

In re Pace Industries, LLC: Court Declines Enforcing Golden Share Rights of Controlling Minority Shareholder
USA (National/Federal)

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The US Bankruptcy Court for the District of Delaware held that a golden share restriction on a debtor's right to file for bankruptcy protection violated the public policy that favors the constitutional right to file bankruptcy and was therefore void and unenforceable. Furthermore, the court held that, under the circumstances, the controlling shareholder had a fiduciary duty to other shareholders and all creditors.

On May 5, 2020, the US Bankruptcy Court for the District of Delaware ruled from the bench in *In re Pace Industries, LLC* that a restriction on the right to file for bankruptcy protection violated the debtor's constitutional right to file bankruptcy and was unenforceable and void as a matter of public policy (No. 20-10927 (Bankr. D. Del. May 5, 2020) (TRANSCRIPT)). The restriction was included in an Amended **Certificate of Incorporation** of an **affiliate** debtor at the request of the majority shareholder.

Background

Founded in 1970 in Arkansas, **Pace Industries, LLC (Pace)** is one of the largest suppliers of aluminum, zinc, and magnesium die cast in North America. **Pace** is 100% owned by KPI Intermediate Holdings, Inc. (Intermediate) and KPI Holdings, LLC. In January 2018, Macquarie Sept (US) I, LLC (Macquarie) bought 250 shares of Series A **Preferred Stock** from Intermediate for \$37 million. As part of the stock sale, Intermediate amended its Certificate of Incorporation to include a **golden share** provision that required written approval or affirmative vote of the majority preferred stockholder for Intermediate or any **Pace** company to file bankruptcy.

On April 12, 2020, **Pace** and ten affiliates, including Intermediate, filed **prepackaged Chapter 11** petitions. The Intermediate petition was filed with unanimous consent of its six board **members**. The List of Equity Shareholders indicates that Macquarie holds 62.5% of the Series A Preferred Stock. The other 37.5% of the stock is owned by one shareholder. On April 15, 2020, the debtors filed a joint **plan** and **disclosure statement**. The plan provided that **unsecured creditors** are to be paid in full. Shareholders do not receive anything under the plan. On April 17, 2020, Macquarie filed its motion to dismiss the Chapter 11 cases. The motion asserted that the court lacked **subject matter jurisdiction**, because the debtor's board lacked authority to file bankruptcy without Macquarie's approval and Macquarie's blocking right did not violate public policy.

Outcome

The court rejected Macquarie's arguments and denied its motion to dismiss. The court stated that there was no case directly on point regarding whether the blocking right of a shareholder who is not a

creditor is unenforceable as a violation of the debtor's constitutional right to file bankruptcy. However, numerous courts confirm the existence of a constitutional right to file bankruptcy. The restriction constituted a waiver of the right to file for bankruptcy protection and therefore it was void as a matter of public policy. The court distinguished the cases that held otherwise because they involved creditors that became shareholders to protect their interests as creditors (see, e.g., *In re Intervention Energy Holdings, LLC*, [553 B.R. 258 \(Bankr. D. Del. 2016\)](#)). Furthermore, the court held that such a blocking right under the facts of this case under Delaware state law created a **fiduciary duty** on the part of the controlling shareholder to other shareholders and all creditors. The court pointed out that the blocking right alone did not create a fiduciary duty but a duty arose under these facts:

- The debtors are in the zone of **insolvency**.
- Without **DIP financing**, the debtors cannot pay debts as they come due.
- **COVID-19** has severely disrupted the debtors' operations.

Federal public policy requires the court to consider the best interests of all parties and "...whether the party seeking to block [access to the bankruptcy courts] has a fiduciary duty that it appears it is not fulfilling by not ... considering the rights of others in its decision to file the motion to dismiss." In this case, the court noted that where the debtor was in financial trouble before COVID-19 hit, having closed facilities and laid off employees, there was no dispute that debtor needed a bankruptcy. As a **prepackaged bankruptcy**, the lenders have agreed to payment in full of all creditors. The bankruptcy will benefit most stakeholders. Dismissal benefits no one except Macquarie, who offered no other viable alternatives.

Declining to follow a Fifth Circuit opinion interpreting Delaware law (*In re Franchise Services of North America, Inc.*, [891 F.3d 198 \(5th Cir. 2018\)](#)), the *Pace* court opined that "under Delaware state law, contrary to the Fifth Circuit's interpretation of that law, would and does find that a blocking right, such as ... exercised in the circumstances of this case, would create a fiduciary duty on the part of the shareholder; a fiduciary duty that, with the debtor in the zone of insolvency, is owed not only to other shareholders, but to all creditors." Further, the court saw "no reason to conclude that a minority shareholder has any more right to block a bankruptcy -- the constitutional right to file a bankruptcy by a corporation than a creditor does."

Practical Implications

This decision reinforces that the constitutional right of access to the bankruptcy courts cannot be contracted away, while potentially creating a split of authority with the Fifth Circuit's ruling in *Franchise Services*. Also, the circumstances surrounding the use of

blocking rights might create a fiduciary duty under state law requiring a shareholder to act in the best interest of all parties. Blocking rights may be unenforceable as a matter of law as a contract term that offends the public policy of a constitutional right to access bankruptcy. Given the context of the extraordinary conditions created by COVID-19, courts may skeptically consider the specific circumstances of each case and weigh the interests of all stakeholders when determining the enforceability of a bankruptcy-blocking golden share.