs need not demonstrate that KKR oversaw the day-to-day operations of Primedia. Allegations of control over the particular transaction at issue are enough.").

1. The "board control" test of controllers is inapplicable to golden shareholders.

The Delaware Court of Chancery realizes that determining actual control is a fact-intensive inquiry.[150] Many cases have examined primarily one factor, the shareholder's control of the board of directors, in determining actual control, notwithstanding that the inquiry should be flexible and fact intensive.[151] This approach originates from the seminal Delaware case *Kahn v Lynch Communication Systems, Inc*.[152] Courts solidified the inquiry in later cases that similarly dealt with freeze-out mergers—that is, a controlling shareholder's proposal to buy the rest of the corporation's shares.[153] Courts subject a freeze-out merger to the heightened entire fairness test out of concern that the board and the minority shareholders likely approved the merger due to their fear of the controlling shareholder's retaliation rather than their independent judgment.[154] For example, the controlling shareholder can replace a dissenting board, and the minority shareholders can end up with less liquid, and hence less valuable, shares if they hold out against the proposal. Minority shareholders can even end up accepting an unfair price from the controlling

150 See *In re KKR Financial Holdings LLC Shareholder Litigation*, 101 A3d 980, 993 (Del Chanc 2014) (analyzing a variety of facts one by one in a totality of the circumstances inquiry); *In re Morton's Restaurant Group, Inc Shareholders Litigation*, 74 A3d 656, 665 (Del Chanc 2013) (same).

151 See *Basho Technologies Holdco B, LLC v Georgetown Basho Investors, LLC*, 2018 WL 3326693, *26–28 (Del Chanc) (identifying factors that indicate actual control, including the exercise of veto rights as to corporate governance decisions); *In re Cysive, Inc Shareholders Litigation*, 836 A2d 531, 550–51 (Del Chanc 2003) (noting the fact-intensive nature of the inquiry, but emphasizing that "the question of whether the large block holder has 'control' may be relevant [to], and intertwined with, the question of whether the merger was approved by uncoerced, independent *directors*") (emphasis added).

152 638 A2d 1110, 1114–15 (Del 1994).

153 See *KKR Financial Holdings*, 101 A3d at 988–89; *Morton's Restaurant Group*, 74 A3d at 660; *In re PNB Holding Co Shareholders Litigation*, 2006 WL 2403999, *1 (Del Chanc); *In re Tesla Motors, Inc Stockholder Litigation*, 2018 WL 1560293, *8–11 (Del Chanc).

154 See, for example, *PNB Holding*, 2006 WL 2403999 at *9:

> Delaware caselaw in [controlling shareholder cases] (that is, the *Lynch* line of jurisprudence) has been premised on the notion that when a controller wants the rest of the shares, the controller's power is so potent that independent directors and minority stockholders cannot freely exercise their judgment, fearing retribution from the controller.

See also, for example, *In re Pure Resources, Inc, Shareholders Litigation*, 808 A2d 421, 441 (Del Chanc 2002) ("[T]he overriding concern of *Lynch* is the controlling shareholders have the ability to take retributive action in the wake of rejection by an independent board, a special committee, or the minority shareholders.").

shareholder to prevent further loss.[155] Therefore, in this context, whether the shareholder in question really deprived the board of its free will becomes the key to deciding whether the shareholder is a controller and entire fairness review should apply.

Relying on the board control test, the Fifth Circuit in *Franchise Services* held that the golden shareholder was not controlling because the debtor's board was able and willing to authorize the bankruptcy filing without having the shareholders vote on the issue.[156] It equated actual control with board control without offering a justification. But mechanically transplanting the board control test from the freeze-out merger context to the golden share context is inappropriate. Rather than preventing bad board actions (compelled merger approvals), the goal of testing the legitimacy of a golden share veto is to prevent bad shareholder actions (self-interested bankruptcy vetoes). In contrast to freeze-out mergers, courts are not worried about the board being too afraid of the golden shareholder to approve any bankruptcy filing, as board approval does not matter when the golden shareholder can bypass the board and veto an approved filing.[157] To prevent outcomes that favor one shareholder at the corporation's expense, courts need to interrogate a board's independence from that shareholder only when the *board* can influence that decision. For purposes of the inquiry, at least with respect to the golden shareholder veto, courts can skip the inquiry into the board's independence and directly scrutinize the shareholder when the shareholder alone controls that decision and the board can do nothing about it.

