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NYC Office Tower Ch. 11 Shines Light On Blocking Provisions

Law360 on **June 28, 2022**

This article analyzes PWM Property Management LLC's bankruptcy filing in the U.S. Bankruptcy Court for the District of Delaware to explain the impact of the use of corporate governance blocking provisions.

The filing also highlights the significance of a creditor-filed proposed plan of reorganization, and a corresponding cooperation agreement, on a debtor's exclusive right to file a Chapter 11 plan as provided under Bankruptcy Code Sections 1121(b) and 1125.

Background

PWM Property Management owns a commercial office tower located at 245 Park Ave. in New York City. On Oct. 31, 2021, PWM filed for Chapter 11.

HNA Group North America LLC, the 100% equity owner of PWM, appointed two independent fiduciaries to authorize PWM's filing.

In filing, PWM sought to reject the property management agreement with SL Green Management Corp., the current manager of the 245 Park building. SLG is a 49% preferred equity holder in PWM and further holds fifty 50% of the mezzanine C loans.

As a basis for rejecting the agreement, PWM claimed SLG failed to bring in a new tenant after losing 245 Park Ave.'s largest tenant, the MLB, remedy billing errors, or otherwise make the building competitive in the New York market.

If SLG did not find a replacement tenant for the MLB by Oct. 31, 2021, a tenant trigger event would activate under the 245 Park prepetition mortgage loan documents, which permitted the servicer to sweep certain excess cash flows, and leave PWM unable to afford to pay SLG its required quarterly dividend payments in exchange for its equity contribution.

To prevent liquidation prospectively, PWM filed for bankruptcy. In late March, PWM won a four-month extension to file its Chapter 11 plan.

Enforceability of Bankruptcy Blocking Provisions

One tool that has been utilized to prevent unwanted bankruptcy is a so-called golden share arrangement. Simply put, the golden share is a term to describe a class of equity interests issued to a capital provider that grants the holder consent rights over certain decisions the company may make, including filing for bankruptcy.[1]

The limited liability company agreement entered into between SLG and the debtor had a similar provision, which SLG relied on when attempting to dismiss the filing.

SLG filed a motion to dismiss PWM's filing as a bad faith bankruptcy filing. In the second amended LLC agreement, entered into between SLG and PWM, SLG's approval was necessary for any action constituting a major decision, and further

> neither the Managing Member nor any Member may cause 245 Park JV, LLC nor any Subsidiary to take any action in furtherance of any Major Decision without the approval of 245 Park Members.

Included in the definition of major decision within the agreement was the "changing, dismissing, engaging professionals to render services for 245 Park or any of its subsidiaries." SLG argued appointing the independent agents was in contravention of the agreement because the appointment constituted a major decision, which required SLG's prior approval.

U.S. Bankruptcy Judge Mary F. Walrath concluded the bankruptcy filing was properly authorized. In deciding, Judge Walrath considered solely "whether blocking rights are enforceable in bankruptcy where a creditor uses its rights to protect its interests as a creditor."

Judge Walrath explained

courts have held that where a party, principally a creditor, is giving a blocking right to the filing of a bankruptcy case, the court must consider the public policy and balance of rights of entities to provide a proper taking of corporate action in their corporate governance documents against the right of entities to file bankruptcy; however in exercising that balancing the courts have made it clear that only in the instance where a blocking right is obtained by a creditor in order to protect its interest as a creditor through its actions as equity is something that should be subject to this balancing.

In determining the proper balance, Judge Walrath looked to and analogized PWM Management to In re: Intervention Energy Holdings LLC and In re: Lake Michigan Beach Pottawattamie Resort LLC, where the presiding bankruptcy judges also held similar blocking provisions invalid.[2]

Judge Walrath ultimately found SLG's actions as both a creditor and equity holder barred enforcement of the consent provision in the agreement and PWM's bankruptcy filing was therefore properly authorized.

