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**I Wish I May, I Wish I Might...File Chapter 11 Tonight:  
Authorization and D&O Considerations  
When Filing Chapter 11**

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## I. INTRODUCTION

Corporate chapter 11 cases come in all shapes, sizes, forms and duration (big, small, consensual, hotly contested, prepackaged, pre-arranged, with a plan of reorganization, with a liquidating plan, conversion to chapter 7, taking 30 days, taking 3 years, etc.), but they all share one thing in common – each chapter 11 case begins with the filing of a petition. While an involuntary chapter 11 is commenced by creditors filing a petition, a voluntary chapter 11 is commenced through the filing of a petition executed by an authorized individual on behalf of the corporate debtor. *Compare* Official Form 1 (a voluntary petition) *with* Official Form 5 (an involuntary petition).

A corporate debtor grants authorization to file through the actions of its governing body (typically, a board of directors or managers). The decision to commence a voluntary chapter 11 case is a serious decision for any board of directors. When making this decision, in the exercise of their fiduciary duties, the decision makers should make an informed decision based on the applicable facts and circumstances. Depending on the circumstances, the decision to file may include consideration of the legal requirements under the applicable organizational documents, historical operations and business practices, current and near-term liquidity requirements and financial condition, and applicable non-bankruptcy law.

While by no means an exhaustive list, the following discussion outlines and identifies certain considerations relevant to authorizing the commencement of a chapter 11 case. When considering a chapter 11 filing, the following legal and business questions should be explored:

1. What do the organizational documents require to authorize a filing?
2. Are there any nonbankruptcy laws governing authorization of a filing?
3. How may the authorization to file be challenged?
4. What if authorization to file cannot be obtained?
5. To whom does the board or decision maker owe a fiduciary duty?
6. What factors, with respect to a decision maker's fiduciary duties, may be relevant to a decision to file?
7. What exit strategy issues should be considered?
8. What are other potential consequences of a filing to be considered?

Each of these considerations are discussed below. It is important to note that each situation is unique. While some of the considerations outlined herein may be relevant to one case, they may not apply in other cases. Nonetheless, any decision to file chapter 11 must be based on a reasoned consideration of the facts and circumstances faced by the filing entity.

## II. AUTHORIZATION TO FILE

### A. What do the organizational documents require to authorize a filing?

#### 1. *In General*

When advising a board of directors in connection with a possible chapter 11 filing, the starting point is to review the organizational documents of the entity. It is important to

note that there is a distinction between requirements in the organizational documents (such as the charter, articles of incorporation, bylaws, limited liability company (“LLC”) agreement, or partnership agreement) versus requirements in contracts (such as shareholder agreements, separate agreements between partners, or loan documents). Violating organizational documents may bring into question whether the filing was duly authorized, whereas breaching a contract may result in a claim, but does not implicate proper authorization. Typically, the organizational documents establish the requirements for approving corporate actions. In some instances, higher voting thresholds of the governing body are required for certain material actions, including filing for chapter 11. Courts generally enforce provisions in organizational documents that limit who may authorize an entity’s petition for chapter 11 relief. *See, e.g., In re Nyack Autopartstores Holding Co.*, 98 B.R. 659, 663 (Bankr. S.D.N.Y. 1989) (“The authority of a corporation to file a bankruptcy petition is left to those in the corporation who have the power of management. State law will govern as to who may exercise the power of management.”) (internal citations omitted).

An ancillary consideration is whether the form of entity impacts the authorization required. Either the organizational documents or, if the documents are silent, state law may dictate the authorization required for that type of entity to file. For example, if the filing entity is a corporation, then typically the board of directors will authorize the filing. If the filing entity is an LLC, then authorization depends on the provisions of the LLC agreement. If an LLC is member managed, then depending on the LLC agreement, the managing member, a majority of the members, all of the members, or some variation thereof must consent to authorize a filing. Alternatively, if managed by a board, the board may have authority to approve a filing either with or without the consent of the member(s). Such provisions are generally held to be enforceable. For example, one court ruled that, in a manager-managed LLC, a resolution – even when issued by the managing member – was not sufficient to authorize the bankruptcy filing of the LLC because the entity’s organizational documents required authorization of at least 75% of all of the entity’s members. *In re Avalon Hotel Partners, L.L.C.*, 302 B.R. 377, 380-81 (Bankr. D. Ore. 2003).

