AMERICAN BANKRUPTCY INSTITUTE
JOURNAL
The Essential Resource for Today's Busy Insolvency Professional

Feature

By R. Stephen McNeill

Is the *Price* Right? Applying Fiduciary Duties to Bankruptcy Blocking Rights

Coordinating Editor
R. Stephen McNeill
Potter Anderson & Corroon, LLP
Wilmington, Del.

Steve McNeill is a partner with Potter Anderson & Corroon, LLP's Restructuring, Bankruptcy and Creditors' Rights Group in Wilmington, Del.

What was once viewed as an inviolable federal public policy has been weakening in recent years, as courts across the U.S. have vigorously begun to protect the contractual rights of shareholders to block a debtor from filing a bankruptcy petition. While cases addressing blocking provisions in situations involving shareholders who are also creditors have previously been addressed,[1] three recent transcript rulings have addressed these provisions in the context of the rights of 100 percent shareholders.

In reaching different conclusions based on similar facts, these rulings have created confusion, which potential debtors and their counsel must navigate in evaluating how a company's bankruptcy filing can be validly authorized. This article discusses these rulings and the ever-evolving interpretation of federal public policy.

Blocking Rights, Generally

A "blocking" right is a contractual right given to a party that allows it, whether individually or as part of a larger group, to block a company's decision-makers from authorizing the company to take certain actions. For purposes of this article, the blocking right at issue is a company's ability to commence a bankruptcy case.

Blocking provisions can take multiple forms, ranging from a unanimous consent provision to a simple majority approval requirement.[2] Naturally, the higher the consent threshold, the easier it is for a single shareholder to exercise the blocking right. Thus, where unanimity is required, the holder of a single share can block the bankruptcy by withholding its consent, but if a simple majority is necessary, more than half of the shares must band together to block the filing.

Whether a corporation is eligible to file for bankruptcy has long been evaluated under state law. In *Price v. Gurney*,[3] the U.S. Supreme Court held that "[t]he District Court in passing on petitions filed by corporations under Chapter X must of course determine whether they are filed by those who have authority [to so] act. In [the] absence of federal incorporation, that authority finds its source in local law."[4] In Delaware,[5] the Delaware General Corporation Law authorizes the use of blocking provisions in a corporate charter subject to certain limitations.[6] Likewise, the Delaware Limited Liability Company Act is widely understood to provide members with maximum flexibility under contract law.[7]

Federal Public Policy

Despite Delaware's longstanding public policy in favor of freedom of contract and the general acceptance of blocking provisions under Delaware law, federal courts have long recognized a federal public policy in favor of permitting a company to commence a bankruptcy case regardless of any purported limitations on that right. The origins of this public policy are

1 *See generally* R. Stephen McNeill & Eric D. Torres, "Loyalty to the Bar: An Analysis of Corporate Charter Bankruptcy Blocking Provisions," 29 *Norton J. Bankr. L. & Prac.* (2020).
2 *Id.* at pt. II(B), n.13.
3 324 U.S. 100 (1945).
4 *Id.* at 106.
5 This article assumes that Delaware law applies, and the three transcript rulings discussed herein involved Delaware corporations.
6 *See* Del. Code Ann. tit. 8, § 102(b)(1) (West 2025).
7 Del. Code Ann. tit. 6, § 18-1101(b) (West 2013) ("It is the policy of this chapter to give the maximum effect to the principle of freedom of contract and to the enforceability of limited liability company agreements.").

murky,[8] although it has been long and, until recently, consistently applied.[9]

Nevertheless, a recent trend has emerged where courts have begun to question whether the public policy is absolute and applicable to all blocking provisions, or whether it was only intended to apply to blocking rights held by creditors, rather than equityholders.[10] In situations where the party is both a creditor and an equityholder, courts in the past decade have begun to analyze the respective investments to evaluate the true intention of the parties.[11]

Given this emerging trend, some courts have also begun to examine the permissibility of blocking provisions using a fiduciary duty analysis. The Fifth Circuit was the first to do so, but the answer was not central to its holding because the shareholder at issue was not a controlling shareholder.[12] In the Fifth Circuit's view, only a controlling shareholder could owe fiduciary duties.[13]

The issue was thoroughly addressed by the Delaware Court of Chancery in *Basho Technologies Holdco v. Georgetown Basho Investors*.[14] Contrary to the view of the Fifth Circuit, *Basho* held that the defendant, who was a minority preferred stockholder in the corporation, owed and had breached its fiduciary duties to the corporation and its other stockholders.[15] Because the shareholder owed fiduciary duties to other shareholders, it could be found to have breached that duty by exercising its blocking right.[16] Although *Basho* involved a right to block additional financing and not a bankruptcy blocking right, its analysis of Delaware law helped set the stage for subsequent related bankruptcy decisions.