2. "Contractual rights" are not a ground for denying fiduciary duties.

Another potential counterargument is that the golden shareholder should not owe fiduciary duties to shareholders for exercising the veto right that it bargained and already paid consideration for. The *Superior Vision Services, Inc v ReliaStar Life*

155 See *Pure Resources*, 808 A2d at 441–42 (explaining how such offers create a "prisoner's dilemma" for minority stockholders).

156 *Franchise Services*, 891 F3d at 211 ("In making [the controlling shareholder] determination, Delaware courts focus on control of the board."); id at 213 (applying the board control test to the facts).

157 Mergers require board approval to be carried out, see 8 Del Code Ann § 251(b), so any approval should be an independent decision not corrupted by the controller. But when approval cannot prevent self-interested outcomes anyway, the focus on approval is misdirected.

Insurance Co[158] court made a similar argument. In that case, the court held that a shareholder should not owe fiduciary duties for exercising a contractual right to decide on a corporate affair because fiduciary duty would limit the right that it legitimately bargained for and hence frustrate the parties' freedom to contract.[159] One may thus argue that the golden shareholder's bankruptcy veto right, arguably also obtained through the "nexus of contracts"[160] among shareholders embodied in the corporate charter, should not give rise to fiduciary duties.

This argument overlooks the distinction between a right to veto in a shareholder vote provided in the charter and that in a standalone contract. The distinction is not merely formalistic and is probably the true reason underlying the *Superior Vision Services* holding. If the debtor files bankruptcy in defiance of a veto right granted by the charter, the golden shareholder can enjoin the filing on the grounds that the corporation did not conduct the shareholder vote required in the charter and thus lacks capacity to file;[161] by contrast, if the right is granted by a separate contract, its remedy would be contractual—namely, damages. Therefore, actual control of the debtor's bankruptcy does not exist as to a contractual right, but it exists when the right is grounded in the charter. And under Delaware law, fiduciary duties vest in a shareholder when the shareholder exercises actual control.[162]

One cannot logically argue, then, that those duties do not exist because they are not part of what the parties explicitly bargained for. The whole point of fiduciary duty is that, to maximize the value of the corporation as a whole, whoever monopolizes decision-making power should not exploit the decision to the corporation's detriment.[163] If a shareholder who controls an important corporate decision (such as bankruptcy) were able to disclaim fiduciary duties merely because it paid for its shares, the corporation would be rendered a mere funnel through which the controller channels minority shareholders' money into its own pocket.

158 2006 WL 2521426 (Del Chanc).

159 Id at *4–5.

160 Frank H. Easterbrook and Daniel R. Fischel, *The Corporate Contract*, 89 Colum L Rev 1416, 1426 (1989).

161 See 8 Del Code Ann § 124; *Southeastern Pennsylvania Transportation Authority v Volgenau*, 2012 WL 4038509, *3 (Del Chanc) ("A challenge to the validity of an action or to the corporation's capacity to undertake the action seeks to make the action void. It is a claim that the act could not occur.").

162 See *Citron*, 569 A2d at 70 (Del 1989).

163 See *Guth*, 5 A2d at 510.

3. LLCs cannot waive fiduciary duties as to creditors.

Many debtors that adopt golden share provisions are not corporations, but LLCs.[164] While grounded in corporate law principles, this Comment's approach applies equally well to LLC debtors. Because default fiduciary duties to LLCs are governed by the same rule as those for corporations,[165] an LLC's creditors also become fiduciary duty beneficiaries upon the LLC's insolvency. But unlike a corporation's fiduciaries,[166] an LLC's members can freely waive fiduciary duties to each other in the LLC's operating agreement.[167] One might argue that this Comment's proposed rule invites opportunistic behavior: a corporation in the zone of insolvency can always switch to the LLC form and waive all fiduciary duties, enabling its golden shareholder to do what it wants with impunity.

However, Delaware's LLC Act provides that any fiduciary duty owed to a party "bound by" the LLC's operating agreement can be waived.[168] Thus, a healthy LLC's residual claimants, who are its members, cannot sue for duty breaches if there is such a waiver because all members necessarily have executed and thus are bound by the operating agreement. But the provision is inapplicable to the residual claimants of an *insolvent* LLC—its creditors—most of whom have no reason to sign the operating agreement and may have never even seen it.