## **2. *Special Purpose Entities***

A special or single purpose entity (“SPE”) is an entity formed to hold an isolated group of assets and to limit the exposure of those assets (and, by extension, the SPEs creditors) to the risks associated with the overall enterprise. SPEs are typically found in complex business structures and either hold the underlying encumbered property (i.e., property subject to mortgage debt) or equity interests in subsidiaries (i.e., intermediate entities with mezzanine debt secured by equity pledges). Often the organizational documents for an SPE contain restrictions governing its ability to: (i) engage in any activity other than owning, operating and/or acquiring a specified asset or collection of assets, (ii) enter into mergers, consolidations or dispositions of the asset(s), (iii) commingle assets, including cash flows and other revenue generated by the asset(s), (iv) incur any debt or guaranty other than a subject loan or trade debt related thereto, and (v) commence a voluntary chapter 11 case. These restrictions may vary from absolute prohibitions absent lender consent to imposing increased authorization hurdles prior to the SPE engaging in such activities.

With respect to authorizing a chapter 11 filing, absolute prohibitions against a filing are unenforceable as a matter of public policy. As a result, the primary means of limiting

an SPE's ability to file for bankruptcy is to require the vote of one or more independent directors. Oftentimes, the independent directors have had little to no prior involvement with the SPE. In fact, their duties may be limited to decisions on a few specified acts (including, but not limited to, authorizing a voluntary filing by that entity). The requirement for an independent director to approve the decision to file a voluntary petition is meant to serve one of the primary goals of establishing the SPE structure: decreasing the potential for a voluntary filing by an SPE as a result of financial distress elsewhere in the corporate structure. For this reason, SPEs are sometimes referred to as "bankruptcy remote" entities. It is important to understand that "bankruptcy remote" does not mean "bankruptcy proof." Instead, while it may be more complicated to obtain authority to file a "bankruptcy remote" entity, it is not impossible to do so. As evidenced by the chapter 11 filing of numerous SPEs over the last few years, independent directors can and have authorized chapter 11 filings when presented with the appropriate facts. *See, e.g., In re General Growth Props., Inc.*, 409 B.R. 43 (Bankr. S.D.N.Y. 2009) (approving the voluntary filings of over 100 SPEs that were appropriately authorized by independent directors); *In re Extended Stay Inc., et al.*, Case No. 09-12764 (JMP) (Bankr. S.D.N.Y. filed June 15, 2009) (filing over 20 SPEs with the independent directors being (i) provided with significant analysis regarding the SPEs' financial distress in the context of the corporate family and (ii) engaged in proper deliberation prior to making the decision to file the SPEs).

To the extent that independent director consent is required to authorize a filing, consideration should be given to: (i) educating the independent directors about the company and its need for restructuring, (ii) replacing, to the extent deemed necessary, inexperienced independent directors with directors who have restructuring or other relevant business experience, and (iii) reviewing the precise scope of the decisions requiring the independent directors' approval. *In re General Growth Props., Inc.*, 409 B.R. at 58-59 (detailing the discussions between the SPE's decision makers, bankruptcy counsel and other restructuring advisors).

**B. Are there any nonbankruptcy laws governing authorization of a filing?**

Frequently, though not always, corporate debtors have detailed articles of incorporation, charters, LLC agreements and partnership agreements for all entities in their corporate family. In some instances, however, the organizational documents for one or more entities do not address the requisite vote required to authorize the filing of a voluntary petition for chapter 11. In those situations, requirements under applicable state law must be examined. The laws vary by state and, within each state, by type of entity (corporation, LLC, partnership, etc.).

The validity of a bankruptcy filing on behalf of a business entity is a determination to be made under state law and not under federal law. *Price v. Gurney*, 324 U.S. 100 (1945) (ruling that bankruptcy courts shall look to applicable state law to determine who has authority to file a company's bankruptcy petition). Courts have frequently upheld provisions that limit who may authorize a company's petition for chapter 11 relief that are contained in state statutes, in addition to those limitations contained in an entity's organizational documents.

