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U.S. Bankruptcy Appellate Panel of the Tenth Circuit

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UNITED STATES BANKRUPTCY APPELLATE PANEL

OF THE TENTH CIRCUIT

IN RE DB CAPITAL HOLDINGS, LLC, Debtor.	BAP No. CO-10-046
DB CAPITAL HOLDINGS, LLC, Appellant, v. ASPEN HH VENTURES, LLC, and WESTLB, AG, Appellees.	Bankr. No. 10-23242 Chapter 11 OPINION[*]

Appeal from the United States Bankruptcy Court
for the District of Colorado

Before CORNISH, Chief Judge, KARLIN, and SOMERS, Bankruptcy Judges.

KARLIN, Bankruptcy Judge.

Debtor, DB Capital Holdings, LLC ("Debtor"), appeals a bankruptcy court order dismissing its bankruptcy case as having been filed without authorization. We affirm.

I. APPELLATE JURISDICTION

Debtor timely filed a notice of appeal from a final order dismissing its Chapter 11 bankruptcy petition, and no party has elected to have the district court

[*] This unpublished opinion may be cited for its persuasive value, but is not precedential, except under the doctrines of law of the case, claim preclusion, and issue preclusion. 10th Cir. BAP L.R. 8018-6.

hear the appeal. Therefore, this Court has appellate jurisdiction.

II. PARTIES[1]

Debtor is a manager-operated Colorado limited liability company. It was created to develop and sell a luxury condominium project in Aspen, Colorado, known as Dancing Bear Residences - Aspen (the "Project"). Debtor has one Class A member,[2] Aspen HH Ventures, LLC ("Aspen"), and one Class B member, Dancing Bear Development, LP ("DB Development"), a Colorado limited partnership. The general partner of DB Development is Dancing Bear Management, LLC ("DB Management" or "Manager"), which has no membership or other interest in the Debtor, and is solely owned by Tom DiVenere. Debtor is managed, pursuant to its Operating Agreement, by DB Management.

The mortgage lender on the Project is WestLB AG ("WestLB"), a German banking corporation. Debtor defaulted on its loan agreements with WestLB, resulting in WestLB filing a Colorado state court receivership on the Project prior to Debtor filing its bankruptcy petition.

III. OPERATING AGREEMENT

In January 2006, Aspen and DB Development entered into an Operating Agreement ("Original Agreement")[3] that is the principal agreement that governs

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[1] Although Debtor is the named party appellant to this appeal, the Court recognizes that this appeal is actually a dispute between Debtor's primary member, Aspen HH Ventures, LLC, the named appellee, and the designated manager of Debtor—Dancing Bear Management, LLC. Dancing Bear Management, LLC is not a named party but is essentially acting as the appellant in this matter. As a result, this decision sometimes refers to Manager, rather than Debtor, as the party to this appeal, in an effort to clarify the parties' actual interests.

[2] A "member" is "a person with an ownership interest in a limited liability company." Colo. Rev. Stat. § 7-80-102(9) (West 2010).

[3] The January 1, 2006 document is actually entitled Amended Operating Agreement, indicating there was a prior agreement. For ease of reference, however, and because no party has suggested an earlier agreement is relevant to these proceedings, the Court will nevertheless refer to it as the Original

(continued...)

how Debtor is managed. The "Member and Managers" of Debtor formally amended the Original Agreement in May 2006 ("May Amendment").[4] The Original Agreement, as modified by the May Amendment, governs whether Manager had authority to file the Chapter 11 petition.[5] The Manager contends that the provisions of the Original Agreement gave it authority to commence bankruptcy proceedings on Debtor's behalf, and a provision in the May Amendment that specifically prohibited such actions should be disregarded.

IV. BACKGROUND[6]

Although the Project belonged to Debtor, its members jointly agreed to grant management authority, over both Debtor and the Project, to Manager. Debtor and Manager are linked by Tom DiVenere, who is the sole owner of Manager, which in turn, is the general partner of DB Development, Debtor's Class B member. DiVenere was the *de facto* Project manager.

In February 2009, the first of two condominium buildings planned for the

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[3] (...continued)
Agreement.

[4] Debtor and Manager executed another operating agreement in March 2006 that briefly superceded the Original Agreement. However, that operating agreement was eliminated by the parties' execution of the May Amendment, because it specifically provides that it, together with the Original Agreement, constitutes the entire Operating Agreement of the Debtor.

