

Restrictions on bankruptcy filings can be effective under appropriate facts

By Bethany D. Simmons, Esq., and Noah Weingarten, Esq., Loeb & Loeb LLP

MARCH 4, 2025

In *In re 301 W North Avenue, LLC*, No. 24-B-2741, 2025 WL 37897, __ B.R. __ (Bankr. N.D. Ill. Jan. 6, 2025), the United States Bankruptcy Court for the Northern District of Illinois (Judge David D. Cleary) granted a secured lender's motion to dismiss a Chapter 11 case for cause based on lack of corporate authorization to commence the bankruptcy proceeding.

The debtor's limited liability company agreement included provisions, added at the behest of the secured lender, that precluded the debtor from filing for bankruptcy without its independent manager's consent, but the independent manager had not consented to the filing. The court ultimately enforced the consent provision because the independent manager had fiduciary duties to the debtor itself and was required to consider the interests of the debtor's members and the debtor's constituents in matters on which the independent manager voted.

The decision is an important reminder for secured lenders and potential debtors alike that, while some restrictions on a debtor's ability to file for bankruptcy are void as against public policy, carefully drafted provisions will be enforced.

Background

301 W North Avenue, LLC (Debtor) is a Delaware limited liability company (LLC) that owned a mixed-use real estate development. The Debtor took a \$26 million loan from BDS III Mortgage Capital G LLC's predecessor-in-interest (Lender) secured by the debtor's real estate.

The loan agreement and the Debtor's LLC agreement (1) required the Debtor to appoint an "Independent Manager;" (2) provided that the Debtor could not file or consent to the filing of any bankruptcy proceeding without the consent of the Independent Manager; and (3) provided that the Independent Manager's resignation would only be effective upon notice to the Lender and an acceptable replacement being appointed.

The Debtor's LLC agreement also provided that the Independent Manager would (1) have a fiduciary duty of loyalty and care similar to that of a director of a business corporation under Delaware law; and (2) consider the interests of the Debtor's members and the Debtor's constituents (including the Debtor's creditors) in voting on matters provided in the LLC agreement and solely to the extent of their economic interests in the Debtor.

The Debtor defaulted on the loan by failing to repay all amounts due by the maturity date. The Lender commenced foreclosure proceedings and the Debtor subsequently commenced its Chapter 11 bankruptcy case. The Debtor's president and manager signed the bankruptcy petition, but the Independent Manager did not consent to the Chapter 11 filing.

The decision is an important reminder for secured lenders and potential debtors alike that, while some restrictions on a debtor's ability to file for bankruptcy are void as against public policy, carefully drafted provisions will be enforced.

Months after the case was filed, the Independent Manager became aware of the Debtor's bankruptcy and resigned, backdating her resignation to 2022 when the Debtor last paid her fees.

After the Debtor filed a Chapter 11 plan and disclosure statement, the Lender filed a motion to dismiss the Chapter 11 case for cause, asserting that the Debtor lacked corporate authority to file for relief under the Bankruptcy Code.

The Debtor opposed the motion to dismiss, arguing that the Independent Manager's resignation permitted the bankruptcy filing and that, even if it did not, the Debtor's LLC agreement impermissibly restricted its right to file.

The court dismissed the bankruptcy case

The court framed the motion to dismiss as raising two issues: (1) was the Debtor authorized to file the Petition; and (2) if not, did Debtor's corporate documents impermissibly restrict its right to file? The court found in the negative on both issues.

The debtor was not authorized to file the Chapter 11 petition

The Court easily found that the bankruptcy filing was unauthorized.

The Court recognized that the Debtor was a Delaware LLC and that, under Delaware law, an LLC can only act through the authorization provided to it under its operating agreement or Delaware law.

The Debtor's LLC agreement stated that the Debtor could not file for bankruptcy without the unanimous written consent of its members and managers, including the Independent Manager. Therefore, the consent of the Independent Manager was required to authorize the debtor to commence the bankruptcy case.

However, the Debtor filed its petition without first obtaining the Independent Manager's consent. The failure to obtain that consent was grounds for finding cause for dismissal of the bankruptcy case.

The debtor's governing documents did not impermissibly restrict its right to file for bankruptcy protection

The Court next considered whether the provisions in the Debtor's LLC agreement restricting its ability to file a bankruptcy petition absent the consent of the Independent Manager were void against public policy. Courts have historically held that "pre-petition agreements purporting to interfere with a debtor's rights under the Bankruptcy Code are not enforceable."

The Court observed that "[p]rovisions that place an independent manager on the board of a [LLC], with requirements that the independent manager must participate in certain corporate decisions, such as the filing of a bankruptcy petition, are not presumptively void."

Provided that the LLC agreement is structured so that the independent manager's fiduciary duties are respected and comply with non-bankruptcy statutes or law, it is enforceable. In contrast, provisions restricting the exercise of fiduciary duties or that nullify

or eliminate the right to file bankruptcy violate public policy and are not enforceable.

The Court found that the Debtor's LLC agreement did not impermissibly restrict its ability to file for bankruptcy because the LLC agreement imposed upon the Independent Manager a fiduciary duty to consider the interests of not only the Lender, but also those of the Debtor. The LLC Agreement also imposed upon the Independent Manager the fiduciary duties of loyalty and care.

The Court found that it was not dispositive that the Independent Manager position was created at the behest of the Lender or that the LLC agreement required that the Independent Manager's resignation would only be effective upon notice to the Lender and an acceptable replacement.

Because the provisions that put the Independent Manager in place were enforceable, and the Independent Manager did not consent to the bankruptcy filing, the Debtor did not have authorization to file the petition, and the motion to dismiss was granted.

Conclusion

While courts have historically not enforced provisions that have made access to a bankruptcy forum more difficult, this decision provides guidance for how to install a gatekeeper who could prevent or make filing for bankruptcy more difficult. This decision makes clear that a counterparty to a debtor can require a debtor to install an independent manager or director provided that this manager or director has duties to the debtor itself and does not act only at the behest of the counterparty.

Bethany D. Simmons and Noah Weingarten are regular, joint contributing columnists on bankruptcy law for Reuters Legal News and Westlaw Today.

About the authors



Bethany D. Simmons (L), a partner with **Loeb & Loeb LLP's** restructuring and bankruptcy practice, focuses her practice on bankruptcy reorganization and commercial litigation, and she has experience guiding debtors in health care and oil and gas industries through the stages of Chapter 11. She can be reached at bsimmons@loeb.com. **Noah Weingarten** (R), an associate in the firm's restructuring and bankruptcy practice, provides advice on complex bankruptcy and restructuring matters. He maintains a commercial and bankruptcy litigation practice with an emphasis on bankruptcy avoidance. He can be reached at nweingarten@loeb.com. The authors are based in New York.

This article was first published on Reuters Legal News and Westlaw Today on March 4, 2025.