For example, in *Winter v. Bel-Aire Investments, Inc.*, the court invalidated a bankruptcy filing on behalf of a corporation made by the president, because the president did not

possess the requisite authority to file under the articles of incorporation. 97 B.R. 88, 89 (Bankr. M.D. Fla. 1989). Florida law requires a valid resolution of a corporation's board of directors before a bankruptcy filing is authorized. *Id.* at 90. In addition, the court noted that the debtor's by-laws limited the president's duties exclusively to the day-to-day management of the business. Consequently, the court ruled "the Bankruptcy Code itself does not establish the requisites for the initiation of a voluntary corporate bankruptcy case, the validity...must be determined with reference to the laws of the state in which the corporation was chartered." *Id.* at 89-90. *See, e.g., In re DeLuca*, 194 B.R. 79, 87 n. 12 (Bankr. E.D. Va. 1986) (noting the court would be able to dismiss a bankruptcy filing based on an action that violated applicable state law); *In re Quarter Moon Livestock Co. Inc.*, 116 B.R. 775, 778 (Bankr. D. Idaho 1990) ("the authority to file a bankruptcy petition must be found in the instruments of the corporation and applicable state law"). *See also* David B. Stratton, *News at 11: Special Purpose Entities and the Authority to File Bankruptcy*, Vol. 23, No. 2, Am. Bankr. Inst. J. 36, 43-44 (March 2004) (collecting cases ruling that the provisions of applicable state law and organizational documents of an entity may be enforced when determining whether an entity has authorization to file) [hereinafter, "Stratton"].

Further support that a bankruptcy court will apply state law to determine whether an entity has authorization to file is reflected in a change to Bankruptcy Rule 1004(a). Prior to December 1, 2002, Bankruptcy Rule 1004(a) stated that a "voluntary petition may be filed on behalf of the partnership by one or more general partners if all general partners consent to [the filing of] the petition." That rule was amended to remove reference to who has authority to file a bankruptcy petition on behalf of a partnership. The advisory committee note making that amendment states that the authority to file issue "is a matter of substantive law beyond the scope of these rules." *See* Stratton, at 45 (discussing this amendment to Bankruptcy Rule 1004(a)). Effectively, this amendment recognizes that state law governs authorization.

### **C. How may the authorization to file be challenged?**

The first phase of many corporate chapter 11 cases is often referred to as the "triage" phase. Depending on the case, the triage phase may last anywhere from a few days to several months. The primary focus of the triage phase is to stabilize the business following the chapter 11 filing. However, in some cases, creditors or interest holders may challenge the validity of the filing (by asserting that the case was filed in bad faith or without proper authorization) during the triage phase.

In *Keenihan v. Heritage Press, Inc. (In re Heritage Press, Inc.)*, the Eight Circuit had to determine, in the context of a motion to dismiss a bankruptcy petition, whether the individual signing Official Form #1 was authorized to do so. 19 F.3d 1255 (8th Cir. 1994). In this case, there were three significant shareholders: the debtor's president and majority shareholder ("Oberlag"), a past president, and that past president's wife (together with the past president, the "Keenihans"). Approximately one month before the bankruptcy petition was filed, the Keenihans, using authority in a pledge agreement, exercised their rights to take control of Oberlag's shares. To enforce these rights, the Keenihans obtained a temporary restraining order ("TRO") ousting Oberlag as President and installing Mr. Keenihan as president. Approximately two weeks before the bankruptcy petition was filed, the debtor's records were amended to show that the Keenihans owned the newly pledged shares, and consequently they held a majority of the

debtor's shares. Oberlag, disregarding the TRO, then held a shareholder's meeting to vote whether the debtor should file for bankruptcy. At that meeting, he did not let the Keenihans vote their newly pledged shares. Not surprisingly, Oberlag obtained a majority vote to file a petition for chapter 11 relief. The Keenihans filed a motion to dismiss the bankruptcy petition on the grounds it was not properly authorized. Notably, the Eight Circuit acknowledged that regardless of whether the TRO was proper, the bankruptcy court was obligated to accept the result. That is, any arguments regarding impropriety of the TRO would have to be made in applicable state court in an appeal of the TRO. The Eight Circuit upheld the provisions in the pledge agreement and the application of state law as set forth in the TRO, and held that "A person filing a voluntary bankruptcy petition on a corporation's behalf must be authorized to do so, and the authorization must derive from state law." 19 F.3d at 1257. Ultimately, because Oberlag did not have the authority to file the debtor's petition, the motion to dismiss the bankruptcy petition was granted. *Id.* at 1259.