[5] Although the Manager initially questioned whether the May Amendment could "resurrect" the Original Agreement because it had been superceded by the March agreement, it now concedes on appeal that the Original Agreement, together with the May Amendment, constitute the entire Operating Agreement of the Debtor. *See* Brief for Appellant DB Capital Holdings, LLC ("Appellant's Brief") at 5, Point II.

[6] At a hearing on June 8, 2010, the parties stipulated to the facts contained in paragraphs 1-3 of Aspen's Motion to Dismiss, and paragraphs 1-8 of Tom DiVenere's Affidavit. Minute Entry dated June 8, 2010 *in* Appendix at 224. The statements contained therein relate to the parties' relationship to each other and to the Project. The facts stated in this Background section are an amalgam of the stipulated facts and the parties' briefs. Essentially, the parties do not disagree on the factual basis for the appealed decision. Their disagreement is limited to the interpretation of Debtor's Operating Agreement.

Project was completed, more than 14 months behind its scheduled completion date, and approximately $4 million over the Project's entire $82 million budget. As of January 2009, Debtor had no funds to continue the Project, and was both insolvent and in breach of its loan agreements with WestLB. Approximately one year later, in February 2010, DiVenere notified Debtor's Class A member, Aspen, that Debtor had defaulted on its loans and was facing foreclosure or bankruptcy. In March 2010, at the request of WestLB, a Colorado state court appointed a receiver to take charge of, maintain, and protect Project property.

In May 2010, Aspen intervened in the receivership action, and filed a cross-complaint seeking dissolution of Debtor and some other, related companies. Shortly thereafter, Aspen requested emergency injunctive relief and immediate appointment of a receiver in the receivership action, contending that Project files had been seized, at DiVenere's request, without authorization.

On May 27, 2010, the state court judge signed an order: 1) directing return of eight boxes of files that had been removed; 2) prohibiting all parties in possession of Debtor's documents from transferring or destroying them; and 3) setting the request for appointment of a receiver for a hearing on June 9, 2010. That same date, Manager filed a Chapter 11 bankruptcy petition on behalf of Debtor. Thomas DiVenere signed the petition as an "authorized individual" with a title of "Member-Manager of Manager."

Thereafter, Aspen filed a motion to dismiss the Chapter 11 case pursuant to 11 U.S.C. § 1112(b), alleging that Manager had filed the petition both without authorization and in bad faith. Following an evidentiary hearing, the bankruptcy court declined to address the bad faith portion of the motion to dismiss, but nevertheless granted Aspen's motion to dismiss, finding that the parties' Operating Agreement precluded Manager from filing for bankruptcy on Debtor's

behalf.[7]

V. ISSUE AND STANDARD OF REVIEW

The only issue is whether or not Manager had authority to file a Chapter 11 bankruptcy petition on Debtor's behalf. This Court reviews the grant of a motion to dismiss *de novo*.[8]

VI. DISCUSSION

A bankruptcy case filed on behalf of an entity without authority under state law to act for that entity is improper and must be dismissed.[9] Bankruptcy courts must look to state law to determine who has authority to commence a bankruptcy case on behalf of a limited liability company ("LLC") organized pursuant to state law.[10] In this case, because Section 11.9 of the Original Agreement specifies that it shall be governed by Colorado law, the bankruptcy court correctly applied Colorado law to the facts.

Colorado has adopted a Limited Liability Company Act ("LLC Act"), and it governs LLCs organized in that state.[11] Pursuant to the LLC Act, an operating agreement governs the rights and duties of an LLC's members and managers.[12]

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[7] Three days after entry of the order from which this appeal is taken, an involuntary Chapter 11 petition was filed by some of Debtor's creditors. That petition is also the subject of a motion to dismiss or suspend, filed by Aspen, which claims that the "involuntary petition was filed as a result of the collusive and otherwise unlawful conduct of DiVenere and the petitioning creditors." *See* Brief of Appellee Aspen HH Ventures, LLC at 4.

[8] *Sutton v. Utah State School for the Deaf & Blind*, 173 F.3d 1226, 1236 (10th Cir. 1999).

[9] *See In re Real Homes, LLC*, 352 B.R. 221, 225 (Bankr. D. Idaho 2005) (a voluntary case may only be commenced by the filing of a petition for relief by an entity who qualifies to be a debtor, and the issue of a filer's authority to file on behalf of an entity must be determined by state law).

[10] *Price v. Gurney*, 324 U.S. 100, 106 (1945).

[11] Colo. Rev. Stat. §§ 7-80-101 to -1101 (West 2010).

[12] *Id.* at § 7-80-108(1)(a) (West 2010). The LLC Act requires each member's (continued...)