Judge Walrath's decision in PWM Management does little to resolve the ongoing debate over the enforceability of bankruptcy blocking provisions because, similar to current standing case law, Judge Walrath does not explicitly render all golden share arrangements as unenforceable, which means, in some instances, the golden share tool is still available to lenders to prevent an unwanted bankruptcy filing.

However, PWM does exemplify the modern trend of bankruptcy courts' increasing skepticism of bankruptcy blocking provisions and favoritism toward leaving the power in the hands of the debtor, as was intended by the enactment of the Bankruptcy Code.

In balancing the rights of creditors under corporate governance documents and an entity's right to file for bankruptcy, courts are not willing to eviscerate a debtor's constitutionally authorized right to file for bankruptcy to allow solely for the protection of a creditor's interest in repayment.

However, even though highly controversial, PWM and other existing cases indicate golden share arrangements are more likely to be enforced when:

- They are established in connection with a substantial equity investment that is more than nominal in comparison to the holder's debt position and the equity investment is viewed as more of an equity investment in substance than it is as a debt; and

- When golden share provisions are used to facilitate a value maximizing transaction, rather than as obstruction purely for hold-up value.

Therefore, courts will look beyond the four corners of a corporate governance document and are more likely to uphold agreed-upon provisions where a lender's investments in a financially distressed entity are more than a mere debt, and the lender's efforts are not simply to prevent a bankruptcy filing to maximize their own interests.

A court's analysis hinges on the factual circumstances of the creditors and the debtors, and not simply the language contained within the controlling corporate governance documents.

Exclusivity Period to File and Solicit a Plan and a Third Party's Ability to Intervene

Section 1121 of the Bankruptcy Code provides for an initial 120-day period after the commencement of a Chapter 11 case where the debtor has the exclusive right to file a Chapter 11 plan.[3]

From a plain reading of Section 1121(b), the debtor is the only party capable of filing a plan during the exclusivity period. Case law provides Section 1121(b) creates not only a bright line but a third rail for third parties to not be able to file a plan during the exclusivity period permitted by Section 1121(b) of the Bankruptcy Code.[4]

Accordingly, filing a plan that identifies terms of a competing plan during the exclusivity period would be a violation.[5]

Further, Section 1125(b) of the Bankruptcy Code bars solicitation of an

> acceptance or rejection of a plan ... after the commencement of the case under [Title 11] from a holder of a claim or interest with respect to such claim or interest, unless, at the time of or before such solicitation, there is transmitted to such holder the plan or a summary of the plan, and a written disclosure statement approved, after notice and a hearing, by the court as containing adequate information.[6]

Courts have consistently narrowly interpreted the meaning of solicitation under Section 1125(b) to determine a filed pleading or other similar document that is distributed to a wide group of parties in interest that summarizes a competing plan constitutes an improper solicitation.[7]

In PWM Management, PWM filed a motion to extend the exclusivity period because absent an extension, the exclusive plan filing and solicitation period would end and PWM had yet to develop a plan.

The mezzanine lenders and SLG subsequently filed an objection, which included a proposed Chapter 11 plan under seal, stating,

> since the exclusive periods have yet to expire or be terminated prior to the filing, the debtors request the Creditor Plan be filed under seal to prevent any perceived violation of Sections 1121(c) or 1125 of the Bankruptcy Code.

In connection with the creditors' proposed Chapter 11 plan, the creditors also entered into a cooperation agreement that largely prohibited them from considering, supporting or discussing any plan of reorganization other than the plan they proposed under seal to the court. PWM subsequently objected to the proposed plan as a violation of Sections 1121 and 1125.

Judge Walrath granted PWM's motion to extend the exclusivity period, while holding filing the creditor-proposed Chapter 11 plan during the exclusive period violated the debtors' exclusive rights to file a plan, as permitted by Bankruptcy Code Section 1121.