Other courts have similarly granted motions to dismiss bankruptcy petitions on the grounds that the individual signing Official Form #1 did not have authority to file pursuant to applicable state law or the debtor's organizational documents. *See, e.g., Phillips v. First City, Texas – Tyler, N.A (In re Phillips)*, 966 F.2d 926, 932 (5th Cir. 1992) (holding that federal law or precedent does not preempt Texas law on who may authorize a debtor's filing or sign the debtor's petition).

**D. What if authorization to file cannot be obtained?**

If the board of directors (or other governing body or party) is unable or unwilling to authorize a filing, then options may be limited. However, under the right circumstances, an orchestrated involuntary filing may be a permissible method to overcome lack of authorization. Section 303 of the Bankruptcy Code details the requirements of filing an involuntary petition. Pursuant to section 303, three creditors who hold noncontingent, undisputed, unsecured claims in the aggregate amount of at least \$14,425 may file an involuntary petition on behalf of a debtor. 11 U.S.C. §303(b)(1). Relying on this provision, an entity could coordinate with three of its unsecured creditors to file an involuntary chapter 11. It should be noted that this type of orchestrated involuntary filing is unlikely to survive a challenge unless there is evidence of a true restructuring purpose and that the involuntary filing was not done solely to delay or to frustrate other creditors. An entity may actively coordinate with its trade creditors to file an involuntary petition "to evade what they perceived to be an insurmountable restriction against...filing voluntary petitions." *In re Kingston Square*, 214 B.R. at 737. The *In re Kingston Square* court held that the bankruptcy filing was not made in bad faith and that "although the debtors plainly orchestrated the filing of the involuntary petitions, they had reason to believe that reorganization was possible and did not circumvent any court-ordered or statutory restrictions on bankruptcy filings such that, absent any evidence of objective futility of the reorganization process, the cases ought not be dismissed now." *Id.* at 714–15.

In the context of SPEs, this approach is further complicated because often each SPE does not have three or more creditors. The Bankruptcy Code states that if there are fewer than 12 creditors who hold claims against an entity that are not contingent or disputed, then even a single creditor, holding a noncontingent, undisputed claim of at least \$14,475, may file an involuntary petition. 11 U.S.C. §303(b)(2). That ability, however, is subject to several

exceptions. For example, the creditor filing an involuntary petition may not be an employee or insider of the debtor, nor can that creditor be the transferee of an otherwise avoidable transfer under certain sections of the Bankruptcy Code. *See In re Arriola Energy Corp.*, 74 B.R. 784 (Bankr. S.D. Tex. 1987) (holding that an insider, as defined in section 101 of the Bankruptcy Code, is not permitted to file an involuntary petition); *In re DemirCo Group*, 343 B.R. 898 (Bankr. C.D. Ill. 2006) (discussing that employees are not permitted to file an involuntary petition); *In re Euro-American Lodging Corp.*, 357 B.R. 700, 726-27 (Bankr. S.D.N.Y. 2007) (holding that claimants that otherwise hold avoidable transfers are not permitted to file an involuntary petition).

The Bankruptcy Code provides additional guidance in the context of filing an involuntary petition on behalf of a partnership. If the alleged debtor is a partnership, then fewer than all of the general partners in such partnership may file an involuntary petition on behalf of the partnership. 11 U.S.C. §303(b)(3)(A). If all of the general partners of a partnership have already commenced bankruptcy cases, then (i) a general partner, (ii) the trustee of a general partner, or (iii) the holder of a claim against the partnership, may file an involuntary petition. *Id.* at 303(b)(3)(B).

Although section 303(b) of the Bankruptcy Code specifically permits three creditors, and in some instances a single creditor, to file an involuntary petition, there are several other considerations, not discussed herein, when determining whether an involuntary petition meets the requirements of section 303 of the Bankruptcy Code and may be enforced by a bankruptcy court. *See generally* 2 Collier on Bankruptcy, ¶¶303.14, 303.17 (16th ed. rev. July 2010) (discussing limitations and exceptions related to requirements of an involuntary filing under sections 303(b)).

