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The “Golden Share”: All That Glitters Is Not Gold

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A recent, highly anticipated ruling by a Bankruptcy Court in Delaware has reilluminated the concept of a "golden share". While an appeal of the ruling seems likely, this latest ruling by Delaware Bankruptcy Judge Mary F. Walrath suggests that as the COVID-19 outbreak continues to disrupt businesses and send shockwaves through the economy, courts may look at the specific circumstances of each case and weigh the interests of all corporate stakeholders in determining whether to enforce a "bankruptcy blocker".

What is a "Golden Share"?

A "golden share" refers to an equity interest in a company that affords the owner a number of consent rights. A key right is the right to block a company from filing for bankruptcy. Private credit lenders may rely upon a "golden share" structure when making preferred equity investments or in connection with a loan restructuring.

The Checkered History of the Enforceability of the "Golden Share" in Delaware

The first Delaware case to address the enforceability of the "golden share" was *In re Intervention Energy Holdings, LLC*, 553 B.R. 258 (Bankr. D. Del. 2016). In that case, as a condition to waiving all of the company's existing events of default, a secured creditor required a borrower to amend its corporate charter to include a "golden share" provision, which required the unanimous consent of the company's common unitholders to file for bankruptcy. The company was also required to issue one common unit to the secured creditor. In response to a subsequent Chapter 11 filing by the company, the secured creditor filed a motion to dismiss, insisting that the key protection it had contracted for be enforced. Because the company had not obtained the unanimous consent of its unitholders, the secured creditor argued that the bankruptcy filing was unauthorized. Finding that the secured creditor was only a nominal unitholder and was primarily a creditor which, unlike a director, does not owe any fiduciary duties to the company, the court held that allowing the parties to contract around the constitutional right to seek bankruptcy relief would be contrary to federal public policy, and therefore, the "golden share" was unenforceable.

The Fifth Circuit Court of Appeals, however, interpreting Delaware law, came to a different conclusion when the "golden share" was held by a preferred shareholder. In *In re Franchise Services of North America, Inc.*, 891 F.3d 198 (5th Cir. 2018), a preferred shareholder agreed to make a $15 million investment in a company so long as the company reincorporated in Delaware and amended its corporate charter to include a "golden share" provision. When the company filed a Chapter 11 petition, the preferred shareholder sought to dismiss the case, arguing that the petition could not be authorized without a shareholder vote. The company responded by asserting that the shareholder's argument was a pretense for its true motivation—to secure undue leverage for repayment of its $3 million claim for unpaid consulting fees. In dismissing the bankruptcy case, the Fifth Circuit Court of Appeals agreed with the preferred shareholder and upheld the right of a bona fide preferred shareholder to exercise its "golden share".

Recently, the efficacy of the "golden share" was tested again in a bankruptcy filing by Pace Industries (*In re: Pace Industries, LLC*, Case No. 20-10927-MFW (Bankr. D. Del.)). In connection with its $37.15 million preferred equity investment, the preferred shareholder obtained various rights and protections, including an amendment and restatement of the company's corporate charter to include a "golden share" provision. In the wake of the COVID-19 pandemic, Pace Industries found itself in dire financial straits, unable to pay hundreds of millions of dollars of debt, closing many of its manufacturing facilities, and laying off the majority of its employees. However, the company successfully negotiated a restructuring and filed a Chapter 11 petition to implement the restructuring, which was supported by the company's secured creditors and which proposed to pay unsecured creditors in full. The preferred shareholder did not consent to the petition and moved to dismiss the case.

In denying the motion to dismiss, Judge Walrath was keenly focused on the harsh reality facing Pace Industries. The court was persuaded by the fact that the COVID-19 outbreak had forced the company to shut down most of its operations and that the proposed debtor-in-possession financing was the company's only source of liquidity in the midst of the global pandemic. Furthermore, Judge Walrath observed that the preferred shareholder had not offered any viable alternatives. As a result, the court concluded that permitting the bankruptcy filing would likely benefit the greatest number of stakeholders, while dismissing the bankruptcy case would violate federal public policy by taking away a debtor's constitutional right to bankruptcy relief. In declining to follow the Fifth Circuit's interpretation of Delaware state law, Judge Walrath went so far as to conclude that a blocking right might create a fiduciary duty on the part of a minority shareholder.

Key Takeaway

Unlike Franchise Services*, the bankruptcy court's ruling in* Pace Industries *echoes the sentiment expressed in* Intervention Energy *and at a minimum calls into question the enforceability of the "golden share". As Judge Walrath noted, "a minority shareholder has [no] more right to block a bankruptcy . . . than a creditor does." While the Judge Walrath's comment that the "golden share" may create a fiduciary duty may be a bridge too far, the case is a reminder that in these extraordinary times, bankruptcy courts will look skeptically on the enforceability of so-called bankruptcy blockers.*

The Private Credit Group and The Private Credit Restructuring Group at Proskauer are closely monitoring the impact that COVID-19 will have on judicial decisions that may affect private credit lenders.

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