Judge Walrath also found the creditors' entry into the cooperation agreement in connection with the proposed plan violated Section 1125, explaining that the creditors could discuss acceptable terms before a debtor filed a plan, however, filing a proposed plan crossed the line.

The court noted that filing the plan on the docket alone was enough to "whet the appetite of interested parties," and simply adding a disclaimer provision in the agreement does not change the fact this was still by and large solicitation of votes for a Chapter 11 plan.

PWM Management exemplifies the broad protections provided to a debtor by Sections 1121 and 1125 of the Bankruptcy Code, and reiterates that the debtor is the only party capable of filing a Chapter 11 plan during the exclusivity period and that no form of solicitation should take place prior.

Similar to the existing case law on bankruptcy blocking provisions, in weighing the interests of creditors and debtors, courts are more willing to protect a debtor's constitutionally authorized right to file for bankruptcy and the protections that follow than any creditor's interest, as was intended by the Bankruptcy Code.

PWM Management illustrates creditor negotiations are likely to be supported, and even encouraged, during the debtors' exclusivity period and/or during the pendency of a grant or denial of an extension of the exclusivity period to facilitate the potential consensual development of a Chapter 11 plan.

However, any document filed with the court by anyone other than the debtor, containing terms of a plan or is otherwise similar to a Chapter 11 plan, whether sealed or not, is a step too far and an encroachment on the debtors' rights provided by Section 1121(b) of the Bankruptcy Code.

Further, cooperation agreements, or similar other agreements or documents, still resemble solicitation for purposes of Section 1125 and are therefore a violation of the Bankruptcy Code because they effectively lock up the votes of the creditors prior to a debtor's proposal of a Chapter 11 plan.

Conclusion

PWM Management serves as a caution to creditors with respect to debtors' protections under the Bankruptcy Code by providing the outer limits of Sections 1121 and 1125 of the Bankruptcy Code.

PWM Management also illustrates courts will read the plain language of Sections 1121 and 1125 and protect a debtor's interest in developing a Chapter 11 plan and subsequent solicitation to allow for a successful reorganization of the debtor at all costs.

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[1] See Peter Antoszyk, "The Golden Share": All that Glitters Is Not Gold, JDSupra (May 18, 2020), The "Golden Share": All That Glitters Is Not Gold | Proskauer Rose LLP - JDSupra.

[2] See In re Intervention Energy Holdings, LLC, 553 B.R. 258, 265 (Bankr. D. Del. 2016) (bankruptcy court struck down a Golden Share arrangement that gave a lender the ostensible power to prevent a bankruptcy filing by its borrower, holding that, "[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…is tantamount to an absolute waiver of that right and…is void as contrary to federal public policy."); See In re Lake Michigan Beach Pottawattamie Resort LLC, 547 B.R. 899, 913 (Bankr. N.D. Ill. 2016) (bankruptcy court struck down the blocking director provisions of the debtor's operating agreement, but acknowledged that blocking director arrangements are permissible, but only in situations where the director owes a duty to consider the interests of all stakeholders in fulfilling her role: "the essential playbook for a successful blocking director is this: the director must be subject to normal director fiduciary duties and therefore in some circumstances vote in favor of a bankruptcy filing, even if it is not in the best interests of the creditor they were chosen by….").

[3] 11 U.SC. §1121(b) (1978).

[4] In re Charles St. African Methodist Episcopal Church of Boston, 499 B.R. 126, 132 (Bankr. D. Mass. 2013).

[5] See Id. at 132–33 (finding a motion to terminate exclusivity, which included a competing plan as an attachment, not of the debtors' violated exclusivity).

[6] 11 U.S.C. § 1125(b) (1978).

[7] See Duff v. U.S. Trustee (In re Cal. Fidelity, Inc.), 198 B.R. 567, 574 (B.A.P. 9th Cir. 1996).

Related Professionals

- **Ashley M. Weringa**
  Associate