### **III. DUTIES WHEN AUTHORIZING A FILING**

#### **A. To whom does the board or decision maker owe a fiduciary duty?**

As a general rule, under most state's laws, directors of a corporation owe a fiduciary duty to the company regardless of whether the corporation is solvent. While solvency does not change to whom the duty is owed (as it is always owed to the company), it may impact which constituency (shareholder v. creditor) may assert a cause of action for breach of such duty. Typically, in the context of solvent corporations, only the shareholders may pursue derivative actions. However, for insolvent corporations, creditors may do so as well.

“The creditors of an insolvent corporation have standing to maintain derivative claims against directors on behalf of the corporation for breaches of fiduciary duties.” *N. Am. Catholic Educ. Programming Found., Inc. v. Gheewalla*, 930 A.2d 92, 101 (Del. 2007). Because the company’s insolvency makes the creditors the principal constituency injured by any fiduciary breaches that diminish that company’s value, “individual creditors of an insolvent corporation have the same incentive to pursue valid derivative claims on its behalf that shareholders have when the corporation is solvent.” *Id.* at 102. Such creditors’ rights derive from their role as residual claimants in the insolvent company. Like shareholders, creditors are limited to suing derivatively, and not directly, for any breaches of fiduciary duties. Thus, directors of a



corporation, regardless of whether or not the corporation is solvent, generally owe direct fiduciary duties only to the entity, not its creditors. *See Id.*

In contrast, in the context of LLCs, limited partnerships, and certain other alternative entities, the members have greater flexibility in establishing fiduciary duties. Absent a provision to the contrary in the LLC agreement, boards of directors for board-managed LLCs have the same fiduciary duties to the LLC that they would have if it were a corporation (meaning the fiduciary duty is owed to the LLC). However, because LLCs are designed to be creatures of contract, the members have greater flexibility in establishing the directors' fiduciary duties. In fact, an LLC agreement can limit the party or parties to whom a duty is owed or otherwise modify the state law standard. *Fisk Ventures v. Segal*, 2008 Del. Ch. LEXIS 158 (Del. Ch. May 8, 2008) (holding that as creatures of contract, LLCs may have different fiduciary duties than those held by directors of corporations); *c.f.* Myron T. Steele, *Freedom of Contract and Default Contractual Duties in Delaware Ltd. P'ships and Ltd. Liab. Cos.*, Vol. 16, No. 2 Am. Bus. L. J. 221, 242 (2009) ("Courts should analyze LLC agreements by the parties' agreement alone. Default fiduciary duties introduce unnecessary confusion to contracting"). Similarly, in the case of a limited partnership, the partnership agreement will determine how a filing of the limited partnership is to be authorized and what duties the general partner may be subject to in making that decision.

In addition, in the SPE context, regardless of the form of entity, it is common that the organizational documents require the decision maker to consider the interests of the SPE's lender or other creditors. Such provisions take a variety of forms, which can run the gamut from a requirement that the independent directors must consider the interests of the SPE's lender or other creditors as a third party beneficiary to the agreement (which may or may not be qualified with a provision like "to the extent permitted by law") to a permissive provision stating that the independent directors may consider the interests of the SPE's lender or other creditors. These types of contractual provisions, however, may be limited. Indeed, as one court has held, it is a potential breach of an independent director's fiduciary duties to prevent a bankruptcy filing solely for the benefit of an SPE lender. *In re Kingston Square Assocs.*, 214 B.R. 713, 735-36 (Bankr. S.D.N.Y. 1997), *see also In re General Growth Props., Inc.*, 409 B.R. at 64. Ultimately, enforceability of provisions that restrict or direct a decision maker's fiduciary (or other duties) depends on the form of entity, the express language in the agreement, applicable state law and public policy concerns.

**B. What factors, with respect to a decision maker's fiduciary duties, may be relevant to a decision to file?**

The factors relevant to a decision to file cover a wide variety of strategic, financial, business and legal issues and vary by each unique situation. It is impossible to compile a comprehensive list, but the following is a sampling of filing factors that a board might consider in authorizing a chapter 11 filing. It should be noted that insolvency is not required for an entity to be a chapter 11 debtor, but is one of many factors to be considered. *See, e.g., In re General Growth Props., Inc.*, 409 B.R. at 60 ("It is well established that the Bankruptcy Code does not require that a debtor be insolvent prior to a filing.").