The parties to this appeal agree that the Original Agreement, as modified by the May Amendment, controls the issue of Manager's authority to file a bankruptcy petition on Debtor's behalf. The May Amendment specifies that the Original Agreement, together with the May Amendment, "shall together constitute the complete Operating Agreement" of Debtor.

Paragraph (v) on page three of that May Amendment expressly bars Debtor from filing a bankruptcy petition, as follows:

> The Company (v) to extent permitted under applicable Law, will not institute proceedings to be adjudicated bankrupt or insolvent; or consent to the institution of bankruptcy or insolvency proceedings against it; or file a petition seeking, or consent to, reorganization or relief under any applicable federal or state law relating to bankruptcy . . . .[13]

Manager argues that this Court should invalidate this provision because it "was executed at the demand, and for the sole benefit of" Debtor's main secured creditor, WestLB.[14] For that reason, it argues, the provision is unenforceable as a matter of public policy. In support, it cites to numerous cases holding that contractual provisions prospectively prohibiting bankruptcy protection are unenforceable.[15]

As the bankruptcy court correctly noted, however, all of the case law upon which Manager relies for this assertion "involves a debtor's agreement with third parties to waive the benefits of bankruptcy."[16] Debtor has not cited any cases

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[12] (...continued)
consent to authorize an act of the LLC that is not in the ordinary course of the business of the LLC, unless the operating agreement provides otherwise. *Id.* at § 7-80-401(2)(c).

[13] *May Amendment* at ¶ v, *in* Appendix at 96.

[14] Appellant's Brief at 9.

[15] *See, e.g., In re Cole*, 226 B.R. 647, 651-52 (9th Cir. BAP 1998), and cases cited therein.

[16] Transcript of bankruptcy court's June 21, 2010, oral ruling ("Tr.") at 11, *ll.* (continued...)

standing for the proposition that members of an LLC cannot agree among themselves not to file bankruptcy, and that if they do, such agreement is void as against public policy, nor has the court located any.

In addition, Debtor does not point to any record evidence that the May Amendment was coerced by a creditor. For that reason, the Court declines to opine whether, under the right set of facts, an LLC's operating agreement containing terms coerced by a creditor would be unenforceable.

Even if the Court were to disregard the May Amendment's express restriction barring the filing of a bankruptcy, subsection (i) of the May Amendment requires the manager to "conduct and operate its business *as presently conducted*" (emphasis added). Filing a Chapter 11 proceeding, with the attendant (and oftentimes expensive and time-consuming) statutory duties placed on debtors-in-possession,[17] and thus their management, essentially makes it impossible to conduct and operate a business as it was being conducted immediately before the filing of the petition.[18] As the Supreme Court has

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[16] (...continued)
21-23, *in* Appendix at 237.

[17] *In re Blue Stone Real Estate, Const. & Dev. Corp.*, 392 B.R. 897, 903 (Bankr. M.D. Fla. 2008) (noting that "[t]he Bankruptcy Code is laden with express requirements of and limitations on business operations of a debtor in possession, not to mention discretionary requirements and limitations that may be imposed by the bankruptcy court where permitted"). Further, the debtor must perform the duties prescribed by Federal Rule of Bankruptcy Procedure 2015, relating to keeping records, making reports, and giving notice of the case, must examine proofs of claims and object to the allowance of any claim that is improper, must seek to employ professionals who are disinterested pursuant to 11 U.S.C. § 327 and Federal Rule of Bankruptcy Procedure 2014, must exercise avoidance powers, including recovery of preferences and fraudulent transfers, and must assume or reject executory contracts and unexpired leases pursuant to 11 U.S.C. § 365(a). And, like a trustee, the debtor in possession cannot use, sell, or lease property of the estate other than in the ordinary course of business, without notice and court approval for extraordinary transactions, such as use of cash collateral and borrowing money pursuant to 11 U.S.C. §§ 363(c)(1) and (2), 364(b), and 363(b).

[18] *See id.* at 902-03 (noting that a debtor in possession operating in Chapter (continued...)

indicated, "the debtor, though left in possession by the judge, does not operate [the business] as it did before the filing of the petition, unfettered and without restraint."[19] To the contrary, the debtor in possession becomes a fiduciary of the estate, holding its powers in trust for the benefit of its creditors, and is subject to the court's imposition of orders and duties.[20]

Maybe even more importantly, because Section 6.1(a) of the Original Agreement expressly calls for the Manager to cease operating in that capacity "upon the dissolution or bankruptcy" of Debtor, we know that Manager would no longer be eligible to manage the LLC after a petition was filed. Because a complete change in management is the exact opposite of "business as presently conducted," this portion of the parties' agreement further buttresses the bankruptcy court's decision that Manager did not have authority to file this bankruptcy without consent of both members of Debtor.