One might argue that even if the waiver itself does not apply to all creditors, by lending money to an LLC that has waived fiduciary duties and has a golden shareholder, a creditor consents to the waiver and should not complain if the golden shareholder later vetoes bankruptcy for its own interest. Indeed, if *all* creditors agree to opt out of bankruptcy in this way, then it might make sense to leave them alone.[169] But when a debtor corporation

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[164] See generally, for example, *Lake Michigan Beach*, 547 Bankr 899; *Global Ship Systems*, 391 Bankr 193.

[165] See 6 Del Code Ann § 18-1104.

[166] Delaware corporate law expressly prohibits corporations from waiving fiduciaries' liability for breaches of the duty of loyalty, see 8 Del Code Ann § 102(b)(7)(i), or for any breach committed in bad faith, see 8 Del Code Ann § 102(b)(7)(ii).

[167] See 6 Del Code Ann § 18-1101(c); *Miller v HCP & Co*, 2018 WL 656378, *2 (Del Chanc) (explaining that LLC members may forgo fiduciary duties only by express waiver).

[168] 6 Del Code Ann § 18-1101(c).

[169] The reason why courts should leave consented creditors alone, then, would be that if the risk of nonrecovery upon insolvency caused by bankruptcy veto rights is truly damaging, creditors would not lend money to debtors with golden share provisions. The market will thus deter companies from adopting these provisions if they want to raise money, and the law does not need to invalidate them to frustrate freedom of contract.

opportunistically converts to an LLC to waive the duties, its creditors could not have consented to the waiver provision because they extended loans before it was adopted,[170] and the debtor would thus be unable to evade the duties.

D. Determining Conflicts of Interest

A controlling shareholder transaction triggers entire fairness review only if that shareholder has a conflict of interest in the transaction.[171] However, while creditors replace the shareholders to become the primary residual owners upon insolvency, Delaware courts hold that a fiduciary does not become conflicted merely because it makes decisions favoring equity over debt.[172] Thus, entire

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This argument raises issues that may be topics of another full-fledged paper. That paper would need to first address whether putting the golden share provision in the charter (or in case of LLCs, the operating agreement) is indeed such a transparent process that every creditor really is aware of the provision when lending its money. This is by no means certain given that many are nonmonitoring investors following the passive strategy to invest in the entire market. And even if they are fully informed of the provision, is it okay for bankruptcy law to leave the creditors alone as long as they *believe* that expected returns from the loan justify the risk of nonrecovery in case of insolvency? For one thing, people tend to discount future risks and overestimate present gains, so not only *individual* creditors can make unwise decisions, but courts may also end up permitting behavior much more harmful to *society* than in each creditor's original perception.

Finally, even assuming every creditor is capable of calculating precisely the risks and returns, this would send courts and commentators back to the familiar and unsettled question of whether *all* relevant parties can be trusted to devise a good enough alternative procedure together so that they are allowed to contract out of bankruptcy. For discussion of parties' ability (or lack thereof) to make informed, contractual decisions about bankruptcy, see generally, for example, Alan Schwartz, *Contracting About Bankruptcy*, 13 J L & Econ 127 (1997); Lynn M. LoPucki, Essay, *Contract Bankruptcy: A Reply to Alan Schwartz*, 109 Yale L J 317 (1999).

170 Presumably, creditors can bargain with the LLC ex ante to require it to not waive fiduciary duty or adopt golden share provisions in future. We can imagine large institutional secured lenders negotiating this. But not all of them can do that, and one purpose of bankruptcy law is precisely to protect the interests of (unsecured) creditors with no such bargaining power from the secured creditor who tries to enforce its claim at the expense of the corporation's aggregate value. See Jackson, 91 Yale L J at 864–65, 868–70 (cited in note 10).

171 See *In re Synthes, Inc Shareholder Litigation*, 50 A3d 1022, 1034 (Del Chanc 2012) ("Under venerable and sound authority, the plaintiffs must plead that [the controlling shareholder] had a conflicting interest in the [transaction] in the sense that he derived a personal financial benefit 'to the exclusion of, and detriment to, the minority stockholders.'"), quoting *Sinclair Oil Corp v Levien*, 280 A2d 717, 720 (Del 1971).