## **1. *Default***

A common reason for filing chapter 11 is to obtain breathing room to restructure the company's debt following a default on its bank or bond debt or when faced with a looming default. A variation on the theme of looming defaults are companies that, due to the conditions of the credit markets, real estate values, their industry or other similar drivers, are unable to re-finance existing debt scheduled to mature in the near term.

## **2. *Liquidity Crisis***

Another very common reason for filing chapter 11 is an impending liquidity crisis. If the company is cash constrained, then it may seek relief under the Bankruptcy Code to facilitate access to cash and defer payments while it rehabilitates and restructures its debt. A bankruptcy filing alleviates pressure on liquidity by deferring payment of prepetition claims (including debt claims) and affording an opportunity to use cash collateral or obtain debtor in possession ("DIP") financing.

In addition, the Bankruptcy Code provisions governing use of cash collateral may override any "cash trap" provisions contained in the company's loan agreements. Cash traps are typically found in mortgage and mezzanine debt and provide that, upon a trigger event (such as falling below a debt service coverage ratio covenant or suffering an event of default), the excess cash generated by the assets or operations of the borrower are trapped and distributed only as provided for in the loan agreement, rather than swept into a centralized cash management system for the entire corporate family. Cash-trap provisions do not entitle lenders to receive additional protections to those already afforded by the Bankruptcy Code. Such protection need only be adequate, not identical to protections provided by prepetition contracts. *See, e.g., In re General Growth Props., Inc.*, at 68-69 (ruling that a debtor family may use funds subject to a "cash-trap" provision upon a showing that the creditor had been adequately protected and afforded applicable protections under the Bankruptcy Code). Therefore, a debtor family may provide adequate protection and seek court authority to use the SPE lender's cash collateral in spite of otherwise applicable cash-trap provisions.

## **3. *Domino Effect***

It is important when analyzing whether to file one or more entities in a corporate family to consider the "domino effect" each entity's filing may have on other entities in the structure. For example, if a subsidiary is solvent but illiquid, then it may need to be included in the filing in order to have access to its affiliates' centralized cash management system or DIP financing. Similarly, an entity may have neither a looming default nor an impending liquidity crisis, but its parent or sister entity may face those challenges. If a bankruptcy filing by the parent or sister would trigger a default for that entity, then it too may need to file. Typically, this occurs either if there are cross-default provisions in the entity's loan documents or if the parent or sister is a guarantor of that entity's debt. Shared services (such as shared employees, corporate services, contracts and leases) should also be considered. If one entity (whether the parent or a subsidiary entity) provides shared services for the benefit of other entities, then the filing of the service provider may impact all of the other entities.

The domino effect is equally applicable to SPE and non-SPE entities. In the SPE context, a common misconception is that the protections often afforded by an SPE structure via isolation of the assets insulates the SPE such that it will not be included in a bankruptcy of the rest of the corporate family. In reality, however, while isolation of the assets may be considered in the context of restructuring the debt, it does not make the SPE immune from a bankruptcy filing of the corporate family. For example, while the SPE's loan documents may prohibit or limit its ability to participate in a centralized cash management system, the SPE may have nonetheless participated, thus commingling its cash with the cash of its affiliates. Likewise, the SPE may be dependent on the other entities for shared services or liquidity or the filing of the other entities may trigger a cash trap at the SPE or a default on the SPE's debt resulting from a filing by a guarantor.

The *General Growth Props., Inc.* court found that the decision to file each SPE for bankruptcy was made after numerous, detailed board meetings following considerable financial analysis by experienced restructuring professionals. 409 B.R. at 62. The court was careful to state, however, that it did not “conclude...that the interests of the subsidiaries or their creditors should be sacrificed to the interests of the parents or their creditors.” *Id.* The court also held that “judgment on an issue as sensitive and fact-specific as whether to file a Chapter 11 petition can be based in good faith on consideration of the interests of the group as well as the interests of the individual debtor.” *Id.* at 63. The bankruptcy court also made clear that independent directors may not serve purely to prevent a bankruptcy filing, decisively stating that “if [creditors] 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.” *Id.* at 64. Consequently, it may be acceptable for an SPE's board of directors to consider the larger corporate structure when determining whether to file for bankruptcy protection. *Id.*; *In re Mirant Corp.*, 2005 WL 2148362 at \*6 (Bankr. N.D. Tex. Jan. 26, 2005) (holding a particular SPE's filing is valid, even if that SPE has positive cash flows and may not be insolvent).