The Court also agrees with the bankruptcy court that even if the entire May Amendment was somehow deemed unenforceable, the Original Agreement also precludes the Manager from filing bankruptcy for Debtor when that agreement is read as a whole, as Colorado law requires.[21] Manager relies principally on the

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[18] (...continued)
11 is not conducting "business as usual" during the time between the commencement of the case and its emergence from bankruptcy as a reorganized debtor).

[19] *Case v. Los Angeles Lumber Prods. Co., Ltd.*, 308 U.S. 106, 125-26 (1939).

[20] *See In re Modern Office Supply, Inc.*, 28 B.R. 943, 944 (Bankr. W.D. Okla. 1983) (noting that the Bankruptcy Code and the Federal Rules of Bankruptcy Procedure establish pervasive reporting and disclosure duties for the debtor in possession).

[21] Absent a contrary statutory provision, Colorado courts consider a limited liability company's operating agreement according to the general principles of contract law. *Condo v. Conners*, No. 09CA1130, 2010 WL 2105926, at *3 (Colo. App. May 27, 2010, *modified on denial of rh'g*, Sept. 16, 2010). Further, Colorado courts have adopted the general principle of contract law that "language should be construed as a whole, and specific phrases or terms should not be

(continued...)

general grant of authority in Section 6.3 of the Original Agreement for his authority to commence a bankruptcy. It provides, in full, as follows (with emphasis on the specific language relied on by Manager):

> 6.3 Rights and Powers of the Manager.
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> (a) The Manager shall (i) contribute his or her time, skill, energy, advice, and experience to the management of the Company's business; (ii) determine all matters relating to the financing, management, and operation of the assets and property of the Company; and (iii) manage the Company. The Manager shall devote such time to the affairs of the Company as the Manager deems reasonably necessary.
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> (b) *In addition to any other rights and powers that he, she or it may possess by law or under this Agreement, the Manager shall have all specific rights and powers required or appropriate to the management of the Company business*, including, but not limited to, the following rights and powers on behalf of the Company:
>
> > (i) to cause any property owned or leased by the Company to be held by the Company, or a nominee;
> >
> > (ii) to employ, engage, or contract with unrelated and non-affiliated persons in the operation and management of1he Company business, on such terms and for such compensation as the Manager shall determine;
> >
> > (iii) to invest and reinvest all funds available to the Company;
> >
> > (iv) to borrow money for Company purposes; to mortgage, hypothecate, pledge, enter into sale and leaseback arrangements with respect to, or otherwise give as security for such indebtedness, property of the Company; but only with respect to the Senior Permitted Liens and to sell and convey title to, and to grant an option for the sale of, property of the Company, as fractional ownership interests in the ordinary course of the Business;
> >
> > (v) to acquire and enter into any contract of insurance that the Manager deems necessary or appropriate for the protection of the Company, the conservation of its assets, or any purpose convenient or beneficial to the Company;
> >
> > (vi) to pay any and all fees and expenses incurred in the modification of the Company and the sale of Company interests therein;

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[21] (...continued)
interpreted in isolation." *Rogers v. Westerman Farm Co.*, 29 P.3d 887, 898 (Colo. 2001) (en banc).

> (vii) to employ, when and if required, such accountants, agents, and attorneys as the Manager may determine to be necessary from time to time; and
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> (viii) to execute, acknowledge, and deliver any and all instruments to effectuate the foregoing provisions of this paragraph.[22]

The bankruptcy court correctly found that Section 6.3 of the Original Agreement does not specifically authorize Manager to commence a bankruptcy on behalf of Debtor.[23] Instead, each of these "rights and powers" pertains to Manager's management of the affairs of the business in the ordinary course. We are also not persuaded that a contractual grant of any power "required or appropriate to the management of the Company's business" would necessarily include authority to petition for bankruptcy on the company's behalf, even without a restrictive provision. Indeed, as noted earlier, the filing of a Chapter 11 bankruptcy proceeding represents a radical departure from how any entity carries on its business outside of bankruptcy.