172 See *Quadrant Structured Products Co, Ltd v Vertin*, 102 A3d 155, 191–92 (Del Chanc 2014). The court held that because shareholders are still residual claimants of the corporation and only secondary to creditors, their interests are supposed to be aligned. Id. Holding that an equity-favoring business decision is conflicted per se risks interfering with the board's good-faith judgment as to whether a riskier or safer strategy is the best for the firm, which should be within the ambit of the business judgment rule.

fairness can seldom apply to a veto of a bankruptcy filing made by a golden shareholder holding only equity and no debt. But when the golden shareholder is also a creditor of the corporation, risks of interestedness are much more pronounced.

As a creditor, the golden shareholder wants to be repaid as much as possible. It probably does not like bankruptcy because the automatic stay prohibits all individual collection actions against the debtor. The golden shareholder could have filed suit first and been fully repaid from everything in the debtor's asset pool, but it would then be forced to share the pool with other creditors if bankruptcy is filed. If its debt is secured, the collateral may depreciate during the bankruptcy process, and it may be "confiscated" for use in the debtor's reorganization.[173] On the other hand, bankruptcy can be good for an insolvent corporation for various reasons. We thus can easily imagine a golden shareholder, for its own gain, blocking a bankruptcy that would benefit the corporation if filed, and this is precisely the type of interested transaction that the entire fairness test aims to screen out. Drawing on the facts of the cases on golden shares, I now lay out several nonexhaustive factors that help determine whether a golden shareholder is materially interested[174] so as to trigger the entire fairness review.

1. The amount of equity versus debt held by the golden shareholder.

A golden shareholder can be interested only when the corporation owes it so much money that bankruptcy does more injury to the golden shareholder's loan than good to that shareholder as the corporation's residual owner. The Fifth Circuit in *Franchise Services* pointed out that it "strains credulity to believe" that the creditor invested $15 million for a golden share just to make sure its $3 million bill would be paid.[175] When the golden shareholder holds more equity stake but less debt, it becomes less certain that its bankruptcy veto was made to collect on that debt rather than made to launch a risky business plan and reap a large portion of the boosted company value via equity. In the latter case, the

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173 See Ayotte and Gaon, 24 Rev Fin Stud at 1307 (cited in note 2).

174 See *Cede & Co v Technicolor, Inc*, 634 A2d 345, 358 (Del 1993) (explaining that for entire fairness to apply, the plaintiff must "establish that any director's self-interest was individually, or collectively, so 'material' as to persuade a trier of fact that the independence of the board 'as a whole' had been compromised").

175 *Franchise Services*, 891 F3d at 208.

golden shareholder's interests are aligned with the residual claimants—either creditors or shareholders.

2. The nature of the debt and ease of collection.

Besides the amount of debt and equity at stake in a potential bankruptcy case, the golden shareholder can be interested due to the fact that it could have collected more outside of bankruptcy. For example, as discussed above, the golden shareholder is more willing to collect outside of bankruptcy if it is a large institutional lender that has the resources to negotiate a secured loan and sue to foreclose on the collateral upon default.[176] That is less likely to be the case if the creditor is just an ordinary unsecured creditor[177] who does not monitor the company's financial condition or lacks the legal resources to bring a timely collection action and win the race to the courthouse. In the latter case, recovery under bankruptcy is at least as good as without bankruptcy, so the bankruptcy veto exercised would not be due to a misaligned incentive as a creditor.

3. The context of a golden share provision's adoption.

The above factors illustrate the reasons why bankruptcy can objectively be undesirable for the golden shareholder; but the most telling evidence of interestedness need only show that the golden shareholder does not desire bankruptcy for some reason linked to its self-interest as a creditor. Context surrounding the adoption of the golden share provision sheds light on the parties' intention. For example: (1) Was the provision adopted concurrently with a loan or forbearance agreement,[178] so that it is likely to have been made in exchange for the loan/forbearance?[179] (2) Did the golden shareholder specifically mention the need to avoid bankruptcy in the loan negotiations, or "coerce" the corporation to adopt the provision?[180] (3) Is the provision designed to expire

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176 See, for example, *Lake Michigan Beach*, 547 Bankr at 903–04 (deciding a case in which a large secured creditor vetoed bankruptcy).

177 In reality, unsecured golden shareholders are rare because someone without the leverage to even bargain for a security interest for its loan would also have a hard time getting a powerful share with a veto right.

