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BANKRUPTCY REMOTE ENTITIES, SUBSTANTIVE CONSOLIDATION, AND THE FUTURE AFTER *TRANSWEST*

In this article the author discusses recent ways courts have dealt with lender requirements designed to prohibit or otherwise impose limits on a borrower's ability to seek bankruptcy court protection. It begins by surveying recent cases holding golden shares and blocking provisions unenforceable as a matter of public policy, and discussing the various standards for substantive consolidation in bankruptcy court. Then it examines in some depth the recent Ninth Circuit Transwest *decision and its impact on the substantive consolidation risks in bankruptcy proceedings.*

By M. Douglas Flahaut *

For as long as there have been federal bankruptcy laws, creative lenders have tried to prohibit borrowers from taking advantage of those bankruptcy protections. However, overt attempts to curtail a borrower's right to file bankruptcy are generally held to be ineffective. Indeed, it has become black-letter bankruptcy law in the United States that "[a]s a matter of public policy, courts will not enforce a promise not to file a bankruptcy petition made by a party eligible to file such petition."[1] Thus, while at least one bankruptcy scholar has argued in recent years that contractual agreements not to file bankruptcy may be perfectly acceptable as a matter of public policy,[2] bankruptcy courts across the country continue to regularly reject agreements not to file bankruptcy as being against public policy and therefore unenforceable.[3]

Notwithstanding the skepticism bankruptcy courts have shown towards lenders who attempt to limit the ability of borrowers to file for bankruptcy protection, creative professionals continue to try to create special purpose entities that are, to a greater or lesser extent, bankruptcy remote. Because of the general prohibition against contracting away one's bankruptcy rights, the way in which lenders try to make a borrower bankruptcy remote often ends up being somewhat complicated. For example, in recent years lenders have focused their efforts on requiring changes to the borrower's bylaws or

[1] 2 Collier on Bankruptcy ¶ 301.08 (16th ed., Henry J. Sommers & Alan Resnick, eds., 2016).

[2] Bruce Markell makes a persuasive case that it may not be against public policy for companies to contractually give away their rights to file bankruptcy. Bruce A. Markell, "Fool's Gold?: Opting Out of Bankruptcy by Manipulating State Entity Law," 36 No. 8, Bankruptcy Law Letter (August 2016).

[3] *See, e.g., Klingman v.* Levinson, 831 F.2d 1292, 1296 n.3 (7th Cir. 1987); *In re Tru Block Concrete Prods., Inc.*, 27 B.R. 486, 492 (Bankr. S.D. Cal. 1982); *Fallick v. Kehr*, 369 F.2d 899, 906 (2nd Cir. 1966) (Friendly, J., dissenting); *In re Citadel Properties, Inc.*, 86 B.R. 275, 275 (Bankr. M.D. Fla. 1988).

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