#### **IV. OTHER CONSIDERATIONS**

##### **A. What exit strategy issues should be considered?**

Filing chapter 11 is the beginning of a process, rather than the end of a process. As a result, when preparing a company to file chapter 11, consideration should be given to the exit strategy. Ideally, prior to filing, the company has defined its exit strategy to some degree. In some cases, the exit strategy is fully crystalized prior to filing through a prepackaged or pre-arranged chapter 11 plan. At the other end of the spectrum, in some cases, the path forward is wholly uncertain. Of course, many cases fall in between: there may be a concept or strategy developed, but not fully defined, as of commencement of the chapter 11 case. Regardless of the circumstance, however, there is one constant – in order to emerge from chapter 11, through a plan of reorganization or liquidation, the bankruptcy court must approve the plan based on the confirmation requirements under section 1129 of the Bankruptcy Code. Consequently, during the pre-filing preparations, these confirmation requirements should be considered.

Among the requirements to consider is the impaired accepting class requirement. Section 1129(a)(10) of the Bankruptcy Code requires that, if there is a class of claims impaired

under the plan, then there must be at least one impaired accepting class (excluding insiders' votes). If there is only one creditor, then it may be difficult to confirm a plan over that creditor's objection. Absent substantive consolidation (in whole or in part) or the court's adoption of the "joint plan" theory, then the lone creditor, to the extent impaired, arguably has absolute veto power over confirmation of the plan. *See, e.g., In re Charter Communs.*, 419 B.R. 221, 266 (Bankr. S.D.N.Y. 2009) (ruling that if a joint plan is filed for multiple debtors, "it is appropriate to test compliance with section 1129(a)(10) [*i.e.* whether there is an impaired accepting class,] on a per-plan basis, not...on a per-debtor basis"); *In re Enron Corp.*, 2004 Bankr. LEXIS 2549, \* 234-35 (Bankr. S.D.N.Y. July 15, 2004) (ruling that a joint plan met the requirements of section 1129(a)(10) even where some entities did not have an impaired accepting class because the plan (i) governed the treatment of claims against the 177 jointly administered debtors, thus the affirmative vote of one impaired class under the plan was sufficient, and (ii) proposed a substantive consolidation component applying the plan's global compromise to each of the debtors lacking an impaired voting class); *In re SPGA, Inc.*, 2001 Bankr. LEXIS 2291 \* 21-22 (Bankr. M.D. Penn. Sept. 28, 2001) (holding that upon substantive consolidation of multiple debtors, only one impaired accepting class is needed to meet the requirements of section 1129(a)(10)); *see also In re South Beach Sec., Inc.*, 376 B.R. 881, 893 (Bankr. N.D. Ill. 2007) (denying confirmation because the proposed plan did not comply with section 1129(a)(10) as no unimpaired non-insider class voted to accept the plan).

Other requirements to consider include cramdown and impairment. For example, an unimpaired class does not have the right to vote. Thus, the ability to reinstate may eliminate a creditor's actual or perceived veto right and the need to cramdown. A desire to reinstate (or to have the option to reinstate) should be considered pre-filing as it may impact the overall filing strategy, including whether some entities should be filed.

## **B. What are other potential consequences of a filing to be considered?**

Particularly with entities that are members of LLCs or partners in partnerships, it is important to review the organizational documents and state law with respect to the LLC or partnership. Unless otherwise provided in the LLC or partnership agreement, a bankruptcy filing by the member or partnership may result in automatic dissolution of the LLC or partnership or disassociation (*i.e.*, loss) of the member or partner's interest or rights in the LLC or partnership. While the enforceability of dissolution or disassociation may be challenged, if identified pre-filing, this is an issue that can easily be remedied either by amending the agreement to override the state law provisions or, to the extent that the member or partner and the LLC or partnership are both filing, by timing the order of filing of entities so that the partner or member files before the partnership or LLC, or vice versa, as appropriate.