178 For an explanation of forbearance, see Part II.B. See also *Intervention Energy Holdings*, 553 Bankr at 261.

179 See, for example, *Lexington Hospitality Group*, 577 Bankr at 681–82.

180 See, for example, *In re DB Capital Holdings, LLC*, 2010 WL 4925811, *3 (BAP 10th Cir).

once the debt owed to the golden shareholder is fully repaid?[181] All of these factors imply that a major (if not the only) reason for the golden share provision's existence originates from the golden shareholder's *loan* to the debtor. Therefore, if these factors are present, a golden shareholder will be much more likely to exercise the veto right in a way that benefits its loan and disregards the debtor's interests.

4. Application.

We now apply the rule to the facts of *Franchise Services*. Suppose the debtor's board presents the bankruptcy matter for a shareholder vote and the creditor is thinking about vetoing it. The creditor envisions that the debtor may sue under this Comment's rule if it exercises its veto. The creditor must be a controlling shareholder because its preferred share enables it to veto any bankruptcy filing. The tricky part is that the court may still not find the creditor to be interested: although its equity holding exceeds its debt holding by $12 million, the debtor still owes it $3 million, which is no small amount. Although the debt appears to be unsecured (a fact unmentioned in the case), it was incurred at the same time as the debtor adopted the golden share provision. The creditor's fate is determined by whether it is interested in the transaction, and the creditor does not like this uncertainty. If the court finds it to be interested, it will bear the burden to prove the veto is entirely fair, which is not easy. Thinking about the rule's impact, the creditor can veto the bankruptcy only when the veto is obviously in the debtor's interest and it can prove that the veto was entirely fair.

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Courts have examined many of these factors in existing cases, but only within the bankruptcy waiver framework. Analysis under that framework is awkward because a court is forced to speculate whether, under all circumstances, the creditor would *never* permit bankruptcy filings against its interest, so that the veto right is equivalent to a bankruptcy waiver. Moving these factors into the interestedness analysis under the corporate law framework solves this problem because the court would no longer have to predict with certainty what the golden shareholder *would* do, but would only decide whether the golden shareholder's

181 See, for example, *Global Ship Systems*, 391 Bankr at 199–200.

self-interest is *capable* of swaying its judgment as to the decision to file for bankruptcy for the debtor.[182]

E. Impacts of the Approach.

Most golden shareholders who are also creditors of a corporation would likely be found materially interested so long as their debt holdings are significant enough to influence their judgment about whether to block the corporation's bankruptcy. This reality, coupled with the controlling shareholder status, would compel the golden shareholder to prove the entire fairness of its decision to avoid liability for breach of the duty of loyalty.[183] The shift of burden to prove entire fairness does not apply in this scenario because if either a majority of the noncontrolling shareholders or a special committee of directors assented to the nonfiling, the golden shareholder's veto would not be contested in court anyway.

This rule does not question a golden share provision's validity as long as state corporate law permits it.[184] Instead, the rule scrutinizes ex post each golden shareholder's veto made under the provision on a case-by-case basis. This enables the court to weed out self-interested decisions and preserve those for which entire fairness can be shown. The latter types of decisions are exactly what we want to retain as legitimate business judgment by corporate decisionmakers. This significantly improves the outcomes under the original bankruptcy waiver framework, which validates or voids the entire veto right and either leaves room for bad-faith decisions to go uncontested or blocks good decisions. Additionally, legal expenses would be unlikely to deter potential plaintiffs (the other creditors) from bringing a lawsuit if they are already well prepared to go to the bankruptcy court.

One may argue that this approach, while increasing accuracy, would invite lawsuits and increase ex post decision costs by deciding vetoes on a case-by-case basis. But the rule would actually disincentivize lawsuits ex ante. Proving entire fairness is

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182 See *Cede*, 634 A2d at 362 (affirming that interestedness is not material unless there is "reasonable probability . . . that the independence of judgment of a 'reasonable person' in the director's position would be affected").