Fiduciary or Not Fiduciary — That Is the Question

The introduction of fiduciary duty into the dismissal analysis in *Basho* cast an already changing landscape into further chaos. The first decision came from Hon. **Mary F. Walrath**'s bench ruling in *In re Pace*,[17] which involved a motion to dismiss filed by a $37 million preferred shareholder who was not a creditor.[18] As part of its investment, the preferred shareholder negotiated revisions to the debtor's charter that limited the board's authority to file for chapter 11.[19]

While acknowledging that there was no ruling directly on point finding that a shareholder could block a bankruptcy filing, Judge Walrath became the first to do so, finding that the blocking provision in the corporate charter was void as against public policy when exercised by a minority shareholder.[20] Interpreting Delaware law to impose a fiduciary duty on a party seeking to exercise a blocking right, consistent with *Basho*, Judge Walrath found that here, where the debtor was in the zone of insolvency, that duty also extended to creditors of the debtor.[21] Because the debtor was clearly insolvent, could not pay its debts without debtor-in-possession financing, and commenced the bankruptcy case with a prepackaged plan that proposed to pay all creditors in full, Judge Walrath found the blocking provision void as violative of federal public policy and denied the motion to dismiss.[22]

Next, Hon. **John T. Dorsey** followed the fiduciary duty rationale from *Pace* in denying a motion to dismiss in *In re Retrotope*.[23] In this case, a preferred shareholder filed a motion to dismiss the bankruptcy for lack of authority, arguing that the debtor did not satisfy the bylaw requirement that certain actions required consent from at least two-thirds of the shareholders.[24] The bylaw provision at issue did not expressly bar a bankruptcy filing, although it would prohibit an asset sale or taking on additional debt, among other actions.[25]

While Judge Dorsey found the provision to be ambiguous regarding whether the filing was authorized under Delaware law, he ultimately held that the provision, if barring a bankruptcy filing, would violate both federal and state public policy because it would prevent the board from exercising its fiduciary duty to creditors while the corporation was insolvent.[26] Accordingly, the debtor had proper authority to file the petition, and the motion to dismiss was denied. Judge Dorsey's decision goes further than Judge Walrath's ruling in *Pace* by finding Delaware public policy to be against the exercise of a blocking right by a nonfiduciary when doing so would prevent the board of directors from satisfying its fiduciary duty to creditors of an insolvent company.

Finally, Hon. **Brendan Linehan Shannon** went against his colleagues in granting a motion to dismiss in *In re PhysIQ*.[27] Similar to *Retrotope*, *PhysIQ* involved a provision requiring the approval of two-thirds of the preferred shareholders to approve the bankruptcy filing, which was not obtained.[28] The moving shareholder argued that under Delaware law, "fiduciary duties are not a basis for directors to breach their contractual obligations," and that relying on public policy to strike down blocking provisions would

8 *See* Marshall E. Tracht, "Contractual Bankruptcy Waivers: Reconciling Theory, Practice and Law," 82 *Corn. L. Rev.* 301, 332 (1997) ("Courts have often stated that bankruptcy waivers violate public policy and are therefore not enforceable. This argument is difficult to evaluate given the consistent failure to identify the policy at issue.").

9 *See, e.g., In re Cole*, 226 B.R. 647, 651-52 (B.A.P. 9th Cir. 1998) (collecting cases); *Fallick v. Kehr*, 369 F.2d 899, 904 (2d Cir. 1966) (stating that advance agreement to waive benefits of Bankruptcy Code would be void).

10 *See, e.g., In re Squire Ct. Partners Ltd. P'ship*, 574 B.R. 701, 708 (Bankr. E.D. Ark. 2017) ("It is one thing to look past corporate governance documents and the structure of a corporation when a creditor has negotiated authority to veto a debtor's decision to file a bankruptcy petition; it is quite another to ignore those documents when the owners retain for themselves the decision whether to file bankruptcy.").