The Uniform Partnership Act (the "UPA") provides for immediate "dissolution" of a partnership upon the bankruptcy of a partner. Unif. Partnership Act 31(5). Upon dissolution of a partnership, that partnership may not continue to take actions that bind each partner. Like the UPA, the Revised Uniform Limited Partnership Act (the "RULPA") provides that the bankruptcy filing of a general partner of a limited partnership immediately dissolves that limited partnership. Revised Unif. Ltd. Partnership Act 17-402(a); 17-801(3). In comparison, the Revised Uniform Partnership Act (the "RUPA") does not provide for dissolution of a partnership upon the bankruptcy of a partner. Instead, under the RUPA, a partner's bankruptcy creates a

dissociation under which the dissociated partner may have some authority to continue to bind the partnership. Revised Unif. Partnership Act 702(a).

Under the UPA, a partnership, which is part of a larger debtor family, arguably dissolves immediately upon filing its chapter 11 petition. If the consent of that partnership is required for subsequent affiliates in the larger debtor family to file their chapter 11 petitions, the subsequently filed petitions – even if done contemporaneously – for other members of a partnership’s debtor family may not be valid. This could mean that the subsequent affiliate would not have the requisite consent to file its chapter 11 petition. A few courts have held that if a partner files chapter 11, such a filing does not immediately dissolve the partnership, even under the UPA, to the extent that an immediate dissolution would interfere with the ability of that partner or partnership to reorganize. *See, e.g., In re Hawkins*, 113 B.R. 315, 316 (Bankr. N.D. Tex. 1990); *In re Safren*, 65 B.R. 566, 569 (Bankr. C.D. Cal. 1986). These courts have held that requiring the immediate dissolution of a partnership upon the filing of a partner’s bankruptcy to be an unenforceable “*ipso facto*” clause, if the effect of such immediate dissolution prohibits a partner’s affiliates from attempting to reorganize pursuant to chapter 11 of the Bankruptcy Code. That is, because the filing of a bankruptcy petition, and nothing more, allegedly prohibits the partnership from filing for bankruptcy, such a consequence cannot be valid because that would run afoul of the ability for the subsequently-filed entity to reorganize under the Bankruptcy Code. Unlike partnerships governed by the UPA, partnerships governed by the RUPA, even after dissociation occurring upon the event of a partner filing for bankruptcy, continue to have sufficient authority to consent to the bankruptcy filing of an affiliate.

In contrast, some courts have enforced the effect of immediate dissolution under the UPA and have ruled that if a partnership is dissolved, it cannot thereafter consent to a bankruptcy filing of an affiliate. *See In re Phillips*, 966 F.2d at 930 (holding that under Texas law, a partner could not place his partnership into bankruptcy after filing for bankruptcy himself); *In re Hunters Horn Assocs.*, 158 B.R. 729, 730-31 (Bankr. M.D. Tenn. 1993) (holding that after the death of one partner and the subsequent bankruptcy filing of the other surviving partner, the partnership became property of the bankrupt partner’s estate); *In re Harms*, 10 B.R. 817, 822 (Bankr. D. Colo. 1981) (dissolving seven limited partnerships immediately upon the bankruptcy filing of the general partner of those partnerships).

There appears to be a split in the bankruptcy courts, when interpreting the provisions of the UPA, as to whether a voluntary chapter 11 petition is valid when authorized by a partnership that was immediately dissolved by a voluntary petition filed mere moments before. Consequently, when filing multiple partnerships in a debtor family, some of which may be partners of other affiliates being filed, it is critically important to consider whether (a) the LLC agreement or partnership expressly overrides the applicable state law dissolution or disassociation provisions (b) the agreement can be revised to override the applicable state law, and (c) the order in which the various entities in a debtor family are filed so as to avoid any risk of triggering dissolution or disassociation.

## **V. CONCLUSION**

Official Form #1, which is the form for commencing a voluntary chapter 11 case, concludes by requiring that an “authorized individual” sign the petition and declare, under penalty of perjury, that he or she has been authorized to file the petition on behalf of the debtor. As a practical matter, to ensure that the individual signing Official Form #1 is authorized and justified in doing so, consideration should be given to (i) the fiduciary duties of that entity’s directors, managers, or partners, (ii) the provisions in organizational documents authorizing a chapter 11 filing, (iii) applicable state law. In addition, when preparing to file a company for chapter 11, it is important to think ahead and explore cash collateral restrictions, exit strategies, consequences of filing and other issues related to the company’s operation in, and emergence from, chapter 11.