But even if one construes the general grant of authority to merely not preclude such a filing, Section 6.4 of the Original Agreement then lists ten limitations on the authority of Manager. Those limitations include the following:

> (a) Notwithstanding any contrary provision of this Agreement, the Manager shall have no authority without the prior written consent of all Members to:
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> . . .
>
> (ii) do any act that would make it impossible to carry on the ordinary business of the Company; [or]

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[22] *Original Agreement* at 15-16, *in* Appendix at 142-43 (emphasis added).

[23] Manager argues that the bankruptcy court determined that the Original Agreement also did not specifically prohibit its filing of a bankruptcy petition. *See* Appellant's Brief at 7 n.4. We disagree. The bankruptcy court simply noted that such was Manager's position, concluding that, "the absence of a provision prohibiting the filing of a bankruptcy petition does not lead to a conclusion that such a filing is actually permitted." *See Tr.* at 9-10, *ll.* 24-25, 1, *in* Appendix at 235-36. The court went on to find that contractual restrictions did, in fact, preclude Manager's conduct.

. . .

(x) intentionally cause or allow the dissolution of the Company.[24]

The bankruptcy court concluded, as do we, that filing a bankruptcy petition "constitutes an act preventing the carrying on of ordinary business of the debtor,"[25] which specifically requires the consent of both members of Debtor.

Debtor argues that a Chapter 11 bankruptcy does not make it "impossible" for a debtor to do business. We agree that a reorganization pursuant to Chapter 11 does not necessarily result in the winding up and ultimate dissolution of a debtor's business, although that is sometimes the case. However, this argument ignores the express modification of the term "business" by the term "ordinary." We believe, as did the bankruptcy court, that the filing of a Chapter 11 bankruptcy petition is an act that makes it impossible to carry on a company's "ordinary business," even though the company's ability to continue to "do business" is not completely eliminated.

Other courts have also reached the conclusion that placing a business into bankruptcy does not fall within the confines of "ordinary business." For example, in *In re Avalon Hotel Partners, LLC,*[26] the bankruptcy court considered whether the manager of an LLC could file a Chapter 11 petition, despite a provision in that debtor's operating agreement that required member approval of "Major Decisions." The non-exclusive list of such decisions in the operating agreement did not include bankruptcy filings. Nonetheless, the court noted that a "decision to file for bankruptcy protection is a decision outside of the ordinary course of

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[24] *Original Agreement* at 16, *in* Appendix at 143.

[25] *Tr.* at 11, *ll.* 15-16, *in* Appendix at 237. There is no dispute that Manager lacked the members' consent to file the bankruptcy petition.

[26] 302 B.R. 377 (Bankr. D. Or. 2003).

business, even for an entity in dissolution."[27]

Similarly, *In re Zaragosa Properties, Inc.*[28] involved dismissal of a Chapter 11 petition that had been filed on behalf of a Panamanian corporation. In that case, the corporation had granted a principal shareholder authority, by a power of attorney, to sign documents on its behalf, "relating to its ordinary course of business."[29] The court concluded that "filing a Petition for Relief under Title 11 is not the ordinary course of anyone's business."[30]

VII. CONCLUSION

Pursuant to Colorado law and the parties' Operating Agreement, Manager did not have authority to file a petition in bankruptcy on behalf of the Debtor. Therefore, the bankruptcy court's order dismissing the petition is AFFIRMED.

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[27] *Id.* at 380.

[28] 156 B.R. 310 (Bankr. M.D. Fla. 1993).

[29] *Id.* at 312.

[30] *Id.* at 313. Debtor asserts that the *Avalon* and *Zaragosa* cases are inapposite here, suggesting they involved extraordinary business decisions and a much more limited grant of authority, respectively. *See* Reply Brief at 4. Instead, Debtor relies on *Amdura National Distribution Co. v. Amdura Corp. (In re Amdura Corp.)*, 75 F.3d 1447 (10th Cir. 1996) for the proposition that "[i]t is well settled that a debtor in possession under Chapter 11 is authorized to carry on its ordinary business." Reply Brief at 3. We disagree with Debtor's citation to this case for the proposition that filing bankruptcy, itself, was in the ordinary course of that business, or that the Tenth Circuit Court of Appeals so held. *Amdura*, and the other cases cited by Debtor, stand only for the proposition that a debtor in possession is allowed to operate a business as would a trustee. *See* 11 U.S.C. §§ 1107(a) and 1108. While 11 U.S.C. § 363(c)(1) allows a trustee (and therefore a debtor in possession) to enter into certain transactions "in the ordinary course of business," unless the bankruptcy court orders otherwise, this does not mean that a company's entire operation within a bankruptcy case is "ordinary."