11 *Compare In re Glob. Ship Sys. LLC*, 391 B.R. 193, 201-03 (Bankr. S.D. Ga. 2007) (finding that because consent right of 20 percent equityholder survived repayment of debt, party was acting as equity), *with In re Lexington Hosp. Grp. LLC*, 577 B.R. 676, 685-87 (Bankr. E.D. Ky. 2017) (finding that because blocking right of 30 percent equityholder expired upon repayment of its debt, 75 percent consent requirement was unenforceable).

12 *See In re Franchise Servs. of N. Am. Inc.*, 891 F.3d 198, 206 (5th Cir. 2018) ("[We are] confin[ing our] analysis to whether U.S. and Delaware law permit the parties to do what they did here: amend a corporate charter to allow a non-fiduciary shareholder fully controlled by an unsecured creditor to prevent a voluntary bankruptcy petition.").

13 *See id.* at 211-13.

14 No. 11802, 2018 WL 3326693 (Del. Ch. July 6, 2018).

15 *See id.* at *24-41.

16 *See id.*

17 *In re Pace Indus. LLC*, No. 20-10927, 2020 Bankr. LEXIS 2266 (Bankr. D. Del. May 5, 2020).

18 *Id.* at *8-9.

19 *See id.*

20 *Id.* at *36-37.

21 *See id.* at *36-41; *but see In re 3-Hightstown LLC*, 631 B.R. 205, 213 (Bankr. D.N.J. 2021) (declining to follow *Pace* in limited liability company context because parties at issue owed no fiduciary duties to anyone under applicable Delaware law).

22 *See In re Pace* at *18, *36-41.

23 *See* Transcript of Hearing, *In re Retrotope Inc.*, No. 22-10228 [D.I. 151] (Bankr. D. Del. 2022).

24 *See id.* at 7.

25 *See id.* at 9-10.

26 *See id.* at 243-44.

27 *See* Transcript of Hearing, *In re PhysIQ Inc.* No. 23-10102 [D.I. 96] (Bankr. D. Del. 2023).

28 *Id.* at 10.

go against that principle.[29] Moreover, even if the right to file for bankruptcy is a constitutional right, the shareholder argued that such a right can be waived like other constitutional rights.[30] On the other hand, the debtor argued that in a contest between a federal right and state law, the state law must yield.[31]

Ultimately, Judge Shannon found that the Supreme Court has made it clear that a corporation's authority to file is governed by state law and that the provision at issue in the case was a common and typical provision in corporate charters.[32] The shareholders reserved for themselves the right to determine whether to file for bankruptcy, recognizing that an exception to this generally accepted practice in cases of insolvency "would quickly swallow the rule" and render such provisions almost always unenforceable.[33]

Thus, since the movant was not a creditor, the traditional policy rationale did not apply and the blocking right was valid, thus Judge Shannon granted the motion to dismiss. This decision stands in sharp contrast to *Pace* and *Retrotope* because it found the presence of fiduciary duty irrelevant when faced with a clear contractual limitation in the organizational documents.

Conclusion

As recent cases have shown, the once-sacrosanct federal public policy in favor of permitting a company to file for bankruptcy continues to morph. Although the policy clearly remains in full effect for situations involving a true creditor seeking to obtain the ability to block a bankruptcy filing, the situation is much more nuanced where that creditor also owns equity in the company.

When it comes to pure equityholders, earlier case law would suggest that these holders should be permitted to block a bankruptcy if permitted by the company's organizational documents. However, a few recent transcript rulings suggest that the public policy may still apply to override contractual provisions in the organizational documents, at least where the party holding the blocking right owes fiduciary duties to creditors. Judge Shannon's latest pronouncement on this issue casts doubt on that analysis by deferring to the primacy of state law in determining whether a company is eligible to file for bankruptcy.

In so holding, the analysis of this issue has appeared to come full circle, returning to its roots from *Price v. Gurney*. Whether this is the last word on the issue, or a Supremacy Clause analysis re-emerges, remains to be seen. abi

Reprinted with permission from the ABI Journal, Vol. XLIV, No. 12, December 2025.

---

29 *Id.* at 15.
30 *Id.* at 19.
31 *Id.* at 43.
32 *See id.* at 57.
33 *Id.* at 59.