183 See *Cinerama, Inc v Technicolor, Inc*, 663 A2d 1156, 1162 (Del 1995).

184 Accordingly, if the corporation files bankruptcy without the golden shareholder's consent, the filing would be dismissed for lack of authority under *Price v Gurney*. 324 US at 104. The corporation's cause of action only arises after it presented a bankruptcy proposal to a vote and got vetoed by the golden shareholder. Arguably, this may make a much-needed bankruptcy available too late. But as analyzed below, the rule's ex ante incentives would make actual lawsuits rare.

usually an onerous burden.[185] Because that burden falls on golden shareholders, they would be liable when the vetoes are indeed entirely fair, but they are unable to prove it. A good-faith shareholder-creditor would thus think twice before adopting a golden share provision, as there is no inherent need for it to obtain control over the debtor via a veto right if it just wants the best for the debtor. With a veto right, the provision would inevitably render the creditor an interested controlling shareholder and expose it to substantial risk of liability whenever it exercises that right. Therefore, the creditor would instead opt for voting rights that do not amount to actual control and trigger entire fairness review.[186] This also means that any well-advised creditor who uses a golden share provision and exercises a veto would make sure that it can pass muster under the entire fairness test, so any golden share veto would be made in good faith and very likely bulletproof. On the other hand, a shareholder-creditor who indeed wishes to block bankruptcy in bad faith would never adopt such a provision. Not only would it have no hope of proving the entire fairness of its veto, rendering the veto void, but the shareholder-creditor would possibly be subject to *monetary damages* for the plaintiffs' expected value from bankruptcy once it loses as a disloyal fiduciary.

By contrast, under the bankruptcy waiver framework, even if the provision becomes void, the court cannot punish the golden shareholder. Overall, because this rule disincentivizes all shareholder-creditors from obtaining controlling status through golden shares in the corporation's decision to file for bankruptcy, the possibility of one creditor opting out of bankruptcy at the expense of other creditors would be reduced.

CONCLUSION

Bankruptcy's most fundamental purpose is to maximize an insolvent business entity's value for the benefit of all of its creditors. But that purpose would be defeated if any creditor could unilaterally opt out of the process. By prohibiting bankruptcy

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185 See *Weinberger*, 457 A2d at 710 ("The requirement of fairness is unflinching in its demand that where one stands on both sides of a transaction, he has the burden of establishing its entire fairness, sufficient to pass the test of careful scrutiny by the courts.").

186 One might argue that this rule unduly limits corporate owners' freedom of contract to give certain shareholders control. But the shareholder-creditors who are confident enough in the merits of their vetoes are still welcome to accept the great power of a veto right and the great responsibility that comes with it.

waivers, bankruptcy law mandates a collective proceeding to prevent creditors from dismantling the debtor piece by piece, eliminating the social costs incurred by a race to the courthouse in the individual collection process. Creditors in turn wield corporate law. They acquire the debtor's shares and cloak bankruptcy waivers in bankruptcy veto rights granted by the debtor's charter. Notwithstanding corporate law's flexibility toward shareholders in deciding how to manage their business, courts currently ask themselves whether they should void those rights as "tantamount" to bankruptcy waivers.[187] The fuzzy standard has yet to develop clear guidelines, and practitioners are left bewildered. What's more, existing line-drawing rules within the waiver-or-no-waiver dichotomy tend to either rule out good-faith business decisions or permit self-interested bankruptcy blockage.

This Comment departs from that framework and proposes imposing fiduciary duties on creditors holding bankruptcy veto rights in debtor corporations, so that courts can examine specific bankruptcy vetoes through the entire fairness review under corporate law. Legally relevant facts would be largely the same under both frameworks. But courts will feel more confident in their reasoning if the facts demonstrate a creditor's tendency to act in its own favor rather than making sweeping assertions as to the creditor's future behavior. Examination of vetoes case by case weeds out bad-faith vetoes while retaining entirely fair ones. The prospect of liability concomitant with actual control of the debtor's bankruptcy decision would deter creditors from using golden shares to block bankruptcy in bad faith, and golden share lawsuits would thus decrease. At the same time, creditors desiring to exercise control in good faith as the debtor's owner are still welcome to undertake the heightened responsibility.

The rule that this Comment proposes is by no means irreproachable, as the ex post determination mechanism may risk delay of much-needed bankruptcy for some debtors. But I maintain confidence in the rule's ex ante correction impacts given the high burden of entire fairness accompanying the fiduciary status to be imposed on golden shareholders. Lastly, the topic that this Comment grapples with is inevitably entrenched in unsettled discussions of what bankruptcy law aims to accomplish, whether bankruptcy should be mandatory at all, and how far freedom of contract between a business entity's owners can go. The solution

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[187] See, for example, *Intervention Energy Holdings*, 553 Bankr at 265.

it offers is premised on how the author views these issues, which itself is subject to debate. I consider principles of fiduciary duty, well developed and familiar as they are, to be useful tools for ensuring that bankruptcy will be filed when it should be.